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**NAVAL  
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**THESIS**

**THE INSTITUTIONAL RISE OF THE CHAEBOLS  
THROUGHOUT SOUTH KOREA'S TRANSITIONAL  
VULNERABILITIES**

by

Daniel Kim

March 2014

Thesis Advisor:  
Second Reader:

Naazneen H. Barma  
Robert J. Weiner

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**THE INSTITUTIONAL RISE OF THE CHAEBOLS THROUGHOUT SOUTH  
KOREA'S TRANSITIONAL VULNERABILITIES**

Daniel Kim  
Captain, United States Army  
B.S., United States Military Academy, 2009

Submitted in partial fulfillment of the  
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES  
(FAR EAST, SOUTHEAST ASIA, AND THE PACIFIC)**

from the

**NAVAL POSTGRADUATE SCHOOL  
March 2014**

Author: Daniel Kim

Approved by: Naazneen H. Barma  
Thesis Advisor

Robert J. Weiner  
Second Reader

Mohammed M. Hafez  
Chair, Department of National Security Affairs

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## ABSTRACT

This thesis is a case study of South Korea's contemporary political economic history through the lens of the balance between the state and big business. It examines the evolving relationship between the state and the *chaebols*, or domestic conglomerates, which is at the heart of the Korean trajectory of postwar industrialization and growth. The thesis proposes that the political transitions over the past 50 years, both authoritarian and democratic, were central markers for the shifting balance between the state and the *chaebols*. The 3<sup>rd</sup> and 4<sup>th</sup> Republics under Park Chung-hee marked the initiation of the state-*chaebol* partnership: monopolization of the market began during Chun Doo-hwan's authoritarian transition; and the inauguration of South Korea's liberal democracy allowed the *chaebols* to establish themselves as a durable national institution both prior to and after the 1997 IMF crisis. Thus, over time, the state-business balance tilted in favor of the *chaebols* and the formation of this business oligarchy created detrimental market conditions that corroded political, economic, and social institutions. The conclusion provides a summary of South Korea's unique market institutional impacts and the lessons learned from the research.



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# I. SOUTH KOREA'S DEVELOPMENTAL POLITICAL ECONOMY

## A. INTRODUCTION

The appropriate balance between state and market in the pursuit of growth and industrialization persists as a crucial question in the study of political economy. In order to better understand the balance between the state and private sector, the following presents a historical examination of South Korea's growth experience. With an unprecedented rate of development, South Korea has been hailed as an Asian Tiger that achieved extremely high economic growth and industrialization during the post-World War II period. In fact, many have called Korea's case study an Asian "economic miracle" after it transitioned from a third world to a modernized country in a span of decades. As of 2011, according to World Bank statistics, Korea is listed as a high income member country of the Organization for Economic Co-operation and Development (OECD) with a gross domestic product (GDP) of over \$1.116 trillion.<sup>1</sup> Meanwhile, neither democratization nor the inception of a free market economic system prevented political turmoil and economic crises. The historical vantage of South Korean industrialization allows a specific evaluation of the benefits and consequences of developmental capitalist growth initiated under mercantilism. The evolution of the private sector was at the center of South Korea's progress as the *chaebols* were at the core of country's nine percent average rate of growth from 1960 to mid-1990s.<sup>2</sup> Therefore, this thesis focuses on the role of the *chaebols*, the family run business conglomerates, during the course of South Korean industrialization as a lens through which to explore the task of describing and prescribing the balance between government intervention and a free market economy.<sup>3</sup> With an emphasis on the centrality of national security, the politics and economics of South Korea have been wedded to each other throughout the country's post-Korean War reconstruction. Most advanced industrialized economies saw capitalism and democracy

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<sup>1</sup> World Bank, "Korea, Rep.," 2011, <http://data.worldbank.org/country/korea-republic>.

<sup>2</sup> Peter M. Beck, "Revitalizing Korea's Chaebol," *Asian Survey* 38, no. 11 (1998): 1018.

<sup>3</sup> Yeonho Lee, "Participatory Democracy and Chaebol Regulation in Korea: State-Market Relations under the MDP Governments, 1997–2003," *Asian Survey* 45, no. 2 (2005): 293.



advance hand in hand.<sup>4</sup> In South Korea, by contrast, the state did not necessarily follow a particular developmental model as long as its results were justified; thus the country's progress in achieving capitalization and democratization was separate and sporadic. Furthermore, in Korea's case, a rapid burst of economic growth came under an authoritarian system of politics. Similar to other Asian countries such as China, Taiwan, Singapore, and Japan, South Korea did not necessarily undergo periods of development that incorporated liberal democracy and a capitalist market system together. While the short term national goals of increasing capital were attained under the mercantilist strategy, the long-term political and economic foci of promoting a sustainable and balanced free market economy along with democratic institutions promoting rule of law were overshadowed by the formation of business oligarchies.

With the advent of industrialization, which rapidly transitioned agrarian societies to modern economies, the process of accumulating capital became a priority for a country's prospect for growth. As the pace of economic growth accelerated, so did institutional changes. Establishing a free market economy was necessary to increase wealth and compete internationally. Capitalism has proven to benefit society as a whole and is now a necessary mechanism for wealth.<sup>5</sup> The inception of this modern phenomenon has not only accelerated the pace of unprecedented growth rates but also allowed "long term effect of compound growth rates."<sup>6</sup> All the meanwhile, economic expansion that changed national conditions required appropriate political institutional adjustment. In Korea's case, the relative influence of the private sector versus the government became one-sided. This thesis will advance the argument that as the businesses overpowered the government, it deprived Korea of stable transitions moving forward by preventing key market institutions from developing.

The conventional understanding of "Korea, Inc." that emphasizes state-led growth is inadequate. The contours of Korea's government-led business culture must be further

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<sup>4</sup> Milton Friedman, "Capitalism and Freedom," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 107.

<sup>5</sup> Thomas K. McCraw, ed., *Creating Modern Capitalism: How Entrepreneurs, Companies, and Countries Triumphed in Three Industrial Revolutions* (Cambridge: Harvard University Press, 1998), 8–9.

<sup>6</sup> *Ibid.*, 11.

expanded since the conglomerates have, in the course of time, played a dominant role throughout South Korea's modernization. For the sake of describing South Korea's economy, the "market" can be viewed as an amalgamation of institutions, synthetic practices or establishments. The institution of the "*chaebol*," or family run business conglomerates, was central in the Korean industrialization experience, an insight often captured in the phrase "Korea, Inc." In the highly top-down Korean governance structure, among the bargains that underpinned the legitimacy of political regimes, the state-business relationship was a major driver of economic development. A historical perspective on the *chaebol* reveals that the immediate and long-term outcomes of this political economic innovation helped Korea achieve unprecedented national growth. Yet, the *chaebol* institution also evolved into an unregulated organization as the government lost the capacity to regulate the private sector. Maintaining a sustainable business-government relationship requires identifying incessant change requires appropriate economic and political reciprocation. Bereft of continuously reciprocated adaptation of the private sector with necessary checks and balances, the state inevitably lost its mantle of control.

The significance of the term "Korean, Inc." changes by the end of the twentieth century as it is evident that the balance of control shifted away from government toward the business sector. Path dependencies, nationalism, and leadership guidance during each political phase of the Korean Republic have all directly contributed to the establishment and furtherance of the *chaebol* system. This thesis will demonstrated that the close state-business partnership that began mutually with both the government and the *chaebols* dependent on one another changed significantly throughout authoritarian transitions and during democratic nascence. As the *chaebols* became the uncontested proprietors of national wealth in a market that lacked comprehensive rule of law institutions, South Korea more generally failed to transition from mercantilist policies towards a liberal market economy. Furthermore, although institutions and political bargains may have been critical to Korea's growth strategy, without embedded checks and balances that allowed transparency and accountability, those benign relationships and institutions were susceptible to corruption and crises despite successful economic performance. The

following will reveal that as the business sector received continual support from the government without institutional rule of law, both the autonomy and the capacity of the private sector expanded to the point that the state was eventually forced to maintain its sponsorship of big business during and after national crises.

Simply focusing on the results and neglecting the processes proved disastrous for South Korea. The government failed to properly identify the risks regarding the incessantly changing nature of the *chaebols* and the impact this evolution had on the broader political economy. Without proper diagnosis of the problems, control measures to mitigate market failures were absent. The neoclassical lens pinpoints the dangers of mercantilism in South Korea to be the hazards associated with the *chaebols* or monopolies. Their government safety nets contributed to the country's 1997 IMF crisis and the long term symptom of a distorted market as the dominance of the *chaebols* prevented the entrepreneurial spirit. In turn, the resulting lack of small and medium enterprises remains a conundrum for the state today. Hence the term "Korea, Inc." has been used to capture the developmental state orientation of the South Korean political economy but it obscures the extent to which the state and business had competing interests and how the relative power balance between the two shifted over time.

Two schools of economic theories will be considered to evaluate South Korea's development in both descriptive and prescriptive senses: the liberal and institutional. From one point of view, liberal economic theorists argue that the role of the government must be minimal in order to achieve market efficiency. In response, proponents of market institutionalism debunk the ideal economic prescription by providing various lenses. For the sake of holistically explaining South Korea's political economic balance, mercantilism along with economic sociology and history will be utilized, such that market systems are viewed as a set of complex interdependencies among economic, political, and social institutions that vary in scope "across time, space, and fields."<sup>7</sup> Key political transitions that have impacted the economic institutions and environment will be identified and examined to understand why, when, how, and to what extent the *chaebols*

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<sup>7</sup> Naazneen H. Barma and Steven K. Vogel, eds., *The Political Economy Reader: Markets as Institutions* (New York: Routledge, 2008), 2.

took control of the national economy from the state, thereby redefining the term Korea, Inc. The historical study of the *chaebols*' collective evolution of autonomy and capacity throughout South Korea's modernization period is critical to understanding the dynamics of the country's political economic balance.

## **B. ANALYTICAL METHODOLOGY AND HYPOTHESES**

The primary lens through which this thesis will analyze South Korea's political economy is by identifying the interplay between the state, the *chaebols*, and the market. The causal logic will utilize independent, intervening, and dependent variables to systematically examine two hypotheses. The independent variables (IVs) of the thesis will be the type of political regime in place (on a scale of fully authoritarian to fully democratic) and the vulnerabilities associated with regime transitions in South Korea (hereafter referred to as *transitional vulnerabilities*, critical political junctures that provide opportune timing for shifts within the state-business balance). The intervening variable of this research will be the relative balance between the state and *chaebols*. The research will apply concepts of "autonomy" and "capacity," traditional political concepts outlined by Max Weber to describe states, to better understand and provide a measure for the relative organizational power of the *chaebols* vis-à-vis the state. In other words, the more autonomous and highly capacitated the *chaebols*, the more the balance of power shifted to these conglomerates. The dependent variables (DVs) include economic growth; the level of corruption and inequality; and the degree of market distortion and monopolization.

The first hypothesis (relating the independent and intervening variables) proposes that the transitions throughout the authoritarian and democratic regime changes were the central reasons for the shift in balance between the state and *chaebols*. Each political period's macroeconomic agenda will be evaluated on the basis of identifying institutions and prescribed policies that shifted the political economic balance. The second hypothesis (relating the intervening and dependent variables) suggests that as the state-business balance tilted in favor of the *chaebols*, the formation of the business oligarchy created detrimental market conditions that corroded political, economic, and social institutions.

Statistical data will be utilized to demonstrate national growth trends to explain South Korea's overall growth. In addition, the thesis will deliver a qualitative analysis, resting on published scholarly works and newspaper articles, which better establishes the priorities and interests of the Korean state and businesses over time.

### **C. THESIS OVERVIEW**

This first chapter has provided an overview of South Korea's economic standing and the nature of the *chaebols*, and outlined the research question and methods shaping the thesis. The second chapter will outline the competing economic explanations for South Korean success, liberalism and the institutionalist perspectives including path dependent factors. The following empirical chapters will focus on analyzing the changing balance between the state and the *chaebols*, along with the effects of this relative balance on key economic outcomes such as growth, corruption, and market distortions. Each chapter will cover one main political period: the first being the military authoritarianism of Park Chung-hee during the 3rd and 4th Republics; the second being the pre-1997 IMF crisis era including the Fifth Republic led by authoritarian leader Chun Doo-hwan and the democratic transition towards the Sixth Republic under Roh Tae Woo; and the last being the 1997 IMF crisis under Kim Dae Jung and post crisis reform under Kim Dae Jung. The final chapter will summarize the findings to include lessons learned from the research in order to evaluate the hypotheses and provide a future outlook for South Korea's political economy.

## II. COMPETING ECONOMIC THEORIES

### A. INTRODUCTION

This chapter presents competing views on the relationship between states and markets in the pursuit of growth and industrialization. The core debate between economic liberalism and mercantilism provides a theoretical framework for understanding the state's rationale behind the economic policies that established the roles of the *chaebol* within the various political eras, as well as a lens for understanding their volatile relationship with the government throughout Korea's industrialization experience. The rudimentary theoretical framework grounding this research originates with the debate between Adam Smith's liberal economic theory and Friedrich List's mercantilist argument for the necessities of government intervention. Highlighting the pertinent theories also provides the lens to comprehensively describe the state's prescriptions and the ensuing economic environment in which the *chaebols* thrived. The debate will start with the theoretical origins of a capitalist market system and further broaden the scope of analysis with modern institutional concepts. The applicability of each theory is assessed against the South Korean context, thereby providing an evaluation of the advantages and weaknesses of the prescription based on timing, conditions, and interests.

### B. ECONOMIC LIBERALISM

Economic liberalism serves as the paradigm for an ideal market economy. Classical liberalism originates with Adam Smith's economic theory in 1776, developed during the English industrial revolution, which suggests a *laissez faire* government role will free a utilitarian market to naturally develop and sustain optimal price mechanisms through the 'invisible hand' of the self-correcting market.<sup>8</sup> The notion of an efficient free market is predicated upon the "division of labor," which allows specialization of the workforce, improved economy of time, utilization of machinery to increase production,

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<sup>8</sup> Ibid., 21–22.

and human nature's "propensity to truck, barter, and exchange."<sup>9</sup> Parallel to the micro-economic logic that the free market is the most efficient allocation mechanism and creates economic surplus as a result, the macro-economic view of economic liberals is that free trade among countries on the basis of comparative advantage maximizes economic gain and increases national wealth.

Because market liberals focus on near perfect economic conditions assuming an even playing field for rational players, the state, as Smith prescribed, is to be limited to providing three attributes not provided by the market in order to protect the system from within and outside: security services, the rule of law structure, and public goods.<sup>10</sup> Any further government intervention in the market is believed to impede upon the natural efficiency of the invisible hand and discourage competition. Modern neoliberal economist Friedrich Hayek supports Smith's arguments asserting that all types of "collectivism"—including broad government intervention in the economic—are inherently inferior to the spontaneous competition that efficiently coordinates the market economy.<sup>11</sup> Hayek further contends that "mixing competition and planning" would be inherently incompatible and that the role of the state should be limited to providing the framework of the "great liberal principle," which is a rule of law that provides predictability and an anti-discriminatory environment to prevent the government from imposing unnecessary power upon individual freedom and interests.<sup>12</sup>

According to Milton Friedman, intervention itself is of an equal or greater problem in comparison to the "market failure," which the state attempts to correct with subsequent price distortions along with resulting inefficiencies illustrated by the market's deadweight loss.<sup>13</sup> Friedman also claims that the freedom allowed in the economy is

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<sup>9</sup> Adam Smith, "An Inquiry into the Nature and Causes of the Wealth of Nations," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 29, 32.

<sup>10</sup> Barma and Vogel, *The Political Economy Reader*, 22.

<sup>11</sup> Barma and Vogel, *The Political Economy Reader*, 88; Friedrich A. Hayek, "The Road to Serfdom," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 92–93.

<sup>12</sup> Barma and Vogel, *The Political Economy Reader*, 88; Hayek, "The Road to Serfdom," 97.

<sup>13</sup> Barma and Vogel, *The Political Economy Reader*, 88.

critical to upholding political liberties since the government's primary purpose is to serve the people.<sup>14</sup> The market liberals would emphasize that South Korea pursued a free trading, export-oriented industrialization strategy that enabled it to benefit on the basis of its comparative advantage on international markets. In this view, the *chaebols* are actually inefficient and distortionary, and South Korea succeeded despite them, not because of them.

To the liberal economists, any prescription that departed from a free market was inefficient. Soon after the “East Asian miracle,” studies attempted to explain how the Asian Tigers including South Korea were able to expedite growth. The World Bank developed a framework, based on Smith's neoclassical economic prescriptions, of the specific policies and conditions necessary for a successful market economy. This neoclassical perspective—while acknowledging that each high performing Asian economy's (HPAE) model is unique—identified a shared set of fundamentals that were needed for growth. These included, bolstering national human capital with education, establishing an environment conducive for savings and investments, limiting inflation, allowing competitive exchange rates, and—most importantly in contrast to the interventionist perspective—limiting price distortion.<sup>15</sup> Within the liberal economic mindset, South Korea's industrial policies focusing on specific sectors such as heavy and chemical industries were ineffective since the targeted industries' growth trajectories were simply market conforming. In other words, policies based on coordination between state and the private sectors did not achieve levels of productivity higher to their competitors at the time.<sup>16</sup>

Yet what is missing from the liberal economic logic is that the execution of each economic prescription requires the planning and coordination of non-market institutions. While liberal theories describe optimistic market conditions, countries must have the

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<sup>14</sup> Barma and Vogel, *The Political Economy Reader*, 88; Milton Friedman, “Capitalism and Freedom,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 108–109.

<sup>15</sup> World Bank, *The East Asian Miracle: Economic Growth and Public Policy* (New York: Oxford University Press, 1993), 347–352.

<sup>16</sup> World Bank, *The East Asian Miracle*, 354–355.



availability of time, resources, and conditions needed to function in accordance with the free market criterion. And although the end goal has been to pursue a self-sustaining liberal market, this cannot be achieved without the proper conditions that need to be addressed by non-economic institutions as well. In South Korea's case, the environment, which lacked an educated work force, economic policies, and industrial infrastructure was not conducive for the immediate implementation of a free market economy. Therefore, creating and transitioning to a free market economy both precipitated the establishment and the correction of the *chaebols* required varying degrees of government intervention and oversight. Explaining South Korea's experience merely with economic liberalism limits the analysis to be primarily economic and restricts the explanation of additional critical political and societal institutions that interact with the economy.

### **C. THE INSTITUTIONAL PERSPECTIVE**

Institutionalism debunks the neoclassical outlook by providing detailed insight into how and why institutions, formal and informal practices and establishments, came about—encompassing both external and internal social, political, and economic circumstances. Given the changing nature of the myriad of institutions at the international, national, and societal levels, economic policies did not remain constant and are unique based on timing, conditions, and interests. The institutionalist perspective is best utilized to describe what had happened in the past in order to prescribe the processes and lessons for sustainable growth. While the market-liberal perspective highlights reliance on primarily free market institutions, the market-institutional school integrates a range of economic, political, and social institutions to provide a broader scope of analysis. The rationality behind employing practical institutions to analyze markets is to assess both efficiency and effectiveness of individual economies avoiding generalizations.

Recognizing the interactions of the myriad of institutions, both synthetic and path dependent formal and informal practices, discloses industrialization as an ongoing process of development. South Korea's initial macroeconomic industrial strategy focused on state generated comprehensive internal processes and inputs that aimed to cultivate

economic capacity by way of transitioning from import substitution industrialization (ISI) to export oriented industrialization (EOI). Accepting the concept that capitalist institutions are constructed,<sup>17</sup> the research intends to elaborate on the durability of a unique national political economic institution—the *chaebols*—that have not only endured various presidential terms but have grown to a point where policy makers could no longer regulate them. This comprehensive analysis of the *chaebols*' rise contributes to the broader scholarly debate on whether South Korea's mercantilist policies were necessary for national growth and worth the risks of stalling democratic institutions in South Korea throughout its post Korean War reconstruction era.

The institutional school encompasses mercantilism, economic socialism, and economic history to be various lenses to view economic progression, as follows.

### **1. Mercantilism**

In an era of competitive nation states facing limited time and resources, political institutions play an integral role in developing and protecting the national markets. Friedrich List of the mercantilist school focuses on the role of the government within the state-market balance since national interests are not necessarily attained through individual self-interests.<sup>18</sup> While a market liberal economy may be ideal, depending on the particular circumstances of a country—including those, for example, that face an existential threat such as the North Korean regime—governments may not have the luxury of time to wait for the economic system to organically mature the forces of production, or countries are not capable of self-sufficiency due to a lack of resources. Among the institutions developing the powers of production is the state, which has in mind not only the capability to produce goods but also to gain industrial independence, which leads to bolstering national security. The mercantilist logic critiques the liberal perspective, emphasizing that the “power of producing wealth” is more important than

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<sup>17</sup> Karl Polanyi, “The Great Transformation,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 137.

<sup>18</sup> Barma and Vogel, *The Political Economy Reader*, 24.

“wealth itself.”<sup>19</sup> Particularly in a top down society such as South Korea, the state leadership’s role directly contributed to the acceleration of the country’s industrial capacity.

Mercantilists recognize that markets are not all created under similar conditions and that the government has the responsibility to protect society from the dangers of a distorted market. Therefore, to foster a well-rounded growth trajectory, List notes that the state must oversee the “balance or the harmony of the productive powers” so that society does not become solely fixated on a single sector of production and to prevent becoming dependent on a foreign country for goods.<sup>20</sup> When the market lacks direction, the state also sets the goals to engineer the productive powers. At times, this would mean directing capital and enabling certain social groups to perform at higher levels. Additionally, it is the responsibility of the government to intervene in response to harmful economic conditions, which potentially threatens national security, created by greed of the private sector and foreign industries that aim to exploit and monopolize the domestic economy.<sup>21</sup> The mercantilist school reasons that it is unlikely for responsible governments to intentionally intervene in the market economy to create inefficiencies; on the contrary, the intent behind the economic policies is to ensure effectiveness.

Mercantilism was the main prescription that allowed South Korea to achieve its economic miracle within a given time frame; however, the fast paced growth was not sustainable. Even with the integrated strategy that focused the partnership between the state and the economy, South Korea continued to struggle with its transition towards a liberal market economy due to socio-political institutions that made rule of law futile.

## **2. Economic Sociology**

South Korea’s economic phenomenon cannot be attributed to one factor alone. Interventionist approaches also known as mercantilism or Keynesian economics,

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<sup>19</sup> Friedrich List, “The National System of Political Economy,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 63.

<sup>20</sup> *Ibid.*, 78–79.

<sup>21</sup> *Ibid.*, 82–83.

highlight the role of the state and the neoclassical arguments tend to emphasize free markets to explain aggregate growth. The sociological institutionalists' focus on the relative balance in the interactions between the state and the business sector. Economic sociologists broaden the overall viewpoint on political economy by asserting that markets are not limited to the scope of economics but operate within society and the two have been inherently interconnected from the beginning. Therefore, viewing the market as an institution, it is an extension of society.

Emphasizing the important role of social agents such as the state, Karl Polanyi points out that markets and regulations also develop together creating a “double movement” in which the free market forces and protectionist measures interact as the market progresses.<sup>22</sup> Overemphasizing the economic impacts of the market, Adam Smith's *Wealth of the Nations* was obsolete by the twentieth century and did not foresee the pervasive consequences of modern technology. While the industrial revolution increases the wealth of countries, the so called self-regulating market was unable to prevent the ‘satanic mills’ or the factories from exploiting the masses and widening the gap between the rich and the poor creating uneven social conditions.<sup>23</sup> Furthermore, top down and bottom up interactions are required for sustainable growth. Explaining that the market is not limited to only economic motives, Polanyi illustrates that social principles of “reciprocity” and “redistribution” ensures the order of production.<sup>24</sup> In addition, existing patterns of “symmetry” and “centricity” further provides insight to how people have engaged in trade and supply operations prior to a formal market system.<sup>25</sup>

South Korea failed to establish proper checks and balances between the government and *chaebols*, which deprived the relationship of balance and made it lopsided. Eventually, the conglomerates grow too big to manage without rule of law, demonstrating how capitalism contains within itself the seeds of self-disruption.

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<sup>22</sup> Barma and Vogel, eds., *The Political Economy Reader*, 117; Karl Polanyi, “The Great Transformation,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 145.

<sup>23</sup> Polanyi, “The Great Transformation,” 125–126.

<sup>24</sup> *Ibid.*, 131.

<sup>25</sup> *Ibid.*, 131–132.

Nonetheless, through the lens of connectivity, economic sociologists recognize that the role of the government can directly impact the market's rate of change enabling adjustments for society.<sup>26</sup> Liberal theories make valid arguments for an exclusive paradigm but the prescription lacks universal applicability; meanwhile, economic sociology serves as a broad and in depth institutional perspective to examine markets. Without understanding the social context in which different countries choose and develop a variety of economic institutions, we cannot understand the *chaebol* without understanding how they relate to Korean society.

### 3. Historical Perspective of Industrialization

History discloses that each society is different, and as a result, no economic systems are alike. Various institutions create unique conditions over time. In response to W. W. Rostow's prematurely outlined five "stages of economic growth" that all countries will undergo,<sup>27</sup> Alexander Gerschenkron may agree with the generalities of early development stating that the ingredients of growth are human capital, physical capital, and total factor productivity. However, in regard to latter phases of development, a linear growth trajectory is often irrelevant.<sup>28</sup> To successfully overcome their challenges, late industrializing countries not only have the advantage of utilizing available technology but are also able to draw upon lessons from previous industrializers to employ pragmatic institutions that fit state objectives. An example of a successful late industrializer that show how a unique institution served as a key agent of growth is Japan's Ministry of International Trade and Industry (MITI), which spearheaded its growth "miracle" with both industrial "rationalization" and "structure" policies that applied both macro and micro level strategies to create conducive growth conditions in order to optimize business

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<sup>26</sup> Ibid., 124.

<sup>27</sup> W. W. Rostow, "The Stages of Economic Growth," in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 201–205.

<sup>28</sup> Barma and Vogel, *The Political Economy Reader*, 196.

operations.<sup>29</sup> What economic history teaches is there are multiple pathways to development as “the magnitude of the challenge changes the quality of the response.”<sup>30</sup>

South Korea’s pattern of development illustrates the veracity of Gerchenkron’s theory on “multiple pathways to development,” which explained that there is no set model for development and each country succeeds with “functional substitute” and a variety of institutions.<sup>31</sup> Similarly, Stephan Haggard argues that as long as the endogenous institutions were sound, regime types did not matter for growth.<sup>32</sup> Chalmers Johnson dismisses a standardized liberal model for the East Asian developmental states and explains that with each country’s various priorities and conditions, interventionism was necessary and efficient to meet the goals of the leadership in order to prepare for an effective market.<sup>33</sup> Haggard also explains that institutional shifts accompanied economic growth in Asia.<sup>34</sup> The *chaebols* were not only economic institutions but also acted collectively as a political institution that deeply impacted society as well. Single party authoritarianism meant a lack of political accountability and transparency that further facilitated the effective corruption nexus between the politicians and the *chaebols*. Eventually, not only did *chaebols*’ organizational growth trends resonate with shifts in economic policy, the government relied upon them to meet each of its policy objectives whether the country was in need of ISI or the transition to EOI.

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<sup>29</sup> Chalmers Johnson, “MITI and the Japanese Miracle,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 277.

<sup>30</sup> Barma and Vogel, eds., *The Political Economy Reader*, 197; Alexander Gerschenkron, “Economic Backwardness in Historical Perspective,” in *The Political Economy Reader: Markets as Institutions*, ed. Naazneen H. Barma and Steven K. Vogel (New York: Routledge, 2008), 215.

<sup>31</sup> Naazneen Barma, “The Political Context: International and Domestic,” lecture series in NS 3645 East Asian Political Economy, Naval Postgraduate School, Monterey, CA, 9 July 2012.

<sup>32</sup> Stephan Haggard, “Institutions and Growth in East Asia,” *Studies in Comparative International Development* 38, no. 4 (2004): 59.

<sup>33</sup> Chalmers Johnson, “Political Institutions and Economic Performance: The Government-Business Relationship in Japan, South Korea, and Taiwan,” in *The Political Economy of the New Asian Industrialism*, ed. Frederic C. Deyo (Ithaca, NY: Cornell University Press, 1987), 141–143.

<sup>34</sup> Stephen Haggard, *Pathways from the Periphery: The Politics of Growth in the Newly Industrializing Countries* (Ithaca, NY: Cornell University Press, 1990), 15.

#### 4. Path Dependency

Social factors and historical events served as powerful impetuses for shaping the nascent stages of South Korea's industrial political economy. The institutionalist approach stresses the role of path dependence, highlighting past experiences that shape future actions, in developing the *raison d'état* of the political leadership during South Korea's high growth periods. Also, understanding the path dependent formation of market institutions is crucial to understanding how the *chaebols* came to existence and which factors further advanced their national position. Two categories of path dependent factors exist—innate factors such as culture and national crises brought by war and political instability. These factors have a clear impact on the nature of South Korea's economic policies and results as culture remained as a catalyst for building a competent working class and trauma served as a powerful reminder for Koreans to never let a foreign power compromise the country's sovereignty.

##### a. Culture—Confucianism

Confucianism cannot be dismissed as it permeates all levels of society. While reform and modernization periods may be explained by the country's adoption of the West's social, economic, and political institutions, the "traditional cultural [Confucian] value system" has and continues to remain in society as the dominating social institution.<sup>35</sup> Expounding upon this enduring practice in East Asia, Lee Kuan Yew stated that "the individual exists in the context of his family," which also illustrates the stronger bond between the paternal system of governance with "default loyalty."<sup>36</sup> The different by-products of Confucianism's role in the state's relationship with society are evident: "communitarian values" created an enduring tightknit national identity that provided political legitimacy; disciplined efforts towards education cultivated a capable workforce; and "long-term relational contracting" extended partnerships beyond the scope of business. This latter point is important in explaining how the political partnership with the *chaebols* was a relatively natural state of affairs, as well as how the promotion of

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<sup>35</sup> Yoon Hyung Kim, "An Introduction to the Korean Model of Political Economy," in *Korea's Political Economy*, ed. Lee-Jay Cho and Yoon Hyung Kim (Boulder, CO: Westview Press, 1994), 47.

<sup>36</sup> Fareed Zakaria, "A Conversation with Lee Kuan Yew," *Foreign Affairs* 73, no. 2 (1994): 113.

prestige that followed with social status attracted top talent to both the government agencies and business conglomerates.<sup>37</sup> In these ways, Korea's primary social culture, Confucianism, remained a prevalent cultural factor that vastly improved and accelerated the quality of human capital.

***b. Nationalism***

In the nascent years following Korea's independence, nationalism served as a critical factor for mobilizing the country. With a top-down nature that prevailed throughout South Korea this nationalism was and still is a cultural trait, serving as a moral institution that emphasizes respect and compliance. As a result, this national institution greatly empowered and legitimized the executive concentration that in turn increased both political and economic autonomy and capacity. Throughout the post war periods, innate social compliance under the tenets of Confucianism served as an operational catalyst by bolstering the effectiveness of the leadership's ability to execute its policies and agendas without having to invest additional efforts towards garnering public support. The cultural environment established optimal conditions for a state-guided economic strategy that required rapid results.

***c. Colonial Trauma***

Traumatic military and political experiences in the past provide insight to the initial rationale in favor of developing robust economic institutions. Its inability to modernize at the end of the Chosun dynasty and the ensuing colonial period under the Japanese provided South Korea with painful lessons not to be repeated. Korea missed a critical opportunity to grow since potential reforms by way of accepting Western institutions and technology were condemned by the *sadaebu*, "social elite and bureaucrats...schooled in Confucianism," who protected the neo-Confucian school of thought and rejected alternative teachings that challenged their traditional beliefs.<sup>38</sup> The

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<sup>37</sup> Minxin Pei, "Constructing the Political Foundations of an Economic Miracle," in *Behind East Asian Growth*, ed. Henry S. Rowan (London: Routledge, 1998), 40.

<sup>38</sup> Yoon Hyung Kim, "An Introduction to the Korean Model of Political Economy," in *Korea's Political Economy*, ed. Lee-Jay Cho and Yoon Hyung Kim (Boulder, CO: Westview Press, 1994), 47.



lack of adaptive policies thwarted the country's potential to import innovative technology and left a nation lagging behind in economic trade relations and weapons modernization. In the end, the insulated foreign policy based on neo-Confucianism led to the end of the Yi dynasty, including the *sadaebu*, by the advances of the Japanese military.<sup>39</sup> The subsequent crisis was the period of Japanese colonial rule during which Korea endured extreme political and social humiliation. During the occupational period, the already homogenous culture became extremely united against their oppressors with intense nationalism evident in the unremitting protests and guerrilla tactics up until independence.<sup>40</sup> As the memories of intrusion remained, not only did South Korea's leadership capitalize on the nationalist sentiment, it also understood that the accumulation of physical capital and total factor productivity were indispensable for developing the means for military security and readiness.

**d.      *The Korean War***

The Korean War and its aftermath represented a permanent existential threat to South Korea. The ongoing civil war was a result of the unrestrained political freedom in Korea immediately following the Japanese occupation. The end of WWII served as a new political platform for Korea's regained sovereignty. Meanwhile, following 36 years of Japanese rule, plans for post-war nation building was left unspecified by the international community. At the 1943 Cairo Conference, the democratic leaders planning the post-war order (including Chiang Kai-shek, Franklin D. Roosevelt, and Winston Churchill) agreed that Korea's "free and independent" future would be determined "in due course."<sup>41</sup> As Korea regained its freedom in February of 1945 at Yalta, Roosevelt and Stalin decided to divide the presence of American and Soviet militaries at the 38<sup>th</sup> parallel.<sup>42</sup> The aftermath of leaving two divergent political parties with incompatible values led to a state of highly armed tensions between the communist and democratic parties of Korea. Even after the

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<sup>39</sup> Kim, "An Introduction to the Korean Model of Political Economy," 47.

<sup>40</sup> Alice H. Amsden, *Asia's Nest Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989), 28.

<sup>41</sup> Alice L. Miller and Richard Wich, *Becoming Asia* (Stanford: Stanford University Press, 2011), 22.

<sup>42</sup> Kim, "An Introduction to the Korean Model of Political Economy," 48.

Korean War, with the continuing presence of the 38<sup>th</sup> parallel, the leadership attained a legitimate justification to promote the country to grow economically in order to prepare for another all-out war. Ultimately, the security dilemma stemming from the Korean War served as a powerful validation for political initiatives.

*e. 1<sup>st</sup> and 2<sup>nd</sup> Republics (1948–1961)*

Korea's first two presidents fumbled the opportunity to cement sound political and economic institutions. As long as South Korea remained an American proxy state against the Communists, post war modernization efforts of the country were entrusted to the newly elected "democratic" leader. Limited foreign intervention allowed a greater role for the political leadership to shape the future of the country. But Korea's first president, Syngman Rhee, lacked the much needed acumen for economic strategy and direction. Following his election in 1948, he procured U.S. support via a U.S.-Korea defense treaty strengthening the bilateral relationship, which allowed the country to survive the war. Based on his extensive American education, Rhee did form a rudimentary democratic political institution—South Korea's first constitution. However, the 1<sup>st</sup> Republic from 1948 to 1960 left South Korea in infrastructural shambles with corrupt rent seeking political culture and incessant social unrest.<sup>43</sup> The 2<sup>nd</sup> Republic, which marked President Yun Bo Seon's nominal tenure from 1960–1962, ended with General Park Chung-hee's military coup d'état and government takeover. With low capital, abysmal domestic savings rate, declining foreign aid, weak financial market, and public skepticism of industrial service, the end of Rhee's rule left South Korea in distress and in immediate need of its first major progressive economic transition and reconstruction.<sup>44</sup>

## **D. CONCLUSION**

A market-institutional lens will be employed in this thesis to demonstrate that the family conglomerates, a unique South Korean institution, played a significant role

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<sup>43</sup> Haggard, *Pathways from the Periphery*, 59.

<sup>44</sup> Kim, "An Introduction to the Korean Model of Political Economy," 49.

throughout industrialization but also became dangerously autonomous over time. The analysis of the state-business relationship reveals the inherent power politics between the two actors while economic history demonstrates that the transitions between authoritarian leaders were periods of lost opportunity for proper reform giving way to myopic policies. With the unqualified and sophomoric democratic experience having failed, the country was hungry for economic growth and stability. Until the early 1960s, no one was in control nor capable of seizing the commanding heights. Meanwhile, the lessons learned from the failed past laid the foundations towards revolutionizing South Korea's political economy. With the increasing salience of economic strategies, the struggle for the "commanding heights" or the 'common ownership of the means of production, distribution, and exchange' has become of national interest.<sup>45</sup> Concomitantly, policies and procedures that directly impacts markets and societies, require in depth exploration of comprehensive institutions throughout time to allow thorough descriptions and applicable prescriptions to the economy that will best serve the people, the most essential national wealth.

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<sup>45</sup> Daniel Yergin and Joseph Stanislaw, *The Commanding Heights: The Battle for the World Economy* (New York: Touchstone, 1998), 7.

### III. INCEPTION OF THE *CHAEBOLS*

#### A. INTRODUCTION: HOW THE ECONOMIC ENDS BEGAN TO JUSTIFY THE POLITICAL MEANS

The South Korean market economy at this time was, by force, an extension of politics rather than a natural institution of society. With General Park Chung Hee at the helm, the country entered its 3<sup>rd</sup> Republic; and over the next three decades, South Korea's history would be forged by political leaders who rose from military backgrounds. With the country transitioning from experiencing periods of ruthless colonial rule and civil war, Park was intent on never again allowing such a defeat by another foreign power and prioritized a robust industrial economy as the national power base. Additionally, South Korea's military leadership did not deem liberal democratic institutions necessary for achieving economic growth. Operating under a constrained timeline, Park aggressively employed all necessary means to achieve its objectives in a top down manner.

Mercantilism was Park's primary *modus operandi* to achieve South Korea's industrial takeoff. Friedrich List described this system as a method of governance that prioritizes the national interest and focus on the ability to generate capital.<sup>46</sup> Lacking the luxury of time, resources, or a capable bourgeoisie as the foundation for a market economy, interventionism was the viable solution for effective results. List further explains that a nation's ability to produce will not only allow the accumulation of physical capital but also provide greater capacity in preparation for crisis such as war.<sup>47</sup> Under the devastated conditions, government interventionism was justified on the basis of South Korea's painful past, marked by failed policies and a direct existential threat. Advocates of interventionism argued that a limited window of opportunity warranted accelerated growth, which in the case of South Korea may not have been feasible with an organically developed free market economy.<sup>48</sup> Hence, South Korea's mercantilist system

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<sup>46</sup> List, "The National System of Political Economy," 63.

<sup>47</sup> *Ibid.*, 70.

<sup>48</sup> Joseph J. Stern et al., *Industrialization and the State: The Korean Heavy and Chemical Industry Drive* (Cambridge: Harvard University Press, 1995), 2.

was initially intended to guide the country towards achieving an advanced market economy that would be internationally competitive as quickly as possible.

The unusual economic success from an authoritarian regime, which took on the entrepreneurial role at the macroeconomic level by making the process of business coordination with the government more efficient, proved that the institutions, not adherence to standardized prescriptions, play a decisive role in determining national economic growth.<sup>49</sup> Due to demonstrated growth, Park continues to be a contentious figure in terms of competing economic explanations. Controlling the commanding heights, the government was at the forefront of building a national industrial base. Park vested the future of the country to the businesses with his policies and capital allocation to the targeted industries. With the ability to shape and guide the economy, the government created optimal conditions for the businesses to rapidly expand. The country's growth results demonstrated that the economic miracle did occur under an illiberal economy. All the meanwhile, throughout Park's reign, checks and balances on the private sector were implemented to regulate the *chaebols* replacing the "invisible hand" of the market.

## **1. 3<sup>rd</sup> and 4<sup>th</sup> Republics (1962–1979)**

### ***a. Political Reform***

Political leadership was the main factor determining the country's future with the dawn of the 3<sup>rd</sup> Republic. At the time, South Korea's political, economic, and social infrastructures were debilitated by war and political turmoil. Assuming the responsibility to take on the challenge of rebuilding national institutions, Park Chung Hee usurped the presidency at a critical state and was in no position to patiently wait for the economy to mature. Mercantilists stress that the role of the government is essential in formulating and implementing national economic policies in order to salvage the economy from crises and mitigate the dangers to an unregulated economy. Once in power, mercantilism was the main prescription that Park subscribed to. The process began by centralizing various

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<sup>49</sup> Amsden, *Asia's Next Giant*, 80; Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990), 341, 373.

facets of society. Similar to Japan's "plan rational" economy, adopted from Germany's *planwirtschaft*, the Korean government focused on "industrial policy" and intentionally altered economic conditions to achieve its goals.<sup>50</sup> "*Chungboo chishi*" or 'government instructions' were commonplace in all aspects of the infrastructural development especially the economic sector where the state demonstrated the paternalistic role during the initial phases of South Korea's economic growth.<sup>51</sup> To Park's advantage, with the country's past history of compromised autonomy and capacity, legitimacy was naturally attained and nationalism was easily fueled to garner support from the people. Historical precedents based on both previously failed domestic institutions and international shocks helped justify the authoritarian regime beginning in the 1960s. Moreover, as the country remained as a poor third world country, political validation was simply hinged upon economic performance for the time being.

Nonetheless, accumulating capital in a post conflict environment required drastic changes. Shifting the macroeconomic focus from the 1950s strategy that emphasized a strictly import-substitution policy, Park aggressively pursued export oriented policies in order to commit the country towards industrialization.<sup>52</sup> Furthermore, international competitiveness was to be attained by increasing domestic capacity, necessitating an array of policies cultivating an environment conducive for entrepreneurship. The state directly regulated the import and export environment allowing capital to be efficiently allocated towards investments. The World Bank summarized the South Korean government's approach as comprehensive "selective intervention," with "import controls under import subsidized industrialization (ISI) to include protectionist policies, tariffs, quotas, licenses," and "export promotion/credit subsidies" promoting EOI to allow foreign direct investments; furthermore, "agricultural subsidies," "public-private

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<sup>50</sup> Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford: Stanford University Press, 1982), 271–272.

<sup>51</sup> Lee-Jay Cho, "Culture, Institutions, and Economic Development in East Asia," in *Korea's Political Economy*, ed. Lee-Jay Cho and Yoon Hyung Kim (Boulder: Westview Press, 1994), 15.

<sup>52</sup> Sung-Hee Jwa, *A New Paradigm for Korea's Economic Development* (Hampshire, UK: Palgrave, 2001), 5.

cooperation [through] deliberation councils,” and “currency manipulation” kept exchange rates low to encourage exports and engineered mild financial repressions for investing.<sup>53</sup>

Arguing that the Korean state played an oversized role in achieving economic development, Amsden states even more forcefully that Park essentially acted as South Korea’s “invisible hand” creating market conditions to include “price controls, restrictions on capacity expansions, limits on market entry, prohibitions on capital flight, restraints on tax evasion, and government control over the banking system.”<sup>54</sup> With an effective operational state, the administration successfully unshackled exports with a *dirigiste* strategy of industrialization in order to eliminate the unnecessary trade barriers, all the while maintaining political stability, allowing society to invest in a burgeoning economy that projected growth. The myriad of political institutions set ideal market operating conditions to institute the transition towards having the private sector become the main driver for national economic growth.

***b. State Led Chaebol Inception***

South Korea’s mercantilist growth strategy successfully identified and integrated key institutions for growth. Much like Japan’s growth formula, which consisted of the “mighty trio”—“state organization, central banking, and *zaibatsu* conglomerates,” the South Korean approach consisted of two key players—the government and the *chaebol* conglomerates, with the state as the dominant actor.<sup>55</sup> Essentially, the onset of the high growth phase was made possible by the initial political bargain between state and business, which yielded rapid industrialization. And it was none other than the government that allowed the establishment of the “*chaebols*,” family-run companies that grew to become conglomerates, as a national institution. The business-political alliance had become the cornerstone of President Park’s initial growth policies and the economic prosperity that followed strengthened his legitimacy.

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<sup>53</sup> World Bank, *The East Asian Miracle*, 6.

<sup>54</sup> Amsden, *Asia’s Next Giant*, 146.

<sup>55</sup> Bruce Cummings, “The Origins and Development of the Northeast Asian Political Economy,” in *The Political Economy of the New Asian Industrialism*, ed. Frederic C. Deyo (Ithaca: Cornell University Press, 1987), 53.

From an operational frame of reference, the state had chosen the *chaebols* to be guaranteed market winners. To actively commit and guarantee success of the political economic partnership, the government assumed control over various sectors. The extensive interventionist system not only allowed the state to pick which companies to win but also allocated government bureaucrats to political and private sectors, including banking and corporations, which were formally and informally associated with the state.<sup>56</sup> The government provided not only a favorable environment for businesses that assisted the state's goals but also safety measures. The entrepreneurial risks that were to be addressed during the nascency of growth were: "pricing collapse through overproduction, competition from cheap imports, and losses through exporting."<sup>57</sup> In lieu of a mature market that played these roles, the state acted as the "entrepreneur, banker, and shaper of the industrial structure" and "deliberately distorted the price structure."<sup>58</sup> Controlling the traffic of capital, the government backed the businesses that were essential to the economy by incentivizing growth with subsidies and protection measures. Companies that abided by the government priorities were allowed to borrow from domestic and international banks "beyond net worth."<sup>59</sup> In short, the state shepherded businesses to boom in order to transform the domestic market to a competitive economy.

*c. Initial Checks and Balances*

Successfully balancing business and politics in South Korea's economic modernization required a collectivized effort. The future of national growth was feasible by way of integrating top-down and bottom-up processes as well as lateral cooperation. Throughout the 3<sup>rd</sup> and 4<sup>th</sup> Republic, checks and balances existed between the state and businesses that allowed durable growth and stability. Priority on human capital development in the sense of meritocratic bureaucracy ultimately led to the accumulation of physical capital, a sound financial market, and stable macroeconomic management;

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<sup>56</sup> Johnson, *MITI and the Japanese Miracle*, 273.

<sup>57</sup> Kim, "An Introduction to the Korean Model of Political Economy," 49.

<sup>58</sup> Robert Wade, "East Asia's Economic Success: Conflicting Perspectives, Partial Insights, Shaky Evidence," *World Politics* 44, no. 2 (1992): 285.

<sup>59</sup> Kim, "An Introduction to the Korean Model of Political Economy," 49.



furthermore, a capable bureaucracy played a crucial role in the reciprocal “state-society interface.”<sup>60</sup> The personnel of these bureaucracies were first selected based on merit, then the state empowered them in their respective specialties by insulating them from other agencies by law, in order to employ policies towards “shared growth.”<sup>61</sup> Park’s bureaucratic institutions served a dual function—assisting as a conduit and intermediary between the government and private sector and enforcing responsible political and business practices.

The Economic Planning Board, an effective bureaucratic organization, served as the primary medium to drive both government and business interests. The EPB, founded on July 22, 1961 and comprised of the country’s top university graduates, centralized and rationalized economic decision making and implementation, playing the role of coordinating the ministries of “Finance, commerce and Industry, Transportation, Agriculture, Health and Social Affairs, and Science and Technology.”<sup>62</sup> At the time, South Korea was catching up to the rest of the modern nations and was easier to choose the industries rather than gambling on technologies that would lead the future.<sup>63</sup> Furthermore, the country did not have the acumen, lacking entrepreneurs and scientists to spearhead the markets’ frontiers.<sup>64</sup> To answer the private sector’s dilemma of lacking experience in growing firms, the EPB sufficiently filled the country’s entrepreneurial talent void and made the strategic investment in heavy and chemical industrialization (HCI).<sup>65</sup> The EPB also generated sustainable and collective growth by adapting to the feedback from the businesses, which allowed the state to pragmatically tailor future policies. Initially, the bureaucratic system may have been formed for economic interests but it also limited the dangers of both excessive authoritarian rule and pervasive

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<sup>60</sup> Hilton L. Root, “Distinctive Institutions in the Rise of Industrial Asia,” in *Behind East Asian Growth*, ed. Henry S. Rowan (London: Routledge, 1998), 63.

<sup>61</sup> Root, “Distinctive Institutions in the Rise of Industrial Asia,” 65.

<sup>62</sup> Eun Mee Kim, *Big Business, Strong State: Collusion and Conflict in South Korean Development, 1960–1990* (Albany, NY: State University of New York Press, 1997), 34; Kim, “An Introduction to the Korean Model of Political Economy,” 49.

<sup>63</sup> Stern et al., *Industrialization and the State*, 5.

<sup>64</sup> *Ibid.*, 5.

<sup>65</sup> *Ibid.*, 6–8.

corruption, with internal checks and balances. Adhering to progressive practicality, Park allowed participation of the various economic sectors to have a stake in national policies. Improving upon the modes of communication, accountability, and transparency, the state-business relationship matured rapidly in depth and scope resulting in high economic growth.

Conventionally, the correct understanding of “Korea, Inc.,”—unlike “Japan, Inc.”—where government and business were on relatively equal standing with each other—emphasizes that the *chaebol* were predominantly led by the state.<sup>66</sup> This was a valid statement only during the 3<sup>rd</sup> and 4<sup>th</sup> Republic. Not only did Park have extensive ties to politics from his military background, he created the Korean Central Intelligence Agency (KCIA) in 1961, located in Namsan of Seoul, in order to prevent the domestic North Korean threat but also to enforce politicians, businessmen, and media personnel.<sup>67</sup> When Park launched South Korea’s 4th Republic in 1972, amendments to the constitution and new *yushin* system, modeled after the *iishin* system of Meiji Japan, prioritized “loyalty and filial piety” that would be the national mottos throughout state led economic development and corporate growth.<sup>68</sup> Under the *yushin* system, Park would further strengthen the executive position, which meant that his guidance was not to be challenged and the *chaebols* stayed untouched but also contained with such an influential chief. Meanwhile, “Korea, Inc.” also indicates the dawn of a national economic institution where the state relied heavily on the private sector. From the perspective of the *chaebols*, they also had to survive within the market. As a result, the conglomerates naturally capitalized on the political relationship with the state and began to champion competition within the economy as well.

#### *d. Unnatural Market Conditions*

Critiquing Park’s tenure in terms of economic security, which in South Korea’s case meant protecting the free market from internal institutions, two issues need to be

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<sup>66</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 50.

<sup>67</sup> John Lie, *Han Unbound* (Stanford: Stanford University Press, 1998), 2, 113.

<sup>68</sup> Cho, “Culture, Institutions, and Economic Development in East Asia,” 29.

addressed: sustainability and substitutability. The existence of an authoritarian regime and its pursuit to establish a competitive free market economy pose significant risks. Overly focused on promoting specific sectors, the plan rational economy was not beneficial to the rest of the country; therefore, the positive transitions towards a completely free market economy were missing. This meant that the political economic structure did not account for preparing for alternative institutions to the chaebols and mitigating the socio-economic risks. In turn, these precedents affected how the market was shaped, in particular deterring market efficiency as a result of binding state intervention. Those who were excluded from political priorities were political-economic losers. In a profit based zero sum game within the market, the conglomerates quickly established organizational autonomy and capacity eventually monopolizing various sectors. If the state were to lose control over the private sector, the balance of economic power would shift to the chaebol and the oligarchs at their heads.

Underlying the economic successes of Park's rule, South Korea's market economy was beginning to develop unnaturally. By the end of the 1970s, challenges with the "distortion of the competitive market structure, misallocation of resources, and severe inflationary pressure and unbalanced development of the industrial structure" remained unresolved.<sup>69</sup> Further aggravating the natural development of the free market system, "growth first and distribution later" caused wealth inequality while Park was not ready to allocate the country's tax to balance the amplifying economic deficiencies.<sup>70</sup> Although initial mercantilist policies yielded transition from ISI to EOI along with high growth, favoritism towards the *chaebols* thwarted the country's long term entrepreneurship. And as South Korea's human capital evolved, the social, political, and economic conditions warranting interventionism changed requiring decisive adjustments to policies.

## **B. CONCLUSION**

The initial phase of South Korea's industrialization began with a political revolution. After the coup d'état, Park took control over South Korea's commanding

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<sup>69</sup> Kim, "An Introduction to the Korean Model of Political Economy," 50.

<sup>70</sup> *Ibid.*, 51.

heights and adhered to the fundamentals of mercantilist theory. Foregoing the option to patiently allow the market to develop, South Korea's security conditions warranted expedited industrialization and the dictator bypassed liberalization to justify accelerated economic progress based on interventionism. The state during Park's era was predominantly a "'comprehensive' developmental state," which focused on development placing industrial policy at the core of the political agenda.<sup>71</sup>

As economic growth became the *raison d'état* of the state, unorthodox practices were implemented to accumulate capital. Given the country's distraught conditions, the *chaebols* were crucial allies for the South Korean leadership at the time in order to achieve industrial power. Park successfully incorporated two elements of political economic growth. With an initial focus on building human capital, in the form of a capable bureaucracy, the decision to utilize the private sector, specifically the *chaebols* paid off to increase the country's physical capital and thereby drive economic growth.

Although a pragmatic authoritarian leader thus produced quickly accelerating growth, with so much of the political economic power concentrated, it was apparent that maintaining a state led partnership with the private sector was not sustainable. The use of the *chaebols* can be lauded as necessary political risk; meanwhile, the over reliance on the *chaebols* began to create imbalances that impacted the market economy's future. Without a longer term contingency plan for continuity, the political transition to another leader portended further changes in the balance of economic power between the state and the *chaebols*. Since the comprehensive developmental state is inherently a transitory state susceptible to internal and external pressures, institutional transitions were imperative in South Korea as economic conditions precipitated changes to industrial policies that specifically facilitated the *chaebols*, especially in the heavy and chemical industries.<sup>72</sup>

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<sup>71</sup> Kim, *Big Business, Strong State*, 5.

<sup>72</sup> *Ibid.*, 5–6.

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## IV. POLITICAL TRANSITIONS AND MARKET VULNERABILITIES

### A. INTRODUCTION

At the end of the 4<sup>th</sup> Republic, South Korea's political economic balance became susceptible to its first transitional vulnerability. The conditions were especially volatile since the changeover was overnight and in conjunction with another military coup. Soon after Park's assassination, with the change in the political interests and environment, the *yushin* system intended to further strengthen state control was terminated overnight. In the midst of uncertainty, the relationship between the state and *chaebols* inevitably changed with a different political economic environment developed by another authoritarian leader. With the a new Republic and during the changeover, the head of state, General Chun Doo Hwan, retained most of the executive powers exercised by Park and the continuation of authoritarianism was clear in how the military killed and violated civil rights during the 1980 Kwangju uprising.<sup>73</sup> With ongoing political unrest caused by the unions, student anti-American movement, and opposition parties, the ruling party was forced to concentrate efforts on maintaining support for current regime and disrupted the state's economic centralization.<sup>74</sup> Predictably, implementation of imprecise economic policies and changes to the well run bureaucracy stifled state capacity. Carrying out the plans promoting market liberalization was simply done at the wrong time when the *chaebols* were beginning to absorb all facets of economic production leaving the rest of economy unprotected. The political blunder proved to be fatal as it fueled the conglomerates' organizational growth not just in terms of economics but politically and socially as well.

Without sound and sustaining institutions based on rule of law, reactionary policies were unable to contain the *chaebols* and the expression "Korea, Inc." coined a national economy led by the business sector. As priority was given to heavy and chemical industries (HCI), dismissing necessary growth of small and medium sized enterprises, the

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<sup>73</sup> Haggard, *Pathways from the Periphery*, 136.

<sup>74</sup> *Ibid.*, 137–138.

*chaebols* were able to monopolize industries and continue to advance their interests within the “free” market economy. And since the overall economic system had not yet matured to a self-regulated economy, the balance soon shifted towards the *chaebols*, which exploited the government policies that were intended to promote national wellbeing. No longer under comprehensive government scrutiny, the *chaebols* maximized their autonomy and capacity. As a result, industrial growth policies were capitalized by businesses that began to cartelize the market and the methods of government control were weakened. Additionally, as the economy matured, the government’s support was not only excessive but was becoming unnecessary for the *chaebols*. In due course, the state became completely dependent on the conglomerates as the businesses took control over the nation’s powers of production. Although growth was occurring, the economy dominated by the *chaebols* led to a worsening in socio-economic conditions as the state was no longer capable of effectively preserving societal interest in the capitalist system.

## **B. THE 5TH REPUBLIC (1979–1988): THE FIRST TRANSITIONAL VULNERABILITY—DANGERS OF AUTHORITARIAN TRANSITIONS**

### **1. The Decreasing Political Stake**

President Chun Doo Hwan’s efforts to adjust the economic environment during the 5<sup>th</sup> Republic exposed the economy to the *chaebols*. First, he altered the bureaucracy that served as an effective intermediary providing oversight of the nation’s economic trajectory. After his military coup d’etat in December of 1979, under the slogan “Just Society” Chun’s new campaign retired 8,000 civil servants, along with Park’s political guard including members of the majority and minority parties, and placed the media under the government. As a result, the crucial institutional checks and balances over the *chaebols* were stifled. Weakening the bureaucracy translated into waning liability and visibility of the private sector. As the state reduced its own intermediary role, the government was no longer able to effectively coordinate its agenda with the businesses. South Korea’s *Fifth Five-Year Economic and Social Development Plan 1982–1986* specifically intended to promote autonomy of overall market investment decisions to the

private sector and decrease government intervention.<sup>75</sup> The new economic strategy was implemented with inopportune timing as the FDI increased and export sectors remained at the forefront of growth. At this juncture, the relationship of the two institutions evolved from “state dominance to symbiosis and [eventually] to competition.”<sup>76</sup> In the end, the state was losing its lead position in the once joint process of successfully carrying out economic initiatives. The once collectivized process that married the state and *chaebols* to maximize equity and stimulate constructive partnerships in pursuit of the national interest was transforming into an exclusively private endeavor.

Correctional measures undertaken by Chun were not decisive enough to balance the market by reducing the *chaebol* presence. The state failed to address the regulatory function due to the pursuit of “fair competition and consumer protection” and did not require the *chaebols* with high debt/asset ratios to repay loans, leaving the people’s assets via the government in the possession of the conglomerates.<sup>77</sup> With the *chaebols* in control of the heavy production sectors, small and medium businesses were occupied with investing in “leisure services” while the larger companies dominated the country’s real estate and development projects.<sup>78</sup> Furthermore, the *chaebols*’ were now afforded the opportunity to attract and venture into international market territories. By 1981, Chun authorized “joint ventures with foreign banks” despite the Fair Trade Law preventing “anticompetitive mergers, unfair advertising, and restrictive trade practices; in 1984, the Tariff Reform Act phased reductions in tariff levels and charges to create uniformity of tariff levels.”<sup>79</sup>

In short, Chun’s era evolved towards a “‘limited’ developmental state,” a hybrid of plan rational and market rational management, which works to support developmental policy goals along with foreign policy and welfare.<sup>80</sup> Although the intent was to reduce

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<sup>75</sup> Tony Michell, *From a Developing to a Newly Industrialized Country: The Republic of Korea, 1961–82* (Geneva: International Labour Office, 1988), 75.

<sup>76</sup> Kim, *Big Business, Strong State*, 5.

<sup>77</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 54.

<sup>78</sup> *Ibid.*, 55.

<sup>79</sup> *Ibid.*, 53.

<sup>80</sup> Kim, *Big Business, Strong State*, 5; Johnson, “MITI and the Japanese Miracle,” 270–271.



government control over investment guidance and to expose industries to “market forces and external competition,” Chun failed to address comprehensive restructuring of the legal “market rational” institutions prior to liberalization as unfair rules allowed the *chaebols* to continuously thrive throughout private sector.<sup>81</sup> In a weak rule of law context, other institutional checks and balances were crucial: “bureaucracy checks the excesses of the business enterprises, the legislature checks the excesses of the bureaucracy, and a free press serves as a check on the three players including itself.”<sup>82</sup> Since the Korean government failed to guarantee the necessary market protection measures, the national economy was not an impartial playing field for all companies. The market imbalance and government political focus provided ample opportunity for the *chaebols* to increase their influence in the financial sectors.

## 2. *Chaebol* Take Over

The change in interests, conditions, and the environment provided the *chaebols* impeccable timing to fully capitalize on the transitional vulnerability that opened during South Korea’s 5<sup>th</sup> Republic and become the lead element for the country’s transition towards capitalism. The *chaebols* were not complacent with state assistance. They expanded autonomy and capacity by expanding to new markets, investing in technology and partnering with multinational corporations making themselves indispensable for the nation’s TFP efforts.<sup>83</sup> The timing, beginning in 1979, for organizational expansion was ripe as the state pursued a new direction for the economy with focus on trade and financial liberalization.<sup>84</sup> As a result, the government focused on small and medium business growth with “minimized credit allocation, forcing companies to rely more on stock offerings and borrowing on the open market,” and “selling commercial banks to private shareholders, establishing new financial institutions.”<sup>85</sup> Once the state

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<sup>81</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 53–54.

<sup>82</sup> *Ibid.*, 55–56.

<sup>83</sup> Kim, *Big Business, Strong State*, 6.

<sup>84</sup> Richard M. Steers, Keun Shin Yoo, and Gerardo R. Ungson, *The Chaebol* (New York: Harper & Row, 1989), 26.

<sup>85</sup> *Ibid.*, 28.

relinquished the means for credit allocation to the private sector, the *chaebols* were no longer beholden to the government. The state, no longer equipped with the ability to intervene in the *chaebols'* operations through market share, was unable to rectify the incomplete policies intended to transition towards an efficiently competitive free market economy.

As a consequence, Chun's political strategy sped the *chaebols'* ascent as the country's oligarchy. Additionally, during the world recession of the 1980s, Chun was focused on controlling price stabilities and neglected to deal with "financially insolvent firms."<sup>86</sup> Without a contingency plan for replacing the bankrupt "shipping companies, overseas construction companies, and general trading companies," the government was forced to provide relief funds.<sup>87</sup> As a solution to the failing businesses, Chun allowed other conglomerates to take over the firms and under the revised "Law Governing Tax Reduction and Exemptions," exempting property and transfer taxes for mergers.<sup>88</sup> Unsurprisingly the market started to operate under "private-sector industrial guidance," more specifically a "[*chaebol*]-guidance" model.<sup>89</sup> As government control of the *chaebols* significantly weakened, the conglomerates were now in control of South Korea's commanding heights.

The *chaebols* ensured that they became inextricably interconnected to the country's economic survival. As the *chaebols* focused on export capacity and increased industrial readiness, the successes of the businesses were soon becoming the source of political legitimacy as well. By the late 1980s, the *chaebols* gained increased freedom as "corporate growth and the stock market" become the sources of "financial support" in place of the government.<sup>90</sup> No longer was it feasible for the state to sufficiently regulate the growing conglomerates. The absence of institutional safeguards to prevent the expansion of the *chaebols* and lost timing led to an imbalance between the state and the

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<sup>86</sup> Kim, "An Introduction to the Korean Model of Political Economy," 54.

<sup>87</sup> Ibid., 54.

<sup>88</sup> Ibid.

<sup>89</sup> Ibid., 55.

<sup>90</sup> Lie, *Han Unbound*, 149.

*chaebols*. Because piecemeal reconstruction efforts by the government failed to retain economic jurisdiction, the *chaebols* not only assumed the driving role in the economy but also asserted their presence in the political realm.

Lastly, the *chaebols* paralyzed the bureaucracy's capacity with systemic corruption. A principal cause for the government's weak ability to police the state-business relationship was due to the political buy-off affecting policies at all levels involving "military officers, politicians, bureaucrats, bankers, businessmen, and tax collectors."<sup>91</sup> To the *chaebols*, it was no hard feat as rule of law and "government intervention [degenerated] into 'rent seeking'" in the midst of economic success.<sup>92</sup> The government and the industries had been working hand in hand for decades while state oversight was pervasive. Reversing the roles of influence, this worked in favor of the *chaebols* since they knew how the government operated as experienced veterans of a once flourishing partnership. With decreased state oversight, bribery became rampant especially as the politicians required funding during the election campaigns, a "quasi-institutionalized" tit-for-tat norm that was commonplace since Park's era.<sup>93</sup> The *chaebols'* accumulation of more wealth and power under the conditions prescribed by Chun soon led to high levels of political funding. A deeper issue to the cancer of corruption was the inability to recognize how corruption functioned to shroud the decision making process and corroded the nation's economic security. The *chaebols'* greed that advanced their ambitions led to South Korea's administrative breakdown as well as subsequent financial, social, and political costs.

### **3. Distorted Market Conditions**

In order to advance a country's long-term capitalist competitiveness, a self-correcting efficient market is desired for the sake of sustainable competitive advantage. Unnecessary government intervention that will prevent natural efficiency of the "invisible

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<sup>91</sup> David Kang, "Bad Loans to Good Friends: Money Politics and the Developmental State in South Korea," *International Organization* 56, no.1 (2002): 177-178.

<sup>92</sup> Amsden, *Asia's Next Giant*, 327.

<sup>93</sup> Kang, "Bad Loans to Good Friends," 186.

hand” and prevent competition will deteriorate the national economy from within.<sup>94</sup> Yet, in South Korea, the sudden shift in political focus towards macro market liberalization policies in order to correct mercantilism of the 60s and 70s, came with a concurrent loss in relevance of equally important microeconomic institutions. The domestic problems were masked by South Korea’s overall growth due to “sharp decline in international oil prices, the fall in international interest rates, and the appreciation of the Japanese yen.”<sup>95</sup> By the 1980s, the state’s industrial policies were shaping an unnatural economy, which was leading towards developing trends of monopolization that were no longer correctable while the country continued to grow economically under false premises. Long-term stability grounded on a market rational system or a laissez-faire economy proved impossible for Korea. Without healthy competition and entrepreneurship, a self-correcting “invisible hand” did not exist. Previous government intervention and *chaebol* monopolization of the market made the transition to a free market economy difficult. And as long as the *chaebols* controlled the majority of the country’s means of production, the transition towards a liberal market economy was becoming unattainable.

Not only was the state reliant upon the *chaebols* for physical capital, but the modes of innovation needed to sustain growth were becoming inefficient. As adverse national economic institutions were becoming permanently embedded, the market became rigid with restricted avenues of growth. The government’s continuing investment distortions forced small and medium size firms to pursue leisure services while the larger businesses focused on heavy industries and real estate, to include commercial building and redevelopment projects. Essentially, the erosion of competitiveness created substantial gaps within the economy that lacked asset investments and bullish trade liberalization reforms worsened the national foreign debt. By 1983, the top five business groups, Hyundai, Samsung, Lucky-Goldstar, Sunkyung, and Daewoo, accumulated approximately 50 billion dollars in sales, which equated to over 50 percent of South

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<sup>94</sup> Barma and Vogel, *The Political Economy Reader*, 21–22.

<sup>95</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 55.

Korea's gross national production (GNP).<sup>96</sup> With most of the country's capital tied to the operations of the *chaebols*, the allocation of South Korea's resources remained confined and improperly distributed.

The deteriorating political economic balance precipitated social imbalances and the wide gap between the rich and poor remained during the periods of growth. From 1965 to 1980, the country's income distribution of the top 20 percent of households remained above 40 percent; with the middle 40 percent of households earning about 35 percent and the bottom 40 percent consistently under 20 percent.<sup>97</sup> Labor, which had been unrepresented and excluded from the state-business partnership since the beginning, became a ubiquitous force for democratization and social change by 1980s.<sup>98</sup> Furthermore, underlying the inaccurately perceived stability, the country continued to suffer internally from the lack of "income distribution, labor management relations, and social welfare."<sup>99</sup> Instead of facilitating a healthy division of labor, the *chaebols* dictated the value of labor as they dominated the industries and obstructed diversification of production. Furthermore, the strictly top down organizational structure of the *chaebols* cannibalized the country's workforce. The country's leaders failed to realize that the litmus test of a healthy economy lies within the well-being of the people.

## C. 6<sup>TH</sup> REPUBLIC: THE SECOND TRANSITIONAL VULNERABILITY— POINT OF NO RETURN

### 1. Introduction

At the dawn of South Korea's 6<sup>th</sup> Republic, South Korea's new democracy was becoming more susceptible to the pressure from the international community to integrate into the globalized political economy, following the 1988 Seoul Olympic games.<sup>100</sup> However, the timing and the internal environment merely presented the country's second

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<sup>96</sup> Sangjin Yoo and Sang M. Lee, "Management Style and Practice of Korean Chaebols." *California Management Review* 29, no. 4 (1987): 96.

<sup>97</sup> Michell, *From a Developing to a Newly Industrialised Country*, 118.

<sup>98</sup> Kim, *Big Business, Strong State*, 4.

<sup>99</sup> Yoon Hyung Kim, "An Introduction to the Korean Model of Political Economy," 51.

<sup>100</sup> Chae-Jin Lee, "South Korean Foreign Relations Face the Globalization Challenges" in *Korea's Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 171.

transitional vulnerability for the *chaebols* as the ill prepared economy was launched into the foreign market system. Nominally marking the end of authoritarian rule, continuing deterioration of political, economic, and social institutions further provided the *chaebols* opportune timing to further their standing as South Korea's most dominant organization. As another former military leader assumed the presidency behind the veneer of democracy, correcting political instabilities caused by party factionalism became the foremost priority of the state. In the midst of stagnating domestic politics, liberalization of foreign policy allowed the economy to expand towards the international market sooner than expected. Given the circumstances, the state began to completely lose accountability and transparency of the private sector as the *chaebols* usurped the market economy by integrating South Korea to foreign capital. The political economic vulnerabilities not only provided prime conditions for the conglomerates to grow but with the nation's future linked to the success of the *chaebols* the private sector was now situated to control the national agenda without interference.

## **2. Roh Tae Woo (1988–1993)**

### ***a. Expansionist Foreign Policy Reform***

With capitalism linking countries to one another, soft power politics became a new mechanism that the state was required to employ. Following events that inspired South Korea's foreign policy *perestroika*, it was none other than the *chaebols* that were entrusted with the obligation to spearhead the country's new age expansion that linked politics with economics. At this time, the *chaebols* had already been funded with "low interest-rate loans" by the government and an export boom from 1986 to 1988 with the rising yen generated continued profits without state support.<sup>101</sup> The state now relied on the *chaebols* for both political funding and success of the national economy; during this time, senior level business leaders began to enter politics as well.<sup>102</sup> Responding to the *chaebols'* request to support increasing the country's competitiveness, Roh's "Sixth Five-

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<sup>101</sup> Kim, *Big Business, Strong State*, 182.

<sup>102</sup> *Ibid.*, 182.

Year Economic and Social Development Plan” focused on outward growth.<sup>103</sup> Meanwhile, not having resolved the symptoms of “compressed modernization” leading to domestic “economic imbalances,” including “concentration of economic power and inequalities of income and wealth,” the political leadership’s diplomatic decision to advance a liberal approach to foreign policy enabled a more aggressive business mindset.<sup>104</sup> With the novel expansionist political strategy, the economic sectors were to follow suit. At this juncture, the state was not ready to actively operate and exchange mass foreign capital as the country as a collective entity suffered from fragile institutions.

*b. Democratic Nascence*

With the balance of political-economic power already swayed towards the *chaebols*, the state was in dire need of decisive reform. Meanwhile, feeble foundations of the liberal political structure presented itself as an internal roadblock and creating yet another deficiency. The beginning years of Korea’s 6<sup>th</sup> Republic reinstated democratic rule but the regime’s capacity was debilitated by political paralysis and national turmoil. In 1987, the first democratic presidential election since 1971 was held with Roh Tae-woo winning the presidency with 36.6 of the electoral votes.<sup>105</sup> Unfortunately, despite Roh’s victory, his party lost the National Assembly elections in April of 1988 and ceded the majority. With the sudden changeover following the four decades of authoritarianism, the new political freedoms and pluralism led to a great deal of contention leveled at the Korean government regarding “rice-pricing policy, social welfare expenditure, trade policy and even defense expenditures.”<sup>106</sup> To worsen matters, another national issue at the time that was the regional patterns of voting that created political and economic polarizations strictly based on the country’s geographic locations.<sup>107</sup>

Lacking a unified consensus, laissez faire governance created uncertainty and doubt. With the 1989 National Assembly special hearing of the 1980 Kwangju massacre,

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<sup>103</sup> Ibid., 176.

<sup>104</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 56–57.

<sup>105</sup> Ibid., 56–57.

<sup>106</sup> Haggard, *Pathways from the Periphery*, 137.

<sup>107</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 57.

which both Presidents Chun and Roh were actively involved in, the attention towards economic policies became secondary and the controversial political atmosphere muddled the state’s credibility. Additionally, during Roh’s presidency, national issues including protracted labor disputes, genuine volatility of real estate speculation, Reverend Moon’s illegal visit to North Korea, prevailing violence on university campuses, and widespread social crimes caused incessant instability.<sup>108</sup> The diminishing economic focus of the state was evident during the democratic transition as the ability to govern was debilitated by political disorder. The unreliable government was no longer efficient or effective and inflexible state capacity caused perils for South Korea’s economy.

*c. Adverse Market Conditions and Socio Political Culture*

South Korean growth soared in the late 1980s, reaching an all-time high in 1988 with 6.8 percent growth (see Figure 1).



Figure 1. South Korea GDP Growth Rate 1987–1990

But society from top to bottom was also suffering from an illusion of wealth.<sup>109</sup> Macroeconomic obscurity ensued as the state was unable to provide clear direction with

<sup>108</sup> Ibid., 57.

<sup>109</sup> Trading Economics; The Bank of Korea, “South Korea GDP Growth Rate,” accessed January 19, 2014, <http://www.tradingeconomics.com/south-korea/gdp-growth>.



the “coexistence of liberalism and state corporatism” creating confusion while businesses were competing against one another to secure government benefits instead of concentrating on developing competitive advantages with technological innovations.<sup>110</sup> As the state was unable to accurately gauge what appropriate reform for long term stability was needed, its reliance on the *chaebols* for economic dynamism continued. Constantly allowing the *chaebols* to take greater risk, state-backed operations created moral hazard with higher stakes. To worsen matters, with the Olympics and profits from real estate and the stock market from 1986–1988, an overconfident public created an exorbitant spending culture with “extravagant luxury consumption.”<sup>111</sup> Within the business sector, distorted corporate speculation based on excessive greed allocated savings earnings toward “nonproductive investments” and in 1989, real estate speculations skyrocketed.<sup>112</sup> As the *chaebols*’ expansion created a national asset bubble, fear of inflation permeated society.

Throughout the 6<sup>th</sup> Republic, continued corruption between the private sector and government caused public distrust. During his political reign, it was reported that Roh secured over \$240 million to his political party for normal operating expenses and disbursed \$40 million to constituents, all the while, personally raising at least \$800 million in private funds.<sup>113</sup> As Koo Ja-kyung, chairman of LG and the Federation of Korean Industries (FKI) retaliated to deregulations stating that political contributions would only go towards politicians willing to support businesses, Roh discarded his anti-*chaebol* campaign.<sup>114</sup> With an uncertain economic environment, accurate calculation of risks that was vital to sustaining stable long term capital management was becoming impossible. As market signals were distorted and dismissed, the country continued operate without authentic evaluation of market conditions. Since the state was no longer a

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<sup>110</sup> Lee-Jay Cho and Yoon Hyung Kim, “A New Vision for Institutional Reforms” in *Korea’s Political Economy* ed. Lee-Jay Cho and Yoon Hyung Kim (Boulder, CO: Westview Press, 1994), 710.

<sup>111</sup> Kim, “An Introduction to the Korean Model of Political Economy,” 57.

<sup>112</sup> *Ibid.*, 57.

<sup>113</sup> Kang, “Bad Loans to Good Friends,” 196.

<sup>114</sup> C. S. Eliot. Kang, “Segyehwa Reform of the South Korean Developmental State,” in *Korea’s Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 91.

major player in market operations, it haplessly left market forces to self-correct. As a consequence, the growing *chaebol*-led economy that reached out to foreign markets and risked external exposure.

#### D. CONCLUSION

The 5<sup>th</sup> Republic marked a turning point for the South Korean economy as the balance between state and business waned and the evolution of the term “Korea, Inc.” defined an era of *chaebol*-led growth. During the authoritarian transition, political vulnerabilities led to the establishment of an oppressive economic environment. As the government stymied its own capabilities by eliminating essential bureaucratic functions and diminishing organizational capacity, the state began to relinquish its systems of oversight over the *chaebols*. Soon after, as economic conditions outpaced faulty policies, the private sector took control of the commanding heights. The high expectations for the regime following the era of industrialization were never met. Without the ability to manage the *chaebols* via effective rule of law institutions, the government became dependent on them for economic growth and political legitimacy. At the dawn of the new democratic Republic, the authoritarian transition of Chun’s era had yielded not only distorted market and social conditions but permitted the *chaebol* reign to be comprehensive and pervasive within the South Korean economy.

Despite the political transitions, South Korea’s market economy were unable to dismantle the oligarchs. The *chaebols* thrived in both “*defensive industrial policies*, [in which the state aimed to] preserve existing structures, maintain employment, and protect beleaguered industries” and “*adaptive industrial policies* [that] encouraged and facilitated industrial change by providing resources from aging or declining sectors to more productive sectors.”<sup>115</sup> In fact, the state was not only unable to regulate the private sector but bolstered the *chaebols*’ autonomy with liberalization policies that expedited organizational growth towards the regional markets. In sum, Chun and Roh’s laissez-faire economic policies were “institutionally inappropriate” to the country’s market

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<sup>115</sup> Steers, Yoo, and Ungson, *The Chaebol*, 25.

conditions.<sup>116</sup> No longer limited to domestic production, the scale of operations for the conglomerates increased dramatically. Without a regulatory system of checks and balances, the South Korean economy was not ready to engage with economies abroad. The indication of a fragile economic system was evident in the nation's political infrastructure. With relentless discord among the various parties, mobilizing a cohesive government agency that would be able to take part in the ownership of the commanding heights seemed impossible. As a result, the basic procedure of monitoring the market was disabled. Moreover, unstable institutions permeated across the country creating volatile socio-economic conditions. With the international market now impacting the domestic economy, the severity of the dangers to an unregulated private sector equated to risks that would jeopardize the entire country. Precariously, as the politically backed *chaebols* controlled the state business partnership, both factions were now committed to each other's success and failure.

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<sup>116</sup> Cho and Kim, "A New Vision for Institutional Reforms," 708.

## V. THE 1997 INTERNATIONAL MONETARY FUND CRISIS

### A. INTRODUCTION

The survival of the *chaebols* as an institution through both a catastrophic economic crisis and a major regulatory reform attests to their durability. A series of mistakes by the government continuously delayed the consequences of the oligarchic concentration of economic activity. Squandering yet another momentous possibility of breaking up the conglomerates in order to regain its position over the commanding heights, the state heightened economic exposure to adverse market shocks. As moral hazard and corruption disrupted the country's policies and capital over the years with endless accumulation of foreign debt, an economic meltdown was unavoidable. In 1997, South Korea finally bore the brunt of its decision for having a *chaebol*-led economy as the region wide Asian financial crisis required a colossal International Monetary Fund (IMF) bailout.

Authoritarian or illiberal mechanisms were not strictly limited to political environments as the *chaebols* continued to dominate the economy. Prior to causing a national economic meltdown, by 1996, the "top 30 conglomerates" owned and produced half of all equity and sales in the country's private sector; the "top five conglomerates" accounted for 55percent of "all domestic bank loans" in 1997.<sup>117</sup> A correlation from political systems can be made upon economic environments as well. Examining the high growth of illiberal Asian states, a form of "mature authoritarianism" evolved, with diversified institutional measures to secure legitimacy and ease the transition from "hard to soft authoritarianism."<sup>118</sup> This perspective can also explain the *chaebols'* maturing and creeping institutionalism in the political economy. With the breadth and depth of the ubiquitous corruption mechanisms, the *chaebols* seized the political and economic domains. And as the political leadership became further dependent on the *chaebols*, the private sector disregarded rule of law, which spawned moral hazards. Lacking

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<sup>117</sup> Beck, "Revitalizing Korea's Chaebol," 1021.

<sup>118</sup> Pei, "Constructing the Political Foundations of an Economic Miracle," 44.

alternatively superior modes of production and innovation at both pre and post crisis periods, the *chaebols* remained as an integral institution throughout South Korea's global growth throughout the twenty-first century.

## **B. KIM YOUNG SAM (1993–1998)**

### **1. Segyehwa Campaign**

With another transition of political leadership and accurate understanding of the need for globalization, conceptualizing the early stages towards improving the economy was on point. When Kim Young Sam was elected president, the country was led by its first civilian government in 30 years. His legacy was his “*segyehwa*” or globalization campaign aimed not only at economic but also political, cultural, and social liberalization as well.<sup>119</sup> The initiative was to better accommodate “a set of processes of stretching and intensifying worldwide interconnectedness” that aimed to incorporate all areas of the country's infrastructures.<sup>120</sup> The primary goal of the country in order to achieve a globalized market oriented environment was to eventually liberalize trade and open the financial markets. Fueling social mobilization, North Korea's aggressive threats against the South's new movement gave more media exposure.<sup>121</sup>

Meanwhile, with more economic success resulting in U.S. and Japan pressuring to further liberalize import and financial markets in addition to competition among the other newly industrializing countries (NIC) in Asia that began to provide cheaper labor, the Korean manufacturing exports sectors required advances in innovation; hence, the focus shifted towards research and development to provide “higher value-added production”<sup>122</sup> The *chaebols* aggressively pursued periphery enterprises in “Europe, Southeast Asia, and former communist bloc” with foreign direct investments in those countries catapulting

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<sup>119</sup> C. S. Eliot Kang, “Segyehwa Reform of the South Korean Developmental State,” in *Korea's Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 2.

<sup>120</sup> Samuel S. Kim, “Korea and Globalization (*Segyehwa*): A Framework for Analysis,” in *Korea's Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 18.

<sup>121</sup> Kang, “Segyehwa Reform of the South Korean Developmental State,” 3.

<sup>122</sup> Lie, *Han Unbound*, 156.

from 32 million dollars in 1985 to 1 billion dollars by 1991.<sup>123</sup> Domestically, subsidiary companies of the top 30 *chaebols* increased dramatically from an average of 4.2 in 1970s to 26.7 by 1997.<sup>124</sup> In order to prepare the country to compete internationally, Kim Young Sam first reinforced “localization (deglobalization)” to enhance domestic production and independent industrial capacity as globalization necessitated “greater deregulation, decentralization, and democratization.”<sup>125</sup> While initial planning and policies for progress addressed national necessities that provided a sense of hope and direction, the feasibility of executing the national schema against the growing *chaebols* remained questionable.

## 2. Proposed Reform and Consequences of Indecision

As the president called upon institutional changes, the state appeared to be regaining its influence vis-à-vis the business sector. With a clear trajectory established by Kim, the government had another opportunity to implement disciplined economic reform processes. The reform strategy was comprehensive but required execution with critical aggressiveness. The schema was to be carried out in three primary areas that would address the economic structure, investment strategy, and political reform by means of “deconcentration of *chaebols*; external opening and liberalization; and a deepening of democratization.”<sup>126</sup> This was once again, a state driven top down operation that required immediate action since the symptoms of economic authoritarianism were beginning to affect political outlook. The main objective of deconcentration was to first cultivate healthy domestic competition that would stabilize domestic economic conditions in order to prepare for the next required stage of reform of opening up to the external markets. In conjunction with U.S. pressure for Korea’s economic liberalization, the economic environment required “technological innovation and increased capital mobility” in order

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<sup>123</sup> Ibid., 156.

<sup>124</sup> Beck “Revitalizing Korea’s Chaebol,” 1022.

<sup>125</sup> Kang, “Segyehwa Reform of the South Korean Developmental State,” 4.

<sup>126</sup> Barry K. Gills and Dongsook S. Gills, “Globalization and Strategic Choice in South Korea: Economic Reform and Labor,” in *Korea’s Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 30.

to meet the challenges of the global markets.<sup>127</sup> Finally, democratization would allow responsible allocation of resources to include welfare spending, “redistribution of income from capital to labor, and social inclusion” that would re-integrate a burgeoning middle class to the economic system.<sup>128</sup> If the aforementioned plan was to be executed properly, policy objectives would eventually restore the balance of the state-business relationship and resolve social, economic, and political issues throughout the process.

Despite the grandeur of the reform blueprint, Kim Young Sam’s leadership failed to deliver South Korea’s much needed lasting change and reform due to indecision. Bureaucratic entities offered different courses of action in regards to prioritizing the president’s reform policies. In 1994, the Economic Planning Board (EPB) recommended the need to open the market system to better utilize the international production forces and attract foreign investment, which would require the government to “ceasing [the] practice of market intervention and removing regulations.”<sup>129</sup> Moreover, support for South Korea’s accession to the Organization for Economic Co-operation and Development (OECD) was not only to increase competitiveness and gain better access to foreign technology but was also to correct labor issues by increasing transparency among businesses.<sup>130</sup> On the other hand, the Ministry of Finance and the Bank of Korea cautioned the EPB’s approach due to inherent risks of macroeconomic stability if the pace of exposure to the domestic markets were to be too sudden.<sup>131</sup>

External opening for the market economy ran the risk of further entrenching the *chaebols*, the conglomerates that have commandeered the entrepreneurial roles, in the economic system. Additionally, dependency on the international system would inevitably make the market conditions more susceptible to external shocks.<sup>132</sup> Kim first chose to break up the big businesses. The five year plan during this era that promised “tax,

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<sup>127</sup> Ibid., 32.

<sup>128</sup> Ibid., 32.

<sup>129</sup> Ibid., 34.

<sup>130</sup> Ibid., 36.

<sup>131</sup> Ibid., 34.

<sup>132</sup> Ibid., 32.

financial, monetary and administrative reforms” in 1993 aimed at enforcing “spending and production targets for the private sector and voluntary limits on business expansion plans.”<sup>133</sup> One course that Kim took was merging the Economic Planning Board (EPB) and Ministry of Finance (MOF) into the Ministry of Finance and Economy (MOFE) in order to create a more effective system of governance but the oversized and politicized bureaucracy was unable maintain manage the various “fiscal, budgetary and other important economic functions” making accountability difficult.<sup>134</sup> In response the *chaebols*’ national investments decreased and so did overall economic growth in 1993 to 3.4 percent causing fear of unemployment.<sup>135</sup> Failing to follow through with complete implementation of anti-*chaebol* measures, Kim, with the advice given by the Ministry of Foreign Affairs, Ministry of Trade, Industry, and Energy (MOTIE), chose to pursue the next step in his reform and opened the domestic market. With the *chaebols* still in control of the commanding heights, the conglomerates remained as the center piece for economic liberalization. Caving to his middle class constituencies, by 1994, Kim Young Sam took a ‘reverse course’ on de-concentration and once again, like his predecessors, promoted “big business, export promotion, and rapid economic growth.”<sup>136</sup> Ultimately, Kim Young Sam’s reforms were “insufficient in scope, depth, and speed” and his indecisiveness “lost opportunity for sequential reforms.”<sup>137</sup> Kim failed to understand the dynamics of “advanced developmental capitalism,” which required effective wielding of state power to balance the coexistence with a growing private sector.<sup>138</sup> As policy initiatives became moot with unsuccessful execution of reform measures, *chaebols* continued to pursue unrestrained operations in the absence of antimonopoly measures.

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<sup>133</sup> Kang, “Segyehwa Reform of the South Korean Developmental State,” 92.

<sup>134</sup> *Ibid.*, 92.

<sup>135</sup> Gills and Gills, “Globalization and Strategic Choice in South Korea,” 35.

<sup>136</sup> *Ibid.*, 36.

<sup>137</sup> *Ibid.*, 39–40.

<sup>138</sup> Kang, “Segyehwa Reform of the South Korean Developmental State,” 92.



### 3. Pre-IMF Flow of Capital

By the 1990s, undeterred by political ineptitude, South Korea's investment portfolio was growing at an explosive pace and the uncontrollable economic changes left the state helpless. While Korea's Foreign Direct Investment (FDI) increased drastically in 1985 from \$32 million to over \$1 billion by 1991, trade was surging as well.<sup>139</sup> Sino-ROK trade alone increased from \$40,000 in 1978 to \$23.6 billion by 1997.<sup>140</sup> "Daily turnover in the foreign-exchange markets [rose] from \$15 billion in 1973 to \$820 billion in 1992 and to \$1.5 trillion by 1998" and the "volume of international banking transactions increased from \$265 billion in 1975 to \$4.2 trillion in 1994."<sup>141</sup> Also catalyzing the burgeoning international business environment, the internet revolution precipitated "informationization—a global information-based economy" as global FDI inflows and outflows were respectively at \$400 billion and \$424 billion in 1997, doubling figures from 1990.<sup>142</sup> The country's growing physical capital was dominated by the private sector. 53,000 parent company Multi-National Corporations (MNC) and 448,000 foreign affiliates controlled "finance, trade, investment, and production" and with decreasing costs of transportation and communication, MNCs were responsible for "70 percent of world trade, 70 percent of patents and technological transfers, and 80 percent of FDI."<sup>143</sup> To the state, the volume of capital flow was simply unmanageable without enforceable regulatory institutions, which meant that the conditions for unconditional entrepreneurialism and expansion among the South Korean businesses were optimal. The changing economic conditions continued to leave the government in a reactive state while the *chaebols* were at the forefront of influencing the international economic operations, which increased both organizational autonomy and capacity.

What caused domestic contagion in South Korea was disproportionate debt. The *chaebols'* speculative investments made possible by foreign debt aggravated the financial

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<sup>139</sup> Lie, *Han Unbound*, 156.

<sup>140</sup> Kang, "Segyehwa Reform of the South Korean Developmental State," 17.

<sup>141</sup> *Ibid.*, 16.

<sup>142</sup> *Ibid.*

<sup>143</sup> *Ibid.*

crisis of 1997. Initially, globalization allowed “outward foreign direct investment (OFDI) for the companies.”<sup>144</sup> While Korea’s business orientation was becoming outward oriented, the government attempted to regulate expansion as the bureaucracy attempted to control “investment, trade, loans, joint ventures, technology transfer, mergers and acquisitions, and other external financial transactions.”<sup>145</sup> However, government efforts to contain the business sector were futile. The *chaebols* used “short-term commercial borrowings to finance long-term projects” and throughout the 1990s, expansion operations took advantage of “economies of scale” to utilize cheaper labor forces and foreign technology.<sup>146</sup> By 1994, the *chaebol* OFDI accounted for 70 percent of the national OFDI with \$1.4 billion.<sup>147</sup> Coincidentally, soon after submitting for OECD membership in 1994, South Korea’s foreign debt doubled to \$157.5 billion in 1996 accounting for 33 percent of the entire GDP along with \$500 billion in overdue loans assumed by the South Korean banks.<sup>148</sup> With depleted reserves, once the debt was called upon, the country had no other option than to file for bankruptcy.

#### 4. Moral Hazard

Institutional examination reveals how and why crisis was unavoidable revealing that the swollen economic bubble that was created from within. Sakong Il, former 1987-1988 Minister of Finance, stated the four reasons why foreign investors lacked faith in South Korea. First, inexperienced commercial banks overextended credit to the *chaebol* who invested the money towards even more borrowing. Second, businesses strategy focused on diversifying market shares rather than specialization and globalization. Third, the government’s economic staff was incapacitated because Kim Young Sam replaced the deputy prime minister, the chief economic planner, seven times and the senior economic secretary to the president six times in five years. Finally, the currency crisis in

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<sup>144</sup> Eun Mee Kim, “Globalization of the South Korean *Chaebol*,” in *Korea’s Globalization*, ed. Samuel S. Kim (Cambridge: Cambridge University Press, 2000), 103.

<sup>145</sup> Lee, “South Korean Foreign Relations Face the Globalization Challenges,” 189.

<sup>146</sup> *Ibid.*, 189.

<sup>147</sup> *Ibid.*, 111.

<sup>148</sup> *Ibid.*, 189–190.

Southeast Asia was of concern to foreign investors looking at Asia as a whole.<sup>149</sup> Fearful of foreign domination of the market in the midst of Japan's new industrial rise, stakeholders of South Korea's economy were mostly native. At the time, South Korea's insulated economic tactics in 1996 disclose that FDI of the external market and foreign companies only accounted for "1 percent of total domestic fixed capital formation."<sup>150</sup> Ultimately, faulty decisions and corporate greed created a false and dangerous sense of invincibility. So disillusioned were the leaders that while IMF officials in November of 1997 visited Seoul and recommended intervention to bail out the country, the economic officials replied, "You're crazy; our system works."<sup>151</sup>

Although the *chaebols* remain as the main culprits of moral hazard, the reckless behavior did not develop overnight. Reverting back to the early industrial stages, interventionist policies resulted in targeted resource allocation to build up the heavy and chemical industries (HCIs). Government backed companies precipitated the formation of monopolies and structural imbalances between the large, medium, and small enterprises. As a result, the overall economy did not mature naturally and in the absence of healthy competition, domestic companies habitually exploited fiscal policies. Various companies, which were established prior to and during the inflated environment, survived the catastrophic crisis; however, many that were founded on feeble structure went bankrupt. For example, POSCO, a successful steel company thrived even in the 1997 financial crisis, attests to its sound infrastructure that were developed during the Park era; meanwhile, a product of the 1990s industrial setting, Hanbo steel company's bankruptcy provides a commonplace tale of the end to businesses that were founded on corruption and feeble management.<sup>152</sup> The 1997 economic crisis serves as a testament to the long-term consequence of excessive state intervention since Park Chung-hee's era that

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<sup>149</sup> Lee, "South Korean Foreign Relations Face the Globalization Challenges," 190.

<sup>150</sup> Ibid., 189.

<sup>151</sup> Ibid., 191.

<sup>152</sup> Dwight H. Perkins et al., *Economics of Development*, 7<sup>th</sup> ed. (New York: W.W. Norton & Company, 2013), 143

thwarted competitive efficiency of the private sector, which created the economic environment shaped by moral hazard among the larger firms with the sense that they were “too big to fail.”<sup>153</sup>

## 5. Money Politics

An unofficial practice that allowed *chaebols* to buy out politicians and weather multiple regime transitions was ‘money politics,’ including “both corrupt practices such as bribery and legal practices such as campaign finance,” a commonplace political institution that enabled the close state business relationship.<sup>154</sup> The bargain was simple: in return for political favor, businesses financed politicians. Eliminating the “false-name financial system,” in which the country’s elites held accounts under “fictitious names” to evade taxes, represented approximately four percent of the country’s domestic deposits and a overnight withdrawal of these funds posed two entrenched issues: first, it would undermine growth in the small- and medium-sized business sector as the funds were a substantial source of finances; second, since the funds involved a vast network of the country’s top elites, much personal and professional gains would be lost in the process.<sup>155</sup>

This was a cancerous problem earlier obscured under South Korea’s unprecedented growth. Although corruption was under control during Park’s era, it was not properly regulated throughout the transitions towards democracy.<sup>156</sup> In the 1960s, since the state retained complete control of the banks and the *chaebols* were relatively in check and small scale corruption did not affect policy. While political contributions existed during Park Chung Hee’s presidency, such activities were not to affect central policies.<sup>157</sup> However, the shift in power from the state to the private sectors had the allowed increased extent of influence and furthered the *chaebol* reign over politicians and the economy. As money became the new source for power, careers of the politicians were

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<sup>153</sup> Jwa, *A New Paradigm for Korea’s Economic Development*, 11.

<sup>154</sup> Kang, “Bad Loans to Good Friends, 178.

<sup>155</sup> Victor D. Cha, “Politics and Democracy under the Kim Young Sam Government: Something Old, Something New,” *Asian Survey* 33, no. 9 (1993): 852.

<sup>156</sup> Kang, “Bad Loans to Good Friends,” 178.

<sup>157</sup> Perkins et al., *Economics of Development*, 143.

tied to their network with the conglomerates. President Kim Young Sam utilized the government led industrial policies to secure funds for political campaigns. At the origin of Kim Young Sam's tenure, it was evident that the private sector was firmly established as a politically backed national institution. The Korean news agencies *Chosun Ilbo* and *Donga Ilbo* estimated that over five billion dollars for the presidential and National Assembly election expenses including financing the campaigns for Kim Young-Sam Kim, Kim Dae-Jung, and Kim Jong-Pil in 1992.<sup>158</sup> *Chaebol* political capacity was further demonstrated when the Hyundai chairman, Chung Ju Yung, was able upstart his own political party winning 24 seats of the South Korean Assembly and taking 16 percent of the national popular vote as the presidential candidate all within 1992.<sup>159</sup>

The *chaebols* leveraged personal careers of politicians to directly impact national economic goals as well. Accepting the deal to continue leading the economy and responding to the initial deconcentration policies, the *chaebols*, in 1994, influenced the Kim Young Sam administration to take a 'reverse course' on the deconcentration policy and heighten the importance of "big business, export promotion and rapid economic growth."<sup>160</sup> By the 1990s, it was obvious that the business oligarchs had replaced the military elite as the *chaebols* effectively ousted the *Hanahoe*, the secret military society comprised of Korean Military Academy (KMA) graduates that once thrived during Park and Chun's era, and became South Korea's most influential institution.<sup>161</sup> Hence, policing corruption was a complex task with both business and political leaders at fault. And subsequently, the country's principal nexus of power formed by the ties between the government and business sector persists to the present day.

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<sup>158</sup> Kang, "Bad Loans to Good Friends," 195.

<sup>159</sup> Cha, "Politics and Democracy under the Kim Young Sam Government," 861.

<sup>160</sup> Gills and Gills, "Globalization and Strategic Choice in South Korea," 36.

<sup>161</sup> *Ibid.*, 35.

## C. KIM DAE JUNG (1998–2003)

### 1. Post-IMF Reform

Ironically, post crisis reconstruction required state intervention and the nation's global economic security strategy necessitated the participation of the high capacity *chaebols*. At the end of the twentieth century, IMF reform focused on interventions that were aimed to rectify the previous generation's institutions to allow better accountability and transparency in order to mitigate future crises. The Kim Dae Jung administration was faced with the daunting task of not only rectifying the market economy but also preparing an economic environment suitable to meet the challenges of global competition. Despite the goal of developing a natural free market to achieve long term stability, it was the government that had to restructure the economy once again due to the "lack of competition" that caused the inefficiencies and perpetuated the financial moral hazard.<sup>162</sup> First, because the 1997 economic crisis was not salvageable at the domestic level, the government was forced to apply to the International Monetary Fund for a \$58 billion bailout package. Among the reforms mandated by the IMF restructuring in 1998, the *chaebols* and creditor banks agreed upon the "Five Principles of Corporate Restructuring" program: "the enhancement of transparency of corporate governance; strengthening fiscal accountability allowing voting rights of a broader populace of investors; institutionalizing cross-debt guarantees; improvement of financial structure; and streamlining business activities."<sup>163</sup> In 1999, Kim Dae-jung added three more policies that pressured *chaebols* to loosen control of "non-banking financial institutions," mitigate "cross subsidiary capital infusion or equity investments and insider trading," and thwart "inheritances and transfers of wealth among family members of *chaebol* leaders who attempt to exploit loopholes."<sup>164</sup> Economic restructuring based on contractual obligations allowed containment and regulation of the *chaebols*. Nevertheless,

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<sup>162</sup> Jwa, *A New Paradigm for Korea's Economic Development*, 13.

<sup>163</sup> Jwa, *A New Paradigm for Korea's Economic Development*, 227–228; Yong-Chool Ha and Wang Hwi Lee, "The Politics of Economic Reform in South Korea: Crony Capitalism after Ten Years," *Asian Survey* 47, no. 6 (2007): 904

<sup>164</sup> Jwa, *A New Paradigm for Korea's Economic Development*, 229.

constituting a mature free market system without the already monopolized conglomerates that have been established as a national financial edifice was not possible.

## 2. Post Crisis Liberalization

South Korea's economy has rapidly rebounded from 1997 with a state-business equilibrium restored to the market. From 1998 to 2008, both Presidents Kim Dae Jung and Roh Moo Hyun aimed to transition out of supporting industries and creating a balanced market environment.<sup>165</sup> While trade GDP ratios have once again increased signifying the economy's steady normalization and integration into the international markets, the *chaebols* continue to exert a degree of independent autonomy. While overall debt ratio has been decreasing as the "Big Deals" have been implemented, monopolies in "semiconductors, petrochemicals, aerospace, rolling stock, power plant equipment, vessel engines, and oil refining" continue to exist.<sup>166</sup> Utilizing neoclassical growth factors to the gauge the business environment, South Korea's concentration of human capital, physical capital, and TFP remain with the *chaebols* who have diversified their network to include social media, political support, national sports, research and development, agriculture, electronics, education, tourism, etc. Through organizational innovation and adaptability that has enmeshed the companies with the country's societal growth, *chaebols* continue to thrive as a powerful institution today.

Truncating the number of *chaebols* was merely the state's short term agenda to stabilize the market. The resolution to handle the bankrupt companies, including Hanbo, Kia, and Daewoo, after the crisis called for corporate finance restructuring plan was based on the "London Approach." In South Korea's case, each creditor bank set up a Decision Committee for Insolvent Enterprises (DCIE) in May 1998 and the Financial Supervisory Commission announced a corporate "blacklist" naming 55 firms (including 20 affiliates of the top five *chaebols* and 32 affiliates of the top six to 64 *chaebols*) that were classified as insolvent and non-viable.<sup>167</sup> The state's "Big Deal," agreed by the

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<sup>165</sup> Perkins et al., *Economics of Development*, 143.

<sup>166</sup> Jwa, *A New Paradigm for Korea's Economic Development*, 229.

<sup>167</sup> Ha and Lee, "The Politics of Economic Reform in South Korea," 905.

“Federation of Korean Industries (the *chaebol* umbrella organization), creditor banks, and the government,” forced the *chaebols* to reduce surplus capacity with business swaps; and as a result, on September 3, 1998, Hyundai, Samsung, Daewoo, LG, and SK restructured their companies with inter-organizational transfer of businesses while re-establishing respective core specialties.<sup>168</sup> By 1999, the *chaebols*, “while reduced in number but increased in size”, were once again leading the nation’s economic rapid recovery and by accumulating foreign currency reserves through their exports, the *chaebol* were re-established as the ‘savior of the economy.’<sup>169</sup> Furthermore, the decision to dismantle the *chaebols* became too costly in a political sense. With the upcoming 2000 general election, President Kim Dae Jung nullified the decision to shutdown Samsung Motor’s factory in the city of Pusan because President Kim Young Sam and the GNP held significant political influence in South Korea’s southwest region.<sup>170</sup> Reducing the autonomy and capacity of the *chaebols* required a durable and continuing strategy that proved difficult to implement.

The long term solution to balancing the *chaebols* by increasing foreign investment in the private sector was also limited.<sup>171</sup> Initially, individual foreigners were limited to owning no more than seven percent of the shares of any Korean company and “collective foreign share portion” was limited to 26 percent.<sup>172</sup> But by December 3, 1997, the Korean government raised both limits to 50 percent and in May of 1998, foreign shareholding ceilings were eliminated and “hostile takeovers” of companies were allowed as well.<sup>173</sup> As a result, Daewoo Motors, Samsung Motors, and Ssangyong Motors were acquired by multinational companies (MNCs) and foreign shareholdings in the South Korean stock market went beyond 40 percent in 2004.<sup>174</sup> Friction points to the reform

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<sup>168</sup> Lee, “Participatory Democracy and Chaebol Regulation in Korea,” 281; Ha and Lee, “The Politics of Economic Reform in South Korea,” 905.

<sup>169</sup> Thomas Kalinowski and Hyewkyung Cho, “The Political Economy of Financial Liberalization in South Korea: State, Big Business, and Foreign Investors,” *Asian Survey* 49, no. 2 (2009): 236.

<sup>170</sup> Ha and Lee, “The Politics of Economic Reform in South Korea,” 908.

<sup>171</sup> *Ibid.*, 906.

<sup>172</sup> Kalinowski and Cho, “The Political Economy of Financial Liberalization in South Korea,” 228.

<sup>173</sup> *Ibid.*, 228.

<sup>174</sup> Ha and Lee, “The Politics of Economic Reform in South Korea,” 906.



arose when public sentiment against the foreign economic involvement was fueled by the *chaebols* and Grand National Party (GNP). The *chaebols* were able to enhance their image as antagonism against the IMF worsened the public's "xenophobic sentiments."<sup>175</sup> Moreover, former chairman of Dae-woo, Kim Woo Choong, claimed that the IMF along with foreign investors "impos[ing] Anglo-American corporate governance to undermine national competitiveness" resulting in mobilizing national sentiment and thwarting General Motors' (GM) plan to acquire Daewoo Motors from employers and trade unions.<sup>176</sup> It was naïve to believe that increasing foreign investors in the national economy would weaken the deeply rooted *chaebol*.<sup>177</sup> Now, in addition to the state and the *chaebols*, foreign investors were added as a major stake holder in the economy.<sup>178</sup> Although foreign investors linked South Korea to the global economy, this did not significantly change the country's corporate structures.

#### D. CONCLUSION

The magnitude of how the 1997 crisis affected South Korea attests to the consequences of permitting monopolies to prevail in a capitalist economy. While President Kim Young-sam faced the option to police the *chaebols* or allow market liberalization allowing international market forces to stabilize the economy, indecision further stimulated corporate monopolization and global ventures, which made the national economy more vulnerable to the international market. Eventually, dismissing institutional errors, relying on the *chaebols* to achieve a successful transition throughout South Korea's *segyehwa* or globalization campaign proved disastrous. South Korean government's implicit under-writing of *chaebol* debt and business practices merely exacerbated the 1997 IMF crisis. Specifically, the *chaebols*' moral hazard as the nation became more reliant on foreign capital worsened the impact of the financial calamity in South Korea. The extent of the *chaebols*' involvement and organizational resilience as they weathered a national market shock provide profound lessons. Over time, the

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<sup>175</sup> Ibid., 906.

<sup>176</sup> Ibid., 907.

<sup>177</sup> Kalinowski and Cho, "The Political Economy of Financial Liberalization in South Korea," 234.

<sup>178</sup> Ibid., 223.

presidential transitions and the reactionary policies intended to foster a liberal market economy facilitated the shifting state-business balance in favor of the *chaebols*. The unrestricted legacy of the family owned businesses persists but this was a political symptom that was perpetuated before the 1997 crisis reform as market stabilization constantly depended on the *chaebols* since industrialization. In the end, even post-crisis reform was too little too late as the state had concentrated and staked the nation's economic security into the fate of the *chaebols*. Ultimately, the South Korean state did not comprehensively adapt to financial liberalization, which required a dynamic solution integrating the state, foreign market, and the *chaebols* to coexist instead of the "simple free-market paradigm" that simply aimed to minimizing and maximizing state intervention.<sup>179</sup> The state cannot expect mass capital alone to naturally empower the state and foster a robust market and as capital become a cornerstone in all facets of society, the *chaebols* have developed into a diverse entity.<sup>180</sup> In South Korea's advanced capitalist society, political, economic, and social institutions continue to impact one another.

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<sup>179</sup> Ibid.

<sup>180</sup> Lee, "Participatory Democracy and Chaebol Regulation in Korea," 301.

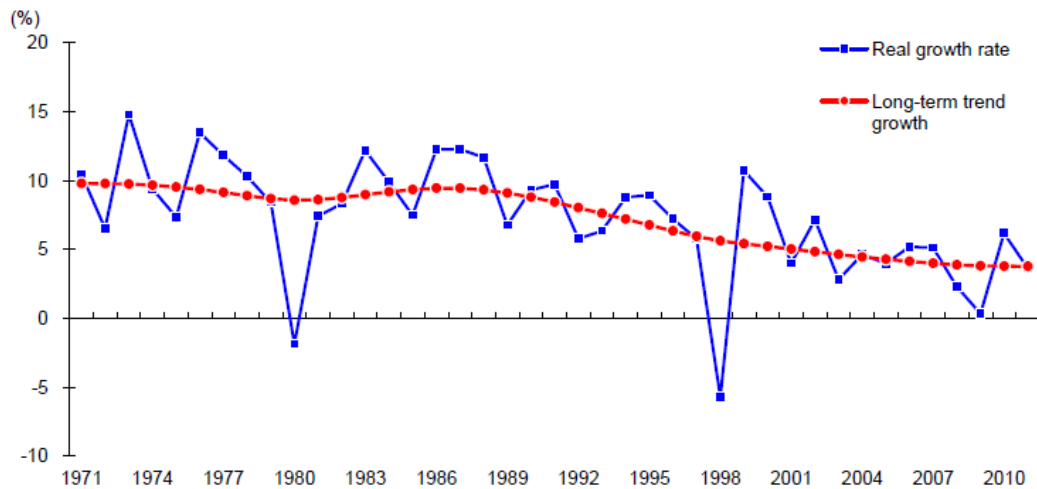
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## VI. CONCLUSION

The tale of South Korea's industrialization serves as a significant case study to the discipline of political economy. The challenge of managing national wealth through the advent of capitalism has spawned a contentious debate between liberal and institutional theorists. On one hand, the concept of allowing a free market economy to develop on its own with a minimal government role seemed ideal. Strictly in terms of economics, the process of growth necessitates the accumulation of physical capital, advances in human capital, and continual application of total factor productivity. Key elements towards the advances towards an efficient economy such as the division of labor, progressive competition, and trade were to be developed by the "invisible hand" of a self-correcting market system. To the market-liberals any state intervention aside from necessary regulatory institutions would distort the competitive process and the overall market system. Yet liberal theories do not address the array of political, economic, and social factors that collectively form the market economy. Not all societies are equipped with the infrastructural foundations for free market economic operations and those with existential security threats are also faced with a constrained timeline. Institutionalism reveals that institutions interact, evolve, and constantly affect one another—and the role of each institution varies among societies. The institutionalist perspective reveals that evolution of market institutions were predicated on multiple factors, including timing, conditions, and interests.

This thesis has examined a series of transitional vulnerabilities in order to diagnose where the South Korea's mercantilist policies failed to sustain the country's evolution towards a free market economy. The comparative analysis of the state-business balance throughout the growth periods illustrates when, how, and why the *chaebols* became the main vehicle for achieving South Korean economic growth. Post war industrialization and the advent of capitalism in South Korea enabled a unique and illiberal economy to develop. To begin, the primary institution utilized to gauge national development of the South Korean plan rational economy was the state-business relationship. The *chaebols* capitalized on the institutional changes during each of the

Republics: the 3<sup>rd</sup> and 4<sup>th</sup> Republics under Park Chung-hee marked the initiation of the state-*chaebol* partnership; monopolization of the market began during Chun Doo-hwan’s authoritarian transition; and the inauguration of South Korea’s liberal democracy allowed the *chaebols* to establish themselves as a durable institution. A focus on these transitional periods discloses both intentional and inadvertent allowance of corporate monopolization, as the *chaebols* operated under a volatile political and economic environment marked by narrow and myopic leadership prerogatives and policies. Furthermore, the growing dominance of the *chaebol* created a series of negative effects in terms of economic outcomes such as growth, corruption, and market distortions. In the end, the advantages of the two different political systems experienced by South Korea—top down authoritarian decisiveness as well as democratic transparency and accountability – were not capitalized upon and Korea’s political leaders failed to prevent the *chaebols* from becoming the country’s oligarchy. Of concern, South Korea’s national growth has been declining and has currently reached a plateau (see Figure 2).<sup>181</sup>



Source: Bank of Korea, Samsung Economic Research Institute.

Figure 2. Korea's Long-Term Growth Trend

<sup>181</sup> Changmock Shin, “Causes of the Decline in Korea’s Long-Term Growth Trend: Expenditures,” Samsung Economic Research Institute, 2012.

Exploring the various organizational and operational practices of the *chaebols* can provide insight to potential innovation or TFP factors, which in turn can indicate and project links to economic stagnation or advances. Research on how the *chaebols* have better adapted to the advanced democratic environment and the impacts they have had on the weak financial system illustrates how Korea's policies have been outpaced by modern economic conditions. The *chaebols* continue to exist today as the main proprietors of the country's wealth directly linking *chaebol* organizational capacity to national economic capacity. Sales of the top 10 *chaebols* in 2011 accounted for approximately 80 percent of South Korea's GDP responsible for 83.1 billion dollars out of country's 1.1 trillion dollar aggregate production.<sup>182</sup> Comparing dominant economic institutions can also provide lessons learned for how to maneuver the state-business relationship. The evolution of "Japan, Inc." reveals similarities and differences to the *chaebols* that would better explain the future and various circumstances of the state-business interface across countries. The recent dawn of the American financial crisis that began in 2007 also reveal similar organizational structures, moral hazard with speculative investments, corruption, and feeble regulatory institutions that were exploited by financial oligarchs—portraying again a similar situation where the national state-business imbalance in the market remains unresolved.

The gravity of the role played by societal forces, especially the state, along with economic players in the market is imperative to grasp during periods of liberalization and crises. Since growth strategies are inherently esoteric to any nation, limiting the description and prescription of capitalist trajectories to one mindset would be myopic and precarious as ideas, interests, and institutions differ among countries. Economic sociology and the history of industrialization teach that each country's balance between the state and market is unique. Stakeholders that are able to influence economic policies must understand that "capitalism's durability lies in its almost infinite malleability" and the onus is upon moral decisions that can achieve sustainable efficiency and efficacy.<sup>183</sup>

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<sup>182</sup> Kwon, Eun-jung. "Top Ten Chaebol Now Almost 80% of Korean Economy," *Hankyoreh*, August, 28, 2012. [http://www.hani.co.kr/arti/english\\_edition/e\\_business/549028.html](http://www.hani.co.kr/arti/english_edition/e_business/549028.html)

<sup>183</sup> Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: W.W. Norton & Company, 2011), 233.

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