

The Korean Developmental State

From dirigisme to neo-liberalism

Iain Pirie

Routledge Studies in the Growth Economies of Asia

The Korean Developmental State

The Korean Developmental State is a comprehensive and up-to-date analysis of processes of state and economic restructuring in South Korea since the 1997 crisis. The book distinguishes itself from previous studies by consistently arguing that structural changes in the global political economy have played a crucial role in reshaping the Korean state's own economic project.

More precisely, Iain Pirie seeks to demonstrate how the Korean state increasingly adopted neo-liberal policies from the 1980s onwards as a rational response to the evolution of global economic structures; an evolution which has been driven by the continuous attempts of major global firms and leading capitalist states to overcome the chronic profitability problems that have dogged the core capitalist area since the late 1960s. The radical restructuring programme the Korean state initiated after the 1997 crisis must be understood as a logical conclusion to these earlier, more incremental, processes of reform it initiated almost two decades earlier. This book seeks to establish the neo-liberal character of the Korean state through a close analysis of key institutional and policy reforms, and serious engagement with more theoretical debates concerning the nature of the neo-liberal state itself.

The Korean Developmental State offers a new perspective on the economic experience of Korea as a development model, one that emphasises global trends and contradictions for Korea's economic crisis and resulting transformation, and as such will be of significant interest to scholars of Korean studies and the Asian economy.

Iain Pirie is an assistant professor at the University of Warwick. His research examines how the changing dictates of international competitiveness have shaped state restructuring processes since the 1970s.

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Abbreviations

BAAR	Basic Act on Administrative Regulation
BIS	Bank of International Settlements
BOK	Bank of Korea
CBI	Central bank independence
DTI	Department of Trade and Industry
ECB	European Central Bank
EPB	Economic Planning Board
ESB	Electricity Supervisory Board
GDP	Gross domestic product
FDI	Foreign direct investment
FIZ	Foreign Investment Zone
FKI	Federation of Korean Industries
FRC	Financial Reform Committee
FSA	Financial Services Authority
FSC	Financial Supervisory Commission
FSS	Financial Supervisory Service
FTC	Fair Trade Commission
ICR	Interest coverage ratio
IFCs	Investment and finance companies
ILO	International Labour Organisation
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IT	Information technology
ITCs	Investment trust companies
KCC	Korean Communications Commission
KCTU	Korean Confederation of Trade Unions
KEPCO	Korean Electrical Power Corporation
KSE	Korean Stock Exchange
LG	Lucky Goldstar
LPP	Livelihood Protection Programme
M&A	Mergers and acquisitions
MFTA	Monopoly and Fair Trade Act
MNCs	Multinational corporations

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MOC	Ministry of Communications
MOCIE	Ministry of Commerce, Industry and Energy
MOF	Ministry of Finance
MOFE	Ministry of Finance and Economy
MPC	Monetary Policy Committee
NBFIs	Non-bank financial institutions
NHS	National Health Service
NPL	Non-performing Loan
NYSE	New York Stock Exchange
OECD	Organisation for Economic Co-operation and Development
PFI	Private Finance Initiative
POSCO	Pohang Iron and Steel Company
R&D	Research and development
RIA	Regulatory Impact Analysis
RRC	Regulatory Reform Committee
SME	Small and medium enterprise
TFP	Total Factor Productivity
TLPP	Temporary Livelihood Protection Programme
US	United States
WTO	World Trade Organisation

1 The Korean developmental state, industrialisation, crisis and post-crisis restructuring

In 1960 South Korea was one of the poorest 25 countries in the world.¹ Its Gross Domestic Product (GDP) per capita was just \$82 (in 1960 prices). United States (US) policymakers' assessment of the country as a 'hopeless case' appeared apposite at the time (Hart-Landsberg, 1993). However, the performance of the Korean economy over the next four decades or so could not have been more different from that predicted by such policymakers in 1960. After almost four decades of rapid growth, in 1997 Korean GDP per capita was approximately \$11,000 (in 1997 prices). Korea was now a member of the Organisation for Economic Co-operation and Development (OECD) and one of the few countries that appeared to have successfully graduated from the Third World. As a result of this remarkable performance a vast volume of literature has been generated on the development of the South Korean political economy over this period. However, in December 1997 the Korean economic 'miracle' came to an abrupt end. Facing massive capital haemorrhaging and with its own reserves rapidly running out, the Korean government was forced to go cap in hand to the International Monetary Fund (IMF) for emergency liquidity support. By January 1998, per capita GDP had fallen to \$6,600 and was set to fall a further 6 per cent by the end of the year (Cumings, 1999a). While the severe recession of 1998 was short-lived, with GDP growth exceeding 9 per cent in both 1999 and 2000, there is near consensus that the crisis has left a deep impression on the Korean political economy (*International Herald Tribune*, 2001). The crisis did not mark the demise of Korea as a centre of capitalist accumulation; it did, however, mark the end of the era of state-led capitalist development. Unsurprisingly, given the epoch-making nature of the crisis and Korea's previous economic performance, the crisis attracted the attention of the global academic, policymaking and journalistic communities. Since 1997, countless journal articles, books and official reports have attempted to explain the origins of the crisis, analyse the changes that have taken place since the crisis, and offer conjecture as to where the Korean political economy is headed and policy advice to the Korean government.

Why then, given that such a vast body of literature on Korea already exists, do we feel the need to write this book? What can we contribute to this already highly developed area of study? We feel that the existing literature conspicuously fails to

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pay due attention to the role that global post-war economic and political structures played in shaping the development of the Korean political economy. Much attention has rightly been focused on Korea's position within the Cold War 'security' system and regional production structures as necessary conditions for the Korean 'miracle'. We fully accept the argument that it is impossible to understand the internal development of Korea without paying proper attention to Korea's role in the Cold War security system and how the economy came to be integrated into the Japanese-dominated regional economy (Cumings, 1979; Woo, 1991: 95–6; Hart-Landsberg, 1993; Lie, 1998). The existing literature on the role wider forces played in creating and shaping modern Korea is, however, guilty of a serious error of omission in that it largely ignores the broader global political-economic context of the post-war developmental project and nationally based Fordist capitalism within which the Korean 'miracle' took place. It is impossible to understand the Korean developmental state project outside the context of the post-war global development project and nationally based capitalism. As the global development project has disintegrated and the locus of economic organisation has increasingly shifted to the supranational level, the Korean state has found itself under immense pressure to adapt to these new realities by marketising and opening up the economy. The central argument of this book is that the ongoing processes of marketisation within Korea, the origins of which can be traced back two decades, must be understood as a response by the Korean state to global structural change, as an attempt to secure and promote Korea's position as a site of capitalist accumulation within a rapidly changing global economy. Changes in the Cold War security system in the 1980s, and the resulting exposure of Korea to the full weight of bilateral US trade pressures, must be understood as playing, at best, a secondary role in driving these processes.

In order to fully understand the epochal nature of the global structural change that has taken place over the last three decades or so, it is necessary to outline the political, economic and ideational conditions that underpinned the post-war development project. At the heart of the development project was the concept of *national* capitalist development. Such development was to be achieved through the active use of state power to promote strategic national industries through the provision of capital and the protection of such industries from the vagaries of global competition. The global governance arrangements that emerged in the post-war period were a product of this global interventionist consensus predicated upon the idea that individual states within the system should be free to intervene in their respective domestic economies (Ruggie, 1982; Cox, 1987; McMichael, 2000a).

Not only were the global political and ideational conditions of the post-war period conducive to the pursuit of national dirigiste economic strategies, but the technologies and industrial structures of the second industrial revolution almost forced states to pursue interventionist economic strategies.² The sheer quantity of capital needed to fully exploit new systems of mass production and successfully compete in global markets meant that the state was almost forced to assist

domestic firms in making such investments. To fail to intervene to assist domestic firms would have been to expose such firms to a competitive disadvantage in the global economy. This was simply not an option in an environment where national economies still primarily interacted through trade in goods and financial instruments rather than through foreign direct investment (FDI) flows. Under such conditions, national economic vitality was principally dependent on the ability of domestic firms to compete internationally. While the old second industrial revolution maxim of 'strong national firms equal a strong national economy' fails to reflect the full complexity of the world in which we now live, it was broadly accurate in the post-war period (Chandler, 1990; Dunning, 1997).³

Such permissive global conditions for the pursuit of national dirigiste projects have been undermined by changes in the global political economy over the last three decades. The most important developments relate to the shift in the locus of economic organisation that has taken place. As major firms sought to restructure the production process in an attempt to overcome the profitability crisis that first developed in the late 1960s they increasingly sought to organise their activities on a transnational basis in order to take full advantage of the range of place-specific competitive advantages available internationally. As full-scale economic restructuring began in earnest in the 1980s FDI grew at four times the speed of global GDP. Between 1990 and 2004 the total global stock of FDI grew from \$1,950 to \$8,895 billion, while the world economy as a whole grew by slightly under 3.5 per cent per annum (United Nations Conference on Trade and Development, 2005: 199, 308; IMF, 1998: 171; 1999: 169; 2006b: 177). These changes serve to undermine the effectiveness of blind support for nominally domestically based firms, since such support is as likely to translate to increased overseas investments as it is domestic investments.

At the same time as a result of structural changes in global markets the levels of capital necessary to compete in key industries have expanded exponentially, principally because of the ever-increasing costs of developing and utilising new technologies (Stopford and Strange, 1991; Dunning, 1993; 1997; Dicken, 1998).⁴ The rise in such costs presented an intractable problem for state-led late development projects of the Korean variety. The ultimate objective of the developmental state project had always been to develop autonomous national exporting capacity across a full range of modern industries. However, there were clear objective limits on the capacity of the state and domestic financial institutions to finance the increasing investments necessary to achieve competitiveness across a range of major global industries.

The scale of the changes that have taken place in systems of production have been dwarfed by those that have taken place in the organisation of global finance. As opportunities for accumulation in the real economy declined within the core capitalist world from the late 1960s onwards we witnessed a massive diversion of funds into largely speculative financial activities. In order to accommodate the rise in speculation and to secure the capacity of 'their' national financial centres to capture market share major states deregulated their financial

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systems, removing both internal controls that sought to segregate functionally distinct markets within the national financial system and external controls that sought to regulate the movement of capital across borders (Moran, 1991). The size of the global financial market increased from about \$300 billion in 1974 to \$7,000 billion in 1996 (Malcolm, 2001: 40).

The development of a more closely integrated global financial market has fundamentally changed the milieu within which national dirigiste projects are situated. One of the few important 'facts' upon which different scholars studying the classical Korean developmental state agree is the centrality of state control of finance to the entire system (Amsden, 1989; Woo, 1991). Nor was centrality of finance to the operation of the entire system of capitalist planning state management a unique feature of the Korean developmental state. Rather, the capacity of the state to manage a relatively closed national financial system in collusion with private sector insiders was also critical to the effectiveness of the Korean, Taiwanese and French developmental states (Zysman, 1983; Fields, 1995).

As global financial integration brought into being a practically unlimited source of funds outside of the state's control it inevitably created pressures on national dirigiste models. National firms, who increasingly possessed overseas subsidiaries, sought to assert their 'right' to access global financial markets in order raise funds at best available terms in order to compete in key global markets. Furthermore, in those dirigiste economies that consistently ran current account surpluses the need to effectively recycle these surpluses generated increasing strains on attempts to maintain a strict division between national and global financial markets.

This change in the locus and nature of capitalist systems of accumulation has supported and been supported by a profound shift in global governance structures and ideational conditions. The concept of development as a nationally based state-led project has been increasingly undermined over the last three decades, not simply by the changes in the locus of production discussed above but also by the inherent weaknesses of Keynesian state-led development itself. The inability of state-led capitalism to deliver on its social and economic promises became evident prior to any wholesale shift in the locus of economic activity as the long post-war boom petered out in the late 1960s, it is in that we find the genesis of the re-articulation of development as a private enterprise.⁵ While the genesis of the re-conceptualisation of development may predate the comprehensive reorganisation of economic activity on a regional/global level, it is nevertheless true that the reorganisation of production has since driven the transformation of the concept of development. The changes in what is understood by development have been profound. The current consensus among global economic managers simply equates development with participation in the global market. The essence of this new consensus is summed up in the 1997 *World Development Report* (World Bank, 1997: 12):

Globalization is not yet truly global – it has yet to touch a large chunk of the world economy. Roughly half of the developing world's people have been left out of the much-discussed rise in the volume of international trade and

capital flows since the early 1980s. Governments' hesitance to open up to the world economy is partly understandable. Joining the world economy carries risks as well as opportunities... But the difficulties should not be exaggerated, particularly when laid against the risks of being left out of the globalization project altogether. The cost of not opening up will be a widening gap in living standards between those countries that have integrated and those that remain outside.

The contemporary World Trade Organisation (WTO)-led global governance system fully reflects both this new 'development' consensus and contemporary material conditions, in that it subordinates national regulation to a comprehensive framework of global rules designed to secure capitalist accumulation on a world scale. In other words, the WTO framework makes effective participation in the global economy conditional upon the acceptance of an ever-increasing number of neo-liberal norms; norms that represent a direct challenge to the dirigiste states of the post-war era. It is important at this point to stress that the state remains a key actor within the contemporary global political economy, that what we are witnessing is a redefinition not a retreat of the state. Global structural change is leading to a tendential shift away from state forms which attempt to decommodify key aspects of economic and social life towards neo-liberal state forms where the state is above all else a 'commodifying agent' (Cerny, 2000: 305; Jayasuriya, 2000; McMichael, 2000b).

Any examination of how the Korean state has responded to the global structural changes outlined above, and how the imperatives of globalisation have come to be internalised within the Korean state itself, must engage with four central questions. First, it is necessary to understand the principal forces which drove Korea's rapid transformation from a severely underdeveloped to an industrial economy in the 1960s and 1970s. In other words it is necessary to examine the exact nature of the Korean developmental state. Second, we must examine why the Korean state embarked upon a gradual liberalisation programme in the 1980s and the relationship between these liberalisation processes and the 1997 crisis. Third, the study examines the forces and imperatives driving the processes of post-crisis restructuring and the exact nature of the contemporary Korean state and economy. Finally, in order to develop a proper contextualised understanding of the contemporary Korean political economy and its development over the last three decades we must engage with more theoretical debates concerning the nature of contemporary neo-liberalism, its social consequences and the viability of other forms of capitalism. These are the critical phenomena and questions with which the preceding seven chapters are concerned. It is useful, however, to take the opportunity in the introduction to briefly summarise the essential arguments of the book and explicitly identify those scholars whose work this study is influenced by and adopts as a point of departure. Inevitably in the relatively concise summary of the main arguments of the book presented below we proceed by assertion. The evidence and analysis to support these arguments is offered in the main body of the work.

Sketch of the main arguments

The autonomy of a miracle

We seek to illustrate the decisive role that supranational political and economic structures played in shaping the evolution of the Korean state and driving the process of industrialisation without simply treating domestic Korean politics as a dependent variable. In pursuing this objective we follow in the footsteps of a number of high profile scholars including Cumings (1979; 1999b), Hart-Landsberg (1993) and Bernard (1996; 1999). The work of these analysts has much to recommend it. For us Hart-Landsberg's work stands out as particularly important because of the manner in which he combines consideration of supranational context with penetrating study of the Korean state itself and its role in the economy.

Hart-Landsberg accepts the arguments of the state-institutionalists, such as Amsden (1989) and Evans (1995), concerning the critical role played by industrial policy and state control of finance in the process of Korean industrialisation. However, by giving due weight to the role that the state's agricultural policies played in creating a proletariat and the role that the violent state played in controlling that proletariat, he develops a far more complete understanding of the Korean developmental state. Furthermore, radicals such as Hart-Landsberg and Cumings provide us with the theoretical basis to develop a far more nuanced and accurate analysis of the developmental state's relationship with private capital than its statist supporters.

State-institutionalists essentially argue that the developmental state forced private capital to serve its interest. The *chaebol*⁶ are explicitly reduced to the position of being 'private agents of the state's purpose' within this literature (Woo, 1991: 175). The government is essentially seen to have 'used' the *chaebol* to achieve certain national objectives such as the achievement of rapid growth, development of heavy industry or the promotion of exports. This analysis obscures the class and fundamentally capitalist nature of the state. The point is that not only were the *chaebol* 'agents of the state's purpose' but that promoting development of the *chaebol* was the state's primary purpose. From the very beginning, the Korean developmental state demonstrated a commitment not simply to 'growth' or 'development' but to capitalist development. At the heart of the state's economic strategy was a policy of developing and supporting large national capitalist firms. That the state sought to dominate and control these firms does not alter the fact that developing private capital was the Korean developmental state's *raison d'être*. The state may not have acted at the behest of the capitalist class – which it itself created – but it was committed to acting in its interests (Cumings, 1979).

Equally significantly, the emphasis of Cumings (1979; 1999b), Hart-Landsberg (1993) and Bernard (1996) on how Korea came to be articulated into a Japanese-dominated regional system of production and on the role of the US in shaping the Korean political economy is to be welcomed. Japan has over the last

century played a profound role in the development of the Korean political economy, initially as a colonial power and later through the interaction of Korean and Japanese firms and as an aid donor. If anything, the US has played an even more integral role in the development of modern Korea. South Korea is essentially a US creation, a creation the US has protected from external threat and provided with both ideational and material support for over four decades.⁷ The scale of the material support the repressive Korean state received from the US between 1947 and 1976 is staggering. Combined US military and economic assistance to Korea totalled \$12.6 billion over this period; economic grants and loans alone totalled \$6 billion. To put these figures into perspective, total US economic grants and loans to all of Africa over the same period came to just \$6.89 billion (Woo, 1991: 45). No serious scholar of the Korean political economy can neglect the role of either the US or Japan in shaping modern Korea.

The monograph adopts the work of these scholars on the role of Japanese-dominated regional production structures and the US in shaping Korean political economy as a point of departure in seeking to understand more fully the context within which Korean industrialisation took place. As we argued in the opening section of this chapter, it is impossible to understand the Korean developmental state outside the context of the post-war global development project and the second industrial revolution. Because of the manner in which the modern Korean state was initially created, its severe initial underdevelopment and the security situation on the peninsula the project of state-led capitalist development took a particularly intense form in Korea. This should not, however, be allowed to blind us to the similarities between the Korean state and post-war core capitalist national industrial states.

Both the Korean state and its more economically advanced counterparts focused very closely on promoting large nationally owned firms. More specifically, the Korean developmental state and the major core capitalist national industrial states both heavily subsidised the investments of large national firms. The fact that certain states, such as the US, may not have done so directly but rather made hidden subventions through defence and medical research policies in no way alters the fact that they did so (Ward and Davies, 1991; Cusack, 1991; Moran, 1999: 139–49). As we argue in the main body of this work the principal rationale underpinning these policies lay in the demands of international competitiveness in the post-war world. In an environment where production was essentially organised at a national level there was a very clear link between the success of major national firms and the national economy as a whole. Within such an environment, and given the prevailing dirigiste norms, to have not subsidised key national firms would have been to seriously prejudice national economic competitiveness.

The Korean state was a dirigiste state in a world of interventionist states. Korean elites were attempting to develop a distinctive Korean capitalism in a world of interconnected but still distinct national capitalisms. The essential argument of the monograph with regard to the Korean developmental state is that it must be understood as a child of its time.

The disintegration of the Korean developmental state and the 1997–8 crisis

From the early 1980s onwards the state began, very gradually, to dismantle the systems of dirigiste control that lay at the heart of the old growth regime. Although the process of reform was uneven, slow and piecemeal by the eve of the 1997–8 crisis the old system of economic governance had effectively been destroyed. The state had given up trying to co-ordinate private sector investor decisions, surrendered its control over the non-bank financial sector and compromised its control over the banking sector, liberalised the regime for outward FDI (the situation with regard to inward investment remained complex) and partially liberalised the capital account. At one level there is a consensus that the liberalisation process and the 1997 crisis were intimately connected. Badly designed poorly regulated economic liberalisation is widely understood as having played a key role in creating the conditions which led to the 1997 crisis.⁸ However, there is no consensus as to whether the problem lay in the design of the liberalisation process or whether the decision to liberalise was itself erroneous (see OECD, 1998; Graham, 2003; Shin and Chang, 2003; Thurbon, 2003 for a range of contrasting positions). Following on from this, there exists a wide variety of often inimical explanations as to why the Korean state moved away from what had been an extremely successful dirigiste development model in the 1980s and 1990s.

We do not find the vast bulk of existing work on the process of pre-crisis liberalisation to be particularly satisfactory. It is not that the existing analysis which privileges domestic political developments, US pressure or the inherent limitations of state-led development does not contain important elements of truth. It is certainly the case that US pressure played a key role in driving certain specific reforms. There is a fairly direct correlation between the US enactment of a series of anti-dumping measures against Korea in the early 1980s and Korea's abolition of most quantitative import restrictions and the reduction of tariffs over the course of that decade (Woo, 1991; Bello *et al.*, 1999). However, this analysis cannot readily explain why the Korean state invited foreign pressure by joining the OECD. In order to do so, we must analyse how Korean state managers actively sought to exploit foreign 'pressure' in order to advance their own liberalisation project which they understood as being vital to future competitiveness (Kim, 1999).

The flaws of state-institutionalist analysis which focuses relatively narrowly on domestic politics in its attempts to understand the liberalisation process are equally serious. The argument within this literature is that liberalisation was primarily the result of the erosion of the state's 'autonomy' from Korean society (the *chaebol*) as the state became more democratic, or alternatively of a growing commitment to neo-liberalism by state managers themselves (Kim, 1997; Wade and Veneroso, 1998; Weiss, 1998; Weiss and Hobson, 2000). The growing political influence of the *chaebol* cannot, in any simple way, explain the state's growing commitment to neo-liberalism. The *chaebol* were enthusiastic

supporters of 'freeing' themselves from government control but were quite hostile to other key elements of the liberalisation process, such as interest rate liberalisation (Lee, 1997). Moreover, we would argue that the primary cause of the shift in the balance of power between the state and the *chaebol* was economic liberalisation itself. It is impossible to understand the increasing autonomy of the *chaebol* from the state and assertiveness within the policy process throughout the 1980s and 1990s outside of the context of financial liberalisation.

Furthermore, the whole idea that the *chaebol* 'captured' or came to control the policymaking process is highly problematic. There were serious attempts by the state to discipline the *chaebol* and force them to engage in wholesale rationalisation in the mid 1990s. It was not the political power of the *chaebol* that undermined these efforts but the macroeconomic effects of promoting rationalisation which proved to be politically unacceptable. Although the political influence of *chaebol* no doubt retarded certain reforms, most notably the liberalisation of inward FDI, and advanced others the neo-liberal project must essentially be understood as one that was embarked upon a reasonably autonomous capitalist state committed to securing the future of Korean capitalism as a whole. The *chaebol* ought to be understood as secondary political actors who did not initiate the programme or determine its basic composition but, nevertheless, played a significant role in shaping its development.

The second major weakness of this analysis relates to the process by which Korean state managers' own preferences are understood to have changed. There is often simply no attempt to explain why Korean state managers became increasingly committed to marketising the Korean economy (Weiss, 1998; Weiss and Hobson, 2000). Even where some attempt is made to understand why Korean state managers became increasingly committed to neo-liberal policies, there is no attempt to understand the *economic* pressures that drove the marketisation process in Korea. The adoption of neo-liberal policies is seen as *ipso facto* economically 'irrational'. The question for such theorists, therefore, is why the Korean state pursued economically irrational policies.⁹

In contrast to the state institutions we argue that neo-liberal reform was rational from the perspective of Korean capitalism. It is not necessarily that, as has commonly been asserted, dirigiste strategies fail to generate the micro-level efficiencies that growth depends on in a relatively advanced economy (Krugman, 1994; Cerny, 1998; Crafts, 1999; Lee, 1999). France registered very high levels of Total Factor Productivity (TFP) growth during the post-war period, whilst employing an array of dirigiste financial controls that supported an extensive system of indicative planning (Armstrong *et al.*, 1984; Maddison, 1996; Coates, 2000).¹⁰ If there were particular problems with the Korean model why not make adjustments to the model within a broad dirigiste framework? Why engage in the far more radical, difficult and dangerous process of seeking to construct a new neo-liberal political economy?

The answer to this question lies not in the demands of competitiveness and growth per se but in the demands of competitiveness and growth in the contemporary era. As production and finance is increasingly organised on a

supranational level, the costs and benefits for states of actively promoting the insertion of their national economies into the global economy are fundamentally altered. If Korean firms were to compete in the global economy it was imperative that the state allowed them to access global capital markets, to forge even closer inter-firm alliances than they had done in the past, and to maximise potential efficiency by organising production on a supranational basis. In an increasing number of global industries, such as cars and electronics, R&D costs are so high and product life cycles so short that firms must establish a global presence; the alternative to doing so is to assume a subordinate role in international production chains. Not only was a radical programme of marketisation/economic opening necessary to promote the competitiveness of Korean firms, it was also important to increase the attractiveness of Korea as a potential location for FDI. The changes in the locus of economic organisation, outlined earlier, rendered Korea's previous hostility to FDI obsolete. As Korean firms themselves have internationalised, and the sheer amount of capital required to compete in the contemporary global economy has eliminated any possibility of developing and maintaining an independent exporting capacity across a range of major global industries, capturing FDI has become important to Korea's economic future.

The paradox at the heart of the Korean liberalisation process was that while the decision to pursue economic reform was rational, from the perspective of Korean capitalism, it was inevitable that this decision would result in an economic crisis. Intensive systems of state control had created a set of deep micro-economic distortions which could not be seriously addressed without deliberately provoking a major crisis. However, the decision to gradually open up the economy and subject Korean firms and financial institutions to the judgments of global markets without effectively addressing these problems made a crisis inevitable. The 1997–8 crisis played an invaluable role in creating political and economic space for the state to address the deep problems in firm-level financial structures. It must therefore be understood as an integral part of the process of neo-liberal reform in Korea. The neo-liberal project must, in turn, be understood as a rational attempt by the Korean state to secure its position as a major centre of accumulation within a changing global economy. The crisis cannot, therefore, be understood, as is commonly claimed, as being the product of a badly implemented or just foolish liberalisation programme. Rather, it was an unavoidable episode in Korea's historic economic ascent.

The new Korean political economy

The central argument of the entire monograph is that Korea must be understood as an unambiguously neo-liberal state and that the establishment of a new neo-liberal mode of regulation has laid the basis for further sustained accumulation. The state has set about creating a new neo-liberal mode of regulation. This project is now well advanced. Financial institutions now enjoy a high degree of freedom to offer whatever products they wish, and invest funds as they choose (OECD, 1999a; Financial Supervisory Service, 2000). At the same time,

however, they are now required to meet much tighter market-based prudential standards. In parallel with the reform of systems of financial governance, market-based mechanisms of corporate governance have been strengthened since the crisis. The most significant reforms have involved enhancing minority shareholders' rights, improving standards of transparency, clarifying directors' responsibilities, tightening laws regulating inter-group relationships, the introduction of hostile mergers and acquisitions, and the simplification of bankruptcy procedures (OECD, 1998; Oh, 2000; Chung and Wang, 2001). Competition policy is increasingly organised around global neo-liberal norms. Restrictions on foreign investment within the Korean economy are now almost non-existent. Additionally, the government has comprehensive plans in place to introduce competition into traditionally government-controlled sectors such as the electricity industry (OECD, 2000b). Moreover, the institutional structures of the state are being transformed to insure that monetary and financial policy is insulated from political pressures. Korea now has both an independent central bank and an independent financial regulator with clearly mandated neo-liberal objectives (Jayasuriya, 2001a). Broader regulatory policymaking structures have also been reformed in order to insure that regulation is non-discriminatory between market actors, minimises scope for bureaucratic discretion and, where possible, makes use of market mechanisms to achieve its objectives (OECD, 2000b).

At the same time as seeking to create a new neo-liberal mode of regulation the state intervened in a highly dirigiste manner in the years immediately following the crisis to expedite processes of corporate and financial restructuring. The use of dirigiste mechanisms to create a neo-liberal economy is not as contradictory as it might first seem. Neo-liberal states globally have in the wake of major financial crises been forced to abandon ideology and intervene extensively in the economy to promote restructuring.¹¹ What is critical are the objectives underpinning intervention.

In the Korean case it is clear that the state has consistently applied two key principles in promoting restructuring. First, the state has shown a clear determination to force firms and financial institutions, no matter how strategically important they may be, to improve their profitability or exit the market. In other words, the state acted to complement, and partially substitute for, underdeveloped mechanisms of market discipline by forcing firms to focus on the 'bottom line' and promoting processes of creative destruction. As a result of the state's determination to impose hard budget constraints on all economic actors only five of Korea's seventeen nationwide commercial banks operating on the eve of the crisis avoided being shutdown, swallowed up by stronger rivals or nationalised (OECD, 1999a: 88; Richards *et al.*, 2002: 102). It must be stressed that the only alternative to nationalisation of key institutions in the wake of the crisis was to allow clearly insolvent institutions to continue to operate. Paradoxically nationalisation of large sections of the banking sector was an integral part of the entire neo-liberal project. The nationalisation of major troubled financial institutions effectively made the Korean state the major creditor of many of Korea's largest and most indebted firms. The state therefore, must be understood to have made a

conscious decision to allow two (Daewoo and Hyundai) of the major five *chaebol* which had dominated the Korean economy prior to the crisis to fail. The failure of these business groups sends out a powerful signal about the determination of the Korean state to subject all firms, no matter how large, to hard budget constraints.

Second, a major strategic objective of the restructuring process was to transfer key assets to foreign ownership. As a combined result of the sale of nationalised banks directly to foreign investors and the minority equity positions foreign investors held in other Korean banks at the end of 2004 the combined foreign ownership share of Korean commercial banks stood at 59 per cent (OECD, 2005: 165). The equally powerful determination of the state to engineer the sale of major manufacturing firms to foreigners is best illustrated by the decision of state owned banks to sell two major car manufacturers, Daewoo Motors and Samsung Motors, to General Motors and Renault respectively. It is simply inconceivable that the state would have allowed, let alone promoted, the sale of a major Korean firm in such a strategically important industry prior to the crisis.

Writing in 2006 it is possible to argue that the dirigiste phase of the neo-liberal project is almost complete. The process of returning the commercial banks to private ownership is well advanced. As the state surrenders its influence over credit allocation it simultaneously surrenders its ability to direct corporate restructuring. In any case the state has largely completed the task of establishing the basic material components of a functioning neo-liberal economy. Foreign ownership of key assets is a reality and significant improvements in levels of profitability have taken place. The average level of ordinary profits within the manufacturing sector rose to 4.7 per cent in 2002, the highest level since 1974, and the profitability of retail, electricity, leisure and telecommunications industries has risen in parallel with their counterparts in manufacturing (Bank of Korea, 2003: 540). Furthermore, the level of ordinary profits within the manufacturing sector remained at 4.7 per cent in 2003 despite a pronounced drop in the overall rate of economic growth (Bank of Korea, 2004: 550). The performance of the manufacturing sector in 2003 would suggest that the 2002 figures did not simply represent a cyclical upturn but a structural 'breakthrough'. The immature dirigiste phase of the Korean neo-liberal project is over and a 'genuine' neo-liberal economy is being born.

Despite the strong evidential base to support the argument that Korea is now a neo-liberal state very few academic analysts subscribe to this argument. The essentially neo-liberal nature of the contemporary Korean state is obscured by the tendency of the majority of statist scholars to caricature neo-liberalism. The neo-liberal state is unproblematically equated with the minimal state. Having done so, it becomes natural to appropriate any evidence that the Korean state has intervened in the restructuring process or sought to regulate the economy to support the thesis that contemporary Korea must be understood as some form of 'reformed' developmental state not a neo-liberal state (Weiss, 2000; 2003b). As we consistently argued what matters is not the fact that the Korean state has

sought to regulate firms and acted to expedite economic restructuring but rather the principles which have underpinned the state's attempts to re-regulate and restructure the economy.

Perhaps surprisingly the vast majority of neo-liberals scholars themselves do not argue that Korea must be understood as a highly effective unambiguously neo-liberal state. Although many broadly neo-liberal analysts acknowledge that significant neo-liberal reform has taken place they, nevertheless, stop short of making the assertion that Korea is now a neo-liberal state (Ahn, 2001; Haggard *et al.*, 2003; Mo and Moon, 2003; Yun, 2003). The tendency of neo-liberals to underplay the significance of neo-liberal reform in post-crisis Korea is a direct result of points of comparison they adopt. At worst Korea is, at least implicitly, compared with an idealised neo-liberal model. At best it is compared with the US. Inevitably comparison with a mature neo-liberal economy such as the US blinds us to Korea's starting point and obscures the dynamics of the processes at work.

The few scholars that do explicitly recognise the neo-liberal nature of the contemporary Korean state, and who are not in the employ of the Korean government, are without exception hostile to the project and believe it will lead to future low growth and frequent crisis (Crotty and Lee, 2001; Hart-Landsberg and Burkett, 2001; Shin and Chang, 2003). No real attempt is made to understand how the crisis is functional from the perspective of Korean capitalism. While we should not fetishise the neo-liberal project and ignore its internal contradictions, the neo-liberal project must be understood as being a rational response to global economic change by a state committed to transforming Korea into an advanced capitalist economy.

Global competition, neo-liberalism and alternatives

The final set of controversies with which the monograph engages involve the alleged convergence of different models of capitalist development around a dominant neo-liberal model under pressures of globalisation. How we understand processes of neo-liberal transformation in Korea is critically dependent upon whether we believe that there exists a viable alternative to neo-liberal reform. A careful reading of processes of state reform in Korea, a key exemplar of successful state-led capitalist development, will in turn make an important contribution to wider debates about the continued viability of different models of capitalist development. The bulk of the academic literature written from the perspective of comparative and international political economy stresses the limits of convergence and the durability of distinctive non-liberal forms of economic governance (see for example Berger and Dore, 1996; Boyer and Drache, 1996; Weiss, 2003a). Systems of economic governance are not understood to be static and more dirigiste states have engaged in reform in response to global structural change. However, reform is largely understood to have taken the form of adjustment within the original model rather than the adoption of a new neo-liberal model of development. Furthermore, the direction of change is not

understood as being unidirectional. Rather, we see growth in welfare state structures in East Asia and the renaissance of the developmental state in post-crisis Korea (Weiss, 2003a).

This monograph takes a radically different position from that articulated within the majority of the comparative and international political economy literature. We argue that we are witnessing a convergence of different capitalist models around a globally dominant neo-liberal model. The extent of this convergence is partially masked within the existing literature by the failure to properly understand the nature of the contemporary neo-liberal state. Although the literature does not necessarily depict the neo-liberal state as a minimal state there is still a failure to fully understand the complexities of this state form. The neo-liberal state is implicitly seen as being synonymous with the ineffective state and is denied any capacity to act coherently in order to pursue strategic objectives. Evidence of a clear capacity to pursue such objectives is taken as proof that the state is developmental rather than neo-liberal.¹²

By this definition, however, it seems difficult to deny that the British state under Thatcher and Blair, or for that matter any contemporary core capitalist states, is developmental. Anyone with even a passing familiarity with the literature on the British financial services revolution in the 1980s and 1990s will be aware that this process was driven by a strong centralised state, frequently acting in opposition to established market actors, acting to secure London's position as a major financial centre (Moran, 1991). Clearly the rather crude definitions of the neo-liberal state form offered by neo-liberalism statist critics are wholly inadequate.

The task of defining the neo-liberal state is an immensely complex one to which the third chapter of this monograph is devoted. For now it is sufficient to make two essential points regarding the essence of the neo-liberal project. First, processes of neo-liberal reform effectively involve the systemic re-ordering of the institutional structures of economic governance in order to promote the commodification of every aspect of social life and the extension of global market disciplines to domestic economic actors. Second, with neo-liberal reform the focus of intervention shifts from the competitiveness of particular firms (national champions) to the competitiveness of the economic space. For example, during the process of financial reform in the UK in the 1980s and the 1990s the British state crafted regulatory frameworks which ensured that long established firms would face intolerable competitive pressures and that foreign institutions would come to dominate key markets. In a sense the competitiveness of London was prioritised over that of British financial institutions (Moran, 1991). The same point can be made with regard to the Korean state's post-crisis restructuring process. The Korean state has allowed major firms to fail and key sectors to be dominated by foreign capital in order to insure that Korea maintains its position as a key centre of global accumulation. The state's allegiance is not to any particular Korean firm or even Korean capital more generally but to ensuring capitalist accumulation in Korea.¹³

When we adopt a more sophisticated definition of neo-liberalism it becomes

difficult to contest the direction of policy reform in key states over the last three decades. Neo-liberal convergence is certainly not complete but the direction of movement is clear. Furthermore, while the argument that moves towards neo-liberalism must principally be explained through an analysis of domestic politics is plausible in individual cases, it is not plausible to attempt to explain the universal trend towards neo-liberal reform in terms of the domestic politics of individual countries.

It must be stressed that by denying the possibilities of a capitalist alternative to neo-liberalism we do not mean to ignore either the social implications of neo-liberal reform or the possibilities of an alternative to neo-liberal reform. Neo-liberalism has been an uneven global social disaster. Everywhere it has taken place it has been accompanied by a rise in inequality and insecurity. In many states, not just in the underdeveloped world, it has produced truly grotesque inequalities. Even in Korea where inequality is not exceptionally high by global standards and where the impact of neo-liberalism has been ameliorated by high levels of growth and employment we have seen an increase in Gini coefficient from 0.283 in 1997 to 0.31 in 2005 and a sizeable increase in the proportion of the labour force employed on fixed-term contracts.¹⁴ Increases in inequality are a necessary not a contingent aspect of the neo-liberal project. National peculiarities and distinctive political cultures simply determine the extent of the increase in inequality that accompanies neo-liberal reform. An alternative to the socially destructive neo-liberal project is necessary. However, that alternative must not simply attempt to compete against neo-liberalism on its own terms by accepting the virtues of international competitiveness and growth but must seek to fundamentally reorganise production on the basis of democratically determined human needs rather than profitability criteria.

The shape of the monograph

In order to advance the central arguments set out above this study is organised into seven further chapters and a conclusion. In Chapter 2 we reflect upon the need to fully recognise both the uniqueness of individual national social formations and the manner in which the changing dictates of international competitiveness create a limited pattern of convergence among those states committed to competing in the global economy. Having done this we analyse how, in the post-war period, global industrial structures served to shape the development of national governance regimes. The explanatory power of the concept of a 'global Fordist accumulation regime' will be considered here. The later part of this chapter is focused upon the development of the global economy since the early 1970s. More precisely, we seek to illustrate the major changes in the global political economy that capitalist state managers and major firms have effected in response to chronic profitability problems. We also seek to illustrate the problems that these changes have created for state-led capitalist development strategies.

The third chapter seeks to develop the major themes introduced in the later part of the previous chapter by exploring in some detail the major features of the

contemporary neo-liberal state. We also set out to establish the extent of the global convergence that has, and is taking place, around the neo-liberal model through an examination of developments in major national economies. Chapters 2 and 3 provide the necessary context against which we must understand the Korean state's efforts to promote capitalist development and to respond to the changing dictates of international competitiveness over the last 40 years.

Chapter 4 consists of a focused examination of state-led capitalist development in Korea. Equal attention will be paid here to the Korean developmental state's relations with domestic social forces and the wider regional and historical conditions that enabled the Park regime to launch a successful state-led capitalist development project in the 1960s.

In Chapter 5 we turn our attention to the protracted pre-crisis economic liberalisation process, the beginnings of which can be dated back to the early 1980s. We distinguish between the very gradual process of neo-liberal policy adjustment up until 1993 and the more radical reform policies pursued by the Kim Young-Sam administration in the years immediately prior to the crisis.

The final three chapters of the monograph, taken together, form a comprehensive analysis of post-crisis restructuring processes. Chapter 6 focuses on the creation of a neo-liberal regulatory regime. Equal attention is paid here to the closely related, but distinct, processes of policy and institutional reform. The essential features of the new, explicitly neo-liberal mode of regulation will be detailed within this chapter.

Against this background, Chapter 7 examines the concrete changes that have taken place in Korean corporate and financial structures since 1997. Particular attention will be paid here to the role of foreign portfolio and direct investment in reshaping the economy. We shall also highlight the recent improvements that have taken place in corporate profitability, which are indicative of the Korean state's success in addressing the structural problems that beset the economy since the crisis.

Chapter 8 moves beyond the economic, narrowly defined, to study the social consequences of the crisis itself and the post-crisis economic restructuring process. Two main questions will be addressed here. First, we will seek to identify those social groups who suffered most acutely as a result of the crisis and whose impoverishment made rapid recovery possible. Second, we will examine the longer-term changes in the distribution of power and wealth within the Korean political economy that are accompanying the consolidation of a new neo-liberal growth regime.

2 Putting Korea in its place

It is of course true that no two individual national social formations are identical, that all states are in fact unique. The character of individual states reflects the manner in which they first came into being and have developed over historical time. In terms of the economic and social policies they pursue, their institutional capacities, the historic blocs upon which they rest and their levels of autonomy from external political pressures and domestic social forces, states exhibit unique configurations.¹ Nevertheless, it is also true that the changing dictates of international competitiveness have shaped the development of individual states and created certain pressures towards a limited form of convergence among those states committed and able to compete in the global economy. While the principal purpose of the proceeding chapters of this monograph is to highlight the particular trajectory that Korea has followed, it is first necessary to ‘situate’ the evolution of the Korean political economy over the past 50 years within the changing global political economy, to understand the important similarities that existed between the post-war core capitalist national industrial states and the Korean developmental state. More importantly still, it is necessary to contextualise Korea’s ‘liberalisation’ drive within broader global processes of economic change (globalisation) and state restructuring. This is what the next two chapters of this monograph seek to do.

At any given point in time states are under pressure to adapt their policies and institutional structures in order to maintain and enhance their respective positions within a dynamic global economy. How global economic pressures impact upon individual states is, however, critically dependent upon the particular position they occupy within global economic and political structures. Moreover, the fact that states must adapt themselves to the changing dictates of international competitiveness in order to compete effectively in the world economy does not necessarily endow them with the capacity to do so. The majority of states outside the core capitalist world have consistently lacked the capacity to attune themselves to the demands of global competitiveness. Even certain core capitalist states have in the past (UK and the second industrial revolution) or are currently (Japan and Germany in the 1980s and 1990s) struggling to fully adapt to the changing dictates of international competitiveness. Despite these important qualifications it is still possible to identify how as a result of the changing

dictates of international competitiveness certain state forms, or modes of regulation, become dominant and experience structural crises. In other words it is possible to identify how the demands of international competitiveness create patterns of convergence among the more successful capitalist states.

In the first half of this chapter we seek to identify the key features of the post-war core capitalist 'national industrial states' and their Northeast Asian counterparts the 'developmental states'. In so doing, we seek to highlight the relationship between changes in global economic structures and changes in the dominant state forms. We argue that global growth in the post-war era was critically dependent on the maintenance of a particular set of economic and social relationships in the core capitalist states (particularly the US) that served to regulate demand, investment and productivity growth. These relationships were based upon institutionalised links between production and consumption which supported class compromise, the pursuit of economies of scale through mass production assembly-line technology and strong government support for the fixed investment programmes of major firms within relatively discreet national economies. It is well-established practice to use the term 'Fordism' to describe the totality of these political and economic practices (Aglietta, 1979; Lipietz, 1987; Harvey, 1990; Jessop, 2002a). We see no reason to differ from convention in this instance. Furthermore, we also accept the characterisation of the post-war global political economy as a global Fordist system. This is not to deny that the term is partially misleading in that different sets of relationships and economic structures existed outside North America and Western Europe, as our work on developmental and national industrial states will highlight. However, its descriptive and analytical value is derived from its capacity to highlight the relationships within key core capitalist states upon which the entire global regime of accumulation rested.

Having analysed the core features of this regime we shall turn our attention to the forces which served to undermine this regime and which resulted in its collapse in the early 1970s. The collapse of the regime and the uneven global crisis of the 1970s ushered in a massive phase of global economic restructuring – although pressures to restructure in the 1970s were ameliorated as the disciplinary power of money was compromised through inflation. We shall examine how capital and capitalist state managers have sought to restore conditions for further accumulation, and ideally create a new relatively stable regime of accumulation, through a fundamental redefinition of the parameters of the market, the transformation of the organisation and technologies of production, and radical spatial restructuring (Harvey, 1990; 2003). In this section we shall also highlight how the evolution of the global financial system has been shaped by chronic profitability problems in the real economy. Some of this discussion may appear rather abstract given that the primary concern of this monograph is the development of the Korean political economy. However, given our central argument that the transformation of the Korean state must be understood as part of a wider global transformation, we must analyse the development of the global political economy in some detail.

The national industrial and developmental states

The history of capitalism is one of continuous economic restructuring. As individual capitalists strive to achieve a competitive advantage the dominant forms of economic organisation are always evolving, technologies of production are continuously being revolutionised and patterns of spatial organisation shifting. The processes of technological change, spatial restructuring and organisational change are symbiotically linked. For example, it is impossible to understand the organisation of major multinational corporations (MNCs) in the contemporary world outside of the revolution in information technology (IT) that has taken place over the preceding decades. At the most basic level the forms of co-ordination that contemporary MNCs exercise over geographically dispersed production units would be impossible to achieve using the technologies of the 1950s or 1960s. On the other hand, the manner in which the IT revolution has evolved cannot be understood without analysing the structure of those corporations that have dominated this revolution. Technologies emerge from particular socio-economic structures and reflect what those structures consider useful. At the same time, however, technological development shapes the evolution of socio-economic structures.

The pace of changes in organisational forms and technologies is critically dependent upon the balance of forces promoting inertia and change. Crises play a critical role in removing potential barriers to innovation and spatial/organisational restructuring (Harvey, 1999). The capital sunk in sub-optimal technologies and locations is devalued and less efficient 'types' of firm are driven from the market.² The massive devaluation of capital during the Great Depression of the 1930s and the even greater physical destruction of capital that took place in the Second World War freed firms from the shackles of past investments. Growth in the post-war period was based upon the new technologies of the second industrial revolution and the unambiguous dominance of the large corporation.

The relationship between changes in systems of economic organisation and changes in state forms is a complex one and there are no simple lines of force; one does not mechanically determine the other. It would be foolish, therefore, to attempt to explain the development of state structures exclusively in terms of changes in structures of production. Apart from anything such an approach effectively represents an uncritical admission that policy is uncontested and that capital can affect whatever policy reforms it wishes to. On the other hand, it is difficult to deny that there is a relationship between the two. Regardless of their theoretical persuasion few serious social scientists would argue that we can understand the 'state' and the 'economy' as independent entities whose historical development can be studied in isolation from each other. What we wish to do in this section of the chapter is demonstrate that the economic structures of the post-war world created conditions conducive to the development of dirigiste capitalist state forms. In so doing, we are not necessarily advancing the more contentious argument that the development of global economic structures be

afforded a privileged role in determining the development of national state forms.³

Any analysis of the post-war world economy must start by recognising the dominance of large nationally based firms in the key industries of the time, the industries of the second industrial revolution (such as electrical machinery, ship-building, steel and industrial chemicals). To be competitive in these industries required extensive investment in fixed capital and, as a result, the minimum efficient scale of production was relatively high. Moreover, the R&D expenditures necessary to become and remain a major technologically independent producer within these industries was of an entirely different order to that in the industries of the first industrial revolution. In order to fully realise the potential value of these huge long-term investments in fixed capital and R&D, firms were forced to make further extensive investments in developing distribution systems, marketing networks and, in the case of consumer goods, 'brand image' (Galbraith, 1967; Mandel, 1978; Chandler, 1990).

At the same time the technologies of the second industry revolution opened up new opportunities for reorganising production to exploit efficiencies of scale and scope. In the age of the railway and the telegram, it was quite possible for firms to effectively manage a network of units spread over thousands of kilometres. The second industrial revolution clearly involved a dramatic 'shrinkage of space', a shift in the locus of economic organisation from the sub-national to the national level (Vernon, 1977: 3). However, what the technologies of the second industrial revolution did not allow was the organisation of integrated networks of production on a global scale. Foreign investments and linkages simply represented an attempt to maximise the value of firm-specific advantages developed within the domestic core of the corporation (Chandler, 1990; Strange, 1996; Dunning, 1997; Dicken, 1998).

Unsurprisingly, the sheer amount of capital necessary to compete effectively in the industries of the second industrial revolution led to a massive concentration of capital and these industries quickly came to be dominated by a small number of large, nationally based industrial monoliths (Mandel, 1978). The characteristics of the corporation and the increasing dominance of a small number of such corporations over the entire industrial economy created the material basis for the emergence and development of dirigiste systems of governance within the core capitalist states. The demands of capitalist accumulation and international competitiveness in the age of the giant corporation almost forced the state to play a direct role in the process of accumulation, as both a source of demand and capital, and as a guarantor of industrial peace. The corporation required the state's assistance in order to make, and fully realise the value of, the vast investments required to remain competitive in the industries of the second industrial revolution. Even the US government despite the strength of its domestic firms and its position as the great champion of 'liberal values' played a significant role in subsidising private investment through its considerable defence and medical research budgets (Ward and Davies, 1991; Cusack, 1991; Moran, 1999).

Even more important still than the role the national industrial state played as a direct source of capital or as a direct consumer of certain products was the commitment the state made to stabilising aggregate demand. For the large corporation, which made vast long-term investments in fixed capital and R&D, nothing was more terrifying than the prospect of serious recession. Smaller firms engaged in labour intensive activities had a very high capacity to adjust to recession by reducing costs (sacking staff); recession did not necessarily mean massive losses for such firms. For the modern corporation, the relative importance of fixed vis-à-vis variable costs meant that adjusting to lower demand was a slow, costly and painful process.

The state was able to create the stable demand environment the large corporation required throughout the 1950s and 1960s through a combination of active fiscal policies, rapidly increased government expenditure in general – including defence spending – and increasing welfare spending in particular. The welfare state and its accoutrements effectively provided a quasi-automatic mechanism to insure the steady growth of aggregate demand (Galbraith, 1967; Jessop, 1993; 1994).⁴ Moreover, because major firms were largely committed to offering their employees high wages and stable terms of employment, the welfare state did not impose any unacceptable constraints or costs upon the corporation. Rather, by creating a general acceptance of the legitimacy of capitalism within the working class, the welfare state created a conducive environment for the firm-level projects of labour incorporation major firms pursued in order to insure that labour disputes did not undermine the profitability of their investments in fixed capital. It was the small firm seeking to maintain a competitive edge not through heavy capital investments but through hyper-exploitation of labour for which the state's regulation of social conditions and acceptance of economically oriented labour unions represented a real problem

As we have argued, the triple commitment of the national industrial state to acting as a source of capital, stabilising demand and maintaining industrial peace through side payments to labour can be understood as its essential distinguishing feature. The fact that different core capitalist states maintained a commitment to these core objectives and principles in the post-war period is what allows us to understand these states as different national variants of one particular state form. What also distinguished the national industrial state from other state-forms, such as the liberal or neo-liberal state, is the very tight focus it maintained on promoting large, nationally based corporations. State elites formed a close set of alliances with a small number of 'strategically important' firms and, predictably, the interests not only of labour but other sections of capital (small business and finance capital) were largely subordinated to those of the corporation.⁵ The parallels between the national industrial and the Korean state are striking in this regard. As we shall argue in the next chapter the entire economic strategy of the Korean developmental state was focused on the promotion of large nationally based firms. The development of such firms was not simply an objective of the Korean state: it was *the* objective of that state.

It is entirely unsurprising that both the Korean and the core capitalist states

shared the same central objective of promoting large national firms given the prevailing global economic structures of the time. The structural position of any state in the global economy in the post-war period was principally determined by the ability of large, nationally based firms to compete in the key high-value-added industries of the second industrial revolution. The rapid growth of the German, French, Korean and Japanese economies in the post-war era was a product of the increasing ability of large German, French, Korean and Japanese firms to compete in high-value-added industries.⁶ The relative decline of the British economy reflected the increasing inability of large British firms to compete internationally in key high-value-added industries.

Not only was the state's structural position in the global economy largely determined by the strength of large nationally based industrial corporations but, equally importantly, for the national industrial state, it was only by developing strong indigenous firms that the state could hope to secure a minimum degree of industrial self-sufficiency. While contemporary policymakers may regard the idea of 'industrial self-sufficiency' as unproductive or, at best, quaint, we must remember that the bureaucrats who ran the apparatus of the post-war national industrial and developmental states had their mindsets shaped by the Great Depression and acute national security threats, respectively. It is entirely understandable, therefore, that such policymakers should have sought to develop some form of security against the vagaries of the global economy.

Nor did the similarities between the national industrial and the developmental states end at the level of overall economic objectives. Not only did the national industrial and developmental states both focus on promoting large firms but, more importantly, both attempted to do so by dirigiste means. More precisely, these states did not simply seek to create a market environment conducive to the development of large firms – they sought to play a far more direct role, as a source of capital, in promoting such firms. The similarities between the two state forms highlight the powerful role global economic structures play in shaping national state forms. Both the developmental and national industrial states pursued highly interventionist economic strategies and developed close relationships with large capital, primarily in order to compete in the post-war global economy (Jayasuriya, 2001b).

Despite the important similarities that undoubtedly existed between the 'national industrial' and 'developmental' states, the economic strategies of the two state forms differed fundamentally from each other in certain key respects. More particularly, two key differences can be identified between the economic strategies of the developmental and national industrial states. The first is the more extensive role that the Korean state in particular, and the Northeast Asian developmental states in general, played in the allocation of capital compared to the national industrial states. The second is the more limited role the developmental states played in regulating demand.

The extensive role the Korean state played in allocating capital was a direct result of Korea's severe initial underdevelopment. The initial weakness of Korean firms was such that only through massive state support could such firms

hope to develop into internationally competitive producers of capital-intensive products. To make matters worse, the total level of available private and public capital within the Korean economy was highly limited. The state could only overcome these difficulties by centralising the allocation of credit and by carefully selecting certain key firms and sectors on which to focus its attention. Given the initial underdevelopment of the Korean economy, it was entirely predictable that the Korean state would play a leading role in the allocation of credit – the same is true of Taiwan and, to a lesser extent, of post-war Japan (Gerschenkron, 1962).

What is more interesting, from our perspective, is why the developmental and national industrial states played such contrasting roles in managing aggregate demand. The Northeast Asian states never developed the comprehensive welfare mechanisms that effectively regulated demand and constituted an integral part of the regime of accumulation in the national industrial states. Clearly, on one very important level, the failure of comprehensive, publicly funded welfare systems to develop in Korea, Japan or Taiwan can be explained by the political dominance of conservative forces within these states (Goodman *et al.*, 1998). In marked contrast to the US and the European political economies, where at least some sections of the working class were integrated, in a subordinate position, into the governing bloc, labour enjoyed no effective political voice within the Asian developmental state. While a focus on the class base of the developmental state reveals a great deal about the underdevelopment of welfare systems in Northeast Asia, there is one great question to which a focus on domestic class configurations offers no answer. If, as we have argued, the corporation required a stable demand environment within which to operate how, if not through welfare mechanisms, did the developmental state maintain an adequate level of effective demand within the national economy?

The short answer to this question is that it did not. For Northeast Asian firms the relatively stable consumer market which would drive growth was not the domestic market but the US. The relatively unrestricted access such firms enjoyed to the US market as a direct result of the region's position in the Cold War system effectively substituted for policies designed to stimulate domestic demand. By making it economically rational for the developmental states to suppress mass domestic consumption this external linkage created conducive conditions for a highly repressive and dynamic form of capitalism to develop in Northeast Asia (Cumings, 1979; Gills, 2000; Jessop, 2000).⁷

In this section of the chapter we have advanced the argument that both the national industrial and developmental states were essentially products of the global economic structures generated by the second industrial revolution. The logic of this argument is that the developmental state must be analysed as essentially a Third World variant of the national industrial state. At the same time, however, we would stress the need to be fully aware of the important differences between the two state forms in terms of the overall economic strategies they pursued and the historical blocs on which they rested. As we have consistently stressed we must appreciate that different states occupy radically different

positions within these structures and that how individual states react to world systems pressures is determined by the exact nature of domestic state–society configurations. Before attempting to do so, however, we must complete our analysis of the dynamic global environment within which Korean capitalism has developed in the past and continues to develop today. It is to the crisis of the post-war global Fordist regime of accumulation and the significant changes that have taken place in the global economy as capital has sought to resolve/escape from this crisis to which we now turn.

Post-Fordism, financialisation, globalisation and primitive accumulation redux

In order to understand the evolution of the global political economy since the end of the 1960s it is imperative that we understand the chronic problems of low profitability that have dogged the major capitalist economies.⁸ Between 1950 and 1970 the net profit rates for manufacturing in the US, Japan and Germany averaged 24.35 per cent, 40.4 per cent and 23.1 per cent respectively (Brenner, 2002: 8).⁹ In contrast between 1970 and 1993 these figures averaged 14.5 per cent, 20.4 per cent and 10.9 per cent (*ibid.*). This fall in manufacturing profits was mirrored by a fall in the level of profits across the entire economy. The average rate of net profits for all private business between 1950 and 1970 in the US, Japan and Germany was 12.9 per cent, 21.6 per cent and 23.2 per cent respectively (*ibid.*). The corresponding figures for the period between 1970 and 1993 were 9.9 per cent, 17.2 per cent and 13.8 per cent (*ibid.*).

The task of measuring profitability is one that is fraught with difficulties and depending on the method employed we are likely to arrive at radically different results. For example, while Brenner (2002) and Wolff (2003) appear to adopt superficially commensurate means of measuring profit they arrive at radically different figures. The debate concerning how we ought to measure profitability need not concern us here and the exact figures that Brenner arrives at are relatively unimportant. What is important is the direction of movement; different analysts may come up with radically different results but they nevertheless identify a coherent pattern of movement. It is clear that by any reasonable criteria profit rates were much lower in the world's three largest economies between 1970 and 1990 than they had been in the previous two decades.

Wolff (2003) argues that there is considerable evidence to suggest that US profitability reached its nadir in 1982 and that, at least partially as a result of the success of capital's attack on labour, a sustained improvement in profitability has since taken place. Wolff (2003: 484) demonstrates that pre-tax US corporate profits fell almost continuously from 1966, when firms enjoyed a 14.2 per cent return on fixed capital, to 1982, when they bottomed out at 4.6 per cent. Between 1982 and 1997 profits have gradually increased reaching 9.6 per cent in 1997. If we adopt the same methodology as Wolff, US profitability averaged approximately 8.5 per cent between 1997 and 2004.¹⁰ These findings appear to support the argument that a palpable sustained improvement in US profitability

has taken place but that profits remain modest when compared to those enjoyed by firms during the long boom.

The recent improvement in US profitability cannot, however, be said to represent clear evidence that the uneven global crisis of profitability has been resolved.¹¹ The situation in the world's second and third largest economies remains bleak. Whatever measure we choose to adopt it is clear that levels of profitability in Japan were much worse between 1994 and 2004 than they had been between 1970 and 1993.¹² Equally, if we consistently focus on operating profit we see that the profitability performance of the German economy between 1994 and 2002 was inferior to its performance over the 1973 to 1993 period (IMF, 2006: 60–3). Furthermore, according to the IMF the rate of profit in Germany was less than half that prevailing in the US between 1995–9 (*ibid.*: 63).

The origins and causes of the ongoing profitability crisis detailed above have been the subject of thousands of monographs and scholarly articles (Fine *et al.*, 1999). There is no need for us to become embroiled in this debate here. Rather we must simply recognise that a clear crisis in the existing Fordist global growth regime developed from the late 1960s onwards, that the long-term crisis in global profitability that can be dated back to the 1960s has yet to be fully resolved and that this crisis has structured the policymaking environment.

The efforts of capital and capitalist state managers to restore profitability (or to escape from the profitability crisis) have manifested themselves in three symbiotically linked phenomena. These phenomena are the privatisation of public and common property and the spatial/organisational restructuring of systems of production and financialisation. Collectively these processes have transformed the global political economy over the last three decades. We examine each of these processes in turn in the remainder of this chapter.

The privatisation of common property and the extension of the global proletariat

Since the end of the 1970s we have witnessed a concerted attempt across the capitalist world to extend the social space for private accumulation by transferring activities from the public to the private sector. The most visible aspect of this process has been the sale of state assets and the break up of public monopolies. Throughout the world we have witnessed a wholesale shift from public to private provision of utilities, a shift that is creating a whole new arena for capitalist accumulation. More significant still, the provision of publicly funded services has increasingly been transferred to the private sector. For example, in the British National Health Service (NHS) not only have 'auxiliary' services such as cleaning and catering been transferred to private sector providers but under the Private Finance Initiative (PFI) private capitalists have been afforded the opportunity to finance the construction of hospitals and make a return on capital invested. Even the core service of performing operations is being progressively transferred to the private sector. In 2005 Health Secretary Patricia Hewitt announced plans to increase the proportion of publicly funded operations

performed by the private sector from 5 per cent to 15 per cent by 2015 (British Broadcasting Corporation, 2005).

The example of the NHS is not an isolated one. Analysts have detected similar processes of ‘creeping privatisation’ in other states, such as Canada, which had earlier developed healthcare systems centred on public provision (Donelan *et al.*, 1999). Equally, the significance of the fact that the public sector shares of total health expenditure in Korea has consistently increased since the beginning of the 1990s cannot be properly understood outside of the privatisation programme that left only 20 per cent of all hospitals under government control by 1999 (OECD, 2003a: 16). These processes are not confined to the healthcare sector. Indeed, in less politically sensitive areas, such as refuse collection, processes of marketisation are largely complete in the major centres of global accumulation.

National level processes of neo-liberal reform have been shaped by the development of supranational frameworks that promote competition and the use of market mechanisms. Price and Pollock (2002) have sought to analyse the implications of WTO rules for ongoing processes of healthcare liberalisation in the UK. They argue that as a result of UK healthcare reforms and its WTO commitments international healthcare providers are in a strong position to demand the right to compete with the NHS across its full range of activities. Their central argument is that under WTO rules UK health services can be understood as being supplied on a commercial basis as:

The WTO has said that only a monopoly provider in the public sector is excluded from coverage. A service is commercial when patients have a choice of hospitals – that is when hospitals are effectively in competition regardless of whether ownership is in public or private hands. According to this interpretation, the market-oriented reforms of the NHS Plan redefine the NHS as a commercial service subject to trade rules. At the very least, final determination of the status of the NHS will be dependent on a disputes settlements panel of the WTO.

(Price and Pollock, 2002)

In addition to the role that the WTO is playing in accelerating the marketisation of national states this institution can be seen as expanding the scope for accumulation through its promotion of intellectual property rights. The WTO has been used to promote ‘strong’ global protection for intellectual property, in terms of both the length of patents granted and the scope of material eligible to be patented (May, 2000). The development of strong intellectual property rights together with the failure to recognise the communal knowledge of indigenous peoples has created new opportunities for primitive accumulation, for profit taking through the theft and the commercialisation of the products of pre-capitalist modes of production (Shiva, 1997). These processes are not politically or legally uncontested, however, and campaigners fighting to preserve the rights of indigenous communities have won some notable victories; particularly note-

worthy is the successful campaign around the Neem tree (Sheridan, 2005). Regardless of the outcomes of this process what is important from our perspective here is to understand what key interests within the WTO are seeking to do and to link this to the sustained profitability problems at the heart of the global economy since the late 1960s.

More significant for the capitalist system as a whole than the role the WTO has played in facilitating attempts to commodify indigenous knowledge is the wider role that this institution has played in promoting the global patentability of biological material. In the long term, as biotechnology and the manipulation of human genetics become key dynamic growth industries (ones which have potential to destroy billions of dollars capital annually through constant innovation) and accumulation centres upon the manipulation of the body there is an imperative to make all forms of life patentable (Herdergen, 2002).¹³

The most dramatic set of changes that have taken place in terms of the extension of the parameters of market (the space for capitalist accumulation) have not involved the reconfiguration of international intellectual property rights or the marketisation of the public sphere in established capitalist states (important as these are) but the drawing of whole new populations into the world market. In large part this extension has taken place as a result of events in the former communist world that global capitalist managers did not control but have been in a position to benefit from and have sought to shape as they have developed. With the collapse of the Soviet Union hundreds of millions of exploitable workers instantly became available to capital. As processes of primitive accumulation (the separation of direct producers (peasantry) from the land) continue apace, and largely unnoticed, across China an almost inconceivably large mass of humanity enters into capital's control.

For the major supranational economic organisations nothing else other than the full enmeshment of the entire global population into capitalist relations of production will suffice. The World Bank is currently and explicitly engaged in attempting to draw the extremely poor in the least developed countries fully into capitalist social relations as proletarians (see Cammack, 2001; 2003). For the World Bank the global poor's most valuable asset is their labour and their capacity to at least ameliorate their poverty depends on their ability to sell their labour power to capital. This argument is not unreasonable. The World Bank may be correct. The point is, however, that it is not enough to accept uncritically the mantra that the poor must sell their labour without seeking to understand how the agenda serves not only the global poor but global capitalism itself.

In attempting to explain the marketisation of the state, the policies of the supranational economic organisations and the development of international intellectual property rights it is important that we remain conscious of how these processes relate to the broader historical development of world capitalism. It is easy to feel moral indignation about the privatisation of healthcare systems, the commodification of public knowledge and the World Bank's policies. However, there is limited analytical value in moral critique that simply leads us to condemn these policies as wrong. Rather, we must understand how these

processes constitute an effort by capitalist state managers to offset the problems generated by the global downturn in profitability since the late 1960s by providing capital with alternative opportunities for profitable investment. The agenda outlined above did not simply reflect the narrow social interests of certain sections of capital. Rather the development of this agenda must be understood as being driven by the laws of motion of capitalism itself. The autonomy of capitalist state managers in the process should not be exaggerated. In response to profitability crisis they acted to expand the space for accumulation. What else were they to do? Rather than condemn particular policies we must critique the capitalist system as a whole.

The distinction we employ within this chapter between the process of seeking to draw new areas of social life/populations into the global market and the restructuring of global systems of production is a fairly arbitrary one that is only employed for organisational reasons. Restructuring production necessarily involves a redefinition of how spaces and individuals relate to the global market and the creation of new patterns of commodification and decommodification. It is to the direct response of major firms to the profitability crisis of the 1970s we now turn in the next section. Throughout the analysis that follows it is important that we are conscious of the arguments advanced above, that we do not treat distinctions that are made for organisational reasons as being of fundamental intellectual significance.

Restructuring production

In response to the crisis of the 1970s major firms sought to accelerate existing organisational restructuring processes and to set new processes of restructuring into motion. What drove these processes was capital's determination to remove rigidities that had developed in the work regime. The concessions that large corporations had made to organised labour during the long boom came to represent highly problematic sources of rigidity and expense as the world economy descended into prolonged slump. High wages and extensive welfare benefits were transformed from a necessary source of demand to a competitive drag. Major firms have sought to radically redefine what constitutes their workforce since the 1970s and to re-engineer their relationships with those workers they continue to directly employ. Across the major capitalist world large firms have sought to reduce the size of their 'core' workforces through sub-contracting and the greater use of casual labour (Harvey, 1990). The proportion of workers employed on a temporary basis in the OECD area increased from 9.6 per cent to 14.5 per cent between 1980 and 2004. Furthermore, the numbers of involuntary part-time workers in the OECD area has increased from 129,000 in 1976 to just over nine million in 2004.¹⁴

Predictably the increase in sub-contracting is leading to the growth of the SME sector and micro enterprises in particular. The data on changes in the proportion of workers employed by SMEs is surprisingly patchy. The OECD (1996a: 48) claims 'there is considerable evidence to show that the proportion of

jobs found in SMEs has been increasing since 1970'. This hardly constitutes a confident well-supported statement of fact. However, Loveman and Sengenberger (1991) demonstrate quite convincingly that the share of employment accounted for by SME rose between 1970 and 1985, reversing what had appeared to be a permanent decline in the importance of SMEs. Some of the more recent work on SMEs seems to assert that the share of total employment they account for is increasing in the core capitalist states without actually providing any precise empirical evidence to support this claim (OECD, 2000a). There is little dispute that levels of employment within SMEs are increasing. However, the scale of the increase is unclear. The evidential basis to support the argument that the importance of micro enterprises (with less than ten employees) within the SME sector is growing is much stronger (*ibid.*).

Although the OECD is keen to highlight the positive impact of the growth of SMEs this institution's own reports are forced to concede that only 10 per cent of such firms engage in research (OECD, 2000a: 11). Furthermore, there is ample evidence that average wages and conditions for workers in SMEs are worse than those in large firms (Loveman and Sengenberger, 1991). The idea propagated by advocates (such as Sabel, 1994) of flexible specialisation that we are witnessing the growth of innovative SME enterprises engaging in high-value-added economic activity is largely a myth. A significant number of innovative SMEs engaged in activities such as software development do exist. However, the principal factor driving growth in this sector is firms' capacity, in the absence of organised opposition from and historical compromises with labour, to demand greater flexibility from their workforces and to hold wage growth down more effectively. Large firms are thus able to make cost savings by sub-contracting out relatively low skilled activities whilst maintaining a monopoly on the key technologies of production.

The growth of micro enterprises that sub-contracting has entailed has created space for the growth of 'domestic, artisanal, familial and paternalistic (godfather, *guy*'nor or even mafia like)' systems of labour control (Harvey, 1990: 152). Neo-liberalism has seen the revival of forms of labour and economic organisation that appeared to be in chronic decline in the post-war era, to belong (thankfully) to a nascent not a mature capitalism. A vast new workforce has been created in the core capitalist world whose material conditions resemble those of informal workers in the developing world as much as workers in the core sectors of the Fordist political economy. In a sense post-modern capitalism is at least partially based upon on pre-modern labour regimes.

Those workers who continued to be directly employed on open-ended contracts by large corporations did not escape the effects of capital's drive to achieve flexibility and decrease costs. Not only have they faced wage restraint but they have also been forced to become more flexible and to effectively work harder. The pressure to work more intensely is difficult to quantify as it necessarily takes different forms in different industries. The mechanisms through which funding bodies effectively force UK academics to publish are quite different from those used to monitor the performance of a call centre

worker. Nevertheless, across different industries we have seen what Hyman (1989: 170) describes as 'a systematic assault on established custom and practice' involving the tightening of disciplinary procedures and management control over the labour process.

The task of effectively disciplining these workers has been made easier by the growth of more peripheral groups whose existence and conditions serve as a warning to those workers who may be tempted to resist the 'new realities of competition in the global market place'. The success of managements' offensive is eloquently demonstrated by the manner in which union leaders define themselves as partners in the competitive struggle (Trade Union Congress, 2003). The new realism of the western trade union movement seems to include an implicit understanding that if workers are to be granted the relative security of open ended contracts they ought to be prepared to do whatever is necessary to enhance the competitiveness of the firms they work for.

The attack on labour has also had a spatial dimension. The credible threat of relocation is a powerful weapon which capital can employ to discipline organised labour. Within MNCs workers in different plants are effectively in competition with each other to demonstrate that they are the most productive and do not require restructuring. Equally, the threat of capital flight empowers regional and national state managers keen on imposing discipline on disruptive labour. The extent to which capital flight actually takes place as a response to the power of organised labour is actually immaterial. If an assailant with a gun threatens me and demands my wallet the fact they do not actually fire the gun does not lessen the impact of the weapon in shaping my behaviour.

On balance capital's attack on working conditions and wages has been successful. Real wage growth in the heartlands of global capital has been very low since 1973. American capital has been extraordinarily successful in controlling the growth of real wages. Real wages in the US grew at an annualised rate of 0.2 per cent per annum between 1973–93 while labour productivity increased by 1.1 per cent per annum (Brenner, 2002: 8). In relative terms wage growth in Germany and Japan remained relatively strong at 1.9 per cent and 2.7 per cent respectively. However, these figures were lower than labour productivity growth (which averaged 2.2 per cent in Germany and 3.1 per cent in Japan) and were less than half the real increases workers in these economies enjoyed 1950–73 (*ibid.*: 8).

Since 1993 the situation for workers in both Germany and Japan has deteriorated significantly and both groups are now enduring the same severe wage squeeze their counterparts in America have been subjected to for decades. Real wage levels have been in more or less consistent decline in Japan since 1999 and were 3.8 per cent lower by the beginning of 2006 than they had been in 1998.¹⁵ The situation is little better in Germany. Real hourly wages in Germany have essentially been static since 1998; annualised real wage growth between 1998 and 2005 was 0.4 per cent (Hein and Truger, 2005: 19). It must be stressed that the German trade unions and the 'social democratic' Schroder administration played a key role in engineering this stagnation through the 'Alliance for Jobs'

and 'Agenda 2010'. In doing so they are responding to the objective fact that major German firms were relocating sizeable proportions of their activities outside Germany and that substantial reductions in wages were necessary to secure the competitiveness of the 'national economic space' (Streeck and Trampusch, 2005).¹⁶

The internationalisation of German capital must be understood as being part of much broader processes of spatial change that have been gathering pace since the mid 1970s. As we have already made clear in the course of this chapter, in periods of expansion there are considerable forces that lock capital into sub-optimal locations. The value of fixed capital sunk in particular locations acts to moderate the pace of spatial reconfiguration in response to the changing competitiveness of different spaces in the global economy. This is not to say that spatial change does not occur, simply that there are forces that regulate the pace of such change. The devaluation of capital that takes place within crises frees capital from the constraints it normally operates under and lays the groundwork for thoroughgoing restructuring. As restructuring began in earnest at the beginning of the 1980s the economic maps of particular states were transformed (Grant and Wallace, 1994). In the UK over the last 25 years we first witnessed the economic devastation of large areas of the country as traditional manufacturing industries were allowed to fail and then the re-articulation of these areas into the national economy as providers of cheap labour for the growing service sector.

From the perspective of this monograph the most important aspect of global spatial transformation has involved the development of integrated transnational systems of production. As processes of industrial restructuring began in earnest in the 1980s we saw firms increasingly organising their activities on a transnational basis in order to take full advantage of the full range of place-specific competitive advantages available internationally. Although FDI formed an important part of post-war Fordist expansion the boom in FDI in the mid to late 1980s and 1990s was of a quite different order of magnitude. In the 1980s FDI grew at four times the speed of global GDP. This expansion was modest, however, when compared to the increase in the global stock of FDI from \$1,950 billion to \$8,895 billion which took place between 1990 and 2004, while the world economy as a whole grew by slightly under 3.5 per cent per annum during this period (IMF, 1998: 171; 1999: 169; 2006b: 177; United Nations Conference on Trade and Development, 2005: 199).

These figures fail to take full account of globalisation of industries such as fast food retailing where franchising is the dominant business model and firms' expansion is thus funded by local capital. Furthermore, they are also blind to the critical importance of transnational non-equity linkages between nominally independent firms. These linkages range from collaborative research projects between global transnational corporations of roughly equal standing to highly unequal relationships between major sportswear brands (Nike, Adidas, Puma and so on) and their myriad suppliers in the third world (Gereffi, 1994).

These developments challenge the basic logic that underpinned industrial

policy in both the national industrial and developmental states, the axiomatic belief that strong national firms equal a strong national economy. As firms denationalise an increasing array of their activities – a process the state must encourage if nominally domestically based firms are to remain competitive – it becomes increasingly difficult to justify an economic strategy that is exclusively based upon domestically based firms. While the industrial structures of the post-war era obliged states to focus all their efforts on promoting large, nationally based firms, it is clear that contemporary economic structures place a different set of demands upon the state. Even if the future competitiveness of the North-east Asian growth economies continues to depend primarily on domestic firms it is clear that global changes have undermined the material basis supporting the highly restrictive policies towards MNCs that states such as Japan and Korea have historically pursued.

A notable feature of major MNCs operating in key global industries (such as automobile, pharmaceuticals, IT hardware and software) is the vast sums they invest in R&D and the rate of technological change that such investments have created (Dicken, 1998: 326).¹⁷ In 2005 the world's top ten companies by R&D spent between \$5.3 billion and \$7.3 billion on R&D (Department of Trade and Industry, 2006: 39). In many respects these figures underestimate the costs of achieving technological competitiveness in key global industries. We must also take into account how the changing technologies of production have increased the levels of fixed capital investment necessary to compete effectively in the world market. The most significant example of the impact of technological change on fixed capital costs relates to semiconductors where the cost of establishing a new plant has risen from \$2 million in the late 1960s to over \$3 billion today (Dicken, 2003: 364). As a result of technological change in many industries in the contemporary global economy any attempt to delineate between fixed investment and R&D costs is highly problematic.

While major consumer electronics, car and semiconductor firms from Europe, Japan and America were, and are, in a position to finance such increased costs primarily from retained profits the situation in a late developer such as Korea was rather different.¹⁸ Between 1970 and 1989 only 29 per cent of total Korean investments were financed from internal funds (Chang and Park, 2004: 39). This compares with over 60 per cent in Germany and the US (*ibid.*). These figures reflected both the starting position and the ambition of key Korean firms.¹⁹ Korean firms were seeking to grow rapidly from a low base, to break into new industries and move from peripheral low-valued-added positions to more established technologically sophisticated high-value-added positions within highly oligopolistic markets. Their ability to employ internal firms was necessarily lower than the industry leaders they sought to emulate who were not only larger but operated at the higher end of the market (Bello and Rosenfeld, 1990: 17–173; Ungson *et al.*, 1997: 134–63; van Hoesel, 1999). To put it crudely, Korean firms were playing 'catch up' and without secure profit streams to draw upon they had no choice but to rely heavily on external finance if they were to make the investments in R&D and fixed capital necessary to achieve their ambitions.

Given that Korean firms were dependent on the financial system to provide the funds necessary for them to achieve/sustain technological competitiveness in key global industries it is critical that we examine the capacity of the financial system to actually do so. Logically there were clear limits to the capacity of the Korean financial system to supply the necessary funds, although these have largely been ignored in the existing literature. The problem was not that the Korean financial system was incapable of funding a single \$5–6 billion investment. Rather, it was that such an investment would amount to well over 1 per cent of peak pre-crisis GDP and there were tight objective limits on how many multibillion dollar investments the Korean financial system could reasonably be expected to fund (Kong, 2000: 23). The state was certainly in no position to fund the development of independent exporting capacity across a range of major global industries. In a fundamental sense, therefore, the limits of the developmental state project, which was based upon the idea that the state could finance the development of such capacity, had been reached by the mid 1980s.

An obvious solution to what appeared to be an intractable financial problem was generated by the rapid growth of global financial markets the late 1960s; theoretically the state could simply allow firms to raise funds on these markets. It is to the forces and logics underpinning the development of a closely integrated global financial market since the late 1960s to which we now turn.

Financialisation and the development of a global financial market

The decline in opportunities for productive investment in the real economy (as evidenced by the decline in the rate of manufacturing profitability) has forced capitalists to seek profits through activities increasingly disconnected from productive activity. The exact form that these attempts to make money out of money itself have taken are numerous and have evolved over time. The main forms include an increased focus on consumer credit and speculation on global currency, security and real estate markets (Itoh and Lapavistas, 1999: 199–200). True speculation on major global financial markets has always existed but compared with the volatility we witness today in key equity, currency and land markets the period between 1945–73 was one of almost inconceivable stability. The daily volume of share trading on the New York Stock Exchange (NYSE) has increased from approximately \$10 million in 1970 to over \$1 billion in 2005.²⁰

There exists a clear link between the decoupling of finance from real productive activity and the internationalisation of finance. Although much can be made of the importance of the development of offshore markets in London since the 1950s, in many respects the present wave of private sector-led financial globalisation can be understood as having begun in the early 1970s. Germain (1997: 119) points out that the ratio of long-term private to public capital exports was largely stable between 1956–71 and that it was only after 1971 that we witnessed an explosion of private capital exports.

The same processes of liberalisation that facilitated the rise of speculation

within particular economies simultaneously promoted the rise of speculation across different national economies. At the same time as controls on competition within national markets were removed external capital controls that sought to segregate separate national financial systems were abolished; significantly the US abandoned capital controls in 1974.

Keynesian scholars sceptical of the virtues of liberal global financial markets have highlighted consistent policy failures that they argue have added to global financial instability.²¹ The argument is that major states lacked the political will to properly regulate financial markets and that with proper regulation the stability of global financial markets could be greatly enhanced (Strange, 1986; 1998; Michie and Smith, 1999). On one level this critique has great force. As any mainstream neo-liberal would accept effective markets require regulation. Without effective regulation to ensure transparency and the exit of insolvent institutions market disciplines are effectively blunted. That the absence of regulation can lead to perverse behaviour and almost suicidal risk taking is not in doubt.

On another level, however, the Keynesian analysis of contemporary monetary instability misses the point. Logically if there are inadequate investment opportunities in the real economy to utilise the pool of available corporate and private savings speculation, the attempt to make money out of money itself is inevitable. The decisions that governments made in the 1970s and the 1980s that promoted the growth of a volatile global financial market must be understood as being overdetermined by conditions in the real economy. The pathologies of the global financial system (rampant currency speculation, asset price bubbles and wild equity price movements) are rooted not so much in regulatory failures as the systemic problems of contemporary capitalism itself.

Predictably as speculation has grown at a staggering rate the overall size of the global financial market has expanded equally quickly. According to the Bank of International Settlements (BIS) the size of global financial markets increased from about \$300 billion in 1974 to \$7,000 billion in 1996 (Malcolm, 2001: 40). By 2004 the total daily foreign exchange turnover reached \$1,880 million compared to \$590 million in 1989 (Bank of International Settlements, 2005: 5).²² The development of a global financial market worthy of the name radically altered the operating environment within which developmental states such as Korea operated.

The demands of major national firms for monies at competitive rates of interests together with the availability of practically unlimited resources on the global market created something of a dilemma for states such as Korea. At the same time, however, financial liberalisation and financial opening promised to destabilise the entire economic model. As we shall argue in the later chapters of this monograph the entire regime of accumulation rested upon an intricate set of relationships between state-controlled domestic financial institutions and major industrial firms. Financial opening destroyed this system by undermining the capacity of domestic elites to manage the vulnerabilities that rapid state-directed debt-financed industrial development created.²³

We are not yet, however, in a position to focus directly upon Korea. Rather, we must first engage in a slightly more abstract analysis of the nature of actually existing contemporary neo-liberal states. Through a vigorous analysis of neo-liberal state forms we are able to shed clear analytical light on the rather confused set of debates surrounding the alleged convergence of different capitalist models and alternatives to neo-liberal reform. An analysis of convergence debates is critical to allow us to develop a proper contextualised understanding of reform in Korea. Moreover, without first developing a clear understanding of what neo-liberalism actually is it is impossible to develop the argument that Korea now constitutes a neo-liberal state.

3 Global competition, neo-liberalism and alternatives

The issue that has dominated debates within international and comparative political economy since the late 1980s has been the impact of structural change in the global economy on distinct national capitalist models. More particularly, the continued viability of dirigiste economic strategies has been called into question and the extent to which we are witnessing a global convergence around a single neo-liberal model has been extensively discussed. A weakness that has dogged these debates has been the consistent failure to properly analyse the role that the state plays in the neo-liberal project.

In part this failure may stem from the radical differences in the role the state plays in actually existing neo-liberalism and the role that the most famous ideologues of neo-liberalism have continuously portrayed the state as playing in the project. In their rhetorical forms Thatcherism and Reaganism demonstrated a profound faith in unfettered markets, a faith clearly echoed by the haute intellectuals of neo-liberalism (Hall and Jacques, 1983; Hayek, 1988; Friedman, 2002). However, in practice markets were not understood as organic institutions whose effective operation simply required the state to ensure the sanctity of contracts and then step aside. When we analyse the actual practices of the Thatcher and Reagan administrations we see the consistent active use of state power in key spheres, most notably financial regulation, to create and regulate ‘competitive’ markets (Moran, 1991; 2003). In the UK in particular it is clear that the neo-liberal project has been underpinned by a massive extension in the powers of the central state as anti-competitive systems of quasi-private regulation have been replaced by market-based systems of public regulation (Moran, 2003). The same focus on the centrality of state power to actually existing neo-liberalism becomes clear when we analyse the work of the key neo-liberal global governance institutions. Rather than the dynamism of markets being immanent everywhere and only constrained by the dead weight of government intervention, effective markets are portrayed as delicate institutions that require complex legal supports. A quick glance at any major OECD or World Bank report reveals that a plethora of different markets require extraordinary elaborate systems of regulation and control if they are to function reasonably effectively. In each individual market, the existence of ‘special circumstances’ – monopoly power, a common physical infrastructure, the need to preserve standards in the professions or the

particular nature of land or financial markets – can be cited as a rationale for regulation. However, collectively these markets constitute a significant part of the core of any modern capitalist economy.

In addition to these various exceptional micromanaged sectors the role that the neo-liberal state plays in the more general functioning of the economy should not be underestimated. The state cannot absent itself from the establishment of effective systems of corporate governance, the provision of education, the protection of the environment, the formation of competition policy, the development of transport infrastructure, and a host of other activities critical to the functioning of capitalism.

Given the realities of the neo-liberal project much of the analysis produced by scholars critical of the neo-liberal convergence thesis cannot escape the charge of caricaturing the neo-liberal project. The neo-liberal state is uncritically equated with the minimal state and the detailed work of institutions such as OECD and World Bank on regulation is ignored. In this context Weiss and Thurbon (2006: 20) recent supposedly innocuous statement on the neo-liberal state takes on considerable importance. The statement reads:

There is no disputing that so called ‘neoliberal’ states intervene to influence economic outcomes, to structure markets through regulatory controls, and in response in particular external pressures or industry demands.... The distinction is not a simplistic one of intervention versus non-intervention, but rather the extent to which the state’s involvement forms part of a broader ‘strategic’ ambition or approach that puts substantive national goals before abstract liberal injunctions about competitive markets.

From this statement we can assume that Weiss and Thurbon have acknowledged the role that the neo-liberal state plays as a regulatory agent. It would seem inappropriate, therefore, to accuse them of caricaturing neo-liberalism. However, at the same time as acknowledging the neo-liberal state’s role as a regulatory agent, the statement clearly defines the limits of the neo-liberal state’s activism. The neo-liberal state does not have strategic ambition. Should we be in any doubt about this we are told elsewhere in the same article that the neo-liberal state ‘has little place in shaping foreign investment flows’ (Weiss and Thurbon, 2006: 3).

We are not convinced that Weiss and Thurbon’s statement fully acknowledges the active role that the neo-liberal state plays in the economy. More specifically, Weiss and Thurbon’s analysis is problematic in three respects. First, the statement implies a necessary (or at least a likely) contradiction between the pursuit of neo-liberal principles and the achievement of ‘substantive national goals’, a term that is so vague as to be almost meaningless. However, no such contradiction necessarily exists. While there is no way of ascertaining the true objectives of global policymakers we would argue that key states have pursued neo-liberal reform precisely because such reform was understood as being the best mechanism through which to achieve substantive national policy goals. It

makes no sense, therefore, to talk about these goals being sacrificed to abstract principles. For example, the decision of the Korean state to sell strategically important financial institutions to foreign investors had more to do with the concrete objective of creating a set of institutions that actually possessed the capacity to assess credit risks than any abstract commitment to economic opening. Similarly the Blair government's decision to grant the Bank of England independence in 1997 can be understood as much as an attempt to resolve the decades old problem of inflationary wage settlements as a surrender to the neo-liberal zeitgeist (Kettle, 2004). If we examine British financial policy since the late 1970s more widely, the idea that the neo-liberal state lacks concrete objectives is exposed as simply being wrong. The reform of systems of financial regulation was explicitly driven by an attempt to secure London's position as a key centre within an increasingly lucrative global financial market (Moran, 1991). Indeed, it is difficult to see how the process could have been said to have been driven by abstract liberal principles as the British state, as the global leader in the financial services revolution, was actively defining what constituted sound neo-liberal systems of regulation in the process of reform.

Second, the idea that the neo-liberal state necessarily has no role to play in 'shaping investment flows' is problematic. In practice all states, including neo-liberal ones, favour certain types of investment over others. Almost every national economy in the world offers some form of tax subsidy for R&D. This support can be justified relatively easily within the framework of neo-classical economics as bridging the gap between the social and private benefits of innovation. Equally, when neo-liberal states act to promote closer ties between leading public research institutes/universities and transnational firms they are not simply seeking to attract FDI in some generic sense. Rather, they are seeking to promote particular forms of high-value-added investment. There *are* significant differences between how neo-liberal and developmental states seek to shape investment flows, differences which we shall make clear in our discussion of industrial policy within the neo-liberal state later in this chapter. However, the differences are far more complex than Weiss and Thurbon's claim that the developmental state intervenes to influence flows while the neo-liberal states abstain from doing so.

Finally, Weiss and Thurbon's (2006: 3) statement that if Korea were a neo-liberal state we would 'at very least expect the state to have abandoned a strategic approach to (foreign) investment policy' belies a general tendency to assume that the (alleged) continuation of certain dirigiste practices can be taken as proof that the state is not neo-liberal. However, the idea of the neo-liberal state, or the developmental state for that matter, is an abstraction. We use labels such as 'neo-liberal' and 'developmental' to describe the dominant characteristics of the national state. Assessing whether or not a particular state may be accurately described as neo-liberal requires a serious consideration of the full range of policies it pursues. In other words, it demands that we engage in a sober analysis of the balance of evidence drawn from the entire economy. It is easy to find evidence that no state in the world confirms perfectly to some abstract neo-liberal model. It is however an exercise entirely devoid of intellectual merit.

Having sought to establish the weakness of attempts to define the neo-liberal state in terms of what it does not do there is a clear onus on us to offer a positive definition of what that state actually is. If we cannot do so the concept must be disregarded as meaningless and unworkable. While the last chapter of the monograph contained a clear attempt to outline the key features of the global neo-liberal project we must now turn to the distinct but closely related task of scrutinising more closely the essential features of actually existing neo-liberal state forms. We must define what it is that distinguishes the neo-liberal state from other states forms and lends that term analytical and descriptive power.

The neo-liberal state

The task of defining the ensemble of institutions and policy that constitute the contemporary neo-liberal state is a complex and challenging one. In undertaking this task it is important that we engage in the study of both the practice of reform in major states which are generally understood as being neo-liberal (particularly UK and US) and key policy documents issued by the dominant multilateral institutions that define international standards of best practice in key policy areas. In so doing we develop a 'governance model' whose characteristics are clearly distinct from other state forms (developmental, national industrial, social-democratic and predatory) and which we may use to judge actually existing states (Korea) against. Our study of the neo-liberal state will focus on seven key policy areas sequentially. The seven we shall focus on are monetary policy, financial regulation, corporate governance, regulatory reform, industrial policy, the organisation of public services and labour market regulation. While analysing each policy area separately it is important to understand the coherence of the project and how reform in each distinct area is informed by the desire to promote market disciplines.

Monetary policy

At the centre of the contemporary neo-liberal monetary policy regime stands central bank independence (CBI). The rationale underpinning CBI in the contemporary era has been well documented by a number of scholars (see particularly Jayasuriya, 2001b; Burnham, 2001). In short CBI can be understood as a mechanism to depoliticise economic policy, secure the confidence of international financial markets and to discipline domestic economic actors. CBI creates certainty through the imposition of clear binding rules to govern monetary policy. In formulating monetary policy the neo-liberal central bank is primarily accountable not to a political agent but to a clearly defined widely publicised inflation target.

Policy ceases to be an object of negotiation. Effective central bank independence transforms monetary policy from a factor that key actors can seek to influence to something which they must adapt themselves to. If domestic firms cannot control costs the central bank will not accommodate price increases

through lax monetary policy and firms will fail. CBI becomes a key mechanism through which domestic firms and workers are subject to the disciplines of the market. At the same time by demonstrating the state's commitment to maintaining a credible anti-inflationary policy CBI plays a critical role in securing the confidence of global financial markets in the currency.

It is important to delineate between neo-liberal CBI and generic CBI. In his seminal article on the creation of the European Central Bank (ECB) Jayasuriya (2001) contrasts this institution with the Bundesbank. Jayasuriya (2001b: 116) argues that in post-war Germany 'it is incorrect to assume, as many have done, that central bank independence is the prime determinant of monetary policy; rather, it is the interaction between monetary authorities and central wage bargaining that provides the basis for a range of macroeconomic outcomes. The public bargaining between the Bundesbank and the unions is an important factor in determining annual macro-economic parameters.' The Bundesbank was part of a system of political bargaining. As a neo-liberal central bank par excellence the ECB's accountability to fixed rules deliberately deprives the institution of the flexibility to engage in political bargaining. Social actors cannot hope to influence policy and must instead accommodate themselves to policy.

In the East Asian case an even more striking distinction can be drawn between the historically independent Taiwanese central bank and the newly created independent Korean central bank. Weiss and Thurbon (2006) argue that the Taiwanese central bank has historically been a developmental institution that has used its powers to ensure that firms in strategically important industries have received relatively cheap credit, activities which are supported by Article 2 of the Central Bank of China Act. On the other hand, the mandate of the newly independent Bank of Korea (BOK) makes it clear that it must abstain from deliberately 'distorting' the allocation of credit.

The defining feature of the neo-liberal monetary regime is not simply CBI. Rather it is the creation of a central bank that stands apart from society and pursues its legally defined mandates to ensure price stability and uphold principles of market neutrality in its operations in an almost automatic manner. The central bank is the ultimate guarantor of the discipline of money and stands above the messy business of political bargaining.

Financial regulation

There are certain parallels between the process of central bank reform and the transformation of the structures of financial regulation that the neo-liberal project entails. Neo-liberal reformers have applied the same basic principles of seeking to replace discretion/bargaining by rules. The history of national financial systems is incredibly diverse and it is difficult to discuss distinctive 'models' that we can associate with particular groups of countries. However, a common feature of many of the national systems of financial regulation that existed prior to the 1970s is that they were largely controlled by insiders and that a high degree of informality existed within the rules/norm setting process

(Zysman, 1983; Moran, 1991; Malcolm, 2001). In relatively liberal market-based financial systems, such as the US and the UK, systems of ‘practitioner-based regulation’ were dominant. In essence market actors regulated themselves with formal government agencies playing a supporting role. The exact legal status of a great deal of regulation, in the UK in particular, was somewhat ambiguous and the distinction between understandings, norms and formal rules was unclear.

In more dirigiste economies such as Japan and France where the state sought to directly influence the allocation of credit, official regulators played a far more prominent role in the financial system (Zysman, 1983; Malcolm, 2001).¹ Nevertheless, the same arguments regarding control by insiders and informality still apply. The system was based upon implicit understandings between private sector insiders and official regulators, the exchange of favours, ‘administrative guidance’ and regulatory forbearance. Furthermore, the prevalence of semi-public institutions and the allocation of public objectives and special privileges to private institutions made the distinction between public power and private actors very unclear (Moran, 1991: 94–100).

The systems of semi-private financial regulation that existed in key states in the post-war era sought, to widely differing degrees, to restrict competition in key financial markets. Even in the relatively liberal US economy there was an effective ban on price competition between brokerages operating on the New York Stock Exchange until 1975. Equally, strict legal barriers served to restrict both the functional and geographical scope of key institutions activities. In the US until the repeal of the Glass-Steagall and McFadden Acts in the 1980s there was a strict legal segregation of the commercial and investment banking markets and tight restrictions on the development of inter-state bank branch networks. When we turn our attention to other national political economies we see very different types of control over price competition and the activities that particular types of institution could engage, there was no universal model. However, wherever we look we see restrictions (*ibid.*).

In their efforts to transform existing systems of financial regulation neo-liberal reformers have sought to codify and nationalise that which was previously implicit and semi-private. Free competition demanded the creation of a level playing field. Rules had to be crafted by state institutions, not collectives of established market operators with a vested interest in restricting competition in order to protect their members. Equally, rules needed to be codified and consistently applied if market outcomes were not to be distorted by the capacity of certain firms to gain a competitive advantage through their relationships with regulatory bodies.²

Among the world’s leading economies it is in Britain where we have seen the most dramatic changes in the institutional structures of financial regulation. The UK has moved from a system almost totally dominated by the principle of self-regulation to one that, with the creation of the Financial Services Authority (FSA), is dominated by what is effectively a universal public regulator. However, the nationalisation of regulation has taken a very particular form both

in Britain and elsewhere. Where regulation globally has been brought firmly within the public sphere there has been a simultaneous effort in many states to protect regulation from the full impact of politicisation.³ In the 1990s in economies as diverse as Korea, Finland, Austria, Malta and the UK we witnessed the creation of autonomous unified regulatory agencies (World Bank, 2002: 83). Furthermore, in the UK and to a lesser extent Korea and Malta upon their establishment these institutions were endowed with very clear sets of 'neo-liberal' operating principles and an obligation to make and apply policy in a transparent manner.⁴ These principles serve to mediate the accountability of these institutions to national parliaments/ministries and to ensure their independence. When the British FSA reports to parliament this represents a process through which this institution is forced to affirm that their actions have been commensurate with their original legally mandated pro-competition objectives. Clear legally mandated objectives create a framework for accountability that effectively limits the scope for arbitrary political interventions. Accountability to rules effectively acts as a partial substitute for accountability to potentially fickle political agents.

In terms of the actual composition of regulation neo-liberal reform has evolved a move away from anti-competitive towards market-based controls. Barriers that separate functionally and geographically distinct markets and arbitrary restrictions on competition have been relentlessly attacked (Moran, 1991). In their place there has emerged a focus on prudential and risk-based supervision. The role of regulation is not to restrict competition but to insure that institutions manage risk 'properly', in a sense contemporary regulatory frameworks allow institutions to do whatever they wish provided they can demonstrate a capacity to do so relatively safely. In many respects the maintenance of systems of prudential supervision is vital to the functioning of market mechanisms. For example, without effective legal frameworks to ensure that banks are forced to declare substandard loans and maintain certain levels of capital, clearly insolvent institutions could continue trading for years and distort market competition. Some of the new principles/risk-based regulation that has grown in importance over the last decade is potentially more problematic when judged by abstract neo-liberal criteria. Such regulation effectively forces banks to develop particular types of internal risk control systems and could be seen as an attempt to micromanage the development of private institutions. On the other hand, however, advocates of such systems of regulation claim that they represent a means of ensuring a degree of financial stability without the costs associated with the proliferation of an endless stream of quantitative restrictions and rules; that they in fact represent a less intrusive form of regulation (FSA, 2006). Whatever the truth of these arguments contemporary debates on financial regulation clearly demonstrate that the neo-liberal project is not without its contradictions.

Of course the arguments advanced in Chapter 2 regarding the rise of fictitious accumulation since the late 1960s call into question the capacity of prudential regulation to control risk taking and ensure any form of stability. We live in a global economy characterised by volatile equity markets, an unsustainable build

up of personal debt in key economies, property bubbles, massive currency fluctuations, and where billions of dollars pursue profits on the global derivatives markets in purely speculative transactions. These phenomena need to be explained in terms of the failure to resolve profitability problems that first emerged in the 1960s, rather than as a consequence of the failure to properly regulate financial markets. On one level, therefore, attempting to regulate processes of fictitious accumulation in order to ensure a degree of stability is not unlike attempting to take the risk out of suicide.

Nevertheless, prudential regulation may be able to achieve a great deal in terms of reducing the risk of systemic crisis in the short to medium term by structuring the risk taking activities of key institutions. Prudential regulation cannot stabilise an unstable economy. However, it can help manage systemically important institutions' (particularly commercial banks') engagement in the most obviously unstable forms of speculation and in so doing insure a fragile form of systemic stability. Indeed, given that we live in a world where the relative value of major currencies can fluctuate by 50–100 per cent over the course of a few years, where third-world debt crises are commonplace and where the New York Stock Exchange index can fall by over 50 per cent in less than two years, the financial and monetary authorities of major states have performed a stunning feat in preventing the breakdown of the global financial system (Itoh and Lapavistas, 1999: 185–206).⁵ To use a medical analogy, skilful management by regulatory and monetary authorities has managed the illness, however it has not and cannot cure the fundamental problems that ail the patient.

Corporate governance

In comparison to the highly viable 'revolution' in systems of financial regulation that has taken place over the last three decades the changes that have taken place in systems of corporate governance have been far less dramatic. Indeed, rather than discuss the development of a new neo-liberal form of corporate governance debates on the evolution of contemporary systems of corporate governance, discuss convergence around a market-based Anglo-American model, which has long been based upon unambiguously liberal principles. The defining characteristic of the Anglo-American system of corporate governance is the active use of market mechanisms to control and discipline the management of large corporations. By way of contrast the Nippo-Rhenish model was primarily based upon 'control by insiders', stable long-term investors who exercised an oversight function and developed close relationships with management.

These different systems of governance required quite different institutional/legal supports. In the UK and US government acted (not always successfully) to protect minority shareholders rights, enforce transparency, promote the active use of independent directors and the use of 'minority shareholder friendly accounting and reporting systems' (Vitols, 2005: 389). The entire purpose of the law was to enhance the power of avaricist shareholders and intensify pressures on management to meet the demands of the market. The law

played a quite different role in the German and Japanese systems. Within these systems the state effectively sought to offer a degree of protection to corporate managers from pressures emulating from the market by placing tight restrictions on mergers and acquisitions. Equally important as the protections the law afforded corporate management was its relative neglect of issues relating to minority shareholders rights, transparency and the role of independent directors (Gourevitch, 1996).

We shall examine whether or not we have actually seen a convergence around the Anglo-American (market based/neo-liberal) model in the next section of this chapter. It is important to make it clear at this point that this system itself is not static. Rather, as a result of various scandals there have been moves towards greater state involvement and the codification of systems of corporate governance in both the US and the UK. The most recent example of this is the US 2002 Sarbanes–Oxley Act that was passed in response to the Enron scandal, which deals with the personal responsibilities of chief executive officers and the composition of audit committees (US Congress, 2002). The important point about the periodic alterations to systems of corporate governance in the UK and US is that the reforms seek to reinforce the basic logic of the system that retains a central focus on market disciplines.

Regulatory reform

The meaning of the term ‘regulatory reform’ is highly problematic. In itself the term is vague and imprecise. The term regulation could perfectly reasonably be used as a catchall term to describe the vast array of social and economic functions that the state performs. Regulatory reform could, therefore, be considered as being synonymous with state reform. Within our analysis here we employ the same definition of ‘regulatory reform’ as that used by the OECD (1997) in the series of long reports it developed on reform in its member countries. This definition is useful as it indicates how neo-liberal reformers themselves conceive of ‘regulatory reform’ as a distinct area of policy transformation. The OECD’s reports focus on environmental protection, health and safety issues, and the regulation of utilities. Although issues relating to financial regulation are touched upon this is generally treated as a distinct area deserving special consideration. The exact policy recommendations of the various country studies reflect national circumstances (see for example OECD, 2000b; 2004a; 2004b; 2006a). Nevertheless, through a careful reading of the framework documents and country case studies it is possible to identify three central principles underpinning the neo-liberal vision of regulatory reform.

First, there is a heavy emphasis not simply on regulatory outcomes but on the regulatory process. In terms of concrete policy the OECD (1997) recommends two things, recommendations that are fully commensurate with the World Bank’s (1997; 2002; 2005) work on regulation.⁶ The first is that independent regulatory agencies insulated from the pressures of competitive politics be established to determine and implement regulatory policy in key sectors that require

relatively close regulation due to issues relating to market concentration and/or the need to ensure common access to certain infrastructures. The other key recommendation is that clear frameworks be established which require regulators to conduct cost benefit analysis of regulation and to explicitly justify the necessity of regulations. When regulations are deemed necessary it must be demonstrated that the agency has formulated regulation so as to impose minimal cost on market actors. These provisions make it clear that regulations are only to be used to address acute market failure rather than as a tool of a particular form of industrial policy which seeks to maintain certain market structures or to afford advantage to particular firms. Furthermore, there are requirements that market actors be consulted in the process of formulating regulation and a consistent stress on transparency. While these frameworks apply to regulators within the central administration and independent regulatory bodies they are of particular significance in the latter case. Accountability to rules 'protects' these institutions from political accountability. In other words, these institutions can deflect political criticism and defend themselves against interference by demonstrating that they are acting in accordance with clearly defined standards of best practice.⁷

The second key set of principles underpinning the reform of regulation is that regulation ought to promote market disciplines/competition and be goal-oriented. What this means in practice is dependent on the sector in question. For example, in telecommunications it means creating licensing systems which promote the entry of new competitors, the use of auctions to allocate spectrum space and forcing incumbents to allow competitors access to the infrastructural resources (the local loop) necessary to facilitate effective competition. The imposition of price controls on dominant market actors may be necessary but it is seen as a very poor short-term substitute for the creation of effective market disciplines. In the case of environmental regulation a market-based approach would, amongst other things, employ differential tax rates for fuels depending on the damage they caused the environment, tax industrial emissions of all sorts and promote the use of carbon trading. The government does not seek to ban in all but the most extreme circumstances but instead seeks to manipulate market signals to achieve its goals. This promotion of the use of market mechanisms and the adoption of goal-based regulation are symbiotically linked.

The final consistent theme of neo-liberal regulatory reform is the emphasis placed on promoting the development and widespread adoption of globally recognised regulatory standards. The ultimate neo-liberal nirvana would be an environment where a single global regulatory regime existed and transnational firms need not concern themselves with adaptation to local legal peculiarities. In those areas where an agreed global framework does not exist mutual recognition of different national standards (on the safety of pharmaceutical products for example) is seen as a reasonable substitute and a means of reducing the compliance burden on MNCs.

In short neo-liberal reformers seek to transform regulation from something that dissipates competitive pressures and restricts international openness to a source of intensified competitive pressure which facilitates global economic

integration. The extent to which they are actually succeeding will be assessed later in the chapter. Of course the fact that the regulation of the telecommunications, electricity and water industries are major issues throughout the advanced capitalist economies is testimony to the success of privatisation, another key aspect of the neo-liberal project.

Industrial policy

To many the idea of a neo-liberal industrial policy is an oxymoron. For such analysts industrial policy involves deliberately distorting the flow of investment while the neo-liberal state confines itself to simply creating an attractive environment for capital to operate in. Indeed, the existence of an active industrial policy is often taken as evidence that a state ought to be understood as being ‘developmental’ rather than neo-liberal. However, such an analysis begs the question of what we actually mean by creating an attractive environment for capital to operate in. This phrase actually borders on being a completely meaningless abstraction. Firms operating in different sectors are likely to have very different notions of what constitutes an attractive environment for accumulation. For example, a firm operating in a high technology sector may regard strong public support for basic science research and an official commitment to fostering links between academia and business as key components of an attractive environment. An international bank, on the other hand, is likely to be more concerned about the quality of systems of financial regulation and the international reputation of that regulatory system. Equally, a firm producing low-value-added technologically simple products may simply want low taxes, few protections for labour and a government that is committed to suppressing labour movements. All governments continuously make choices about what sectors they choose to promote through their economic, social, education and infrastructure policies. In a sense no government, other than a mythical night watchman state, can avoid influencing the flow of capital.

Furthermore, in practice all major advanced capitalist states continue to pursue policies of direct R&D support that run contrary to any abstract neo-liberal principles. All major economies employ grant schemes to which firms may apply for subsidies towards R&D projects. Indeed, supposedly model neo-liberal states such as the US and UK are among the ‘worst offenders’. In 1997 15 per cent of total business R&D expenditure in the US and 10 per cent of business R&D expenditure in the UK was directly funded by the government (OECD, 2000a: 221). Even if we allow for the fact that these figures are distorted by the presence of large arms sectors in both these political economies they do not stand out as being particularly low by international standards (*ibid.*).

These schemes are very difficult to justify according to the ideology of neo-liberalism. In contrast to general tax subsidies for R&D which are, subject to certain conditions, available to all firms, more selective direct cash supports necessarily afford certain firms a competitive advantage over their rivals. In a sense the state continues to ‘pick winners’ and interfere in the process of market

competition. Obviously this contradicts the general thrust of neo-liberalism towards the deepening and extension of market disciplines. Unless we wish entirely to reject the analytical and descriptive value of the concept of the neo-liberal state we must simply accept that a feature of 'actually existing' neo-liberal states is that they do in fact directly subsidise investments in R&D by those firms they consider to be of most importance to the national economy.

The argument that neo-liberal states continue to pursue industrial policies, and that aspects of these policies appear rather dirigiste, should not be allowed to disguise the fact that neo-liberalism represents a break with the policies of the national industrial and developmental states. In developmental and national industrial states the focus of industrial policy was on developing particular 'national champions'. The focus of policy was micro-level. Large firms were selected and in many cases afforded not only R&D supports but also other forms of subsidy, and even a degree of protection from international competition. Indeed, in many states (such as Japan and Korea) that undisputedly employed highly active dirigiste industrial policies in the post-war era public R&D has traditionally been relatively unimportant (OECD, 2000a: 221). In the developmental and national industrial states there was a sense that key firms had to be supported not because they had great potential in the international marketplace but because there was simply a sense that a 'great country' ought to possess certain industries.

While there are certain continuities, in terms of direct R&D supports, between this policy of developing national champions and what we might define as 'actually existing neo-liberal industrial policy' there are also important discontinuities. First, there is a sense in which industrial policy is increasingly defined as 'innovation policy'. The purpose of industrial policy is not to offer some general subsidy for investments or to soften the operations of market disciplines through protectionism but is to promote continuous innovation. Beath (2002: 225) argues that since 1984 and the establishment of the Technology Framework Programmes EU industrial policy has been almost solely driven by a desire to promote technological innovation. It is also interesting to note that all the funds that the UK Department of Trade and Industry (DTI) spends supporting large firms are devoted to programmes whose sole explicit objective is to promote technological innovation (Wren, 2002: 854). The UK is not alone. The popular assertion that the US does not pursue industrial policy reflects the reality that the central government's industrial policy simply consists of supporting R&D and that analysts frequently fail to recognise this as industrial policy.⁸

Second, and notwithstanding what we have already said, there is a shift away from promoting the competitiveness of particular firms (national champions) to meso-level competitiveness (the construction of networks) and information dissemination. This shift in emphasis can be ascertained by analysing both the policy practices of key neo-liberal states and the attempts of the World Bank to define precisely what market supporting (neo-liberal) industrial policy actually consists of, which make constant references to the need to construct networks.⁹ If we take the example of industrial policy in the UK, an early leader in

neo-liberal reform, we see that successive governments have demonstrated an almost total lack of concern for the health of leading British firms in key industries. The British car industry has effectively been allowed to collapse and British financial markets have been allowed to be dominated by foreign institutions. Indeed, the government could be said to have discriminated against British firms by offering foreign MNCs financial supports not available to local capital. The British state cannot be said to have supported national champions.¹⁰

The state's energies have instead been focused upon fostering 'collaboration between firms and other institutions in networks and clusters to develop skills and market technological-complex products' (DTI cited in Wren, 2001: 850). In practical terms this has meant actively encouraging the development of innovative collaborative intra-firm linkages and networks encompassing market actors and non-market institutions (particularly universities).¹¹ The second key pillar of contemporary UK industrial policy that has run parallel with this focus on networks is an increasing concern with information dissemination rather than direct material supports. In 2000 the British state established the Small Business Support Service, to provide small firms with advisory and technological rather than direct financial support. A key component of official SME policy is also the fostering of the development of inter-SME networks/innovation clusters (*ibid.*).

The organisation of public services

Many of the key issues relating to the organisation of public services within neo-liberal states have already been highlighted in the section on the privatisation of common property in Chapter 2. Three key points are, however, worth reiterating. First, through privatisation there has been a clear redefinition of the contours of the state and the transformation of key activities from the public to the private sector. Although the distinction between private and public is not unproblematic given the existence of extensive systems of official regulation, there remains a palpable sense in which in the neo-liberal state seeks to transform the provision of power, clean water and so on from essential services to be provided by the state into commodities to be traded on the market. The second key point regarding the provision of public services is that the neo-liberal project is compatible with falling, stable or rising public spending as it involves not just a redefinition of the contours of the state but a transformation in the nature of the 'public sector'. The provision of key social services may well continue to be funded by the state but by outsourcing their delivery to private agents the state effectively transforms the public sector into a space for capitalist accumulation. The failure to understand the processes through which public spending is being transformed has serious analytical consequences. Sceptics of the claim that globalisation is transforming the state and that a global neo-liberal revolution is taking place frequently point out that we are not witnessing a 'race to the bottom' in terms of levels of government spending and social provision (see for instance Hobson, 2003). However, if the arguments advanced in this monograph stand up to scrutiny the value of this analysis is compromised by the fact that

contemporary neo-liberalism seeks to transform, not reduce, levels of public spending.

The need to engage in qualitative as well as quantitative analysis of changes in levels of state spending is particularly clear when we study systems of welfare provision and labour market regulation. It is to the question of social policy we now turn.

Labour market regulation

The reproduction and the control of wage labour is fundamental to the functioning of any capitalist political economy. Any serious analysis of the neo-liberal state must, therefore, analyse the distinctive features of how this state seeks to regulate labour markets and ensure the continued subordination of labour to capital. We must, nevertheless, proceed with a certain degree of caution in setting out a neo-liberal model of labour market regulation. It is much more difficult to escape from path-dependency in the area of labour market regulation than in other policy areas. States such as Korea have, we would argue, demonstrated that it is possible for capable and relatively autonomous states to systematically redesign systems of financial regulation, corporate governance and utilities regulation in the space of a few years. It is more difficult to find evidence of a complete break with the past when we study welfare and labour market reform. Nevertheless, over the last 30 years different national welfare/labour market restructuring programmes have shared a certain focus on promoting ‘flexibility’, transferring wealth from labour to capital and transforming welfare systems into tools for promoting international competitiveness – characteristics that allow us to meaningfully discuss the development of a neo-liberal model of labour regulation that is becoming increasingly dominant throughout the world.

We would argue that careful analysis of the content of national restructuring processes and the ‘blueprints’ for the neo-liberal model of labour regulation, as set by institutions such as the OECD, allows us to highlight three essential defining features of neo-liberal labour market restructuring. First, when we analyse neo-liberal reform in key states such as the US and Britain we see a drive away from the collective regulation of wages towards the individualisation of the relationship between capital and labour (Bonefeld, 1993). Trade Unions are not necessarily subject to direct repression, especially when reform takes place within the context of capitalist democracy, but they are not regarded as legitimate co-ordinating agents to be afforded a secure institutionalised position within the structures of the state. In practice, however, there are complications. There are numerous cases, such as Germany and Korea, when states have sought to incorporate trade unions into the processes of reform in order to take advantage of their capacity to restrict wage growth (OECD, 2003b; Ulman *et al.*, 2005). A key defining feature of their incorporation is a fairly open desire to engineer a redistribution of wealth from labour to capital through severe wage restraint. As such the incorporation of trade unions is less of a mechanism of representation than a means through which labour participates in its own disempowerment.

Second, there is an emphasis within the neo-liberal literature and on the part of policymakers on promoting market disciplines/labour flexibility.¹² In practice this means making it relatively cheap for firms to dismiss employees who become surplus to requirements, allowing fairly unrestricted use of fixed contracts and effectively allowing the 'market' to determine pay and conditions free from intrusive intervention. This is not to say that neo-liberalism dictates that governments ought to abstain completely from regulating pay and conditions, simply that such intervention should be limited. The neo-liberal supranational organisations such as the OECD and World Bank's position on the establishment of minimum wages is indicative of the wider neo-liberal approach to labour market regulation. These institutions advocate the establishment of minimum wages that are set at a level low enough not to impede job creation. Minimum wages, and most other forms of labour regulation, are only justified as a response to the market power of employers and ought to attempt to simulate the outcomes that a perfectly competitive market would produce (World Bank, 1995; OECD, 2006b). This essential principle can be expanded to justify legislation to prevent racial or sexual discrimination: the state intervenes to correct for reactionary social attitudes and other market imperfections and mimics the perfectly competitive market. In practice, however, there is a consistent emphasis in the neo-liberal literature on the need to avoid creating rigidities which translates into the advocacy of minimum wages that are set at a low proportion of medium wages and limited controls over working hours. Of course this means that labour market regulation has a very limited positive impact on the material well-being of the poor.

Finally, social welfare systems are reconfigured so as to prioritise concerns about international competitiveness and to reinforce market disciplines (Jessop, 1993; 2002). In practical terms this means a shift away from passive forms of support for the unemployed that simply provide recipients with material support, to active labour market programmes that require the recipients of official support to participate in workfare and training programmes. Through these policies social support mechanisms become a means through which the labour force can be 'improved' and the structural competitiveness of the national economic space enhanced. In terms of the emphasis on active labour market support there are certain similarities between the neo-liberal welfare state and the classical social democratic Swedish welfare state. However, we should not overstate these continuities. Active labour market policies in post-war Sweden were a mechanism through which the state sought to guarantee Swedish workers that it would protect them from the scourge of long-term unemployment and provide them with a generous level of support when they were unemployed (Coates, 2000). The social democratic state sought to marry the concerns of social justice and international competitiveness; it did not subordinate the concerns of social justice to those of structural competitiveness. Active labour market policies in the neo-liberal state work quite differently. The state guarantees nothing more than the provision of a minimal level of material support. Recipients of benefit will engage in training, not because the state offers any insurance that participa-

tion in such training will lead to a longer-term improvement in their material situation but because their benefits will be withdrawn if they refuse to do so. Training may enhance the attractiveness of the claimant to capital. Whether or not the claimant gains long-term employment is critically dependent upon the vagaries of the market. Moreover, in a significant number of cases it is highly questionable whether training and workfare programmes actually afford participants the opportunity to learn new skills (Bonefeld, 1993; Lodemel and Trickey, 2002).¹³ In these cases programmes are best understood as a means of social control, of ensuring that standards of work discipline are maintained among the unemployed, and ultimately as a mechanism for ensuring that life is fairly unpleasant for the unemployed so that they are 'motivated' to find work. At the heart of the entire neo-liberal welfare model is the principle of forcing the unemployed to continuously demonstrate a commitment to reengage with the wage-labour nexus by taking any job available no matter what the pay and conditions may be. The balance between coercion and support is completely different in the neo-liberal and social democratic welfare systems.

It must be reiterated once again that even within different states that would commonly be regarded as neo-liberal the exact composition of systems of labour market regulation differs markedly. For example, it is certainly the case that British employees enjoy far higher levels of legal protection against dismissal than their US counterparts, largely as a result of EU legislation. Equally, in real terms the minimum wage in the UK is much higher than in the US (European Commission, 2006). The point must also be made that the neo-liberal mode of labour market regulation shares many common features with systems of regulation in quite different political economies. For example, in terms of its hostility to trade unions and emphasis on flexibility the neo-liberal model shares a great deal in common with the system of labour regulation that prevailed in Korea until the late 1980s. However, it is the combination of the three distinct features outlined above that makes the neo-liberal welfare regime relatively distinct. The Korean state did not use welfare as a means of enhancing the structural competitiveness of the economy and disciplining labour. Rather, it simply did not provide support for the unemployed

It must be stressed that in attempting to define a 'neo-liberal welfare model' we are not simply attempting to define particular actually existing welfare regimes. Rather, we are seeking to set out a model against which national systems and national reform efforts may be assessed. Throughout our attempts to construct a model we have been guided both by prevailing practices within those states (such as the UK, US and Australia) which are almost universally accepted as neo-liberal and the principles advanced by supranational institutions who play a critical role in promoting neo-liberal reform globally. The practice of synthesising an analysis based on an examination of both abstract principles and concrete practice is inelegant and intellectually problematic. However, the alternative of either ignoring practice or the importance of the principles of 'good governance' propagated by key neo-liberal supranational institutions is more problematic still.

Having established the key features of neo-liberal state form we are now in a position to consider the extent to which states globally conform to this model, whether we are witnessing a global convergence around a dominant neo-liberal model. It is important that we do so in order to properly contextualise and fully understand contemporary processes of restructuring in Korea. It is to this task we now turn.

Neo-liberal convergence and alternatives

Any attempt to assess the limits and the realities of the convergence of distinct national models of capitalism around a dominant neo-liberal model is faced with one critical problem. Given the existence of numerous national social formations and a range of policy areas it is possible to present an array of evidence to support any position we care to adopt within the convergence debate. Nevertheless, a careful consideration of evidence from key national political economies reveals that a global convergence around a neo-liberal capitalist model is taking place. How tight that convergence is likely to be is another matter and a question to which we offer no definitive answer. While it is easy to identify key points of divergence between distinct national political economies it is much harder to contest the argument that different national restructuring programmes share certain common neo-liberal objectives and that the direction of movement is the same.

In terms of monetary policy in state after state we have seen the passage of legislation to enhance CBI and to create strict rules-based anti-inflationary regimes. In addition to the creation of a neo-liberal central bank par excellence in the Euro zone area in 1999, we have also seen moves since the late 1980s to create neo-liberal autonomous central banks that are accountable to strict inflationary targets in the UK, New Zealand, Sweden, Japan and numerous countries outside of the core capitalist world. By 2005 the only developed capitalist economies that had central banks that were clearly under the direct control of politicians were Australia and Norway (Bernhard, 2005).¹⁴

In every major economy in the developed world we have seen a comprehensive overhaul in systems of financial regulation. This fact can be illustrated by focusing on developments in Japan, a state that is universally regarded as a global laggard in terms of financial reform. The point is that even in Japan the changes in systems of financial regulation constitute a revolution and a paradigmatic shift towards neo-liberalism if we take account of the starting point. The Japanese ‘Big Bang’ in the late 1990s largely abolished the legal barriers separating different financial markets and removed restrictions on price competition in key markets. Particularly significant was the full liberalisation of brokerage commissions in 2000. Such development must be placed in the context of gradually, but consistently, rising foreign participation in the Japanese financial system (Malcolm, 2001). Furthermore, the situation is not static. In 2006 the government passed legislation to privatise the Japanese Post Office. The importance of this cannot be overestimated. Japanese Post is the world’s largest finan-

cial institution and controls \$3 trillion of financial resources, 15 per cent of total household assets (*Financial Times*, 2005). Reform in Japan may be slow, and the process as yet incomplete, but the direction of change is clear.

When we turn our attention to corporate governance we see equally strong evidence of at least limited global neo-liberal convergence. The Nippo-Rhenish model of corporate governance, which is based less upon market disciplines than the development of stable long-term relationships between firms and monitoring agents (banks), has been in crisis since the early 1990s. As the German and Japanese economies stagnated policymakers in both countries reformed the legal/institutional frameworks of corporate governance. The new German Raising of Equity Relief Act that was passed in 1998 required listed corporations to adopt internationally recognised accounting standards and strengthened the rights of minority shareholders (Goergen *et al.*, 2004: 23). Legislation that had sought to limit the influence of capital markets on firm governance, such as unequal voting rights, was abolished and the tax system was reformed in order to foster the development of an active capital market capable of disciplining management. Together with changes in the laws pertaining to mergers and acquisitions that, while not unambiguous, create a tangible threat of hostile takeover, these reforms represent a very clear break with the past. Finally, the Corporate Sector Supervisory and Transparency Act of 1998 makes it clear that the duty of management is to maximise shareholder value not, as had previously been the case, to serve the interests of the myriad of different stakeholders (Beyer and Hoppner, 2003).

The same processes of reform are visible in Japan. Japanese accounting systems have been brought into line with global norms, transparency has been enhanced and government regulation of the accounting industry has been tightened (Patrick, 2004). At the same time the costs shareholders incur by bringing derivative suits against management has been reduced, the role of external directors has been enhanced and the market for mergers and acquisitions (M&A) has been liberalised (Milhaupt, 2005). As in the German case the clear explicit purpose of these reforms is to subject management to the disciplines of the market and to force them to maximise shareholder value.

The changes in national systems of corporate governance can appear reasonably modest when we compare them to the reorganisation of public services globally that has taken place since the late 1970s. Almost every country in the world has instigated a major privatisation programme that transferred key economic activities from the state sector to the private sector (OECD, 1996a). Furthermore, there is also a strong global trend towards the marketisation of the provision of those public services that continue to be funded through taxation. Taking the example of urban waste management we have seen privatisation not just in the EU and the US but also as a process of creeping 'marketisation' in large parts of Africa and Asia (Davies, 2002). In key markets such as France, North America and the UK private firms already dominate the waste disposal business. In other markets, such as Germany where private firms accounted for 40 per cent of total business in 2001, the private sector is likely to become

dominant as clear plans for enhanced marketisation are enacted (*ibid.*: 20). As we have already made clear in Chapter 2 similar processes of marketisation can be seen in national health care systems and other areas of service provision in key states, although the pace of reform varies markedly between different sectors and states.

It is more difficult to assess the extent of convergence around neo-liberal norms in terms of both the reform of systems of regulatory policymaking and industrial policy without exploring the interstices of the national political economies in question.¹⁵ Nevertheless, there are a number of salient points that can be made regarding reform in these areas. In terms of industrial policy it is important to highlight the deep hostility of the contemporary global trade regime to 'traditional' forms of industrial policy aimed at developing national champions and the problems that this regime poses for such policies (Bora *et al.*, 2000; Rodrik, 2004). If a state chooses to subsidise a troubled national champion it is not simply a domestic matter. To a degree states may bypass these controls through hidden subventions, the extent of which is impossible to ascertain given that they are hidden, however the constraints that the WTO places on conventional industrial policy are considerable. While it remains difficult to assess the extent to which key states attempt to protect major firms from collapse the evidence is much clearer regarding states' attitude to foreign takeover of leading national champions. Even Japan, which has historically been extremely hostile to foreign investment, has allowed foreign MNCs to purchase key national champions. The Japanese state's move towards allowing foreign investors to gain at least partial control over 'national champions' is clearest in the car industry where Renault has purchased a 36.8 per cent stake in Nissan, Japan's second largest car manufacturer, and Daimler-Chrysler has purchased a 34 per cent stake in Mitsubishi, Japan's fourth largest car manufacturer (Dicken, 2003: 375).

In terms of the reform of regulatory policymaking frameworks, when we read policy documents from a variety of national contexts we see the same policy themes recurring repeatedly. We see a consistent emphasis upon transparency, formalisation and the use of regulatory impact analysis. How these policy themes actually translate in practice varies markedly in different national contexts. For example, France's efforts are judged as being particular poor and the OECD (2004a: 98) concludes rather frankly that 'attempts to introduce regulatory impact analysis have failed'. Despite the mixed results of attempts to reform regulatory structures developments in this policy area do not necessarily support the argument that different models of capitalism remain viable and will continue to exist in the long-term. The situation is dynamic. Ideationally the hegemony of neo-liberal norms is complete. Indeed, the principles that regulation ought to be made by agencies that are autonomous from political control and that strict cost-benefit analysis ought to be used in justifying regulation are not even conceived of as being neo-liberal norms. Rather, they are presented simply as the good sense that dominates policy discourse. The fact that reform has not yet been universally successful in achieving its stated goals neither indicates a lack of commitment by state elites to reform nor suggests such

reform will not be successful in the future. If we take the case of France where reform is understood to have been most disappointing we do not see any clear alternative solutions to slow growth and high unemployment, being articulated by the major political parties other than further liberalisation. Furthermore, the fact that states may fail to successfully redefine themselves as neo-liberal states while their relative significance as centres of accumulation in the global economy declines does nothing to demonstrate the long-term viability of non neo-liberal capitalist models of development. Although it may well be possible that the processes of reform of regulatory structures in certain key states will continue to stagnate the overall experience of reform in core capitalist states suggests that at least piecemeal advance is more likely.

Given the explicitly normative focus of much of the analysis that supports the idea that it remains possible and desirable to construct capitalist alternatives to neo-liberalism, and the serious negative social impact of neo-liberal reform, it is necessary to pay particular attention to the viability of different forms of labour/social regulation. Ultimately if any alternative is to be judged as relatively progressive it must devise mechanisms of avoiding the serious increases in inequality that neo-liberalism has generated. We would argue that the focus of advocates of alternative models of capitalism on enhancing competitiveness renders capitalist alternatives to neo-liberalism unable to address the inequality between capital and labour (see Radice, 2000 for a critique of the progressive competitiveness thesis). As advocates of the 'progressive competitiveness' thesis themselves are keen to highlight, international competitiveness demands high levels of investment, and thus high profitability (Hutton, 1996; Weiss, 1998).¹⁶ The guilty half-secret this argument rests upon is that sustained increases in profitability require that labour's share of national income be constrained. So ultimately any egalitarian redistribution must be intra not inter class. The more affluent sections of wage labour must redistribute to the poor if the full negative consequences associated with competitiveness in the neo-liberal model are to be avoided.

Over the last two and a half decades we have seen malaise and crisis in those states that have traditionally sought to achieve an equitable intra-working class distribution of income through highly institutionalised solidaristic wage bargaining arrangements and high levels of social spending. As has been well documented the German 'social market' model has been in crisis for the best part of two decades. Highly institutionalised consensual wage bargaining structures have proven unable to deliver the flexibility and cost savings that internationalising German capital requires to justify domestic over foreign investments. At the same time, rising unemployment has created massive fiscal pressures on the welfare state. The German state has responded to these pressures by significantly reducing welfare benefits, liberalising labour markets and demanding that trade unions impose savage wage restraint upon their members (German Federal Government, 2004).¹⁷

The Swedish case would at first glance appear to offer more support for the progressive competitiveness thesis. A cursory examination of the Swedish

political economy would suggest that Sweden has succeeded in creating a dynamic national capitalism without embracing full-blown neo-liberal reform. When we scratch beneath the surface, however, the picture is more complex. The restructuring of the economy in the 1980s and 1990s left much of the old system of highly institutionalised solidaristic collective determination in ruins. As Coates argues, internationalising Swedish capital increasingly perceives its prospects as being 'de-linked' from the overall vitality of the national economy and is increasingly unwillingly to endure the costs associated with participation in key corporatist wage setting forums given the existence of a viable exit option (Coates, 2000: 100–1).

Internationalisation also destroyed the basic economic logic underpinning the model. In a discrete national economy it was assumed that wage restraint by core workers would lead to higher profits and investment in high productivity sectors. As solidaristic wage policies forced business in low productivity sectors (who were effectively forced to pay workers more than they produced) to close they would be reemployed in the expanding high productivity sectors (*ibid.*: 96–101). However, in an internationalising economy it could not be assumed that the high profits which leading firms enjoyed would be reemployed in the domestic economy.

As corporatist labour market institutions broke down capital has sought to exploit the weakest sections of society in order to improve competitiveness. Gini coefficient increased by 25 per cent between the mid 1980s and the mid 1990s (Kenworthy and Pontusson, 2002). At the same time, we have seen the normalisation of unemployment as governments have come, at least implicitly, to see the maintenance of rates of unemployment in excess of 5 per cent as acceptable. Rather than supporting the progressive competitiveness thesis the Swedish case illustrates how the dictates of international competitiveness in the contemporary era place intense pressure on embedded systems of intra-class redistribution.

In contrast to the rather limited evidence supporting the argument that various forms of 'social' capitalism remain viable in the contemporary world the evidence that, in certain circumstances, brutal neo-liberal restructuring can significantly enhance national competitiveness is overwhelming. The most economically successful states in the developed world (Australia, the UK and US) are among those states that have pursued neo-liberal reform with the greatest vigour (OECD, 2004c).¹⁸ There is an unfortunate tendency on the part of non-Marxist progressive political economists to consistently underestimate the strength of neo-liberal economies and to deny the capacity of neo-liberal reform to create the conditions for sustained accumulation. A proper critique of neo-liberal capitalism is not possible if we allow the normative to proceed the analytical.

Ultimately a capitalist alternative to neo-liberalism is not feasible in the contemporary global economy. Wherever we look the direction of change is clear. Whatever their complexities and limits all national reform efforts over the last two decades have sought to create economies which conform more closely to the neo-liberal model outlined in this chapter. Furthermore, such processes

cannot simply be explained with reference to domestic politics. A focus on domestic politics is feasible in individual cases but cannot explain why national political economies with quite different political and social traditions have followed similar paths of economic reform.

Reforms in each of the individual policy areas detailed above must be understood in relation to changes in the composition of the global market. The growing need to maintain confidence of global financial markets in national currencies has driven processes of CBI. The desire of key states to secure the competitiveness of national financial centres has structured the development of national systems of financial regulation. Reform of corporate governance has, at least in part, been driven by the requirements of major 'national' firms seeking to raise funds on international markets. The marketisation of the state cannot be understood outside of the serious problems that global capitalism has faced since the 1970s and the need to open new arenas for private accumulation. National processes of regulatory reform are explicitly informed by the need to improve the attractiveness of the national operating environment to transnational capital. In summary in order to understand the global rise of neo-liberalism we must understand how changes in the composition of the world market and more particularly how the shift in the locus of production and finance to the supra-national level has undermined other more 'controlled' stat-based capitalisms.¹⁹ Global neo-liberal convergence is developing as a result of different national policymakers' attempts to secure the competitiveness of their respective economic spaces in a rapidly evolving global economy; a global economy whose evolution can only be properly understood within the context of the structural crisis of global capitalism which became apparent in the 1970s. As such global neo-liberal convergence must be understood as a product of the logics of capitalism itself, not simply the agency of policymakers

While the construction of a capitalist alternative to neo-liberalism is pure fantasy it is imperative that we devise an alternative to neo-liberalism if we are concerned with inequality and human emancipation. In terms of its social impact neo-liberalism is perhaps best described as an uneven disaster. Many neo-liberal restructuring programmes have failed to generate economic growth. In these situations the compound effects of crisis and marketisation have been predictably disastrous. However, even in those cases where reform has been at least a qualified success in macroeconomic terms income inequality has increased markedly. For example, in Mexico Gini coefficient increased from 0.43 in 1984 to 0.55 in 2000 (Cortes and Rubalcava, 1992; World Bank, 2005: 259). The increase in inequality has not been confined to the developing world and US Gini coefficient increased from 0.39 in 1970 to 0.46 in 2000.²⁰ The increase in inequality should not be understood as a contingent or regrettable outcome. Rather, it must be understood as an integral part of the neo-liberal project, as part of the process of redistributing wealth from the working class to capital through the creation of new insecurities and inequalities.²¹

Income inequality is less severe in other core capitalist neo-liberal states than in the US. In Britain Gini coefficient (after the redistributive effects of taxes and

benefits are accounted for) was 0.32 in 2004 and there has been no clear upward trend in levels of inequality in Britain since the early 1990s. However, in order to place this figure in context we must take into account the fact that levels of inequality in the UK were relatively low in Britain prior to the pursuit of full-blooded neo-liberal reform, in 1980 UK Gini coefficient stood at 0.28.²² Wherever we care to look neo-liberal reform has led to an increase in economic inequality. The scale of inequalities the project generates is mediated, however, by the political traditions and established social structures of the particular national economies in question. The significance of differences between individual national neo-liberal states in generating or ameliorating acute poverty should not be underestimated.

The necessary alternative to neo-liberalism is not another form of capitalist development but rather the rejection of the imperatives of capitalism. Rather than seek to promote alternative models of capitalism with a capacity to 'out compete' neo-liberalism (as Ruigrok and Tulder (1995), Weiss (1998), etc. do.) we must challenge the necessity and desirability of competing on international markets and the value of further economic growth. An entirely new economic system must be brought into being based upon democratic control of the economy and a deep respect for the fragile global ecosystem.

Conclusion

Over the course of this chapter we have sought to do two things. The first is to define the key characteristics of the neo-liberal state. Although this discussion may seem overly long and abstract within the context of a study of the Korean political economy it is indispensable. In countless articles we see the term 'neo-liberalism' employed consistently without any real attempt being made to define the term. It is simply nonsensical, however, to discuss the development of the neo-liberal state in Korea without first establishing what this term actually means. The second purpose of this chapter has been to analyse the extent of global convergence around the dominant neo-liberal model and the possibilities of constructing alternatives. Again this analysis relates directly to the central argument of the monograph concerning the transformation of the Korean state. It is important to understand how neo-liberal reform in Korea is part of a global process of state restructuring linked to changes in the composition of the global market. In pursuing neo-liberal reform Korea is conforming to a global norm. What is exceptional in the Korean case is the speed with which reform has been affected since 1997 and the clarity of the break with the past. Before we analyse the shift from a developmental to a neo-liberal state in Korea it is necessary to establish a firm understanding of the nature of the classical Korean developmental state as it operated in the 1960s and 1970s. It is to this task we now turn.

4 Ontology of a miracle

The transformation in the fortunes of the Korean economy that took place in the 1960s was, on a highly intuitive level, miraculous. The Korea of the early 1960s was, in many respects, a paradigmatic example of ‘Asian despotism’ (Said, 1985). The government was corrupt, the economy was underdeveloped, and no bourgeoisie worthy of the name existed. By the end of the decade Korea clearly had a government both capable of and committed to promoting economic growth. While the country was still relatively poor, a wholesale shift in the structure of economic organisation was clearly underway: industrial and export growth averaged 18.4 per cent and 27.75 per cent, respectively, between 1962 and 1970 (Hart-Landsberg, 1993). Nevertheless, Korea’s economic transformation was clearly not a miracle in the strict sense of the term. As the Collins English Dictionary informs us, a miracle is an ‘event that is contrary to the established laws of nature and attributable to a supernatural cause’. Korea’s rapid growth, on the other hand, clearly had very earthly rather than supernatural origins. It is with the conditions that gave rise to and sustained the long boom of the 1960s and 1970s that this chapter is concerned.

In order to unravel the complexities of the Korean political economy this chapter is organised three parts. The first focuses on the processes and historical legacies that created conditions conducive to the emergence of a strong autonomous growth-oriented state in Korea in the early 1960s. We shall also examine the essential continuities and discontinuities in the process of state formation and development within Korea. The second analyses the role the US and Japanese states played in shaping how Korea came to be integrated into the regional and global division of labour in the 1960s and 1970s. Against this context, the third section of the chapter focuses on how the Korean developmental state actually functioned in practice – the precise nature of its relationship with domestic classes.

The birth of a tiger: Japanese imperialism, Syungman Rhee and US power

If the history of Korea as written by pro-President Park sycophants is to be believed, prior to the 1961 coup Korea simply stagnated.¹ According to this

reading of Korean history, the key event that transformed the fortunes of the Korean economy was the rise to power of the strong, autonomous, growth-oriented Park regime. The 1975 Korean Development Institute report on the history of the Korean economy is indicative of this approach, to quote: 'It was the third republic that made the 1960s the decade of development, and marked the turning point in the history of Korean modernisation' (cited in Lie, 1998: 43). This report is representative of a much wider body of literature that emphasises the incompetence and the negative legacies of the Rhee regime and largely ignores the importance of Japanese colonialism in creating the foundations for the developmental state. Typical of this approach is Steinberg (1989: 54):

The legacies of the Rhee period were not enviable, autocratic leadership ... lack of economic management – indeed, almost no interest – from the top; a record of extreme corruption.

Elsewhere in the literature we see constant references to the fact that South Korea lagged behind the north, that Rhee lacked a 'well articulated growth strategy', to the 'economic chaos' which existed, and the government's 'mendicant mentality' (Song, 1990: 89; Clifford, 1998: 31). Although much, but not all, of this analysis is factually correct, we feel it largely misses the point. The importance of the Rhee regime, and the Japanese colonial regime before it, in establishing foundations for growth lies not in their macroeconomic achievements (and there were achievements), or the changes in the structures of the economy they induced, but in the state structures they created.

Any study of the post-1961 Korean developmental state must begin by examining the nature of Japanese imperialism in general and the particular form that Japanese imperialism took in Korea. Japanese imperialism differed from its Western counterpart in several fundamental respects. Japan always sought to exercise a more intensive form of control over its colonies than the European powers and to more fully integrate its colonies into its own economic structures. This reflected both the logics of parallel colonialism and the nature of the Japanese political economy itself. The geographical and cultural proximity of Japan's colonies made it possible for Japan to fully integrate them into its own economic structures; the nature of the Japanese political economy ensured that the state would take a prominent role in every stage of this integration. Domestically, the Japanese state had not confined itself to creating the key components of a capitalist economy, then stepped back in order to allow the economy to develop 'organically'. Rather the state pursued highly interventionist financial and industrial policies in order to ensure that capital flowed to strategically important industries and firms (Francks, 1992). Although clear parallels exist between the Japanese state and Western European 'late developers' such as Germany, the Japanese state was relatively more backward when it launched its great development drive in the mid-nineteenth century and was even less politically and economically liberal than these European states (Fischer, 1997). Given the role that the Japanese state played within the domestic economy, it is unsurprising

that the Japanese colonial state took a far more prominent role in shaping, not just establishing, the necessary preconditions for capitalist development in its colonies than any of its European counterparts.² The Japanese colonial project required the construction not only of colonial states capable of playing a prominent economic role but also of pervasive security/policing networks to support state-led accumulation. It was in Korea, the most important and closest of Japan's colonies, that this state capitalist colonial project took its most intense form (Cumings, 1979; 1997; Woo, 1991; Kohli, 1999).

By the end of the 1930s, Korea's economic structures were very far from those we would expect to find in a classic underdeveloped colony. Korea was being integrated into the Japanese economic bloc as an important site of industrial production, not as an export-oriented monoculture economy – this particular privilege being reserved for Manchuria. Throughout the 1930s the annual rate of industrial growth in Korea averaged 15 per cent. By 1943, almost 1.3 million Koreans were employed in manufacturing and industrial production accounted for 40 per cent of total economic output (Kohli, 1999). As Cumings (1979) argues, Korea was taking on the characteristics of a semi-peripheral rather than a peripheral economy.

What is most important, from our perspective, is not simply that industrialisation took place in colonial Korea but the role that the strong interventionist state played in this process. In order to facilitate economic exploitation and political control the Japanese constructed a highly repressive, efficient, modern state in Korea. The key characteristic that set the Korean colonial state apart from its counterparts elsewhere in the world was its sheer size. By 1940 the Korean civil service numbered over 100,000 and the police force over 60,000 (Cumings, 1997; Kohli, 1999). To put these figures in context, the key administrative organs of British rule in India, the Indian Civil Service and the Indian Office, collectively employed less than 2,000 career civil servants on the eve of decolonisation (Cain and Hopkins, 1993; Evans, 1995). The colonial state in Korea exercised an exceptionally extensive and highly intensive form of control over all aspects of social and economic life. The parallels between the colonial state and the developmental state that later emerged are striking. Both states ruthlessly exploited labour and directly intervened in the process of accumulation through both the discretionary allocation of credit and direct subsidies to large industrial capital. What caused history to repeat itself in this manner was not simply chance or conscious emulation but the structural legacies of Japanese colonialism (Woo, 1991).

While the productive capacity created by the Japanese industrialisation effort was largely destroyed in the Korean War, colonial industrialisation, nevertheless, left a deep imprint on the Korean political economy. Two related but distinct points can be made in this regard. First, the modern Korean state clearly bore the hallmarks of its colonial origins. The very first actions of the US following the surrender of Japanese forces in the southern part of Korea in 1945 was to begin to resuscitate the instruments of Japanese rule in order to restore 'the rule of law', to quote Hart-Landsberg (1993: 123–4):

To carry out its strategy, U.S. policymakers found it useful to breathe new life into the old institutions of Japanese colonial rule. . . . For example, the U.S. military government restored the Japanese colonial police force, recruiting for duty the very same Koreans. As under Japanese rule, the Korean National Police (KNP) was to operate as a highly centralized, national force, with local and provincial police responsible only to national police headquarters, and not local political officials. . . . The KNP trained at the same police academy the Japanese had established, wore the same uniforms, and used the same rifles.

The human and institutional legacies of Japanese colonialism played a key role in shaping the development of the modern Korean state. What confirmed the development of a strong, bureaucratic, hypermilitarised state in Korea, however, were the actions of the US. Not only did the US take the first steps towards reviving the institutions of colonialism but, by installing and supporting Rhee as Korean president, they ensured the process would continue long after direct US rule ended. Rhee, lacking ties to any group within Korean society and facing a population deeply hostile to his rule, sought to reconstruct the leviathan colonial state to augment his control over a hostile nation. The resources for this state building effort came almost exclusively from the US, which bankrolled the Rhee regime at the rate of \$1 billion a year throughout the early to middle 1950s. The modern post-colonial Korean state was in many respects no less an externally created structure than the colonial state it replaced. The state's 'fiscal base' was US aid, the first Korean president was a US placeman, and the new institutions were constructed around the old structures of the colonial state. From the very beginning the state stood some distance apart from Korean society and, despite Rhee's corrupt personal alliances with selected business groups, the state as a whole remained free from deeply embedded ties to any major social group throughout the 1950s.³ The Korean state's historically embedded autonomy made it a suitable vehicle for achieving industrial transformation. Moreover, the state's high level of autonomy was matched by an equally exceptional level of administrative capacity. In terms of its sheer size, its repressive capacity, and its level of penetration into all aspects of national life, the Korean state of 1961 could match anything the Japanese created. While numbers do not reveal the whole story, it is still useful to note that in 1961 the civil service and military had 240,000 and over 600,000 personnel respectively (Lie, 1998). It is true that the Korean bureaucracy was no model of Weberian efficiency, nevertheless, it was this bureaucracy upon which two decades of rapid state-led growth was based.

The second key feature of Japanese colonialism that left a permanent imprint on the Korean political economy was the very limited scope within it for any form of urban-based, dependent or comprador bourgeoisie to develop. While traditional rural elites were integrated into the Japanese colonial project, there was to be virtually no room for any involvement of native capital within the industrial sector of the economy.⁴ As Woo (1991: 66) argues, Japanese colonial-

ism led to the birth of capitalism without any significant indigenous bourgeoisie in Korea. While a bourgeoisie of sorts developed under the Rhee regime, it must be stressed how weak this pseudo-bourgeoisie in fact was. Deeply enmeshed in unproductive rent-seeking activity, the 'bourgeoisie' of the 1950s looked to the state itself as the principal source of accumulation. Entrepreneurial skill was of little importance in determining the success or failure of 'capitalists' under the Rhee regime; what mattered were political connections. If a capitalist proved to be a reliable political ally the state would provide, regardless of managerial or entrepreneurial abilities. Favoured businesspeople, with access to import licences, could make huge profits by simply exploiting differences between official and market prices. Additionally, the government simply gave old Japanese enterprises to selected businesspeople and extended the same businesspeople 'loans' that in hyperinflationary conditions amounted to little more than gifts that they were free to spend as they pleased. Most important of all, aid financed government procurement and infrastructure schemes offered selected firms exorbitant profits for doing very little badly. It was through these policies that the *chaebol* we know today first began to establish themselves (Amsden, 1989: 38–41; Woo, 1991: 68).

The principal logic that drove state policy towards capital was that of state building, not economic development. As with other aspects of Rhee's state building project, it was the US aid spigot that provided the resources necessary for such policies and prevented total economic collapse. The secular decline in US aid from 1958 onwards marked the beginning of the end of this model of state/business relations. Upon seizing power the Park regime set about fundamentally transforming the state's relationship with big business. The Park regime forced the bourgeoisie to become 'proper' capitalists, to produce and sell products relatively efficiently in order to survive and expand rather than simply to rely on government largesse. Although the state was to remain the main source of investment capital for another 20 years, after Park's coup access to official credit became dependent on firms' ability to meet economic/efficiency criteria, not simply exploit political connections (Woo, 1991; Cumings, 1997; Kong, 2000).

Neither the exceptional level of relative autonomy the post-1961 Korean state possessed, nor the particular development strategy the Park regime pursued, can be properly understood without first analysing the legacies of Japanese colonialism and the Rhee regime. It was the twin legacies of the strong hypermilitarised, repressive bureaucratic state and the exceptional weakness of the national bourgeoisie that created a conducive domestic environment for successful state-led capitalist development in 1960s Korea. Indeed, it is impossible to understand the historic mission of the Park regime to create a productive national bourgeoisie outside the context of the initial weakness of that class.

It must be stressed that the argument presented here in no way implies that the 1961 coup and the choices made by the leaders of that coup were unimportant in shaping the development of modern Korea. We simply reject the ultravoluntarist accounts of Korean development offered by Park's sycophants which

ignore the historically embedded structures that made certain choices feasible and others impracticable.

When studying the evolution of the modern Korean state we are initially confronted by a paradox. On the one hand, the manner in which the state was first created left a deep long-lasting impression on that state. Even the contemporary Korean neo-liberal state is clearly recognisable as the child of the colonial state the Japanese established. It is the same powerful bureaucracy whose roots lay in the colonial period and whose power was consolidated as part of Rhee's state building efforts which has played a key role in actively managing the processes of neo-liberal economic restructuring since 1997.

On the other hand, the state has shown a quite remarkable ability to transform itself first from a predatory state to a very effective instrument for promoting state-led capitalist development in the 1960s and then to a highly efficient neo-liberal regulatory state in the 1990s. This apparent paradox can be explained by the fact that the quasi-permanent features of the state, its autonomy and bureaucratic capacity, have afforded it a remarkable capacity to launch new economic projects and transform systems of social and economic regulation – to periodically reinvent itself. Despite an apparent decline in the Korean state's level of relative autonomy in the 1980s and 1990s, as a very small number of large conglomerates came to exercise a more extensive influence over the policy process, it would be overstating the case to argue that the major institutions of the Korean state were captured by private interests. Indeed, it would be impossible to explain the state's serious, but unsuccessful, attempts to force the *chaebol* to restructure in the early 1990s had the state simply come to act at the *chaebol*'s behest (see Chapter 5). Moreover, in addition to retaining a certain form of autonomy from the capitalist class the capacity of the Korean state to physically implement those policies to which it is fully committed has not seriously been questioned.⁵ In terms of levels of education, admission standards and general all-round competence the Korean bureaucracy compares favourably to the majority of its counterparts not only in the underdeveloped world but to many in the core capitalist world (Wade, 1990; Evans, 1995; Woo-Cumings, 2001: 361).

The high levels of both autonomy and capacity the state possesses have proved key to its ability to act as a 'collective capitalist', to commit itself to and effectively implement economic reforms necessary to secure Korea's future as a site of capitalist accumulation, often in the face of considerable opposition from the private sector. At critical political and economic conjectures, namely 1961 and 1997, the Korean state has proven to be a highly efficient instrument which newly ensconced reforming elites have used to transform existing economic arrangements. In these processes of economic restructuring the Korean state has effectively transformed itself. The very features of the Korean state which lay behind the success of the developmental state project are key to explaining the fact that contemporary Korea is a successful neo-liberal economy.

Our analysis of the state's transformative capacity must be qualified all the same by a recognition that Korean state managers themselves have sometimes been reluctant to undertake key reforms necessary to maintain and enhance

'national' competitiveness within a more deeply integrated global economy. As a result of both the success of autocratic state-led capitalist development in Korea and the outstanding capacity of the Korean bureaucracy to micromanage the economy in a relatively efficient manner, the state did prove reluctant to surrender control to, albeit regulated, markets. Nevertheless, this tendency can be greatly exaggerated. The Korean state did substantially liberalise the economy prior to the 1997 crisis. Moreover, the slow pace and incomplete nature of the pre-crisis liberalisation process primarily reflected acute material constraints rather than simple intransigence on the part of state bureaucrats; if state managers were reluctant to surrender control to the market it was because they had good reason to be reluctant. Furthermore, the state has enthusiastically embraced neo-liberal reform since the crisis.

We would argue that the growing commitment of the bureaucracy to neo-liberal reform, which may come as surprise to scholars who accept the continuous theory of the state advanced here, is a product of state elites' deep commitment to capitalist development. No major analyst would question the fact that since Park's coup, and the reorganisation of the upper echelons of the state that followed, the Korean bureaucracy has understood itself as being imbued with a 'historic mission' to transform Korea into an advanced capitalist economy. The development of comprehensive systems of official control over the economy in the 1960s and 1970s was not an end in itself. Rather, these systems must be understood as tools to allow the state to achieve its ultimate objective of transforming Korea into a core capitalist economy. Once the astute highly educated men who ran the key economic ministries came to recognise that the limits of state-led development were fast being approached they sought, at first somewhat reluctantly, to reform the economy in order to create the conditions necessary for Korea to continue its economic ascent. In a perfect world state managers may well have preferred state-led capitalist development to neo-liberal development. However, once it became clear that the choice such managers faced was actually between economic decline and neo-liberal reform, the former was simply not an option. We will examine the contemporary neo-liberal Korean state in some depth later. The remainder of this chapter is concerned with the evolution of the Korean economy in the 1960s and 1970s.

Before we can properly understand the precise nature of the Korean developmental state and its relationship with domestic social forces we must focus on the efforts of the incoming Park regime to create new external linkages to strengthen the economy and compensate for the decline in US aid. It is also important that we are fully aware of the key role that events in Southeast Asia played in opening up new opportunities for the Korean state and providing an initial impetus to the Park regime's industrialisation drive. It is to the key external relationship that shaped the evolution of the Korean state over the course of the 1960s and 1970s we now turn.

The Vietnam War, Japanese capital and Korean industrialisation

Between 1957 and 1961, US economic aid to Korea fell from \$382 million to \$192.8 million per annum (Woo, 1991: 80). It was principally this drop in aid that plunged the Korean economy into a severe recession in the late 1950s and effectively accounted for the demise of the Rhee and short-lived Chang regimes. By the time of Park's coup in 1961, the Korean economy was in a state of almost total collapse. Park's response to reduced US aid involved not only a radical transformation in domestic economic structures but vigorous political efforts – supported by the US – to attract new sources of foreign economic assistance and opportunities. These efforts culminated in the signing of a treaty normalising relations with Japan in 1965. Around the same time as this treaty was signed, events in Vietnam were conspiring to present an equally important source of opportunity for Korean policymakers. As US involvement in the Vietnam War escalated, Park, eager to prove Korea's worth as an ally, was quick to offer troops to assist in the anti-communist crusade, in return of course for considerable financial support from the US (Hart-Landsberg, 1993).

Both the resurrection of economic and political ties with Japan and the Vietnam War were to have a profound impact on the development of the Korean political economy. The impact of such events was two-fold: first, they provided an important short-term boost to the Korean economy when it was at its nadir. As part of the Normalisation Treaty, Japan provided Korea with soft loans and grants totalling \$800 million. The impact of the Vietnam War on the Korean economy was if anything more important, in the short-term, than the normalisation of relations with Japan. In total Korea made over \$1 billion as a direct result of the Vietnam War.⁶ It was these monies that were to fuel the industrial take-off that began in Korea in the mid-1960s (Lie, 1998).

The most important impact of both the Normalisation Treaty and the Vietnam War on the Korean political economy was not, however, the short-term macro-economic boost they provided but the role they were to play in determining how Korea came to be integrated into regional and global economic structures. It was during the mid to late 1960s that Korea first started to become a serious producer of industrial goods, a major exporter of low-value-added goods to the US, and an integral part of the Japanese-dominated regional division of labour. None of these closely related events can be understood outside the context of the Vietnam War or the normalisation of Korean–Japanese relations.

The Vietnam War provided both a conducive environment for Korean firms to penetrate the US market and a captive market in South Vietnam in which Korean firms could take their first steps as exporters of heavy industrial products. Between 1964 and 1968, Korean exports to the United States grew by a stunning 232 per cent (Hart-Landsberg, 1993: 172; Lie, 1998: 65). Such numbers represented not only the exchange of goods but also the construction of relationships between firms and individuals in Korea and the United States. It was the set of tangible human relationships constructed in the 1960s that were to

sustain ever-increasing levels of economic interaction between Korea and America over the next 30 years or so. Indeed, the contemporary Korean economy still bears the hallmarks of the trade links developed in the 1960s; Korean exports continue to be skewed very heavily towards the US. The Vietnam War facilitated this take-off in Korean-US trade by sparking a giddy inflationary import-inducing boom in the US and, more importantly, creating a favourable political climate within the US for Korean exports. As a direct result of Korea's military engagement in Vietnam, Korean goods were afforded preferential access to US markets. Korean imports constituted a tiny proportion of total US imports, at the time, and an open door policy towards Korean goods represented a relatively inexpensive gesture of thanks for the US to make towards its most loyal ally.

While of less quantitative importance than Korean exports to the US, Korea's exports to Vietnam were of equal qualitative importance in shaping the long-term development of the Korean political economy. As a *quid pro quo* for the troops sent to Vietnam, the US agreed to procure a large proportion of the items required to support the South Vietnamese government and the US troops stationed there from Korea. It was in this uncompetitive captive market that Korean firms first began exporting heavy industrial products in large quantities. South Vietnam accounted for 94.3 per cent of Korean steel exports, 51 per cent of transportation equipment exports, 40.8 per cent of non-electrical machinery exports, and 40.9 per cent of chemical exports (Woo, 1991: 95-6). The real value of these exports was not only monetary, but also in the foundations they helped to establish for the industrial deepening drive of the 1970s.

By focusing on the role of the Korean-US relationship in creating effective demand for Korean products, we reveal a great deal about one side of the growth equation. In order to complete this equation we must turn our attention to the supply side. Korea's position within the Cold War geo-political system offered it almost limitless exporting opportunities and access to a certain amount of capital through official loans and grants. The geo-politics of the Cold War alone, however, cannot explain why Korea was able to maintain such high rates of growth in its productive capacity over a period of almost two decades. As we argue in the next section of this chapter, in part, the answer to this question lies in understanding the nature of the Korean state itself, its effectiveness in channelling available capital to strategically important sectors while repressing wage growth. Nevertheless, in order to develop a fuller, more satisfactory, understanding of why Korea's productive capacity grew so rapidly, it is equally important to analyse how Korea came to be integrated into the Japanese-dominated regional division of labour following the signing of the Normalisation Treaty in 1965. Indeed, it is impossible to understand the form the Korean state took, and the role it played in the development process, without understanding how that state was shaped through its articulation within regional production networks (Cumings, 1979; Bernard and Ravenhill, 1995; Bernard, 1999; Gills, 2000).

The processes of Korea's re-integration into a Japanese-dominated regional economy proceeded with great speed in the period immediately following the

normalisation of Korean–Japanese relations. The principal mechanism through which this integration took place was inter-firm collaborative arrangements. It was through such arrangements that Korean firms gained access – at a price – to the technology necessary to sustain a prolonged period of rapid growth. These networks of production were vital in shaping the long-term development of the Korean economy. They allowed Japanese capital to shift the manufacture, but not the design or development, of mass (volume-based) products to Korean firms and instead focus on high-value-innovation-intensive activities.⁷ Such processes, paradoxically, acted both to assist Korea in improving its position within the global division of labour and to create constraints that would have to be overcome if Korea was to become a core capitalist economy. On the one hand, these linkages facilitated the transformation of Korea from a global mendicant to a major centre not only of labour-intensive light manufacturing but capital-intensive heavy industry. On the other hand, the close networks of inter-firm alliances between Korean and Japanese firms tended to lock Korean firms into relations of technological dependence with their Japanese allies. In so doing, they hampered Korean firms from graduating from volume-based mass production to higher-value-added activities. This is the dark side of regional productive alliances that ‘flying geese’ theorists, who assume that regional economic convergence will take place over time, are so keen to ignore.

It is, nevertheless, true that Korean firms (supported by the state) made considerable efforts to develop greater technological expertise, and that these efforts were not entirely futile. Unlike the Southeast Asian states, Korea did avoid falling into the trap of extreme technological dependence on Japan (Hatch and Yamamura, 1996). Moreover, according to Lall (1996), by the early 1990s Korean R&D expenditure was the highest, and its technological base the most developed, in the Third World. What Korea did not succeed in doing, however, was building firms with the capacity to develop cutting-edge, innovation-intensive products. Indeed, if the central arguments of this book concerning globalisation are correct, then by the 1980s in order to become major high tech producers ‘Korean firms’ would have to transform themselves into truly global firms (Evans, 1995; Ungson *et al.*, 1997; van Hoesel, 1999).

In this section we have completed the task of illustrating the global/regional context within which Korean state-led development took place. We have now drawn attention not only to the global political and economic structures within which Korea was situated but also to how Korea’s precise position within these structures created a conducive environment within Korea for rapid capitalist accumulation to take place. It is vital to study the broader regional and global context within which Korea was situated in the post-war period if we wish to develop a sophisticated, nuanced understanding of the Korean developmental state. Nevertheless, the majority of works on the developmental state pay, at best, rather cursory attention to how Korea’s integration into the global economy was shaped through its position within regional production structures and the Cold War geo-political system. More problematic still is the failure of even that analysis which is sensitive to the importance of regional production and security

structures in shaping Korea's integration into global economy to properly examine the nature of the global economic structures within which Korea was becoming articulated.

Having established both the concrete historical conditions out of which the Korean developmental state emerged and the environment within which that state developed we are now in a position to focus directly upon the developmental state itself and its relationship with domestic social classes. It is to this task we now turn.

Political repression, finance and the dynamics of state-led capitalist development

Immediately following the military coup of 1961, the government arrested 51 of Korea's leading businessmen. At one level this simply represented the politics of gesture; the businessmen involved were quickly fined and released. On another level, however, the military coup of 1961 did usher in a fundamental change in the state's relationship with private capital. From the very earliest days of his rule, Park demonstrated a strong commitment to transforming Korea into an advanced capitalist economy. In order to achieve this objective the state would do all in its power to both support and discipline private capital. From the perspective of the Korean bourgeoisie the developmental state was a Janus-faced creature. In certain respects the Korea of the 1960s and 1970s was a capitalist paradise. The Korean state showered favoured capitalists with cheap credit and proved ruthlessly effective at suppressing wage growth and maintaining discipline in the factories. In other respects, however, the Korea of this period was a nightmarish place to do business. Through its credit and licence allocation policies the government exercised a form of micro-level control over the Korean economy almost unique in the capitalist world. As a *quid pro quo* for extensive government support, business was expected to follow the state's orders to engage in unprofitable exporting activities and invest in difficult, but strategically important, sectors of the economy. The Korean state offered the bourgeoisie everything they could have possibly desired except freedom from intrusive state controls (Clifford, 1998). While a great deal of the literature rightly draws attention to important policy shifts that took place throughout the 1960s and 1970s we would highlight certain constants within the state's economic strategy.

The principal objectives of state policy throughout this period continued to be to develop both strong, internationally competitive, indigenous firms and a minimum level of industrial self-sufficiency.⁸ These objectives reflected both the demands of international economic competitiveness under conditions of the second industrial revolution and Park's own peculiar brand of economic nationalism. It must be stressed that in the 1960s systems of production were still principally organised on a national rather than the supranational level – although as we argue later in this chapter, trans-national inter-firm linkages were important in the post-war economy. Within this environment, national economic vitality was principally dependent on developing strong nationally based firms.

Equally important, for the nationalist Park, only by promoting domestic firms could Korea develop a measure of industrial self-sufficiency. For Park, the nation's security and his aspirations to create a powerful independent state rested upon Korea's ability to achieve self-sufficiency in certain key heavy industrial products. Park's favourite maxim of 'steel is national power' was not simply a mobilising slogan (Park cited in Clifford, 1998: 67). Rather it reflected his sincere belief that Korean national strength and independence depended on being self-sufficient in steel, chemicals, arms, ships, electronics and machinery. A minimal level of industrial self-sufficiency was an insurance policy against diplomatic or economic disaster; it was a guarantee that even if the US abandoned them, or the world economy entered depression, South Korea would survive (Woo, 1991).

In order to achieve these objectives, the Park regime implemented a comprehensive system of capitalist economic planning. Underpinning this system was the very strict control the state maintained over all forms of finance throughout the course of the Park regime. The government directly controlled the commercial banking sector, acted as a conduit for foreign loans and aid, and intervened extensively in the stock and security markets. An integral part of this strategy was the setting of artificially low interest rates in order to create conditions of acute credit shortage – without which official credit rationing would not have been an effective instrument of economic manipulation. Comparing the interest rates on 'official' commercial bank and unofficial curb market loans allows us to assess the level of price distortion within the Korean financial system. The difference between the two rates vacillated between about 20 per cent and 30 per cent between the mid-1960s and the end of the 1970s (Woo, 1991: 104; Rhee, 1994: 67). Moreover, especially favoured firms or projects were able to secure foreign and/or policy loans from the state, both of which carried an interest rate much lower than the official commercial rate. This system of financial control was reinforced by systems of direct subsidy, licence allocation and arbitrary political intervention – that in the final instance included the outright confiscation of assets (Hart-Landsberg, 1993; Woo-Cumings, 1999a).

The state used this elaborate system of dirigiste controls to effect a thorough transformation in the nature of the economy and society. The achievements of the developmental state in transforming Korea's industrial structures can hardly be overstated. Over the course of the 1960s the state, by offering financial support for manufacturing and shutting down the lucrative rent-seeking activities detailed in section one of this chapter, succeeded in transforming the Korean bourgeoisie from a class deeply immersed in commercial rent-seeking activities to one largely engaged in productive industrial activity. If firms met certain reasonably objective efficiency criteria and paid the appropriate bribes they would receive credit. Critically it was no longer sufficient for firms to simply pay bribes in order to secure favours from the state. Such policies were integral to the achievement of average annual rates of output and export growth of 9.6 per cent and 42.1 per cent respectively between 1963 and 1970 (Amsden, 1989: 56). To place these figures in context, despite massive US aid, the Korean

economy had grown by an average of only 4.5 per cent per annum between 1953 and 1962 (Woo, 1991: 46).

The achievements of the Korean state in the 1960s, however, appear modest in comparison to the results of the 1970s state-led industrial deepening drive. Over the course of the decade, the state transformed Korea from an economy based primarily on labour-intensive light manufacturing to a major global producer of capital-intensive goods such as steel, chemicals, ships and arms. What made this achievement all the more remarkable was that the Korean bourgeoisie themselves initially regarded the state's plan as a quixotic dream and showed an extreme reluctance to invest in heavy and chemical industries. Given the range of instruments that the state had at its disposal, it was no surprise that it was able to induce certain investments into the sectors it chose. In the final instance the Korean state could, given its control of credit and the fact that most firms were technically insolvent, bankrupt any firm which refused to cooperate. The real challenge lay in ensuring that capital was an enthusiastic rather than a reluctant participant in the industrial deepening drive. The development of a robust heavy industrial base in Korea required that a section of capital come to view heavy industrial as its principal activity, not something that it was required to do by the state in order to make profits elsewhere. Not only did the Korean state succeed in creating a group of large firms whose principal activities revolved around heavy industry, but also by 1980 a number of these firms had developed into major players in the key industries of the second industrial revolution.

This transformation in the nature of individual firms was reflected in national economic statistics. It is useful to briefly outline the macroeconomic achievements of the heavy and chemical industrialisation drive because they give a good impression of the scale of the overall structural change that took place within the Korean corporate sector. The share of heavy and chemical industry in total manufacturing rose from 40.5 per cent in 1971 to 54.9 per cent in 1979. Moreover, the share of heavy industrial exports in total exports rose from a meagre 13.7 per cent in 1971 to an impressive 37.7 per cent in 1979. What made this growth in the relative importance of heavy industry within the Korean economy all the more impressive was that the economy and exports as a whole grew by 9.57 per cent and 39.1 per cent per annum, respectively, over the same period (Amsden, 1989: 56–8).

Analysis of how the state effected such a profound change in economic structures is important for two reasons. First, it reveals a great deal about the complex and dynamic nature of the relationship between the developmental state and capital. And second, it was through the state-led process of industrial deepening that the corporate structures that were to remain essentially unchanged until the crisis of 1997 were formed. It is important to stress that the Korean state largely developed willing capitalist partners in the industrial deepening programme not through corporatist ties with capitalists in general but through personal ties with selected 'large' conglomerates. Small and medium-sized enterprises were to play little or no role in heavy industrialisation. The state was able to secure the enthusiastic support of selected capitalists by the mid-1970s through massive

investment in developing supporting infrastructure and by, almost literally, giving them every last *won* it had.

The state systematically starved other sectors of the economy of capital and repressed consumption in order to ensure a massive flow of resources to heavy industry. In 1978 heavy and chemical industry accounted for only 48 per cent of total value added in manufacturing but claimed a prodigious 59.5 per cent of total domestic loans to the manufacturing sector (Rhee, 1994: 73). In addition to providing enormous amounts of cheap credit to selected heavy industrial firms, the state exempted heavy and chemical industries from taxation. Massive foreign borrowing complemented this vast mobilisation of domestic resources. Between 1976 and 1980, \$4.66 billion of state-guaranteed foreign loans were pumped into selected ventures within the heavy industry sector. Over the same period total foreign loans to light manufacturing amounted to just over \$1.1 billion. Even these figures grossly underestimate the quantity of foreign loans directed towards the industrial deepening drive, as they exclude the huge public overseas borrowing that funded the development of the infrastructure heavy industry required (Woo, 1991: 133).

The most important consequence of this vast state-directed mobilisation of capital was not the transformation in the sectoral structure of the Korean economy it achieved but the resulting changes in the nature of the state's relationship with capital and Korean capital itself. It was within the processes of industrial deepening that the state relationship with the *chaebol* took a 'symbiotic' form and that these firms developed into the industrial monoliths with which students of modern Korean are so familiar. The Park regime had from the very beginning sought to maintain close relationships with those firms it believed were capable of achieving international competitiveness. Not unreasonably given the prevailing global industrial structures, the state largely equated internationally competitiveness with size and privileged large firms over small. On one level, therefore, there was a clear continuity in the state's relationship with *haute* capital between the 1960s and 1970s. Nevertheless, there clearly was a very important quantitative and qualitative shift in the nature of the state's relationship with the *chaebol* in the 1970s.

The state's economic policy throughout the industrial deepening drive focused almost exclusively on promoting the growth of a handful of large *chaebol*, on whose success the state perceived the future reproduction and development of Korean capitalism to depend. Close personal relationships between large capital and leading policymakers largely superseded the institutional mechanisms of state-capital co-ordination that had developed in the 1960s. The fortunate few *chaebol* chosen by the state to lead Korea's drive towards industrialised nation status came to enjoy both easy access to credit and unprecedented influence within the policy process. State managers, however, were not simply the passive recipients of the *chaebol*'s demands, and they sought to maintain an extensive and intensive set of controls over the behaviour of large capital. In the absence of effective market disciplines, due to soft-budget constraints and import prohibition, the state took responsibility for tackling problems of 'over-

competition', ensuring that the *chaebol* operated with a minimum level of efficiency, and met certain output and export targets (Chang, 1996).

The material basis for this symbiotic relationship between *haute* capital and the state is to be found in the nature of the industries of the second industrial revolution, and the particular set of problems and opportunities developing such industries presented for Korea. The most obvious point that must be made with regard to the industries of the second industrial revolution is that the minimum efficient scale of production and the level of R&D spending necessary to remain competitive in such industries was relatively high.⁹ Firms engaged in such activities are therefore by their very nature large firms (Chandler, 1990). Moreover, the high level of capital necessary to compete in such industries presented an acute problem for a state such as Korea which at the beginning of the 1970s had no firms capable of making such investments, a small domestic market and a far smaller fiscal base than the advanced industrial states. Nevertheless, these were problems the state had to overcome or accept a low-value added niche in the global economy.

The Korean state could only hope to overcome these problems by forming a very close relationship with selected private capitalists. Only by selecting a small number of large firms and placing them on a 'steroid' diet of cheap credit and market reserves could the Korean state hope to develop a set of firms capable of competing in the key industries of the second industrial revolution. The Korean state was effectively forced to bet everything it had on the success of a handful of firms.¹⁰ If such firms failed to become internationally competitive producers of heavy industrial products, Korea would become just another heavily indebted Third World mendicant. Alternatively, were such firms to become major producers of heavy industrial products this would represent a fundamental improvement in Korea's position in the international division of labour (Evans, 1995). The state and the *chaebol* were locked in a relationship of mutual dependence. On the one hand, it is true that the *chaebol* existed in a state of permanent bankruptcy and were totally dependent on official loans not just to fund their growth but to ensure their very survival. In one very important sense, therefore, the state was totally dominant over the *chaebol*. On the other hand, it is equally true that the 'strong' Korean state was frighteningly dependent on the success of around ten of the largest *chaebol*. The symbiotic relationship between *haute* capital and the state was based on a mutual recognition that, to paraphrase Benjamin Franklin, were they not to hang together they would, most assuredly, all hang separately.

Underpinning this entire system of state/capital alliances – and more broadly the project of forced-paced, state-led industrialisation – was the systematic repression of labour and small farmers. Political and social repression constituted an integral part of the Korean 'miracle'. The growth rates Korea achieved throughout the Park regime would not have been possible without the active use of state policy to create a large, cheap, disciplined proletariat. The state created such a workforce through two closely related but distinct policies. First, through its control of agricultural price levels the state sought to systematically

transform the countryside. The primary purpose of this policy was to expand the size of the proletariat by making the lives of small farmers so unpleasant that they were eager to leave their land and work dangerously long hours for subsistence wages in the cities.¹¹ It was deliberate state-policy, not the 'natural dynamics' of industrialisation, that led to the proportion of the Korean population involved in farming to fall from 72 per cent to 28 per cent between 1960 and 1980 (Lie, 1998: 111). The squeezing of agriculture was not an avoidable policy error but a necessary aspect of the process of primitive accumulation and the state's overarching strategy of promoting the rapid development of capitalist industry in Korea (Gills, 1999).

In addition to largely creating the Korean proletariat through its agricultural policies, the state was equally active in controlling and shaping that class's political and material development through a plethora of corporatist and non-corporatist mechanisms. The Korean state did everything in its power to assure that resources which could be used to develop the national capital stock were not 'wasted' through feckless consumption by the working class. The state made it illegal for workers to strike or form independent trade unions; workers who broke these laws risked not only prison but also severe beatings and torture.¹² As a direct result of these policies, labour conditions in Korea were bad even when compared to those prevailing in other industrialising states. Under the Park regime, Korean workers endured both the highest rates of industrial accidents and the longest working hours in the world. Moreover, while labour productivity increased rapidly, real wages grew only slowly. For example, between 1971 and 1981 labour productivity grew by an average of 11.1 per cent per annum while real wages only increased by a paltry 7.8 per cent per annum (Hart-Landsberg, 1993: 200).

To make matters even worse, the state itself offered workers virtually no protection against the vagaries of unemployment, ill health or old age. The only major pieces of social legislation enacted by the Park regime were the Industrial Accident Insurance Scheme (1964), the Public Assistance Programme (1965) and the National Health Insurance Scheme (1977). Of these three programmes only the public assistance programme – which provided a very niggardly level of assistance to the destitute – was designed to assist the poor. The coverage of both the industrial accident and health insurance schemes was limited to relatively well-paid core industrial workers. Such policies were an element within the state's broader strategy of promoting 'enterprise corporatism' (the new community movement) within leading firms. It was rational from the perspective of both capital and the state to offer certain material benefits (job security, relatively high wages) to core workers in order to ensure their allegiance to the prevailing order. Leading firms engaged in capital-intensive production required a stable, disciplined, committed workforce to fully realise the value of massive fixed investments. It was also imperative from the authoritarian state's perspective that such core workers be co-opted into the project of state led capitalist development. To put it bluntly, it is highly unlikely that the authoritarian state could have survived the emergence of a strong democratic labour movement among core workers in leading firms (Kwon, 1998; 1999).

The analysis of capitalist development in Korea offered above focuses on the particular configuration of relationships between state, capital and labour that underpinned rapid growth. Our analysis of the internal dynamics of capitalist development in Korea directly contradicts the standard neo-liberal reading of the Korean 'miracle'. It is clear that massive price-distorting government intervention and a quite pronounced level of state violence were both integral components of the process of accelerated capitalist development in Korea. The argument advanced here shares a great deal in common with the more critical statist as well as the Marxist literature on the Korean developmental state, emphasising as it does the importance of the strong repressive state in promoting capitalist accumulation (Woo, 1991; Hart-Landsberg, 1993; Rhee, 1994; Cumings, 1997). One key point of divergence, that we have already identified between the argument presented here and that offered within such literature, however, is the emphasis we place on the importance of global economic structures in shaping national level patterns of state/capital interaction. That said, we fully accept the need to focus on how the Korean social formation has developed over historical time, and the uniqueness of that social formation, in order to understand the precise nature of Korean state/capital relations. A proper understanding of the role world systems pressures play in shaping national state structures should inform our analysis of distinct national social formations, not substitute for such analysis.

Conclusion

If there is a central theme to the analysis of the Korean developmental state offered within this thesis it is that the project of state-led industrialisation was a product of, and its success was dependent on the existence of, a complex confluence of circumstances. It is impossible to understand why Korea exhibited such economic dynamism without understanding Korean history, the nature of post-war global political/economic structures, and the particular position Korea occupied within these structures. Such an understanding of Korean development highlights two things. First, it exposes the shortcomings of those theorists who argue that it is possible for other states to replicate the Korean experience by simply pursuing the 'correct' policies. Second, and more importantly, from our perspective, it serves to highlight the essentially time-bound nature of the Korean state-led development project. Global industrial/economic and political structures are by their very nature dynamic, not ossified and static. As we argued in Chapter 2 the changes in the composition of the global market have rendered dirigiste developmental strategies increasingly dysfunctional over the last two or three decades. By the end of the 1970s it was very clear that the limits of state-led development in Korea had been reached. The Korean state was effectively bankrupt and in 1980 the economy contracted by more than 5 per cent. It is the 1979–80 crisis and the processes of economic liberalisation and restructuring that emerged out of that crisis to which we turn in the next chapter.

5 Disintegration of the development state and the failure of economic liberalisation in Korea

In 1980 the Korean economic miracle appeared to be over. Inflation was running at over 25 per cent, the economy was set to contract by 5.2 per cent over the course of the year and the country was facing an acute foreign exchange crisis (Woo-Cumings, 1991: 177–97). The Korean economy was, however, fundamentally stronger than other semi-peripheral economies in Latin America and Asia that were facing a similar set of difficulties at the time. The heavy and chemical industrialisation drive had bankrupted the Korean state. Critically, however, the heavy and chemical industrialisation drive had basically been a success and created billions of dollars of new export capacity. This newly created export capacity provided the basis upon which a strong economic recovery could be constructed. Following sizeable loans by the Japanese government and the international financial institutions to ease foreign exchange problems inflation was once again brought under control, the state organised a comprehensive programme of corporate rationalisation and the economy resumed its rapid growth trajectory (*ibid.*).¹

At first glance, therefore, the crisis appears to have been a minor blip in the success story that was Korean state-led development. Upon closer examination, however, it is clear that it marked a turning point in Korean history and the beginning of the end of the Korean developmental state project. It was in direct response to the crisis that the first tentative steps were taken to dismantle the elaborate system of dirigiste controls that had underpinned the developmental state project. Over the next 15 or so years all the major mechanisms of state economic planning would slowly, but surely, be run down. At the same time, the first tentative steps were taken towards establishing new market-supporting regulatory and institutional structures. These processes of institutional/policy reconfiguration were, we would contend, primarily driven by the changing demands of international competitiveness. Of particular importance was the massive rise in the level of investment required to remain competitive in the key global industries associated with the third industrial revolution. The 1979–80 crisis demonstrated the clear objective limits on the capacity of the Korean state, and purely domestic financial institutions, to fund the investments needed to drive Korea's economic ascent over the coming decades. More precisely it was clear after 1979 that, in the long term, the state could not realistically hope to fund the

massive investments necessary if domestic firms were to continue upgrading their R&D capacities and reduce their dependence on Japanese suppliers.

In examining the state's attempts to promote 'national competitiveness' within this new environment we shall distinguish between two distinct periods within the overall liberalisation process prior to 1997. The first period, from 1980 to 1992, saw the slow stuttering development of a programme of partial liberalisation and very limited economic opening. The process of reform up until 1993 can be best understood using Jessop's (2002a: 169; 2002b: 457–9) concept of 'neo-liberal policy adjustment'. Within neo-liberal policy adjustment the government introduces selected neo-liberal policies in an attempt to improve the functioning of the existing mode of regulation and regime of accumulation. At the time, however, the core elements of old regime are essentially left in place. The regime is not dismantled, but reformed so as to improve its capacity to compete in a changing global economy

The second period, from 1993 to 1997, was marked by a tangible increase in the pace and scope of the processes of marketisation. The state went beyond the policy of 'neo-liberal policy adjustment' to dismantle key elements of the old regime of accumulation and mode of regulation. To refer back to Jessop's framework the state could be understood as being in the process of attempting to affect a 'neo-liberal regime shift' (Jessop, 2002a: 169; 2002b: 457–9). That is to say the state was seeking to radically redesign systems of social and economic regulation along neo-liberal lines and create a new neo-liberal regime of accumulation. As we shall argue in the later part of the chapter, the state did not entirely succeed in its latter endeavours. Nevertheless, the idea of a 'neo-liberal regime shift' captures what Korean political leaders were seeking to achieve. We shall analyse the content and rationale driving economic reform in each of these two periods in the first and second sections of this chapter respectively.

Economic reform from 1980–92: saying a long goodbye to the Leviathan State

In the late 1970s as the contradictions of state-led industrialisation became increasingly visible, a powerful group of reform-orientated economists emerged within the key organs of the Korean economic bureaucracy. President Park himself, on the other hand, was at best lukewarm about the prospect of economic liberalisation and so long as he remained in power liberalisation would only proceed in a painstakingly slow and cautious manner. Park's personal views were, however, unexpectedly and dramatically removed from the equation by an assassin's bullet on 26 October 1979. It was this assassination that was to set in motion a series of events that would over the next year lead to the emergence of a government with a strong formal commitment to economic liberalisation. Following his successful coup in 1980, General Chun Doo Hwan sought advice from the most reform-oriented sections of the bureaucracy and sought to upgrade the relative importance of those institutions within the state apparatus most committed to economic reform.

The American trained neo-classical economists within the Economic Planning Board (EPB), who had been completely marginalised since the start of the heavy and chemical industrialisation drive in 1973, suddenly found themselves accorded a central role in co-ordinating economic policy (Hart-Landsberg, 1993: 190; Rhee, 1994). Indeed, new legislation was passed which decreed that 'each economic minister ought to get the EPB's prior sanction on every major economic policy proposal requiring the President's or the Prime Minister's final approval' (Rhee, 1994: 191). Of equal significance to these institutional changes was the personal influence that leading technocrats such as Kim Jae Ik, who tutored the president on economics three or four times a week, were able to exercise over the new economically illiterate and intellectually limited president (Clifford, 1998: 181). The 1981 five-year plan clearly reflected the views of this rising reform-minded elite, to quote:

In striving to reach the goals envisioned in the Fifth Plan, Korea will depart from the quantitative target-oriented methods, as were the primary tactics of the past four Plans. The present Plan, in its place, relies on structural reform of economic institutions and policies, working towards, among other things, import liberalization, autonomous banking, an efficient industrial incentive system, and a competitive banking system.

(Republic of Korea Government, cited in Kong, 2000: 73)

The conditions for the neo-liberalisation of the Korean economy were, on one level, clearly in place by the end of 1980. The government was quite explicit about its desire to create a more market-based economy and the 1979–80 crisis quite clearly demonstrated the objective financial limits that rendered state-led development unsustainable in the long-term. The global political and ideological climate also increasingly favoured neo-liberal reform. The UK and US governments had embarked upon the processes of deregulation and selective neo-liberal re-regulation that were to lead to the end of financial compartmentalisation and development of unrestricted price competition between different market actors within these economies (Cerny, 1993). At the same time the prestige and material importance of trans-national regulatory institutions, such as the BIS and the International Organisation of Securities Commissions (IOSCO), was growing as the globalisation of finance gathered pace. These institutions were important in establishing clear explicitly neo-liberal standards of best regulatory practice that influenced policy debates globally. The frameworks and rules enunciated by these organisations were important, within the Korean context, not because domestic liberalisation processes actually brought systems of financial regulation into line with these frameworks (Porter, 1993) – they did not, in all but the most cosmetic sense. Rather, the work of these institutions was important in providing intellectual stimulus for reform and influencing the general direction within which the reform process developed. In addition to these changes in the broad global ideological and political climate, the internal drive for reform in Korea was buttressed by a particularly ferocious US bilateral

economic offensive (Woo, 1991: 176–203; Bello *et al.*, 1999: 72–80; Kong, 2000: 151–3).

On another level, however, a powerful set of political and economic problems ensured that economic liberalisation in Korea was always going to be a slow, piecemeal process. Although the EPB was convinced of the virtues of neo-liberal reform, the attitudes of senior personnel within the economic ministries remained more complex. It is not that these ministries were oblivious to the need to reform the old model. They were in fact every bit as aware of the need to liberalise as the EPB. However, they were equally aware of the problems that had accompanied financial liberalisation elsewhere in the developing world and they were determined not to undermine the achievements of the past through over-hasty reform. The continued influence of these ministries would ensure that liberalisation would only proceed at a snail's pace (Kim, 1999). Moreover, very large sections of Korean industry in the 1980s were simply in no position to survive, let alone prosper, within an open, marketised economy. The economic and political consequences of destroying, or at best selling to foreigners, a large section of the national economic base ensured that no Korean government would launch a programme of neo-liberal shock therapy while painful options continued to exist.

The fact that the liberalisation process within Korea was slow, cautious and stuttering has led various scholars to assert that no significant liberalisation measures were enacted prior to the election of Kim Young-Sam in late 1992 (Amsden, 1989; Chang *et al.*, 1998). We would argue that this represents a serious mistake, and that a number of very important reforms were enacted in the 1980s and early 1990s. As the World Bank's comprehensive 1986 report on the Korean economy makes clear, the liberalisation measures that were enacted as part of the Chun regime's five-year reform plan were important. The World Bank (1986: 49) sums up the most important liberalisation measures undertaken prior to 1986 as including:

- reducing the government's role in specific credit allocation decisions, and abruptly terminating policies which awarded the heavy chemical industrial sector large-scale preferences;
- selling the commercial banks to private shareholders;
- establishing new financial institutions;
- increasing real interest rates, reducing the gap between the organised and unorganised sectors of the market;
- eliminating interest rate subsidies for particular borrowers, reducing the size of special funds, and more generally scaling back the role of policy targeting in lending decisions.

These measures were built upon after 1986 when the state fully liberalised bank-lending rates and long-term deposit rates, and eased controls on various money and capital market instruments (OECD, 1996b: 40–82; Woo-Cumings, 1997: 85; Emery, 2001: 39–50). The Korean economy of 1993 was a quite different entity

from that which had existed 13 years earlier. Although the economy remained relatively closed by international standards, fundamental reforms had taken place in the internal structures of the economy since 1980. The predominance of reforms aimed at enhancing the competitiveness of domestic firms over those measures that offered foreign firms easy profits can be illustrated by comparing the rules governing inward and outward direct investment. On the one hand, inward investment, which threatened the position of Korean firms in domestic markets, remained subject to extensive set of controls and restrictions. On the other hand, overseas investments by domestic firms were largely freed from official controls after 1987 (OECD, 1996b: 53; van Hoesel, 1999: 80–2). The extent of the disjunction between the rules governing capital inflows and outflows is evidenced by the fact that in 1990 Korean firms invested \$1.61 billion overseas while direct investment in Korea was limited to \$800 million (E. Kim, 2000: 110).

The failure of those reforms that were of most interest to foreign states to take precedence over those designed to enhance the competitiveness of domestic firms and financial institutions strongly suggests that the primary political forces driving liberalisation came from within Korea itself. Furthermore, that the programme was initiated in the early 1980s in the wake of a major crisis, when the corporate sector was on its knees and in a weak position to influence policy debates by a new military junta with few links to major business groups, indicates the centrality of state managers acting autonomously from individual capitalists in driving reform (Rhee, 1994). Liberalisation was essentially a project driven by Korean capitalist state managers in an attempt to secure the country's position as a site of accumulation within a changing global economy. While foreign pressure and the influence of domestic capital was no doubt important in accounting for certain individual reforms, the liberalisation project as a whole must be understood in terms of the state's own efforts to secure conditions for further accumulation within Korea. The full significance of different aspects of the pre-1993 reforms are outlined below. For the sake of convenience we make a distinction between those reforms that relate principally to the financial sector and those that relate primarily to the corporate sector.

Financial 'liberalisation'

Financial liberalisation in Korea can in certain respects be better understood as a multi-speed process rather than simply a slow process. Certain important elements of the Korean financial system were liberalised relatively quickly while other equally important elements remained firmly under state control until 1993. Liberalisation was most rapid in the non-bank financial sector. The rules governing the operations of non-bank financial institutions (NBFIs) were substantially liberalised by the end of the 1980s. To quote Woo (1991: 196–7):

With financial liberalization, the state accelerated deregulation of the NBFIs, allowing them private ownership, and greater flexibility in interest rates and management; lifting ceilings on commercial papers and unsecured

corporate bonds that the NBFIs deal in; removing the burden of making policy loans; relaxing entry barriers; and permitting a wide variety of financial services.

The importance of these reforms should not be underestimated. Under the generic term 'NBFIs' we include insurance firms, investment and finance companies (IFCs), investment trust and securities firms.² As we may expect IFCs acted principally as brokers and dealers in short-term commercial paper whereas insurance companies and investment trusts made longer-term investments in corporate bonds and direct loans to business (*ibid.*: 196; OECD, 1999a). Even before deregulation these institutions, collectively, accounted for 29.1 per cent of total deposits. As a direct result of liberalisation, the share of total deposits held within these institutions rose to 59.0 per cent by 1986 (Hahm, 2003: 85). In one sense, therefore, the NBFIs could actually be considered to be more important than the commercial banks. Given the level of deposits held within the NBFIs it is remarkable that the importance of reform in this sector has often been ignored or severely downplayed (Amsden, 1989; Kim, 1997).

Much of the increase in deposits within the sector was accounted for by the numerous new institutions, mainly investment companies, that the major *chaebol* established within the more permissive regulatory environment that existed in the 1980s and early 1990s in order to fund their investment programmes. Fields (1995: 115) informs us that the *chaebol* controlled three-fourths of all IFCs and that the ten largest *chaebol* accounted for 30 per cent of these institutions' investments. According to the same source, all the major insurance companies were partly or fully owned by the *chaebol* and the ten largest conglomerates controlled a massive 40 per cent of insurance companies assets (*ibid.*: 116). Given that all the major *chaebol* also controlled at least one securities firm, these organisations had truly graduated from being industrial conglomerates to being industrial and financial concerns.

At the same time as deregulating the NBFIs sector, the state abandoned the practice of seeking to control the stock market by determining the price of new issues and levels of dividends by administrative fiat. As a direct result of deregulation, the total value of the Korean stock market rose from 6.9 per cent of GDP in 1980 to 50 per cent of GDP in 1994 (OECD, 1996b: 49; Woo-Cumings, 1997: 90). Taken as a totality the reforms outlined above served to destroy the old dualist financial system where a semi-legal, unregulated curb market co-existed with a state-controlled financial sector. The unregulated and highly dangerous curb market simply lost its appeal and disappeared as new 'legitimate' opportunities for investing and borrowing in the market-based non-bank financial sector proliferated. The demise of the unregulated, anachronistic curb market, the creation of a set of lightly regulated NBFIs and the creation of a functioning equity market were all regarded as significant achievements by financial modernisers within the state.

Despite these highly visible achievements, the non-bank financial liberalisation programme as a whole must, nevertheless, be understood as a failure, both

in 'objective' economic terms and in terms of the government's own stated goals. The most important consequence of liberalisation of the NBF sector was to allow the *chaebol* to establish a new set of institutions to finance their reckless investment plans within which profitability concerns were subordinated to the pursuit of expansion for expansion's sake.³ Given the Korean government's constant, and well-founded, concern over the state of corporate finances, this outcome must be regarded as little short of a disaster. The scale of new debts that the *chaebol* accumulated was such that despite the growth of the stock market, the debt-to-equity ratio of such firms averaged over 300 per cent in 1994 (Jung and Lee, 2001: 142). The deregulation of the stock market had, therefore, done nothing to effect the significant improvements in the financial structures of Korean firms that the state initially believed it would.

As we have already suggested, the attitude of the state towards reform of the commercial banks was much more cautious than its attitude towards the liberalisation of the non-bank financial sector. Although five of the six main government-owned banks were privatised in the early 1980s these institutions continued to be subject to tight government controls throughout the period in question. The government remained influential in selecting bank management until 1993; maintained an 8 per cent ceiling on individual equity holdings in banks; tightly controlled the amounts banks could lend to various categories of firm and for different forms of economic activity; used the commercial banks as a conduit for policy loans; closely restricted product innovation; and maintained various forms of more informal guidance mechanisms (OECD, 1996b: 40–82; S.Y. Park, 1999: 207–18; Kong, 2000; Emery, 2001: 38–57). The commercial banks had been at the heart of the state-led development project and the government was not about to relinquish control of them overnight.

Nevertheless, despite the plethora of dirigiste controls that remained in place, it is not the case that no significant changes in structures of bank regulation took place prior to the election of Kim Young-Sam in late 1992. For example, interest rates had, formally at least, been liberalised on most forms of loans and deposits by the early 1990s and policy loans were rapidly declining as a proportion of overall bank lending. Although the state was unwilling to cede control of the commercial banks it was very keen to ensure that market principles played a more important role in influencing banks' day-to-day activities. In other words, the bureaucracy wanted to both have its cake and eat it. It wanted to create an efficient market-oriented banking sector, but it also wanted to retain the final say on all major decisions concerning bank lending policies. This was, quite simply, a circle that could not be squared.

In attempting to explain why the state was unwilling to release its grasp on the banking sector it is simply not good enough to assert, as neo-liberals tend to, that the state acted irrationally, or that the bureaucracy had a deep-seated 'fear' of the market. Rather we must examine the acute economic difficulties the state faced in liberalising the commercial bank sector. The essential problems emanated from the distorted corporate/economic structures that were the legacies of over two decades of state-led development. First, the heavy debt burdens

and opaque financial structures of Korean firms were always going to mean that, regardless of the prevailing regulatory regime, the Korean banking sector would rest on a financial house of cards. This point is well made by the OECD in its 1998 report on the Korean economy, to quote:

As a practical matter, with the high leveraging and lack of transparency that prevailed in corporate Korea, insistence on rigorous credit standards would have been tantamount to forswearing participation in the expansion of Korean industry over the past three decades.

(OECD, 1998: 58)

Perhaps not unreasonably, the Korean state sought to retain a certain degree of control over the operations of leading banks given the impossibility of creating a stable, solvent, market-based banking system in Korea. Second, it was difficult to see how the state, which was clearly unwilling to sell major domestic banks to foreign investors, could remove tight ownership restrictions without simply turning the commercial banks into honey pots for the *chaebol*. At the same time, however, ownership restrictions ensured these institutions would have no effective owners capable of holding bank management to account. Given the impossibility of creating effective private sector owners to hold senior bank management to account, the state had little choice but to continue to monitor the performance of bank management itself.

While the liberalisation of Korea's internal financial structures had until 1993 taken place in a slow and uneven manner, the processes of internal restructuring were relatively well advanced compared to the process of external financial opening. The restrictions on overseas borrowing by Korean firms and banks remained extremely tight, strict limits were still in place on equity purchases by non-residents, an elaborate set of controls continued to restrict the operations of foreign banks in Korea, and it was still almost impossible to move significant amounts of capital in and out of Korea without gaining the explicit approval of the government. Nevertheless, it is not true that no market-opening measures were enacted prior to 1993. Korea's first joint venture banks, Shinhan Bank and Korea-Am, were established in 1982 and 1983, respectively (World Bank, 1986: 79). Additionally, as a result of US pressure the scope of activities open to foreign banks was expanded. To quote Woo-Cumings (1997: 82), 'By 1985 Americans got what they had demanded by and large: permission to expand their working capital, to venture into trust banking, to join the National Banking Association and the Clearing House, and most important, to receive BOK rediscounts on export loans.' Partly as a result of these measures, the number of foreign bank branches in Korea almost doubled between 1981 and 1993 from 40 to 73 (*ibid.*: 81). Furthermore, by the late 1980s Korea's extremely large life insurance market had also been opened up to foreign participation (*ibid.*).⁴

Moreover, in an attempt to enhance the ability of domestic firms to access the vast pool of internationally mobile capital, the government allowed limited foreign equity investment in Korean firms. The maximum permissible levels of

foreign investment in listed firms was capped at 15 per cent of total equity, and no single foreign investor was allowed to own more 5 per cent of total equity, in order to ensure that foreigners could never control Korean firms (Kong, 2000: 164). In a sense, the opening of equity markets to limited foreign participation represented a relatively painless reform for the Korean state. It may have increased Korea's exposure to global financial volatility somewhat, but it held none of the demons that allowing firms and financial institutions greater access to foreign capital markets or allowing full foreign ownership of domestic firms held.

The system of capital controls that had formed an integral part of the developmental state model essentially remained in place in 1993. This clearly reflected the position of the Ministry of Finance (MOF) and the BOK who were acutely aware of the need to 'sequence' reform correctly and the dangers of overly rapid reform (Gills, 1996; Kim, 1999). The position of these ministries was in fact shared by the World Bank (1986), which held Korea up as a model of financial liberalisation and praised the government for its 'proper' sequencing of reforms, for focusing upon internal reform prior to market opening. An essential problem with the argument of the World Bank, MOF and BOK regarding sequencing was that Korean elites proved to be consistently unable to seriously address the domestic level distortions that made financial opening so problematic. Korean elites were not in fact preparing the economy for external opening. The fundamental problems that made financial opening so difficult stemmed from the precarious financial structures of Korean firms. The consistently high debt levels, relatively limited profitability and opaque financial structures of Korean industry had proved sustainable for over two decades within a financial system where all external capital movements were closely controlled and all foreign borrowing required approval by the state.⁵ From the moment Korean firms and private financial institutions became actively involved in borrowing on the international capital market, however, it was only a matter of time before the whole system came crashing down (Wade, 1998). Greater foreign equity investments posed a different, but equally acute, set of problems for the Korean state. The prospect of foreign ownership of large sections of the economy was simply unacceptable, not only to domestic capital and the population at large but to key sections of the Korean economic bureaucracy itself. For these groups it was inconceivable that, having spent the last two decades engineering one of the most successful economic nationalist projects ever seen, they should willingly surrender control over the national economic base to 'outsiders'.

Despite the problems that further financial opening posed for the state-capital complex there is still ample evidence that those within this complex believed that the long-term competitiveness of Korean firms was, to a large extent, dependent on their ability to access global capital markets. This view was expressed particularly clearly by the *chaebol's* collective mouthpiece, the Federation of Korean Industries (FKI), in their opening missive to the Kim Young-Sam administration in 1992; the FKI complained bitterly about the controls on foreign borrowing by Korean firms and the burden that high domestic interest

rates placed upon Korean firms' competitiveness (Kong, 2000: 161). The views expressed within this key publication were entirely consistent with those articulated in the FKI's annual reports since 1988 that had demanded that restrictions on borrowing from international banks and the issue of securities on international markets be lifted (Kim, 1999). These firms wanted the freedom to raise money on global markets, where real interest rates were around half domestic levels, in the same manner as their counterparts elsewhere in the world. In the late 1980s leading politicians, including figures close to the then deputy prime minister and head of the EPB, Cho Soon, made similar statements to the FKI about the potential for problems in domestic systems of industrial finance to undermine Korea's competitiveness in key global industries (Gills, 1996: 681). The most immediate cause of many of the problems the *chaebol* faced in financing major investments stemmed from their own decision to prioritise growth over profitability and efficiency concerns. If the *chaebol* had refrained from making more marginal, and in some cases near lunatic, investments, the demand for capital would have fallen and they could have financed necessary core investments more cheaply and easily using purely domestic means.⁶

Nevertheless, there was a clear disjuncture developing between the massive, and rapidly increasing, investments in R&D and fixed capital necessary to remain competitive within key global industries and the capacity of domestic financial institutions to fund such investments. The Korean financial system was engaged in a hopeless enterprise. The mediocre financial system of a medium-sized upper middle-income economy, albeit one with a high savings rate, could no longer hope to support the investments necessary to build and maintain independent export capacity in a range of major global industries. Put simply, technology was becoming much more expensive. The proportion of GDP of all the leading industrialised nations devoted to non-defence related R&D in 1990 was much greater than it had been a decade earlier (Dunning, 1993: 63). Moreover, the costs of remaining competitive were accelerating particularly rapidly within those industries within which Korea's most important firms sought to compete, namely cars and electronics. By the mid 1990s it was not uncommon for major car manufacturers, such as GM and Ford, to invest \$5 billion in developing a new model (Dicken, 1998: 326).⁷ The picture was just as bleak in the electronics sector. The annual R&D budgets of leading global electronics firms were well in excess of \$6 billion by the end of the 1980s. Additionally, the cost of establishing a single semiconductor plant had risen from \$2 million in the late 1960s to \$1 billion by the mid-1990s (Dicken, 2003: 407).⁸ The problem was not that the Korean financial system was incapable of funding a single \$5–6 billion investment. Rather, it was that such an investment would amount to well over 1 per cent of peak pre-crisis GDP and there were tight objective limits on how many multibillion dollar investments the Korean financial system could reasonably be expected to fund (Kong, 2000: 23).

If Korean firms were to become first-rank, technologically sophisticated global players they had to be allowed to access global capital markets. However, capital account liberalisation did not offer an easy solution to the problems of

industrial finance. Most Korean firms already carried excessive debt levels relative to their limited profitability and were in no position to mount a bid for leadership in the key industries of the third industrial revolution. Many of these firms would simply have collapsed had they been afforded freer access to global financial markets. The debt problems that beset the *chaebol* were not simply, as they might at first seem, a result of the fact that these firms invested too much. The reason why Korea was under pressure to open its capital account and allow firms to access the vast pool of internationally mobile capital was because of the massive levels of investment required to compete in the key global industries of the third industrial revolution. While the aggregate level of corporate investment was not excessive it is true that major firms were over-reliant on debt finance and that investments were badly targeted. Due principally to the desire of the founding families to retain control over the *chaebol* these firms did not necessarily fully exploit opportunities to raise capital through equity financing.⁹ Equity financing accounted for 17.9 per cent of Korean firms' external fundraising activities in the first half of the 1980s, whereas it accounted for 34.3 per cent of all funds raised by Taiwanese firms (Fields, 1995: 107). By 1992 this situation had actually become worse, with equity financing only accounting for 15.2 per cent of total funds raised (Hahm, 2003: 86).¹⁰ The structure of external financing was, however, a relatively minor problem in comparison with major firms' own incredibly wasteful investment strategies. At the same time that the *chaebol* were making highly speculative, largely unprofitable, investments in new areas of business, keeping marginal businesses afloat and developing excess productive capacity, they remained technologically inferior to their major global competitors.

As Bello and Rosenfeld (1990: 113–18) demonstrate, Korean firms continued to be dependent upon licensing agreements with Japanese and American firms to access almost all the key technologies necessary to produce competitive products within the electronics and car industries at the start of the 1990s. Equally importantly, Korea continued to rely on physical high-tech components from Japanese and US suppliers. As Kong (2000: 170) highlights, the ratio of technological imports to R&D was only marginally lower in 1987–93 than it had been in 1977–81, at 18 per cent as opposed to 21 per cent. As a result of their dependence on high-tech imports and licensing agreements Korean firms often made very little money on many of their key products. This point is well made by Bello and Rosenfeld (1990: 114):

Every time Korea exports a computerized lathe or other machine tool, 35 to 45 per cent of the gross value is pocketed by Japanese manufacturers of computer-guidance equipment. Japanese inputs account for between 20 per cent and 30 per cent of the value of a Korean car. In many electronics exports, the proportion is even higher: 85 per cent of the value of a Korean-produced color TV set is accounted for by Japanese parts. Seventy to 90 per cent of the components of a Korean laptop computer from Japan account for almost 60 per cent of the price.

However, it is important to be aware of the fact that Korean R&D did increase from 1.95 per cent of GDP in 1990 to 2.69 per cent of GDP in 1995 (Miotti and Sachwald, 2001: 137). Moreover, many *chaebol* were spending over 5 per cent of total sales revenue on R&D by the mid 1990s and certain firms such as Samsung Electronics and Hyundai Motors did achieve some form of technological independence, something Bello and Rosenfeld assumed to be impossible (van Hoesel, 1999: 169–71; Lautier, 2001: 218). Nevertheless, it is important not to overstate these firms' achievements. The Hyundai group total R&D spend in 1994 was \$1.1 billion and Korea's leading firm Samsung Electronics invested \$750 million in R&D in the same year. These figures were several times lower than the corresponding figures for leading European, Japanese and American firms. Unsurprisingly Korean firms got what they paid for. By the mid 1990s Hyundai Motors was able to produce saleable cars without the assistance of others, a considerable achievement. It was, however, only able to produce relatively low-tech low-value-added vehicles. As van Hoesel (1999: 171) correctly highlights, Samsung electronics could boast a number of achievements including developing the world's first 64-megabyte DRAM chip in 1992 and winning the respected US-based *PC World* magazine's best notebook award in 1994. Nevertheless, the same analyst is forced to conclude that 'in the field of consumer electronics Samsung Electronics cannot yet be labelled an innovator – the company usually follows top companies in developing and producing new items' (ibid.: 171).

Although the *chaebol* investments in R&D capacities were considerable, it would have been necessary for them to re-orient their entire business strategies away from diversification and unthinking expansion towards developing greater innovative capacities in key areas of competence if they were to secure their own long-term competitiveness. In practice, such a wholesale shift in investment spending would have at best taken decades to achieve and may well have proved impossible to engineer. However, the future of Korean firms as major independent players in the global economy depended on them making massive sustained investments in developing greater innovative capacity, investments that only the global market had the capacity to fund. Even if the *chaebol* had adopted more focused investment strategies, these conglomerates would still have faced an uphill struggle to maintain and enhance their international competitiveness. Their long-term future depended on their ability to compete not simply on price but in terms of product quality with larger and more technologically advanced global counterparts.¹¹ Critically, and in marked contrast to the past, this was a struggle that the *chaebol* would have to face alone without extensive official financial support. Even if the *chaebol* had invested more astutely, it was inevitable that many Korean firms would fail to meet the challenges posed by the third industrial revolution. The developmental state project of creating an autonomous national industrial base was under threat by the end of the 1980s, not only because of the *chaebol's* own recklessness but because of the ever-increasing outlays necessary to remain competitive within key global industries.

In order for a new regime of accumulation to begin to be born Korean firms had to be allowed to access global financial markets and processes of creative destruction had to be allowed to take their course. Leading Korean firms, and even entire business groups, had to be allowed to bankrupt themselves and to be taken over by foreign MNCs. The most dynamic *chaebol* subsidiaries had to be freed from their obligations to weaker affiliates and be provided with a supportive environment within which to raise equity capital on global financial markets and integrate themselves fully into trans-national inter-firm innovation networks. Additionally, Korean firms of all types had to be subject to hard budget constraints and the disciplines of the market.

The processes of deep integration into the global economy were always likely to be traumatic. However, a crisis on the scale of that which occurred in 1997 could have been avoided if the state had forced the *chaebol* to stop their endless horizontal expansion, close marginal businesses and focus more tightly on improving profitability and long-term competitiveness. At the most basic level, the *chaebol* had to be forced to refrain from making investments whose profitability was always likely to be lower than the prevailing cost of capital. Of course, it is not always possible to accurately assess the likely profitability of investments, particular where these investments have long gestation periods. However, Korean management did not so much miscalculate the likely profitability of investments as subordinate concerns about profitability to their insatiable desire to move into new business areas and create more production capacity, the economics of grandeur! In reality, the state's actual reform efforts, up until 1993, fell far short of effecting the necessary changes in corporate behaviour outlined above. It is to the state's rather feeble attempts to reform the corporate landscape in Korea that we now turn.

Restructuring the Korean corporate sector

In its attempts to prepare domestic firms for the challenges posed by global structural change, the Korean government has pursued three major policy initiatives. The first involved the progressive dismantling of the system of licensing controls that had strictly limited the entry of new firms into key industries. When considered alongside the declining importance of policy loans, the demise of this system represented a significant shift away from the highly dirigiste industrial policies of the past. Although the government's influence over the lending policies of financial institutions meant that the state continued to play an important role in 'picking winners', by 1993 the state had largely abandoned its longstanding policy of co-ordinating private sector investment.

The second set of major changes in the state's economic strategy centred upon the legal frameworks governing outward and inward FDI. Following the 1980–1 crisis there was a growing awareness among the economic bureaucracy of the potential contribution that inward FDI could make to the national economy. The new president's speeches fully reflected the views of the most reformist elements of bureaucracy towards FDI, to quote:

In the past when foreign companies wanted to invest in Korea there was too much red tape involved because the government wanted to regulate and control them. My policy is to eliminate as much red tape as possible and to simplify administrative procedures. I have made instructions to this effect and studies are being made to improve the investment climate. In the past foreigners weren't allowed a share over 50 per cent but I am going to allow foreign investors to go up to 100 per cent.

(Chun Doo Hwan, cited in Bishop, 1997: 85)

What made FDI so attractive was not simply the fact that it represented a stable source of foreign capital but the positive externalities that, theoretically at least, accompanied it. The reformists within the state saw FDI as creating the 'market linkages and competitive pressures necessary to keep Korean industry efficient' (Bishop, 1997: 83).

On the other hand, however, a large influx of FDI posed potentially serious problems for the Korean state-capital complex. The entry of more efficient foreign producers threatened to jeopardise the position of key domestic firms and undermine many of the achievements of the developmental state. Having spent the last two decades attempting, with some success, to develop an independent industrial base the Korean state was not about to allow large sections of that base to be destroyed or taken over by foreign firms. This continuing desire to protect domestic industry meant that while a number of significant liberalisation measures were enacted, substantial controls on inward investment would remain in place throughout the period under discussion to protect Korea's 'independent' industrial base. Largely as a result of these controls, FDI inflows remained fairly negligible up until the early 1990s. In 1992 inward FDI amounted to \$803 million. This figure was over eight times the 1983 level, in absolute terms, but remained an almost insignificant 0.2 per cent of GDP (Bishop, 1997: 90). In 1992 the average level of inward FDI for all OECD countries was 1.1 per cent of GDP in the same year and the highest was 4.6 per cent (OECD, 1996b: 11).

While liberalisation of restrictions on inward FDI proceeded at a snail's pace, liberalisation of the regime governing outward investment progressed far more rapidly. After 1987 Korean firms enjoyed a very high degree of freedom to invest overseas. Although large investments still required government approval, the fact that total outward direct investment reached nearly \$2 billion in 1993 demonstrates the state's increasing willingness to grant such permission (van Hoesel, 1999: 81; E. Kim, 2000: 110). The coexistence of a relatively liberal regime for outward direct investment with more restrictive controls on inward investment threatened to create serious problems for Korean economic managers. First, it was becoming increasingly evident by the early 1990s that Korea needed to attract far greater levels of inward FDI in order to offset the negative effects of outward investment by domestic firms. Indeed, Gills (1996: 682) informs us that by the mid-1990s Korean state managers were concerned about '*chaebol* exodus fearing loss of the technological capacity and employment'. Put

simply, if Korean firms were to relocate sizeable parts of their operations overseas this would necessarily entail a significant loss of jobs and national output. Given the unavoidable consequences of domestic firms' spatial restructuring, it was imperative that Korea attract significant amounts of FDI in order to secure and enhance domestic growth prospects. Second, the restrictions on inward FDI made it more difficult for domestic firms to engage in the forms of cross-border joint ventures and non-equity alliances that firm-level competitiveness is increasingly dependent upon in the contemporary global economy. Finally, and perhaps most importantly, given the increasing concentration of finance, productive resources, technological innovation and world trade in the hands of major MNCs, the costs and benefits of promoting inward investment were rapidly changing. It was clear that the state's previous ambitions to create an 'autonomous' national economic base would have to be moderated in the face of these new global realities. The global concentration of economic power meant that Korean firms could not hope to become competitive in the full gamut of global markets. The future of Korea as a major centre of capitalist accumulation would, therefore, depend as much on the success of the state in attracting overseas investment as promoting domestic firms (Stopford and Strange, 1991; Gills, 1996; Dicken, 1998; Kong, 2000).

The final major policy initiative the state pursued in order to enhance the competitiveness and efficiency of the corporate sector was focused on promoting competition within domestic product markets and halting the tentacle-like spread of the *chaebol*. In 1980 Korea's first comprehensive antimonopoly law, the Monopoly and Fair Trade Act (MFTA), was enacted. A year later, in 1981, a new regulatory agency, the Fair Trade Commission (FTC), was established to enforce this law. The law contained the full range of internationally standard provisions concerning the regulation of pre-existing monopolies, inter-group subsidies, mergers, and collaborative agreements that sought to distort market competition (OECD, 2000b: 171–3). The Act represented a significant break with past government policy in that it was based on the neo-liberal axiom that competition *per se* is a good thing which the state ought to promote. As the OECD (*ibid.*) notes, prior to 1980 the Korean government did not necessarily take such a negative view of cartels and monopolies. Rather, such arrangements were seen as necessary to ensure properly 'co-ordinated' investment and production plans.

More interesting still than those elements of MFTA that dealt with standard competition policy concerns were the more unusual features of the Act that reflected the peculiar nature of Korean economic development. The MFTA, particularly following the 1986, 1990 and 1992 amendments, contained a number of measures to prevent 'the immoderate concentration of economic power and to encourage balanced economic development' which were a direct response to the *chaebol* 'problem' (MFTA, cited in Lee, 1997: 47). In concrete terms the Act, following the 1986 amendment, set out to halt the growth of economic concentration by restricting the use of cross-firm payment guarantees and limiting intra-firm investment. Together with the systems of financial support for

small and medium-sized enterprises that were also introduced in the 1980s we could well have expected the MFTA to lead to a significant reconfiguration of Korean industry.

More precisely, if enforced, the MFTA had the potential to enhance the competitiveness of Korean firms and prepare the economy for deeper integration into global circuits of accumulation in three distant but related ways. First, by promoting more intensive competition within domestic product markets the MFTA promised to force firms to become more efficient and thus prepare them, in some way, for the challenges posed by full market opening. Second, by offering small businesses financial support and protection from 'predatory' competition, the government's policies promised to overcome the long-term structural weakness of the small business sector. The third and most important, potential effect of the MFTA related not to its explicit objectives of promoting competition and 'balanced' economic development but to its impact on the financial structures of major Korean firms. Had the rules limiting the use of mutual debt guarantees to 200 per cent of total equity been properly enforced this would have represented a valuable first step towards improving the financial structures of leading Korean firms. Put simply, such controls would have limited the ability of the *chaebol* to use stronger affiliates as collateral when raising funds to finance reckless and unprofitable expansion plans. These controls would, therefore, have improved the financial position of the more efficient, profitable and potentially solvent *chaebol* subsidiaries. Additionally, by making it more difficult for the *chaebol* to finance further expansion the MFTA promised to improve the overall financial health of these business groups. Even the most cursory glance at the financial structures of Korean firms reveals how important state action to force the managers of these entities to focus on their profitability and financial structures in fact was. The Korean corporate sector was the most indebted in the world. In 1985, for example, the average debt-to-equity ratio of Korean firms stood at almost 400 per cent. To put this figure into context UK and American corporate debt-to-equity ratios stood at about 100 per cent. Only in Japan were corporate debts to equity levels roughly comparable at around 320 per cent (Jung and Lee, 2001: 142). The high levels of corporate debt would not have been overly troubling had the corporate sector also been profitable. In reality, however, the returns on capital employed within the Korean corporate sector were consistently lower than prevailing interest rates throughout the 1980s and 1990s (Joh, 2001: 124).

This discussion of the potential effects of the MFTA is, however, purely academic. Despite the Korean state's rhetoric, the FTC was never given the sanctions necessary to properly enforce the MFTA. Moreover, the key provisions of the Act were undermined by the existence of various loosely defined exceptions for investments necessary to enhance 'international competitiveness' and such like (Kong, 2000: 173–6; OECD, 2000b: 167–204). The state's failure to properly enforce anti-monopoly regulations is often attributed to the growing political influence of the *chaebol* and the existence of close ties between political and economic elites (Rhee, 1994; Kim, 1997). We would argue, however, that this

analysis is somewhat crude and fails to fully appreciate the true nature of the state's relationship with the *chaebol*. The central problems the state faced in attempting to force the *chaebol* to streamline their activities were as much economic as they were political. The *chaebol*, collectively, dominated both the 'modern' sectors of the Korean economy and the country's export profile. Moreover, they employed hundreds of thousands of relatively highly paid workers directly and millions more indirectly through their networks of suppliers. There were clear long-term benefits to forcing the *chaebol* to close marginal affiliates, cease their endless horizontal expansion, and focus on improving the competitiveness and long-term profitability of their core businesses. Whatever the long-term benefits of forcing the *chaebol* to reform in the short-term, restructuring would in all probability have led to a full-scale recession and massive job losses across the social spectrum. For obvious reasons, no Korean administration was willing to endure the political and economic consequences that would, no doubt, accompany major corporate restructuring (Gills, 1996; Kong, 2000).

The failure to properly enforce the MFTA was indicative of the wider failure of the Korean state, until 1993 anyway, to undertake the difficult but necessary reforms that any comprehensive liberalisation programme would have entailed. The process of economic reform in Korea, up until this point, can perhaps be best described as uneven or retarded liberalisation. On the one hand, substantial deregulation did take place. The non-bank financial sector was largely freed from non-market based controls, the majority of the commercial banks were privatised, the old system of industrial licensing was almost completely dismantled and Korean firms were granted considerable freedom to invest overseas. On the other hand, it is clear that progress in advancing the more problematic, but nevertheless critical, aspects of the overall process of marketisation had been slow or non-existent. The most notable single aspect of this overall tendency of the state to delay difficult reforms indefinitely was the failure of the state to substantially liberalise the capital account. The importance of this issue cannot be over-estimated. As we have consistently argued the fundamental limitations of autocratic capitalist development and the need to promote Korea's deep integration into global circuits of accumulation drove the entire reform process. Clearly this objective required the dismantling of capital controls. The state's reluctance to abolish these controls was a direct consequence of its inability to address the fundamental structural problems, most notably the chronically low levels of corporate profitability and the weak financial structures of major firms, which made deep integration into the global economy so problematic for Korea. Deep integration into global circuits of finance and production was always likely to be very difficult and likely to involve considerable economic destruction. In order to minimise the vulnerabilities of the economy and the levels of economic dislocation involved within this process, it was necessary for major firms to first rationalise their activities, create more focused investment plans and actually make reasonable profits. In other words, it was necessary for major firms to take a step back, shed marginal business and scrap over-ambitious expansion plans in order to create the conditions for rapid, sustained, long-term economic

expansion. The government understood perfectly well that to open the Korean economy fully to global market forces prior to tackling the problems that beset the corporate sector was to invite economic disaster.

A deliberately precipitated economic crisis was avoided up until 1993 because of the state's decision to confine itself to a programme of 'neo-liberal policy adjustment' (to adopt Jessop's term) that left key elements of the old regime, such as capital controls, essentially intact. Yet Korea's long-term competitiveness arguably depended on its ability to achieve a regime shift, to dismantle the old model. The extent to which the Korean bureaucrats who first initiated 'policy adjustment' in the 1980s recognised this or alternatively believed that incremental reforms would be sufficient to secure the competitiveness of the old model is difficult to assess. However, it seems reasonable to assume, given the existing work on the attitudes of Korean state managers, that the EPB wanted to see Korea become a fully fledged neo-liberal economy and saw 'policy adjustment' as laying the groundwork for a 'regime shift' while senior personnel within both the BOK and the Ministry of Finance sought to preserve elements of the old system (Kim, 1999; Gills, 1996: 677–81). Whatever the intentions of state managers, however, the economic problems encountered in the liberalisation process were to insure that reform would be limited to adjustment within the existing regime of accumulation and mode of regulation until 1993.

Despite the fact that 12 years of incremental reform had done little to prepare the Korean economy for the trauma of what Jessop describes as 'neo-liberal regime shift', key personnel within the Kim Young-Sam administration elected in late 1992 were, for good reason, committed to affecting such a shift. It is to the Kim Young-Sam administration's attempts to address the problems that dogged the domestic economy and resolve the contradictions inherent within the processes of uneven liberalisation to which we now turn.

The economic consequences of Kim Young-Sam: racing towards the abyss

Shortly after the election of Kim Young-Sam, Korea's first civilian president for over 30 years, the government published a new comprehensive five-year economic plan. This plan constituted an ambitious and coherent vision for the creation of an open-market based economy and an efficient regulatory state. Moreover, the rhetoric of 'globalisation and accelerated liberalisation' was initially backed up by an equally impressive set of concrete actions. The government finally stopped directly intervening in the selection of bank management; began to liberalise the rules limiting both overseas borrowing by Koreans and equity purchases by foreigners; and, most impressively of all, the state actually made a serious attempt to force the *chaebol* to reform themselves into more streamlined, profit-oriented organisations (Gills, 1996; OECD, 1996b; Kong, 2000: 144–208).

In one very important sense, these early reforms set the tone for the entire

Kim Young-Sam presidency. Over the next five years a plethora of capital account controls were removed, the environment for inward direct investment was improved considerably, and the procedures and structures of economic policymaking were fundamentally altered. On another level, however, the economic reform programme of the new administration failed to live up to the expectations generated by its dramatic start. Put simply, while the processes of market opening and liberalisation continued apace, very little progress was made in tackling the fundamental problems that made deep integration into the global economy so problematic for Korea. It was this combination of accelerated market opening and the continuing failure to tackle the deep structural problems that beset the Korean economy – most notably the financial structures of leading firms – that led directly to the 1997 crisis.

The decision of the Kim Young-Sam administration to accelerate and deepen the liberalisation process can be attributed to a number of different factors. Aspects of this acceleration can be understood as having been forced on the government by the impending creation of the WTO and the demands that this organisation placed upon member governments (Gills, 1996; Kong, 2000: 151–3). However, it is a simple empirical fact that many of the reforms Korea undertook were not forced upon it by the WTO. It is not sufficient, therefore, simply to attribute the acceleration in the pace of neo-liberal reform that took place after 1992 to changes that were taking place in systems of international trade regulation. Nor can this change of pace simply be understood as having been a result of pressure from the *chaebol*. The fact that the Kim Young-Sam administration, initially at least, made a serious attempt to force the *chaebol* to reform undermines the argument that the government was simply in the *chaebol*'s pocket.

In part, the Kim Young-Sam administration's more wholehearted embrace of neo-liberal reform reflected the new president's personal political ambitions. There is no doubt that Kim Young-Sam wished to develop a higher international profile and to differentiate himself as a new civilian leader from the generals who had gone before him. Two key means of achieving these objectives were gaining membership of the OECD – something that would require considerable economic reform – and the creation of a 'new liberal economy' (Gills, 1996; Kong, 2000: 144–208).

The most important explanation as to why the Kim Young-Sam administration felt the need to break with previous gradualist patterns of reforms, however, can be found by analysing Korea's macroeconomic performance. By the standards of most economies Korea's economic performance in the early 1990s was spectacular. Korean GDP grew by 5.0 per cent in 1992 and 5.8 per cent in 1993 (Kong, 2000: 23). By Korean standards, however, this performance was worrying. Korea had not registered two consecutive years of sub 6 per cent growth since 1961–2 (Amsden, 1989: 56). Surprising as it may sound, 5 per cent growth represented a crisis in the minds of the public, business leaders and state managers. Although the 'poor' growth performance of the economy in 1993 was largely a result of the government's own short-lived but serious attempt to force the *chaebol* to rationalise their activities, this does not alter the fact that the

administration clearly felt that 'something' ought to be done to boost the economy. Indeed, given the fact that the government's own initial economic plans discussed the need to fundamentally reform the economy in order to secure future growth, it is quite probable that the technocrats around Kim Young-Sam saw the downturn as a symptom not of conjunctural but structural economic problems. That recovery required substantial reform and, perhaps most importantly of all, that domestic economic actors be granted greater access to the global financial market.¹² Key sections of the state elite had of course long been committed to such reform but their plans had been scuppered by the economic ministries' highly salient concerns about the fragility of the corporate and financial sectors. The 'poor performance' of the economy in the early 1990s demonstrated for such reformists that the process of economic opening must be accelerated regardless of the economy's internal weaknesses. There may also have been a sense that, following the failure of the state's corporate reform drive in the first half of 1993, the government simply accepted the fact that it was unable to resolve the internal problems of the Korean economy. To put it crudely, the Korean economy was as well prepared for deep integration into global circuits of finance and production as it was ever likely to be.

It is against this context that we must understand Korea's new-found determination to join the OECD. Ultimately, Kim Young-Sam's personal ambitions can only offer a very partial explanation as to why the Korean state suddenly felt the pressing need to join the OECD as rapidly as possible in the mid-1990s. The government was determined to join the OECD because it saw membership as a useful way of advancing processes of domestic neo-liberal reform – the success of which it believed future national competitiveness to rest upon. Moreover, membership of the OECD would serve to 'lock in' neo-liberal reforms by imposing considerable costs on any future administration that sought to resuscitate the dirigiste policies of the past. It is entirely incorrect, if this interpretation is correct, to view the reforms that were undertaken in preparation for OECD membership as a product of external political pressure (Kim, 1999).

In order to understand the development of the processes of economic restructuring under the Kim Young-Sam administration more fully this study is divided into three sections. The first focuses on the restructuring of the Korean state itself, and the creation of new institutional and legal frameworks that sought to embed the new neo-liberal policy regime within the structures of the state. The second and third sections deal with the substantive changes that took place between 1993 and 1997 in the financial and corporate governance regimes respectively. The global and domestic factors that drove the process of accelerated liberalisation after 1992 and accounted for the failure of the government to resolve the fundamental weaknesses of Korean capitalism will be more fully drawn out here.

Institutional reform

As we argued in Chapter 2 the creation of market-conforming systems of economic governance involves not only the adoption of a new set of economic

policies but radical changes in the structures of the state itself. At the heart of the neo-liberal project is an attempt to place key aspects of economic policy outside the confines of political control. This is achieved by farming out key regulatory and policymaking functions to independent governance institutions. The independence and fidelity of these institutions to their legally mandated objectives is ensured by creating internal decision-making structures that are as transparent as possible, thus ensuring that any 'improper' political interference in their operations is highly visible. The centrality of such institutional restructuring within the broader contemporary neo-liberal project cannot be overestimated. Put simply, it is only by strictly curtailing the levels of political control over and bureaucratic discretion within the policymaking and implementation process that the state can demonstrate a credible long-term (quasi-permanent) commitment to the pursuit of market-conforming policies (Gill, 1998; Jayasuriya, 2000; 2001a; 2001b).

It is interesting to note that despite the importance of institutional restructuring within the neo-liberal project globally, no fundamental overhaul of the institutional structures of economic governance took place in Korea prior to 1993. Certain important changes had taken place, such as the creation of the FTC. By no stretch of the imagination can such measures be understood as constituting a coherent, state-wide programme of institutional reform. Indeed, even after the increase in the overall pace of economic liberalisation after the election of Kim Young-Sam, the processes of institutional/legal restructuring continued to advance only in a slow and uneven fashion. Prior to the financial crisis, both the levels of insulation key economic policymaking enjoyed from political control and the levels of transparency within the policymaking and implementation process were relatively low. While the Korean state may no longer have been the dirigiste entity it once was, it could still not be accurately described as a neo-liberal regulatory state.

That said, the institutional reforms that did take place prior to 1997–8 crisis can, at a stretch, be seen as laying the foundations for the construction of a new form of state. Three distinct, but related, sets of reforms within the nascent programme of state reconfiguration that began under the Kim Young-Sam administration deserve particular attention. First, the autonomy and power of the competition authority was upgraded. In 1994 the FTC was separated from the MOFE (Ministry of Finance and Economy) and in 1996 the head of FTC was given full ministerial status and all other ministries were forced to consult with him or her when making policy.¹³ At least partly as a result of these measures the number of actions taken by FTC rose from roughly 500 a year between 1981 and 1992 to around 1,000 a year in the mid-1990s (OECD, 1996b: 112–13). The upgrading of the importance and autonomy of the market-promoting FTC within the state was indicative of the increasing extent to which the government perceived its principal role as being to support the functioning of market mechanisms.

Second, the first tentative steps were taken in 1997, with the establishment of the Korean Communications Commission (KCC), to create a new set of

autonomous agencies to take over the key regulatory functions of the economic ministries. It is important not to over-estimate the autonomy of the KCC, and thus the significance of its creation, as it remained under the jurisdiction of the Ministry of Communications (MOC) (OECD, 2000a: 93). However, the creation of such a functionally distinct body charged with regulating a key economic sector such as telecommunications did represent an important, and necessary, first step towards the establishment of a set of truly autonomous regulatory bodies. The creation of the KCC can thus be seen as a significant initial move towards placing key aspects of economic policy beyond direct political control.

Finally, and perhaps most importantly, the legal frameworks governing the formation of new, and the revision of old, regulations were substantially altered in the mid-1990s. A number of important pieces of legislation were enacted immediately prior to the economic crisis that enhanced the levels of transparency within the policymaking and implementation processes, and forced the authorities to justify new regulations according to a clear set of well publicised, market-conforming criteria. By the end of 1997, the mechanisms to ensure 'regulatory quality' had been developed to such an extent that it would have been very difficult for any future administration to resuscitate the dirigiste strategies of old (OECD, 2000b: 127–66). We shall study the operation of such mechanisms in more detail in our analysis of post-crisis regulatory reform. Despite the important changes in institutional frameworks outlined above, we would stress again that the pace of institutional reform was relatively slow in comparison to the changes that took place at the level of economic policy between 1993 and 1997. It is to the very significant shift in financial policy that took place over this period to which we now turn.

Financial reform

In 1994 the Korean government produced a comprehensive plan to further liberalise domestic financial markets and to remove many of the key capital controls that insulated the domestic financial system from global market pressures.¹⁴ Moreover, unlike a great many of the other economic plans it produced, the government actually implemented this financial deregulation blueprint. Two sets of policy reforms particularly stand out within the administration's wide-ranging programme of financial deregulation. The first relates primarily to the domestic policy environment in which commercial banks operated. In 1993, the government relinquished formal control over the appointment of bank management; restrictions on product innovation were gradually eased throughout the early to mid-1990s; controls on the amounts banks could lend to various categories of firm and for different forms of economic activity were relaxed in 1993–4; by 1996, interest rates on all forms of borrowing had been liberalised; and the phasing out of the practice of channelling policy loans through commercial banks continued apace throughout this period. At the same time as enhancing the operational autonomy of the banking sector, the state strengthened ownership controls in order to offset any possible increase in the influence of the

chaebol over the allocation of credit as a result of liberalisation. Taken as a whole these reforms were, according to the MOFE, intended to create a policy environment that fostered the development of an efficient, market-based banking system within Korea (OECD, 1996b: 40–82).

However, as the 1997–8 financial crisis demonstrated, the Korean banking system remained as weak, and fundamentally insolvent, after the 1993–7 liberalisation measures as it had been before. In effect, the reforms transformed a weak quasi-state controlled banking system into a weak system within which levels of direct state intervention were greatly reduced. The essential problem was not that the financial reform measures were badly designed but that such measures were not accompanied by a sustained effort to improve the financial position of the firms to whom the banks lent. As we have already argued, as long as Korean firms remained insolvent and unprofitable it was inevitable that Korean financial institutions would, in turn, remain insolvent and unprofitable.

The problems associated with the chronic weakness of the Korean financial sector were becoming acute by the mid-1990s. The government was finally beginning to dismantle the systems of controls that previously placed strict limits on both the activities of foreign banks within Korea and the ability of domestic financial institutions to raise funds overseas. Within this new, more open financial environment, where Korean banks were active in global financial markets, the acute weaknesses of the financial system could not be managed as they had been in the past. It is the exact nature of the financial opening measures undertaken by the Kim Young-Sam administration, the second important set of financial reforms, and the rationale that underpinned them, to which we now turn.

The most important of the financial opening measures enacted by the Kim Young-Sam administration related to the removal of restrictions on the ability of domestic banks to borrow overseas. The comprehensive nature of deregulation in this area is best illustrated by the OECD 1996 report (1996b: 54) that simply concluded that, from 1994 onwards, foreign currency borrowing by banks was ‘largely freed from controls’. The importance of this reform cannot be overestimated. Never before in the history of modern Korea had a set of private actors enjoyed this form of *uncontrolled* access to global financial markets. By granting Korean banks unrestricted access to global markets, the state effectively signalled that its longstanding policy of attempting to maintain a system of Chinese walls between the domestic and global financial markets was no more.

Although, as already indicated, the lifting of controls on the banks’ overseas borrowing activities was the single most important aspect of the financial opening programme, it was by no means the only significant aspect of that programme. Five other aspects of the programme are worth briefly outlining. First, domestic bond markets were more fully opened to overseas investors (Shin and Chang, 2003: 72). Second, from 1997 onwards SMEs were allowed to borrow abroad to finance the import of capital goods (OECD, 1996b: 59). Third, overseas borrowings relating to FDI were fully liberalised (Shin and Chang, 2003: 73). Fourth, firms engaged in major infrastructure projects were allowed to

borrow overseas (ibid.: 73). Finally, the limits on foreign ownership of domestic stocks were progressively increased from 15 per cent in 1993 to 26 per cent on the eve of the crisis (Emery, 2001: 45). Although this clearly represented a move towards greater financial openness, the unwillingness of the government to allow majority foreign ownership of Korean industry was equally telling. Economic nationalism may well have been in retreat, but it was certainly not dead.

Although financial opening was clearly necessary in order to enhance long-term national competitiveness, the problems associated with it were substantial. The Korean state continued to demonstrate an almost complete inability to correct microeconomic financial deformations that previous dirigiste policies had created. By substantially liberalising the capital account without addressing the key problems that beset the corporate sector, the state created ideal conditions for the development of a major financial crisis. We now turn to the administration's failed attempts to improve the competitiveness and financial stability of the corporate sector.

Restructuring the Korean corporate sector

After the first six months of Kim Young-Sam's term in office it would have been very easy to believe that the new government would in fact succeed in improving the financial structures and profitability of Korean industry. In the period immediately following its election the administration demonstrated an unprecedented commitment to forcing major firms to rationalise their activities. The government was determined to unravel the webs of opaque inter-firm debt guarantees and investments which these conglomerates used to support loss-making subsidiaries and to fund their endless horizontal expansion plans. The limit on leading firms' investments in other firms was lowered from 40 per cent to 25 per cent of net assets, and a ceiling of 200 per cent of the guaranteeing company's capital was set on mutual debt guarantees between affiliated companies. Moreover, the government initially appeared to be quite determined to enforce these regulations. Not only was the status and autonomy of the FTC – the body charged with enforcing these new financial standards – improved, but a strict three year schedule was established for the full implementation of all the measures (OECD, 1996b: 115–16).

Despite this highly promising start the Kim Young-Sam administration's plans to force the *chaebol* to streamline their operations, curtail their endless unprofitable expansion plans and focus more clearly on improving profitability lay in ruins by the end of 1994. From this point onwards no serious attempt was made to tackle the deep structural problems that had long dogged the *chaebol*. The administration, which had come to power committed to disciplining the *chaebol*, increasingly put itself at the service of the *chaebol*, supporting their often feckless investment plans (Gills, 1996; Gills and Gills, 2000; Kong, 2000: 173–9).¹⁵

The absolute failure of the government's reform efforts is best demonstrated by reviewing a few selected figures that illustrate the financial state of Korean

industry on the eve of the crisis: For example, in 1997 the average debt-to-equity ratio within the Korean corporate sector stood at 396.3 per cent, compared to 318.7 per cent in 1994 (Jung and Lee, 2001: 144). Equally significantly, according to a number of respected analysts, around 40 per cent of Korean firms were technically insolvent immediately prior to the crisis (Woo-Cumings, 2001: 358). Most seriously in 1996 the leading 30 *chaebol* recorded returns on assets of just 0.23 per cent (Hahm, 2003: 94). A situation where high debt levels are combined with high profitability is sustainable. A situation where the corporate sector is both highly indebted and making negligible profits is not. The Korean corporate sector was in an even more fragile state in 1997 than it had been when Kim Young-Sam became president.

The failure of the administration to reform the *chaebol* was primarily attributable to the intractable nature of the problems the state faced in attempting to achieve any significant progress in this area. The severity of these problems was perfectly demonstrated by the administration's strong initial attempts to force the *chaebol* to restructure. As a direct result of the government drive to reform the *chaebol*, facility investment fell by 12.4 per cent in the first quarter of 1993 (Gills and Gills, 2000: 35). Nor was this simply a short-term blip as economic growth – at an annualised rate – fell to 3.4 per cent in the second quarter of 1993, the lowest figure since the 1980–1 economic crisis (*ibid.*). By the middle of 1993 it was clear, therefore, that the government faced the same stark choice as its predecessors had. It could push ahead with corporate reform and endure the inevitable social, political and economic consequences in terms of rising unemployment and falling growth and investment as the *chaebol* rationalised their operations. Or it could abandon its attempts to reform the *chaebol*, encourage them to increase their investment levels and enjoy strong short- to medium-term economic growth. It was unrealistic to expect the government not to perform a *volte-face* given such circumstances. The collective failure of successive Korean governments to seriously tackle the problems that beset the corporate sector reflects not so much the weakness of these governments but the seriousness of the problems they faced. As we have already argued, reform of the *chaebol* was never likely to occur in the absence of a major economic crisis that would effectively eliminate the option of simply carrying on as before and glossing over deep-rooted problems. Of course the failure to reform the *chaebol* insured that such a crisis would, sooner or later, strike the Korean economy (Woo-Cumings, 1999; 2001).

Despite the failure of the state's attempts to improve firms' financial structures, it would be misleading to suggest that no significant changes took place in the Korean corporate sector between 1993 and 1997. The most important of these changes related to firms' attempts to improve competitiveness through greater overseas investment and the government's attempts to attract greater inward FDI. The overseas investment drive of the major *chaebol* in the mid-1990s led some observers to argue that Korean firms were among the world leaders in promoting and profiting from globalisation (Hoon, 1997). Although even the most cursory glance at the internal financial structures of such firms

demonstrates that such analysis represented a serious misjudgement, the work of Hoon *et al.* did, nevertheless, reflect a real phenomenon. Between 1993 and 1996, the annual level of outward Korean FDI increased from \$1.88 billion to \$6.17 billion per annum (E. Kim, 2000: 110). Nor do such numbers tell the complete story. Korean firms were at the forefront of the new global wave of 'asset seeking investment' and the globalisation of corporate R&D. A relatively high proportion of Korean overseas investments involved the purchase of technologically advanced foreign firms and the establishment of major research facilities in the economically advanced countries (see particularly, von Hoesel, 1999; Ungson *et al.*, 1997; Shin, 1998). In terms of the composition of their R&D activities, Korean firms were among the most globalised in the world. These investments were important for two reasons. First, they appeared to offer a viable means through which Korean firms could at least partially overcome both their own technological weakness and those of the Korean national innovation system more generally.¹⁶ Second, the globalisation of 'core' activities such as R&D represented a palpable first step in the denationalisation of Korean firms and the transformation of these firms into truly global entities.

Another phenomenon that the aggregate FDI figures fail to illustrate is the growing significance of non-equity strategic alliances between domestic and overseas firms. Although the importance of these forms of global linkages varied, a number of major *chaebol*, such as Lucky Goldstar (LG), demonstrated a marked preference for these more economical forms of global expansion (Ungson *et al.*, 1997: 125–7). The success of firms such as LG future was, by 1997, dependent as much on their involvement in global marketing and research networks as on the development of independent firm-level expertise.¹⁷ Whether through straight FDI or through strategic alliances, Korean firms' attempts to globalise their operations were very strongly supported by the Kim Young-Sam administration. Although major investments still required the approval of the BOK, the consensus within the literature is that gaining such approval was a relatively undemanding task. Certainly neither LG Electronics nor Hyundai Electronics faced any serious problems in gaining permission to invest \$2.26 billion in an electronics plant in Wales or \$1.3 billion in a semiconductor plant in America, respectively (Ungson *et al.*, 1997: 121; von Hoesel, 1999: 198). Moreover, the government offered firms wishing to invest overseas a host of tax benefits, preferential credit agreements and guarantees against political risks such as war, expropriation and inconvertibility (Shin, 1998: 52–4; von Hoesel, 1999: 81–2).

At the same time as it vigorously promoted overseas expansion by domestic firms, the Kim Young-Sam administration abolished many of the controls that had previously limited FDI within Korea. Vast new swathes of the economy were opened up to FDI and the bureaucratic procedures potential investors had to go through were simplified (Bishop, 1997; Kong, 2000: 164–5). As a result of these policies, inward FDI increased from \$1.04 billion in 1993 to \$3.2 billion in 1996 (E. Kim, 2000: 110). Although the reforms undertaken by Kim Young-Sam administration were clearly significant, investors continued to complain bitterly about the difficulties of doing business in Korea and argued that the

operating environment was not as liberal as the formal regulations suggested (Bishop, 1997: 118–50; Personal communications with foreign businesspeople). The principal complaint of overseas investors was the difficulty of obtaining the various licences and permits which firms of all nationalities required in order to operate within in Korea. Although no formal distinction was made between foreign and domestic firms, foreign investors contend that in reality they were discriminated against. When foreign firms threatened the position of key domestic firms, it has been alleged that the bureaucracy did everything possible to make life difficult for these firms by such expedients as ‘losing’ forms.

It is very difficult to accurately assess the validity of these complaints – because of the informal nature of the alleged restrictions. Intuitively, however, we suspect that there was a high degree of truth in such complaints. It is almost inconceivable that a number of influential groups within the Korean state would not have attempted to prevent foreign investment undermining the position of key domestic firms. Although the Korean political elite and the more conservative elements of the bureaucracy fully appreciated the need for Korea to attract FDI at an abstract level, such groups were embedded within decades-old relationships with major domestic firms. It is unrealistic, therefore, to have expected such groups not to show some preference for domestic firms over overseas ones, although we may argue about the degree of preference shown. ‘Losing forms’ represented an important means through which working-level bureaucrats, who were acutely aware of the possible problems that could accompany overly rapid liberalisation, could exercise a form of low-level prudential control over the pace of the FDI liberalisation process. In all probability these bureaucrats believed that they were not simply acting in the narrow interests of key ‘client’ firms but in the interests of Korean society as a whole by obstructing foreign investors. The argument that foreign firms were discriminated against is given further credence by the fact that inward FDI was only slightly over half the level of outward FDI in 1996 (E. Kim, 2000: 110).

It was not until after the 1997–8 crisis that the Korean state would demonstrate a clear determination to open up the economy to FDI and to tackle the deep-rooted structural problems that plagued the corporate sector. Kim Young-Sam’s economic reform programme can be best summed up as a less than entirely successful attempt to affect a ‘neo-liberal regime shift’. The effect of the administration’s policies was to undermine the old regime of accumulation without fully establishing the necessary conditions for a new functioning neo-liberal regime of accumulation to be born. Korea in the early 1990s was neither a functioning dirigiste state nor an effective neo-liberal state. However, what the Kim Young-Sam administration’s policies did by dismantling core elements of the old mode of regulation was to create the conditions for a major economic crisis. As we shall argue, this crisis in turn can be understood as creating the necessary political and economic space for a new neo-liberal state and economy to be born. In this sense at least Kim Young-Sam’s contribution to establishing a new neo-liberal regime of accumulation was highly significant. We shall focus on the post-crisis processes of economic reform in the second part of the book.

Before doing so, however, it is necessary to summarise the key themes of the analysis offered within this chapter.

Conclusion

Two central conclusions stand out from the analysis presented within this chapter. The first is that, in many respects, the neo-liberal project was relatively far advanced in Korea prior to the 1997 crisis. Moreover, it is equally clear that the liberalisation process was principally driven by concerns about national competitiveness not by external political pressure, and that significant sections of the Korean elite were deeply committed to the project. That said, Korean elites did have to factor in US demands for market opening and incorporate these within their own internally driven reform programme. It is important to highlight the clear continuities that existed between pre- and post-crisis processes of neo-liberal reform. By doing so, we refute the argument that the neo-liberal project has simply been imposed on Korea by foreign powers, principally the US, in the wake of the crisis. Far more important than US pressure in accounting for Kim Dae-Jung's decision to fully embrace neo-liberal reform in the wake of the crisis was the fact that he inherited an economy that had already been substantially liberalised.

The second, equally important and somewhat paradoxical, conclusion of this chapter is that prior to 1997 there had been a conspicuous failure to address the structural problems that beset the Korean economy. Prior to the crisis Korean elites won considerable praise for carefully 'sequencing' reforms, for having embraced the central ideas of the post-Washington consensus in the 1980s while the majority of mainstream economists still misguidedly argued the case for shock therapy. However, in reality the Korean reform process was not 'properly' sequenced, it was simply slow. Korean elites never undertook the difficult but necessary reforms that were required to prepare the way for successful market opening. Korea simply walked towards the edge of the cliff while others ran. Even the most cursory glance at the financial structures of Korean firms and financial institutions prior to the crisis illustrates how ill-prepared such entities still were to survive the rigours of competition within a rapidly integrating global economy. Moreover, in the absence of a major economic crisis, it was politically impossible for the state to tackle these deep structural problems, not only because of the political power of the *chaebol* but, more importantly, because of the macroeconomic and social effects of forcing firms to restructure their activities. It is necessary, therefore, to understand the 1997 crisis as a necessary and unavoidable part of the liberalisation process in Korea. The 1997 economic crisis effectively eliminated the option taken by previous Korean governments of simply papering over the cracks and maintaining short- to medium-term economic growth at all costs. At the same time, it created an opportunity to move ahead with a positive programme of reform.

The crisis marked the beginning of the third phase of the economic liberalisation process. The conditions were now in place to move forward decisively with

the project to effect the 'neo-liberal regime shift' that Kim-Young Sam had initiated in 1993. As we shall argue in the next three chapters the state has acted decisively since 1997 to establish the core elements of a new neo-liberal mode of regulation and regime of accumulation. Jessop's contrast between policy adjustment and regime shift is helpful here. Discontinuities are obviously apparent between the period of cautiously incremental neo-liberal policy adjustment until 1993, and the more ambitious pursuit of neo-liberal regime shift thereafter. More marked still is the contrast between Kim Young-Sam's attempt to create a functioning neo-liberal economy in the early to mid 1990s, which never even looked like succeeding, and the substantive progress that has been made towards this objective since the crisis. However, while these discontinuities are important it is equally apparent that the creation of a neo-liberal economy represents a logical, but by no means inevitable, conclusion to the process of economic liberalisation embarked upon in 1980. The direction if not the pace of change has been clear for over two decades.

6 Building institutions for markets

Between 1997 and 2000 a dramatic transformation took place in the rules and institutions governing economic activity within Korea. Almost half of the 11,000 regulations in place prior to the crisis were abolished and the majority of the remaining regulations reformed. Additionally, over 1,840 informal regulations were identified and either abolished or, in a small minority of cases, formalised (OECD, 2000b: 49). At the same time as large parts of the old regulatory frameworks were being relegated to the dustbin of history, new prudential standards, designed to enhance the functioning of market pressures, were being created. In parallel with these processes of policy reform, an equally important set of changes has taken place at the level of institutional structures. The most visible, and important, aspects of this process of institutional reconfiguration have involved the creation of a new independent financial regulatory authority and a more autonomous central bank. Such reforms serve to place significant aspects of economic policy beyond direct political control and to reassure global capital that economic policy will be determined by clear technical criteria, not fickle politicians. At the heart of this institutional reconfiguration is a desire to ensure that political pressures and interests are not allowed to distort the functioning of markets (Jayasuriya, 2001a).

Understood as a totality, the reforms outlined above have one central overall objective, to allow the full extension of market discipline to every aspect of economic life within Korea. For this reason it is highly appropriate to use the title of the World Bank's 2002 world development report as the title of this chapter (World Bank, 2002). The appropriation of the title of a major World Bank report also serves to illustrate how the new policy regime is entirely commensurate with global post-Washington consensus norms in a way the old systems of economic governance within Korea were not. Indeed, the IMF was instrumental in designing several of the key reforms that have been enacted since the onset of the crisis. The intimate involvement of the IMF in the reform process should not, however, be allowed to disguise the fact that there was very significant support for market-based reform within Korea itself; neo-liberalism was not simply something imposed from the outside. Particular attention will be paid here to how the crisis, and the intervention of the IMF, affected the balance of power between reformers and conservatives within the Korean state-capital

complex. This will show both the importance of external intervention in determining the precise nature of policy outcomes and the extent to which the enactment of full-blooded neo-liberal policies represented the logical conclusion of the reform programme the state had embarked upon almost two decades earlier. In analysing the importance of external intervention, it must be stressed that, thanks to the strong recovery in 1999, Korea was really only dependent on external non-commercial borrowing, and thus forced to follow IMF dictates, for one year. Indeed, by August 2001 Korea had paid back the IMF in full – three years ahead of schedule (Gruenwald, 2001: 1). There has been no major palpable shift in economic policy since the end of effective external stewardship thanks to the profound commitment of the politicians, senior bureaucrats and growing sections of Korean capital to the neo-liberal project.

An extensive if uneven literature now exists focused upon the post-crisis legal and institutional restructuring process. This literature can usefully be divided into four broad schools. First, there are those neo-liberal analysts who emphasise the continuing weaknesses of Korean regulatory systems (S.S. Kim, 2000; Kirk, 2000; Emery, 2001; Graham, 2003). These analysts tend to focus principally on systems of corporate governance as this is where the principal deficiencies of the current system of economic governance are seen to lie. Second, there are more optimistic broadly neo-liberal analysts who argue that a number of key reforms have been enacted since the crisis and Korea is now far better placed to meet the challenges posed by globalisation (Ahn, 2001; Haggard *et al.*, 2003; Mo and Moon, 2003; Yun, 2003). However, none of these analysts explicitly argue, as we do here, that the key elements of a new neo-liberal mode of regulation are in place. Third, there are those left-Keynesians who assert that Korea is becoming a neo-liberal state and that this is undermining its long-term growth prospects (Crotty and Lee, 2001; Shin and Chang, 2003). Within this school we could also include the constructivist work of Hall (2003) on the ‘discursive demolition of the Asian development model’. Hall argues that Korea is pursuing neo-liberal reform not because of the dictates of international competitiveness but because of prevailing ideational conditions. More precisely he argues that through their collective efforts to de-legitimize the old model, the US Treasury, the IMF and Kim Dae-Jung have created an ideational environment inimical to anything other than neo-liberal development. This analysis is very similar to that offered by left-Keynesian economists in their somewhat cursory and unsatisfactory attempts to analyse the forces driving neo-liberal reform, although the language employed is very different. For these scholars, as for Hall, the key to understanding why Korea has adopted neo-liberalism lies in a combination of Kim Dae-Jung’s personal desire to use neo-liberal reform as a means of weakening the hated *chaebol*, whom he considered enemies of democracy, and IMF pressure (Crotty and Lee, 2001: 5–8). Finally, Weiss (2003b: 251–8) offers a quite distinctive reading of the institutional reform process. Weiss focuses her attention on the creation of the FSC which she understands as being a new ‘pilot agency’ capable of implementing a coherent industrial policy and disciplining capital. Weiss believes that a new ‘reformed’ developmental state is

being born and that the neo-liberal excesses of the early 1990s are a thing of the past.

We will address the issues raised by these scholars, and defend our own distinctive analysis of the contemporary Korean state, in the course of this chapter. A clear alternative, focused upon material conditions and imperatives, to the analysis of those scholars who highlight the importance of Kim Dae-Jung's personal political project and the discursive practices of the IMF and US in driving economic reform is also advanced here.

One problem we face in constructing our analysis is that the existing academic literature on institutional and policy restructuring is highly uneven. Certain reforms, relating to corporate governance, have been the subject of extensive study while other important reforms, such as changes in the laws governing the formation of new regulations, have been partially ignored by the academic community. On the whole most Korean specialists have focused almost exclusively on policy reforms rather than on institutional reforms. Reforms such as the creation of an independent financial regulator are discussed in passing rather than analysed in depth, even within those texts which assert that such reforms are important (Graham, 2003: 111; Shin and Chang, 2003: 92). The reader would remain almost completely unaware of the changes in regulatory policy-making structures and electricity regulation were they to confine themselves to reading English language academic publications. The failure to analyse why the state did not create an independent telecommunications regulator, despite the best advice of the transnational neo-liberal policy community, is particularly striking given the extensive literature that exists on this industry (Hyun and Lent, 1999; Choi *et al.*, 2001; Tcha *et al.*, 2000). As a result of the gaps in the current academic literature we draw very heavily on official reports in developing our analysis of many key institutional reforms.

In attempting to analyse the changes in the economic policy regime over the last four years we are confronted with one major problem. Put simply, the scope of the reform programme has been such that it is almost impossible to conduct a truly comprehensive survey. This study here focuses on five different aspects of the overall process. The first section of this chapter focuses on the reconfiguration of institutional structures and policymaking procedures. The second section analyses the transformation in systems of financial regulation that has taken place since the crisis. Against this context, in section three, we move on to examine the important recent changes that have taken place in the laws relating to corporate governance. The fourth section focuses on the economic opening measures that have been enacted since the crisis. The fifth, and final, section of this chapter looks at privatisation and the marketisation of the state itself.

A number of key points concerning the organisation and scope of this chapter must be made clear before we proceed. First, we would stress that the divisions posited between different aspects of the reform process are somewhat arbitrary. For example, should the creation of an independent financial regulator be understood as an aspect of institutional or financial sector reform? The essential point

is that the neo-liberal project must be understood as an over-arching unified whole. Second, the dictates of space have forced us to exclude from our analysis several, unquestionably important, aspects of the process of institutional and policy reform, such as the reform of taxation and land-use policy. Finally, it is important to make clear that this chapter is only concerned with changes in institutional structures and the creation of new regulatory frameworks. The purpose of this chapter is not to analyse the often highly interventionist short-term policies the government has pursued in order to expedite economic restructuring in the wake of the crisis.¹ Rather, it is to illustrate the progress the Korean state has made towards its ultimate objective of creating an unambiguously neo-liberal system of economic governance. Policies related to the labour market and welfare provision are also ignored here, although many would fit comfortably within this chapter, as these policies are examined in Chapter 9. Such artificial divisions are, unfortunately, necessary for reasons of exposition.

Institutional and procedural reform

Our analysis of the processes of institutional and procedural restructuring in post-crisis Korea is divided into four parts. The first focuses on the significance of the new BOK act, passed on 31 December 1997, that gives the central bank much greater autonomy from political control. The particular importance of central bank independence within an economy such as Korea's where the central bank had previously been an instrument of industrial policy will be drawn out here. Against this context, we will move on to study the significance of the creation of an independent unified regulatory agency, the FSC. The historic importance of the establishment of such a strong autonomous institution in a state where practices of regulatory forbearance and direct intervention in the decision-making of institutions had been the norm is highly significant. Third, we will examine the systematic application of market-based principles to processes of policymaking and review. Both the important continuities between pre- and post-crisis reform efforts and the significance of fresh innovations that have taken place in the wake of the crisis will be highlighted here. Finally, we shall draw attention to the ways in which Korean institutional frameworks continue to fall short of global neo-liberal standards of 'best practice'. We will pay special attention to the failure of the state to create truly independent regulators in key sectors such as telecommunications and electricity.

Although we deal with each of the major reforms separately, we would stress at the outset that the importance of individual measures can only be understood when they are viewed as part of a broader process. The whole is greater than the sum of its parts. If we get bogged down in the minutiae of policy detail, there is a danger that we shall fail to capture a proper sense of the fundamental importance of, and the dynamics and contradictions within, the process as a whole.

Central bank independence

The BOK has historically been little more than an appendage of the MOFE. According to Maxfield (1994: 561, cited in Jayasuriya, 2001a) ‘the central bank [did] little more than implement credit policies in line with overall government spending plans’. In other words, rather than being a genuine policymaking institution, the bank’s role was simply to facilitate the smooth functioning of industrial policies formulated elsewhere. This subordination of the bank to the economic ministries reflected the dictates of the Korean system of economic planning. This system required that the central bank engage in a plethora of rediscounting and support operations that were incompatible with any sort of focus on price stability or control of monetary aggregates. The principal objective of monetary policy was essentially a microeconomic one, to ensure that sufficient funds were channelled towards chosen projects and economic actors.

Given the history of central banking in Korea, the new BOK act that was passed, at the insistence of the IMF, on 31 December 1997, must rank as the single most important piece of legislation enacted since the onset of the economic crisis. Enhancing the authority and autonomy of national monetary authorities always represents a major policy initiative, as, by its very nature, it involves a major shift in macroeconomic policymaking responsibility away from politicians to autonomous technocrats. The intrinsic importance of this shift is perhaps best illustrated by the experience of Britain. In Britain, unlike Korea, there was no real history of using monetary policy to influence the allocation of credit. Moreover, prior to the creation of an independent central bank, Britain had been governed for 18 years by an administration that had demonstrated a clear willingness to inflict considerable damage on the economy in its attempts to force domestic producers to control costs and achieve price stability (Kaldor, 1982; 1996; Cairncross, 1992; Hutton, 1996; Bonefeld, 1993). Despite this historical backdrop, granting operational independence to the Bank of England is generally regarded, not least by the government itself, as the single most important piece of legislation enacted by the Blair administration. The importance the government itself attaches to central bank independence is revealed by both the urgency with which it sought to implement such reforms and the central place discussion of the ‘new monetary framework’ takes within official reports (HM Treasury, 2002).² In Britain, central bank independence formed the centrepiece of the Blair administration’s economic policy. In Korea, where price stability had been less of a priority and monetary policy had previously been used to channel capital into favoured industries and economic actors, the creation of an independent central bank represented an epochal event.

Nor was there anything equivocal about the form of independence that was granted to the BOK. The 1997 BOK Act created, at the stroke of a pen, a highly autonomous central bank with a very clear mandate to pursue price stability and abstain from deliberately distorting the allocation of credit. A close examination of the new act reveals the full importance of the 1997 central bank reforms (Bank of Korea, 1997). First, the personal autonomy of members of the

Monetary Policy Committee (MPC) was greatly enhanced. The Governor of the BOK, a civil servant, replaced the Minister of Finance and Economy as head of the MPC. The now internationally standard provisions making it impossible for politicians to remove any member of the MPC, who is neither mad nor criminal, are included in Article 18 of the new Act. More unusually, Chapter 2 Article 13 of the Act stipulates that three of the seven members of the committee are to be nominated by private business institutions. Two of the three private institutions, the Korea Securities Dealers' Association and the Federation of Banks, represent the financial community; this has very important implications for the conduct of monetary policy. As Jayasuriya (2001a: 7) argues 'the membership of such groups is clearly indicative of the fact that monetary policy will have to reflect the preferences of the financial community which is not likely to be sympathetic to activist industrial policy'. That said, it would be wrong to understand the BOK as having been captured by a narrow set of private interests. The majority of the MPC members continue to be nominated by the economic bureaucracy and the Governor of the Central Bank acts as chairperson of the committee.³ More important still, the MPC does not enjoy the freedom to make policy as it chooses. While the MPC enjoys autonomy from direct political control it has a clear legal obligation to maintain price stability and uphold principles of market neutrality in its operations. These legal constraints ensure that the MPC is forced to act in the general not the particular interests of capital (Bank of Korea, 1997).

The requirement that the bank upholds market neutrality and avoids deliberately distorting the allocation also undermines the parallels that Weiss and Thurbon (2006) attempt to draw between the historically independent Taiwanese Central Bank and the newly independent Korean Central Bank. Weiss and Thurbon are undoubtedly correct in saying there is no intrinsic tension between CBI and the central bank using its powers to ensure that firms in strategically important industries have received relatively cheap credit. However, even the most cursory glance at the rules the Korean central bank operates within make it clear that it is a neo-liberal institution.

In the pursuit of its legally mandated objectives the MPC enjoys almost complete control over the instruments of monetary policy. Under the terms of the 1997 Act, the MOFE ceded the power to overturn any decision of the MPC. Moreover, any request the MOFE makes to the MPC to reconsider policy must be made public immediately. The public nature of the consultation and dispute resolution process is of the utmost importance. It strongly discourages the MOFE from seeking frequent revision of monetary policy, as to do so would undermine the credibility of the regime, and it makes it virtually impossible for the President to support any appeal by the MOFE. Theoretically, were the MPC and MOFE to fundamentally disagree on the conduct of monetary policy the final decision would rest with the President (Bank of Korea, 1997: Chapter 5, Article 88). In practice, however, the President's power in this area is far more imagined than real. Were a president to publicly overturn a major decision by the MPC, the economic and the political costs would be enormous. They would

in an instant destroy the credibility of Korea's anti-inflationary regime and fatally undermine the countries' standing within global capital markets. It seems implausible that any President would consider such a course of action in anything other than the most extreme crisis situation.

Given that the 1997 BOK Act represented a dramatic, and fundamental, change in the structures of Korean economic governance it is surprising how little attention it has commanded in the English language academic literature on Korea. The new BOK act has been welcomed as a positive step by the mainstream academic literature (Emery, 2001: 158; Graham, 2003: 110–11). However, the reforms are dealt with in a few lines, their precise content is not examined, nor the pressures and aspirations that led the government to pursue reform. In part this failure may be a product of the near axiomatic belief in mainstream economics that central bank independence is simply a 'good', intrinsically, which need not be explained. The most interesting work on BOK reform is not to be found in any work specifically focused on Korea but as part of the groundbreaking work by Jayasuriya (2001a; 2001b) on globalisation and institutional restructuring. Jayasuriya, correctly in our view, highlights how the need to secure and maintain the confidence of global financial markets played a key role in the creation of an independent central bank. The central ideas of Jayasuriya's work are fully incorporated into our analysis of the forces and imperatives that drove central bank reform below. We shall also draw upon Matthews' (1998: 755) valuable work, which highlights the role BOK reform has played in disciplining domestic firms.

Equally scholars, who consistently argue that *de jure* legal changes have not been fully translated into practice, have not explored the actual level of autonomy the BOK enjoys in practice. In part, to be fair, this may be explained by the fact the BOK has since the end of 1998 faced a relatively benign macroeconomic environment and has, therefore, yet to make any really difficult and controversial decisions. The real tests of BOK independence are yet to come. Although this statement must be qualified by a recognition of the fact that in the Korean context the importance of central bank independence was as much microeconomic as it was macroeconomic.

The most obvious answer to the question of why the government introduced the act is to understand central bank reform as an attempt to placate the IMF. The stand-by agreement Korea signed with the IMF on 5 December 1997 made it clear that the IMF regarded central bank reform as a matter of some urgency, to quote:

The following financial sector reform bills submitted to the National Assembly will be passed before the end of the year... (1) A revised Bank of Korea Act, which provides for central bank independence, with price stability as its main mandate.

(IMF, 1997)

Despite the involvement of the IMF in promoting central bank reform it would, nevertheless, be incorrect to understand the 1997 BOK reform as simply being a

product of external pressures. There is clear evidence that key sections of the Korean elite were themselves committed to creating a more autonomous central bank. The newly elected President, Kim Dae-Jung, had been a consistent advocate of greater central bank independence throughout his political career (Kim, 1996: 107–9). Moreover, in June 1997 the Kim Young-Sam government, acting on the advice of Financial Reform Committee (FRC), had introduced legislation to the National Assembly to significantly enhance the autonomy and power of the BOK (Emery, 2001: 41–2). The attitude of these more reform-oriented sections of the elite to the IMF plans for central bank reform was largely positive, if somewhat ambiguous. Even these sections of the Korean elite felt somewhat uncomfortable with the full extent of autonomy and power ceded to the BOK under the terms of the 1997 act. However, these forces clearly welcomed the IMF's assistance in overcoming conservative resistance to central bank reform. In a sense, the IMF and reform-oriented state elites were locked in a relationship of mutual dependence. Reform-minded state elites had consistently failed to advance certain key policy measures in the face of concerted opposition from powerful conservative forces; such groups clearly needed external support to accelerate the processes of state restructuring (Interviews with senior BOK officials, 2001). Equally, the IMF needed the support of key personnel within the Korean state to advance its own neo-liberal agenda. As the experience of Indonesia demonstrates, where economically liberal forces are weak within the domestic state–capital complex, there are limits to what IMF conditionality can achieve, even when the state faces massive fiscal pressures. The IMF can impose a terrible price on states that defy its will, but in the final instance, it cannot always impose its will on recalcitrant national elites (Robison and Rosser, 1998; Hamilton-Hart, 2000; Eklof, 2001).

The growing commitment of key sections of the Korean elite to greater central bank independence in the 1990s cannot be understood outside the context of the important changes that were taking place in domestic financial structures. The declining importance of policy loans and other forms of subsidised credit made it possible for Korean elites to seriously consider granting the BOK greater autonomy in the 1990s. Moreover, the 1993–7 financial liberalisation plan massively increased the vulnerability of the Korean economy to changes in global financial market sentiment. By creating a more autonomous central bank, the state could send out a powerful signal to global markets about its commitment to maintaining price stability. The desire to secure sustained inflows of foreign capital was clearly an important factor in motivating Korean elites to support greater central bank independence. In seeking to enhance central bank autonomy, in order to reassure global markets of their commitment to price stability, Korean elites were following a lead set by countless underdeveloped and developed states over the course of the 1990s. The growth of a unified global financial market has been accompanied by a secular rise in the levels of central bank independence throughout the world (Jayasuriya, 2001a; 2001b).

However, in Korea where the central bank had previously been used as an

instrument of industrial policy, central bank independence was about far more than the control of inflation and the desire to attract capital inflows. The commitment of key sections of the economic bureaucracy to reforming the BOK reflected their determination to discipline key domestic firms. Creating an independent central bank was an important step towards cutting off the automatic supply of credit that politically connected, strategically important, but unprofitable firms had previously enjoyed (Matthews, 1998: 755). The primary significance of CBI in Korea lies in its capacity to subject major Korean firms to hard budget constraints for the first time in modern history.

The restructuring of the institutions of financial and monetary governance within post-crisis Korea has not been limited to central bank reform. We have seen equally dramatic changes in the institutional structures of financial regulation since the onset of the crisis. It is to these processes, centred on the creation of the FSC/Financial Supervisory Agency (FSS), that we now turn.

The creation of an independent financial regulator

Prior to the 1997 crisis, four separate agencies collectively performed the task of financial supervision in Korea. None of the four agencies, which supervised banks, securities companies, insurance firms and merchant banks, respectively, enjoyed much autonomy from political control. This lack of autonomy was important because it allowed political elites to manipulate financial regulations and maintain low regulatory standards in order to promote broader political and economic objectives. More precisely, by applying regulations in a highly discretionary manner and failing to develop proper prudential standards, the state was able to achieve two goals. The ability of leading politicians to effectively choose whether or not to apply selected regulations to particular financial institutions gave them tremendous power to influence such institutions' day-to-day lending and investment decisions. Political elites used this power both cynically to enrich themselves, through loans and bribes, and more public-spiritedly to encourage banks to fund industries the state considered important.⁴ More importantly, it was necessary for the state to both practise a form of generalised regulatory forbearance and to refrain from developing stronger regulatory systems in order to maintain the illusion that the financial system was solvent. The development and enforcement of internationally recognised regulatory standards would have forced a high proportion of financial institutions to exit the market, effectively undermining the entire financial system. Indeed, if even the rather weak, existing standards had been consistently enforced, this would have caused considerable difficulties for a number of key institutions. Paradoxically, it was necessary for the government to abstain from developing and enforcing stronger prudential standards in order to postpone the collapse of the financial system. It is no exaggeration, therefore, to say that creating more autonomous regulatory bodies mandated to properly enforce regulations could have potentially undermined the viability of the entire financial system (OECD, 1998: 57–61).

When understood against this context, it becomes clear that the creation of an independent universal regulator in 1998 represented a very clear crossing of the financial Rubicon by the Korean state. The Act establishing the FSC/FSS, and the later Presidential decree buttressing their autonomy, make it very clear that these institutions enjoy a high degree of independence from direct political control and will refrain from regulatory forbearance. Although the FSC, the executive board that determines the policies and monitors the performance of the FSS, is situated within the Prime Minister's office it 'performs its duties independently of any government organisation' (FSC, 2000: 25). While politicians had previously controlled the instruments of financial regulation, the FSC is principally composed of independent members appointed for a fixed-term over whom the executive exercises no effective control.⁵ Moreover, the powers, at least formally, delegated to the FSC are considerable, to quote:

As part of its regulatory responsibilities, the FSC deliberates and resolves policy making matters relating to the inspection and supervision of financial institutions and the securities and futures market. The FSC also has the authority to issue and revoke licences to financial institutions. This gives the FSC unrestricted jurisdiction to carry out its tasks efficiently and effectively. Legislation relating to the financial sector is drafted and submitted by the MOFE but this must be done in consultation with the FSC.

(FSC, 2000: 25)

By placing such an autonomous and powerful organisation at the heart of the post-crisis process of financial re-regulation, the Korean state sent out a clear signal about its intentions to create an 'appropriately' regulated market-based financial system.⁶ This point will be reinforced when we analyse the tightening of prudential standards that has taken place since the crisis later in this chapter.

The creation of the FSC has attracted a great deal more critical attention than the parallel process of central bank reform. Questions have been raised about the extent to which the FSC is, in practice, independent from political control. The World Bank (2003: 6) reports that 'concerns arise because of the role taken by MOFE in interpreting law and supervisory regulation, giving the FSC only limited freedom in implementing supervision'. We should take the World Bank's carefully measured criticisms seriously. However, the fact that the autonomy of the FSC may in some relatively limited way be compromised does not undermine the argument presented here that the creation of such an institution is a development of first-order importance.

Interestingly, the FSC's main radical critics seem to be in little doubt about the power it enjoys. Crotty and Lee (2001: 27–9) and Shin and Chang (2003: 92) all see the FSC as 'an all powerful' neo-liberal leviathan which is busying itself destroying the Korean economy. This understanding of the FSC as an instrument for neo-liberal reform has been challenged by Weiss (2003b: 249–58) who understands the FSC as an autonomous pilot agency that is the locus of policy-making within a reconstituted developmental state. Weiss' analysis is flawed.

First, it rests, implicitly at least, on the assertion that *because* the FSC has intervened heavily in the economy and sought to discipline financial institutions it cannot be understood as a neo-liberal institution. In making this assertion Weiss ignores the operating principles the FSC works within, the market-supporting nature of the new financial regulation (see below), and the ultimate purpose of the FSC's interventions within the marketplace.⁷

The second equally problematic basis on which Weiss constructs her argument are the rules drawn up by the FSC which suspend the voting rights of investors attempting hostile takeovers for five days when they acquire 5 per cent of total voting stock and a guideline that suggests that 50 per cent of the members of the boards of local banks ought to be Korean nationals. The laws relating to the suspension of voting rights seem to us to be completely unexceptional. These laws apply equally to Korean and foreign investors and it is quite normal for governments (even neo-liberal ones) to draw up laws of this nature to govern the takeover process. Weiss's analysis of the FSC guideline on the composition of boards is equally flawed. When she discusses the attempts of the FSC to influence the composition of boards Weiss inserts the term guideline in quotes. She invites the reader to believe that this guideline has substantive force and are indicative of the Korean state's broader economic nationalism. However, she provides no evidence whatsoever to support her implicit claims. It is equally plausible to suggest that the guideline ought to be taken at face value. On its own the publication of a single guideline concerning the composition of boards tells us less about the attitude of state managers to foreign investment than the fact that, as Weiss herself concedes, almost 40 per cent of total Korean commercial bank stock is owned by overseas investors. Indeed, the publication of the guideline in question could well be understood as a cosmetic gesture by the Korean state to placate Korean parliamentarians who attempted unsuccessfully to pass legislation to limit the numbers of foreigners who could sit on boards (Office of the United States Trade Representative, 2006).

What is most striking about the existing work on the FSC is its failure to engage in any in-depth analysis of the forces and motives that lay behind the creation of this institution. Weiss (2003: 252), who goes into as much depth as anyone, argues that the FSC, and the project it is seen to represent, came into being due to a renewed sense of public purpose within the bureaucracy and the increased leverage the state enjoyed over private sector actors after the crisis. This may well be true but it fails to identify the motive. The forces and motives that drove the state to establish the FSC were, in many respects, identical to those that motivated it to create an independent central bank. The agreements Korea signed with the IMF in late 1997 clearly stipulated that a unified autonomous financial regulator be created with all possible haste. Clearly the role of external political actors in creating the FSC cannot be ignored. On the other hand, it is important to be aware of the commitment of key forces within the Korean state-society complex to establishing an independent regulator. Three key points can be made in this regard. First, it is clear that an important constituency that favoured the creation of a more independent financial regulator

existed within the Korean state prior to the 1997 crisis. For example, the FRC had in July 1997 called for the establishment of a unified financial regulator whose 'chairman would have cabinet rank and report to the Prime Minister rather than the Minister of Finance and Economy' (Emery, 2001: 44).⁸

Second, since its creation the FSC has demonstrated a commitment not simply to establishing its credibility as an independent regulator, by refraining from regulatory forbearance and incrementally tightening prudential standards, but to thoroughly overhauling the entire system of financial regulation. The actions of the FSC since its creation tell us a great deal about the views of the wider state elite on financial restructuring and about their commitment to creating an autonomous regulator in the first place. The essential point is that although the FSC is autonomous from direct political control its members are drawn from ruling elites and are appointed by the government. The views and objectives of the FSC are clearly not likely to be inimical to those held by the dominant forces within the central government. Moreover, in the years immediately following the crisis, the autonomy of the FSC was partially compromised by the need to draw heavily on the fiscal and legislative powers of central government to expedite restructuring. The fact that the FSC has been determined, and able, to create a new, stronger, more stable financial system, therefore, demonstrates the fact that powerful forces within the broader Korean state-capital complex were acutely aware of the need to radically restructure the financial system. The creation of an independent regulator represents an integral part of this restructuring process, and the more reform-minded elements of the Korean elite were no doubt entirely comfortable with the IMF 'demand' that one be formed. Paradoxically, the central government needed to cede regulatory authority to an autonomous agency in order to achieve its objectives of strengthening regulatory standards and restructuring the financial sector. However committed central government elites may have been to improving standards of prudential regulation, this objective was in practice always likely to be compromised by other economic, social and political concerns. It is one thing to profess a quite sincere, abstract commitment to developing and enforcing stricter regulatory standards; it is quite another to actually do so when enforcing these regulations is likely to undermine growth, industrial policy and employment objectives. In contrast to the central government, the FSC as an independent regulator is able to focus on overhauling the entire system of financial regulation relatively free from concerns about the broader consequences of its actions.

Finally, the desire of the state to attract foreign investment, and the expertise that accompanies it, into the domestic financial sector has made it imperative for the state to 'improve' regulatory structures.⁹ Put simply, it is highly unlikely that overseas investors would be willing to make major investments in domestic institutions without reassurance that the state would apply regulations consistently and fairly. The old practices of regulatory forbearance had, by their very nature, the potential to create an uneven playing field. Given the Korean state's long history of, in the final instance, favouring domestic capital over foreign, this was clearly not a situation overseas investors could feel entirely comfortable

with. Moreover, the prospect that politicians might attempt to manipulate regulatory standards in order to interfere with day-to-day management decisions was enough to strike fear into the heart of the most courageous foreign banker.

The creation of the FSC and an independent central bank represented a shift of the most profound significance. Korea went, almost overnight, from having a system of financial and monetary governance that left all major decisions in the hands of politicians, to one in which all key day-to-day decisions are made by autonomous bureaucrats. Or, to put it another way, from institutional structures that supported interventionist policies to new structures that seek to embed the principles of the contemporary neo-liberal order deep within the Korean state. Although the creation of FSA and the reform of the BOK are, perhaps, the most visible aspects of the process of state restructuring, no area of economic policymaking has been left untouched. The procedures and laws governing the creation of new, and the revision of existing, regulations have been thoroughly overhauled since the beginning of 1997. It is to the important changes in the structures that determine how regulations are developed and revised we now turn.

The new regulatory framework

On 22 August 1997, the Basic Act on Administrative Regulation (BAAR) was passed into Korean law. This act forms the legislative core of the regulatory reform process in Korea. The BAAR can be understood as having two closely related objectives. The first is to ensure that all regulations rest upon a sound legal basis. The plethora of long-standing, informal quasi-regulations and guidance mechanisms that existed prior to the crisis have now been abolished. The second, more important, objective of the Act is to ensure that regulations are restricted to those that can be justified according to clear, neo-liberal, economic criteria. The legitimate purpose of regulation is to create a conducive environment for private firms to operate within and to address problems of acute market failure. It is not to attempt to maintain or create certain economic/market structures. Moreover, when regulations are deemed necessary, they are to be formulated so as to minimise the cost to market actors (OECD, 2000b; Oh, 2000).

The BAAR established three central mechanisms to bring the Korean regulatory system in line with the principles enunciated above. First, and most important, the BAAR established a powerful new institution, the Regulatory Reform Committee (RRC). The RRC is an independent administrative committee under the authority of the President. The majority of its members are drawn from outside government (from business and academia) and cannot be dismissed during their term of office unless they are hospitalised or imprisoned. This committee is responsible for establishing the overall direction of the regulatory reform process and for reviewing new and existing regulations (Oh, 2000: 83). As such it has played a pivotal role in the post-crisis processes of regulatory streamlining (see Oh, 2000: 83 and OECD, 2000b: 127–66 for a detailed analysis of the work of the RRC).

Second, as a result of the BAAR extensive systems of public consultation are now built into the process of formulating new, and reviewing old, regulations. The essential purpose of these systems is to insure that the views of all market actors on the necessity and design of regulation are taken into account. In other words, public consultation ensures that regulation reflects the general rather than the particular interests of capital. The demand that regulation reflect the general interest of capital acts as a barrier against dirigiste industrial policies that, by their very nature, discriminate in favour of certain 'strategically important' firms and industries at the expense of other market participants. Third, the BAAR stipulates that clear regulatory impact analysis (RIA) procedures are to be applied when making new and revising existing regulations. These procedures force regulators to demonstrate that regulations are necessary to tackle acute social and economic problems, and that regulations 'hinder competition' as little as possible (OECD, 2000b: 150). This effectively presents another barrier to more strategic dirigiste regulations that seek to actively shape market and economic structures, rather than allow market forces to work to the fullest possible extent and quite deliberately restrict competition.

The changes that have taken place in the structures of regulatory formation and revision are interesting for two reasons. First, these changes constitute an integral part of the broader process of advancing and 'locking-in' neo-liberal reform. The creation of the RRC and the changes in regulatory development procedures (increased transparency and the use of RIA) have created formidable barriers to any attempt to resuscitate old-style dirigiste regulation. By doing so, these new regulatory frameworks give a powerful signal to capital, both domestic and foreign, about the state's intention to refrain, as much as possible, from directly interfering in the functioning of markets. Firms cannot expect the state to use the regulatory process to shield them from market disciplines. The state is to set environmental and minimum labour standards, ensure that corporate and financial governance systems meet global norms and then 'let the market rip'.

The reforms detailed above are of special significance to foreign capital. Overseas investors often found it more difficult to deal with intrusive regulations, because of discrimination and lack of local knowledge, and had until 1997 been unwilling to invest heavily in Korea (Bishop, 1997: 118–63; 2001). The changes ushered in by the BAAR, which demonstrated the state's long-term commitment to creating more market-based systems of regulation, have played a key role in enhancing the attractiveness of Korea to global capital. The changes in the structures of regulatory development and revision must, therefore, be understood within the context of the state's overall drive to promote Korea's deep integration into global circuits of accumulation of which they are a part.

The second interesting thing about these changes is the fact that the BAAR was passed prior to the crisis – although the mechanisms it created only became operational in 1998. It is the BAAR, more than any other piece of legislation, which demonstrates the lines of continuity between pre- and post-crisis processes of reform. Although it is clear that without a major crisis the neo-

liberal project would have continued to develop in a rather distorted uneven form, it is equally clear that very important forces within the state were committed to this project. The crisis and external intervention have not conspired to impose a new or alien project on the Korean state. Rather, the crisis has forced Korean elites to follow the liberalisation program they embarked upon nearly two decades earlier through to its inescapable conclusion.

So far within this chapter we have stressed the extent to which the dictates of the contemporary neo-liberal order are now embedded within the structures of the Korean state. It would be inaccurate, however, to give the impression that all the old interventionist structures of economic governance have simply ‘melted into air’ (Marx and Engels, 1977: 39). Certain aspects of the economic governance regime still very much bear the hallmarks of Korea’s dirigiste past. One key respect in which Korea continues to fall short of global neo-liberal norms has been the failure of the state to develop independent regulators in the telecommunications and electricity sectors. It is to the reasons for, and the importance of, this failure to which we now turn.

The institutional structures of telecommunications and electricity sector regulation

Given the scope of the changes that have taken place in the institutional structures of economic governance since the crisis, it is remarkable how little the structures of telecommunications and electricity regulation have changed. The status of the KCC has changed little since it was created shortly prior to the crisis – it remains under the jurisdiction of the MOC and cannot properly be described as an autonomous regulator. Although a new agency, the Electricity Supervisory Board (ESB), has been created to regulate the electricity sector, this institution is no more autonomous than the KCC – the ESB is under the jurisdiction of the Ministry of Commerce, Industry and Energy (MOCIE) (OECD, 2001a: 166). It must be stressed that by failing to create genuinely autonomous regulatory institutions in these key sectors the Korean state is acting contrary to the prevailing global neo-liberal wisdom and is ignoring some fairly crude prodding by the OECD (OECD, 2000b: 162–70; 2000c: 162–70; World Bank, 2002).

Despite the failure to overhaul the institutional structures of electricity and telecommunications regulation, it is not the case that no efforts have been made to liberalise, and enhance competition within, these industries. In 1999 a comprehensive ten-year plan was drawn up to fully liberalise the electricity market (OECD, 2000b: 263–4). However, in the face of continuous problems and fierce opposition from organised labour the liberalisation programme was radically revised in 2004. As intended in the original 1999 plan six independent power generating companies have been created and the privatisation of five of these six is still planned, the sixth is the nuclear generator which shall remain in public hands. However, earlier plans to privatise KEPCO’s transmission structures have been abandoned. These plans have been replaced by a new scheme to create a number of autonomous publicly owned business units

within KEPCO in order to promote internal competition (*Korean Times*, 2004; OECD, 2005: 42).

The government has argued that the lack of competition within the electricity sector makes the creation of a more autonomous regulator inappropriate and has indicated that such an organisation will be created as competition develops. This argument appears, at first glance, to be plausible enough. If we accept this line of reasoning, however, we must ask why the transition to competition within the electricity industry is likely to take so long, if indeed it occurs at all. In 2006 no significant element of KEPCO has been privatised. The most obvious answer is that opposition from workers within KEPCO has presented a formidable barrier to more rapid reform. There is clearly some truth in this argument; labour unions are strongly opposed to privatisation and major strikes against privatisation have occurred (*Financial Times*, 2002a). Equally important, however, in accounting for the slow pace of, and partial abandonment of, reform within this sector may be the concerns of officials within the economic bureaucracy. Officials within the economic ministries seem somewhat reluctant to rely entirely on the market to meet Korea's energy needs. Indeed, given the government's position that nuclear power generation, which accounts for 40 per cent of total power, can only be safely entrusted to a public corporation, the state will continue to play a key role as a producer of electricity (OECD, 2000b: 269–70).

The concerns of the MOCIE can be understood as stemming from traditional dirigiste anxieties about the efficiency and stability of markets. These long-standing concerns have, no doubt, been reinforced by the recent well-publicised failures of deregulation elsewhere – most notably in California. Quite reasonably Korean elites are, above all else, determined to ensure that the country maintains a reliable electricity supply. It is a simple empirical fact that electricity supplies in Korea are far more reliable than supplies in the US, the average Korean household suffers from 20 minutes of power cuts a year compared to over two hours in the US.¹⁰ The state-owned electricity companies may not be paragons of efficiency but they fulfil this basic function. There is an asymmetry of risk within the liberalisation process. It is possible that by delaying liberalisation the state is forfeiting certain efficiency gains. However, the consequences of an unsuccessful liberalisation programme, which undermines the security of the electricity supply, are potentially far worse. Although the government has been criticised for allowing liberalisation to fall behind schedule, it is logical for the state to adopt a cautious approach, carefully sequence reform and only liberalise markets when it can be reasonably certain that this will not threaten energy security. This reading of the stuttering electricity liberalisation process neatly explains the state's 'failure' to create a proper independent regulator. So long as the ESB remains under the control of the MOCIE, the ministry retains considerable ability to shape, structure and control markets in a highly dirigiste manner. The creation of an independent, competitively neutral regulator committed to promoting market competition would signal the death knell for the state's attempts to 'guide' firms' commercial decisions.

In contrast to the electricity sector, the reasons for, and the importance of, the

state's failure to create a more autonomous telecommunications regulator are made very clear by the government's own statements and reports. The MOC continues, quite explicitly, to use telecommunications regulations to enhance the competitiveness of domestic equipment manufacturers. Service-based firms are required by law to contribute 0.5 and 0.75 per cent of total revenue to R&D by equipment manufacturers.¹¹ The government also continues to 'advise' facility-based operators on what percentage of their revenue to spend on research. And, perhaps most importantly, the MOC uses its control over technical standards to create a captive market for domestic manufactures (OECD, 2000b: 294; 2000c: 177–8). This policy has been highly successful and Korean telecommunications equipment manufacturers are highly competitive in global markets (Korea Development Bank, 2000: 32–43). Clearly the use of regulation to promote domestic manufacturing industry requires that the Ministry itself, rather than an autonomous agency, be the locus of regulation-making and implementation.

Second, the government has attempted, through its licensing and regulatory practices, to 'plan' the development of key telecommunications markets. The state has set fixed ceilings on dominant firms' market shares, set onerous licensing requirements for new firms, sought to guarantee minimal market shares for and offered relatively cheap bandwidth licences to selected marginal operators, and actively encouraged consolidation among smaller firms (*Financial Times*, 2001; *Korean Herald*, 2001; *Korean Times*, 2001a; 2001b; OECD, 2006b: 43). This form of 'market engineering' is clearly not commensurate with the creation of an independent regulator, such as the US Federal Communications Commission, committed to developing frameworks that allow market forces to operate to the fullest possible extent. The only saving grace of the state's market engineering measures, from a neo-liberal perspective, is that the ultimate purpose of many of these measures is to foster higher levels of sustainable competition than would otherwise develop.

Although the institutional structures of electricity and telecommunications regulation have changed little since 1997, we should not allow this to blind us to the importance of the overall institutional reconfiguration that has taken place. As we made clear in Chapter 3, the 'pure' neo-liberal state is simply an abstraction to which no state conforms perfectly; when we describe a state as neo-liberal we are simply seeking to highlight its dominant characteristics. It is only to be expected that the Korean regulatory regime will continue to display certain features that reflect its dirigiste past. What is remarkable, however, is the extent to which the dictates of the contemporary global neo-liberal order have become embedded within the structures of the state. These processes of restructuring have been driven by a complex confluence of forces. On the one hand, aspects of the process have been driven entirely by the Korean state itself. As we have already argued, important sections of the Korean elite demonstrated a clear commitment to restructuring the state along neo-liberal lines prior to the onset of the crisis. Moreover, other more conservative elements of the state–capital complex were compelled, in the wake of the 1997 crisis, to face the reality that the future of Korea as a major centre of accumulation depended on the

establishment of a neo-liberal governance regime. On the other hand, other aspects of the institutional restructuring process, such as the establishment of the FSC/FSS and the reform of the BOK, have been driven by a combination of internal and external forces. Particularly important in these cases has been the role that external intervention has played in strengthening the position of the most reform-minded elements of the Korean elite vis-à-vis their more conservative counterparts.

Having analysed the development of institutional restructuring since the onset of the crisis, we shall now move on to consider the concrete policy level changes that have accompanied this process. It is to the new system of financial regulation that has been created since the crisis we now turn.

Financial regulation

When judged by contemporary neo-liberal standards the system of financial regulation that existed within Korea prior to the crisis was woefully inadequate. Although Korea took a small step towards bringing systems of bank supervision in line with international norms with the formal adoption of BIS capital adequacy standards, the significance of this reform should not be exaggerated (Emery, 2001).¹² The convergence with standards of ‘global best practice’ was more cosmetic than real. The system of bank regulation still allowed institutions to exaggerate the size of their capital bases, maintain massive unsupported off-balance-sheet liabilities, hide losses on securities trading and classify loans as performing when, by international standards, they were clearly not (OECD, 1999a: 83–7). The clear inadequacies within the regulatory regime were accentuated by the lack of autonomy the institution charged with enforcing banking regulations, the Office of Bank Supervision, enjoyed from direct political control, and the well established practice of applying regulations selectively. At the same time as failing to develop and enforce proper prudential standards, the state maintained strict controls over product innovation, on the amounts banks could lend to various categories of firm and for different forms of economic activity, and the interest rates paid on certain types of deposit accounts, and continued to channel policy loans through the commercial banks.

It must be stressed, however, that these non-market-based controls were being slowly, but surely, dismantled. Interest rates on all forms of loans, with the exception of policy loans, had been liberalised and controls over the amounts banks could lend to different types of firms were relaxed somewhat in the years immediately prior to the crisis. Additionally, the proportion of all bank lending accounted for by policy loans had been steadily declining since the mid-1980s (OECD, 1996b: 40–82; Woo-Cumings, 1997; Kong, 2000). In short, the system of dirigiste bank regulation was suffering a death by 1,000 cuts prior to the crisis. The crisis simply hastened, not caused, the death of this system. In contrast to the banking sector, the old systems of non-market-based control had, by the eve of the crisis, already been largely dismantled in the non-bank financial sector. It is also the case, however, that the systems of prudential market-based

supervision within this sector were extraordinarily weak even compared with those that existed in the banking sector (OECD, 1998: 57–88; World Bank, 1999: 83–95).

In the wake of the crisis, the Korean system of financial regulation has been radically redesigned so as to conform fully to global standards of ‘best practice’ (FSC, 2000). This process has involved both further financial deregulation and the development of far tighter market-based controls. In other words, the old decaying dirigiste controls over financial institutions that sought to control and restrict the functioning of market mechanisms have been replaced by new regulatory structures that seek to promote the functioning of market disciplines. As a direct result of the removal of restrictive dirigiste controls, an entirely new set of investment vehicles and products (mutual funds and asset-backed securities) have developed since the onset of the crisis (H.-J. Kim, 2000). Moreover, financial institutions of all types now enjoy a high degree of freedom to offer whatever products, and invest funds as, they choose, provided they can meet the relevant prudential standards. This new commercial freedom is leading to a blurring of the boundaries between different categories of financial institution and the gradual development of a universal banking system (FSC, 2000).

The most important changes that have taken place in the structure of financial regulation since the onset of the crisis relate not to removal of dirigiste controls, however, as these were decaying anyway, but to the tightening of market-based prudential standards. In place of the old, rather ineffectual, system of ill-enforced prudential standards, a new system of regulation based on the ‘highest international standards of business conduct and regulatory enforcement’ is being constructed (*ibid.*: 31). The new regulatory regime is being built, quite explicitly, around the standards of best practice, and guidelines, drawn up by the major international organisations of financial supervisors, most notably the BIS and the IOSCO. This attempt to create a regulatory regime based on such standards has led to the enactment of eight particularly important reform measures since the crisis.

First, loan classifications are now determined so as to fully reflect the borrower’s ability to pay, not simply past payment performance. Loans are now declared substandard if, on the basis of ‘financial position and future cash flows’, the borrower is thought to be at considerable risk of being unable to repay the interest and principal in full or has fallen three months into arrears (Financial Supervisory Service, 2000: 54). This new standard is obviously far stricter than the one it replaced which simply required financial institutions to declare a loan substandard if the borrower fell six months into arrears.

Second, all securities must now be valued on a mark-to-market basis rather than at historic cost. Losses on the securities market cannot, therefore, be concealed as in the past, although as the Enron crisis demonstrates, the mark-to-market accounting system is also far from perfect (OECD, 1999a: 85).

Third, very clear rules have been established to insure that all liabilities are now carried on balance sheet (*ibid.*: 85). Fourth, the capital adequacy and solvency standards that all institutions are required to meet have been significantly

tightened. Merchant banks are now required to meet the same capital adequacy standards as the commercial banks (*ibid.*: 95–7). Furthermore, the rules governing what may be regarded as capital for the purposes of calculating bank capital adequacy standards are now more restrictive. Additionally, insurance companies are now required to meet a solvency margin of 4 per cent plus 0.3 per cent of sums at risk, these standards being identical to those existing in the EU (*ibid.*: 94). And, finally, securities firms are now required to meet IOSCO operational net capital ratios (*ibid.*: 97).

Fifth, new rules to control foreign currency maturity mismatches and prudential limits on institutions foreign lending exposure, based on international credit ratings, have been established. Sixth, the FSS now conducts ongoing assessments of all institutions' risk management systems and is in continual consultation with private institutions on areas where improvements are necessary (*ibid.*: 81). Seventh, the requirements for public disclosure of financial standards have been upgraded; statements must now be produced quarterly instead of yearly, and International Accounting Standards must be observed when preparing these statements (*ibid.*: 82). Finally, the maximum permitted exposure to a single borrower has been reduced from 45 per cent to 25 per cent of total capital (*ibid.*: 87).

The significance of the reforms enunciated above has been enhanced by the new willingness of the state, since the crisis, to consistently and strictly enforce regulations. The state's determination to force institutions to comply with regulatory standards has been demonstrated by both the changes that have taken place in legal/institutional structures of regulatory enforcement and the concrete actions of the regulatory authorities. As we have already argued, the creation of an independent unified financial regulator represented an important step towards ending old practices of selected regulatory forbearance. Moreover, a system of prompt corrective action has been established which *requires* regulators to act, in a progressively more stringent manner, when an institution's capital adequacy/solvency standards fall below specific thresholds (*ibid.*: 81). As a result of this system a large number of often quite major financial institutions that have been unable to meet capital adequacy/solvency standards have been closed down or nationalised. The role that the state has played in forcing insolvent institutions to exit the market, minimising the impact of their collapse on the wider financial system and rehabilitating weak but systematically important institutions will be examined in Chapter 7 (see also Financial Supervisory Service, 2000; Emery, 2001; Samsung Economic Research Institute, 2001).

Despite the apparently comprehensive nature of the financial reform processes certain neo-liberal analysts continue to highlight weaknesses in systems of financial regulation (Emery, 2001: 90–122; World Bank, 2003). The criticisms of contemporary systems of regulation are, however, more subtle than those articulated with regard to other areas of the reform process. It has not been argued that 'nothing has changed', that the FSC has acted in the same manner as previous regulators and simply allowed unviable institutions to continue functioning as normal. Rather, the arguments of those scholars who emphasise weak-

ness within the system are fourfold. First, that important gaps remain in regulatory frameworks with regard to both new financial products and less systemically important institutions (World Bank, 2003: 2–3). Second, that Korean regulators lack the technical capacity to effectively implement the latest regulatory devices, such as systematic stress testing (*ibid.*: 2). Third, that while final outcomes have often been correct, regulators have, particularly when dealing with NBFIs, acted in a less than prompt fashion (Emery, 2001: 109–15). Finally, that there is a ‘perception in the market that regulations are often overlooked or weakly sanctioned’ (World Bank, 2003: 6).

Certain of these criticisms are, in all probability, basically correct. New financial products have created new regulatory issues which have yet to be fully resolved. Moreover, as regulators have focused on ensuring that key institutions are well regulated it is inevitable that the regulatory systems governing more peripheral institutions have been partially neglected. It also true that certain distressed NBFIs, which fail to meet relevant regulatory standards, have been allowed to struggle on for some time without an effective final resolution to their problems through either effective rehabilitation or by forcing them to exit the market.¹³ This does not, however, reflect intrinsic problems in regulatory systems. Rather, it is a direct result of the scale of the challenges that confronted regulators. Regulators could not reasonably be expected to act simultaneously against the vast number of institutions facing problems. There may also be a certain macroeconomic logic to staggering the processes of shutting down failing institutions, of allowing more peripheral institutions a period of grace while the problems of core institutions are dealt with decisively.

Less convincing than the argument that weakness in aspects of the regulatory system remain is the assertion that the FSC has been inconsistent in enforcing key regulations concerning core financial institutions. Econometric work on banks loan/bond ratios in the wake of crisis by Choi (2000) illustrates the state’s determination to enforce key capital adequacy standards and the serious implications of this policy on firms’ access to finance. Furthermore, firm-level econometric analysis by Borensztein and Lee (2002) demonstrates that *chaebol* firms lost their preferential access to bank finance in the wake of the crisis, a clear indication that for the banking sector at least rules concerning connected lending are being enforced. While equally compelling evidence is unavailable to support the argument that the FSC was committed to enforcing the full scope of regulations relating to banks, there is no reason to assume that the FSC has failed to consistently enforce them. Rather, the fact that the FSC can be demonstrated to have clearly enforced key capital standards and rules on connected lending would seem to suggest other core regulations have, in all probability, been consistently enforced. Moreover, it must be stressed that no evidence is offered by critics that suggests the FSC consistently failed to implement key regulations, indeed the World Bank’s (2003:6) claim is only that there was a perception that this was the case.

When analysing contemporary systems of financial regulation we would do well to remember Korea’s starting point. As made clear at the beginning of this section, pre-crisis systems of financial regulation were extraordinarily weak and

incoherent. The fact that the essential components of a new neo-liberal system are in place less than ten years after the crisis is remarkable. Furthermore, care must be taken not to compare Korea with an idealised system where regulators always act in a timely efficient manner, as many scholars do, but to compare Korea to actually existing imperfect neo-liberal systems elsewhere in the world.

Strikingly, while the government has been criticised for practicing regulatory forbearance by some scholars another very different group of analysts argue that the state enforced regulatory standards in an overly zealous manner in the wake of the crisis. It is argued that 1998 was the wrong time to begin the process of tightening financial standards (Choi, 2000). Reform was necessary but by strengthening regulations during a serious recession the state induced a credit crunch and made the crisis worse. More controversially Shin and Chang (2003: 95–7) cast doubts about the desirability of new regulatory standards, which they view as obstacles to high rates of investment and entrepreneurial risk taking. Shin and Chang's analysis is based upon the assumption that a reformed version of the old dirigiste model, with capital controls in place, is viable. We have consistently argued that in view of Korean leaders this was not the case. There was no real alternative to exposing firms and financial institutions to the judgements of global markets. Given this new operating environment, enhanced regulatory standards are necessary to force banks to discipline firms and prevent them from pursuing the ambitious expansionary plans that had been viable when they were shielded from the judgements of global financial markets. The argument that reform ought to have been delayed until some modest recovery was apparent, on the other hand, makes perfect economic sense. The problem is we cannot be sure that reforms would not simply have been endlessly delayed had the crisis not allowed reformers to seize the moment.

Given that the short-term effect of these measures has been strongly deflationary, we must ask ourselves why, in the wake of the most serious economic crisis in over 40 years, the state, or more accurately the FSC, has been willing to pursue a policy that so obviously retards short-term growth prospects? Again we face the problem that, with the exception of the literature which essentially understands the entire neo-liberal project as dysfunctional, the need to explain the state's new found commitment to 'prudential standards' is ignored because their adoption is assumed to be intrinsically logical. We would argue that the forces that are leading the FSC to pursue this apparently perverse policy are, unsurprisingly given the symbiotic nature of these reforms, the same as those that led the state to create an autonomous regulator in the first place.

On the one hand, it is clear that the IMF was important in 'kick-starting' the process of regulatory reform. The 1997 stand-by agreement Korea signed with the IMF (1997) demanded that the following reforms be enacted:

- Prudential standards will be upgraded to meet Basle core principles.
- Accounting standards and disclosure rules will be strengthened to meet international practice. Financial statements of large financial institutions will be audited by internationally recognised firms.

- The commercial orientation of bank lending will be fully respected, and the government will not intervene in bank management and lending decisions. Remaining directed lending will be eliminated immediately.
- While policy lending (agriculture, small business, etc.) will be maintained, the interest subsidy will be borne by the budget.

Moreover, there is evidence that the then US Treasury Secretary, Robert Rubin, personally held up the signing of this agreement for eight hours because of a dispute with Korean officials over accounting standards (Cumings, 1999a: 26). We may reasonably infer that not only was the IMF/US important in providing an initial stimulus to the reform process, but that significant points of disagreement existed between significant sections of the Korean elite and the IMF/US.

On the other hand, we would argue that important sections of the Korean state–capital complex were, and still are, highly committed to upgrading standards of financial regulation. The very fact that some attempts, albeit rather tentative ones, to introduce BIS-based capital standards had been made prior to the crisis demonstrates that elements of the state had long been committed to developing tighter regulatory standards. This argument is reinforced when we consider the attempts to draw up more stringent capital adequacy standards alongside the related, also unsuccessful, attempts of the state elite to enhance the autonomy of regulatory institutions.

More importantly still, Korean elites themselves have demonstrated an unquestionable commitment to thoroughly overhauling the financial system since the crisis. The reforms the Korean state has enacted in its attempts to transform the system of financial governance have, in many cases, gone far beyond anything the IMF called for in the 1997 agreement. For example, it has been the FSC, not the IMF, which has been responsible for upgrading the solvency standards securities firms are required to meet. Moreover, it was also the FSC, working alongside the MOFE, that instigated the legislation necessary to establish mutual funds in the wake of the crisis. Perhaps the most compelling evidence of the commitment of key sections of the financial bureaucracy to upgrading regulatory standards is, however, provided by the fact that the 1997 agreement has been implemented in full since the crisis.

The process of upgrading financial standards is, by its very nature, a relatively complex and drawn out one. We are highly sceptical, therefore, about the ability of purely external forces to successfully push through a comprehensive package of financial reform in the face of determined domestic opposition. In Korea, where recovery from crisis was rapid, the government appeared to be in a uniquely strong position to fudge and delay reform. By the beginning of 1999 it was clear that Korea would not require additional official funding, and the IMF was busy setting Korea up as an example of the efficiency of its policy prescriptions. The IMF had, therefore, not only lost any fiscal leverage over the state, but its ability to criticise government policy was highly constrained by its desire to associate itself with Korea's renaissance. However, as the economy recovered, and the IMF's coercive power declined, there was no let up in FSC efforts to

improve standards of regulation. Indeed, most of the key banking reform measures – such as the introduction of forward-looking loan classification criteria and qualitative assessments of banks' risk management systems, the tightening of capital adequacy standards and exposure limits, and the shifting of trust account liabilities on to balance sheet – were implemented not in the immediate wake of the crisis but from 1999 onwards. The restoration of strong economic growth in 1999 eased concerns about the deflationary effects of reform and spurred the FSC, to intensify, not water down, its reform efforts.

Although we cannot assume that the views of the FSC, which is autonomous from direct political control, on financial regulation are identical to those held by the broader state elite, the former are, nevertheless, indicative of the overall thinking of broader sections of the Korean elite. The members of the FSC are appointed by the government and come from within the governing elite, albeit the most reform-oriented sections thereof. Their views are, therefore, unlikely to be inimical to those held by the wider state elite. Moreover, as we have already argued, the FSC has only been able to advance restructuring so rapidly in the wake of the crisis thanks to the strong fiscal and legislative support it has received from the central administration. Given the clear commitment of key elements of the state elite to financial restructuring, it is inaccurate to understand the IMF as imposing a hostile agenda upon the state. Rather, the importance of external political intervention lies in how it has affected the balance of power between conservative and reformist forces within the Korean state–capital complex. By the end of 1997 reformist forces were as a result of the crisis itself (which fully exposed the objective limits of the old model), external intervention and the election of the former dissident Kim Dae-Jung to the presidency in December strongly hegemonic within the Korean governing bloc. The reformers who now controlled the state hope to achieve two related objectives by strengthening standards of prudential regulation.

First, and most obviously, improving prudential standards is necessary to reduce the risk of financial crisis re-occurring. As we have argued throughout this book, the economic opening programme that preceded the crisis was not accompanied by a sustained attempt to improve the profitability and financial structures of Korean economic actors. Liberalisation had the effect therefore, of exposing clearly unsound financial institutions and firms to global market pressures. This was what made the crisis inevitable. What was sustainable in a relatively closed financial system was not sustainable in a more open system. Clearly, it was necessary to force financial institutions to improve standards of solvency if these institutions were to compete within a more open economy. Upgrading prudential standards may have had negative short-term consequences as institutions closed or reduced lending activities, but it was vital to do so if another systemic crisis was to be avoided.¹⁴

Second, the upgrading of standards of financial regulation was vital to induce greater foreign participation within the financial system, something the state regarded as key to the success of its entire economic project. Two key points can be made in this regard. First, the upgrading of prudential standards would

increase the confidence of global market actors in Korean financial institutions and the accuracy of the accounts they produced. This enhanced confidence would allow domestic institutions to raise funds on global capital markets more cheaply and encourage greater foreign investment within Korean banks. In the absence of reliable accounts, potential foreign investors must spend millions of dollars checking the validity of statistics presented on balance sheets; clearly this is likely to prejudice their willingness to invest. Second, the absence of strict market-based regulatory standards, and unrestrained commercial freedom, could seriously impair the profitability of foreign firms' investments. Clearly non-market-based controls that restricted lending decisions, product innovation and effective price competition constrained the ability of foreign banks to exploit their greater cost efficiencies, skills in assessing risks and familiarity with new products to their full advantage. Although the effects of weak market-based regulatory standards on foreign banks' profitability were less obvious, they were no less important. In the absence of proper regulatory standards weak inefficient institutions could run down their capital bases, hide debts and continue to maintain market share even when their profitability was low or even negative. Within such an environment there was no guarantee that the greater efficiency of foreign firms would enable them to rapidly gain market share and enjoy supernormal profits (Interviews with foreign bankers, 2001). In order to fully expose inefficient financial institutions to market pressures, and force them to improve or exit the market, the state had to create strong regulatory frameworks, not adopt a *laissez-faire* financial policy.

As important as the processes of financial re-regulation are, the vitality of the financial sector is ultimately dependent on the health of the corporate sector. If the financial structure of firms remains weak then, whatever regulatory standards are in place, the position of financial institutions will remain precarious. The importance of improving the financial structures and competitiveness of Korean firms cannot be overestimated. If Korean firms fail to adjust to the dictates of competition within the contemporary global economy then the economy will remain weak and prone to crisis. If these firms are more successful, however, and Korea also succeeds in attracting significant investments from key foreign firms, then the state may achieve its ultimate goal of becoming a core capitalist state. Enhancing standards of corporate governance represents a key mechanism through which the state has sought to improve the financial structures and efficiency of domestic firms. We now turn to the changes in systems of corporate governance that have taken place since the crisis.

Corporate governance

Korea did not have a 'modern' legal system of corporate governance prior to the crisis. The laws defining the responsibilities of controlling shareholders, accounting and listing standards, exit procedures, and protecting minority shareholders were all weak and underdeveloped (OECD, 1999a: 107–38; World Bank, 1999: 58–67; Kim and Jeong, 2000; Oh, 2000: 211–16). The lack of

formal rules governing relationships between management, investors and creditors distinguished the Korean system from its counterparts in the developed world. For all their differences, the Anglo-American and Nippo-Rhenish systems of corporate governance were both predicated on certain common economic and legal structures. As Woo-Cumings (2001: 346) argues both systems were based 'on the highly evolved structure of the modern corporation, with a whole panoply of legal or otherwise regularised sets of norms that dictate the behaviour of transacting parties'. More importantly still, both these systems were constructed around strong monitoring agencies, be they strategic banks or avaricious shareholders, who kept a close check on firm management. Although the state fulfilled this monitoring role quite ably within Korea until the 1980s, the gradual dismantling of dirigiste controls from this point onwards increasingly undermined the ability of the state to monitor the behaviour of leading firms.

In the period leading up to the crisis, the dominant shareholders within major *chaebol* enjoyed almost complete *carte blanche*, to run these businesses as they saw fit, despite almost always holding a relatively small minority of total equity (Gills and Gills, 2000: 31). This power emanated principally from the almost complete control over information these shareholders enjoyed. Put simply, in the absence of proper accounting standards or other legislation to enhance minority shareholders' and creditors' access to information, dominant shareholders could tell these groups whatever they choose. Clearly, without accurate information, outside investors and creditors could not properly scrutinise management actions.¹⁵ The exceptional freedom controlling shareholders, usually the founding families, enjoyed was, however, not simply a product of official neglect, the failure to develop proper legal checks on their behaviour, but of active state policy. The few formal rules that controlled investor behaviour principally served to secure, not dilute, the control of the founding families by restricting hostile takeovers and preventing institutional investors from exercising their ownership rights in full (OECD, 1999a: 110; Chung and Wang, 2001).

The extraordinary power the core *chaebol* shareholders enjoyed did not in and of itself constitute an economic problem, although we may argue that it constituted a social and political one. If core shareholders had focused their efforts on improving the profitability and financial standing of the firms they controlled, the lack of external control over their behaviour would not have overly concerned anyone. In reality of course the behaviour of these shareholders was anything but benign. The founding families of the *chaebol* used stronger firms to guarantee the debts of their weaker counterparts within the group and pursued reckless debt-financed expansion plans. Although these practices were little different from those mandated by the developmental state, prior to liberalisation, the environment Korean firms operated within was changing rapidly and the *chaebol*'s borrowing was rapidly becoming unsustainable.¹⁶ The majority of Korean firms had always been heavily indebted. The average debt-to-equity ratio of the Korean corporate sector was over 300 per cent throughout the 1960s and 1970s (Joh, 2001: 124). Moreover, the return on capital employed had

persistently hovered perilously close to or even below the cost of capital (Lim *et al.*, 2003: 14). However, so long as all foreign borrowing was strictly controlled by the state it was possible for bureaucrats and private sector insiders to collude in order to maintain the illusion of solvency. Major creditors or the state itself would always supply key firms with additional credit so that such firms were never forced to repay loans from often insufficient operating profits. As the elaborate system of capital controls that had insulated domestic financial markets from global market pressures were dismantled over the course of the 1990s, insolvent Korean firms and financial institutions were increasingly exposed to the judgement of the global market. International investors could not be forced or persuaded to extend credit indefinitely to clearly insolvent financial institutions and firms in the same manner as domestic investors had been over the previous three decades.

It is against this context of weak oversight and the abuse of power by controlling shareholders that we must understand the changes in the structures of corporate governance that have taken place since the onset of the crisis. The vast array of reforms that have been enacted to create a 'modern', legally based, system of corporate governance can be divided into five broad categories. First, the new administration has made concerted attempts to bring Korean accounting standards fully in line with US Generally Accepted Accounting Principles. More precisely major changes have included 'the elimination of deferred assets and liabilities; the introduction of new rules for the accounting of derivatives; the adoption of limits on asset revaluation; and a reduction in the scope for shifting between different accounting standards in corporate accounts' (OECD, 1999a: 116). Moreover, 'reporting entities' (firms) are now required to produce consolidated financial statements that include the accounts of any subsidiaries or controlled companies. Equally importantly, business groups, the *chaebol*, are obliged to produce combined financial statements. These new requirements have exposed previously opaque webs of inter-group transactions to public scrutiny and allowed investors to accurately assess the overall financial position of different business groups and the financial position of individual companies within these groups (Korean Accounting Institute, 2001). The effectiveness of these reforms was dependent, however, on the willingness and the ability of the Korean state to force controlling shareholders to act honestly when preparing accounts. As the recent scandal in the US involving Enron and Arthur Anderson demonstrates, corporate duplicity, and collusion between the audited and the auditor, is a complex and a global problem. It is unrealistic, therefore, to expect any controls the Korean government may put in place to solve the problem; they can make it more difficult for managers to lie but cannot prevent them from doing so. There can be little doubt that the independence of auditors from controlling shareholders/management has improved since the 1997/8 crisis and that it is now significantly more difficult for controlling shareholders to manipulate accounts for their own ends. Since December 1998 all listed companies have been required to establish auditor selection committees that include shareholders, major creditors and outside directors. Moreover, any single investor who

owns more than 3 per cent of total equity is barred from exercising voting power above this level in the selection process (OECD, 1998: 110). Furthermore, the minimum contract length for auditors has been increased to strengthen these firms' ability to resist management pressures (OECD, 2001a: 130). The incentives for auditors to behave in an honest and robust fashion have also been increased substantially. The fines and prison sentences individual accountants are liable to receive have increased substantially.

Second, the legal protections minority shareholders enjoy from expropriation have been significantly enhanced. The ownership threshold needed to demand the inspection of books, the punishment of a director for misconduct, to file a derivative suit or call for a special general meeting have all been lowered from 5 per cent to between 1.5 per cent and 0.05 per cent (OECD, 1999a: 113; 2001a: 128). Moreover, the fiduciary duties of controlling shareholders has been significantly enhanced by the 1998 Commercial Code that makes it clear that *de facto* directors shall be treated in the same manner as *de jure* directors (Kim and Jeong, 2000). It is no longer possible, therefore, for dominant shareholders to escape liability for their actions. These legal safeguards are due to be further buttressed in the near future by the introduction of legislation allowing shareholders to launch class action lawsuits (*Financial Times*, 2002b). It is also worth noting that from 1999 onwards listed firms have been required to fill 25 per cent of their board seats with outside directors. It is highly questionable, however, how independent and involved these directors have in fact been (OECD, 1999a: 114–15; Chung and Wang, 2001: 94–8).

Third, management is now disciplined by the existence of an active market for corporate control. In May 1998 all forms of M&A were fully liberalised (Chung and Wang, 2001: 108–10). This represented a remarkable policy shift given that prior to the crisis hostile M&A were banned and friendly M&A were only allowed when the total assets of all companies involved did not exceed two trillion won (OECD, 1998: 111).

Fourth, measures have been enacted to create a functioning bankruptcy system. Before the crisis there had been little application of bankruptcy laws in Korea and the concept of bankruptcy was unfamiliar to both the legal profession and the general public. Cultural norms and the fact that most debtors' assets tended to be secured by mortgage can in part explain the infrequency with which the insolvency laws were invoked (Oh, 2000: 214). After all what is the point of launching insolvency procedures if there are no assets to be retrieved? The nature of Korean insolvency procedures themselves, however, created a powerful set of incentives for creditors to avoid entering into legal proceedings. Although clearly not the only problem, perhaps the most serious flaw within the bankruptcy system was the length of time the entire procedure took. In most cases bankruptcy proceedings took the best part of a decade to be resolved and delays of over ten years were far from uncommon. In these circumstances, from a creditor's perspective, the conclusion of almost any form of informal agreement with the debtor was preferable to going to court. Since the crisis there has been a series of changes in Korean bankruptcy laws to reduce the time and costs

that entry into bankruptcy procedures invokes. These reforms have been successful and by 2004 the average time and costs involved in closing a business through the bankruptcy system in Korea was lower than the OECD average (OECD, 2005: 110).¹⁷ These changes have made it far more attractive for creditors to instigate formal bankruptcy procedures, and have made it more difficult for firms to simply carry on trading as normal when they are clearly insolvent. The reform of the bankruptcy system has served to focus the minds of corporate managers on maintain reasonable levels of profitability and ensuring that the financial structures of the firms they control are sound.

Fifth, and finally, the concerted attempts of the state to create structures of corporate governance that expose managers to market pressures and enhance transparency have been buttressed by the creation of a set of more dirigiste controls to regulate the financial behaviour of firms. All new debt guarantees were banned in 1998 and all existing guarantees had to be eliminated within less than three years. Moreover, by the end of 1999 the major *chaebol* were required to reduce their debt to equity ratios below 200 per cent, and with the exception of firms undergoing debt workouts they did so (OECD, 2000c: 155). However, after the introduction of consolidated financial statements in 2000 reported debt-to-equity ratios rose to over 200 per cent for all of the leading *chaebol* (Graham, 2003: 129).¹⁸ On one level this may seem disappointing. However, on another level, this is a very positive development in that it demonstrates the effectiveness of new accounting standards in preventing firms from concealing uncomfortable truths. These controls severely curtailed the freedom of investors to run the firms they owned as they pleased. Additionally, no controls of a similar nature exist anywhere in the core capitalist world, the financial policies of firms within these jurisdictions being determined purely by shareholders and creditors. Nevertheless, these controls do represent a necessary part of the neo-liberal project within Korea. The financial distortions that had developed within the corporate sector over the last three decades were simply too acute, and the consequences of failing to correct them too severe, to make a less interventionist policy viable. The success of the entire neo-liberal project was dependent upon the ability of major firms to improve financial structures and compete within a more open economy. Somewhat paradoxically, therefore, the success of the entire neo-liberal project in Korea was at least partially dependent upon the effectiveness of a highly dirigiste set of controls. It is worth noting, however, that the controls on inter-firm debt guarantees introduced immediately after the crisis were modified in 2001 to become more selective. We may expect to see the gradual unwinding of these interventionist controls as the Korean government becomes more confident that mechanisms of shareholder and creditor discipline are forcing managers to maintain a sharp focus on improving profitability and maintaining solvency (Lee, 2002).

Despite the extent of the legal changes that have taken place the overwhelming majority of the literature on corporate governance is fairly sceptical about the extent to which the raft of formal legal changes in systems of corporate governance have changed how systems of governance actually function in practice

(Richards *et al.*, 2002: 116–22; Graham, 2003: 116–71; Cho, 2003; Lim *et al.*, 2003). The argument advanced here is that the existing literature underestimates the effectiveness of corporate governance reform in Korea and the extent to which legal changes have been translated into changes in corporate behaviour. We would stress that the differences between our analysis and that offered in the existing literature are ones of emphasis. Korean systems of corporate governance are far from perfect, as are systems of corporate governance in every major economy. Nevertheless, there have been significant concrete improvements in systems of corporate governance since the crisis.

This is not to say that we ought to be dismissive of the plethora of surveys that highlight the discrepancies between formal changes in systems of corporate governance and the realities on the ground. A 2000 PriceWaterhouse Coopers' report labels Korea as having the lowest standards of transparency among 35 major economies (Graham, 2003: 161). Equally, a more recent Crédit Agricole survey of Asian corporate governance systems awarded Korea 3.5 out of ten. By way of contrast Singapore received a 7.5 (OECD, 2004e: 130). However, we should not accept these reports uncritically. In comparing Korea with other major economies these surveys take no account of Korea's starting point. The fact that standards of corporate governance in Korea may be lower than in the US or Singapore does not necessarily mean that they have not substantially improved. Furthermore, such surveys are ultimately based upon the subjective perceptions of specialists who have long experience with systems of Korean corporate governance. Inevitably these perceptions will not simply reflect the present but will be influenced by recent history. The fact that standards of corporate governance have historically been appalling in Korea cannot but distort judgments about the effectiveness of contemporary systems of corporate governance.

The critical source of evidence that demonstrates the effectiveness of the post-crisis corporate governance reform process is the profitability of Korean firms in the years since the crisis, something that is completely ignored in the standard discussions of corporate governance reform in Korea. The performance of the Korean corporate sector since the crisis illustrates managers' new focus on improving profitability and financial soundness, and how reform has succeeded in effecting a change in corporate behavior. The average level of ordinary profits within the manufacturing sector rose to 4.7 per cent in 2002, the highest level since 1974 (Bank of Korea, 2003: 540).¹⁹ To put these figures into perspective, the level of American manufacturing profitability in 2002 was 4.9 per cent (*ibid.*: 545). More importantly still, levels of ordinary profits in Korea remained at 4.7 per cent in 2003 despite a fall in growth from 6.3 per cent to 3.1 per cent (Bank of Korea, 2004: 555). A modest increase in the rate of growth to 4.6 per cent in 2004 was accompanied by a rise in the level of ordinary profits in manufacturing to 7.8 per cent, the highest level since 1965 (Bank of Korea, 2005: 594). In 2005 profit levels fell back to 5.1 per cent as growth slowed to 4.0 per cent. The fact that major increases in profitability have been achieved in a mixed macroeconomic environment illustrates the deep structural changes that

have taken place in the economy. Improved corporate performance has not been the by-product of a cyclical upturn. While it was a rarity for Korean manufacturing firms to register profits in excess of 4 per cent in the three decades prior to 1997 it is now a regular occurrence (Bank of Korea, 2006a: 589).²⁰

While not the only objective of the corporate governance reform programme, the key to establishing a new sustainable growth regime was to force controlling shareholders to change their behavior and eschew expansion in favor of focusing on improving financial performance. In other words, it was vital that Korean firms were actually subject to market disciplines if a new stable growth regime was to be established – market disciplines which could not function without improved transparency (which allows suppliers of capital to make informed judgments about firms) and a functioning bankruptcy system.

Of course the fact that managers have focused upon improving profitability does not decisively prove that effective comprehensive systems of market-based corporate governance are in place. However, we may reasonably ask how we could ever conclusively prove the existence of such a system. All existing systems of corporate governance are imperfect and it would be easy to highlight cases where corporate governance mechanisms have failed in any major world economy. It would be easy to make a superficially convincing argument that corporate governance systems in every major economy are failing by referring to the various scandals that litter the global financial press. On the other hand, it would require a Herculean effort to conduct the micro-level analysis necessary to prove conclusively that in the majority of cases corporate governance mechanisms operate relatively effectively in any given country. In the absence of limitless resources all we can do here is employ the available evidence in order to advance the argument that corporate governance reform has achieved a great deal in Korea.

The reforms that have taken place in the structures of corporate governance not only served to force Korean managers to improve their firms' financial structures but also helped create the means for them to do so. By improving standards of protection for outside shareholders the state significantly improved the attractiveness of holding Korean equity to both foreign and domestic investors.²¹ By doing so these measures increased the ability of corporate managers to tackle debt problems by issuing fresh equity and to make more extensive use of the equity market as a source of funding for long-term expansion. A vibrant equity market represented a sort of holy grail for Korean state elites as it created the possibility that selected corporate expansion could coexist with serious attempts to improve the financial structures of Korean firms. Or, to put it another way, it promised to alleviate, but not eliminate, the negative economic and social consequences of tackling the long-term financial problems that beset the corporate sector.

Despite the fact that the reform of the corporate governance regime has been principally driven by the Korean state's own attempts to enhance economic competitiveness external political agents have, nevertheless, played an important role in shaping key aspects of the reform process. As we have already argued

US pressure did play a key role in promoting the upgrading of accounting standards. Reform of accounting standards has played a pivotal role within the entire process of corporate restructuring. The effectiveness of all the other measures that sought to force managers/controlling shareholders to focus on increasing profitability and reducing debt levels was critically dependent on making managers produce accurate accounts. Outside shareholders, creditors and the state itself could only effectively discipline managers/controlling shareholders if they had access to accurate financial information.

Moreover, international organisations have played a less direct but, nevertheless, important role in shaping other key corporate governance reforms. Although the 1997 agreement Korea signed with the IMF had little to say about many aspects of corporate governance, including minority shareholders rights, reform efforts in these areas have still been influenced by ideas and policy proclamations emulating from the major international economic organisations. In their efforts to create neo-liberal regulatory frameworks Korean state elites have sought to comply with international standards of best practice, standards that the international economic institutions have played a key role in establishing.²² The subtle ideational power of the international economic institutions is we would contend more important in shaping the policies of the more successful developing states, including Korea, than the iron glove of conditionality.

Although different aspects of the reform programme may, at first glance, appear to be unrelated, we would stress the absolute necessity of understanding the programme as a coherent whole. The essential point is that all these reforms share the same central objective. Whether through administrative fiat or shareholder pressure, the central objective of all these reforms is to focus the attention of Korean managers on creating solvent, profitable firms. The central place this objective occupies within the state's overall economic strategy is demonstrated by its willingness to enforce controls which are clearly deflationary in nature and that go beyond anything that exists elsewhere in the world. As illustrated in Chapter 4 the state elite had long been concerned about the financial structures of leading firms but had failed to take serious corrective action for fear of inducing a serious recession. In many respects the financial crisis made it easier for the state to take decisive action. The crisis illuminated all the failings of the corporate sector and demonstrated that if *chaebol* were to compete effectively in global markets they simply had to become more efficient and improve their financial structures. In the wake of the crisis it was clear that, in the absence of old systems of capital controls, global financial markets would fully expose any internal financial frailties within Korean firms, and the domestic financial institutions who lent to them. Although the short-term effects of tackling corporate debt problems may be deflationary after 1997 nobody could plausibly argue that any real alternative to addressing the problem of corporate debt in a vigorous manner existed. To allow firms to maintain high levels of debt and low profitability was to guarantee that history would repeat itself.

The success of the neo-liberal project and Korea's future as a major centre of capitalist accumulation is primarily dependent on the ability of the state to force

domestic firms and financial institutions to focus on improving profitability and financial stability. However, the capacity of the government to attract significant amounts of foreign investment, particularly FDI, into strategically important sectors of the economy is also critical. Additionally, if domestic firms and financial institutions are to improve their competitiveness it is vital that they are able to attract investment from and form joint ventures with their foreign counterparts. It is to the changes in the legal frameworks governing foreign investment that have been enacted since the crisis we now turn.

Enhancing economic openness

By the end of 2000 the majority of the controls that were in place on foreign investment within Korea and overseas investment by Korean firms and individuals prior to the crisis had been eliminated. Capital account transactions involving firms, financial institutions and private individuals have been fully liberalised; tight controls on foreign land ownership have been removed; blanket ceilings on individual and total foreign equity purchases have been abolished; and restrictions on foreign investment have been partially or fully lifted within 29 categories of business (OECD, 1998: 39; 2000a: 75; Emery, 2001: 83–5; S.-Y. Kim, 2000).

The removal of restrictions on foreign equity and direct investment is, we would argue, particularly significant. At the end of December 2005 foreigners held, in terms of market capitalisation, 40 per cent of all stock listed on the Korean Stock Exchange (KSE) (*Korean Times*, 2006a). Moreover, at the end of 2004 foreigners owned 46.5 per cent of total shares in the leading ten *chaebol* and 53.02 per cent of the shares in Samsung, Korea's leading conglomerate (*Korean Times*, 2006c). The removal of the blanket ceiling on foreign equity investments has had the precise effect economic nationalists within the Korean state-capital complex feared, and reformists desired. For nationalists the nightmare has become reality; foreign fund managers now control key national firms. The illusion that Korea's economic destiny lies in the hands of Koreans has been shattered forever. For reformists the massive influx of foreign portfolio investment is manna from heaven. Not only has this influx of foreign capital boosted stock prices, and thus the ability of firms to seek non-debt based financing, but widespread foreign ownership also promises to improve standards of corporate governance and financial performance. The full economic and political implications of foreign portfolio investment shall be fully drawn out over the course of the next chapter. For our purposes here it is sufficient to recognise that the liberalisation of controls over foreign equity ownership has led to a large influx of portfolio investment and that this constitutes a development of first-order importance.

Despite the important role that foreign portfolio investment has played in reshaping the Korean economy since the crisis, the focus within most of the literature has been on the state's attempts to promote inward FDI (Kirk, 2000; Bishop, 2001; OECD, 2001a: 175; 2001b: 152–6).²³ The state's efforts to attract

FDI since the crisis have gone far beyond simply removing restrictions on investments. Four key measures the state has taken to attract potential foreign investors stand out. First, the notification and registration procedures that potential investors have to complete have been greatly simplified. Second, in 1998 the government established the Korean Investment Service Centre to provide foreign investors with the various permits and licenses that all firms, domestic and foreign, require to do business in Korea. This is very important, as foreign firms had previously experienced acute problems acquiring documents from working level bureaucrats within the ministries eager to protect important domestic firms. Third, the central government has increased the scope and generosity of tax incentives available to foreign investors (see OECD, 1999a: 43–7 for an analysis of these benefits). Finally, the freedom of local governments to actively pursue FDI has been greatly enhanced since the crisis. The devolution of authority, in this area, to local governments has led to the establishment of various local tax exemptions, science and industrial parks, and Foreign Investment Zones (FIZ).²⁴ The central government has supported the efforts of local governments to attract FDI by establishing a 50 billion won fund from which local governments may draw half the cost of any subsidy that they choose to offer to foreign investors (Yun, 2003: 247). Although the efforts of local governments within Korea to attract foreign investment may appear unexceptional to the outside observer we must remember that prior to the crisis these entities made no real effort to attract FDI. When understood against this context the active role local governments are now playing in courting foreign firms is remarkable (OECD, 2001b: 152–6).

At first glance the results of these reforms appear mixed. Inward FDI, on a notification basis, increased from an average of \$1.2 billion per annum between 1991–6 to \$1.3 billion in 1997, \$2.9 billion in 1998, \$5.2 billion in 1999 and \$9.3 billion in 2000 and 2001. This was followed by a severe drop to \$3 billion in 2002 (United Nations Conference on Trade and Development, 2003: 251; 2005: 306). FDI recovered to \$3.9 billion in 2003 and rose further to \$7.7 billion in 2005 (United Nations Conference on Trade and Development, 2005: 306). FDI remained at approximately the same level in 2005 (United Nations Conference on Trade and Development, 2006: 301). The significance of these figures is open to interpretation, not least because of their extreme volatility. On the one hand, these statistics lend considerable support to the argument that a quantitative shift in the FDI regime has taken place since the crisis. FDI exceeded pre-crisis highs by almost 500 per cent in 1999 and 2000 and by almost 300 per cent in 2004. The 2004 and 2005 figures are particularly significant as they partially undermine the argument that the state ‘used’ FDI to promote restructuring before once again closing its economy. On the other hand, however, these figures also indicate that FDI inflows remain low in Korea when judged on a comparative basis.

We would argue, however, that aggregate FDI figures give a very poor impression of the real impact of FDI on the Korean political economy since 1997 or the state’s stance towards FDI. A significant proportion of FDI has been

concentrated within the financial sector. At the end of 2004 the combined foreign ownership share of Korean commercial banks stood at 59 per cent. The Korean government itself owed a reasonable proportion of remaining bank equity and levels of foreign ownership in purely privately owned banks ranged between 63 and 100 per cent (OECD, 2005: 165).

By maintaining strict laws which effectively prevented the *chaebol* from investing in the banking sector the government effectively ensured that the sector would come to be dominated by overseas firms. The importance of the state's actions cannot be overstated. As we argue more fully in Chapter 7 commercial bank restructuring lay at the heart of the entire post-crisis economic reform programme. Furthermore, the banks themselves had historically been at the heart of the Korean developmental state project. Without wishing to engage in hyperbole we would suggest that in selling commercial banks to foreigners the state made a conscious decision to entrust the destiny of the entire Korean political economy into the hands of global capital. The Korean government made a clear decision to prioritise the competitiveness of the economic 'space' over that of particular Korean financial interests. The financial system was to be revitalised in the wake of the crisis. However, national financial institutions were not to be protected.²⁵ As such the government's policy towards commercial banks followed a very different set of principles to those subscribed to by the developmental state, the object of policy was the competitiveness of the national economic space not individual national champions.

A similar argument can be made with reference to the car industry. Since 1997 the second and third largest car firms in Korea, Samsung and Daewoo Motors, have been sold to overseas investors. The sale of Samsung and Daewoo Motors is significant because the car industry was a key strategic sector that the state had sought to nurture for some considerable time. The state's decision to support the sale of Samsung and to seek to engineer the sale of Daewoo to overseas investors is indicative of a clear paradigm shift in the operation of industrial policy. By promoting the sale of key car manufactures to overseas firms the state prioritised securing Korea's position as a site of accumulation within the global car industry over protecting 'national champions'.

Despite the evidence from key sectors of the economy there is still a considerable body of scholarship that remains sceptical about the Korean governments commitment to attracting foreign investment. In certain cases their 'analysis' amounts to a blunt refusal to consider evidence. For example, Kirk (2000) simply asserts that whatever legal changes are enacted, state officials and private sector insiders will always 'protect' Korean firms from foreign competition because of an almost instinctive dislike of foreigners. S.S. Kim (2000) suggests that Korea is still hostile to FDI on the basis of a late 1998 *Newsweek* report which assessed the progress of the major Asian economies a year after the onset of the crisis and judged Korea to be the joint worst performing country in terms of offering a attractive environment for FDI. It is, however, difficult to take such a survey seriously given that Singapore was accorded the joint lowest rating alongside not only Korea but also Indonesia. In other words, a country in the

throes of disintegration was assessed to offer as attractive an environment for FDI as the wealthy and stable base for many MNC's Asian headquarters!

Weiss and Thurbon (2006) argue that the Korean state promoted FDI in the wake of the crisis as a means of promoting 'industrial streamlining'. However, the state is seen to have insured that Korea's 'national champions', and thus her economic autonomy, were protected within this process. Furthermore, as processes of industrial streamlining were completed at the end of 2001 FDI is seen to have fallen back to 'normal' pre-crisis levels. The empirical evidence offers limited support to the thesis that the state used FDI in the wake of the crisis before once again adopting a negative attitude towards such investment. FDI flows in 2004 and 2005 were much closer to the record inflows registered in the years immediately following the crisis than inflows at any point prior to the crisis. However, the fundamental problem with Weiss and Thurbon's argument is not with their analysis of the quantitative data but with their complete failure to understand how the Korean state has 'used' FDI to promote restructuring. As we have already argued, rather than protecting national champions and employing FDI to promote streamlining the state has instead sought to promote the sale of critical strategically important firms to foreign investors. Weiss and Thurbon's analysis is further undermined by an examination of portfolio investment. What does the term 'national champion' actually mean when the majority of the equity in many of Korea's leading firms, the national champions that are the subject of Weiss and Thurbon's analysis, is owned by foreign investors?

A more sophisticated argument regarding the environment for FDI is advanced by Graham (2003: 111–12). Graham acknowledges that the crisis did mark a turning point in the Korean state attitude towards FDI. However, alongside Chung and Wang (2001: 141–2), he views the levels of FDI attracted since the crisis as 'disappointing' and highlights two reasons why this has been the case. First, there are a number of 'technical' issues which have impeded the flow of FDI into Korea. Most important in this regard are the low levels of corporate transparency, which made it difficult for investors to assess the true value of assets (*ibid.*: 157–8; see also Emery, 2001: 138). Second, Graham argues that despite the *du jure* changes in rules governing FDI, bureaucrats often remain reluctant to sell major troubled firms to foreigners. Graham cites Ford's failed bid for Kia Motors to support his case. Nevertheless, as Graham acknowledges, larger more important firms have since been sold to foreigners. At most, any reluctance by the state to sell Kia motors to Ford should be understood as a result of a small-time lag between the implementation of policy changes and changes in bureaucratic practices. A more persuasive argument, advanced by Yun (2003: 248–9) with particular reference to local governments, is that Korean bureaucrats, who had previously focused on developing domestic firms, simply did not know what they were doing when courting foreign firms and made clumsy mistakes.

The long-standing doubts of key elements of the state elite about the value of foreign equity and direct investment appear to have dissipated in the wake of the crisis. How do we explain this remarkable change in the state's policies towards FDI?

It is clear that the shift in Korean political elites' attitude towards foreign investment, both direct and portfolio, cannot be attributed to external political pressure. Although the agreement Korea signed with the IMF in 1997 included certain clauses directly related to foreign investment, the measures the government has enacted since the crisis easily surpass anything called for by this agreement. For example, two of the main measures that the Korean government was required to enact under the terms of the 1997 agreement (IMF, 1997) were to:

- Liberalise foreign investment in the Korean equity market by increasing the ceiling on aggregate ownership from 26 per cent to 50 per cent by end-1997 and to 55 per cent by end-1998. The ceiling on individual foreign ownership will be increased from 7 per cent to 50 per cent by end-1998;
- Further reduce restrictions on foreign direct investment through simplification of procedures.

The Korean state has, of course, not simply raised the ceilings on foreign equity ownership, but abolished these ceilings altogether. Moreover, the state has gone far beyond reducing restrictions on FDI, as requested by the IMF, establishing various incentive schemes to attract overseas firms. The state has adopted new, more positive, policies towards foreign investment in the wake of the crisis in order to restore and enhance Korea's position as a major site of accumulation within the global economy. Three related points can be made in this regard. First, FDI was critical to the entire restructuring project as it provided a key mechanism through which to discipline Korean firms. One of the keys to subjecting Korean firms to market discipline was to ensure that large troubled firms had access to neither special financial privileges from the state nor funds from financial institutions which they themselves controlled. The influx of large quantities of foreign capital into the financial system provided a mechanism for checking unprofitable politically connected firms' access to capital and ensuring that the financial sector was not simply captured by the major industrial conglomerates. Analysts sceptical of the argument that Korea is a neo-liberal political economy are free to argue that discipline is not an exclusively neo-liberal concept and that the state 'used' FDI to create a set of institutions capable of disciplining the *chaebol*, a strategic objective of a reformed developmental state. However, as we have consistently argued throughout the book, the consistent singular emphasis on enhancing market disciplines (pressure on firms to improve profitability) is distinctively neo-liberal.

Second, opening the equity market fully to foreign investors opened up an important new source of capital for Korean firms seeking to reduce debt levels. At the same time it created a new set of disciplinary pressures and promised to impact on corporate behaviour. Management of large firms must focus on increasing profitability if they are to satisfy foreign institutional investors and avoid problems associated with a declining share price, investor 'interference' in autonomous managerial decision-making and the prospect of hostile acquisitions the management of major firms must focus on improving profitability. Foreign

institutional investors have become part of the disciplinary structure which the state has sought to construct in order to ensure that major firms focus on the improving their financial structures. Moreover, the influx of foreign indirect investment since the crisis forces us to seriously consider what the term 'Korean firm' actually means. Can we unproblematically assert that Samsung remains a Korean firm when overseas investors own a majority of equity and in the last instance have the power to dismiss the existing management of these firms. Furthermore, if major Korean firms are ultimately owned by the same institutions as their counterparts in the US, Australia and UK will their methods of operating remain distinct in the long term? Clearly we are not yet in a position to give a definitive answer to this question. However, we would argue that in opening equity reformist state managers hoped to reshape the behaviour of firms and force managers to focus more intensely on the pursuit of profitability.

Finally, the crisis very clearly exposed the limits of any industrial policy focused very tightly on promoting domestic firms. While the future vitality of the Korean economy remains critically dependent on the capacity of major Korean firms the crisis demonstrated the limits of relatively autocratic industrial development. As major Korean firms in key industries experienced serious difficulties it became clear that if Korea was to enhance its position as a site of accumulation in these industries it would have to attract major foreign firms. The fact that aggregate levels of FDI have not been enormous is less relevant than the fact that investment has been concentrated in key sectors. All FDI does not have the same economic significance. A one billion dollar investment from a US biotechnology firm and a billion dollar investment from a Chinese mining firm are likely to have a quite different impact on the broader development of a national economy and its structural position within the global capitalist order.

This basic proposition that the state ought to promote FDI is challenged by Crotty and Lee (2001: 36–43) and Shin and Chang (2003: 103–9) who argue that increased FDI is undermining national policy autonomy, something which they understand to be a negative development. We do not accept the underlying proposition that it is possible to return to a system of state-led capitalist development providing a large majority of industry continues to be controlled by Koreans. If the central arguments of this thesis regarding global structural change and the obsolescence of state-led development hold, then these scholars' arguments concerning national policy autonomy have little purchase – FDI in strategic importance has played, and is likely to continue to play a key role, in promoting the international competitiveness of the Korean economy.

Privatisation and the marketisation of the state

The final aspect of the process of state and institutional restructuring that we examine in this chapter relates to privatisation and the transformation of the public sphere into a space for capitalist accumulation. In the immediate wake of the crisis the government drew up plans to privatise the electricity industry, the country's highly competitive national steel manufacture (the Pohang Iron and

Steel Company (POSCO)) and the national railway network. As we have already said the plan to privatise the electricity industry has largely been abandoned. The same fate befell the plans to privatise the railways in the face of worker opposition. Nevertheless, the privatisation programme has not been a complete failure. POSCO has been privatised and the sale of Korea Telecom, which was initiated prior to the crisis, has been completed. Moreover, the final restrictions on the capacity of private firms to operate hospitals as profit maximising entities have been removed (*Korean Times*, 2005).

There have also been ‘achievements’ in terms of reform of the pension systems and the provision of services by local governments in order to allow greater space for private capitalist accumulation. Since 2001 the management of a relatively small proportion of the National Pension Fund, whose assets are likely to account for 35 per cent of GDP by 2015, has been contracted out to private sector management companies (OECD, 2005: 65). The reforms in the organisation of how local governments deliver services have been no less significant. Park (2004) conducted a survey of the extent of contracting out of services among two regional and municipal governments which demonstrated that a sharp increase in contracting out had taken place since 1997, largely as a result of pressure from the central government. In 2002 private contracts accounted for 2.1 per cent of total local government operating budgets (*ibid.*: 500). Furthermore, as Park is quick to point out, ‘if we include contracting-out cases involving capital expenditures, the ratio would go up to 30 per cent easily’ (*ibid.*: 508).

Another area where there exists considerable potential for future private accumulation is through the financing and operation of social and physical infrastructure projects. In 1998 the Act on Private Participation in Infrastructure was passed in order to promote private sector involvement in infrastructure projects (OECD, 2001b: 135–6). The government has gone beyond simply allowing the private sector to be involved in infrastructure development and has offered private firms minimal revenue guarantees in order to induce their co-operation. In 2005 the state and private sector collectively agreed to invest six trillion won (0.7 per cent of GDP) in public-private partnership projects (OECD, 2005: 58).

It seems difficult to contest the fact that there has been a palpable shift towards the greater marketisation of the public sector and a redefinition of what constitutes the public sector through privatisation since the crisis. Nevertheless, in certain key areas the pace of change has been somewhat sluggish and the results of the reform process have been unspectacular. The combined effects of labour resistance and the reluctance of bureaucrats steeped in the dirigiste traditions of the developmental state to cede control to the private sector have not blocked the ‘reform’ of public services in Korea. What they have and are continuing to do, however, is ensure that the process of public sector reform is a long drawn out one.

In any case the marketisation of the state and the transformation of the public sector into a site of capitalist accumulation is in many respects a less important aspect of the neo-liberal project in Korea than elsewhere in the world. For one

thing the public sector in Korea is much smaller than in other reasonably developed economies, with public consumption accounting for 13.5 per cent of GDP and total government revenue standing at 23 per cent of GDP in 2004 (OECD, 2005: 8). More significantly, the problems associated with the dearth of profitable investment activities in the conventional private sector which generated a structural pressure on state managers in core capitalist states to marketise the public sector is less acute in contemporary Korea. Low profitability in the Korean corporate sector has historically been a result not of a lack of profitable investment opportunities but the failure of major firms to prioritise profitability objectives. Korean GDP remains less than half US levels, the organic composition of capital in the manufacturing sector remains much higher than in the US, Japan or Western Europe and there remains substantial potential to secure healthy returns on capital through carefully targeted investments which seek to increase labour profitability. Indeed as firms have focused on profitability and labour has been squeezed the financial performance of the Korean corporate sector has substantially improved since 1997 while fixed investment has continued to account for approximately 30 per cent of GDP (*ibid.*: 8).

Conclusion

When we understand the different elements of the policy and institutional restructuring process as constituting a coherent unified totality two fundamental points become clear. First, although no single reform, in and of itself, represents an epochal shift in the legal frameworks of accumulation within Korea, the reforms collectively do constitute such a fundamental shift. Systems of corporate governance and financial regulation have been radically redesigned so as to fully conform to global neo-liberal norms. The legal frameworks that govern foreign investment and the government's attitude towards such investment have been transformed since the crisis as Korea has moved from seeking to restrict to actively promoting foreign investment. Moreover, the institutional structures of economic governance and legally defined policymaking procedures have been transformed so as to 'lock in' those neo-liberal reforms that have already been enacted and insulate economic policy from political pressures. Key aspects of economic policy, including financial and monetary policy, have been farmed out to autonomous agencies that possess clear mandates to pursue market conforming objectives. Additionally, policymaking procedures have been reformed so as to place a formidable set of obstacles in the way of any attempt by the economic ministries to resuscitate the dirigiste policies of the past. On balance, therefore, and despite both limited progress of attempts to marketise the state itself and the survival of essentially dirigiste structures of power and telecommunications regulation, it is accurate to label the contemporary Korean state as a neo-liberal competition state.

Second, it is clear that these changes in the legal structures of accumulation are being driven primarily by forces within the Korean state-capital complex, not by external political pressure. The 1997 crisis has heightened Korean state

managers' awareness of the need to thoroughly overhaul the system of economic governance in order to secure and enhance Korea's position as a site of accumulation within a changing global economy. Although a number of highly significant reforms were undertaken prior to the crisis in response to global structural change, and important continuities exist between pre- and post-crisis reform processes, the state had shown considerable reluctance to enact difficult but necessary reforms. In the wake of the crisis, which was itself a product of uneven liberalisation, it was clear to Korean elites that difficult reforms could no longer be postponed. The extent of the state's own commitment to economic reform is evidenced by the extent to which the reforms enacted since the crisis have gone beyond anything demanded by the IMF within the 1997 agreement. By stressing the importance of domestic social forces in driving processes of reform we do not, however, intend to ignore the important role that external political actors have played in the process. The fiscal pressures on the Korean state in the wake of the crisis gave the US/IMF considerable leverage over domestic state managers. Moreover, domestic elites have consistently sought to benchmark their reform efforts against standards of best practice as defined by the international economic organisations. External political actors may, therefore, accurately be understood as having played an important role in both strengthening the position of reformists within the Korean state-capital complex in the wake of the crisis and in shaping the programme advanced by these forces.

In addition to benchmarking domestic reform efforts against the standards established by major international economic organisations, Korean elites have enjoyed the advantage of being able to draw on the experience of other countries in designing Korea's own comprehensive economic liberalisation programme. Late liberalisers, such as Korea, enjoy the advantage of being able to learn from the mistakes of the plethora of states that have already attempted to liberalise their economies. The fact that Korea had a highly educated and competent bureaucracy, fully aware of the mixed experiences of other liberalising economies, ensured that it made full use of the potential advantages of lateness.

A deliberate attempt has been made to avoid discussing concrete processes of economic restructuring in any depth within this chapter. Nevertheless, the ultimate purpose of the entire programme of economic reform is, of course, to effect concrete material changes. Or, more precisely, the ultimate objective of the programme is to improve the ability of domestic firms and financial institutions to compete within a rapidly integrating global economy and to attract greater levels of foreign investment. It is to the material changes that have taken place within the Korean corporate and financial sectors since the crisis that we turn in the next chapter. In our analysis of the economic restructuring process we shall pay particular attention to the role that the highly active state has played in expediting corporate and financial restructuring and the role foreign investment is playing in transforming the Korean economy.

7 Corporate and financial restructuring in post-crisis Korea

The immediate trigger for the 1997–8 Korean crisis was the collapse of the Malaysian, Indonesian and Thai economies. These events, however, only brought forward the inevitable. As we have made clear throughout the book, the fundamental cause of the crisis lay in the weak profitability of domestic firms. It is only a slight exaggeration to say that major Korean firms made no money in the years immediately prior to 1997 and that these firms had in any case only a passing interest in actually improving their profitability. It had never really been necessary for Korean firms to make a profit in order to survive and prosper. Rather, up until the 1980s firms' success had been dependent upon their ability to meet government-defined targets and objectives. Economic liberalisation freed the *chaebol* from these obligations and allowed management to pursue quixotic expansion plans without concerning themselves about government-defined targets or anything as mundane as profitability and solvency. As Korean firms and financial institutions came to enjoy increasing unfettered access to global markets it was inevitable that their acute financial vulnerabilities would be exposed and the entire regime of accumulation would collapse. This is precisely what happened in late 1997.

When judged by the scale of economic destruction it wrought, the Korean crisis was not particularly exceptional. The Korean economy contracted by 6.7 per cent in 1998 (Hill and Chu, 2001: 4). This was a serious slump. Nevertheless, one can find numerous examples of economies that have contracted more rapidly. Indeed, Malaysia, Thailand and Indonesia all suffered more severe economic contractions than Korea in 1998 (*ibid.*: 4). At the micro and meso levels, the effects of the Korean crisis were more dramatic; major business groups collapsed and large sections of the financial system were closed or nationalised. However, this did not make Korea unique. In the early 1980s the Argentinean and Chilean governments were both effectively forced to nationalise their respective financial systems (Green, 1995). In a great many economic crises we have witnessed not just the collapse of major firms but the complete destruction of major industries, and in the case of the former Soviet Union full-scale de-industrialisation. In 1996 Korea had important steel, shipbuilding, car, consumer electronics and semiconductor industries. In 2006 Korea continues to be a major exporter in all these areas.

What makes the Korean case exceptional is both the strength of the macroeconomic recovery and, more importantly, the speed with which the microeconomic weaknesses that beset the economy have been addressed and a new relatively stable growth regime established. GDP growth averaged approximately 5.1 per cent per annum between 1999 and 2005 (IMF, 2006b: 178). Although this performance is unimpressive when judged against Korea's growth performance over the previous 40 years, it confounded the almost universal view that swift recovery from the crisis was impossible and that a prolonged period of low growth was unavoidable (Kong, 2000). A set of well capitalised, profitable, privately, and often foreign-owned, institutions now lie at the heart of the Korean financial system. Furthermore, the debt-to-equity ratios of the manufacturing sector as a whole fell from around 400 per cent in 1997 to 100.9 per cent in 2005 (Bank of Korea, 2006a: 581). Although this fall is mainly due to the large volume of new equity that has been issued since the crisis, it is still true that overall levels of corporate debt have fallen steadily since 1998 (*ibid.*: 584). Moreover, the profitability of domestic firms has improved dramatically since the crisis.

The most visible of all the changes that have taken place within the corporate sector, however, relate not to the internal financial structures of domestic firms but to the growing role that foreign firms are playing within the Korean economy. Major troubled firms, such as Daewoo Motors and Samsung Motors, have been taken over by foreign investors. At the same time, healthier domestic firms have sought to attract capital and expertise from abroad by establishing joint ventures and other forms of strategic partnerships with major MNCs. Foreign portfolio investors now hold a majority of voting stock within a number of Korea's most successful firms. When understood against the strong commitment previous governments had demonstrated to building independent industrial capacity, the recent influx of foreign investment represents an event of epochal significance (Kong, 2000: 26–65).¹

Major economic crises represent the breakdown of a particular regime of accumulation. What only becomes clear in retrospect is whether the breakdown of this regime will usher in a prolonged period of economic chaos and decline or if the crisis itself has created the political and economic foundations for a new, relatively stable growth regime to develop. It is clear that since the crisis Korea has established itself as a relatively robust and dynamic neo-liberal economy. In part the impressive performance of the Korean economy since the crisis reflects the fundamental pre-existing strengths of the economy. Korea had a reasonably sound physical infrastructure, a well-educated and disciplined workforce, and – regardless of the financial problems major firms faced – a well developed manufacturing base. However, these achievements also reflect the intelligent, swift and decisive response of the state to the structural problems that beset the economy.

Although the Korean state has committed itself to refraining from directly intervening in the economy in order to shape economic outcomes in the long term, the scale of the problems the economy faced in the wake of the crisis

forced the state to act in a more dirigiste manner. The single most important decision the state took, with regard to the post-crisis restructuring process, was to largely devolve responsibility for promoting corporate and financial restructuring to the autonomous FSC.

As we made clear in the previous chapter, the FSC enjoys a high level of autonomy from central government control, although it is dependent on central government for legislative and financial support. That said, the members of the FSC were not entirely free to direct the restructuring process as they chose. Rather, they were obliged to follow the operating guidelines that were established at the birth of this institution when acting to promote restructuring as when acting in a more conventional regulatory role. The most important of these guidelines, with regard to the restructuring process, was the duty to promote the functioning of market mechanisms, to respect the autonomy of private institutions and to take swift firm action against those institutions that fail to meet appropriate regulatory standards (FSC, 2000: 33–5).

The scope of the powers that have been devolved to the FSC in order to allow it to promote restructuring is extensive. The FSC has taken the key decisions about which financial institutions are to be supported with public money and which institutions are to be allowed to fail. Additionally, having presided over the nationalisation of key financial institutions, the FSC has been charged with taking the key decisions concerning how and to whom these institutions are to be sold. Equally importantly the FSC has played a decisive role in co-ordinating workout arrangements between troubled smaller conglomerates/major independent firms and creditors. Additionally, the FSC directly determined which small firms would receive support in the wake of the crisis. Moreover, we would argue that the FSC has been unable to remove itself completely from decisions concerning whether troubled major firms will receive additional funding. It must be stressed that the management of nationalised banks formally retain the authority to decide whether firms' debts will be rolled over or whether they will be denied further access to credit. However, the FSC was the nearest thing these banks had to an owner; and the FSC/FSS has played, and continues to play, an active role in restructuring them in order to enable their successful re-privatisation. We may therefore legitimately ask if it is possible for the FSC not to exert some covert informal influence over these banks' lending decisions. Indeed, we may argue that the FSC has a duty, as an owner, to scrutinise management's lending policies.

The importance of the state's decision to cede control over the financial restructuring process to autonomous technocrats cannot be overestimated.² The essential point is that no matter how committed politicians are to building a viable market-oriented financial system, there will inevitably be conflict between this and the government's other economic, social and political objectives. It is always difficult for politicians to take measures that will deny key firms access to credit, damage exports, depress growth and result in large increases in unemployment. Moreover, in a nationalist society such as Korea, moves to sell major domestic financial institutions to foreign investors will solicit at best a mixed

response from domestic capital and the public at large. The autonomous bureaucrats within the FSC, on the other hand, are in a far stronger position to take unpalatable and politically unpopular decisions. Not only are they more isolated from political pressure to support key firms but they are also free from the problem of possessing multiple potentially conflicting objectives. The FSC's *raison d'être* is to create a viable-market based economy. If this objective requires that growth and employment be compromised in the short term, so be it.

Despite the determined efforts of the FSC and the achievements outlined above, it would still be inaccurate to view the processes of restructuring as complete. A bifurcated structure is developing in both the corporate and financial sectors. On the one hand, a core of financially sound and highly profitable firms and financial institutions are developing. On the other hand, however, a significant proportion of Korean firms remain in a precarious position and a number of major financial institutions remain largely unprofitable (Richards *et al.*, 2002: 85–115). Additionally, as potential take-overs have collapsed, the state's policy of seeking to attract foreign capital and expertise to revive the fortunes of struggling domestic firms and financial institutions has resulted in failure as often as it has success.

The central objective of this chapter is to provide a balanced assessment of the complex ongoing processes of corporate and financial restructuring. Particular attention will be paid to the role of the interventionist state and foreign capital in driving these processes. Particular care will be taken not to simply equate the failures of the restructuring process with a lack of commitment to creating an efficient market-based economy. Rather we shall draw out the difficult problems and obstacles that the state faces in its attempts to create such an economy. Equally, our analysis will seek to identify the 'dynamics' of the restructuring process, to understand how the economy is evolving, not simply to describe the Korean economy as it currently exists.

The basic argument advanced within this chapter is that the successes of the restructuring process far outweigh its failings and that contemporary Korea is fundamentally a strong neo-liberal economy. The reading of the post-crisis restructuring process offered here contrasts sharply with that advanced by the large majority of scholars working on the Korean political economy. The literature on the post-crisis Korean political economy can be divided into three broad schools. First, there is the mainstream neo-liberal approach that basically accepts the need for the state to force leading firms to rationalise, to ensure the swift exit of unprofitable firms from the market and to promote foreign ownership of key assets. However, the Korean state is understood to have pursued these objectives with insignificant vigour and to have subordinated 'sound market principles' to what is politically expedient (Emery, 2001; Jang and Kim, 2002; Graham, 2003; Lee, 2003).

Second, there are the important distinctive arguments advanced by Weiss (2003b). Weiss argues that the central principles and objectives governing the state's largely successful post-crisis corporate and financial sector restructuring programmes share more in common with those of the classical developmental

state than any neo-liberal ideal. According to her reading of the crisis, the state is using traditional dirigiste tools to create a set of new 'streamlined national champions' in both the financial and corporate sectors (*ibid.*: 250–8). This policy clearly represents a continuation of the state's historical dirigiste economic nationalist project.

The final major approach to understanding the post-crisis restructuring process is that advanced by the left-Keynesians Crotty and Lee (2001) and Shin and Chang (2003). These scholars agree with the argument advanced here that the state is seeking to create a neo-liberal economy by dirigiste means. As Crotty and Lee (2001: 25) assert, 'in order to achieve its goal of transforming Korea into a free-market economy, the government took direct control of the financial system and used this power to dictate restructuring to the largest financial corporations'. For these scholars, however, rather than creating the conditions for Korea to continue its historic economic ascent these policies are doomed to fail and lock Korea into a low-investment/low-growth trajectory. The particular arguments advanced by these scholars will be engaged with and refuted within the course of this chapter. In doing so we shall draw upon a body of work that is broadly commensurate with the analysis offered here (Ahn, 2001; Haggard *et al.*, 2003; Mo and Moon, 2003; Yun, 2003). For the sake of convenience, the symbiotic processes of financial and corporate restructuring are considered separately. It is to the process of financial restructuring we now turn.

Financial restructuring

In the immediate wake of the crisis, a vast array of different types of financial institutions serving quite distinct purposes were operating within Korea, most of them in very serious financial difficulties. No set of Korean financial institutions was free from the problems of impaired asset sheets and weak profitability (OECD, 1999a: 83–98). In attempting to promote financial restructuring and resolve the problems posed by failing institutions the state, or more precisely the FSC, has treated functionally distinct financial institutions very differently. On the one hand, the state has lavished a great deal of public money and civil servants' time on resolving the problems of those institutions which constitute an integral part of a functioning market economy, most notably the commercial banks. On the other hand, the state has devoted relatively few resources to rehabilitating those institutions whose failure is unlikely to greatly effect the long-term development of the Korean economy. The most extreme manifestation of this more hands-off policy was the state's decision to allow almost all the merchant banks to collapse (Richards *et al.*, 2001: 83). Given the range of policies the state has pursued with regard to different types of financial institutions it is, in many respects, most logical to analyse the evolution of each distinct set of institutions since the crisis separately. This is a logic that we fully subscribe to within this study. Unfortunately, however, space prevents us from properly analysing the development of the full plethora of Korean financial institutions. Our analysis will focus on the development of the critical commercial banking

sector and carefully selected key non-bank financial institutions. Despite the relatively low number of institutions examined here our sample effectively demonstrates the full range of policies the state has adopted, from the dirigiste to the relatively laissez-faire. It is the policies that have been employed to expedite bank restructuring since the crisis and the results of these policies to which we turn first. Our analysis of bank restructuring provides the context against which we shall develop our understanding of the diverse range of strategies the state has adopted to resolve the problems that beset important non-bank financial institutions. Having done so we shall attempt to draw out the most significant features of the overall financial restructuring process.

Commercial banks

In her important recent essay on Korean economic restructuring, *Miracle as Prologue*, Meredith Woo-Cumings (2001) emphasised the key role that the strong interventionist state has played in promoting market-based reform since the crisis. It is when we focus upon the restructuring of the commercial banks that the salience of Woo-Cumings' argument becomes most clearly apparent. The Korean State has systematically attempted to create a set of strong, viable, privately owned commercial banks through dirigiste means. At first glance there may appear to be a contradiction between the nature of the policies the state has pursued in order to advance bank restructuring and the ultimate objectives of the restructuring programme. Somewhat ironically, however, even the most cursory analysis of the development of the Korean banking system reveals the indispensable role that extensive state intervention has played in the construction of a relatively strong, market-based banking system since 1997. In the immediate wake of the crisis it was clear that a number of Korean banks were in a quite hopeless condition and that other weak but viable banks would require extensive support were they to meet new prudential standards. The only effective alternative to nationalising key banks, using public money to re-capitalise and purchase bad loans from weak but viable institutions, was to allow practices of regulatory forbearance to continue unabated. Given the financial position of leading Korean banks, the state could not realistically have enforced tighter financial regulations without simultaneously establishing mechanisms to prevent the collapse of systematically important institutions. No state, however committed it may be to abstaining from directly intervening within the process of accumulation, can simply stand aside and watch as key domestic banks go bankrupt. Not only are the macroeconomic consequences of the partial or total collapse of the banking system likely to be severe but, even more importantly, a functioning banking system is a key component of any modern economy. If the state simply stood aside and allowed the commercial banking sector to collapse, it would seriously impair the long-term growth potential of the economy.

The Korean state implemented two central policies in the wake of the crisis in order to strengthen the domestic banking system. First, the government demonstrated a clear commitment to abstaining from regulatory forbearance and

closed down or nationalised failing institutions. As a result of these policies, five major commercial banks were placed under full government control and five other banks were shut down (Samsung Economic Research Institute, 2001: 117; Richards *et al.*, 2002: 103). The government minimised the disruption caused by the failure of major financial institutions by organising the transfer of depositors' claims and performing assets to stronger institutions. To prevent any weakening of strong institutions as a result of these arrangements the state purchased all non-performing loans (NPLs) from dissolved institutions and injected enough capital into the newly merged banks to bring their capital adequacy ratios up to the level of the acquiring institution.

These policies have carried with them considerable fiscal costs and total government spending on the bank-restructuring programme between 1997 and 2004 amounted to 86.8 trillion won, slightly in excess of 15 per cent of 2000 GDP (OECD, 2005: 129). However, the quantitative improvements in the position of commercial banks would appear to justify these heavy outlays. The commercial banks, collectively, broke all previous profit records in both 2001 and 2002 (*Korean Herald*, 2003b). Furthermore, the level of substandard loans within the banking system fell to 2.33 per cent of total loans by the end of 2002 (FSC, 2004).

The banking sector suffered a setback in 2003 as profits after loss provisioning fell from 3.7 trillion won to 0.3 trillion won and the level of substandard loans rose to 2.8 per cent (OECD, 2005: 165). These developments were principally due to a rapid slowdown of the economy in 2003 and problems related to credit card borrowing. With the resolution of the problems in the credit card sector and a strong upturn in economic growth bank profits rose sharply in 2004. In 2004 net profits after loss provision rose to six trillion won, 2.3 trillion won higher than the previous record figures. Moreover, the level of substandard loans fell to a new record low of 2 per cent (*ibid.*). The performance of the banking sector in 2005 was more impressive still with profits increasing 63.3 per cent to 10.9 trillion won and the total level of substandard loans declining to 1.28 per cent (Bank of Korea, 2006b: 65, 77).

While the concrete improvements that have taken place in bank balance sheets are not in doubt, serious questions continue to be raised about the longer term profitability of the banking sector and the potential for serious problems relating to non-performing loans to re-emerge (Ahn, 2001; Richards *et al.*, 2001: 80–114; Graham, 2003: 115). The essential point these analysts make is that while there has been a quantitative improvement in banks' balance sheets, important deficiencies in banks' internal management structures remain. This argument is summed up by Stiglitz who argues that Korean banks must continue to 'learn how to be banks' (cited in Ahn, 2001: 269). The inability of Korean banks to properly assess and price risk has serious implications for lending margins (and thus profitability) and long-term balance sheet strength.

It is difficult to assess the validity of these arguments. Ultimately they are based upon subjective qualitative judgment of bank's internal management systems. As such these arguments are impossible to disprove or prove. Never-

theless, it is clearly possible to overstate the seriousness of weaknesses in internal management structures and overall strength of the banking system. How we define the long-term is open to interpretation but the performance of banking sector has been fairly consistently strong for the last eight years. Of course we can identify weaknesses and potential for problems to re-emerge. However, we could do the same for any national banking system if we chose. The point is that the Korean banking system does not appear to possess a set of structural weaknesses that sets it apart from banking systems in North America or the EU. We would also highlight the importance of Borensztein and Lee's (2002) work on the difficulties that large but unprofitable firms have faced in attracting bank finance since the crisis; for perhaps the first time in Korean history profitability is an important determinant of large firms' ability to raise credit (see also *Korean Herald*, 2002b). Korean banks may still lack skill in assessing risk. Nevertheless, it is clear that, at least partially as a result of the influx of foreign investment since the crisis, a new credit culture has emerged within leading domestic banks. Korean banks will no longer blindly extend credit to major firms without asking any questions about the ability of these firms to service their debts, however clumsily banks now attempt to manage risk.

Advanced systems of credit control take time to develop. The extent to which they are now in place in Korea is difficult to assess without conducting detailed analyses of individual institutions. What we can say however is that the new regulatory/competitive environment that Korean banks operate within affords them every incentive to develop such systems. A key means through which domestic banks are 'learning' how to be banks, developing new credit cultures, is through their relationships with strategic foreign investors.

A major strategic objective of the state commercial bank restructuring programme has been to increase foreign ownership within the sector. One of the principal means through which the state has sought to advance this objective has been through the re-privatisation process. Korea First Bank, one of the country's largest banks, was sold to Newbridge Capital, a US financial institution. The importance of this sale cannot be overestimated. As Yun (2003: 253–5) highlights, since its sale Korea First Bank has established itself as a leader, and a model for other banks to aspire towards, in terms of developing new product areas, credit evaluation systems and human resource management. Moreover, Korea First Bank has proven to be a bulwark against residual government attempts to influence private sector lending decisions by refusing to participate in schemes to stabilise the bond market or finance workout firms (*ibid.*: 253–5).

The state built upon this earlier sale by selling Korea Exchange Bank to the US firm Lonestar in 2003 and KorAm bank, Korea's seventh largest bank, to Citigroup in 2004 (Cho, 2004: 7–8). However, the process of re-privatising the commercial banks has not been without its problems. The state continues (as of September 2006) to hold a majority equity position in Korea's second largest bank, Woori Bank. This is despite the fact that the government had earlier committed itself to reducing its stake in the Woori Group, of which Woori Bank is part, to under 50 per cent by the end of 2003 (*Korean Times*, 2004; OECD,

2003a: 130). Furthermore, between 1998 and 2001 the state's concerted efforts to sell Seoul Bank to a major overseas financial institution met with little success, despite some initial interest from the Hong Kong Shanghai Banking Corporation and Deutsche Bank. Following these initial failures Seoul Bank was sold to Hana Bank, a Korean institution in 2002 (*Financial Times*, 2002e). The sale of Seoul Bank in 2002 is indicative of a broader shift towards a new, more pragmatic approach to promoting foreign ownership of the commercial banks. While continuing to recognise the value of attracting foreign expertise into the sector, the state has demonstrated a greater willingness to sell nationalised institutions to strong domestic banks (Richards *et al.*, 2002: 105–12). In part, this policy has clearly been driven by a desire to promote the development of large, efficient internationally competitive domestic banks, although for reasons detailed below we would hesitate to label these banks 'national champions'.

The second key policy the state has pursued in its attempts to promote bank restructuring does not involve actively intervening within failing institutions but rather supporting the attempts of healthier private banks to improve efficiency. The government has used its position as a minority shareholder within stronger banks to actively promote foreign investment within and mergers between these institutions in order to realise economies of scale and reduce operating costs. Still more important than the role the government has played as a shareholder have been the changes it has effected in the legal frameworks within which banks operate. The state has largely removed controls on foreign investment within domestic banks since the crisis. Indeed, in the years immediately following the crisis foreigners were effectively granted preferential treatment due to the tight ownership controls domestic investors were subject to. Technically, any single foreign investor is still prohibited from owning more than 10 per cent of any commercial bank, as opposed to the 4 per cent limit on individual domestic investors that was in place until 2003. In practice, however, the government has allowed overseas investors to purchase far larger stakes in domestic banks due to the expertise these firms possess (Richards *et al.*, 2002: 113). Indeed, since the end of 1999, the majority of major Korean banks have had single foreign shareholders who own over 10 per cent of total stock. The list of major foreign shareholders reads like a list of Who's Who of international banking with Goldman Sachs, ING Group, Bank of New York, Commertz Bank and Allianz Group all holding substantial shares within major Korean banks (Samsung Economic Research Institute, 2001: 39–40). Inevitably the state's effective discrimination against domestic investors until 2003 has ensured that the largest single equity holders in all major Korean banks are foreign. As a combined result of the sale of nationalised institutions directly to foreign investors and the minority equity positions foreign investors held 59 per cent total equity within the Korean banking sector (OECD, 2005: 165) It is possible, despite the remaining unresolved issues within the privatisation process, to categorise the state's bank restructuring efforts as a success. Furthermore, the fundamentally neo-liberal character of the reforms is clear.

A central theme of the reform process is the extension of market disciplines. The state has made it clear in its restructuring program that banks must meet appropriate market-based regulatory standards to avoid being shut down/nationalised. The ability of Korean banks to meet these regulatory standards ultimately depends on their ability to generate profits. At the same time, by forcing commercial banks to comply with enhanced market-based regulatory standards the state encouraged the development of a new credit culture and forced banks to analyse the profitability and financial soundness of potential borrowers.

Equally indicative of state commitment to neo-liberalism is the position it has adopted towards foreign investment. This aspect of the restructuring process in particular exposes the limitations of Weiss's (2003: 250–6) understanding of the commercial bank restructuring process. As we have already made clear, Weiss's central argument concerning the creation of 'national champions' in both the corporate and financial sector has a certain merit. However, we part company from Weiss when she advances the corollary argument that the state is still trying to manage/limit foreign involvement in the banking sector despite WTO rules and the conditions of the 1997 International Monetary Fund (IMF) support package which have forced Korea to accept greater foreign participation. Rather, the Korean state has actively sought to promote foreign ownership of key banks and with it Korea's deep integration into global circuits of finance, not simply complied with its international obligations. The sale of Korea First Bank to a foreign investor may have been required as part of the commitments Korea made to the IMF as part of the 1997 financing agreement. However, the decision to sell Korea Exchange Bank and KorAm Bank to overseas rather than domestic investors was essentially a unilateral one by the Korean state. In any case, the fact that 40 per cent of total banking stock is controlled by foreign investors clearly demonstrates that any attempt by the state to prevent the domination of the banking sector by foreign investors is failing. Indeed, the label 'national champions' is stripped of much of its substantive meaning when, as is the case in Korea, the largest single equity holders in leading nominally domestic banks are invariably foreign financial institutions. Understood within this context it is clear that the policy of promoting mergers between domestic banks in an attempt to create internationally competitive entities cannot be understood as a continuation of the previous dirigiste economic nationalist project. Rather, it represents an integral part of the policy of seeking to create a successful neo-liberal economy through dirigiste means.

We must also recognise that the fiscal costs of bank restructuring have been huge. Approximately 53 per cent of total public funds devoted to the financial restructuring process have been used to strengthen the commercial banks (OECD, 2005: 164) The state has placed the creation of an efficient viable set of commercial banks at the heart of its economic strategy and has invested heavily in this objective. The state has not, however, demonstrated the same determination to strengthen all non-bank financial institutions. It is to the policies that the state has pursued in this area to which we now turn.

Non-bank financial institutions

An incredible diversity of non-bank financial institutions existed within Korea in 1997. None of these institutions has been unaffected by either the crisis itself or the state's attempts to strengthen and restructure the financial system in the wake of the crisis. The state has, however, adopted very different policies towards different types of non-bank financial institutions. We will analyse the evolution of three key sets of financial institutions within this section of the chapter: the merchant banks, insurance firms and investment trust companies.

Merchant banks

Prior to their recent demise, the Korean merchant banks were principally engaged in underwriting primary capital market issues, leasing and short-term unsecured lending (OECD, 1999a: 95). These activities would normally be associated with short-term financial companies rather than merchant banks. It is necessary, therefore, to understand the Korean 'merchant banks' as effectively constituting short-term financing companies whatever their official label may be. The growth of the 'merchant banking' sector prior to the crisis was a direct consequence of the lax regulatory regime. Merchant banks were subject to far fewer controls over their ability to develop new products than the commercial banks; nor was the amount they could lend to various categories of firm and for different forms of economic activity controlled. All other things being equal, we might have expected the absence of non-market-based controls to contribute positively to the profitability and general health of the merchant banks. However, the merchant banks were not only free from intrusive counter-productive controls but were also free from any form of effective prudential market-based controls. The merchant banks were permitted to maintain clearly excessive levels of interest and exchange rate risk. Moreover, due to the absence of proper limits on connected lending, these institutions were massively over-exposed to the *chaebol* who owned them (ibid.: 95–6). The absolute failure of the state's experiment with deregulation in this sector is instantly apparent when we focus on the financial state of the merchant banks. In 1998, 20 per cent of total merchant bank loans were non-performing, these institutions collectively suffered losses of 337 billion won in losses and registered high negative returns on both equity and assets (ibid.: 95). It must also be added that, unlike commercial bank lending, the vast majority of merchant bank lending was not collateralised. Many of the non-performing assets held by the merchant banks were, therefore, literally worthless.

In its attempts to resolve the problems that beset the merchant banks the state has made it very clear that it regards these institutions as essentially dispensable. Failing merchant banks have, as a rule, not been nationalised or offered emergency financial support. The state has, instead, largely confined itself to managing the effects of their collapse by establishing a bridging bank that arranges payment to depositors of failing institutions and assumes the performing loans

carried by now defunct institutions. By June 2004, 28 of the 30 merchant banks that were operating prior to the crisis had been shut down or merged with other financial institutions and the asset share of merchant banks had been reduced to 0.5 per cent of total assets.³

The collapse of the merchant bank sector highlights the state's determination to promote processes of creative destruction. Although we have stressed the fact that the merchant banks did not play an indispensable role within the financial system, it is still true that they accounted for 5 per cent of total assets held by all Korean financial institutions in 1996 (Richards *et al.*, 2001: 84). The fact that the state has allowed the merchant bank sector to implode in the wake of crisis is, therefore, not without significance. The state made it clear that while systemically important financial institutions may be nationalised or given other forms of emergency support, other institutions that fail to meet new regulatory standards will simply be shut down.

Insurance firms

Collectively insurance companies perform an indispensable social and economic function within the Korean political economy. Korea is one of the largest insurance markets in the world and millions of ordinary citizens hold policies to protect themselves, and their families, against the slings and arrows of outrageous misfortune. Were the sector to have collapsed in the same manner as the merchant banking sector, it would have created major social, political and economic problems. The state could not, therefore, have realistically been expected to contemplate allowing the insurance system to collapse. The most important actions that the state has taken to rehabilitate the insurance system relate primarily to life insurance institutions. These institutions were by far the most important and troubled within the Korean insurance industry and it is these companies that we will focus on here.

Prior to the crisis the Korean life insurance sector had a bifurcated structure. A core of strong established profitable life insurance firms did exist within Korea. However, a plethora of new institutions had, as a result of deregulation, entered the market in the 1990s and had largely failed to generate profits. Eighteen of these relatively new, unprofitable institutions were required to submit management improvement plans in early 1998 due to their weak financial position. The other 15 Korean life insurance firms were judged to be healthy and were allowed to continue operations as normal. Four of those institutions which had initially been required to submit management improvement plans had their plans rejected and were declared non-viable and closed in August 1998. The assets and liabilities of these firms were transferred to stronger firms who also received one trillion won in public funds to compensate for the weakness of the assets they received. In spring 1999 another five life insurance companies that failed to meet enhanced regulatory standards were placed under the control of the state, re-capitalised with public funds and put up for auction to foreign buyers (Emery, 2001: 113–14).

Despite some early successes in privatising these newly nationalised institutions, the state has been forced to take control of other weak institutions as it has continued to tighten solvency requirements. By 2003 11 of the 33 life insurance firms that had existed on the eve of the crisis had been forced to exit the market (OECD, 2003b: 133). Additionally, the latter part of the privatisation process did not go entirely according to plan and the sale of Korea's third largest life insurance firm, Korea Life, to MetLife, the largest US public life insurer, collapsed spectacularly in March 2002 (*Financial Times*, 2002c). Korea Life was finally sold in late 2002 to a consortium within which a Korean group, Hanwha, held a majority stake and Japan's Orix Life and Australia's Macquarie Life both held significant minority stakes (*Korean Herald*, 2003a). The sale of Korea Life completed the re-privatisation process within this sector and must be understood as a significant step forward in the restructuring process. However, the failure to sell Korea Life to MetLife, an institution with almost unparalleled levels of managerial expertise and financial strength, must still be a source of regret to the economic bureaucracy. The Korean state has, since the crisis, consistently attached great importance to attracting investments from leading foreign financial firms because of the expertise these institutions possess.⁴

At the same time as tightening and enforcing prudential standards the state has removed a range of arbitrary official controls that had previously been in place over all insurance firms. The significance of these reforms should not be underestimated. Product innovation and the range of products insurance companies were allowed to invest in had both been severely restricted prior to these reforms. Moreover, in direct contradiction to free-market principles, the Korea Insurance Development Institute, a legally mandated cartel, tightly controlled the premiums individual firms could charge (OECD, 1999a: 92). Management within those firms that meet minimum prudential standards now enjoy almost total freedom to pursue whatever strategies they choose in order to improve profitability.

The success of the state's dual strategy of tightening prudential standards and temporarily nationalising failing institutions while simultaneously removing dirigiste controls over healthier institutions can be judged by its effect on profitability within the sector. The reasonable levels of sustained profits that insurance firms have, collectively, enjoyed since 2001 can be seen as evidence that the state's restructuring efforts have been successful. The 1.1 trillion won (approximately \$0.94 billion) profit that the sector posted in fiscal year 2001 was the first net surplus that Korean life insurance firms had registered since 1994. During fiscal year 2002 the life insurance sector enjoyed profits of 2.8 trillion won. These achievements were partially reversed in 2003 as life insurers' profits declined to 1.58 trillion won. However, these results have proven to be something of a blip with profits recovering to 2.11 trillion won in 2004 and 2.09 trillion won in 2005 (*Asian Pulse News*, 2003; 2004; 2006). Given the failure of the sector to collectively register a surplus for six consecutive years to 2001 the performance of the sector since 2001 has been truly remarkable.

Insurance firms and banks collectively account for the absolute majority of all

funds deposited within the Korean financial system. Following eight years of intensive restructuring the banking sector is now relatively free from impaired assets, well capitalised and profitable. Additionally, given the insurance sector's impressive recent performance we can now say with some confidence that a set of fundamentally strong institutions lie at the heart of the financial system. Banks and insurance firms do not, however, constitute the entire core of a modern financial system. One other key set of financial institutions that lies at the heart of any such system are collective investment instruments. It is to these institutions we now turn.

Investment trust companies

The Korean investment trust companies (ITCs) bear a certain resemblance to mutual funds that operate elsewhere in the world. There is, however, one key difference between these two types of collective investment instruments, as the OECD (1999a: 97) highlights:

Unlike mutual funds, which closely link investor return and the performance of the underlying portfolio very closely, the ITCs apparently have not separated funds invested in various portfolios. Thus, securities were carried at historic cost and were moved among various portfolios in the ITC in order to assure desired returns to investors. Given the lack of mark-to-market valuation, it may have been possible to continue making payments to investors even as the underlying portfolio contained significant concealed losses.

Despite, or perhaps because of, the clear weaknesses within their internal systems of financial management, it was not readily apparent that the ITCs as a whole were in serious trouble in 1998. Although two ITCs were shut down in the immediate wake of the crisis, the sector as a whole experienced a giddy boom in 1998 with total deposits growing by nearly 40 per cent (Samsung Economic Research Institute, 2001: 29). In retrospect it is clear that the 1998 investment trust boom was unsustainable. The lightly regulated ITCs attracted funds by offering very high interest rates and proceeded to invest heavily in bonds issued by some of Korea's most troubled firms, many of whom were affiliated with the ITCs. Even at the height of the boom in late 1998, the ITCs had a collective negative net worth of 3.5 trillion won (OECD, 1999a: 98). The entire financial house of cards underpinning the boom was shattered by the collapse of the Daewoo group in May 1999. Despite government attempts to prop up the ITCs, the level of deposits at these institutions fell by 8.4 per cent in 1999 and 50.2 per cent in 2000 (Samsung Economic Research Institute, 2001: 29).

On one level this represented a relatively unproblematic development. In 1998 legislation was enacted to facilitate the development of mutual funds and it is difficult to see what long-term role the ITCs are likely to play within the Korean financial system (OECD, 1999a: 98). On another level, however, the

demise of the ITCs created a set of acute economic problems. The ITCs had historically purchased the preponderance of all corporate bond issues and their collapse threatened to create a major corporate funding crisis. Moreover, given the secular decline in bank trust fund deposits, the total level of monies within collective investment funds is now exceptionally low. The absence of a well developed collective investments sector is likely to seriously impair the long-term development of Korean bond and equity markets.

In order to resuscitate the ITC sector, the state had by the end of 2004 invested almost 19 trillion won into these institutions and nationalised the three largest ITC firms to save them from collapse (OECD, 2005: 166–8). Whatever their faults the ITCs could not simply be allowed to collapse as this would have severely depressed the bond market and created a corporate financing crisis. At the same time as injecting public funds the government has substantially strengthened the regulatory regime these institutions operate under in order to prevent similar problems occurring in the future. All ITC assets are now valued mark-to-market, movement of funds between different portfolios has been restricted and external audits have been made mandatory (OECD, 1999a: 97–8). The combined effect of these measures is to link future investor returns more closely to the performance of the underlying portfolio. The new regulations, therefore, serve to force Korean ITCs to transform themselves into something very closely resembling mutual funds.

Although it is still too early to reach any final judgment early indications appear to suggest that the state's restructuring programme has been a success. Funds started returning to the sector in 2002 and in nominal terms the total level of investment within the sector rose to record levels in 2005.⁵ The three largest ITCs were sold between February 2004 and May 2005 (BOK, 2006b: 56). The state sold an 80 per cent stake in the third largest ITC, Hyundai ITC, to the US firm Prudential Financial (WTO, 2004). The sale of a majority stake in one of Korea's major ITCs to a foreign firm is part of a wider process of market opening and the total market share of overseas asset management firms rose from negligible levels prior to the crisis to 17 per cent in 2004 (*Korean Times*, 2006b). It is clear that the activities of foreign firms will be key to the future vitality of the collective investment sector in Korea. The vitality of the collective investment sector is in turn integral to the successful long-term development of Korean equity and bond markets.

Overall assessment of the post-crisis financial restructuring process

Understood as a totality, a number of points regarding the objectives and achievements of the state's financial restructuring process become clear. First, the government has shown a new determination to refrain from regulatory forbearance and has taken decisive action against those institutions that fail to meet newly enhanced regulatory standards. In deciding precisely what action to take against failing institutions, the state has strictly distinguished between those institutions that, collectively, perform an indispensable social or economic func-

tion from those whose collapse is unlikely to seriously affect Korea's long-term growth potential.⁶ This distinction is clearly illustrated by the state's willingness to lavish vast sums of money on rehabilitating key banks and insurance firms while simultaneously allowing the merchant bank sector to collapse.

In addition to upgrading regulatory standards, the state has sought to strengthen the financial system by attracting foreign capital and expertise. It must be stressed that the state has not limited itself to simply removing the barriers that had been in place on foreign investment but has actively favoured foreigners over domestic investors when drawing up new ownership rules and privatising key institutions. The state's attempts to sell major institutions to foreign investors may not always have been successful. However, this in no way alters the significance of the fact that the state did attempt to sell these institutions to foreign investors. Given the symbiotic relationships that had previously existed between domestic financial institutions, the state and leading firms, the entry of foreign firms into the Korean financial system represents an event of first-order significance. Foreign investment has played a decisive role in shattering the old incestuous links between the state, finance and industry, and is driving the convergence of Korean financial management practices with global norms.

Perhaps unsurprisingly given the decisive role that major foreign firms are playing within the financial restructuring process, the Korean financial system is increasingly coming to resemble the highly marketised US and UK systems. As we illustrated in the previous chapter, financial institutions are now obliged to meet the appropriate BIS/IOSCO-defined prudential standards and are increasingly free to engage in whatever activities they wish provided they can meet these criteria – the era of universal banking is dawning in Korea. Firms and major financial institutions increasingly relate to each other as buyers and sellers in a marketplace not, as was the case in Japan or Germany until relatively recently, as long-term partners.⁷ Korea is not alone in reforming its financial system along Anglo-Saxon lines. All major financial system are becoming more market-based and the trends towards financial decompartmentalisation that began in Britain and America in the 1970s and early 1980s have become global (Cerny, 1993; 2004; Loriaux *et al.*, 1997; Underhill, 1997).

On balance, the FSC's attempts to restructure the Korean financial system have been successful. The major Korean banks are now well capitalised and profitable. As has been well documented by a range of scholars – including Emery (2001: 109–15) and Ahm (2001: 465–6) – the restructuring process in the NBFIs has been protracted and fraught with difficulties. Quite reasonably in the years immediately following the crisis the state concentrated its resources on regenerating core institutions, principally the commercial banks, and was far slower to address problems in the non-bank sector. Although the process of non-bank financial restructuring has been somewhat haphazard and piecemeal, even here the direction of change is clear. Failing institutions may not have always been forced to exit as quickly as many analysts would have liked, but major institutions have been shutdown and progress has been made in rehabilitating

key institutions, such as insurance firms. Writing in 2006 it is also possible to point towards considerable evidence that suggests that longstanding problems in the investment trust sector have finally been resolved. Equally significant to any judgement we may wish to make about the determination of the state to create a new financial sector is the econometric work by Bongini *et al.* (2001) that indicates that those institutions with connections to major firms were as likely to be shutdown as those without. It is critically important that we do not exaggerate the failings of the restructuring programme by comparing the Korean financial system with a mythical ideal or with the well established neo-liberal systems in the Anglo-Saxon world, something the vast bulk of the literature at least implicitly does. Rather, we must remain aware of Korea's starting point and how far it has travelled in the period since the crisis. It is clear that despite continued problems within certain types of NBFIs, significant progress has been made in attracting foreign capital into the sector and improving the profitability of key insurance institutions, perhaps the most important NBFIs. Despite the problems that remain within the ITC sector, it is now possible to argue that a core of sound banks and insurance firms now stand at the heart of the Korean financial system.

Critically of course the entire analysis of financial restructuring offered within this chapter assumes that the leaders of the Korean state are right to think that the establishment of a neo-liberal financial system is necessary to secure long-term growth. If, on the other hand, we subscribe to the arguments advanced by Crotty and Lee (2001) and Shin and Chang (2003) that state-led capitalist development remains viable and that neo-liberalism will bring nothing but woe then our understanding of the financial restructuring process will be very different. The central argument of these scholars is that the post-crisis investment squeeze has created serious long-term corporate profitability problems which will inevitably lead to vulnerabilities in the financial sector (Crotty and Lee, 2001: 27–34; Shin and Chang, 2003: 83–119). We will deal with the questions raised relating to corporate profitability in the second half of the chapter. It is, nonetheless, appropriate to address three other closely related problems these analysts raise here. First, that the shift towards consumer finance is creating financing problems for industry (Crotty and Lee, 2001: 27–34; Shin and Chang, 2003: 98–9). We understand the logic of this argument when applied to SMEs, which are dependent on domestic financial institutions for funds.⁸ The validity of the argument is more questionable when applied to large firms with access to global capital markets and equity financing. For major firms there are no obvious limits to the levels of profitable investments that may be financed; what the market may limit is the ability of firms to invest wastefully. Second, these analysts claim that major financial institutions have essentially been 'given away' to foreign investors at fire sale prices (Crotty and Lee, 2003: 42–3; Shin and Chang, 2003: 103–8). We do not dispute this point but would argue that such sales remain economically rational because of the expertise these firms possess and their role as exemplars of 'best practice' (Yun, 2003: 251–5). Finally, and most importantly, throughout the course of their work these schol-

ars highlight the inherent instability of neo-liberal financial systems. Again we essentially agree with this argument, but would place greater emphasis on both the capacity of prudential regulation to, in the medium term, manage systemic risks which stem not so much from design of financial markets as the logics of capitalism itself (see Chapters 2 and 3). We do not wish to fetishise neo-liberalism and ignore the inherent instability of markets. Nevertheless, by highlighting the problems inherent in neo-liberal reform these scholars do not necessarily make the case that there exists a superior alternative strategy which state managers could have pursued to secure Korea's position in the global economy. The actions of Korean capitalist state managers were rational in their own terms.

The creation of this central core of sound financial institutions represents an achievement of first-order importance within the overall restructuring process. It must be stressed, however, that the solvency of the entire financial system remains critically dependent on the profitability of the corporate sector. It is to the attempts of the state to improve the profitability and financial structures of the Korean corporate sector since the crisis that we now turn.

Corporate restructuring

In its attempts to promote corporate restructuring, the state has adopted very different policies towards the largest five *chaebol*, mid-sized conglomerates and smaller firms. We shall examine the successes and failures of the state's policies towards each of these different types of firms separately within this chapter. Having done, so we will assess the achievements of the state's corporate restructuring drive as a whole and draw attention to the problems that remain within Korean firms.

The top five chaebol

In the immediate wake of the crisis, the state seriously underestimated the problems that beset the largest *chaebol*. The leading *chaebol* were believed to have adequate resources to weather the crisis and were, at least theoretically, to be allowed to pursue 'self-directed business restructuring' (OECD, 1999a: 122). In reality, however, the state always intended to involve itself more deeply in the restructuring of leading firms than the language of 'self-directed' or 'voluntary' restructuring suggested. The new president, Kim Dae-Jung, placed heavy informal personal pressure on the owners of leading *chaebol* to tackle problems of over-capacity through business swaps, selling marginal businesses, and granting more autonomy to subsidiaries. Moreover, tax incentives were offered to leading firms to promote swaps and the age-old threat of the tax probe served to concentrate executives' minds on the government's objectives and concerns (Kirk, 2000). The state's attempts to realise efficiencies of scale and tackle problems of over-capacity by promoting business swaps has, nevertheless, been at best partially successful. The objectives of the government's restructuring drive were

highly ambitious. It was planned that the leading five conglomerates would swap business in nine key industries and focus their attention on improving competitiveness within those industries within which they had been effectively granted a dominant domestic position (Samsung Economic Research Institute, 2001: 107).

While there remain important dissenting opinions, such as Weiss (2003) and Mo and Moon (2003), the programme is generally understood as a failure. This judgement seems somewhat harsh given that six of the major deals did go ahead as planned and led to a substantial reduction in costs/excess capacity (Samsung Economic Research Institute, 2001: 108). The scale of changes that the state had initially sought to initiate as part of the Big Deal programme have in fact been dwarfed by the changes that have actually taken place in the corporate sector since 1998. The single most striking feature of the corporate restructuring process in Korea is the sheer level of creative destruction that has taken place and the role that the state has played in promoting these processes. Two of the major five conglomerates, Daewoo and Hyundai, that collectively dominated the economy, have effectively collapsed. The fate of the Daewoo Group and Hyundai Engineering and Construction, Hyundai Group's parent company, demonstrates that firms which are heavily indebted and unprofitable will now struggle to attract finance, no matter how large they may be. Given the state's effective control of key banks in the wake of the crisis, the state must be understood as having made a conscious decision to cut off credit to key firms and whole processes of corporate restructuring must be understood as being a highly politicised one.

Much has been made of the fact that individual firms within these failed conglomerates have often continued to struggle on for years (many Daewoo and Hyundai subsidiaries remain the subject of 'workout programs in 2006') with the benefit of quasi-official support.⁹ However, it is inevitable that it will take several years to resolve the problems created by the failure of two of the five major business groups that dominated Korea's leading industries. The fact that many of the problems emanating from these failures linger on is far less significant than the fact that two groups were allowed to fail in the first place. Furthermore, we would also argue that those analysts who consistently berate the government for failing to force major firms to exit the market promptly fail to fully appreciate the constraints state managers face (Kirk, 2000; Graham, 2003: 116–71; Lee, 2003). State managers must concern themselves with questions of systemic stability and ensure that the economy does not spiral into recession. It is true that there are costs involved in delaying action but there is also a certain macroeconomic logic to staggering the process of shutting down insolvent firms, in order to cushion the deflationary shock. It must be remembered that, at the same time as seeking to resolve the problems of leading *chaebol*, the state also faced the challenge of forcing smaller conglomerates and independent firms to rationalise and become profitable. The scale of the changes that have taken place within the wider corporate sector should not be underestimated. Fifteen of the top 30 conglomerates in 1998 ceased to enjoy this position by 2003 and the total number of listed firms fell by 13 per cent during the same period (OECD, 2003b: 127).

Given the scale of the restructuring process compromises were inevitable. In any case, with the benefit of a certain historical perspective, it would appear that Korean state managers' judgements about the viability of key firms have on occasion proven to be far superior to those of their critics. For example, Hynix has in the recent past been portrayed as representing everything that was wrong with the restructuring process in Korea. In 2002 Hynix owed \$17.1 billion and was haemorrhaging funds at an alarming rate.¹⁰ The case of Hynix appeared to be a simple one of a firm that was clearly not viable being supported by state influenced creditors. However, in 2005 Hynix recorded a \$1.9 billion profit, building upon a profitable performance in 2004. Thanks to extensive debt restructuring and the return to profitability Hynix debt shrunk to less than \$5 billion by 2006. Furthermore, with an operating profits to sales ratio of 23 per cent Hynix is alongside Samsung the most profitable chip manufacturer in the world (*International Herald Tribune*, 2006).

Just as significant as the sheer level of destruction that has taken place has been the state's determination to sell key assets to foreign investors. This determination is best illustrated by the decision of state-owned banks to sell two major car manufacturers, Daewoo Motors and Samsung Motors, to General Motors and Renault respectively. It is simply inconceivable that the state would have allowed, let alone promoted, the sale of a major Korean firm in such a strategically important industry prior to the crisis.

Moreover, an important mechanism by which leading firms have sought to improve their competitiveness and profitability has been through the establishment of joint ventures with, and by seeking strategic investment from, leading MNCs. From Korean firms' perspective the main attraction of building links with foreign firms is the technological, marketing and managerial expertise to which they gain access. The performance of Korea's major joint-venture firm, LG Philips, has been nothing short of spectacular, and major firms such as Samsung Motors and Hyundai Motors that have attracted investment from MNCs also enjoy high profitability (*Financial Times*, 2002d; *Korean Herald*, 2002a). Additionally, foreign portfolio investors hold the majority of voting shares in several other major 'domestic' firms, including Korea's most profitable firm, Samsung Electronics. Furthermore, as we already made clear in Chapter 6, the influx of foreign portfolio investment is making old distinctions between foreign and domestic firms increasingly problematic.

The increasing levels of foreign ownership in the corporate sector compromises Weiss's arguments relating to the promotion of 'national champions' in the corporate sector in exactly the same manner as foreign ownership of key commercial bank's ownership compromises her analysis of financial restructuring. We do not dispute that Weiss (2003: 252) is essentially correct in arguing that the objective of 'creating a few lean and highly competitive players in strategic industries' was at the heart of the state's 'Big Deal' programme. However, this policy takes on an entirely different meaning when understood alongside the state's efforts to promote foreign investment; it becomes clear that such policies must be understood as being part of rather than standing in opposition to the

neo-liberal project. Indeed, in highlighting the particular importance to the Korean state of creating competitive domestic car firms, Weiss (*ibid.*: 252) ignores the fact that the two car firms the state had originally intended to merge as part of the 'Big Deal' programme were both sold to foreign investors.

A great deal of attention has been devoted to the evolution of the five major *chaebol* since the crisis within the popular, policy-oriented and academic literature. On one level this is quite justifiable. These massive firms dominate key industrial sectors and the vitality of the Korean economy is clearly linked to their ability to generate profits. Nevertheless, it remains the case that the top five *chaebol* only constitute 10 per cent of total value added within the Korean economy (OECD, 1999a: 121). Too often the development of the smaller *chaebol* and small and medium-sized enterprises (SMEs) that make up the other 90 per cent of total value added within the Korean economy is overlooked. It is to the recent evolution of the smaller *chaebol* that we now turn.

Smaller conglomerates

In marked contrast to the initial policy adopted towards the major *chaebol*, the state never intended to allow lesser conglomerates to pursue 'self-directed restructuring'. Nobody was ever under any illusion that all of these conglomerates possessed sufficient financial resources to weather the crisis without external support from creditor banks. From early 1998 onwards, the state played a critical role in ensuring that creditor banks would force troubled smaller conglomerates to restructure and would, when necessary, provide troubled but viable subsidiaries with emergency financial assistance. In July 1998, 200 financial institutions signed a 'Corporate Restructuring Agreement' drawn up by the FSC specifying workout procedures. Under the terms of this agreement creditors were given the responsibility of assessing the viability of the subsidiaries of troubled conglomerates. Companies which creditors judged to be unviable were sold or liquidated, healthy profitable firms were to be allowed to carry on trading as normal and troubled but viable firms were to enter workout programmes. The basic principle underpinning these workout programmes is that firms make every effort to retrench and improve efficiency while creditors reduce these firms' financial expenses to a manageable level. Under the terms of the 'Corporate Restructuring Agreement' the FSC set a four-month time limit on workout programmes, laid down a set of rules determining the allocation of losses between different creditors and established itself as the arbiter in any disputes between creditors. By March 1999, 15 of the 6th to 64th-largest conglomerates had entered into the workout process (OECD, 1999a: 130; Emery, 2001: 126–7).

Of the 248 companies belonging to these *chaebol* 12 were deemed to be healthy, a further 198 were liquidated or sold, and 38 were judged viable with support. These 38 firms were joined in the workout programme by 28 firms from smaller conglomerates and 12 standalone enterprises (OECD, 1999a: 130). It was initially hoped that the workout process would be concluded by the end of 1999. However, the problems that beset *chaebol* were far more serious than state

managers believed them to be and this did not happen. Rather, the programme was expanded to include firms from other troubled conglomerates. In total 17 of the leading 30 *chaebol* entered workout programmes or formal bankruptcy between 1997 and 2004 (OECD, 2004e: 46). At the end of 2006 the workout programme had still to be completed (*Korean Times*, 2006b).

Unsurprisingly given its extended and incomplete nature the workout process has been labelled a failure by scholars from a wide range of theoretical perspectives (Park, 2003: 181–204; Shin and Chang, 2003: 89–90). Park argues that many of the firms initially included in the restructuring programme were never viable and that debt restructuring has been overemphasised at the expense of corporate reorganisation. Too often the original management of workout firms has been allowed to remain in control and these managers have been reluctant to sell profitable affiliates and make necessary cuts. Park sums up his criticism by saying that ‘the overall restructuring programme was not aggressive enough and the government was too concerned with short-term stability’ (Park, 2003: 202). Shin and Chang (2003: 89), on the other hand, do not argue that the programme has been ‘too soft’ but simply that it has not worked; that while a substantial quantity of debt has been restructured a high proportion of workout firms remain in severe trouble. From our point of view, however, the most significant aspect of the whole bank-led restructuring process is not what has happened to firms in rehabilitation programmes. Rather, it is that almost 80 per cent of the subsidiaries of those *chaebol* that entered into the (initial) workout process were immediately liquidated or sold. The workout process, or bank-led restructuring process, can be understood as a relatively efficient means of closing firms within an economy that is only now developing an effective bankruptcy system. Park (2003: 181–204) may be correct in arguing that certain firms were admitted into rehabilitation programmes that should simply have been liquidated. However, it is clear that most firms were simply closed. As for the rehabilitation process itself while it is clear that it has not been an unadulterated success it is too early to make any final judgements.

The failure to meet the initial, massively over-ambitious, target date of late 1999 is, we would argue, of little or no consequence. It will only be possible to finally determine the success or failure of the workout programme some years down the line when it becomes clear whether or not graduate firms are able to achieve sustained profitability. Despite the fact that it is too early to properly assess the success of state restructuring policies towards the smaller *chaebol*, there can be no questioning the scale of the changes that have taken place within this important sector of the economy. While it is true that smaller *chaebol* had been allowed to fail in the past, the partial or total collapse of 17 of the leading 30 *chaebol* is a historically unprecedented event. Clearly, the fact that the state was not only willing to allow but actually promoted such a brutal and full-blooded rationalisation of this sector is highly indicative of its determination to allow those firms that prove unable to meet the challenges posed by global competition to collapse. As important as the developments that have taken place within the conglomerate sector since the beginning of 1998 are, however, the

changes within the small business sector are arguably more significant still. We shall focus on these changes in the next sub-section of this chapter.

SMEs

Historically, the developmental state neglected the SME sector. After the demise of the Park regime in 1979, however, the importance successive governments attached to promoting SMEs gradually increased. This shift was driven by both economic and political considerations. On the one hand, from the early 1980s onwards, the state increasingly came to recognise the need to strengthen the domestic components industry by supporting smaller firms. On the other hand, since the beginning of the democratisation process in 1987, newly accountable politicians have responded to public hostility towards the *chaebol* by making SMEs the principal beneficiaries of the state's industrial promotion efforts (Lee, 1997: 46–77; Haggard and Mo, 2000: 208–10). Many of the state's attempts to assist SMEs went far beyond anything that could be justified according to the canons of contemporary liberal economics, and massively distorted the functioning of market mechanisms. For example, numerous business lines were reserved for smaller firms, banks were forced to lend a fixed proportion of their assets to SMEs, and in 1996 a total of 14 trillion won was spent on providing direct assistance to these firms (OECD, 2000b: 192–3; 2000c: 145–8). As a result of these policies the importance of SMEs within the Korean economy grew considerably in the 17 years prior to the crisis. Whereas in 1980 these firms accounted for only 35.2 per cent of total value added within the Korean economy, by 1997 SMEs were responsible for over 45 per cent of total value added (Lee, 1999: 71; OECD, 2000c: 147).

The SME sector was, however, particularly severely affected by the 1997 crisis. The most immediate cause of many of the problems that afflicted SMEs was the unwillingness, or inability, of the *chaebol* to make payments to subcontractors and the reluctance of banks to extend fresh credit in the wake of the crisis. Many observers have, nevertheless, argued that the problems that beset the SME sector were not simply conjunctural, to quote the OECD (2000b: 148):

Despite the upward trend in their share of economic activity, SMEs have remained a less dynamic sector, dependent to some extent on government assistance. The extensive support to SMEs appeared to weaken their own efforts to improve productivity. This may have resulted in a vicious circle in which declines in SME competitiveness prompted additional government assistance, further undermining incentives to rationalise... Given their reliance on bank lending, SME had a debt to equity ratio of over 300 per cent in 1997.

Despite these criticisms of previous interventionist policies, the state adopted a highly dirigiste strategy in the immediate wake of the crisis to ensure that 'viable' SMEs were able to overcome temporary liquidity problems and that

other firms were forced to exit the market. Banks were instructed to automatically extend credit to the 95 per cent of SMEs that were officially categorised as being viable, while the other 5 per cent were allowed to collapse. The state also provided 2.4 trillion won of direct budgetary supports to those SMEs that it regarded as viable (*ibid.*: 148).

In retrospect, these measures represented the apex of the state's policy of shielding SMEs from competitive pressures. Since 1998 the state has begun to move away from fully guaranteeing loans to SMEs. Furthermore, in 2005 the entire loan guarantees programme was radically restructured. The 2005 reforms seek to create much stronger controls to insure that non-viable firms are unable to access credit through official loan guarantees (OECD, 2005: 162). At the same time, the number of business lines reserved for SMEs is being rapidly reduced, as are the number of items government departments are required to procure from these firms (OECD, 2000b: 192–3; 2000c: 150).

It would be inaccurate to understand these changes as representing the unravelling of the government's attempts to promote the development of the SME sector. Rather, the state continues to devote considerable resources to providing support for smaller firms. What has changed, however, is the fundamental character of official support mechanisms. Where the focus of pre-crisis SME policy was on protecting the sector as a whole from competitive pressures, the state's new policy concentrates on assisting particular types of firms in their attempts to meet the challenges posed by global competition. More precisely, the purpose of the state's new policy is to promote small high-tech, innovative, risk-taking firms. Towards this end, small firms which invest at least 5 per cent of sales revenue in R&D, are active in patenting and commercialising new products, and have been the recipients of substantial investment by venture capital funds, or which make extensive use of new technology, are eligible for various forms of official support (OECD, 2000c: 151). Most significantly, 80 per cent of all credit guarantees are now reserved for firms with the potential to 'develop a technological edge' (OECD, 2005: 172). It must be stressed, however, that while the state is active in providing the physical, human and financial resources that small high-tech firms require to compete effectively, it does not guarantee markets for these firms. In stark contrast to previous protectionist SME policy this new approach which combines extensive market opening with selected support for high-tech firms is fully in line with contemporary neo-liberal norms. As that bastion of neo-liberal virtue, the OECD (2000c: 122) recognises:

Improved SME performance matters not only in its own right, but also because small firms are less likely to suffer 'lock-in' with respect to existing plants, technologies and organisational structures, making them important for innovation and commercial experimentation with new technologies. At the same time, SME operations are typically characterised by high turbulence and churning, and the social benefits tend to exceed the private ones. In the knowledge-based economy, policy intervention must be conducive to entrepreneurship and risk-taking, but should not shelter SMEs from change.

Today, information and communication technologies open up new opportunities for combining the advantages of small scale with those from networking among SMEs (and/or between SMEs and larger firms, or between firms and other actors such as research institutes)... The available information suggests that successful network development requires a combination of measures facilitating the provision of venture capital, public procurement, technology diffusion, programmes and incentives conducive to training.

Whether as a result of these policies or as a result of psychological contagion from the US it is certainly true that there was an explosion of high-tech start-ups in 1999–2000. Perhaps inevitably this explosion of start-ups was accompanied by an unsustainable stock market boom as the price-to-earnings ratios of many small high-tech firms rose well into the thousands. More seriously still, it is certainly the case that the investment climate that prevailed in 1999 and early 2000 allowed many firms which never had a realistic chance of becoming profitable to attract funding.¹¹ Nonetheless, the flurry of high-technology start-ups is likely to enhance Korea's long-term growth prospects and the government's policy of offering incentives to encourage the development of such firms should, therefore, be understood as being fundamentally sound.

By their very nature, small high-tech firms are risky investments and it is inevitable that many of these firms will experience problems developing or marketing their products and will go bankrupt. If a core of profitable, technologically sophisticated small firms is to develop then thousands of other firms must be allowed to attempt to develop new high-value-added business lines and fail in the process. There are two main reasons why it is important that a core of such firms should develop within Korea. First, the creation of a core of such firms is important in its own right. Large firms with billions of dollars invested in fixed capital and long-term R&D programmes focused on improving existing types of technology are likely to be reluctant to adopt new radically different technologies and operating systems that may ultimately prove to be commercially unsuccessful. It is instructive to note that it was small start-ups that led the initial development of the semiconductor and personal computer industries (Bello and Rosenfeld, 1990: 117). Although new start-up firms' R&D budgets were much smaller than the existing electronics and computer monoliths long established firms were still committed to developing mainframe and vacuum tube technology, respectively. As a result of their initial insight and flexibility firms such as Microsoft, Intel and Texas Instruments quickly developed into highly profitable industrial behemoths.

Second, the development of a strong, technologically sophisticated set of small firms is likely to enhance both the competitiveness of larger domestic firms and the ability of Korea to attract investment from technologically advanced foreign firms. Without a strong SME sector to service the needs of larger firms for both physical components and services, the international competitiveness of the larger domestic firms will be seriously impaired. More seri-

ously still, in the absence of a technologically dynamic SME sector, leading overseas firms and domestic multinationals will simply not locate high-value-added economic activities that require extensive support networks of specialist high-tech firms within Korea. Dynamic small firms form a vital component of any 'cluster' of technologically advanced activity and without such firms Korea has little hope of becoming a major global centre of high-value-added production.

It is still difficult to assess how successful the state's new SME policy is likely to be in creating the core of technologically dynamic small firms that are vital to the country's future economic development. Many of the projects that new high technology firms are engaged in have long gestation times and, although the principles underpinning the new SME policy are fundamentally sound, the results of this policy are still not entirely clear.¹² What is clear, however, is the message the government's new SME policy sends out about its commitment to making industrial policy commensurate with allowing market disciplines to operate to the fullest possible extent. Selected small businesses may be eligible for public assistance in order to meet the challenges posed by global competition, but no firm can expect to be shielded from competitive pressures in contemporary Korea. The fact that, in sharp contrast to the leading *chaebol*, small businesses enjoyed a high degree of public support has in no way effected the state's determination to expose these firms to the disciplines of the market.

As far as we are aware the only reasonably detailed academic studies of the state's new policy towards SMEs are Shin and Chang (2003: 109–12) and Weiss (2003: 257–8). The work of these scholars differs from our own in that it focuses entirely on the new financial supports available to SMEs. The state's parallel policy of subjecting all SME to the disciplines of the global marketplace is not highlighted. In part this may explain why Weiss understands new state supports for high-tech SMEs as part of a return to dirigiste policies and as being at odds with neo-liberal norms, despite the fact that the state SME policies are fully supported by the OECD (2000c: 120–3). While the authors cited above regard the objectives of the policy as sound, they disagree on whether current policies are likely to be successful. Shin and Chan (2003: 111) believe the policy is unlikely to create a vibrant SME sector. On the other hand, Weiss (2003: 257) argues that the positive results of policy are already evident in that Korea now has the highest number of venture firms in all Asia. It is, we would argue, far too early to make any final judgements on this issue.

Our analysis of the development of different types of firms since the crisis has consistently emphasised the new determination of the government to force firms to become competitive within the global market place or exit the market. This new commitment to allowing market discipline to function is illustrated as much by the refusal of the state to support failing business groups, including Hyundai and Daewoo, as by any more positive policy initiatives.

Although we are very clear about the central principles underlying the state's new policy, we have been somewhat circumspect in reaching firm conclusions

about the success, or lack thereof, of the policies that the state has adopted. In part this is unavoidable as the process of corporate restructuring is as yet incomplete and serious questions remain about the competitiveness of Korean industry.¹³ However, it is possible to see the achievements and failings of the corporate restructuring process more clearly and reach a much firmer set of conclusions when we analyse the profitability and debt levels of the corporate sector as a whole. It is to this task that we now turn.

Overall assessment of the corporate restructuring process

The fundamental objectives underpinning all the policies the state has pursued to expedite corporate restructuring are very simple. They are to ensure that firms take decisive action to improve their internal financial structures and, most importantly of all, their levels of profitability. It is clear that Korean industry as a whole has made progress towards achieving these two closely related objectives, but that important problems still remain. The average level of ordinary profits within the manufacturing sector rose to 4.7 per cent in 2002, the highest level since 1974 (Bank of Korea, 2003: 540). To put these figures into perspective, the level of American manufacturing profitability in 2002 was 4.9 per cent (*ibid.*: 545). More importantly still, levels of ordinary profits in Korea remained at 4.7 per cent in 2003 despite a fall in growth from 6.3 per cent to 3.1 per cent (Bank of Korea, 2004: 555). A modest increase in the rate of growth to 4.6 per cent in 2004 was accompanied by a rise in the level of ordinary profits in manufacturing to 7.8 per cent, the highest level since 1965 (Bank of Korea, 2005: 594). In 2005 profit levels fell back to 5.1 per cent as growth slowed to 4.0 per cent (Bank of Korea, 2006a: 589). The fact that improved profitability since 2002 has been achieved in a mixed macroeconomic environment demonstrates the structural rather than the cyclical nature of the improvement.

The profitability of non-manufacturing industries has risen alongside manufacturing profitability since 1998. The level of ordinary profits for all Korean firms fell from approximately 1 per cent in 1996 to -1.2 in 1998 (Bank of Korea, 2005: 595). The profits figures remained relatively weak through to 2001. However, since this point profits have been extremely healthy. In 2002, 2003, 2004 and 2005 the level of ordinary profits for all industry was 4.3 per cent, 4.8 per cent, 7.0 per cent and 6.2 per cent respectively (Bank of Korea, 2006a: 588). At the same time as improving profitability, Korean firms have also succeeded in controlling their levels of collective indebtedness. As a result of increased profitability and financial prudence the interest coverage ratio (ICR) for Korean firms as a whole rose to 420 per cent in 2005 (*ibid.*: 588).¹⁴ To put this figure into perspective the ICR for all Korean firms fell from 115 per cent in 1997 to 61.3 per cent as the crisis took hold in 1998 (*ibid.*: 594). The financial health of the manufacturing sector is particularly robust. In 2005 ICR for the manufacturing sector was 525 per cent (*ibid.*: 594). This compares with an ICR of 129 per cent in 1997 and 68 per cent in 1998 (*ibid.*: 589).

The essential positive reading of the development of corporate profitability

and firms' internal financial structures offered above is not unchallenged. The most direct challenge emanates from left-Keynesian scholars whose analysis is directly inimical to that offered here. These scholars argue that neo-liberal reforms, and the financial constraints they impose on firms, have locked the Korean corporate sector into a low profit/low investment trajectory (Crotty and Lee, 2001: 84–8; Shin and Chang, 2003: 83–129). A more cautious analysis of the problems of corporate profitability is provided by neo-liberal scholars. The argument here is that while there has been a limited upturn in profitability since the crisis, excessive leveraging continues to act as a drag on profitability, and/or that the corporate sector is becoming increasingly polarised (Richards *et al.*, 2002: 85–100; Graham, 2003: 105–82).

The difference between the analysis offered here and within these texts essentially stems from two separate factors. The first is the point of comparison used. The left-Keynesian school compares post-crisis levels of profitability as much with profitability over the course of the 1970s, 1980s and 1990s as with profitability in the years immediately prior to the crisis (Crotty and Lee, 2001: 23–4; Shin and Chang, 2003: 86). This is misleading as it fails to give an accurate impression of the real starting point of the corporate sector. The neo-liberals, on the other hand, tend implicitly at least to compare Korea to established neo-liberal economies (most often the US), and again this leads them to downplay the initial problems that Korean industry faced and the progress that has been made (Richards *et al.*, 2002: 85–99; Graham, 2003: 147–62). Second, and more important, is the question of time. The performance of the Korean corporate sector has been far more impressive since 2002 (and 2004 in particular) than prior to this point. We cannot castigate the left-Keynesians for lacking perfect foresight. However, we may justifiably label their denunciations of the neo-liberal project as a failure as rash and premature.

While the performance of the corporate sector as a whole has improved markedly over the last few years and many of the criticisms of the financial performance of Korean firms are not warranted, problems still remain. As both the IMF and the OECD have highlighted the Korean corporate sector is highly polarised (Richards *et al.*, 2002: 89; OECD, 2005). While the corporate sector as a whole had an ICR of 420 per cent in 2005 30.8 per cent of all listed Korean firms had ICR ratios of less than 100 per cent (*Korean Times*, 2006e). These statistics fit a broader pattern that has established itself since 2002 with at least a quarter of externally audited firms failing to achieve an ICR of over 100 per cent in any one year despite a marked improvement in the general performance of the corporate sector (OECD, 2005: 159). A serious macroeconomic downturn is likely to push thousands of these firms over the precipice upon which they are currently perched.

Despite the important problems highlighted above, the accomplishments of the corporate restructuring programme far outweigh its failings. As many chief executives have no doubt pleaded over the years, improving profitability is not easy. The fact that Korean firms as a whole recorded record profits just five years after the worst economic crisis since the civil war in an unfavourable

global economic environment is remarkable. It is also remarkable that the corporate sector has been forced to curb its tendencies to engage in relentless debt-financed expansion. Although a large minority of firms remain in serious difficulties, it is now possible, for the first time, to be confident about the ability of the majority of Korean firms to survive the rigours of global competition. Nevertheless, the viability of the whole neo-liberal project remains critically dependent on the maintenance of at least a minimal degree of stability in the global economy. A full-scale global recession might well see all the gains of the last five years destroyed.

Conclusion

What is most striking about the post-crisis corporate and financial restructuring process is the dramatic changes that have taken place in the structures of the Korean economy. In the wake of the crisis almost a quarter of Korean financial institutions were forced out of the market and major banks were nationalised (Samsung Economic Research Institute, 2001: 117). Following the re-privatisation of these institutions a set of profitable, well-capitalised institutions, which comply fully with internationally recognised solvency and asset classification standards, now stand at the heart of the Korean financial system. Equally significantly, two of the major five *chaebol* have effectively been allowed to collapse since the crisis. In and of itself this represents a fundamental change in the Korean corporate landscape. The most remarkable aspect of the corporate restructuring programme is the improvement in profitability that has taken place. In the immediate wake of the crisis no one imagined that Korean manufacturing firms would enjoy significantly higher levels of ordinary profitability than their US counterparts in less than five years' time.

The improvement in firm-level financial structures and the rapid return of strong economic growth has, however, come at a price. As firms cut investment and sought to reduce debt levels, it was inevitable that important as well as wasteful investments programmes would be cut. Although vital to long-term competitiveness, investments in R&D have, by their very nature, long gestation periods. As management came under pressure to reduce debt levels and improve short-term profitability, R&D budgets were slashed. The full impact on Korea's long-term competitiveness of the cutbacks in R&D spending in the years immediately following the crisis will not be clear for a number of years. What is important is that Korean firms do not come to fetishise low debt levels in the same way that they once fetishised growth. Clearly, the fact that Korean firms no longer squander tens of billions of dollars on unprofitable and unnecessary investments is to be welcomed. However, it is vital for Korea's long-term competitiveness that major firms be willing to make the well focused, large, sustained investments necessary to remain competitive in key global industries. One of the primary imperatives driving the entire process of neo-liberal reform in Korea since the 1980s has been the need to allow large firms to access global financial markets in order to fund the investments necessary to compete in key

global industries. A minority of Korean firms need to further reduce their debt levels. Other firms, however, are now in a position to be bolder and make the heavy investments in R&D and marketing necessary to mount a serious challenge for leadership of key global industries. The debt problems that beset the corporate sector in the past were principally the result not of over investment but of years of badly targeted investment; too many investments simply did not generate the revenues necessary to pay for themselves.

The most serious adverse consequences of the post-crisis restructuring process, however, relate not to Korea's long-term economic competitiveness but to levels of income inequality and individuals' economic security. It is to the social effects of the crisis we turn in the next chapter.

8 Social impact of crisis and neo-liberal restructuring

The 1997 Korean crisis represented more than simply the collapse of a particular regime of accumulation or a hiatus in the country's long economic ascent. It represented a human tragedy. In the wake of the crisis unemployment more than quadrupled, labour market participation rates and real wages fell sharply, and income inequality increased dramatically (OECD, 1999a; S.-L. Park, 1999). The social effects of the crisis were so obvious and severe that no serious analyst of the Korean political economy could ignore them. A plethora of policy-oriented and more academic research papers were published in the years immediately following the crisis which attempted assess its social impact (You and Lee, 1999; Kim and Moon, 2000; Lee and Lee, 2000; Yoon, 2001).

The intense scholarly and official interest in the relatively immediate impact of the crisis serves to highlight the relative paucity of studies that seek to analyse the longer-term patterns of inequality which neo-liberal restructuring is generating. It is a simple matter of empirical fact that while overall levels of inequality have declined from the peaks experienced in the years immediately following the crisis, levels of inequality remain substantially higher in contemporary Korea than they were prior to the crisis. At the beginning of 2005 Gini coefficient for salary and wage earner households in Korea stood at 0.31.¹ This figure is significantly closer to the post-crisis high of 0.320 than the 1997 figure of 0.283 (Lee and Lee, 2000: 78; *English JoongAng Ilbo*, 2002). The rise in income inequality is equally clear when we study the ratio of income of the top 10 per cent of households to the bottom 10 per cent which rose from 3.7 in 1997 to 4.2 in 2002 (OECD, 2004e: 90). Furthermore, it is now blatantly obvious that further rapid growth offers little prospect of further decline in the levels of economic inequality, as levels of Gini coefficient have essentially been stable since 2002 – despite steady economic growth. The rise in inequality since the crisis reflects deep-seated changes in the way that labour markets and the economy are organised. With hindsight, it is clear that the assumption within much of the early literature on the social impact of the crisis, that problems relating to increased inequality and poverty would largely disappear with the resumption of strong positive growth, were simply wrong (Hoa, 2000; Lee and Lee, 2000).

An understanding of how neo-liberal reform has intensified inequalities must be at the heart of any study of social conditions in Korea. However, the count-

less highly optimistic studies of the development of 'productive welfare systems' and labour market policies in contemporary Korea often fail to seriously address the new patterns of inequality that neo-liberal reform is creating.² This criticism may seem misplaced given that many of these studies are acutely aware of particular inequalities, most often those between permanent and non-permanent employees, within the Korean political economy. However, what this policy-oriented body of literature fails to do is seriously analyse the extent to which the particular 'social problems' they seek to remedy are in fact integral features of a functioning neo-liberal regime of accumulation. Equally, while seeking to address different social problems and particular broadly intra-working class inequalities the literature completely ignores the redistribution of wealth from labour to capital that has taken place since 1997 (IMF, 2004: 33–49; OECD, 2004e: 79–104; You *et al.*, 2004).

The most popular non-explanations for the sharp rise in inequality offered within the mainstream literature are that this is almost a 'natural' consequence of the increasing proportion of elderly in Korean society and/or the result of technological change (Kang, 2000; Jeong, 2003; Hur, 2004). What neither of these, essentially apolitical, 'explanations' can shed any analytical light on is why we have seen a swift relatively dramatic sustained increase in inequality since 1997. The Korean population did not suddenly become old in 1997 nor did the technical character of production, which in any case is intrinsically bound up with development of systems of labour control, shift dramatically almost in an instant.

The existing literature on Korean social policy and labour markets, at least implicitly, assumes that any outstanding social problems can be solved/managed providing the economy continues to grow and that processes of constructing a market-oriented 'productive welfare model' continue. Fundamental questions about the basic compatibility of the Korean neo-liberal project with a modicum of social justice are largely ignored.

The failure to analyse the broader structural change in the Korean political economy leads to what can only be described as a number of rather bizarre conclusions. The overwhelming majority of the literature on Korean social policy is of a positive nature and stresses the extent to which the Korean government has acted judiciously to improve social safety nets, empower its citizens and establish universal 'social rights' without comprising economic competitiveness. These analysts do not feel compelled to address the clear tension between the argument that Korea is making a bold attempt to fashion a 'comprehensive welfare state based on social rights' and the fact that inequalities are now far higher than they were prior to the crisis. Contrary to what the mainstream literature may claim, what we are witnessing is a fairly brutal process of neo-liberal restructuring, not the construction of anything we could meaningfully describe as a 'welfare society'. In so far as a complete social catastrophe has been avoided this has less to do with the very limited extension of official welfare provisioning that has taken place since the crisis than the fact that the economy has experienced strong economic growth.

Within this chapter we argue that the creation of new insecurities and the intensification of exploitation have been key to the restoration of corporate profitability/international competitiveness since the crisis. Furthermore, we make the claim that the underdeveloped nature of welfare provision is a source of competitive advantage for Korea. In so doing we highlight many of the comforting myths advanced by the less critical literature. Many of the features of the contemporary Korean labour market which are almost universally regarded as dysfunctional actually constitute important mechanisms through which capital has, operating within the constraints set by pre-existing political and economics structures, effected a redistribution of income away from labour. Most significantly, high levels of temporary employment in Korea and the creation of other insecurities among weaker sections of the working class represent a means through which capital has been able to improve profitability while preserving some form of material compromise with core workers.

The argument that pre-existing social, economic and political structures play a critical role in determining the particular form that actually existing neo-liberal labour restructuring projects take appears to be so obvious as to be bordering on the trite. Nevertheless, the means through which pre-existing structures have impacted on neo-liberal labour market restructuring programs has differed markedly depending on the national context. It has not always been the case that agreements and implicit compacts between core workers and capital have been preserved in any form within the process of neo-liberal restructuring. For example, in Britain and the US the state-capital complex could well have been seen to deliberately provoke decisive confrontations with the most organised and politically powerful sections of the working class in order to break their power (Gamble, 1994).

In order to advance the central arguments set out above, this chapter is divided into four sections. In the first section we offer an overview of the broad trajectory through which the Korean political economy has passed over the last 15 years. Within this section we do not attempt to offer a comprehensive analysis of the ontology of the crisis or the nature of the contemporary Korean political economy. Rather, we confine ourselves to highlighting the competitive pressures that have driven the state's efforts to restructure labour markets. The second section examines the immediate social impact of the crisis. Against this context, the third section draws attention to the important structural changes in Korean labour markets which the crisis has accelerated and how these changes have served to impoverish significant sections of the Korean proletariat and in so doing facilitate the restoration of rapid economic growth. The final section of this chapter examines post-crisis processes of welfare reform in Korea. In examining the development of social provisioning since the crisis we turn the argument posed by the majority of the mainstream literature on Korean social policy on its head. Given the scale of the processes of labour market restructuring and the insecurities that have been created, what must be explained is not why we have seen a marked extension in social safety-nets but rather why the state has been so successful in controlling the growth of social expenditure.³

The immediate impact of the crisis

Aggregate macroeconomic statistics give a very poor impression of the effect that the crisis had on different social groups' economic well-being. For example, despite the fact that GDP contracted by 6 per cent in 1998, the real income of the wealthiest 10 per cent of Koreans only declined by 2.5 per cent (You and Lee, 1999: 18). Clearly the crisis did not radically affect the lifestyles of the most privileged members of Korean society. By way of contrast, the real incomes of the poorest 20 per cent of Koreans fell by almost a quarter (S.-L. Park, 1999: 9–10). Who suffered most and who remained largely unaffected by the crisis was principally determined by pre-existing social and economic power structures. Those who held dominant positions within these structures were able to protect themselves, while those who were already on the margins of Korean society saw their incomes fall sharply.

While the Korean working class as a whole suffered as a result of the crisis, in order to properly understand the impact of the crisis it is necessary to make a distinction between core and unprotected workers. We use the term 'core workers' to refer to male employees of large firms with permanent contracts. We use the term 'unprotected workers' to refer to the rest of the Korean working class.

Core workers

Historically there had been little difference between the conditions that Korean workers in large and small firms had to endure. However, in the 1987–9 strike wave workers in large manufacturing firms, who were overwhelmingly male, won considerable concessions from capital, concessions which they largely managed to retain, and even build upon, through the early and mid 1990s. As a result of the capacity of workers within large firms to successfully assert their interests the wage premium such workers enjoyed over their counterparts in small firms increased from 7.1 per cent in 1980 to 27.7 per cent in 1997 (Koo, 2001: 206). Furthermore, in an effort to offset the attractions of radical unionism major firms sought to build a sense of corporate belonging through the development of relatively comprehensive corporate welfare systems (free healthcare, subsidised housing) (Woo-Cumings, 2001: 360). Through such concessions core workers came to be materially integrated into the capitalist development project. Furthermore, permanent workers in large firms also enjoyed strong legal safeguards which made it practically impossible for firms to dismiss permanent workers who did not breach the terms of their employment contract. As we have already made clear, in the search for greater flexibility the Korean state had with the active support of capital sought to reform labour laws in the mid 1990s and lay-offs were scheduled to be legalised in 2000. In the immediate wake of the crisis new legislation was passed to allow lay-offs immediately and to widen the conditions under which lay-offs were permissible; although permanent Korean workers nevertheless remain among the most protected in world (see the next section for more details).

The vast majority (93 per cent) of firms with over 1,000 employees did not actually dismiss workers in 1998. Importantly, however, the threat of dismissal played an indispensable role in enabling employers to reduce labour costs through other means. 'Honourable' retirement schemes were initiated by 51 per cent of large firms in the wake of the crisis in order to reduce labour costs. Additionally, 18 per cent of large firms also carried out early retirement programmes (Park *et al.*, 2001). In theory, neither honourable nor early retirement programmes involved any form of coercion. In practice, however, the threat of dismissal allowed management to persuade reluctant workers that it would be in everyone's best interests for them to leave the company. Workers effectively faced a choice of leaving voluntarily and benefiting from sizeable compensation packages or attempting to stay where they were clearly not wanted and potentially losing thousands of dollars.⁴

Large firms' attempts to 'streamline' their workforces cannot simply be understood as a response to the exigencies of the crisis. Rather, they represented an attempt by major firms to advance a long-term strategy of seeking to reduce the numbers of workers they directly employ through the greater use of subcontracting. Between 1993 and 1996 the proportion of all workers employed at firms with over 500 employees fell from 17.2 per cent to 15.4 per cent (You *et al.*, 2004: 37). Since the end of 1996 there has been a marked acceleration in the rate at which major firms have shed labour and the percentage of total employees employed by firms with over 500 workers fell to 9.9 per cent by 2001 (*ibid.*: 32). What these figures clearly demonstrate is that while workers may not have been dismissed from large firms in huge numbers in the immediate wake of the crisis they frequently found that they were forced to leave the firms they worked for by one means or another in the medium term.

The relative strength of the firms they worked for, Korean labour law (which even after the 1998 reforms still offered permanent workers considerable protection) and social norms did not necessarily prevent core workers from losing their jobs.⁵ What they critically affected was the means and speed through which separation was achieved. The means of separation had important material consequences for individual workers. In a society with very weak welfare safety nets the relatively large payouts newly unemployed former core workers received played an important role in saving these workers from severe material hardship while they sought new employment. In hindsight a payment of seven months' wages to a worker dismissed during the 1998 recession was invaluable, as together with unemployment benefit this would have allowed them to survive without serious hardship until employment growth resumed in 1999. Furthermore, it is probable that many workers at large firms whose jobs were outsourced were re-employed, with degraded terms and conditions, by new firms who took over these contracts.

In order to illustrate the full extent of the human consequences of the 1997–8 crisis it is necessary to turn our attention away from relatively protected core workers to the millions of Korean workers whose labour market position was more precarious. The ability of major firms to offer even a modicum of 'protec-

tion' to core male employees was directly related to their successful efforts to reduce costs by sacking and imposing massive wage cuts on temporary and female workers.

Unprotected workers

While male employees at large Korean firms were, prior to the crisis, among the most heavily protected workers in the world, the economic well-being of the majority of Korean workers rested upon very fragile foundations. In 1997 46 per cent of all Korean employees lacked permanent contracts (OECD, 2000c: 189). To place this figure within an international context, the proportion of all employees who lacked permanent contracts of employment was 15 per cent higher within Korea than any other OECD country (ibid.: 189). According to various surveys conducted between 1996 and 2001 the average wage of temporary workers was between 50 per cent and 70 per cent of that of permanent employees (Korean Confederation of Trade Unions, 2001). In sharp contrast to permanent employees, temporary workers enjoyed virtually no legal or social protections against dismissal. In 1998, 743,000 of the newly unemployed had previously been temporary workers, while only 257,000 had previously been permanent employees (OECD, 1999a: 148).

It was not simply those temporary workers who lost their jobs that suffered as a result of the crisis. Temporary workers were, on the whole, in a weak position to oppose salary cuts and reductions of over 30 per cent in basic wages were not uncommon. At the same time, bonus and overtime payments completely ceased (Pak, 1998: 309). Korea's feeble minimum wage legislation offered little succour to vulnerable workers.

While those workers who lacked permanent contracts of employment were most acutely effected by the crisis, many permanent employees also lay outside the social compact between *haute* capital and core workers. Despite enjoying the same formal legal protections as core workers against dismissal, the real levels of protection afforded to female employees and workers of both genders employed in small firms was, in effect, very limited.⁶ In 1998, 23.9 per cent of firms with fewer than 299 employees carried out dismissals, in contrast to only 7 per cent of firms employing over 1,000 workers (Park *et al.*, 2001). These figures reflect both the weakness of small firms and the nature of systems of labour control within relatively low-value-added labour intensive sectors.

Korean women found themselves particularly vulnerable to both wage cuts and dismissals in the immediate wake of the crisis. Korea has historically been a patriarchal society. These traditional norms were reflected in the manner in which Korean women came to be integrated into processes of capitalist development. Up until the early 1990s Korea and Japan were the only two countries in the world where women's wages were less than half those of men (Bai and Cho, 1995: 135). The subordinate position of women within Korea intensified their exposure to the effects of the economic crisis in two distinct, but closely related, ways. First, decades of discrimination had left women in a vulnerable structural

position within Korean labour markets. The majority of female employees were employed as temporary workers whom management could dismiss at the first signs of a downturn. Additionally, female workers were largely concentrated within small low-wage firms that, as we have already said, were disproportionately affected by the crisis. Furthermore, women were directly discriminated against in the post-crisis corporate restructuring process. Even those female workers who were fortunate enough to hold permanent positions within large firms found themselves under intense pressure to 'volunteer' for honourable retirement (Cho, 2002). As a result of direct discrimination against women and the greater structural vulnerability of female workers total female employment fell by 6.9 per cent, whereas total male employment fell by 4.1 per cent over the course of 1998 (Lee and Cho, 2001).

None of the analysis offered above is particularly controversial. The literature on the social impact of the crisis is well developed and the key points are not disputed. There is a stark contrast, however, between the well developed nature of the literature on the immediate effects of the crisis and the relative paucity of work that seeks to seriously examine the more permanent changes in work practices and income distribution that the crisis has engendered. It is to these longer-term changes we now turn.

Labour market restructuring

When we look past the relatively immediate impact of the crisis the manner in which the Korean state–capital complex used the space created by the crisis to effect longer-term changes in the structures of Korean labour markets quickly becomes apparent. The purpose of these changes is to tighten the hegemony of capital over labour and to enhance international competitiveness. The evidence strongly suggests that capital has succeeded in improving cost competitiveness and effecting a redistribution of income away from labour since the crisis. According to the OECD unit labour costs declined by about 9 per cent in real terms between 1998 and 2003 (OECD, 2003b: 41; OECD, 2004e: 83). Although real wage growth actually outstripped productivity growth in 2001 and 2002 this should not fool us into believing that the gains capital made in the years immediately following the crisis are being reversed. Average real wage growth averaged 2.7 per cent per annum over the course of 2004 and 2005 (Korean Labour Institute, 2006a: 140).

The unit labour cost figures cited above are, however, somewhat misleading and fail to give an accurate impression of the true scale of the redistribution of income from labour to capital that is taking place in contemporary Korea. The official figures on wage growth are seriously flawed. The essential problem is that they are only concerned with permanent workers in firms with over five regular employees (Hur, 2004). In an economy where half of all workers are employed on a flexible basis this is a matter of no small importance. Furthermore, it is widely recognised that it is irregular workers who have borne the brunt of capital's attempts to improve profitability. The IMF informs us that

‘while wages for regular workers have been growing at close to double digits in recent years, non-regular workers have seen their wages stagnate’ (IMF, 2004: 36). If we assume the IMF is correct then it becomes clear that unit labour costs have been slashed since 1997 and that a truly massive redistribution of income towards capital is taking place.

The state–capital project to restructure labour markets in order to enhance corporate profitability and international competitiveness has two main components. First, there has been a marked extension in the already large temporary labour sector and workers outside of large firms have been subject to intensified exploitation. Second, capital has sought to tighten its control over core elements of the labour force and to redefine what constitutes the core. While core workers have retained certain material privileges capital has, nevertheless, sought to restructure longstanding incorporative relationships between core workers and *haute* capital in order to attune these relationships to the need for greater flexibility and control. In order to address the issues and questions raised we shall analyse the enlargement of the periphery and restructuring of the relationship between core workers and capital separately.

Extending the ‘periphery’ and intensifying exploitation

Since the 1997 crisis there has been a marked expansion in the unprotected labour sector vis-à-vis the protected sector. This shift has been the result of a determined effort by large firms to restructure employment relationships and the search for greater flexibility by Korean capital as a whole. Large firms have succeeded in massively reducing the numbers of workers they employ directly since the 1997 crisis. In 1997 26.5 per cent of all Korean workers were employed in firms with over 300 workers. By 2004 this figure had fallen to 13.5 per cent.⁷ In the manufacturing sector over the same period the proportion of all workers employed by large firms fell from 30.7 per cent in 1997 to 20.6 per cent in 2002. This fall in employment in large firms has not been matched by a similarly dramatic decline in the proportion of total value added these firms account for. The proportion of value added attributable to large firms fell very modestly from 53.3 per cent in 1997 to 48.8 per cent in 2001. More significantly still, large firms’ share of total investments was exactly the same, 85 per cent, in 2001 as it was in 1997 (*ibid.*). The real importance of large firms has not declined at all. Rather, what we are witnessing is a process whereby large firms are retaining direct control over high-value-added aspects of the production process while farming out other aspects of the process to legally independent small firms unaffiliated with the *chaebol*.

The logics driving this reorganisation of production are clear. Large firms are contracting out everything but the core, highly skilled and capital intensive aspects of the production process in order to enhance labour flexibility and reduce costs.⁸ Small firms are in a better position to drive down wages and conditions than large, often unionised, firms who cannot easily reclaim the significant material concessions their employees had gained in the decade prior to the

crisis. The quite dramatic reduction in the overall level of employment at major corporations has allowed these firms to improve cost competitiveness and flexibility without directly attacking the conditions of what they would define as their highly skilled core employees.

At the same time as large firms have reduced the total number of workers they employ, firms of all sizes have sought greater flexibility through the greater use of temporary workers. In seeking to improve flexibility through the greater use of temporary workers they were following long established practice. Historically levels of temporary work had been high within Korea and in the nine years prior to the crisis temporary employment had consistently grown faster than permanent employment (Koo, 2001: 207). On the eve of the crisis 46 per cent of workers were employed on a non-permanent basis. The crisis gave a massive new impetus to these ongoing processes of casualisation. Over 90 per cent of all new jobs created between 1998 and 2002 were non-permanent (IMF, 2004: 34). The proportion of workers employed on a non-permanent basis increased to 54 per cent in 2002 (OECD, 2004e: 89).⁹ After 2002 the Korean government reclassified those workers who lacked formal permanent contracts but who believe the length of their contracts to be unlimited due to continuous renewal of contracts as permanent employees. This had the effect of reducing the number of employees categorised as temporary to 18 per cent. However, by 2004 this figure had risen to 29.7 per cent (OECD, 2005: 141). Furthermore, the precariousness of the position of those employees who continue to be classified as non-permanent is beyond question.

Far more significant than the numerical growth of the unprotected labour sector has been the intensification of the exploitation of those workers within this sector that has taken place since the 1997 crisis. The wage gap between permanent employees of major firms and other less privileged members of the Korean working class has increased markedly since the crisis. As we have already stated the IMF suggests that wages for non-regular workers have stagnated over the last few years while permanent workers have enjoyed high single digit wage increases.¹⁰

The wage gap between regular workers in small and large firms has also grown markedly since the crisis. In 1997 workers in firms with over 500 employees enjoyed wages 72.3 per cent higher than their counterparts in firms with between ten and 29 employees (Korean Labour Institute, 2004: 137–8). At the end of 2005 employees in large firms were paid 99.2 per cent more than their counterparts in firms with between ten and 29 employees (Korean Labour Institute, 2006b: 140).¹¹

In its latest report the OECD ‘blames’ the high wages that workers within large unionised firms enjoy for low wages outside these firms (OECD, 2004e). The logic of the OECD’s argument seems questionable.¹² Would any saving *haute* capital made as a result of wage restraint by core workers necessarily create ‘greater room’ for pay increases for the poorest workers? The OECD’s argument seems to rest upon the assumption that greater wage restraint by employees in large firms would ease inflationary pressures, boost export com-

petitiveness and growth. Higher growth would in turn create generalised labour shortages which would result in wage increases for lower paid workers. However, the link between employment and GDP growth is complex. For example, levels of employment fell slightly during the second half of 2003 when the economy grew by 3 per cent, whereas in 2001 a similar rate of economy growth was accompanied by a significant gain in employment (ibid.: 81). As the OECD itself highlights, consumption rather than export-led growth is likely to have a greater impact on levels of employment. A reduction in core workers' wages may actually reduce employment in so far as it leads to falling domestic consumption. It is undoubtedly true that the stability of the entire regime of accumulation and the avoidance of crisis critically depends on the maintenance of a certain degree of international wage competitiveness. It is not necessarily true that heightened international cost competitiveness will always lead to employment growth.

Furthermore, the arguments relating to the potential for wage restraint to create greater room for monetary expansion are not as simple as they might first appear. Greater wage moderation may reduce one form of inflationary pressure. However, its effect on asset price inflation, something which is a far greater threat to contemporary global economic stability, is highly indirect. Additionally in imperfectly competitive product markets the relationship between firms' costs and consumer price inflation is immensely complex.¹³ In any case even if the state could engineer a return to ultra-full employment through the judicious use of macroeconomic instruments, as soon as we understand labour markets not simply as macroeconomic entities but as complex social and political entities it becomes highly questionable whether or not it actually has an interest in doing so.

In order to understand how the rise in the 'structural' rate of unemployment is functional from the perspective of capital it is necessary to examine the impact of this rise on less secure employees. Between 2002 and 2005 the unemployment rate in Korea fluctuated between about 3 per cent and 4 per cent (Korean Labour Institute 2005: 25; Korean Labour Institute, 2006b: 132). By international standards this is modest and Korea has a much smaller pool of long-term unemployed than the major continental European and Japanese economies. Nevertheless, current levels of unemployment are much higher than the sub 2 per cent levels which had been the norm prior to the crisis (Kim and Moon, 2000: 69). The rise in the 'structural rate' of unemployment since the crisis marks the end of the era of 'overfull employment', of serious generalised labour shortages. The end of 'overfull employment' has had a profound impact on the weaker sections of the Korean working class. Within this environment even unskilled labour was a scarce commodity for which different firms had to actively compete. Now that the era of acute labour shortages appears to be a thing of the past capital is in a far stronger position to squeeze 'non-core workers'. The rise in unemployment is directly related to the successful attempt by Korean capital to restore international competitiveness at the expense of the weakest elements of the Korean proletariat.

Of course the analysis of the impact of the rise on unemployment offered above is an anathema to neo-classic and orthodox Keynesian analysis for whom unemployment is necessarily the result of the failure of wages to fall sufficiently. Orthodox economic analysis is, however, based upon a relatively crude macroeconomic apolitical understanding of labour markets within relatively discrete national economies. When we reject crude methodological individualism and introduce the notion of labour markets as complex historically structured entities and sites of contestation between capital and labour it becomes relatively easy to see how sections of capital have every reason to welcome a rise in unemployment in order to facilitate the restructuring of production relations.¹⁴ Equally, in an economy deeply integrated into supranational production structures increases in money wages and effective domestic demand will have a radically different impact than would be the case in the discrete economies so cherished by traditional macroeconomic theory.

The intensification of the exploitation of less secure employees has been key to allowing capital to gain the rapid unit labour cost reductions and flexibility the establishment of a dynamic new neo-liberal regime of accumulation requires without deliberately provoking a decisive confrontation with the most powerful organised sections of the proletariat. It is to the changes in the relationship between capital and core workers since the crisis we now turn.

Restructuring the core worker–capital relationship

The majority of permanent workers in large firms have been spared the worst effects of capital's drive to improve profitability and competitiveness.¹⁵ Nevertheless, Korean capital has sought to tighten its hegemony over such workers through two concrete sets of policy changes/non-changes. Most importantly, capital, with the full support of the state, was quick to exploit the economic crisis to advance its longstanding ambition to enhance its ability to dismiss permanent employees in the name of restoring 'national' competitiveness.

As a result of capital's demands, a new labour law was passed in February 1998, under the terms of which layoffs were allowed immediately, the conditions under which they were permissible were extended, and the employment of non-union labour was legalised (Kim and Moon, 2000: 69). It is important, however, to bear in mind the exceptional nature of the employment security permanent workers enjoyed prior to 1997. Although recent changes in Korean labour law represent a radical departure from the past a recent OECD survey found that permanent workers in Korea continued to enjoy the second highest levels of legal protection against dismissal within the OECD area (OECD, 2000d: 63). Moreover, a leitmotif running through all the OECD recent work on Korea has been its intense criticism of labour market rigidities (OECD, 2004e; 2005). These observations clearly reflect this organisation's neo-liberal agenda and should not simply be understood as constituting neutral 'facts'. Nevertheless, it is not plausible to suggest that the OECD's analysis of levels of employment security within all its member countries is driven by a desire to promote

restructuring in Korea, that its comparative surveys are deliberately distorted. The OECD's analysis must, therefore, be seen as reflecting the material reality that permanent employees in Korea continue to enjoy *relatively* high levels of employment protection.

In order to dismiss permanent employees, management must still prove that there exists an 'urgent managerial need', that workers have been consulted and that all efforts to avoid layoffs have been made. In addition to the need to meet certain legal preconditions in order to dismiss permanent workers, statutory levels of severance pay in Korea remain high by international standards (OECD, 2000d: 62–3). In light of the considerable protection permanent employees still enjoy, it appears highly unlikely that major Korean firms will instigate programs of mass layoffs lightly. This does not mean, however, that the changes that have taken place in labour legislation have been unimportant. The threat of dismissals has, we would argue, been key to major firms' success in reducing the levels of workers they directly employ through quasi-voluntary methods.

The success of major firms in reducing their workforces would indicate that the legal protections permanent workers enjoy do not actually prevent capital from shedding labour. However, they profoundly affect the costs of actually doing so. These costs make it irrational for capital to simply dismiss workers as a result of cyclical fluctuations, as opposed to long-term restructuring strategies. Of course the fact that permanent workers at large firms can at least expect a considerable amount of compensation when they are 'persuaded' to leave is significant when we consider the levels of security they enjoy.

At the same time as affording firms similar rights to dismiss workers as their continental European, if not their UK or US, counterparts the Korean state–capital complex has shown a marked reluctance to grant organised labour greater freedom. Although there has been some measure of liberalisation Korean trade union law is still far more restrictive than that existing in other OECD countries. The restrictions on the right of public sector workers to organise and strike are more extensive than anywhere else in the OECD. Moreover, multiple trade unions are not allowed at enterprise level and, uniquely among OECD states, unemployed workers are forbidden from joining a union.

A consistent theme of the process of trade union law reform has been the failure of the state to actually fulfil promises which have been made to labour. While there are plans to allow multiple trade unions at enterprise level, allow the unemployed to join unions and to greatly reduce the areas where industrial action is prohibited over the next few years past experience forces us to be cautious. For example, while a plan was initiated in 1997 to allow multiple trade unions at enterprise level by 2002 this target date was later 'deferred' to 2007 (OECD, 2000c: 65).

Even those Korean workers who theoretically enjoy the right to both organise and take collective action are constrained from taking effective legal industrial action by the Korean penal code and the state's willingness to use legislation 'creatively'. The definition of what constitutes unlawful 'obstruction of business' is unusually broad in Korea and hundreds of striking workers have found

themselves arrested for activities that would be perfectly legal elsewhere in the world (*ibid.*: 72–4). Furthermore, businesses have sued individual trade unionists in the civil courts for ‘obstruction of business’. As a result of such claims individual trade unionists have been made bankrupt and several have immolated themselves in protest. Although President Roh Moo-Hyun has expressed concern about the practice of suing trade unionists the government has yet to take any action to protect trade unionists from bankruptcy.

Significantly, while the state has been unwilling to liberalise trade union legislation the state–capital complex has not acted decisively to break the power of the unionised, skilled workers in large firms. Extending subcontracting has primarily involved attacking less skilled, often female, workers fulfilling auxiliary roles who, while they may have been union members, were unlikely to hold critical posts within the trade union hierarchy. These processes did not involve directly attacking Korea’s ‘labour aristocracy’; the highly skilled well paid confident core of the workforce.

The relatively privileged minority of workers who are employed on a permanent basis at large firms still enjoy a far higher degree of security than, and a considerable wage premium over, other sections of the Korean proletariat (*ibid.*). It must be stressed that the principal reason why such patterns of co-operation and control continue (in modified forms) is that they reflect clear economic logics and political realities. Capital had, with the prompting of the state, attempted to incorporate such workers into the development project in the mid 1980s because of the capacity they demonstrated to disrupt capitalist accumulation (Kwon and O’Donnell, 2001: 206–7).

It is this logic of incorporation that helps explain the relatively high degree of legal security these workers enjoyed prior to the crisis. The same concerns continue to apply and, for the moment at least, the logics and imperatives of attempting to avoid a full-scale open conflict with core workers continue to prevail over the very real counter-pressure to break the trade union movement, remove workers’ legal protections and extend commodification.

Despite the clear problems that a direct attack on such workers entails for the state–capital complex there are serious questions about the sustainability of relatively inclusive relationships between large firms and core workers. There is a clear sense in which capital understands core workers as being ‘out of control’ and the competitiveness of the entire Korean economy as being dependant on tightening control over core workers. The mouthpiece of major Korean firms, the Federation of Korean Industries (FKI), continually moans about high wage structures and unreasonable trade unions. Recent evidence offers uneven support to views articulated by the FKI. In 2002 permanent employees at firms with over 500 regular workers’ wages grew by 14 per cent in real terms, and despite an economic slowdown wages still grew by 7.7 per cent in 2003. However, the levels of real wage increases enjoyed by the employees of large firms decreased to 5.7 per cent in 2004 and fell further to 2.8 per cent in 2005 (Korean Labour Institute, 2006a: 140).

So far the state’s response to the ‘problem’ of high wage growth has been

two-fold. First, the state has sought to change legal frameworks in order to make it even easier for firms to further increase their use of temporary labour (*Korean Herald*, 2004). The logic of this move seems to be that if major firms must pay high wages to permanent unionised employees it is important to keep the number of such employees down to an absolute minimum. Second, there has been a concerted attempt to persuade core workers to moderate their wage demands and act in the 'national interest', efforts which culminated in the signing of the Social Pact for Job Creation in February 2004 (OECD, 2004e: 79–81).

What the government has not done is take decisive action to remove the extensive legal protections labour continues to enjoy against dismissals. Furthermore, there has not been a concerted attempt by *haute* capital backed by the power of the state to actually break the trade union movement as a whole similar to that Britain experienced under Thatcher and America under Reagan (Gamble, 1994). Reform efforts can, therefore, be understood as taking place within the parameters of existing relationships and understandings; there is still no direct full frontal assault on core workers.

Our analysis of the labour market restructuring process in Korea effectively serves to highlight both the common features which this process shared with other neo-liberal labour market restructuring projects elsewhere in the world and the critical importance of path dependence. On the one hand, we have seen an essentially neo-liberal emphasis on the extension of commodification and the generation of new insecurities (through the increasing use of fixed-term contracts and by making permanent workers easier to dismiss) in the name of flexibility and international competitiveness. On the other hand, we see the importance of particular national level political, social and economic structures in determining which groups have enjoyed a degree of protection from commodification and which groups have borne the brunt of capital's offensive. When we turn our attention the development of social welfare systems we see a similar combination of the adoption of aspects of a globally standard neo-liberal welfare model with certain more idiosyncratic policies which can only be understood as a direct product of Korea's particular history.

Welfare reform

Any analysis of welfare reform in post-crisis Korea must start by recognising the historic underdevelopment of official systems of social protection. Prior to the crisis, levels of state support for the poor were extremely limited. The principal components of the Korean welfare regime, the national health and pensions programmes, served to protect relatively prosperous core workers rather than the destitute and the more precariously employed who were excluded from these schemes (Kwon, 1999). Although the Livelihood Protection Program (LPP) theoretically guaranteed all Koreans a minimum level of income, this scheme remained very limited and ineffective at combating poverty right up until the crisis. The eligibility criteria for receiving benefits under this scheme have been widely criticised for being overly strict (*ibid.*; OECD, 2000d).

Even when a family was entitled to receive support under the rules of the LPP, it would only actually receive benefits if the local government responsible could afford to provide them: eligible claimants had no absolute right to receive benefits. If a family were able to meet the eligibility criteria and sufficient resources were available to fund benefits they could expect to receive support equal to up to 60 per cent of the official poverty line (*ibid.*: 72–82; OECD, 2000c: 121–43). The Korean welfare system may have done little to assist the poor, but it had one major advantage when viewed from the perspective of state–capital elites. Put simply, the system was extraordinarily cheap. In 1997 Korean public social spending amounted to 5.1 per cent of total GDP (OECD, 2000d: 126). To put this figure into perspective the average level of public social expenditure within the OECD in 1997 was 23.1 per cent of GDP (*ibid.*: 126). Under intense pressure from trade unions and facing a massive rise in unemployment, the Korean state expanded the welfare system in order to ameliorate the social effects of the crisis (Kim, 1996).

The Korean state's 'social' response to the crisis and attempt to construct welfare systems to support a more flexible neo-liberal labour market contained three main elements. First, and most importantly, large-scale public works and vocational training programmes were set up to assist the unemployed. It must be stressed, however, that the uninsured unemployed were not guaranteed a place on either a public works programme or a vocational training scheme. Rather, there were a fixed number of places on these programmes and the unemployed were forced to compete for them. In principle, the poor were to be given priority access to the public works scheme. In practice, however, the better educated and relatively well-off members of the unemployed proved most adept at securing places on both the vocational training programmes and the very generous public works support programme (OECD, 2000d: 99–103). From the perspective of those within the state–capital complex the one great advantage of public works programmes and ad hoc training schemes is their flexibility. Whereas changes to systems of unemployment benefit and support for the destitute are inevitably going to have permanent fiscal consequences, these programmes may not. Rather, they can be introduced during serious recessions and gradually abolished as macroeconomic conditions, and the politics of legitimation, dictate.¹⁶ They constitute a flexible form of welfare provision to support a flexible neo-liberal mode of accumulation. The programmes that were established in the wake of the crisis began to be wound down in 2000 as the economic recovery took root and unemployment returned to 'more acceptable' levels (*ibid.*: 75–6). Between 2000 and 2004 government spending on employment subsidies fell from 113.9 billion won to 97.4 billion won. Equally significantly, between 2001 and 2003 the number of unemployed workers in government-funded training schemes fell from 180,394 to 108,187 (OECD, 2004e: 92). Additionally, the government also ended all centrally funded public works programmes in 2003.

These figures should not be interpreted as evidence that employment subsidy, vocational training and public works programmes do not have a future. At the same time as general programmes simply aimed to provide support for unem-

ployed were scaled down spending on targeted spending on programmes for youth and the long-term employed were increased. Furthermore, these general programmes form an integral part of the new welfare regime whose size will adjust to macroeconomic circumstances.

The extension of active labour market policies is critical to the argument that Korea is developing a comprehensive 'productive' welfare system which simultaneously guarantees universal welfare rights and enhances international competitiveness (Kwon, 2003; Lee, 2004; Mishra *et al.*, 2004). A cold hard look at the actual levels of expenditure on active labour market programmes reveals both the validity and the serious limitations of the argument that such a welfare regime is developing in Korea. Total spending on active labour market programmes amounted to a meagre 0.3 per cent of GDP in 2001 (OECD, 2004e: 92). To put this figure in perspective it was the fourth lowest in the OECD and less than a fifth of Dutch spending on such programmes (*ibid.*). Of course the limited expenditures on active labour market programmes can partly be explained by the relatively low levels of unemployment in Korea. However, even if we allow for the fact that unemployment in Korea is lower than the OECD average, spending on active labour market programmes is still low by international standards. Furthermore, it seems difficult to argue that such programmes are a central pillar of the government's economic strategy given that a little over 1 per cent of total government spending is devoted to them. Although relatively full employment places objective limits on the growth of active labour market programmes there are still hundreds of thousands of uninsured unemployed whom we would assume would be grateful for a place on a government training scheme and the support that comes with it. There is clearly plenty of additional scope to expand these programmes even within the context of quasi-full employment.

At the same time as recognising the low overall levels of state spending on active labour market programmes it is equally important to be conscious of the fact that spending on active labour programmes is very high in relation to total expenditure on all labour market programmes. Spending on active labour market programmes is over twice the level of spending on 'passive' support for the unemployed (the OECD classifies LPP and unemployment insurance system (UIS)) (*ibid.*). This is clearly indicative of the fact that concerns about skills upgrading, employability, the promotion of the knowledge-based economy and international competitiveness lie at the heart of the new Korean welfare regime. In highlighting the importance of these objectives the literature on productive welfare in Korea does us a great service. What this literature fails to do, however, is to properly emphasise the niggardly and incomplete nature of the contemporary Korean welfare system (Kwon, 2003; Lee, 2004; Mishra *et al.*, 2004).

The second major set of changes the state initiated in the wake of the crisis relate to the UIS. The system was reformed so as to lengthen claimants' eligibility period and increase the level of benefits paid. At the same time, an effort has been made to extend the coverage of the scheme to workers employed in the

SMEs sector, workers on very short-term contracts and part-time employees (Hur, 2001). By 2004 85 per cent of all Korean employees were theoretically covered by UIS. However, the OECD estimates that more than a third of workers who are supposed to be covered by the scheme are not in fact covered due to the failure of small businesses to meet their legal obligations to participate (OECD, 2005: 144).

Levels of coverage will not increase substantially in the future without radical reform of the eligibility criteria and a new determination on the part of the government to force employers to meet their legal obligations. Furthermore, there is a direct positive correlation between levels of job security and membership of the UIS. Thus, in 2004 while 54 per cent of total workers were covered by the UIS only 23.6 per cent of the unemployed were eligible to claim benefits (*ibid.*: 144). Our analysis of UIS reform reinforces the central argument of this chapter about the success of the state–capital complex in carrying out a comprehensive programme of neo-liberal labour restructuring, which intensified inequalities and insecurities, while effectively limiting the expansion of welfare rights/spending.

The final major element of the state's attempt to 'manage' the social impact of the crisis and neo-liberal restructuring involved the introduction of a new means-tested support scheme to support the LPP and increasing the levels of support available under the LPP. In the immediate wake of the crisis a new scheme, the Temporary Livelihood Protection Programme (TLPP), was established with a less stringent means test in order to provide a minimal level of income, up to 29 per cent of the official poverty level, to Koreans suffering acute temporary economic difficulties rather than chronic poverty (OECD, 2000d: 131). Additionally, benefit levels available to those Koreans eligible for support as part of the main LPP are now set so that recipients' total income is equal to the official poverty line. In return for these more generous benefits recipients who are physically able to are now required to accept training, public works jobs and take part in job placement programmes (OECD, 2000c: 76).¹⁷

Despite the changes that have taken place in the LPP and the development of the TLPP, the most striking feature of the Korean welfare regime remains its frugality. Korean social spending rose from 3.9 per cent of GDP in 1996 to 6.9 per cent of GDP in 1999 as the state took action to ameliorate the social impact of the crisis. Social spending fell back slightly to 6.1 per cent of GDP in 2001 as the economic recovery continued and unemployment fell (OECD, 2004f).¹⁸ To put these figures in perspective the state with the next lowest level of social expenditure in the OECD was Mexico which spent 11.8 per cent of its GDP on social welfare. Korean social spending may have increased but it is still extraordinarily low (*ibid.*).

The Korean state–capital complex has succeeded in creating extensive new labour market insecurities which have been integral to the reduction of unit labour costs whilst restricting social expenditure to levels well below those prevailing in other major neo-liberal states. The emerging Korean welfare state is best understood as, to use Jessop's term, a Schumpeterian workfare state with

highly distinctive national characteristics (Jessop, 1993). The Schumpeterian workfare state can be distinguished from other (Keynesian social-democratic) welfare states by the emphasis that this model places on promoting international competitiveness. To quote Jessop 'its distinctive objectives in economic and social reproduction are: to promote product, process, organisational and market innovation in open economies in order to strengthen as far as possible the structural competitiveness of the national economy by intervening on the supply side, and to subordinate social policy to the needs of labour market flexibility and/or the constraints of international competition' (Jessop, 1994: 263). At an individual level the emphasis on promoting competitiveness is likely to mean that rather than simply receive benefits as a right the recipient will be forced to pursue a programme to improve their employability in return for material support.

The principal purpose of the Korean workfare system is the same as other Schumpeterian workfare systems elsewhere in the world, namely, to maximise national competitiveness within the global economy by producing/reproducing a technically capable national workforce and maintaining the political stability necessary for sustained accumulation to take place. However, the very success of the neo-liberal project in Korea has allowed the state to limit expenditures on both retraining the unemployed and supporting the poor. The essential point is that, given the existence of quasi-full employment in Korea, the contribution that an effective welfare state is likely to make to both national competitiveness (there are far fewer potential trainees) and political stability is limited. Equally significantly, the rapid return to quasi-full employment in Korea has mitigated the pressure on the state to develop more generous comprehensive safety nets in order to ensure the acquiescence of the working class to the prevailing capitalist order. The politics of neglecting the unemployed are necessarily different in an environment where unemployment is 3.4 per cent than in a national political economy suffering from chronic unemployment problems.¹⁹

The question of whether or not the underdevelopment of welfare systems should be understood as a 'problem' is more complicated than the mainstream literature on social policy and productive welfare would lead us to believe. We certainly cannot proceed from the implicit uncritical assumption that the development of comprehensive welfare systems represents some sort of a general social and economic good. Rather, we must critically examine for whom the underdevelopment of welfare system may be a problem and for whom it may be a boon. If our principal concern is with the well-being of the poorest members of society then the underdevelopment of welfare systems does constitute a problem. However, if we view the question from the perspective of Korean capital the answer is far less clear. The critical question from the perspective of capital is who pays for any major extension of welfare provision. If an extension of the welfare state was effectively funded through an intra-class redistribution of wealth, and did not effect the incentives for the unemployed to take low paid work, capital could afford to take a relaxed attitude to a substantial rise in welfare expenditure. Furthermore, as the work of Glyn, amongst others, on the

Scandinavian welfare states demonstrates, it is technically possible to achieve such an inter-class redistribution of income (Glyn, 1995: 44–5).²⁰

Ultimately the question of who pays for any extension of the welfare state is a political one, the answer to which cannot be determined in advance. The Korean state together with *haute* capital is currently attempting to use Korea's weakly institutionalised chronically unstable corporatist forum to put pressure on organised labour to make material sacrifices supposedly for the sake of poorer workers (OECD, 2004e: 78–101). Nevertheless, it seems ridiculous to suggest that the relatively prosperous sections of the working class would simply offer to fund massive extension of the welfare system. It seems more plausible that an extension of welfare provisioning would in one form or other translate into higher costs for capital, that some form of inter- as well as intra-class redistribution would take place. Understood within this context, the under-development of welfare systems must not simply be understood as a 'problem' but as an integral feature of a relatively dynamic growth regime.

Conclusion

Within this chapter we have argued that Korean capital has, with the full support of the state, successfully restructured labour markets in order to improve international competitiveness. The new competitiveness of the Korean economy has been bought at the expense of the most vulnerable members of Korean society. By intensifying the exploitation of weaker sections of the working class capital has succeeded in effecting a significant reduction of unit labour costs without deliberately provoking a decisive conflict with and shattering the power of the most organised sections of the working class.

Labour market restructuring and welfare reform are qualitatively different from other aspects of the neo-liberal project. Since the crisis the Korean state has acted decisively to create new systems of financial regulation and corporate governance and has activity sought to benchmark reforms against established global standards. While contemporary Korean systems of corporate governance and financial regulation are not identical to those existing in other neo-liberal states the policy of benchmarking reform has created systems which share the same basic characteristics as those existing in other more established neo-liberal economies.

The same process of benchmarking has informed the process of labour market restructuring. International organisations such as the OECD and the IMF play an important role in creating global regulatory norms based upon 'flexibility' with employment protections being dismissed as rigidities to be overcome. Political and economic elites have adopted the mantra of 'flexibility' as they have presided over massive increase in casualisation and a reduction in legal protection against dismissal that permanent employees enjoy.²¹ We should be in no doubt about the essentially neo-liberal nature of the labour market reform process in Korea. At the heart of the restructuring process has been a very clear neo-liberal focus on increasing flexibility (the right of capital to dismiss workers

and use casual labour), effecting a redistribution of income from labour to capital, and transforming welfare systems into tools for promoting national competitiveness. Nevertheless, path-dependent factors are of far greater importance in processes of labor market restructuring and welfare reform. It is incredibly difficult to systematically redesign labour market and welfare regimes according to certain internationally recognised standards of best practice; it is much more difficult to escape from path dependency. Furthermore, as we have argued, the constraints on the freedom of workers to organise and strike that reflect Korea's authoritarian past and clearly defy the principles articulated by the avowedly neo-liberal OECD are functional from the perspective of capital. For capital (international and domestic) national deviations from international norms are unproblematic provided local idiosyncrasies serve to empower employers and disorganise labour. The contemporary Korean labour regime is clearly neo-liberal. However, it is very much a 'Korean' neo-liberal regime that bears the hallmarks of the country's political and economic history and differs markedly from neo-liberal labour regimes elsewhere in the world.

9 Conclusion

A neo-liberal state and the contradictions of neo-liberalism

This monograph has sought to advance two closely related but distinct arguments. First, we have argued that Korea must now be understood as an unambiguously neo-liberal state and that the state's interventions in the economy since the crisis have been driven by explicitly neo-liberal concerns. The key components of a neo-liberal regulatory regime are now in place. Systems of corporate governance and financial regulation have been completely overhauled so as to bring them into conformity with global standards of 'best practice' as defined by leading neo-liberal states and supranational institutions. At the same time the extensive controls on foreign investment that had existed prior to the crisis were dismantled and policy is now framed so as to promote rather than prevent the sale of strategic assets to foreign investors. Equally significantly, systems of labour regulation have been reformed so as to enhance flexibility (the ability of firms to dismiss unwanted employees) and the new welfare regime is being constructed so as to prioritise concerns about competitiveness as opposed to equality.

Reform has not been limited to changes in particular policies. Rather, the institutional structures of the state and legally defined policymaking procedures have been transformed since 1998. This transformation has served to 'lock in place' those neo-liberal reforms that have already been enacted and insulate economic policy from political pressures. Key aspects of economic policy, including financial and monetary policy, have been farmed out to autonomous agencies that possess clear mandates to pursue market conforming objectives. Additionally, policymaking procedures have been reformed so as to place a formidable set of obstacles in the way of any attempt to resuscitate the dirigiste policies of the past. On balance, therefore, and despite both the limited progress in marketising the state itself and the survival of essentially dirigiste structures of power and telecommunications regulation, it is accurate to label the contemporary Korean state as a neo-liberal competition state.

At first glance the state's attempts to promote economic restructuring by directly intervening in the market in the years immediately following the crisis may appear to contradict the argument that the state should now be considered to be neo-liberal. However, given the scale of the structural problems that beset the corporate and financial sectors in the wake of the crisis non-intervention was

simply not viable. What is significant is not the fact that intervention has taken place but the objectives and principles underpinning that intervention. When we study the state-led restructuring programme its unambiguously neo-liberal character becomes clear. Firms and financial institutions were to be 'restructured' and subjected to the disciplines of hard budget constraints and global market competition. They were not to be protected indefinitely from the judgements of global markets. This determination to subject key firms to market disciplines resulted in the virtual collapse of 17 of the leading 30 *chaebol* between 1997 and 2004, a historically unprecedented event. Moreover, throughout the entire restructuring process the state has actively sought to promote Korea's ever-deeper integration into global circuits of accumulation by engineering the sale of key firms and financial institutions to foreign investors. Quantitative measurements of FDI give a poor impression of the real significance of FDI in the post-crisis restructuring process as they fail to reveal the strategic significance of the firms that have been transferred to foreign ownership or the sectors within which foreign investment has been concentrated.

The second principal argument of the monograph is that neo-liberal reform cannot be understood as something that external political agents have imposed upon reticent domestic elites. The direct coercive role of external political agents in the reform process should not be exaggerated. The idea that the IMF, acting on behalf of US financial elites, forced the Korean government to engage in neo-liberal restructuring in the wake of the 1997–8 crisis is simply wrong. Market-based reform has consistently gone beyond what the IMF initially demanded and there has been no attempt to undo previous reform following the repayment of the initial IMF loans. For a considerable period prior to the crisis key sections of the Korean elite had been committed to wholesale neo-liberal reform and important reforms were enacted prior to the crisis. The crisis created the political space necessary for reformist elites to carry the project that they had initiated well over a decade earlier through its logical conclusion.

While it is important to recognise the centrality of the Korean state in the process of neo-liberal reform it is equally vital to understand how the state's actions and decisions were structured by, and to an extent even determined by, changes in the composition of global markets. A statist approach that fetishises the agency of the state completely fails to capture the real imperatives driving the process of neo-liberal reform. It is easy to exaggerate the levels of agency/choice the Korean state has actually exercised in the whole process. On one level, the Korean state clearly made a choice to pursue neo-liberal reform. On another level, however, we may ask what viable alternatives actually existed for the Korean state. As we have consistently argued the only real alternative to engineering a programme of neo-liberal restructuring was to accept the long-term decline of Korea as a site of accumulation in the global economy.

Beyond these two clear unambiguous arguments the analysis presented in this monograph reflects the somewhat ambiguous and contradictory nature of the contemporary neo-liberal project in general and the form that this project has taken in Korea in particular. Two main partial contradictions stand out in the

analysis of neo-liberalism offered here. The first relates to the arguments concerning the ‘success’ of neo-liberal restructuring in Korea and the establishment of a stable regime of accumulation in the wake of the crisis. On the one hand, we stress the extent to which neo-liberal reform has succeeded in effecting a redistribution of income from labour to capital and effectively disciplining capital in order to force firms to improve profitability. As a result of these ‘achievements’ the serious structural problems that lay behind the 1997–8 financial crisis have been resolved and the conditions for further capitalist accumulation have been restored. Furthermore, by any reasonable comparative measurement the Korean economy can be described as stable. At the time of writing (2006) the economy has experienced seven years of continuous growth and there do not appear to be any obvious catastrophic structural problems or strong oppositional forces which promise to derail the neo-liberal project. In a sense, therefore, it makes sense to describe Korea as a stable neo-liberal regime of accumulation. On the other hand, however, the concept of stability can only be a relative one in the contemporary global economy. Neo-liberalism necessarily involves promoting ever deeper integration into global circuits of accumulation. This integration necessarily involves heightening the exposure of national economies to the vagaries of the global market. Furthermore, the argument of this monograph is not that Korea is exceptional amongst neo-liberal (or for that matter capitalist) economies in that it is free of serious essentially internal structural problems; simply that there are no obvious structural problems that promise to lead to full-scale collapse in the short to medium term.

The second key contradiction within our analysis of neo-liberalism relates to the dominance and (at least partial) failure of the global neo-liberal project. The global dominance of neo-liberalism is very real. Wherever we look we can see national states reconfiguring themselves along neo-liberal lines and seeking to integrate themselves ever more deeply into global circuits of accumulation. Policy debates globally are dominated by neo-liberal norms concerning flexibility, competitiveness and market disciplines that have been raised to the status of an almost unquestionable ‘common sense’. Moreover, the WTO-based global economic governance regime effectively makes full participation in the global economy dependent upon at least limited conformity with key neo-liberal norms (Bora, 2000; Rodrik, 2004). Nonetheless, the global triumph of neo-liberalism rests upon a very precarious basis. Put simply it is highly questionable if the global neo-liberal project can be properly understood as being a success when assessed on its own terms. It is inadequate to understand the neo-liberal project as simply being about effecting a redistribution of wealth from the working and middle classes to the *haute* bourgeoisie. Rather, the project must be understood as having developed in response to structural problems in the global economy – the decline in profitability in the most important capitalist economies. It is not immediately obvious that global restructuring has succeeded in creating adequate opportunities for profitable investment to resolve the crisis of overaccumulation that developed in the late 1960s. While there has been a moderate recovery in profitability in the US, levels of profitability in continental Europe

and Japan remain weak. Furthermore, it is clear when we analyse both the volume of trading and the volatility of key markets that fictitious accumulation in the financial sector dominates over real accumulation

These contradictions make the future of both the Korean political economy and the global political economy highly uncertain. As we have already argued the fact that neo-liberal restructuring in Korea may have succeeded in addressing the structural problems which lay behind the 1997–8 crisis does little to protect the economy against problems emulating from an unstable global economy. Should the economy suffer a major crisis this will not necessarily mean the end of the neo-liberal project in Korea. However, it is likely to open up political space for oppositional forces which seek to construct a different future for Korea. Similarly given the prevalence of fictitious accumulation in the contemporary global economy a major breakdown of the world economy as a whole is far from inconceivable. How the global economy is likely to be reconfigured in the wake of such a breakdown is impossible to predict. Such a crisis may mark not simply the end of the neo-liberal project but the end of capitalism itself and the beginning of the creation of a more humane and rational economic system.

While the future of the Korean political economy may be uncertain we may say one thing with confidence. It is clearer now than ever in the past that it is impossible to analyse the development of Korea, and the stability of the Korean political economy, without simultaneously analysing the changing composition of the global market. Rather more provocatively we would contend that in order to understand the development of the contemporary Korean and global political economies we must refer back to the theories which Marx developed in the nineteenth century and to more recent scholarship on the global political economy that takes Marx's work as a point of departure.

Notes

1 The Korean developmental state, industrialisation, crisis and post-crisis restructuring

- 1 Except for when we are discussing matters relating to intra-Korean relations we shall refer to South Korea as Korea from this point onwards.
- 2 Indeed, it is precisely these material conditions that gave meaning to the central idea (nationally based capitalist development) that underpinned the post-war development project. It is impossible to understand post-war ideational and political conditions outside the context of the second industrial revolution.
- 3 It is true that certain Southeast Asian states (particularly Malaysia and Singapore) achieved high levels of growth on the basis of attracting foreign capital rather than developing strong indigenous firms (Bowie and Unger, 1997; Roden *et al.*, 1997). That such states were able to, and were to a certain degree forced to, pursue such strategies in the post-colonial era was a product of the particular legacies of the colonial order in this region (Hua, 1983). As a general rule it remains true that national prosperity in the post-war period depended on the strength of indigenous firms.
- 4 In fact, the costs of research and development (R&D) are now so high that even the largest firms are forced to enter technology-based, cross-border inter-firm alliances in order to develop new products (Dunning, 1993; 1997).
- 5 It was the collapse of the long post-war that created the material conditions that have supported the global spatial restructuring of economic relations. See Chapter 2 for details.
- 6 The *chaebol* are large diversified conglomerates who have dominated the Korean economy since the 1960s.
- 7 While direct economic assistance ended in the mid 1970s the US continues to play an important role as South Korea's closest military ally.
- 8 Clearly the exact timing of the crisis was determined by the international financial markets' loss of confidence in the economies of East Asia. However, it is important that we do not exaggerate the scope of the 1997 'Asian Crisis'. The 'Asian Crisis' was essentially a crisis of four states (Indonesia, Malaysia, Thailand and Korea). The large majority of economies in East Asia experienced a slowdown in growth rather than crisis; Korea was the only economy in Northeast Asia to experience a full-scale crisis in 1997. The four crisis stricken economies shared little if anything in common with each other. For example, foreign firms had historically dominated the Malaysian economy whereas levels of FDI in pre-crisis Korea were negligible. Talk of a crisis of the 'Asian model' is palpably nonsense. The radical differences in the affected economies and the fact that most economies in the region did not experience crisis highlights the need to look for the underlying causes (the shift in the sentiment of the global financial markets was clearly the trigger) of the crisis in each of the four cases at a national level. It has also become clear, with the benefit of hindsight, that the

Indonesian crisis must be treated separately from the other three cases as the late 1990s witnessed a profound crisis of the entire political order, not simply the breakdown of a particular growth regime as was the case in Korea, Malaysia and Thailand. Obviously this further complicates any attempt to formulate a regional level explanation of the crisis.

- 9 A great deal of importance is often given to the influence of American-trained neo-liberal economists in bodies such as the Economic Planning Board (EPB) in promoting liberalisation (Evans, 1995: 229). However, I do not believe that the neo-liberal sympathies of the staff of agencies such as EPB offer any real explanation as to why Korea pursued neo-liberal reform. As Hart-Landsberg (1993) makes clear in his book *The Rush to Development* such agencies had from their inception in the 1960s been broadly pro-market. This is precisely why the EPB was marginalised by President Park during Korea's heavy industrialisation drive in the 1970s. In order to understand the growing influence of such agencies in the 1980s and 1990s we must focus on the increasingly obvious limitations of the state-led development model in a changing global economy. It was these limitations together with the state's deep long-term commitment to promoting Korea as a site of capitalist accumulation, not the personal views of members of EPB, which were the catalyst driving the liberalisation process.
- 10 TFP growth averaged 3.3 per cent for the French economy between 1950 and 1973. Korea's TFP growth over its own period of high growth (1960–94) averaged only 1.5 per cent (Crafts, 1999).
- 11 Examples of this pragmatism include Pinochet's decision to effectively nationalise the banking sector in 1982–3 and the Reagan administration's intervention to resolve the savings and loans crisis in the 1980s which cost American taxpayers \$126 billion (Edwards and Edwards, 1987: 102; Friedman, 2000: 39).
- 12 See for example Weiss and Thurbon (2006).
- 13 The precise policies neo-liberal state pursue in order to promote the competitiveness of the space are detailed in Chapter 3.
- 14 Given a perfectly equal distribution of income the Gini coefficient would be zero. In a situation where one person monopolised all income the Gini coefficient would be one. Gini for households (including non-salary or wage earner households) was 0.35 in 2005. The problem with using this later measure of inequality is lack of reliable historical statistics that make meaningful comparison impossible.

2 Putting Korea in its place

- 1 We use the term autonomy to refer to the capacity of state managers to operate autonomously from powerful transnational and more nationally rooted social forces (classes). The use of the term is not meant to imply that individual capitalist states are free from the systemic imperatives generated by capitalism itself. In a highly autonomous capitalist state the business class as a whole may have little direct influence over policy. However, as a capitalist state the state's primary objective must be to secure the subordination of labour to capital and maintain conditions for accumulation. The failure to do so would mean the collapse of the entire social order upon which the state rests.
- 2 To give a practical example of the effects of devaluation, a US firm producing steel prior to the Great Depression in an obsolete factory would have been deterred from purchasing a new modern factory by the costs of writing off the value embedded in the existing factory. However, the exchange value of the old factory is likely to be reduced to almost zero in a deep depression. The depression will thus destroy the barriers to innovation embodied within existing investments.
- 3 Nor are we seeking to deny that global economic structures themselves are shaped by the development of national state forms.
- 4 In practice the welfare systems of different 'national industrial states' differed

- markedly from each other and we must be cautious not to overstate the similarities that existed. Again the point must be reinforced that what we are discussing here is a stylised model that does not correspond precisely to historical reality (Gough, 1979; Esping-Anderson, 1990).
- 5 Britain represented an exception to the general rule in that finance capital remained hegemonic within the state (Strange, 1971; Ingham, 1984; Hutton, 1996). The failure of the British state to subordinate finance to the needs of industry is at the core of arguments concerning the inability of the British state to fully adjust to the dictates of competitiveness associated with the second industrial revolution.
 - 6 As we already argued in Chapter 1 certain East Asian states (particularly Hong Kong, Malaysia and Singapore) achieved high levels of growth on the basis of attracting foreign capital rather than developing strong indigenous firms (Bowie and Unger, 1997; Roden *et al.*, 1997; Lindblad, 1998). That such states were able, and to a certain degree forced, to pursue such strategies in the post-colonial era was a product of the particular legacies of the colonial order in this region (Hua, 1983). Such states may be understood as the exception to the general rule that national prosperity in the post-war period was dependent upon the success of indigenous firms.
 - 7 See Chapter 4 for a more detailed exposition of the role the US has played in shaping the development of modern Korea.
 - 8 In discussing the crisis of profitability in the global economy we confine ourselves to analysing profitability figures from the US, Germany and Japan, the three largest economies in the world. Because of the size of these economies we can ascertain a great deal about the health of the global capitalist system as a whole through an analysis of their performance. We also avoid many of the practical problems relating to the collection of reliable data by confining ourselves to an analysis of these three major economies.
 - 9 All of the profitability statistics taken from Brenner (2002) refer to the level of gross operating profits in relation to gross capital stock.
 - 10 In line with Wolff's methodology this figure was ascertained by using figures for Tangible Capital Stock and National Income available from the US Bureau of Economic Analysis' website (www.bea.gov).
 - 11 Due to the laws of combined and uneven development the crisis of profitability is at once both local and global. To deny that it is a crisis of global capitalism rather than a crisis of individual national economies is ridiculous given that profitability declined simultaneously in Western Europe, the US and Japan. However, the impact of the crisis was/is not even and countries which occupy very different positions in the global economy were/are effected in very different ways by the global downturn and profitability clearly did not fall has not fallen in every national capitalist social formation.
 - 12 Annual net operating profits as a percentage of total capital stock were over 250 per cent lower in the later period than the first. This figure is derived from statistics on total capital stock and net operating profits that we ascertained through an email request to the Japanese Cabinet Office's Economic and Social Research Institute.
 - 13 Market capitalisation of US biotechnology firms increased from \$45 billion in 1994 to \$311 billion in 2005. This figure is taken from the Biotechnology Industry Organisation website (www.bio.org/speeches/pubs/er/statistics.asp).
 - 14 These figures are taken from the list of labour force statistics available from the OECD's website (www.oecd.org/document/33/0,2340,en_2825_495670_37523873_1_1_1_1,00.html).
 - 15 This figure is derived from statistics on total hours worked, nominal wages and inflation that we ascertained through an email request to the Japanese Cabinet Office's Economic and Social Research Institute.
 - 16 The power of organised labour is one factor among many in determining the dynamic competitiveness of a space. The quality of both social and physical infrastructure is

also critical to the competitiveness of the space. The social infrastructure can be understood to include the level of skills of workers in an area, the existence of supporting educational institutions and craft traditions, the existence of supporting industries and the capacity of government authorities to support particular types of accumulation.

- 17 In so far as a geographically uneven economic upturn (largely confined to the US) has occurred since the mid 1990s hyper-innovation, that has led to accelerated devaluation of fixed capital investments and simultaneously created new opportunities for profitable investment, has played a key role in the process. Logically from the perspective of Marxist economics radical technological change, which renders billions of dollars of fixed capital investments obsolete, and crises can play a similar role in devaluing capital and offsetting the tendency towards over-accumulation.
- 18 Indeed as we have consistently argued the problem advanced capitalist economies have faced since the end of the 1960s relates to a lack of profitable investment opportunities, not to a vibrant demand for funds by large firms seeking to make productive investments.
- 19 This heavy reliance on external funds was also both a product and a cause of the pathologically low profitability of the Korean corporate sector.
- 20 NYSE Daily Share Volume NYSE Statistics Archive (www.nyse.com/marketinfo/datalib/1022221393023.html)
- 21 See particularly Strange (1986; 1998) and Michie and Smith (1999) for an analysis of policy failures and financial instability.
- 22 It is impossible to compare levels of foreign exchange turnover in the contemporary global market with levels prior to the late 1980s due to a lack of reliable data.
- 23 Japan and other creditor states with state-managed financial systems faced a different but equally serious problem. On the one hand, the state had to encourage domestic financial institutions to participate in the world market in order to recycle surpluses but in doing so the state effectively undermined its own attempts to maintain the effective separation of the domestic market from the global.

3 Global competition, neo-liberalism and alternatives

- 1 It is interesting to note, however, that the regulation of the securities industry in post-war Japan was largely devolved to private regional stock exchanges. Although the state enjoyed the formal power to impose rules on these institutions this never occurred in practice.
- 2 There is a clear contradiction, however, between the idea of codification/the creation of a level playing field and the shift towards more risk or principle-based regulatory approaches that is now taking place in leading financial centres and within international accords (Bank of International Settlements, 2004; FSA, 2006). Risk-based supervision relies as much upon the subjective judgement of regulators about firms strategy, internal systems of control and the compliance of senior management as simple quantitative measurements.
- 3 In other states such as the US the key longstanding public regulatory agents have always enjoyed a high degree of freedom from direct day-to-day political interference (see for example www.sec.org/about.whatwedo.shtml).
- 4 Information on the mandates and operating principles of the Maltese Financial Services Authority, the British FSA and the Korean Financial Supervisory Service (FSS) are available from their respective websites: www.mfsa.com.mt/mfsa/default.asp (Malta), www.fsa.gov.uk/Pages/About/Aims/index.shtml (Britain), www.English.fss.or.kr/en/laws/com/lawcomm2_v.jsp?seqno=17&gubun=18sub_title=Rules%20On%20Operation%20Of%20The%20Financial%20Supervisory%20Commission&no=1 (Korea).
- 5 Figures on US stock market calculated by author from information on the New York

- Stock Exchange daily closing indexes available from NYSE statistical archive www.nyse.com/marketinfo/datalib/1022221393023.html.
- 6 The remainder of this section is based upon OECD (1997).
 - 7 The parallels with CBI are obvious.
 - 8 The last major Congressional Budget Office (1983: xvi) report assessing the merits and problems associated with industrial policy stated very clearly that the US 'does not have an industrial policy'. The fact that the US state spends billions funding civilian R&D and university science programmes clearly negates the argument that the US does not pursue an industrial policy unless we define industrial policy very narrowly. As we have already said in 1997 15 per cent of total US business R&D expenditure was publicly funded, although approximately half of this total was accounted for by defence-related industries.
 - 9 See the industrial policy homepage within the learning for development section of the World Bank's website (web.worldbank.org/WBSITE/EXTERNAL/WBI/WBIPROGRAMS/KFDLP/0,,contentMDK_%3A20750656~pagePK%3A64156158~piPK%3A64152884~theSitePK%3A461198,00.html) for a large collection of papers that seek to define what the key components of the 'new industrial policy' are.
 - 10 Beath (2002) argues that the move away from supporting national 'champions' is part of a global trend. What makes the UK exceptional is how complete this shift has been.
 - 11 The advocates of 'new industrial policy' talk endlessly about the need to foster the development of 'innovation clusters'.
 - 12 Should anyone doubt the centrality of 'promoting flexibility' in contemporary political debates they need only read the Lisbon Strategy agreed upon by European leaders in 2000 and championed most actively by the British Prime Minister of the day whose administration consistently boasts of the UK levels of flexibility (McCartney, 1999; European Commission, 2000). When a British government minister boasts that the UK has 'a labour market that enables businesses to react quickly to changes in their markets' they are essentially saying that UK employees can cheaply and easily be made redundant.
 - 13 It is impossible to generalise about the quality of training programmes for the unemployed. In many cases they may be excellent and make an important contribution to both the strategic competitiveness of the economic space and the employability of the unemployed person. In others cases (for example the Youth Training Scheme introduced by Thatcher government in the UK) there is a minimal pretence that the schemes improve either the national skills base or the career prospects of the trainee.
 - 14 Of course the fact that a central bank is autonomous does not make it neo-liberal. However, the fact 'new' independent central banks are obliged to refrain from deliberately distorting the allocation of credit and stand apart from society and impose the discipline of money through inflation targets makes them unambiguously neo-liberal.
 - 15 The meaning we attach to the term 'regulatory policymaking' is outlined in the previous section of this chapter.
 - 16 The arguments of these scholars concerning investment are fundamentally flawed. The problem is that they focus on the means through which investment funds are supplied by the financial system and ignore the critical lack of adequate opportunities for profitable investment in the real economy since the early 1970s (Hutton, 1996). We would argue that wage restraint is important not because it generates additional investable funds but because it has capacity to make marginal investments more profitable and increase the relative attractiveness of investments in the economic space where restraint is effective relative to other spaces.
 - 17 Real wages in Germany have been stagnant since 1998. However, wage restraint does not appear to have restored the attractiveness of Germany as a site of accumulation in the global economy.
 - 18 While Norway's recent economic record is extremely impressive the wider significance

ance of its performance is limited due to the importance of oil revenues in fuelling growth. See OECD (2004d) for details.

- 19 See Chapter 2 for an analysis of the main changes in the global economy since the late 1960s in terms of the necessary rise of fictitious accumulation, spatial reorganisation and the attack on labour.
- 20 US Gini coefficient figures are available from www.census.gov/hhes/income/histinc/ie6.html.
- 21 See Chapter 2.
- 22 UK Gini coefficient figures are available from www.statistics.gov.uk.

4 Ontology of a miracle

- 1 It is generally acknowledged that considerable industrialisation took place under Japanese colonialism. The standard Korean accounts of such industrialisation, however, stress that such industry was primarily located in the north and that the little that was located in the south was destroyed in the Korean War. See Woo (1991) for a brief summary of the literature.
- 2 Although, as we may reasonably expect, certain similarities existed between Japanese colonialism and the colonialism of the European late developers such as Germany (Woo, 1991). Parallels also suggest themselves between the French settler colonies such as Algeria and colonial Vietnam.
- 3 It is questionable whether the Korean state under Rhee can properly be regarded as a capitalist state. It is not entirely clear that this state, which had no fiscal base in the Korean political economy, was committed, in the same manner as the developmental state, to the development of the bourgeoisie as a class. It is one thing to dole out favours to selected capitalists. It is quite another to act so as to create conditions conducive to the reproduction and development of that class as a whole. We would contend that it was only with the coming to power of the Park regime, which was fully committed to promoting capitalist development, that the Korean state took on a fundamentally capitalist character.
- 4 The power of rural elites was broken by the virtual collapse of the regime of private property in the countryside during the chaos of the civil war (Lie, 1998).
- 5 There is a key difference here between regulatory forbearance, bureaucrats choosing not to consistently enforce rules with the implicit support of politicians, and the state actually being unable to enforce rules.
- 6 Hart-Landsberg (1993) argues that total foreign exchange earnings from Vietnam War-related activities totalled around \$3 billion.
- 7 The development of these trans-national networks by Japanese firms in the 1960s and 1970s can in fact be understood as a precursor to the development of fully integrated supra-national systems of production in the 1980s and 1990s. However, these networks themselves can still be better understood as constituting an attempt by Japanese firms to realise additional profits from competences developed within the domestic core of the firm, through exporting not only physical products but licences, rather than fully integrated supra-national systems of production.
- 8 The 'big push' for self-sufficiency had to be delayed until the foundations for full-scale industrialisation had been laid in light industry. The degree to which a meaningful form of industrial self-sufficiency was achieved was limited by Korea's, unavoidable, technological dependence on Japan.
- 9 Although as we argue later in this chapter Korean firms tended to licence technology from overseas in order to limit R&D spending.
- 10 Indeed by 1980 the industrial deepening drive had effectively bankrupted the state. This should not, however, take away from the fact that the drive was basically a success. By 1980 Korea had achieved a minimal level of industrial self-sufficiency and was a major exporter of steel, arms, ships and electronics (Amsden, 1989; Woo, 1991).

- 11 Following the Korean War and breakdown of rural property systems there was no large-scale capitalist farming in Korea. Land ownership was capped at 7.5 hectares. Almost all rural families owned at least some land and the rural labour market was highly underdeveloped (Gills, 1999).
- 12 It was not actually technically illegal for workers to form independent trade unions. However, the law only allowed one union per enterprise. By establishing a company-controlled union, management could, effectively prevent labour from establishing a democratic union (Hart-Landsberg, 1993).

5 Disintegration of the development state and the failure of economic liberalisation in Korea

- 1 The economy grew by more than 6 per cent in 1981 and more than 25 per cent in 1982 (Hart-Landsberg, 1993: 231).
- 2 Some Korean financing companies have, for no obvious reason, always been called merchant banks. In the 1990s the remaining Korean financing companies acquired the title 'merchant banks'. Whatever they may officially be called they are short-term financing companies, not merchant banks in the conventional sense.
- 3 The profitability problem in Korea prior to the 1997 crisis needs to be understood as quite distinct from the profitability problem that dogged the core capitalist world from the early 1970s onwards. In Korea the problem was largely a micro-level one, major firms were not disciplined by clear monitoring mechanisms and did not actually prioritise profitability concerns. The problem in the core capitalist world was a macro-structural one in that available funds for investment exceeded the opportunities for profitable investment in the real economy.
- 4 External political pressures did not play a dominant role in driving the liberalisation process as a whole. They did, however, play a decisive role in forcing the Korean state to allow foreign financial firms greater access to Korean markets.
- 5 Shin and Chang (2003: 51–3) argue that levels of operating profits and operational margins were responsible if unexceptional within the pre-crisis Korean corporate sector. We fully accept this point. Furthermore, we would stress that it would have been impossible for the Korean economy to have grown as rapidly as it did in three and a half decades prior to the crisis if operating profits had consistently been exceptionally low. However, it remains the case that levels of ordinary profitability were consistently very weak and that returns on assets employed hovered perilously close to cost of capital throughout much of the 1960s, 1970s and 1980s. The essential point that we make about the relatively low level of corporate profits relative to the corporate sector's enormous debt burden and the fragility of Korean firms remains valid.
- 6 Although it is also true that the Korean financial system was simply not very efficient and that this imposed additional costs on industry and generally made the process of financing industrial investment more difficult (Woo-Cumings, 1997).
- 7 Today we could reasonably expect a major firm to invest \$8 billion in developing a new model (Dicken, 2003: 364).
- 8 The cost of a state-of-the-art semiconductor plant today is around \$3 billion.
- 9 Even in the late 1980s many leading Korean firms were not listed on the stock market.
- 10 There was a brief boom in stock market financing between 1985 and 1988. In 1988, stock market financing accounted for 40.6 per cent of corporate finance (Hahm, 2003: 86).
- 11 Although the major *chaebol* were very large, they were also highly diversified. The individual *chaebol* subsidiaries were much smaller than their major competitors.
- 12 The administration was correct in believing that the removal of capital controls would provide at least a short-term stimulus to the Korean economy.
- 13 The MOFE was created in 1993 as a result of a merger between the Ministry of

Finance (MOF) and the EPB. Prior to the merger the FTC had been an office within the EPB (Kim, 1999).

- 14 The plan was updated in 1995 (OECD, 1996b: 40).
- 15 Two of the more spectacular examples of the *chaebol* extreme profligacy during Kim Young-Sam's term in office were Hanro's decisions to borrow \$6 billion in order to build a steel mill and Samsung's decision to enter the car industry. Hanro had a dreadful track record in manufacturing and, unsurprisingly, the steel mill was never completed and the entire group collapsed in early 1997. Even when judged by the standards of the pre-crisis Korean political economy Hanro's decision to enter the steel industry stood out as reckless (Chang *et al.*, 1998: 740; van Hoesel, 1999: 75). The only people who ever believed the project was viable were Hanro's owners and, presumably, creditors. For different, but related, reasons Samsung's investments in car production were equally problematic. Samsung lacked strength in machine-related industries and, more importantly, the Korean, and global, car industries were already suffering acute problems of overcapacity (Chang *et al.*, 1998: 740–1). Samsung motors never recorded a profit before its sale, at a price that fully reflected its loss making status, to Renault in 2000. Moreover, during its brief life Samsung Motors received billions of dollars worth of support from the conglomerate's highly profitable electronics division. The financial position of Korea's strongest firm was, therefore, compromised by its commitments to one of Korea's worst companies. The best overall indicator of the *chaebol*'s wastefulness is the fact that the *chaebol*, collectively, were basically making no money by 1996. Within a liberalised environment the *chaebol* proved to be more feckless and ambitious than any developmental state official (Graham, 2003: 165).
- 16 Although, as we have already argued, for Korean firms to compete on a equal technological basis with their European, Japanese and US counterparts they would have had to massively increase their R&D spending and re-orientate their entire investment strategies.
- 17 These new 'strategic alliances' differed from the longstanding dependent relationships that many Korean firms had historically been, and often still were, locked into with Japanese capital in that Korean firms now sought – often unsuccessfully – the status of equal partners within these new alliances. In order to achieve this enhanced status Korean firms had to jointly develop, and thus jointly own, new products with their foreign partners, rather than simply licence technology developed abroad (Ungson *et al.*, 1997: 110–63).

6 Building institutions for markets

- 1 These policies are dealt with in Chapter 7.
- 2 The first thing the new Chancellor, Gordon Brown, did after taking office was to begin the process of increasing the autonomy of the Bank of England. Interestingly another major theme of British government economic reports has been the importance of recent changes in systems of financial regulation. Shortly after its election, the Blair administration set about creating a unified independent financial regulator, the FSA. The British FSA is very similar to Korea's FSS. The structures of British and Korean financial and monetary governance would appear to be converging!
- 3 The Minister of Finance retains the right to nominate one committee member.
- 4 With the decline in comprehensive planning in the 1980s and 1990s the personal financial motive became increasingly important (Chang, 1998).
- 5 Five of the nine members of the FSC are appointed directly by the President and enjoy security of tenure. The Deputy Head of the BOK and the Korean Deposit Insurance Corporation, both civil servants, and the Deputy Minister of Finance and Economy also sit on the FSC. The members of the FSC are expected to follow certain 'operating principles'. These principles include the obligation to operate in a transparent

- manner, harmonise Korean standards with international norms, protect financial consumers, respect the autonomy of private institutions, strengthen prudential standards and take swift action against institutions which fail to meet these standards (FSC, 2000: 33–5).
- 6 The FSC has also been assigned a ‘special task: implementing and overseeing the restructuring process in the financial and corporate sectors’ (FSC, 2000: 26). The role the FSC has played in promoting the restructuring of the financial and corporate sectors will be considered in more detail in Chapter 7.
 - 7 In the years immediately preceding a serious financial crisis the fact that a regulator may intervene extensively and in a highly illiberal fashion in the market tells us nothing about its fundamental character; under such circumstances the regulator has no choice but to intervene. What matters is the objectives underpinning its intervention. As we shall make clear in our analysis of the concrete processes of financial restructuring in Chapter 7 the FSC interventions aim to create an efficient market-based open financial system.
 - 8 It is difficult to see how a genuinely independent regulator, committed to developing and consistently enforcing a more rigorous set of regulatory standards, could have functioned in pre-crisis Korea. As we have already argued, the development and enforcement of higher prudential standards would have induced a systemic financial crisis.
 - 9 The role foreign investment has played in the financial restructuring process and the importance the state has attached to attracting overseas financial institutions will be examined in some detail in Chapter 6.
 - 10 Figures taken from the Ministry of Commerce, Information and Energy website (www.mocie.go.kr/eng/default.asp).
 - 11 The requirement was reduced from between 1.8 per cent to 3 per cent of revenue to 1 per cent in 2001. It was further reduced to its present levels in 2002 (OECD, 2001: 177; OECDa, 2004e: 123).
 - 12 Under the terms of the 1988 Basle accord, which Korea adopted in 1992, banks were required to maintain a minimum risk-adjusted capital adequacy standard of 8 per cent (Kapstein, 1994: 114–19).
 - 13 Although as our analysis of the concrete processes of financial restructuring in this chapter illustrates the state has taken decisive action against major insolvent NBFIs, albeit not always in a timely manner.
 - 14 This is to overstate the capacity of systems to stabilise the financial system, the establishment of prudential controls offer no guarantee that a major financial crisis will not re-occur. However, the failure to development prudential control almost guarantees crisis. Of course there is a contradiction between the fact that global architects of neo-liberalism demand that financial institutions discipline firms and the fact that these same institutions engage in fictitious accumulation on a truly epic scale.
 - 15 As we shall argue later in this chapter, the disciplinary power of creditors was severely limited anyway by the absence of an effective bankruptcy system.
 - 16 Perhaps the most important consequence of the demise of the state’s monitoring capacity was that the investment plans of the different *chaebol* could no longer be co-ordinated. In the absence of either state controls or market discipline, the *chaebol* enthusiastically invested billions of dollars into sectors where massive overcapacity already existed. Many of the *chaebol*’s investments in the late 1980s and 1990s did simply represent a complete waste of money (Chang *et al.*, 1998).
 - 17 A unified insolvency law was implemented in 2006 which promises to further reduce the costs of closing a business (OECD, 2005: 110).
 - 18 The ‘increase’ in debt-to-equity ratios to over 200 per cent proved to be temporary.
 - 19 Unless otherwise stated profitability ratios for the post-crisis Korean corporate sector are calculated in relation to sales.
 - 20 The discussion of corporate profitability here is deliberately cursory. We shall discuss

- the performance of the cooperate sector in more detail in the following chapter and we are eager to keep repetition to a minimum.
- 21 The implications of greater foreign equity ownership will be examined in the next two chapters.
 - 22 A particularly important point of reference within contemporary debates on corporate governance in Korea is the 1999 OECD Principles of Corporate Governance (OECD, 1999b; 2000b: 57; Emery, 2001: 133).
 - 23 In practice, the distinction between what constitutes direct as opposed to portfolio investment is somewhat messy. A workable distinction, used in most dictionaries of economics, is that direct investment involves participation in management of the firm while portfolio investment does not.
 - 24 Foreign firms investing large sums within FIZs 'are exempt from plant/site fees and receive infrastructure support' (OECD, 2001b: 173).
 - 25 See chapter 7 for a detailed discussion of process of financial restructuring. The parallels with financial reform in the 1980s when the competitiveness of London as an economic space was secured by sacrificing the interests of domestic institutions are obvious. London is a great financial centre but it is one dominated by overseas not British institutions.

7 Corporate and financial restructuring in post-crisis Korea

- 1 Important as inflows of foreign investment have been we should not allow an analysis of such flows to disguise the fact that the central objective of neo-liberal reform has been to discipline domestic actors.
- 2 Although we must recognise that the FSC is ultimately dependent on the central governments to fund its restructuring plans and is, therefore, forced to work closely with the central government.
- 3 These figures were ascertained from the BOK website (www.bok.org.kr).
- 4 By 2005 foreign insurance firms with branches in Korea accounted for 17.3 per cent of the total life insurance sales (*Korean Times*, 2006e).
- 5 Information on changes in the total level of funds held within ITCs is available from the Korean Investment Trust Companies Association (www.kitca.or.kr).
- 6 Prior to the 1997 crisis the Korean state had sought to maintain strict boundaries between different types of financial institutions by clearly stipulating what activities particular types of institution could and could not engage in. Although the new Korean regulatory frameworks emphasise commercial freedom and facilitate the development of multifaceted financial institutions it is still possible to distinguish between different types of institution. It may not be possible to do so in a decade's time.
- 7 Prior to economic liberalisation in the 1980s Korean financial institutions had simply been used to facilitate the state's economic plans. In the years leading up to the crisis, Korean financial institutions continued to play a largely passive role within the economy. Financial institutions focused upon corporate financing and extended credit, in the case of the NBFIs largely to connected firms, without asking too many awkward questions about borrowers' ability to pay or seeking to exert any real influence over borrowers' business strategies.
- 8 Of course legitimate questions can be raised about how well the old financial system worked, as many NBFIs effectively acted as personal piggybanks for their *chaebol* owners.
- 9 Certain Daewoo and Hyundai subsidiaries remain the subject of 'workout' programmes in 2006 (*Korean Times*, 2006f).
- 10 Between 2001 and 2003 Hynix lost \$9 billion.
- 11 In 2004 40 per cent of all SMEs failed to register a profit (OECD, 2005: 158)
- 12 State support has increased the possibility that a core of sound small, technologically

sophisticated firms will develop within Korea. It has not, however, made this outcome inevitable.

- 13 The process of corporate restructuring is far less advanced than the process of financial restructuring.
- 14 ICR is a measure of firms capacity to service interest payments from operating income. If a firm has an ICR of less than 100 per cent its operating income is less than its interest payment obligations and it will be forced to draw upon reserves or fresh borrowing to avoid defaulting on existing loans.

8 The social impact of crisis and neo-liberal restructuring

- 1 This figure was ascertained though an email request to the Korean National Statistics Office.
- 2 The essays within Mishra *et al.* (2004) are guilty of this to varying degrees. See also Kwon (2003) and Lee (2004).
- 3 One of few scholars to seriously examine why the growth of welfare spending has been so limited in post-crisis Korea is Kong (2004). However, Kong's recent work is quite tightly focused on the emergence and demise of tripartite dialogue in Korea. Although Kong is clearly aware of the deep structural changes which has taken place in Korean labour markets and changes in the welfare regime, these changes form the background not the primary focus of Kong's work. While the analysis developed here is broadly commensurate with Kong's the focus of this chapter is fundamentally different.
- 4 On average, workers who took retirement received payments equivalent to 7 months' wages (*ibid.*).
- 5 The role of trade unions in protecting core workers' material conditions will be discussed later in the chapter.
- 6 Workers employed in firms with fewer than five employees were exempt from much of the legislation preventing firms from dismissing competent permanent employees. Workers at other SMEs enjoyed the same fundamental legal rights as employees at larger enterprises (Kim *et al.*, 2000: 139).
- 7 The statistics for the levels of employment within SMEs in 2004 were ascertained from the Small and Medium Business Administration's (SMBA) website (www.smba.go.kr). The method used to present and calculate value added and total investment has changed significantly since 2001. These changes render it very difficult to make direct comparisons between the post and pre 2001 era, hence the use of relatively old figures for value added and investments. However, more recent statistics on Korean SMEs are fully commensurate with the analysis presented here.
- 8 As we made clear in the previous section Korean firms did not suddenly discover the benefits of subcontracting in 1997 and major firms gradually sought to reduce the size of their workforces over the course of the 1990s. It is equally important, however, that we do not underplay the importance of the crisis. The rate at which large firms have shed workers since the crisis is nothing short of phenomenal. In the absence of a major crisis and the new opportunities that the crisis created for capital the proportion of the total workforce employed by major firms would not have declined by half in the five years.
- 9 The changes in the structure of Korean labour markets have not been gender neutral and the proportion of women employees who lack permanent contracts is over 35 per cent higher than the corresponding figure for their male counterparts (IMF, 2002: 30).
- 10 It is difficult to discuss the wage level and conditions of non-regular workers in any depth because of the paucity of data available about such employees.
- 11 In part the existence and growth of such wage differentials may reflect the scarcity and the importance of the transferable skills that workers at large firms possess. However, no one argues that the growing wage differentials between workers at large

- and small firms is simply a result of the 'market value' of the skills workers at large firms possess.
- 12 A notable example of where wage restraint by core workers did improve living standards for the weaker sections of the working class is post-war Sweden (see Coates, 2000). However, this only occurred as a result of a highly complex set of corporatist arrangements that governed wage levels across different industries and sectors, arrangements that ran contrary to basic neo-liberal principles concerning the need to remove labour market 'rigidities' and promote wage flexibility. Furthermore, as we argue later the viability of these arrangements was critically dependent on the existence of a discrete national economy.
 - 13 Nor should we entirely discount the potential for the interests of certain sections of finance capital in maintaining reasonably high positive real interest rates to complicate monetary policymaking.
 - 14 It is important not to caricature contemporary neo-classical work on labour markets. Contemporary neo-classical analysis is not blind to the importance of market structures and institutions. Despite this, however, these scholars continued commitment to methodological individualism prevents them from developing an understanding of labour markets as sites of class conflict. See Fine (1998) for an excellent analysis of recent developments in labour market theory.
 - 15 Permanent employees at small firms with over five employees occupy an intermediate position in the Korean labour market. On the one hand, the firms they work for are on the whole far more precariously placed than major firms and operate within relatively low-value-added labour intensive sectors where the material basis for any form of incorporative relationship with labour has never existed. On the other hand, they do enjoy the same legal protections as workers at large firms and enjoy much greater security than temporary employees.
 - 16 The point regarding the politics of legitimisation is important and we shall expand upon this later.
 - 17 We would argue that the introduction of compulsory training makes the OECD's continued categorisation of the LPP programme as a form of 'passive support' for unemployed problematic. If vocational training is to be made available and support is only afforded to those citizens who are willing to undergo such training we could easily categorise the LPP as a form of active labour market programme.
 - 18 According to the Korean Ministry of Planning and Budget (MPE) the proportion of GDP devoted to public social and educational spending increased by 0.6 per cent of GDP in 2002, increased by 0.3 per cent of GDP in 2003, decreased by 0.1 per cent of GDP in 2004, increased by 0.7 per cent of GDP in 2005 and is projected to fall by 0.1 per cent in 2006. MPE figures are not directly comparable with the OECD's as local government expenditure is excluded from the former. What is interesting about these figures is that they show that social expenditure has been relatively stable since 2001. These figures are available from the MPE website (www.mpb.go.kr).
 - 19 In the third quarter of 2006 unemployment stood at 3.3 per cent (Korean Labour Institute, 2006b: 118). Embedded social norms which place the primary responsibility for the care of those unable to work, due to old age and ill-health, on the family, not the state, are also of vital importance in accounting for Korea's ability to keep official levels of welfare expenditure so low. A detailed consideration of such norms is beyond the scope of the present study. We would direct the interested reader towards Goodman *et al.* (1998).
 - 20 The Swedish social democratic model was a product of a complex political and economic history which generated high levels of working class solidarity (but not necessarily militancy) and an unusually high level of toleration by the labour movement for redistribution from the most productive skilled workers to other sections of the working class. Obviously Korea's political and economic history is very different from Sweden's. See Coates (2000) for an analysis of the Swedish case.

- 21 The student of modern Korean history will be well aware of the similarities between the emphasis that the classical developmental state placed on 'flexibility' and the emphasis that the contemporary neo-liberal state currently places on flexibility. The Korean labour market only developed a substantial degree of rigidity after the partially successful strike wave of the mid 1980s.

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