The 1997 Financial Crisis and the Changing Role of the State in Korea: The Korean Experience

The developmental state and the financial system

Wonseop Song

PhD

University of York

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Abstract

The major aim of this research is to investigate the changing role of the state in South Korea (henceforth Korea) after the financial crisis of 1997. Considering the complexity of Korean dynamics in this period, the change in financial systems and the country's developmental state will be the main points of focus. In order to analyse the main focus of thesis, the research will be simply the process of answering to the questions of, "What has been essential to both state definition and finance in Korea?" and, therefore, "How essential is the state's definition and the role of the state in finance when examining how far Korean state has changed in the aftermath of the 1997 financial crisis?"

In this thesis the core question is this: "How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?" In Korea, as a representative structure of developmental states, the financial system was a kernel of the state-leading developmental plans; in other words, it is how the state could control over 'capital' and execute 'industrial policy' for the state's aim of economic development. Two subordinate issues therefore need to be raised to figure out the outline of the process of the changing role of the state before and after the financial crisis: "Whether state's purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the 1997 crisis was successful or not" and "what was the direction of the financial supervision system reform after the 1997 financial crisis in Korea? And was the direction matched the goal pursued by the state?"

Before the 1997 crisis, Korean developmental state had already been changing in many ways; the success of economic development raised the issue of different roles of the state to previous 'strong', 'economy-centred' and 'coercive' role of the state. However, it is true that the financial crisis accelerated this issue as a crucial subject of the developmental state theory. As Korea has been transformed to different types of state, changing roles of the state has been inevitably required after the financial crisis.

Under this situation, this thesis will conduct some empirical researches to find answers to the main question and subordinate questions.

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Author’s declaration

I hereby declare that I have read and understood the University of York's regulations on plagiarism and academic misconduct. I undertake that all of the material presented for examination within this thesis is my own work, and that it has not been written in whole or in part by any other person but myself. I can definitely confirm that the work in the thesis has not been previously presented for award at this or any other university. I also confirm that any references to other published or unpublished works by any other person or people have been acknowledged and dully credited within this study

Chapter 1
INTRODUCTION

1.1. The focus of this thesis

The major aim of this research is to investigate the changing role of the state in Korea after the financial crisis of 1997. Considering the complexity of Korean dynamics in this period, the change in financial systems and the country's developmental state will be the main points of focus. In order to analyse the main focus of thesis, the research will be simply the process of answering to the questions of, "What has been essential to both state definition and finance in Korea?" and, therefore, "How essential is the state's definition and the role of the state in finance when examining how far Korean state has changed in the aftermath of the 1997 financial crisis?" Although a large number of research products have focused on the East Asian experience of development, many dimensions of the financial crisis of 1997 remain unexplored. Specifically, there are few research products about the contour of the process with regard to the changing role of the state before and after the financial crisis. Furthermore, most research projects are not concerned with the changes in the developmental state and financial system.

In this thesis, the main procedure is finding answers to the core question of "how has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?", as examined through the lens of the changing nature of the financial and related regulatory systems. This occurs on the basis of the belief that a focus on the restructuring of the financial system before and after the 1997 crisis can provide a clue not only to investigate the transformation of developmental states and the changing role of the state but also to identify the political dynamics shaping economic, political, and social reformation. In Korea, which we can use as a representative structure for developmental states, the financial system was part of the state-led developmental plans. In other words, it was the means by which the state could control capital and execute industrial policy to support its aim of economic development. Two subordinate issues therefore need to be raised to figure out the outline of the process of the changing role of the state before and after the financial crisis: “Whether state’s purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the 1997 crisis was successful or not” and “what was the direction of the financial supervision system reform after the 1997 financial crisis in Korea? And was the direction matched the goal pursued by the state?”

Before the 1997 crisis, the Korean developmental state had already begun changing in many ways; the success of economic development raised the issue of the different roles of the state, in contrast to the previous strong, economy-centred and coercive role of the state. However, it is true that the financial crisis accelerated this issue and made it a crucial subject of developmental state theory. As Korea transformed to a different type of state, the state’s roles were also changed after the financial crisis.

This thesis will assume that there are three fundamental variables that affect the changing process of the Korean developmental state before and after the crisis: 1) the changes taking place among institutions that deal with financial systems, 2) the politics between elite bureaucrats and financial policy administrations and 3) the situational factors that pull or push the state to abide by certain changes, such as globalisation, industrialisation, liberalisation and democratisation. Considering these three variables, this thesis will focus on examining the core questions of “How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?”

This thesis can contribute to current researches about the changing role of the state in transformation of developmental states because it will focus on the procedure of growth, crisis and reorganisation in the Korean developmental state. It will examine the process of economic, political and social transformation in Korea from the standpoint of new comparative political economy (Evans and Stephens 1998: 730), not by the existing state-centred perspective. Accordingly, possible answers to the main question of this thesis, “How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?” can be a good guideline for other researches to use when considering other East Asian countries and Newly Industrialising Countries (NICs).

Because it also utilises empirical case studies to investigate the role that the Korean state played in stabilising both the economy and society after the 1997 financial crisis, this study contributes to other research regarding the role of the state in the stabilisation process following a financial crisis. Therefore, another verification aim of this research, which focuses on the understudied aspects of the financial crisis, is to answer the following question: How did the role of the state change in the stabilisation process after a financial crisis. This will be a good textbook for other countries confronting severe financial crises.

1.2. Background

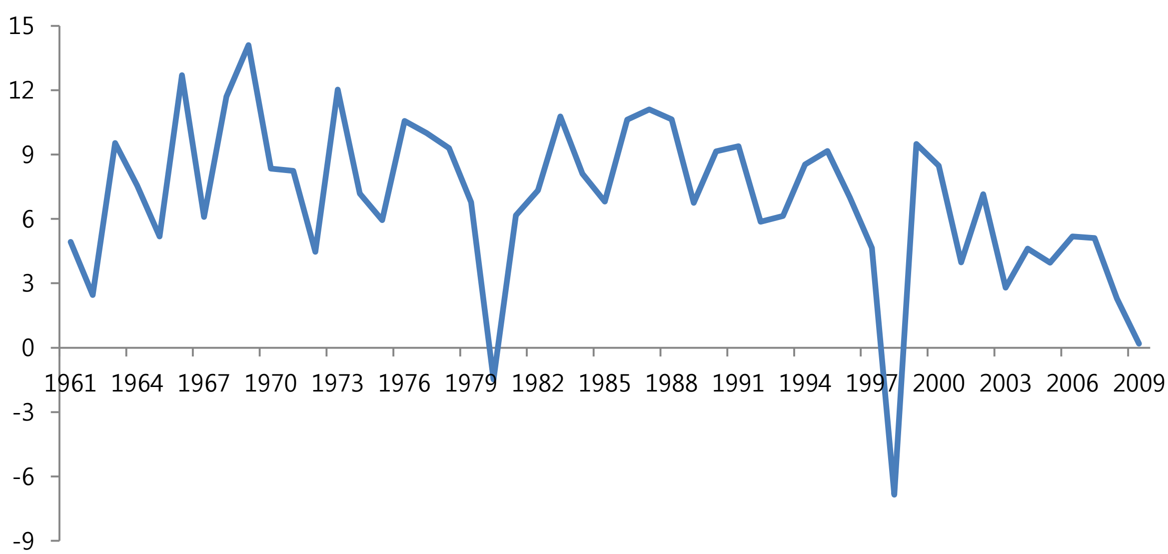
Korea experienced an enormous shock of unprecedented severity in 1997 after decades of uninterrupted high levels of economic growth. Korean economic growth was considered miraculous in that it was one of the fastest rates in the world and succeeded in transforming the industrial structure while maintaining a relatively equitable income distribution. Korea's high economic growth rate has been explained by concepts such as the strong state (Wade 1990: 33), administrative guidance (Johnson 1982: 29) and embedded autonomy (Evans 1995: 51-53). In addition, the path leading to this economic miracle can be illustrated by the relationship between developmental financial policies and economic growth (Shin and Chang 2003: 11-16). However, the economic crisis of 1997 jeopardised the success of the Korean economy. In the winter of 1997, Korea was plunged into the largest financial crisis in its modern history. Unknown to most outsiders, Korea had actually experienced three major financial crises since the beginning of its economic miracle in the 1960s (Chang and Yoo 2002: 372-374). The first was a relatively mild and protracted affair that occurred between 1969 and 1972. During this period, the economy continued to grow, although the rate of growth was not as fast as before.

There was a more severe crisis in 1980 when the economy contracted for the first time since the 1960s. However, even the 1980 crisis pales in comparison to the one in 1997. By the spring of 1998, the Korean economy was in free fall, and many feared that it would not recover for several years. This prediction proved far too pessimistic. Although the economy contracted by 6.7 percent in 1998, it quickly began to recover in 1999. However, the financial crisis of 1997 was by far the severest that the country has ever experienced in its modern economic history.

The 1997 crisis led to a thorough restructuring of the country's economic system, which was created by General Park Chung Hee's military government after he gained control of the government in 1961 through a military rebellion and propelled the country's economic development in the following decades. This system was based on a close collaboration between the state, banks, and *chaebols* (family-owned conglomerates) with the state as the dominant player (Shin and Chang 2003: 1).

The Korean economic system has undergone a variety of changes over time. Since the 1980s, and in particular from the mid-1990s, there have been attempts to restructure the system by reducing the role of the state, deregulating the financial system, and reining in the *chaebols*. After the 1997 crisis, the International Monetary Fund (IMF) and the Kim Dae-Jung government, which came to power right after Korea signed the bailout agreement with the IMF, carried out a wholesale restructuring of the system in the belief that the country's previous economic system was the root cause of the crisis. As a result, the Korean economic system was basically remoulded into an essentially Anglo-American system based on minimal state intervention, arm's-length contractual relationships, and a focus on short-term financial profitability.

<Figure 1.1> Economic growths in Korea (%)



Source: BOK website, World Bank (2010).
Note: The annual growth rates of real GDP.

In this situation, the Asian financial crisis of 1997 triggered fierce debate over the East Asian development model, which is usually called the developmental state theory. Neoclassical scholars argue that the demands of global agents undermine state autonomy and capacity (Aoki, Murdock & Okuno-Fujiwara 1997: 26). Thus, when faced with this crisis, Korea's only option was to accept financial assistance from international organisations, such as the IMF, which demanded the transformation of the country's financial system into a neoliberal economic system in order to constrain the state's ability to manoeuvre within the domestic market. However, proponents of the developmental state theory insist that this crisis paradoxically provided an opportunity to strengthen state capacity and autonomy (Shin and Chang 2003: 81). The state inevitably became the fundamental body responsible for concluding an entente with foreign organisations and meeting their conditions[1]; therefore, a strong state (Wade 1990: 33), administrative guidance (Johnson 1982: 29), and embedded autonomy (Evans 1995: 51-53) were essential requirements needed to overcome the crisis and stabilise the economy and society. In other words, state capacity and autonomy could be strengthened by overcoming the crisis because the state's autonomy “to formulate and undertake goals that are reflective of the demands or interests of the IMF programme and the state” and the state's capacity “to implement official goals (the IMF programme), especially over the actual or potential opposition of powerful social groups (labours and capital) or in the face of recalcitrant socioeconomic circumstances” (Skocpol 1985: 9) were prerequisites for dealing with the crisis. Accordingly, the state became very important as a distributor of financial resources to ensure the success of the stabilisation plan (IMF programme in Korea) and as the principal agent for implementing innovative programs and monitoring them.

Although there are two contrasting views (one view that the crisis weakened state capacity and autonomy, and the other view that the crisis paradoxically provides an opportunity to strengthen the state autonomy and capacity), it is true that developmental states, including Korea, were already changing before the crisis occurred. Therefore, there have been many changes in the main features of developmental states, such as the state capacity and autonomy and strong,

[1] For an instance, the IMF programme instituted in Korea after the crisis consisted of three elements: (1) macroeconomic retrenchment, (2) market opening, and (3) structural reform (Shin and Chang 2003, 54-58)

effective, efficient, and cohesive bureaucracy with embedded autonomy (Evans 1995: 43-54). However, the financial crisis accelerated the issue of 'the transformation of developmental states and the changing role of the state' as a crucial subject in the developmental state theory.

1.2.1. Why Korea is interesting as a case study of developmental state theory

The Korean miracle of economic development since 1960 has been mainly explained by the concept of the developmental state (Johnson 1999: 38). The features of the Korean developmental state can be compactly illustrated by two main factors: "the regulation of industrial capital through financial support" (Amsden 1989: 13-14) and "the economic discipline based on politically independent bureaucracy" (Amsden 1989: 11-18; Wade 1990: 195-227; Evans 1995: 43-73). In a nutshell, the Korean state had both the state capacity and autonomy to manage industrial policy for the aim of economic development, and strong, effective, efficient, and cohesive bureaucracy with embedded autonomy to successfully execute its economic growth plans for the era of the economic miracle. More specifically, the Korean state has managed financial resources as leverage in industrial policies; the state has lent industrial capital to firms with economic development plans, eventually making the industrial capital follow the state policies. As a matter of fact, the Korean state has successfully intervened in markets using this procedure (Ryu and Chang 2001: 123-126).

The Korean state has exerted its influence on industrial capital as follows: the state → financial capital (bank) → industrial capital (*chaebols*). It means the Korean state has first exercised its high level of "state capacity and autonomy" on capital for rapid economic growth, and second, it maintained its "coherent, meritocratic bureaucracy" with "embedded autonomy" for the state's aim (Sonn 1998a: 158).

Based on the high level of state capacity and autonomy described above, the Korean developmental state could intervene in markets very successfully. However, the Korean state had a distinct resource allocation and competitive mechanism, qualitatively different from its market mechanism. Also different from other East Asian countries, the Korean state has a unique strategy for market intervention (Shin and Chang 2003: 11-16): the Korean markets were actually incomplete (Hattori 2007: 24). The market intervention in Korea should be explained as "market-substituting" (Ryu 2006: 35-37) [2] rather than "market-friendly" (World Bank 1991: 5) or "market-enhancing" (Aoki, Murdock and Okuno-Fujiwara 1997: 8-13). Also, such market intervention is consequently evaluated as efficient no less than the market mechanism (Chang 2006: 100-102). Accordingly, it can be evaluated that the Korean developmental state has a unique feature rather lacked by other developmental states, such as Japan, Taiwan, and so on.

However, the financial crisis in 1997 (a huge shock of unprecedented severity) aroused a controversial debate whether the developmental model of Korea is still valid[3]. There was one assertion that the financial crisis accelerated the transformation of the Korean developmental state to a "regulatory state." In this thesis, a ‘regulatory state’ is a state that emphasizes a limited role for the government, or a state to the market based on a free market model. Basically, unlike a developmental state, a regulatory state does not implement industrial policies for the development of industries, and it does not develop extensive welfare policies as it does not put the public interest ahead of private interests. However, it does not mean that the regulatory state defined in this thesis implements a non-intervention policy that guarantees a completely free market. Instead, the goal of the state is to design and operate a very delicately developed regulatory device in order to encourage a fair market policy. At least in respect to institutional aspects, the Korean developmental state has been gradually transformed to possess feature of regulatory states by domestic and international requirements; in this situation the IMF programme strongly required Korea to restrict state intervention and carry out structural reforms following neo-liberal[4] guidelines.

Based on this assertion, the Korean state has experienced both the crisis stage of the developmental state and the transformation into a regulatory state.

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[2] Ryu (2006) insists that the Korean state created markets through the concept of ‘rent-granting’ by the state, in contrast to the meaning of ‘rent-seeking’ by the people (Ryu 2006: 35-37).

[3] Actually, such debate about the validity of Korean developmental model has been started since the early 1980’s when financial liberalization started (Kim 1999: 157-160).

[4] In this thesis, Neo-liberal (-ism) is an economic concept. Neo-liberalism is a theory that criticizes market intervention by the power of the state, and puts an emphasis on the strong functioning of the market and free activity of the private sector. It was adopted in earnest as a response to the failure of modified capitalism, which adopted the theories of Keynes in the 1970s, and advocates laissez-faire economic principles. Neo-liberalism puts stress on the free market, deregulation and property rights.

The other assertion is that the financial crisis paradoxically provided the opportunity and resources to strengthen the Korean government's autonomy, especially its internal autonomy (Sonn 1998b: 54-62; Shin and Chang 2003: 117-118). However, the state's external autonomy in regard to foreign capital and international organisations diminished as a result of the crisis (Ibid.). Thus, based on this argument, internal autonomy increased because the role of state as a distributor of financial resources and a principal agent for implementing innovative programs and monitoring such procedures was emphasised through the IMF bailout[5]. Accordingly, it can be argued the financial crisis provided the best opportunity to restore both the state's autonomy and capacity. However, the restoration of the developmental state model does not mean simply reverting to the old model; the requirements of the new paradigm's model of the developmental state must be outlined. Based this assertion, the Korean state has experienced both the crisis of the developmental state and the process of reorganisation.

One interpretation of the relationship between the financial crisis in Korea and the rapid economic development of the country focuses on the specific institutions constructed by the state and shows how the degeneration of these entities led to the economic crisis of 1997. In Korea, the state-led financial system was an essential institution for economic development, and the government developed a specific government-bank-business relationship based on control, discipline and cooperation. These specific institutions were built by mixing the state and the market mechanism, and they functioned as a kind of quasi-internal organisation of the whole economy (Lee 1992: 14-15).

This strategy promoted rapid economic growth by allocating financial resources into priority industries and big business despite some problems, such as high indebtedness, bad corporate governance of business and weakness of banks (Krugman 1994: 70-72). As the economy developed, the financial system and the specific relationship started to change, and then the specific institution began to operate poorly. Yet, there was no reformulation of a former institution or building of a new and proper one, and the problems grew more and more serious

[5] Although the aim of innovation program by the IMF requirements were the restriction of state intervention in market and the establishment of healthy market discipline, the main agent of executing such programs was still the state(Ryu 1998: 27-30).

until the incautious financial liberalisation with these problems led the Korean economy to the economic crisis of 1997 (Chang 1998: 1557).

In summary, the features of Korea as a developmental state can be explained through several aspects. The growth, crisis, transformation and reorganisation of developmental states can be explicitly found in the history of the Korean miracle of economic development and the financial crisis. In other words, Korea is one of the best examples to investigate changes in state capacity and autonomy, as well as the strong, effective, efficient, and cohesive bureaucracy with embedded autonomy. The changing role of the state that corresponds to these can also be seen. Although many researches have already discussed Korea as a developmental state, I certainly think that there are complex dynamics of Korea that remain unexplained. Therefore, the analysis of Korean developmental state is worth researching, especially for the theme of this study: the changing role of the state with changes in developmental states. This is a main reason Korea was chosen as a case study for developmental state theory.

1.2.2. Empirical Concern

Most importantly, the changing role of the Korean state after the financial crisis in 1997 cannot be understood merely by referencing the dichotomy between the state and the market or the reorganisation of the developmental state and its reformation into a neoliberal state.

First, we need to examine the state’s unique characteristics, such as state autonomy, state capacity, an efficient and cohesive bureaucracy and embedded autonomy, to understand the nature and process of the changes in the Korean developmental state.

Since the middle of the 1990s, an emphasis on the market-centric theory and a firm belief in neoliberal capitalism has diffused throughout Korea. These perspectives highlighted many limitations in the Korean developmental state. The most important of these shortcomings is the limitations of a state-led financial system, which was the core of most strategies for development (Park 1994: 129-133). In other words, the state's capacity and autonomy to allocate financial resources to certain industries and the existence of a cohesive, meritocratic bureaucracy to supervise these financial distributions were crucial factors identifying a developmental state.

However, it appears this diffusion of the market-centric theory made the restructuring of Korea's financial system into a neoliberal system. Regarding the institutional aspects, the Korean developmental state has gradually been transformed into a regulatory state as a result of domestic requirements.

In addition to these domestic requirements, situational international factors, such as globalisation and liberalisation, have made it difficult to sustain a developmental financial system in Korea. For example, even the state's financial support for domestic industrial development has been regulated by the launch of a WTO regime based on the principles of non-discrimination, reciprocity, market access and fair competition (Hoekman and Kostecki 1996: 24). Furthermore, the most notable change in the Korean financial system resulted from the implementation of an IMF programme in Korea after the 1997 financial crisis. This programme consisted of three elements: (1) macroeconomic retrenchment, (2) the opening of the market and (3) structural reform (Shin and Chang 2003: 54-58)[6].

In a nutshell, the structural reforms in the IMF programme were directed at remoulding the Korean economy in the image of the idealised Anglo-American system in the name of keeping

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[6] In more details, fuller liberalisation of product and capital markets was undertaken. All the trade-related subsidies were abolished and the remaining import barriers like the 'Import Diversification Programme', which was mainly targeted at Japanese imports, were removed. The upper limit to foreigners' domestic shareholdings was eliminated, the bond market was fully opened, and commercial lending was further liberalised. In the financial sector, it was thought that the most serious structural problem lay in the supervision and monitoring system. So the Financial Supervisory Commission was launched as the agency for comprehensive supervision of financial institutions. The supervision standard was tightened by applying the BIS (Bank for International Settlements) capital adequacy ratio, introducing new standard called forward looking criteria (FLC), and so on. The governance of financial institutions was reformed by introducing the external board system in which a significant number of non-executive directors take part in decision-making. The government also closed many unviable commercial banks and non-bank financial institutions, and forced mergers and acquisition (M&As) among them. In the corporate sector, the chaebols structure became the major target of reform, because it was accused of being the cause of 'over-expansion without accountability' that led to the crisis. The chaebols were made to radically reduce their debt-equity ratios, which rose far above 400 per cent at the end of 1997, to 200 per cent in less than two years' time. Loan guarantees and internal transactions among chaebols affiliate firms were prohibited. The chaebols were also requested to concentrate on 'core' business by selling, closing, and swapping 'peripheral' business. The reform of corporate governance was particularly predicated on the perception that the 'dictatorial' management by the 'owner' families was the root cause of their 'reckless' expansion and the consequent national crisis.

up with the perceived global standard: external liberalisation progressed in full; the financial sector was assigned the role of the nerve centre of economic management; the role of the state was confined to supervision of financial institutions and maintaining competitive market order; and companies were required to compete as independent units, rather than as members of business groups. This means that the Korean state seemed to restructure the economic system to a market-centric one under the IMF regime, but can we surely verify or identify those changes in Korea as the features of a regulatory state?

As a result of reforms by internal and external requirements, the external forms of the Korean economic system have been changed to those of the neo-liberal economic system. Along with the changes in the financial system, there have also been many changes in the Korean developmental state, especially in regards to the role of the state. Succinctly speaking, all changes in the financial system and in the Korean developmental state seem to be steps in the procedure of transforming to the regulatory state[7]. If that is the case, has the role of the Korean state been minimised by the neo-liberal reform? Is the role of the state restricted to that of a supervisor? In other words, has a proposition of 'the retreat of the state' (Strange 1996) been empirically verified in the Korean experience? Answers to these questions can be helpful for building on the thesis with a regard to the core question: how has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?

1.3. The analytical structure

To investigate the main focus of thesis and to answer the core question of "*How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?*" through examining changing features of developmental states (state autonomy, state capacity, an efficient and

[7] According to Ahn (2002: 192), the regulatory state is based on free market principles. In contrast to the DS, the regulatory state is guided by regulations for fair market competition rather than by comprehensive intervention in economic affairs.

cohesive bureaucracy and embedded autonomy), the analytical structure of this thesis is as following.

Firstly, the analysis period will be divided into two periods: before and after the 1997 crisis. It is true that there had been many changes in both the Korean developmental state and the role of the state before the 1997 financial crisis, but the crisis revealed this issue to be a crucial aspect of developmental state theory. Additionally, Korea has experienced enormous changes in its state-led financial system, which is the core of developmental states since the 1997 financial crisis[8]. This thesis will therefore take 1997 as the critical juncture for the changes in the Korean developmental state, the roles of the state and the state-led financial systems.

Secondly, for the period before the crisis (1960 to 1997), there will be general explanation of the changes in the financial system and the developmental state in Korea. In order to investigate changes in the main features of the Korean developmental state, state capacity and autonomy and embedded autonomy in the era of an economic miracle of development, the changes in the financial system will be used as an explanatory variable[9]. All of these changes will be analysed in conjunction with the changing role of the state. For the latter period, there will be case studies investigating the change of state capacity and autonomy and embedded autonomy. One of these case studies will be the public fund. In this thesis, the public fund is defined as the special fund set up by the government to support the restructuring of financial institutions after 1997.As one of the crucial methods to restore the financial system and to overcome the financial crisis, the investigation of mobilising, distributing and recovering the public fund can be very helpful to see changes in main features of developmental states. These include 'state capacity and autonomy' and 'embedded autonomy', after the 1997 financial crisis.

Thirdly, for the entire analysis period, there will be an investigation into the relationship between the change of the Korean developmental state and the (economic) bureaucracy. Evans insists that

[8] Although the period between 1980 and 1992 can be regarded as the duration of 'regulated deregulation of the financial system' and the period after 1993 is said to be the time that extensive financial liberalization developed especially in financial opening (Dalla and Khatkhate 1995: 28).

[9] As a good example of neo-liberal financial reforms, there will be explanation of adopting several formal measures of deregulation on interest rates and entry and operation of financial institutions, reduction of policy loans and privatization of commercial banks since the early 1980s

the existence of ‘strong, effective, efficient, and cohesive bureaucracy’ and ‘embedded autonomy’ is the main difference between predatory states and developmental states (Evans 1995: 43-54). Accordingly, the investigation of changes in bureaucracy and ‘embedded autonomy’ will be expected to show changes in Korean developmental state. As to some issues following questions will be asked: 1) What was the role of bureaucracy in the Korean developmental state? How did the role of bureaucracy change in the Korean developmental state? 2) Is ‘Bureaucratic rationality’ (Wade 1990: 195-227) still in Korea or has it disappeared? Whether there is ‘Bureaucratic rationality’ or not, how can it be restored to the best situation? Is it possible? All answers for each question will be sought, especially, surely in accordance with the change of Korean developmental state.

Fourthly, with major findings in this research, the analysis for answering the main question of this thesis will be tried out. By the synthesis of the findings in the researches, this thesis can be helpful for adopting a few theoretical and empirical assumptions.

1.4. A brief introduction of each chapter

The main discourse of this thesis will concentrate on the changing role of the state in Korea after the financial crisis, with focus on the change of developmental state and financial system. However, before addressing these issues through case studies, it is worth investigating the relevant theories and histories of such issues.

Chapter 2 primarily provides theoretical reviews of the developmental state theory. There will be detailed explanations about the developmental state theory, main features of developmental states, critiques and limitations for the developmental state theory. In this chapter, the debate about the Korean ‘miracle’ of economic development will be briefly provided; the neo-classical arguments (market-centric position)[10] vs. the alternative argument (state-centric position) which is summarised as ‘developmental state theory’. Then, based on state-centric position as the concept of ‘developmental state’ (Johnson 1999: 38) is the best method to explain the Korean

[10] It emphasizes free market operations that are not distorted by state intervention as a key of economic success.

‘miracle’ of economic development since 1960, general explanations of the developmental state theory will be added. More specifically, the outline of this theory will be presented, and then main features of developmental states will be summarised as ‘state capacity and autonomy’, ‘strong, effective, efficient, and cohesive bureaucracy’ and ‘embedded autonomy’ (Evans 1995: 43-54) and so on. Then the critiques of the developmental state theory will be continued. These examples include the ambiguity of the concept of state autonomy, overestimation of the national bureaucracy and overlooking international political environment, etc. and finally the conclusion and emerging issues will be presented.

In Chapter 3, it is presumed that the developmental state theory has been changing its focus to the transformation of developmental states and the restoration of state autonomy and capacity; this is a qualitative transformation to the new paradigm’s developmental states and the possibility of state autonomy and the capacity to correct market failure and solve social conflicts. As a representative of developmental states, Korea has also experienced the transformation process. In other words, it can be said that Korea has currently experienced both the crisis and the reorganisation of its developmental state. Furthermore, the financial crisis in 1997 revealed this experience more certainly in Korea and accelerated these issues to become a crucial subject of developmental state theory. After the brief description about the new comparative political economy of the crisis and restoration of developmental states, the analytical framework and methodology for this research will be presented: “the perspective of this research” and “the model of path analysis”, respectively. The chapter will then show how a focus on the restructuring of the financial system after the 1997 crisis can provide a clue not only to investigate the transformation of developmental states and the changing role of the state but also to identify the political dynamics shaping economic, political, and social reformation in Korea. In a nutshell, the reasons for choosing the public fund, the Financial Supervisory System and Korean Bureaucracy as case studies will be added.

Chapter 4 mainly presents historical reviews of Korean developmental state, including specific explanations about the industrial policy, the state-led financial system and unique institutions which can be specific characteristics of the Korean developmental state. However, it will be more focused on the formation and change of the state-led financial system to explain the change of Korean developmental state. In short, this chapter primarily provides background on Korea's developmental state and financial control before the 1997 financial crisis.

In this chapter, in order to show how Korean developmental state operates, with a particular focus on the relationship between the state and the financial system, an interpretation about the development of the Korean economy by focusing on the unique institutions established by the state, and analysis of the changes that led to the crisis will be presented. Then, based on these, critical surveys about changes in the Korean developmental state and changes in financial control in Korea will be added. In other words, it will show the change of Korean developmental state with the change of the financial system and the degeneration of institutions. In this process, there will be expectations to get some suggestions for the answer of the main question of this thesis, "How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?" and also raise the requirement of "redefinition of a new role of the state for further development".

In Chapter 5, it will examine the directions of bureaucratic reform, which was the most critical institutional change made in Korea after the financial crisis of 1997, in order to define the direction of change of the Korean developmental state. According to Chibber (2002), the core of a developmental state is the 'functional nature' implemented by the bureaucratic system of the developmental state, which means that the goal of a developmental state can be achieved if this functional nature is implemented well (Chibber 2002: 951-953). In other words, it is difficult to regard the Korean stare as developmental if the Korean bureaucratic system cannot fulfil its functions properly. Additionally, if the financial reform promoted by the Korean state after the financial crisis in 1997 was not successful, the reasons can be found in the bureaucratic system. So, chapter 5 will provide in-depth research on the formation, the development and the changes of the Korean bureaucratic system.

To empirically examine whether the state's purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the financial crisis of 1997 was successful or not, chapter 6 will trace how the high degree of state autonomy and capacity that appear in the model of a developmental state actually changed amidst the foreign exchange crisis. To do this, chapter 6 will examine the two opposing viewpoints about the change of the Korean developmental state through an analysis of the formation and execution process of the public fund, which was the core policy tool used to cope with the foreign exchange crisis. The state autonomy and the state capacity are shown when the state can direct the financial institutions as to their structure/operations/use of funds. And the public fund was the most direct and core financial policy tool for the government to intervene with the market at the time of the foreign exchange crisis. Therefore, the processes of the formation, input, retrieval, follow-up management and supervision of the public fund are a good basis for an evaluation of the autonomy and capacity of the state. This is even truer because the processes were not merely internal problems of the bureaucracy of the government but had great influence on the relationship among the government, financial capital and industrial capital.

For analysis and examination, chapter 6 will divide the processes of ‘input’ and ‘retrieval’ of the public fund. The input of the public fund refers to the input of an emergency fund by the government into the financial institutions that were suffering from financial pressure due to the foreign exchange crisis. The retrieval of the public fund refers to the process of management and supervision by the government for the managerial normalization of the financial institutions that received benefits. The reason for dividing the two is that the formation and input of funding through policy-making is the process of “financial support” that reveals the ‘autonomy of the state,’ while the management and retrieval of the fund through the evaluation of policies shows the ‘discipline’ ability to supervise and guide the players in the market according to the judgment of the state, i.e., the ‘capacity of the state.’

In Chapter 7, an analysis for restructuring of financial supervision system will be presented to evaluate the direction of the financial supervision system reform after the 1997 economic crisis in Korea, and to address the question of whether the direction matched the goal pursued by the state. Actually, it can be said that the economic crisis of 1997 in Korea was the result of the indiscriminate opening of the financial sector under the ‘neo-liberal ideology,’ at a time when the public supervisory regulation capacity over the financial market had been weakened significantly. So, after the 1997 financial crisis, the Korean state launched the restructuring of its financial supervision system for the purpose of strengthening its weakened supervisory regulation capacity. Accordingly, the purpose of chapter 6 is to determine whether the changes in the financial supervision system after the 1997 financial crisis served the goal pursued by the Korean state.

Chapter 6 will attempt to analyse what kind of success was achieved by the financial supervision system changes made to meet this condition at a time when the strengthening of the supervisory regulation of the financial market was recognized as essential after the financial crisis. To determine this, Korea's financial supervision system changes after the 1997 financial reform will be examined, and then it will be determined whether, as a result thereof, supervisory regulation capacity was strengthened. Chapter 6 will review and evaluate not only the political alignment of the stakeholders in the financial supervision system reform, but also the role that Korean bureaucrats played in the reform process. Also, by citing a few cases to evaluate whether reforms were executed well, the process and result of the reform will be evaluated.

Then, Chapter 8 will present a general analysis in an attempt to answer the large and small questions of the thesis by integrating and analysing the results of the case studies (Chapter 5: Korean Bureaucracy, Chapter 6: Public Fund, Chapter 7: Restructuring Financial Supervisory System) conducted so far. And the process will be analysed from the viewpoint of 'new comparative political economy,' as stated in Chapter 3. In other words, this chapter will try to find out whether Korea recovered its attributes of a developmental state or quickly took the path to becoming a different state. How did the explanatory variables that had changed the Korean developmental state before the financial crisis in 1997 influence the change of the Korean developmental state in the process of overcoming the crisis, through 'financial reform' after the financial crisis? This is the question that this chapter of analysis will answer.

Finally, Chapter 9 will provide a short conclusion. The purpose of chapter 9 is to 1) summarize the results of the research thus far, 2) mention its significance and limitations, and finally 3) add finishing touch to this thesis by describing the researcher's thoughts on the 'role of neo-liberalism and the state' and 'government control' in Korean society.

Chapter 2
THEORETICAL REVIEW

2.1. Introduction

The Korean miracle of economic development since 1960 has been mainly explained by the concept of the developmental state (Johnson 1999: 38). The features of the Korean developmental state can be compactly illustrated by two main factors: "the regulation of industrial capital through financial support" (Amsden 1989: 13-14) and "the economic discipline based on politically independent bureaucracy" (Amsden 1989: 11-18; Wade 1990: 195-227; Evans 1995: 43-73). In a nutshell, the Korean state had both the state capacity and autonomy to manage industrial policy for the aim of economic development, and strong, effective, efficient, and cohesive bureaucracy with embedded autonomy to successfully execute its economic growth plans for the era of the economic miracle. More specifically, the Korean state has managed financial resources as leverage in industrial policies; the state has lent industrial capital to firms with economic development plans, eventually making the industrial capital follow the state policies. As a matter of fact, the Korean state has successfully intervened in markets using this procedure (Ryu and Chang 2001: 123-126).

So, the purpose of this chapter is to highlight the elements of developmental states that played a key role in the evolution of the Korean state and the nature of the transition of the Korean developmental state. In order to satisfy the aim of this chapter, it will examine the debate about developmental state theory, which has contributed significantly to clarifying the nature and configuration of the Korean developmental state. Therefore, the main point of rereading and reconsidering developmental theory in this chapter is to identify which of its arguments can help explain Korea's developmental state transformation, and, more critically, how these arguments can be theoretically synchronised with current developmental studies to investigate the 'changing roles of the state with the transformation of the Korean developmental state'. Succinctly speaking, Chapter 2 will provide theoretical reviews of the developmental state theory; there will be detailed explanations about the developmental state theory, main features of developmental states and critiques and limitations of developmental state theory.

Firstly, in this chapter, the debate about the Korean "miracle" of economic development will be briefly discussed. The neoclassical arguments (market-centric position)[11] will be contrasted with the alternative argument (state-centric position), which is summarised as "developmental state theory." Then, based on the state-centric position, which theorises that the concept of the "developmental state" (Johnson 1999: 38) is the best method for explaining the "miracle" of economic development in Korea since 1960, general explanations of the developmental state theory will be provided. More specifically, the outline of this theory will be presented, after which the main features of developmental states will be summarised, including "state capacity and autonomy," "strong, effective, efficient, and cohesive bureaucracy" and "embedded autonomy" (Evans 1995: 43-54). Then, common critiques[12] of the developmental state theory will be presented; for example, the ambiguity of the concept of state autonomy, the overestimation of the national bureaucracy and the neglect of examining the international political environment. Finally, the conclusion and current emerging issues will be presented.

2.2. Debates on the factors of the successful development of Korea

The Korean "miracle" of economic development has been explained using various theories, such as "Magic of Marketplace," "Confucian Culture," "Strong State" and "External Environment" (Park 1999: 118)[13]. The rapid economic development of East Asia, in particular Korea, has drawn the interest of many researchers and theorists. These theories can be divided into two main categories based on which mechanism they stress, namely the market or the state.

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[11] It emphasizes free market operations that are not distorted by state intervention as a key of economic success.

[12] Despite this research accepting the developmental state's theme and the considerable role of the state, there is a critique that neither the state thesis nor the developmental state thesis can solely explain the developmental state's nature and transition.

[13] To explain the success of Korean economic development, these concepts are the core logics of 'market-centric approach (Neo-classical arguments)', 'institutional approach', 'state-centric approach (developmental state theory)' and 'world system theory or dependency theory' respectively.

The neoclassical arguments (market-centric position) emphasise free-market operations that are not distorted by state intervention as a key to economic success. Early theories argue that economic development in East Asia, including Korea, is a result of minimal state intervention, whether any of those interventions were self-cancelling or market preserving and market liberalisation (Ballassa 1988: 275-278). However, these arguments are refuted by many real-world examples. Thus, there was such heavy state intervention in reality that it cannot be explained as just getting the prices right (Amsden 1989: 11-15; Wade 1990: 34-51). After these critiques, a more elaborate analysis called the market-friendly state intervention approach was presented (World Bank 1993). According to this framework, important factors of economic success in East Asia were macroeconomic stability, export growth (including the best institutional structures for promoting such growth), high levels of savings on and investment in human and physical capital and efficient resource allocation based on the market and exports. This position is more realistic because it acknowledges the positive role of the state and its various interventions in economic development and notes that state intervention used competition based on contests to increase exports. However, it also argues that state intervention should be market friendly in its scope and manner and that selective intervention will fail. These evaluations of the performance of industrial policies are very ambiguous and even the differentiation between market-friendly and selective interventions are not easy to explain (Amsden 1994: 628-629; Lall 1997:123-127). Furthermore, this approach does not examine the nature of the market itself and supports market-conforming policies; similar to neoclassical arguments, it assumes the existence of an ideal market.[14]

The alternative argument (the state-centric position) contains in developmental state theory. It argues the government intervened in the economy intentionally and heavily, even getting the prices wrong in East Asian countries, including Korea. These strong interventions were the most important factor leading to economic development (Amsden, 1989: 18-20; Wade 1990: 306-309).

[14] In reality the market as such is embedded in broad social system and even the appearance of market itself demands proper institutional conditions mostly provided by government. Moreover, other institutions are essential for market operation because it is always incomplete for problems related with transaction cost and information, which are more serious especially in developing countries.(Granovetter 1985: 490-493; Stiglitz 1989: 199-200; North 1990: 109-112)

Strong industrial policies, such as the selective promotion of industries, financial control and various trade protections, are keys to economic success. The conditions for successful state intervention in the developmental state are related to the embedded autonomy and effective capacity of the state (Leftwich 1995: 405-406; Evans: 1995: 50-51; Ahrens 1998: 85-87). First, the state in East Asia has strong autonomy because there are no strong interest groups such as land owners, capitalists, and workers. In addition, there is a long and well-developed bureaucratic tradition that led to the development of the state's strong administrative capacity. Second, a specific relationship between state and society is also an essential factor needed to avoid government failure. Thus, the close, cooperative relationship between the government and the private sector mitigated information problems, and the mechanisms for government control over business, such as subsidies in return for performance, limited rent-seeking. In addition, the principle of shared growth and the use of external threats were also considered helpful for good governance and the implementation of development policies (Campos and Root 1996: 4-10; Root 1996: 212-215). These arguments are more informative than the market-friendly explanation and indicate the important role of the state in economic development. This perspective examines the relationship between state and society beyond a naive statist perspective.[15] However, it should also consider how this relationship changes and how the developmental state evolves during economic development more extensively.

2.3. Market-centric position: Market friendly view and market enhancing view

One of the theories that explain economic growth in Korea is market-oriented theory, which limits the role of the government to enhancing market efficiency. The perspectives that explain economic growth in Korea using market-oriented theory can be divided into the ‘market friendly view’ and the ‘market enhancing view’. This section will first examine the ‘market friendly view’

[15] The limit of state-centric theories or developmental state theories was said to be lack of attention of the relation between the state and the society, in that these are conformed mutually (Migdal 1994: 23-30). They noticed the importance of this relationship and mention ‘embedded autonomy’ or ‘interdependence’ (Evans 1995: 50-51; Weiss and Hobson 1995: 230-234), but they do not analyze the change of this relationship extensively yet (Haggard 1998: 80-82).

based on neoclassical and orthodox economics, and then will explain the economic growth in Korea from this point of view. And then, the new viewpoint of the 'market enhancing view' – as it is said to be different from other points of view (neoclassical arguments and developmental state view) – will be summarized briefly and economic growth in Korea will also be explained using this viewpoint. Finally, criticisms of the viewpoints that look at the Korean economy with these market-oriented views will briefly be introduced.

2.3.1. Market friendly view

There has been an argument that East Asian economic development can primarily be explained by the macroeconomic stability that provided proper incentives for investment and saving as well as high human capital accumulation, while the intervention of government in specific industries was at best irreverent, or, worse, had a harmful or distortive effect on the allocation of resources. In the sense that this view approves only of those government actions that facilitate the development and efficiency of market, it was referred to as the market friendly view by the World Bank's *World Development Report 1991*. The market friendly view expects that most economic coordination cam be achieved through the market mechanism and that when markets alone are insufficient, other private sector organisations, such as intra-firm coordination, will suffice. The role of government in this view is limited to providing a legal infrastructure for market transactions and providing goods subject to extreme market failure.

Economic growth in Korea can also be explained with such a 'market friendly view.' In this respect, the best reports analysing the economic growth of Korea are '*Korea; Managing the Industrial Transition'* and '*World Development Report 1991*, published by World Bank in 1987 and 1991, respectively. First, *Korea; Managing the Industrial Transition* summarizes Korea's economic growth as follows:

> *Korea has managed to be pragmatic and flexible in the conduct of both its macroeconomic and industrial policies, that even in the presence of economic biases it has been careful to integrate the components of its incentive policies to be at least modestly pro-export, and that it has tried as much as possible not to move contrary to market signals. There have clearly been lapses in policy, although even during the HCI episode, which proved costly, exports remained the ultimate objective which forced industry to be competitive at world prices.*

> *Now that Korea is moving into perhaps the final phase of its industrial transformation -- having successfully moved from an agricultural economy to a manufacturing economy based on productive labour and partially to a capital-intensive exporter--it faces new challenges. The move to higher technology and skill output will require a continued favourable climate of economic management supplemented by ever-more efficient markets and continually less direct intervention in those markets (World Bank 1987: xiv).*

And, *World Development Report 1991*, which specified the research viewpoint as a 'market friendly approach' (World Bank 1991: 6), explains the economic growth of Korea like this:

> *Undoubtedly, this economy is an example of spectacularly rapid development. But analysts differ as to the causes. The growth rate during the period 1960-87 in Korea was 9.0 percent. Social indicators have also improved rapidly. Korea continued its import substitution approach in the 1960s. A strong export drive was also launched in the 1960s. After experiencing economic difficulties in the late 1970s, Korea pursued a more and more liberal approach in the 1980s. During the period 1960-87, the annual growth of total factor productivity (TFP) was an estimated 1.7 percent in Korea. Income distribution compares very favorably with that of other developing economies, though it is estimated to have worsened (World Bank 1991: 39).*

After all, a 'market friendly view' is a viewpoint which stresses purely economic factors based on 'Neoliberal Economics.' Thus, based on such a viewpoint, the growth of the Korean economy can be summarized in two words – industrialization and globalization. The share of the industrial sector (manufacturing, construction and public utilities) in total value-added more than doubled from 17 percent in the 1950s to 38 percent in the 1980s and has fluctuated around this level ever since. The service sector has also increased its share from 41 percent in the 1950s to 60 percent in the 2000s. By contrast, the primary sector has experienced a precipitous fall in its share from 42 percent to 3 percent in the same period. Along with rapid industrialization, integration into the global economy accelerated, as indicated by total trading volume, which rose from about 10 percent of GDP in the 1950s to 80-90 percent in recent years. Cross-border capital flows also increased rapidly in this period (Sakong 2010: 3). In addition, such a viewpoint explains the role of the government in Korea's economic growth as follows. Government interventions should be limited to those areas where market failure is clearly present. For examples, support for SMEs should be focused on start-up companies that suffer from information asymmetry. At the same, greater efforts should be made to strengthen market competition. Market-led growth is not equivalent to laissez faire; on the contrary, government needs to actively promote competition between producers, speed up market opening, regulate monopolies, and protect consumers. It should be kept in mind that competition is the main driver toward innovation and TFP growth (Koh 2010: 76).

In other words, in this way, the economic growth of Korea was first characterized by industrialization and globalization, and secondly what was important was ‘minimal government intervention,’ in which the role of the government was limited to minimizing market distortion in order to carry out the ensuing policies successfully. This method of explanation and viewpoint can be called a ‘market friendly view.’

In addition, a closer look at the growth of the Korean economy from this viewpoint will lead to two kinds of methodologies used for the research of different speeds of economic growth. The first is ‘growth accounting,’ which approaches the issue from the supply side and explains performance from the perspective of supply of capital and labour input and increase in productivity.[16] The second is ‘cross-country growth regression’ analysis, which is, to sum it up simply, a methodology summarizing the relative importance of various supply- and demand-side elements to economic growth in a short form (Eichengreen, Perkins and Shin 2013: 13-14). Firstly, according to ‘growth accounting’ analysis, the growth of the Korean economy was made possible by the rapid accumulation of capital, the increase of the labour force in modern sectors, and the rapid increase in productivity achieved by these input factors. In addition, it is explained that TFP (Total Factor Productivity) rose rapidly as a result of comprehensive economic reforms in the 1960s and 1980s, and as a result, a high ROE (return on equity) was achieved and investment was facilitated, which became important factors in Korea’s economic growth (Ibid. 48). On the other hand, ‘cross-country growth regression’ analysis explains that an export-oriented policy and change of systems like the open economy policy were the most important factors in the growth of GDP and productivity in Korea (Ibid. 49). Ultimately, these analyses are weighted too much towards economic factors, making them only statistical and quantitative analyses in their character.

[16] In fact, variations of the first methodology have been widely used to analyze the Korean economy’s extremely rapid growth from the 1960s to the 1980s.

Finally, the following interpretations may be used to explain Korea's economic growth 'descriptively and in detail' from this viewpoint. The first interpretation is that the foremost driving force of Korea's economic growth is its excellent and diligent labour force. The 'endogenous growth model' explains the economic growth based on such excellent human capital, and explains that the miracle of the Korean economy was enabled by the excellence and diligence of Koreans and their enthusiasm for education. The second interpretation is that the input of 'efficient capital' in addition to such excellent labour force in quantity and quality was another force driving the growth of the Korean economy. The government and the private sector worked together to quickly put capital into industries in order to achieve the goal of economic growth, and the Korean economy was able to grow on the basis of sufficient capital. The third interpretation is that technological progress was the power that built the Korean economy. It is obvious that if a certain quantity of capital and labour are put in, a better technology can yield several times the output. This 'market friendly view' explains that technological progress was the core element that triggered the development of key industries in the ruins of war, and led the rapid growth of the Korean economy for 60 years. The final interpretation in this view highlights Korea's excellent strategies as the driving force of the growth of the Korean economy. Korea adopted a strategy of intensively developing several key industries, including automobiles, shipbuilding, semiconductors and petrochemicals, and this is still the basic strategy that is in use. Moreover, the state of Korea adopted market-opening and export promotion strategies in the belief that only exports could lay the foundation for a self-supporting economy and enable the country to overcome long-time despair and poverty with hope and pride, and the results were very successful.

Explaining the growth of the Korean economy with the factors of labour, capital, technology, strategy, etc. like this is a 'market friendly view,' which interprets that ultimately miraculous growth was achieved because the state of Korea adapted well to the market.

As we have examined so far, any explanation of the economic growth of Korea from this viewpoint tends to lean too heavily on extremely statistical and quantitative analysis, or tries to identify the reasons for economic growth with many specific economic factors such as labour market, capital market, foreign exchange market, export & import, and productivity. Ultimately, the characteristic of this 'market friendly view' starts from the proposition that minimal intervention of the government for an 'efficient market' should be the basis for economic growth, and the reasons for economic growth are found not in the government but in the market.

2.3.2. Market enhancing view

The market-friendly view expects that most market imperfections can be resolved by private-sector institutions, whereas the developmental-state view (a detailed explanation will be provided later) looks to government intervention as the solution. In this sense, these two views consider the role of government and that of market (or, more broadly, market-based institution) as substitutes, with competing roles for the resolution of market failures.

There is a suggestion of third view: the market-enhancing view (Aoki, Murdock, and Okuno-Fugiwara 1997: 1-2). Instead of viewing government and the market as the only alternatives, and as mutually exclusive substitutes, there is a suggestion of another role of government policy to facilitate or complement private-sector coordination. This view is based on the premise that private-sector institutions have important comparative advantages *vis-à-vis* the government, in particular in their ability to provide appropriate incentives and to process locally available information. There is also recognition that private-sector institutions do not solve all important market imperfections and that this is particularly true for economies in a low state of development. The capabilities of the private sector are more limited in developing economies. The market-enhancing view thus stresses the mechanisms whereby government policy is directed at improving the ability of the private sector to solve coordination problems and overcome other market imperfections.

From this view, in analysing the capability of government to facilitate private-sector coordination, the behaviour of government should be treated as constrained by its limited information-processing capacity and the incentives of government can be seen to be influenced by the political economy of its institutions and interactions with the private sector. This implies that government should be regarded as an endogenous player interacting with the economic system as a coherent cluster of institutions rather than a neutral, omnipotent agent exogenously attached to the economic system with the mission of revolving its coordination failures.

For example, the economic growth of Korea can be explained as follows from this viewpoint (Cho 1997: 228-229). The Korean government targeted industrialization and achieved it by allocating cheap credit to large industrialists, forcing them to build industries and increase their exports, while threatening to withdraw the credit if they did not perform up to par. As an additional result, depositors were paid lower rates of return on their deposits but they were rewarded as wage earners with the expansion of job opportunities and the increase in real wages, Rapid income increases contributed to the accumulation of domestic savings and the subsequent expansion of the financial market. What made this approach work in Korea? This question cannot be answered completely. But, what contributed most to the effectiveness of government intervention from the Korean economic development standpoint seem to be effective economic management and the competitive business environment. In Korea, close consultation between government and business and the government's risk partnership with business made what could have been a much distorted investment approach into quite an effective developmental strategy. When the risk capital market was poorly developed, the Korean government controlled banks and affected a close relationship between government, banks, and industry, and thereby made itself an effective risk partner with industry. This implicit coinsurance scheme among the government, industries, and banks allowed the credit-based economy and its highly leveraged corporate firms to explore risky investment opportunities and to operate without the danger of major financial crisis.

According to their claim so far, the market-friendly view emphasizes the role of private-sector institutions, the developmental state view emphasizes government intervention, whereas the market-enhancing view emphasizes the role of government policy in promoting private-sector coordination. However, as explained earlier, what the market-friendly view considers to be most important is the private sector, but at the same time it mentions the role of the government in many cases. In other words, the role of the government or the state that is asserted in the market-enhancing view is not much different from the role claimed in the market-friendly view. This researcher thinks that the two views are not greatly different, as they both establish theories that limit the role of the government or the state to enhancing market efficiency and examine the economic growth of Korea from such a viewpoint.

2.3.3. Critiques

The criticisms of looking at the Korean economy from a market-oriented viewpoint can be summarized largely by the two categories as follows. Firstly, the scholars who look at the growth of the Korean economy from this perspective do not like political intervention with the market. Because they claim that markets are inherently efficient. But history shows that markets are created. This is to say that in a functioning society markets are shaped and re-shaped by political power. Without the dispossession of landlords in Korea, there would have been no increased agricultural surplus to prime industrialisation. Without the focus on manufacturing for export, there would have been no way to engage tens of millions of former farmers in the modern economy. And without financial repression, it would not have been possible to pay for an accelerated economic learning process. In all of the above, markets and competition were made to serve development.

Secondly, there is no significant economy that has developed successfully through market centred policies, policies of free trade and deregulation from the beginning. Looking back upon the economic history of Korea, the Korean economy began to grow with the 5-year economic plans led by the government during the 1960s, and it was the intent of the Korean state to make the heavy and chemical industries the centre of economy during the 1970s. Also, many economic policies implemented since the 1980s were established based on the state's goal of achieving economic growth through active intervention. What have always been required for Korean economic growth were proactive state's interventions that foster early accumulation of capital and technological learning.

In short, this researcher thinks that attempts to explain the growth of the Korean economy from a market-oriented viewpoint ignore the historical facts, as they miss the most important factor in the growth of the Korean economy – the role of the state.

2.4. State-centric position: Developmental state theory (and its critiques)

Another theory explaining the economic growth of Korea is a state-centred theory represented by the theory of the developmental state. In this thesis, the concept of the developmental state (Johnson 1999: 38) is regarded as the best method to explain the miracle of Korean economic development since 1960 for the reasons set out above. In summary, the features of Korea as a developmental state can be compactly illustrated by two main factors: the regulation of industrial capital through financial support (Amsden 1989: 13-14) and economic discipline based on a politically independent bureaucracy (Amsden 1989: 11-18; Wade 1990: 195-227; Evans 1995: 43-73).

The Korean state used financial resources as leverage in its industrial policies. Through the allocation of these funds, the government forced industrial capital to follow state policies. As a matter of fact, the Korean government intervened in markets through this process (Ryu and Chang 2001: 123-126). The Korean state exerted influence on industrial capital in the following direction: the state → financial capital (banks) → industrial capital (*chaebols*). This means the Korean state exercised a high level of autonomy in relation to capital, leading to rapid economic growth (Sonn 1998a: 158).

The features of the Korean developmental state were previously summarised. However, to fully clarify the nature and configuration of the Korean developmental state and to critically investigate the changing role of the state during the transformation process, it is essential to look at developmental state theory in detail.

2.4.1. Developmental state theory

The developmental state (DS) thesis is a second-generation theory that explains economic development in NICs (newly industrialising countries). It challenges the first-generation theory presented by neoclassical economists and the World Bank, which contended that the dynamic economic development of NICs was possibly a result of laissez-faire economic policies and an open economy and that state intervention complied with market principles. The DS theory is based on the classical concept of Weberian bureaucratic organisation, which is characterised by hierarchical organisation, specialised job responsibilities, merit-based hiring, performance-based promotion, rule of law and occupational officials (Weber 1978: 956–963). In addition, this approach emphasises the idea that the state is not a subordinate actor in the world system; it is an independent actor (Evans et al. 1985)[17].

Most importantly, in this theory, the state is regarded as the main promoter of economic development and social redistribution as well as an agent that shapes social and political processes, although it is also influenced by society.

This view of the state as an actor is strongly related to the research focusing on the importance of the state in development. In *Bringing the State Back In*, Evans et al. examine a state's capacity to pursue specific kinds of policies and the level of state autonomy needed to formulate and undertake goals that are not reflective of the demands or interests of specific social groups (Evans, Rueschmeyer and Skocpol 1985: 9-28).[18] To do this, they focus on the state in relation to particular kinds of socioeconomic and political environments populated by actors with given interests and resources (Ibid.). Regarding the determinants of state autonomy and state capacity, they conclude the "states may be viewed as organisations through which official collectivities may pursue distinctive goals, realising them more or less effectively given the available state resources in relation to social settings" (Ibid.). Furthermore, Rueschmeyer and Evans argue the state must acquire a certain degree of "relative autonomy" from the dominant class in order to promote economic transformation effectively (Evans and Rueschmeyer 1985: 49).

Based on these state-centric approaches, DS can be defined as "states whose politics have concentrated sufficient power, autonomy and capacity at centre to shape, pursue and encourage the achievement of explicit developmental objectives, whether by establishing and promoting the conditions and direction of economic growth, or by organising it directly, or varying a

[17] This is also called as Neo Weberian's view (Yoon 2002: 21-22) against the world-systems theory or dependency theory which stresses that world-systems (and not nation states) should be the basic unit of social analysis (Wallerstein 1979: 66-94). The world-systems theory or dependency theory can be evaluated as one of methods to explain the economic development in Korea (Choi 1996: 24-25).

[18] The DS theory raised by Evans et al. is not entirely new thesis. Many conceptual insights are derived from such giants of developmental economics literature as Gerog F. List, Alexander Gerschenkron and A. Hirschman. Evans et al. can be regarded as successors to elaborate such giant assertions that emphasize the leading role of the state for economic development.

combination of both" (Leftwich 1995: 401). However, Chalmers Johnson was the first to conceptualise the developmental state. In *MITI and the Japanese Miracle*, he notes:

> *In states that were late to industrialise, the state itself led the industrialisation drive, that is, it took on developmental functions. These two differing orientations toward private economic activities, the regulatory orientation and the developmental orientation, produced two different kinds of business-government relationships. The United States is a good example of a state in which the regulatory orientation predominates, whereas Japan is a good example of a state in which the developmental orientation predominates (Johnson 1982, 19).*

Johnson indicates that a *plan-rational* bureaucratic apparatus called MITI (the Ministry of International Trade and Industry) was the main reason for the successful economic development in Japan. He also categorised these types of states as *plan-rational*, *market-rational* and *plan-ideological* (Johnson 1982: 17-34)[19]. Based on the history of MITI, Johnson demonstrated the essential features of a developmental state (DS): The first element of the DS is the existence of a small, inexpensive, but elite bureaucracy staffed by the best managerial talent available in the system. The most accurate term for these members of the bureaucracy is not professionals, civil servants, or experts, but managers, and they should be rotated frequently throughout their economic service. The duty of this bureaucracy is, first, to identify and choose the industries that should be developed, thus creating their industrial structure policy; second, to identify and select the best method to develop the chosen industries rapidly, thus creating their industrial rationalisation policy; and third, to supervise competition in the strategic sectors in order to guarantee their economic health and effectiveness. The second element of the DS is a political system in which the bureaucracy is given sufficient scope to take initiative and operate effectively, which means that the legislative and judicial branches of government must function as "safety valves." The third element of the DS is the perfection of market-conforming methods of state intervention in the economy. In implementing its industrial policy, the state must take care to preserve competition to as high a degree as is compatible with its priorities (Johnson 1982: 315-320). This is necessary to avoid weakening state control and the inevitable inefficiency, loss of incentives, corruption, and bureaucratism it generates. The fourth element of the DS is a pilot organisation such as MITI.

[19] The developmental states such as Japan and Korea can be regarded as *plan-rational*, the regulatory states such as the US and UK can be categorized as market-rational (Ibid.)

Since the publication of Johnson's study, many scholars have elaborated on the concept of DS. First, this concept has been expanded to explain regional economic development in Asian countries, such as Korea, Taiwan (East) and Singapore (Southeast), and in Latin American and African nations.[20] Second and more importantly, Peter Evans argued the crucial reason for successful developmental states, such as Korea, is a balance between state autonomy in relation to society and embeddedness; he developed the concept of embedded autonomy to explain the idea of state autonomy (Evans 1995: 3-20). In *Embedded Autonomy*, he states:

> *A state that was only autonomous would lack both sources of intelligence and the ability to rely on decentralised private implementation. Dense connecting networks without a robust internal structure would leave the state incapable of resolving 'collective action' problems, of transcending the individual interests of its private counterparts. Only when embeddedness and autonomy are joined together can a state be called developmental (Evans 1995, 12).*

In other words, this apparently contradictory combination of autonomy and embeddedness provides the underlying structural basis for successful state involvement in industrial transformation and development (Ibid. 12-13). Thus embedded autonomy, which is the mirror image of the incoherent despotism of the predatory state, is the key to a developmental state's effectiveness (Ibid. 43-50). Evans found that both predatory and developmental states can be regarded as "strong" states because both have "despotic power"[21] and "infrastructural power;" [22] however, there are variations in both states as a result of underlying differences in state structure and state-society relations (Ibid. 44-45). He regarded Japan, Korea and Taiwan as models of the "developmental state." [23]

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[20] The representative literatures are Alice H. Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (Oxford: Oxford University Press, 1989); S. Haggard, *Pathway from the Periphery* (Ithaca: Cornell University Press, 1990); Robert Wade, *Governing the Market: Theory and the Role of Government in East Asian Industrialization* (Princeton: Princeton University Press, 1990); Linda Weiss and John M. Hobson, *State and Economic Development: A Comparative Historical Analysis* (Cambridge: Polity Press, 1995); Meredith Woo-Cumings (eds.*), The Developmental State* (New York: Cornell University Press, 1999).

[21] Michael Mann (1984, 188)

[22] Ibid., 189

[23] He also regarded Zaire as the model of the "predatory state" and India, Brazil as the model of the "Intermediate state" (Evans 1995: 45).

Meanwhile, Virek Chibber criticised the view of the statist exaggeration as a way to explain the origins of the developmental state. He stated that successful developmental states such as Japan and Korea have unique features not because the states have dominance over capital, but because the states have an alliance with local capitalists who have the same objective of "economic growth" (Chibber 1999: 312). From his analysis of Korea, he also summarised the main features of the developmental state as the state's general dominance over all classes and the state's ability to achieve a position of dominance over its business class through a series of reforms. These reforms included measures that increased the institutional coherence of the state (such as the creation of a pilot agency) but centered most crucially on the usurpation of control over finance (Ibid. 311). Chibber concluded in his article, "*Building a Developmental State*," that:

> *This analysis of the origins of the developmental state in Korea thus affirms the centrality of state intervention in the remarkable industrial transformation of the country. But it does so in a fashion that renders it consistent with the larger literature on the state in capitalist societies. The Korean state was exceptional not because it was able to ignore the constraints that bedevil most capitalist states; it was exceptional because of the manner in which it accommodated itself to those constraints (Ibid. 338-339).*

However, the pioneer in exploring the reasons behind Korea's phenomenal growth was A. Amsden, who emphasised subsidies and discipline as the main elements of Korean economic development. In other words, the role of the state as entrepreneur in allocating its subsidies to selected industries under the sternest disciplines was the key to the economic 'miracle' (Amsden 1989: 11-18).[24] In addition to this, R. Wade analysed Taiwanese economic development to present the 'governed market theory'[25] as a substitute for 'free market theory' in explaining East

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[24] The sternest discipline imposed by the Korean government on virtually all large size firms related to export targets. And, firms have been subject to four general controls in exchange for government support. First, the government has owned and controlled all commercial banks. Second, in luring firms to enter new industries with the plums of protection and subsidies, the government has imposed discipline by limiting the number it has allowed to enter (although usually to not fewer than two firms per industry). Third, discipline has been imposed on "market-dominating enterprises" through yearly negotiated price controls, in the name of curbing of monopoly power. Fourth, investors have been subject to controls on capital flight, or the remittance of liquid capital overseas (Ibid, 16-18).

[25] The political economy approach interprets East Asian success as the result of a higher level and different composition of investment than in less successful countries. The difference in investment is due, in important if difficult to quantity part, to government actions to constrain and accelerate the competitive process. These actions were carried out by a relatively authoritarian and corporatist state. We called this the governed market theory of East Asian economic success (Wade 1990: 297)

Asian industrialisation. Similar to Amsden's literature, he insisted that state 'administrative guidance'[26] has been crucial for successful economic growth in Taiwan (Wade 1990: 284-306). When the main reasons for successful economic development in Korea and Taiwan are combined, it is clear that the historical embodiments of the developmental state display much variation, but the fundamental features of Evan's 'embedded autonomy' seem to be visible as a central theme.

Recently, DS theory has been a popular topic of discussion, especially the role of the state in economic development and economic crises. Ha-Joon Chang is a representative scholar of DS theory who is popular for attempting to construct a theoretical alternative to neoliberalism and for criticising neoliberal thinking that preaches the virtues of unregulated markets and recommends deregulation, opening up, and privatisation. The majority of his findings are focused on more empirical issues through common theoretical threads, which he calls the institutionalist political economy approach (Chang 2003: 3)[27]. Chang has provided some criticism of neoliberal theories, pointing out the limitations of two dominant theories of state intervention, namely, welfare economics and neoliberalism. He then proposed an institutionalist theory to overcome these limitations (Chang 2003: 36–38, and 69–70). In other words, he added an institutionalist view to the existing DS theory to explain the reasons for economic development and the process of structural change in the modern economy. The DS theory, as Chang pointed out, both rejects the assumption of market primacy that underlies neoclassical economies and emphasises 'the role of the state'. He insists that there are two roles of the state that are especially crucial in economic development, namely entrepreneurship and conflict management (ibid.)[28].

Also, he noted in his article, *State, Institutions and Structural Change*:

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[26] Taiwan's industrial officials are engaged with the bigger industrial firms in relations that would be called "administrative guidance" in Japan (Ibid. 284).

[27] Accordingly, he is sometimes regarded as one of Institutional developmental state theorists.

[28] The roles of the state as entrepreneur and conflict manager have been important in Korean economic development since 1960's. Accordingly, the Korean economic system, which was based on a close collaboration between the state, banks, and the chaebols, with the state as the dominant player, was therefore often known (somewhat misleadingly) as 'Korea Inc.' (Shin and Chang 2003: 1).

> *The role of the state as the entrepreneur and the conflict manager will be constrained by many factors, even if the state possesses the administrative capacity to perform such functions (obviously, some states do not possess such capacity). Its autonomy* vis-à-vis *interest groups will determine how effectively it can institute a new property rights structure and manage conflicts in the way it wants. Many states certainly are lacking such autonomy. Even for a highly autonomous state, the prevailing ideologies, institutions and political agenda of the society will set a limit to its innovativeness in the design of coordination structure and of conflict management system (Chang 2003, 70).*

In his analysis regarding economic development and structural changes in a modern economy, the state is the most important agent and plays a crucial role as one of the institutions influencing the economy. He is therefore really trying to investigate an adequate understanding of certain fundamental issues surrounding the role of the state (Chang 2003: 97).

The DS theories, as described above, were developed by many scholars and have been formed on an empirical basis and through exhaustive analysis of actual examples. So, these theoretical structures have been regarded as being persuasive in analysing East Asian economic development. Features of developmental state theories can be summarised as follows (Lee 2003b:101):

1) Economic development goals of the state achieved through nationalism's integration and national mobilisation

2) State autonomy from dominant private interest groups

3) Discretionary and selective intervention by the state to foster strategic industries and a good level of connectivity between the state and society, termed as embeddedness

4) The state's management of social conflicts and an exclusion of public participation

5) Strategic and selective integration into the world economic system

Accordingly, it can be said that Korean developmental state could achieve its economic development goals very quickly and effectively with relative autonomy from dominant social classes and embedded autonomy by allocating national resources to strategic industries through the discretionary and selective intervention of the government.

2.4.2. Characteristics of the developmental state

Though it is true that the viewpoints of the developmental state in Korea have changed much after 1997, the basic characteristics that can define a developmental state have not changed. For this reason, I would like here to discuss several characteristics of a developmental state, which is an essential concept for the development of the thesis in the future. According to the state-centric theory of the state, especially the approach developed by Peter B. Evans, Dietrich Rueschmeyer and Theda Skocpol, the state is a Weberian bureaucracy. In other words, the DS is based on the classical concept of Weberian bureaucratic organisation, which is characterised by hierarchical organisation, specialised job responsibilities, merit-based hiring, performance-based promotion, the rule of law and occupational officials (Weber 1978: 956-963). Bureaucrats, who are independent from other social actors and are loyal to the state, pursue economic development as a national goal. Based on its identification with the state, the independent, effective bureaucracy can implement strategic national policies because of the developmental state's unique characteristics: state autonomy, state capacity, the presence of a ruling coalition (a socio-political structure that allows the DS to support strategic industries) and the state-capital relationship based on embedded autonomy. However, these structural and institutional characteristics are not fixed; they can change for a variety of reasons. All states are formed and defined by the contradictory and complex state-society relationship; therefore, the role, status, structure and behavioural patterns of a state are bound to change as a result of the changing dynamics of the state-society relationship. Under these prerequisites, the essential characteristics of the developmental state will be investigated in detail.

State capacity and state autonomy

State autonomy, as Skocpol conceptualised, is “*to formulate and undertake goals that are not simply reflective of the demands or interests of social groups, classes, or society,*” and the capacity of the state is to “*implement official goals, especially over the actual or potential opposition of powerful social groups or in the face of recalcitrant socioeconomic circumstances*” (Skocpol 1985: 9).

Concerning various concepts of state autonomy and capacity, H-C Sonn is a representative Korean scholar. Sonn examined diverse notions of state autonomy and capacity as analysed by many scholars, and then insisted that "*In a case of the concept of state autonomy, there are several methods to conceptualise it. But, especially for the Korean case, we need to select the sternest method to conceptualise the state autonomy as 'relative autonomy.' The conceptualisation like this must be accepted for the best method in the present time, although there are still many problems unsolved*" (Sonn 1989: 243). Additionally, he maintained that "*for the concept of state capacity, it is the most desirable conceptualisation method to be understood as state capacity as the execution capacity to achieve the aim of the state's strategic policies*" (Ibid.). Accordingly, he concluded that the hierarchical-complement relationship between state 'relative autonomy' and state capacity can result in the best consequences for state strategies. Although this is a complementary relationship, state autonomy is of greater priority than state capacity. Thus, analysis that regards state capacity as the state's effective execution capacity basically agrees that state autonomy is 'the essential condition,' while state capacity is 'the sufficient condition.'[29] In a nutshell, state autonomy and state capacity have a strong complementary relationship.

These scholars, as presented above, view state capacity as the state's effective execution capacity; they argue the following features constitute state capacity: (1) the capacity to establish policy goals and to execute state policies independently in the face of pressure from other dominant groups, (2) the capacity to change dominant social groups' behaviours in order to implement policies and (3) the capacity to reorganise domestic circumstances in the pursuit of policy goals (Weiss 1998: 14-40).

In agreement with this view, Joel S. Migdal defined state capacity as the ability of state leaders to use the agencies of the state to get people to do what they want them to do. Thus, it is the state's ability to achieve the kind of changes in society that its leaders have sought through the

[29] J-C, Park (1989), *Korean industrial policy and the role of the state, 1948-1972: A Comparative Research between the first republic (1948-1960) and the third republic (1963-1972),* PhD thesis in Korea University ;M, Kang (1990), *The Interpretation of Korean State Theory*, Korean Political Science Review 23(2), pp. 7-26 ; C-H, Ann (1993), *The Role of the state in 50's for the development of Korean capitalism*, PhD thesis in Seoul National University ; S-W, Yoon (2002), *The crisis and the reorganization of East Asian developmental states: A Comparative Study between Korea and Taiwan*, PhD thesis in Korea University.

planning of state policies and actions (Migdal 1988: 3-9). In other words, state capabilities include the capacities to penetrate society, regulate social relationships, and extract resources and appropriate resources in determined ways. Migdal argued that state capacity varies because of certain attributes of "stateness." He presented four necessary conditions to strengthen "stateness," or the essential conditions needed to build up state capacity. First, leaders attempt to hold a monopoly over the principal means of coercion in their societies by maintaining firm control over standing armies and police forces. Second, through state autonomy from domestic and outside forces, state officials act upon their own preferences to make decisions that reshape, ignore, or circumvent the preferences of even the strongest social actors. Third, there is significant differentiation among the components of the state; thus, numerous specialised organisations can take on the specialised, complex tasks of governing the details of people's lives. Fourth, these components must be explicitly coordinated, allowing coherence among the parts of the state and the shared purposes of those working in various agencies (Ibid.18-19). Additionally, he provided four sufficient conditions for creating a strong state: (1) world historical timing in which exogenous political forces favour concentrated social control, (2) the existence of a serious military threat from outside or from other communal groups within the country (which is related to the issue of world historical timing), (3) the existence of a social group with people sufficiently independent of the existing basis of social control and skilful enough to execute the grand designs of state leaders (in other words, the foundation for an independent bureaucracy[30]) and (4) the presence of skilful leaders capable of selecting bureaucrats who can offer strategies of survival to the population based on the principles of the leaders and can keep a keen eye on the changing risk calculus (Ibid. 271-277).

John A. Hall[31] argued that state capacity can be structured according to three aspects: state infrastructures that can be explained by the administration-bureaucrat relationship and internal decision making, a state-society relationship that allows the state to use financial control to

[30] Bureaucrats of the state, both those at the tops of agencies and the implementers in the field, must identify their own ultimate interests with those of the state as an autonomous organization.

[31] He had a firm belief of Adam Smith's view, 'little else is required to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice.' He has sought to cast light on the larger claim that economic development is achieved under aegis of a 'tolerable state', i.e. a minimal liberal state, operating according to classical *laissez-faire* principles(Hall 1986, 154).

dominate industries and a structure or circumstance of society that favours state intervention in order to achieve economic development and execute industrial policies (Hall 1986: 154-176).

As shown by various scholarly studies, state capacity is composed of the following core elements: a well-developed bureaucratic apparatus that is effective, efficient and strongly cohesive, policy instruments such as the dominant power over financial resources and the accumulation of social knowledge from state-owned statistical organisations (Zysman 1983: 295-298; Rueschmeyer and Evans 1985: 48-49; Skocpol 1985: 16-17; Migdal 1988: 269-275; Evans 1995: 43-50). The importance of the state's bureaucratic apparatus to state capacity is detailedly presented in research conducted by Evans and Mann. Evans insisted that a bureaucratic apparatus must be strong and autonomous; this type of autonomy refers to embedded autonomy based on interactions between society and state, not autonomy resulting from complete isolation from society (Evans 1995:51-53).

Mann also indicates that the state's power to penetrate into society and to implement its policy decisions, which is called infrastructural power, is the core of state capacity (Mann 1984: 189). Accordingly, the most important condition for state capacity is the existence of a well-developed bureaucracy. The main distinction between the success of economic development in East Asia and its failure in Latin America is the existence of an effective, efficient and cohesive bureaucracy (Woo-Cumings 1999: 13–15).

In addition to state capacity, Evans insists that state autonomy is the main criterion for distinguishing between a predatory state and developmental state. The major distinctions between predatory states, such as Zaire under Mobutu Sese Seko's rein, and developmental states in East Asia, such as Japan, Korea and Taiwan, are the existence of a strong, effective, efficient, and cohesive bureaucracy and embedded autonomy (Evans 1995: 43–54). He indicates that an analysis of Japan's Ministry of International Trade and Industry (MITI) provides the best starting point to understand the structural features of the developmental state. MITI was the pilot agency designed to implement industrial rationalisation and an industrial structural policy through the provision of new capital, the approval of investment loans from the Development Bank of Japan, its authority over foreign currency allocations for industrial purposes and licences to import foreign technology, its ability to provide tax breaks, and its capacity to articulate administrative guidance cartels that would regulate competition in an industry. He also argues that Korea’s Economic Planning Board (EPB) is similar to Japan’s MITI; however, internal cohesiveness is weaker in Korea’s EPB, and its embeddedness in relation to society is less institutionalised than that of Japan’s MITI (ibid.)[32].

Thus, the necessity of a coherent, meritocratic bureaucracy with embedded autonomy in developmental states is supported by the previously discussed empirical, historical analysis.

In a nutshell, the "isolated" autonomy of bureaucracy has little correlation with the state's capacity to promote economic development; the "embedded autonomy" (which also means an external network between state and society, state, and markets) can only be the basis for the state’s leading economic development plan. It means that developmental states increase private firms’ motivation to participate in industrial investments and provide long-term economic plans to private economy. So while the quantity of state intervention that occurs in developmental states does not matter when explaining the reasons for economic development, the type of intervention does matter. However, in cases of newly industrialising countries (NICs), such as Korea, those arguments about state autonomy need to be more delicately analysed. It can be said that NICs have been strongly and externally regulated by their dependent positions in *the world capitalism system* (Wallerstein 1974). Accordingly, to get a good grasp on the details of a state's autonomy, the analysis of NICs (including Korea) should be performed separately according to internal and external state autonomy. Internal refers to the instrumental and structural autonomy in the social organisation, and external means the implemental and systemic autonomy in the world system, which also means the concept of dynamic relationships between dominant countries and specific countries in the world system (Sonn 1989: 315-317).

In summary, as the basis of effective state intervention, the concepts of "state capacity" and "state autonomy" are distinguishable in some parts, mutually overlapping in many parts, and closely related. It is certain that developmental states must balance these two aspects to achieve their aim of economic development. Also, a state can be formed as a "developmental state" only if there is "embedded autonomy" and "coherent, meritocratic, effective bureaucracy” in specific states.

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[32] In Taiwan, there was the Council for Economic Planning and Development (CEPD) similar to MITI and EPB.

Ruling coalition and state's industrial strategy

State capacity and autonomy are the most important factors that help explain successful economic development in East Asia and characterise developmental states. However, other crucial points, such as socio-political and socio-structural conditions that make it possible for the state to execute its strategies, must be considered in analyses of developmental states. This means that developmental states can also be characterised from the perspective of the ruling coalition[33], not just by the state-centric approach. In other words, an analysis of a ruling coalition transfers the emphasis from the state to the ruling coalition and explains the ruling coalition's strategies using domestic and international socio-political factors. This approach is necessary to provide a more complete analysis of developmental states (Deyo 1987: 16-20).[34]

Various ruling coalition analyses have been used to characterise the developmental state and explain economic development in East Asia. Deyo contends a state's strategic capacity based on the ruling coalition is formulated by a developmental coalition between the state and subordinate partners selected by the state, which is a closed political structure that can strengthen the political power of the ruling coalition (Deyo 1987: 232-233). In addition, J.-K. Baek states that if there are severe collisions between the ruling coalition's developmental strategies and progressive challenges from counter-ruling or distributive coalitions, intense conflicts will occur; this process can lead to changes in strategies or create a systematic crisis (Baek 1991: 32-38). The main distinction between Korea and Mexico as developmental states is that when there were severe conflicts between the ruling and counter-ruling coalitions, which derived from radical inconsistencies between ruling structures and choices of strategies, Korea dealt with those conflicts successfully, but Mexico did not (Ibid.).

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[33] In the analysis of developmental state, it takes a serious view of the role of states and also connects socio-political constraints to state's choice of (industrial) strategies with conflicts between interest groups who participate in economic development and class coalition.

[34] In a field of political economy, 'ruling coalition analysis' has several merits as following; firstly, it can provide theoretical frameworks which are relatively solid and elaborate with direct connection to some useful middle range theories because 'ruling coalition analysis' is inevitably related with elite theory, class analysis, civil society theory, election alliance analysis, etc., secondly, it essentially has dialectic explanation structure for state's choice of (industrial) strategies and policy changes because there is always a counter-ruling coalition in this analysis so interaction between them can explain them, thirdly, historical-structural and empirical analysis is possible in 'ruling coalition analysis' (Baek 1993: 135-136).

An analysis of the ruling coalition is also essential for understanding the stages of crisis and reform that developmental states undergo. Using comparative analysis[35] to assess economic adjustment in debtors in developing countries after the debt crisis of the 1980s, Haggard and Kaufman emphasised that some conditions are very important for analysing the process of the politics of economic adjustment after the crisis. First, because of the free-rider problem facing social groups and a general uncertainty concerning the ultimate beneficiaries of reform, the initiation of policy reform appears more likely when technocratic decision makers enjoy some degree of independence from particularistic interests. Second, no reform can be sustained in the long term unless it appeals to, or creates, a new coalition of beneficiaries; this is also true of reforms that have as their objective a reduction of the state's role in the economy (Haggard and Kaufman 1992: 4–8). In Korea, the strategic capacity of the state and the features of the ruling coalition have been the key elements for the success of economic adjustment since 1980s. It could be said that distributive conflicts among contending social groups in Korea are relatively successful when mediated by state action and the broader institutional milieu. In a nutshell, economic adjustment after the crisis could only be successful in organisationally coherent states that could build the links with key social actors that were required to support developmental projects and avoid the problems of capture and rent seeking. Sustainability of a state's independent autonomy from the ruling coalition and the maintenance of state autonomy when implementing policies, are crucial for the reform of developmental states.

State-capital relations (Government-Business Relations) and embedded autonomy

In states that were late to industrialise, the states themselves led the drive to industrialisation by taking on developmental functions. The two differing orientations toward private economic activities, the regulatory orientation and the developmental orientation, produced two different kinds of government-business relationship.

[35] They say that their analysis will examine variations in policy choices cross-nationally and over time, differences in the timing of reform initiatives, the degree to which orthodox prescriptions were adopted, and the extent to which reforms were sustained and consolidated (Haggard and Kaufman 1992: 7).

Chalmers Johnson notes the United States is a good example of a state in which the regulatory orientation predominates, whereas Japan is a good example of a state in which the developmental orientation predominates (Johnson 1982: 19)[36]. The developmental, or plan rational, state's dominant feature is the ability to establish substantive social and economic goals; therefore, it is similar to a socialist state. The main difference between these states is that plan rational is known as market-substituting in socialist states and market-confronting in developmental states. This means that developmental states play important roles as leading agents for economic growth through activities such as the establishment of policy goals, resource mobilisation, and strategic intervention in the market. However, the social and economic goals of plan rational states can only be realised through production, investment and cooperation by private companies. Accordingly, the state-capital (or government-business) relationship should be included as a crucial factor in characterising developmental states and explaining successful economic development in East Asia.

These features of state-capital relations can be observed in the process of industrialisation in Japan, Korea and Taiwan. Based on the developmental growth model, although there are differences among these countries, the miracle of development in Japan, Korea and Taiwan was accomplished by state dominance in the government-business relationship. East Asian governments motivated private companies to accelerate investment, encourage production, follow industrial or export-led economic strategies and increase productivity through the practical use of policy instruments, such as various industrial, trade and financial policies, financial policy guidance, tax reductions and exemptions, export subsidies, and tariff and non-tariff barriers. These states also developed collaborative institutional organisations, such as a policy-making advisory board, to enhance the exchange of information, mediate policy conflicts and ensure close communication between the government and private companies (Campos and Root 1996: 7-27). Accordingly, Johnson's public-private cooperation, Wade's administrative guidance and Evans's embedded autonomy, which are specific features of the East Asian developmental model, can be driven by cooperative state-capital or government-business relationships.

[36] A regulatory state is also called as 'market rational' state and a developmental state is called as 'plan rational' state (Johnson 1982: 19).

Regarding social and economic goals, whether the state can mobilise social groups, especially capital groups such as private companies, is an essential element of embedded autonomy and state capacity. Therefore, the state-capital relationship is also an important characteristic of developmental states.

2.4.3. Korean developmental state after the 1997 financial crisis

Though it is difficult to think that there was a significant change in the theory of the developmental state itself after the 1997 financial crisis, it is true that the viewpoint of looking at the Korean developmental state changed greatly after the financial crisis. However, it is also true that there has not been sufficient literature or research on the theory of the developmental state since the 1997 financial crisis. Here, I would like to add a couple of characteristics that are different from the existing theories of the developmental state by looking at the Korean developmental state since the financial crisis examined in several theses and related literature.

Pirie (2008) claims that the 1997-8 crisis played an invaluable role in creating political and economic space for the Korean state to address the deep problems in firm-level financial structures (Pirie 2008: 10) In his arguments, the neo-liberal project must 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. Therefore, by his opinion, the crisis cannot be understood, as is commonly claimed, as being the product of a badly implemented or just foolish liberalisation programme. Rather, it was unavoidable episode in Korea’s historic economic ascent

The central argument of his entire book is that Korea after the 1997 crisis 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 (Ibid. 11-12). On the basis of this argument, he refers to such evidence that the Korean state has consistently applied two key principles in promoting restructuring after the 1997 financial crisis. 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 final result and promoting process of creative destruction.

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 crisis.

In addition to these, he asserts that 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; 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 (Pirie 2008: 144-145).

And the back surface of above claims, the author, Pirie, have such a steadfast faith that the neo-liberal project must be understood as being a rational response to global economic change by a state committed to transferring Korea into an advanced capitalist economy, because he considers that the ultimate objective of the entire programme of economic reform in Korea after the 1997 crisis 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.

Eventually, in summary, the point that he claims in his book, '*the Korean developmental state'* is that it is accurate to label the Korean state after 1997 crisis as a neo-liberal state by the reason which can be summarized as follows (Pirie 2008: 196-197): Firstly, Korean systems of corporate governance and financial regulation have been completely overhauled so as to bring them into conformity with global standards of 'beat 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 in framed so as to promote rather than prevent the sale of strategic assets to foreign investors. Secondly, 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.

Based on Pirie's opinion that the state of Korea since the 1997 financial crisis should be treated as a Neoliberal state, it can be interpreted that Korea's reform to accept the standards and principles of Anglo-American Capitalism after the financial crisis in 1997 was successful. However, a closer look at the reform of the financial supervision system - one of the reforms made in Korea after the financial crisis – makes it possible to say that it is difficult to consider the state of Korea as a Neoliberal state. Lim and Lee claim that while the change of the financial supervision system after the financial crisis itself may seem to correspond well with the intent of a Neoliberal financial reform, the process of change since then is true to Korea's heritage as a developmental state (Lim and Lee 2009: 141).

It was predicted that the direction of Korea's reform after the financial crisis in 1997 would accept the standards and principles of Anglo-American Capitalism. But they claim that Korea has been showing a pattern of change that is different from the direction of Neoliberal reform in the process of reform after the financial crisis, as the process of reform is influenced not only by external pressures but also by domestic political and economic interest groups, politicians, coalitions of bureaucrats and politicians, etc. (Lim and Lee 2009: 136-138). In fact, following the crisis in 1997 the state of Korea distributed some of its finance-related authority and functions, which used to be concentrated in the Ministry of Finance & Economy, to the Bank of Korea and the Financial Supervisory Commission. That is, the method of financial supervision was changed from the previous concentrated system to a divided system. As a result, a single supervisory authority took charge of financial supervision with the integrated supervision system, and the goal of monetary policy was to enhance the legal independence of the Bank of Korea while the Ministry of Finance & Economy assumed responsibility for economic policy and policy coordination in a specialization system. However, while it seemed that the government was reducing market intervention, Lim and Lee asserted that the Korean government prepared another channel to influence the financial market by securing leverage over the Financial Supervisory Commission (Lim and Lee 2009: 131-134). In other words, the Korean state accommodated Neo-liberal demands for financial reform in a modified form by installing an integrated financial supervisory organization which had limited independence.

In this way, Lim and Lee claim that the actual operation of financial supervision returned to the concentrated system of the past developmental state because there were few checks and balances among public agencies, and the Ministry of Finance & Economy pursued continuous intervention while expanding its power (Lim and Lee 2009: 139-140). The reason for their claim can be found in their recognition of the role of Korean bureaucrats in the process of reform:

> *Contrary to expectations that the role of bureaucrats in Korea would be reduced considerably after democratization, they in fact played an ongoing role in the process of reform and the checks, discord and conflicts among related agencies and public organizations became important variables of influence on the process of reform. Having been deprived of much of their power after democratization and globalization, government departments and bureaucrats used the crisis as an opportunity to propose a new agenda for reform, and actively used the process of reform to grasp the initiative of reform and expand their power (Lim and Lee 2009: 142).*

Ultimately, Lim and Lee claimed that the reform of the financial supervisory system in Korea after the financial crisis was not successful because attributes of a developmental state still exist in Korea. In other words, through a political and economic analysis of the financial supervisory system after the financial crisis in 1997, they consider Korea after the financial crisis as a transitional state that still has the characteristics of a developmental state though it is in the process of shifting to a Neo-liberal state. Behind their claim is a belief that Korea should be changed into a Neo-liberal state.

As stated above, in opposition to the argument that the state of Korea changed into a Neo-liberal state as a result of reasonable choice after the financial crisis in 1997 and the type of state that Korea should aim to be is a Neo-liberal state, Lee (2002) asserts that Korea is changing into a state that is different in character from the Anglo-American regulatory states, though Korea has been changing into a Neo-liberal regulatory state that has lost the efficiency of a developmental state model following the financial crisis. That is, he asserts that though Korea has the characteristics of a regulatory state after the financial crisis, its features of a regulatory state do not necessarily make it a small state, a less intervening state or a weak government in Korea.

As the Korean government was reducing the financial expenditures it made on the development of strategic industries after 1997, it seems compatible with the idea of a small state. But Lee insists that it has not been effectively making a small state by reducing the number of public servants and combining government agencies, because Korea needed to expand the role of the state and government departments in order to monitor and regulate market participants after the financial crisis (Lee 2002: 70-72). According to the existing studies, while regulation was implemented by expanding private neutral organizations in the U.K. and the U.S. in the process of Re-regulation, Japan strengthened its regulation by expanding government organization. In Korea, the U.K. or U.S. models did not succeed and it finally adopted the Re-regulation model of Japan (Lee 2002: 66-68). That is to say, the Financial Supervisory Commission and the Financial Supervisory Service were established after 1997 in addition to the existing Ministry of Finance & Economy, the Ministry of Planning & Budget, and the Fair Trade Commission to institutionally reinforce the market monitoring capacity of the government, and as a result the size of the government departments concerned has also increased (Lee 2002: 73).

He also asserts that while Korea is changing into a regulatory state the government did not reduce its intervention through the reforms since 1997, in that the government is still carrying out political intervention and pressure (Lee 2002: 73-75). As the basis of his assertion, he says that the logic of the past developmental state was enhancing the efficiency of capital accumulation by allowing monopoly for a few selected companies, and the existence of such a monopoly group makes it difficult for the government to withdraw its intervention. In other words, government authorities have political concerns if they set business conglomerates – big companies that are difficult even for the government to control – free from the control of the government, and such a relationship between the government and industries cannot be explained by normal market logic (Lee 2002: 76-78).

This argument suggests that there will be an empirical limit if we consider the theory of Minimal State advocated by Neo-liberalism as the ideological basis for the change of state occurring in Korea. This researcher thinks that this opinion explains the situation of Korea after the financial crisis most appropriately for the following reasons. As mainstream concepts in modern economics, Neoclassicism and Monetarism insist that the role of the state for market operation and market intervention by the state should be differentiated. But this researcher thinks what we must pay attention to from a political and economic perspective is that the former does not necessarily establish a weaker and smaller government, because it may be necessary to establish a rather large and powerful state in order for the government to be able to play its role in the market in the process of experiencing financial crisis and implementing economic reform. In other words, it should not be overlooked that the government, rather than the market, needs to have the power to establish the relationship between the state and the market. Ultimately, this researcher thinks that it is not acceptable empirically to assume that Korea is changing into a Neo-liberal regulatory state that is totally free from the attributes of a developmental state following the financial crisis of 1997.

To sum up all the literature, the characteristics of the developmental state of Korea after the financial crisis can be summarized as follows. It is true that the role of the Korean government is focused on the establishment and operation of regulations to be able to monitor market participants while respecting the market mechanism. However, a developmental regulatory state with strong attributes of a developmental state is being established, as the government has been accustomed to political intervention and protection for a long time for the development of strategic industries. While the previous discussions were based on a dichotomous logic of a developmental state and a (Neo-liberal) regulatory state, it should not be overlooked that the actual appearance of the state of Korea is a mixed and complex one with both kinds of characteristics. This researcher thinks this suggests that the diversity of transformational models should be considered when engaging in discussions about a (Neo-liberal) regulatory state.

2.4.4. Critiques

1) Standardisation is limited by diversity

The development model outlined by the DS theory has a limited range of application to other countries except Japan, Korea and Taiwan. All three countries have relied heavily on the export of manufactured goods for growth and economic transformation. Indeed, export-oriented development became so linked with the hyper growth of Japan, Korea and Taiwan in the public mind that it became “a new development orthodoxy” (Haggard 1986: 344). Although these countries share a high rate of growth and the developmental state label, they differ significantly in both the structure of their states and their strategies and have little commonality in their institutional and structural properties. The methods of statecraft utilised by these three nations and their patterns of state-societal interactions also differ, with the exception of a common devotion to export-led growth. Furthermore, the three have followed different economic strategies, and the size of their economies is also different (Pempel 1999: 147-151). Economic catch-up and state intervention suggest similarities to Japan, Korea and Taiwan; however, numerous specific features of their political and economic structures reveal important differences. Compared with most countries, Japan, Korea and Taiwan share important similarities in history, geography, culture and economic success. However, their differences in state structure and state strategy make identifying any links between East Asian economic successes and defining a single type of state problematic at best.

Unravelling this puzzle is important not simply for understanding the three countries themselves but more significantly for resolving several of the ambiguities identified in the concept of the developmental state if NICs such as Singapore, Hong Kong and South East Asian countries are included in the developmental state model.

2) Ambiguity of the concept of state autonomy

State autonomy is conceptualised with ambiguity. All modern states, as pointed out by Skocpol (1979), possess 'potential autonomy' themselves[37], so the concept of state autonomy must be analysed carefully and delicately. In the beginning, state-centric theorists insisted that the autonomy of state-society or state-capital was conceptualised through 'dis-embeddedness from society,' but Evans emphasised that the autonomy of state-society or state-capital must be focused on 'embeddedness in society.' The most important concept of the developmental state seems to be contradiction. In other words, even the famous 'embedded autonomy' presented by Evans represents changing state-society relationships, from the state-dominant relationship to the state-correlated relationship. Especially for the classification of capitalists related with the developmental state, Cho argues that it is ambiguous to distinguish between rent-seeking capitalists or political capitalists and industrialists. Although this classification is possible, it can

[37] Theda Skocpol (1979), *State and Social Revolutions,* Cambridge: Cambridge University Press, pp.24-33.

only be made within the historical and social circumstances of specific countries and is a fluid classification (Cho 1997: 64-66). Eventually, it can be said that the concept of state autonomy is the most important criterion for distinguishing between predatory states and developmental states, and should necessarily be determined by qualitative classification at a point in the sequential distinction standard.

In Korea, it is true that ‘high stateness’ and ‘low classness’ had been shown since the establishment of the Korean government in 1948, because Korean citizens in those days inevitably required ‘state-centric’ society to overcome their existence crisis.

Accordingly, the Korean state was actually ‘omniscient and omnipotent’, irrelevant to state capacity, and it held a dominant position able to construct new structures of society in all aspects, including politics, society, and the economy (Kwon 2006: 20-28). This means that the concept of state autonomy has no meaning if the society is fundamentally too weak compared to the state. State autonomy (or the embedded autonomy to decide whether states are developmental or not) is only meaningful under specific social and historical conditions.

3) Overestimation of the national bureaucracy

The existence of a strong, effective, efficient, and cohesive bureaucracy or a strong meritocratic state bureaucracy is a kernel for developmental states. The developmental state privileges the political and economic role played by state bureaucrats. There can be little serious question of the important roles played by national government bureaucracies and individual officials in the economic development of East Asia, including Korea. However, developmental state theorists too often treat the national bureaucracy as totally depoliticised, socially disembodied, and in rational pursuit of a self-evident national interest such as macroeconomic improvements, GNP growth, increased exports, improved living standards, and so forth. In other words, developmental state theorists cannot largely answer to the following questions: What is the dynamic of the functioning of the economic bureaucracy, and what are the socioeconomic underpinnings of the developmental state? To explain the economic ’miracles’ of Japan and Korea, developmental statists emphasise too much a strong meritocratic state bureaucracy and consider too little politics in state bureaucracy and numerous other conditions. Its apolitical underpinnings[38] make the developmental state a concept easily mobilised in the service of bureaucratic authoritarianism and anti-representational politics, with few guarantees of positive economic consequences (Pempel 1999: 144–146).

4) Overlooking international political environment

There is the question of the international political environment within which the developmental state thrives.

The developmental state is assessed mostly in a domestic context: in order to achieve its aims, it focuses on the domestic political and social environments. According to developmental state theory, as highlighted by Lee, there is not a sufficient level of understanding of how the international political and economic environment related to economic growth at that time, or of the peculiarity of international circumstances which developmental states such as Japan, Korea and Taiwan encountered (Lee 2003a: 28-31). Theories of domestic politics and economics alone do not fully explain the miracle of economic growth in Japan, Korean and Taiwan. These three countries developed well beyond any projections based on their relative strength in the 1950s. More importantly for all three, they not only advanced their own economic wellbeing in the face of structural impediments within the international system; they were helped in their efforts by the U.S. in its role as leader of an anti-communism hegemony. It is hard to imagine the economic success of these countries being so pronounced if the United States not been so anxious to assist with their economic enrichment. Moreover, the three states' key economic strategies from the 1970s to the 1990s were strongly influenced by the economic and military aid given by the United States in this era of Cold War (Cumings 1987: 67; Pempel 1999: 154-155). The peculiarity of international political conditions was also vital to the miracle of economic growth in these three countries. The analysis of developmental states should therefore consider international circumstances as well as domestic situations.

[38] One major result of such a depoliticized view is that the developmental state, as Bruce Cuming suggested, too easily emerges as a "web without a spider." (Cuming 1999: 82-92)

5) Questions of degree, period and transformation

The degree of state autonomy that characterises developmental states is too abstract a criterion to classify many states as developmental states. The period referred to as developmental state is an extremely variable category even within a single country. Most importantly, the transformation of developmental states raises difficult questions, such as, "Can we still regard Japan, Korea and Taiwan as developmental states?"

The transformation of the developmental state in Japan started in the 1970s (Kim 1994: 192-193). State-capital relations in Korea began to qualitatively to change in the late 1980s and early 1990s; the relationship between the government and businesses became more distant, and meetings were less frequent. In addition, firms that were dependent on the state's channelling of foreign loans to them in the early 1970s had to obtain these funds directly by the end of the 1980s (Evans 1995: 231).[39] This changing trajectory of state-capital relations is paradoxically strongly related to the state's weakened control over capital (*chaebols* in Korea) that had experienced economies of scale as a result of the remarkable state-led economic development (Lee 1998: 30-35). The Korean case shows the dynamics of the changing relationship between developmental states and capital: a state (bureaucracy)-dominant relationship with capital → an equivalent relationship between them → a capital-reinforcing relationship with the state.

Based on the claims of domestic and international capital, there have been radical changes in Korean financial markets since the late 1980s, especially the extensive financial liberalisation of the economic system. Consequently, the Korean developmental system, which was based on close collaboration between the state, banks, and capital (*chaebols)* with the state as the dominant player, has been losing validity. Since the late 1980s, Korean state autonomy has become too weak to investigate capital flows and to ensure financial soundness. This failure of financial regulation was caused by the debt-and-development crisis (Radelet and Sachs 1998)

[39] The growth of international marketing channels and overseas production facilities made the chaebols less dependent on the domestic market to which the state could control access. At the same time, the domestic market power of large firms expanded tremendously. In the mid-1070s the combined sales of the top ten chaebols amounted to 15 percent of Korea's GNP; in the mid-1980s they amounted to 67 percent (Amsden 1989: 116).

and the 1997 financial crisis in Korea. Thus, based on this perspective, the retreat of the Korean developmental state had already started or been completed by that time.

6) The difficulty of replication

The developmental state model becomes harder to follow because of the special kind of state-society connectedness (embeddedness) that is rooted in East Asia's unique historical experience.

East Asian developmental states began the post-World War II period with legacies of long bureaucratic traditions and considerable pre-war experience in direct economic intervention. After World War II, traditional agrarian elites were decimated, industrial groups were disorganised and undercapitalised, and external resources were channelled through the state apparatus in East Asian developmental states. The imposition of American hegemony, reinforced by the threatening alternative of expansionary Asian communism, also left these states no choice but to rely on private capital as a primary instrument of industrialisation. The environment conspired to create the conviction that regime survival depended on rapid market-based industrialisation. Their small size and lack of resources made obvious the necessity of export competitiveness. In a nutshell, these historical, geopolitical, and economic conditions were prerequisites for developmental states. On a logical basis, it can be strictly said that all above conditions must be satisfied if the model of East Asian developmental states can be successfully institutionalised in other regions.

In other words, the combination of historically accumulated bureaucratic capacity and conjunctionally generated autonomy placed East Asian states such as Japan, Korea, and Taiwan in exceptional positions; therefore, it is very difficult to adapt the developmental state theory for other states' economic growth.

7) Problems of "henceforth"

In the aftermath the East Asian crisis (including the 1997 financial crisis in Korea), the developmental state theory has been necessarily changing its focus to "good governance": a desirable governance structure the least developed among developing countries may make or select in the era of global capitalism. Most of all, an alternative to good governance is closely related with the establishment of institutions, which can actualise "more wealth and more democracy." For instance, the 1997 financial crisis in Korea revealed the limit of "hands-on relationship" between states and firms, which had contributed to economic accomplishments for nearly 30 years.

Nonetheless, can the arm’s length relationship of the Anglo-American model (new-classical model) be a viable alternative relationship for the Korean (East Asian) economic system based on its unique historical and geopolitical experience?

In addition to this, developmental state theory also needs to focus on the current issue of states after the developmental phase. Although there are many points of view put forwards to explain the Korean financial crisis[40], from a developmental state theory perspective, the crisis occurred because the Korean state autonomy had become too weak since the late 1980s to investigate capital flows and to supervise financial soundness. In other words, the financial crisis in Korea is strongly related to a weak state or the theory of states acquired by capital. However, developing states cannot easily be regarded as regulatory states even if state autonomy and capacity become too weak to control capital, because it is often too difficult to distinguish between the concepts of regulatory states and regulations for developmental aims in developing states. It is too soon to label certain East Asian countries as regulatory states governed by market rationality because there has been a conventional view that the East Asian crisis was an inevitable result of the fundamentally inefficient and corrupt economic systems in the countries concerned.

[40] The announcement by the Korean government on 3 December 1997 that it was going to call in the IMF shocked the world. To be sure, the international financial market, especially the so-called emerging markets, was looking very unstable following the Thai and the Indonesian financial crises that broke out in the previous summer. However, for many people it was still difficult to believe that one of the ‘miracle’ economies of the late twentieth century and a newly anointed member of the OECD was going to the IMF with bowl in hand because it did not have enough foreign exchange reserve even to last it for a month. The conventional view was that this crisis was an inevitable result of the country’s fundamentally inefficient and corrupt economic system; this was neither a crisis due to cyclical factors nor even one due to a short-term macroeconomic mismanagement, but one due to long-run factors.

2.5. Conclusion and Emerging Issues

Developmental state theory, even though there is not full agreement about the contents of the theory, is often used as a contrast to neo-classical theory. In other words, it is entirely opposed to the market-centric theory of the neoclassical school and it is also distanced from Bolshevik nationalism. Developmental statists often attribute state success to the success of administrative guidance (Johnson, 1982: 29), and they also insist that developmental states can only be successful if there is embedded autonomy (Evans, 1995: 51–53) between state and society, and state and capital. They regard Japan, Korea and Taiwan as representatives of strong developmental states (Wade: 1990, 33). It also means that the effect of states on markets and markets on states in developmental states is synergetic. The crucial point is that this synergy can only be actualised in the presence of state-dominant relations with markets. In the developmental state theory, the state bureaucracy, which functions as ‘pockets of efficiency’ (Rauch and Evans 2000: 55) is not significantly different to a Weberian ideal bureaucracy characterised by hierarchical organisation, specialised job responsibilities, merit-based hiring, performance-based promotion, rule of law and occupational officials (Weber 1978: 956-963). From this perspective, this type of bureaucracy is in contrast to the bureaucracy of the neo-classical point of view. Neo-classical statists criticise the system and claim that state officials just focus on private profits, ensuring that effective resource distribution is eventually distorted. In other words, their view is that the state bureaucracy swiftly becomes a rent-seeking bureaucracy. However, state bureaucracy as pockets of efficiency has a distinct feature typical of Weberian state bureaucracy: the achievement and efficiency of economic bureaucrats is closely connected with political and social considerations, so that there is embedded autonomy in the structure of developmental states.

However, the relationships between developmental states and capital have been changing since states started to execute industrial policies for economic and social development. The state’s bureaucratic-dominant relationship with capital makes the relation between them more equal, which in turn influences capital’s reinforcing relationship with the state. In other words, state autonomy has paradoxically been weakened by the state championing this remarkable economic development. Accordingly, the developmental state theory has changed its focus to the transformation of developmental states and the restoration of state autonomy and capacity. This is a new way of understanding states because the old descriptive factors used cannot capture how the state has changed. And, this raised the question about the possibility of state autonomy and the capacity to correct market failure and to solve social conflicts.

For example, the characteristics of the developmental state of Korea after the financial crisis can be summarized as follows. It is true that the role of the Korean government is focused on the establishment and operation of regulations to be able to monitor market participants while respecting the market mechanism. However, a developmental regulatory state with strong attributes of a developmental state is being established, as the government has been accustomed to political intervention and protection for a long time for the development of strategic industries. While the previous discussions were based on a dichotomous logic of a developmental state and a (Neo-liberal) regulatory state, it should not be overlooked that the actual appearance of the state of Korea is a mixed and complex one with both kinds of characteristics. This researcher thinks this suggests that the diversity of transformational models should be considered when engaging in discussions about a (Neo-liberal) regulatory state.

The East Asian economic crises accelerated this issue of reorganisation of developing states. The crises particularly revealed that the developing states were not sufficiently focused on their structural, social and institutional problems. They were too focused on state autonomy and capacity to succeed in their aim of economic development. They also gave insufficient consideration to social and political issues that could decrease the efficiency of the economic system. Nevertheless, the significance of state autonomy and capacity, featuring coherent, meritocratic bureaucracy with embedded autonomy in developing states cannot be replaced by any concept found in neo-classical market-centric theory because the East Asian crises, including the financial crisis in Korea, were strongly related to market failure, especially of the financial markets, and not just fundamental problems in those countries.

Emerging Issues

Economic growth paradoxically requires alteration to the role of the state in developmental states. It is not a coincidence that Korea has recently been transformed from a typical developmental state. Changing the role of the state is essential in East Asian countries, including Korea, corresponding to the economic growth basis.

At least with respect to institutional aspects, the Korean developmental state has gradually transformed to possess features of a regulatory state. Most of all, it can be said that the state-dominant financial system as the leverage of the state-leading economic development has significantly changed since the 1980s. In other words, the developmental state's financial system has gradually changed to the neo-classical financial system: liberalisation in financial markets. After the 1990s, especially in the aftermath of the 1997 financial crisis, this phenomenon of financial liberalisation has rapidly settled into Korea.

To this end, following issues emerge:

- What are some changing features of developmental states that we can identify in the evolution of Korea's financial system?
- How can we investigate changing the role of the state with regard to financial reform after the 1997 financial crisis in Korea?

Chapter 3
ANALYTICAL FRAMEWORK AND METHODOLOGY

3.1. Introduction

In this thesis, the core question is "*How did the financial crisis transform Korean developmental state and how did it influence the role of the state in finance as well as the structure of the state bureaucracy?*" In order to answer this question, it is essential to decide lens for viewing works in a number of disciplines including economics, politics and international relations. Accordingly, Chapter 3 primarily attempts to build an analytical framework and methodology for this research.

The first section of this chapter highlights a comparative institutional approach in developmental state theses. This researcher will use the conceptual and theoretical groundwork of new comparative political economists, which is prevalent in modern social science. Thus, new comparative political economy allows this researcher to capture the complexity of real political and economic situations in the Korean developmental state, but not at the expense of theoretical clarity. One of the great attractions and strengths of this approach, as Thelen and Steinmo (1992) said, is in how it strikes this balance between necessary complexity and desirable parsimony (Thelen and Steinmo 1992: 13).

The second section proposes an analytical framework and strategy for understanding some variables that influence the transformation of Korea's developmental state as follows: developmental state → the crisis of developmental state → the reorganisation of developmental state. It also examines the changing role of the state with particular focus on the changes in Korea's developmental state as influenced by those variables. For this, we suggest some analytical strategies. On the basis of these analytical strategies, this thesis has established the following explanatory variables to be structural factors of the crisis of the Korean developmental state. Three variables that influence the state's autonomy are ① the change in the state–world system relationship, ② the change in the state–civil society relationship, and ③ the change in the state–capital relation. A fourth variable serves to weaken the state's capacity: internal disturbances of state bureaucracy.

Meanwhile, this research has also assumed that there are some factors to define "the processes of the reorganisation of developmental state." Four elements are included as explanatory variables: ① the intensity of the crisis of developmental state, ② the role of the state (the efficacy of state’s policy actions toward the crisis), ③ the response patterns and reactions of social groups, and ④ the structural heritage based on the judgment that the processes are inevitably "path dependent"—similar to the former growth mechanism.

The last section will propose an analytical model to examine the changing role of the state in the transformation of Korea's developmental state. To investigate the main theme of this research and answer the main questions of this thesis, this researcher will suggest some case studies to use for examining the restructuring of the financial system after the 1997 financial crisis (the public fund and Financial Supervisory System).

In summary, this chapter will firstly present the brief description about the new comparative political economy of the crisis and restoration of developmental states, and secondly provide the analytical framework and methodology for this research: "the perspective of this research" and "the model of path analysis," respectively. It will then show how a focus on the restructuring of the financial system after the 1997 crisis can not only provide a clue to investigate "the transformation of developmental state and the changing role of the state" but also help identify the political dynamics in shaping economic, political, and social reformation. In short, the reasons for choosing the public fund and the Financial Supervisory System as case studies will be additionally given.

3.2. New comparative political economy and developmental state theory

It is true that the developmental state theory has been formulated by the countercritique of the neoclassical paradigm, which explains East Asian economic growth in terms of the economic benefits of trade liberalisation, private enterprise, and a restricted role for the state. Developmental statists, such as Chalmers Johnson, Alice Amsden and Robert Wade, sustained that the 'miracle' of East Asian countries must be understood as a process in which states have played a strategic role in controlling domestic and international market forces and mobilising them to national goals. Their thesis can be broadly classified as *'New Institutionalism'* because it has mainly focused on the "synergy" between the state and the market which provides the basis for outstanding development experience.[41] The institutionalist perspective, presented by Ö nis, is significant because it attempts to transcend the structuralist development economics which downplayed the key role of markets in the industrialisation process. In other words, the broad institutionalist perspective aims to move beyond what appears to be an increasingly sterile, neoclassical, political economy vs. structuralist, developmental economics controversy in a number of fundamental respects (Ö nis 1991: 110). Based on this perspective, Evans tells trajectories of developmental states and explains all features of developmental states in his book, *"Embedded Autonomy: States and Industrial Transformation (1995)"*.

In his book, Evans (1995) called his research strategy a comparative institutional approach. Institutional because it looks for explanations that go beyond the utilitarian calculations of individuals to the enduring patterns of relationships within which such calculations are immersed; comparative because it focuses on concrete variations across historical cases rather than on generic explanations (Evans 1995: 22-42).

A comparative institutional approach to the state especially requires the rejection of reductionism[42]. The state cannot be reduced to an aggregation of the interests of individual office holders, vector sum of political forces, or condensed expression of some logic of economic

[41] Ziya Ö nis (1991) summarized that fundamental to East Asian development has been the focus on industrialization as opposed to considerations involving maximizing profitability on the basis of current comparative advantage. In other words, market rationality has been constrained by the priorities of industrialization. Key to rapid industrialization is a strong and autonomous state, providing directional thrust to the operation of the market mechanism. The market is guided by a conception of long-term national rationality of investment formulated by government officials. It is the "synergy" between the state and the market which provides the basis for outstanding development experience (Ziya Önis 1991, 109).

[42] Reductionism can either mean '*an approach to understanding the nature of complex things by reducing them to the interactions of their parts, or to simpler or more fundamental things*' or '*a philosophical position that a complex system is nothing but the sum of its parts, and that an account of it can be reduced to accounts of individual constituents'* (*see* in the Interdisciplinary Encyclopaedia of Religion and Science).

necessity. States are the historical products of their societies, but that does not make them pawns in the social games of other actors. They must be dealt with as institutions and social actors in their own right, influencing the course of economic and social change even as they are shaped by it. In other words, the state is seen as a historically rooted institution—not simply a collection of strategic individuals. The interaction of the state and society is constrained by institutionalised sets of relations. Economic outcomes are the products of social and political institutions; they are not just responses to prevailing market conditions. Accordingly, a comparative institutional approach aims to understand diverse outcomes. It should not pigeonhole cases into a generic mold or onto a one-dimensional scale (Evans 1995: 18).

Before they used a comparative institutional approach, Evans and Stephens actually used the term, "the new comparative historical political economy" (Evans and Stephens 1988) [43]. They emphasised that, in Stinchcombe's terms, the persistence of current institutional arrangements cannot be explained purely in terms of "constant causes." Rather, it is also a product of "historic causes." They also introduced "the new comparative political economy," which put emphasis on a historical context as an explanatory variable (Evans and Stephens 1988: 730). For example, the contrast in the political consciousness of the Korean *chaebol*[44] and Japanese *keiretsu*[45] in the developmental period cannot be explained entirely by the differences between their respective positions in their domestic economies and the international system. Rather, they are the legacies of past social arrangements such as class coalitions, relationship to the state, etc. are essential to understanding the differences in the political expressions of the capitalist classes in these two countries in this period.

The neo-utilitarian vision[46], on the other hand, unquestionably captures a significant aspect of the functioning of most states and the dominant aspects of some. For instance, "rent-seeking,"

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[43] Both approaches are essentially same, but the label "comparative institutional" avoids confusion with contemporary definitions that equate "the new political economy" with neoliberal extensions of economic analysis to political issues (Evans 1995, 252-253).

[44] The *chaebol* are the large conglomerate firms that dominate Korea's industrial economy (Evans 1995, 252)

[45] The oligopolistic organization of each industry by conglomerates (Johnson 1982, 12).

[46] Buchanan, Tollison, and Tullock are representative scholars of this vision.

conceptualised more primitively as "corruption," has always been a well-known facet of the operation of third-world states. However this is empirically true, it cannot be generalised as the dominant aspect of the functioning of all third-world states. The neo-utilitarian vision mostly uses a deductive analytical framework, not an empirical approach, so it does not lie primarily in drawing attention to the empirical realities of third-world states. Its aim is simply providing an analytical frame that makes these realities explicable, demonstrating how they could be derived from a parsimonious set of assumptions about how states work (Evans 1995: 24). In addition, the neo-utilitarian vision of an efficient economy requires a traditional neoclassical state, a "night-watchman state," the actions of which are "restricted largely, if not entirely, to protecting individual rights, persons and property, and enforcing voluntarily negotiated private contracts" (Buchanan, Tollison, and Tullock 1980: 9).

A neo-utilitarian political economy, as argued by Evans (1995), was both cynical and utopian: cynical in denying the practical importance of "public sprit" and utopian in assuming that the "invisible hand" offers an easy substitute. Its utopian side gave it charisma but also burdened it with positions that were hard to defend, logically or empirically. Its extreme view of the state, however elegant, was logically untenable. Its utopian belief in the power of the market to reconstruct society was equally so (Evans 1995: 25).

The neo-utilitarian model of the state was only one part of a larger tradition of the "strategic actor" or "rational choice" models that continued to evolve during the 1970s and 1980s.

As this evolution proceeded, a number of concepts of critical importance to the ideological principles of the neoliberal policy revolution began to emerge. For example, North's earlier work (e.g. The New Institutional Economics 1986) was taken as justifying the neo-utilitarian focus on free markets as the key to development. But, in North's later work, the "pervasiveness of informal constraints" is emphasised, noting that "In our daily interaction with others, whether within the family, in external social relations, or in business activities, the governing structure is overwhelmingly defined by codes of conduct, norms of behaviour, and conventions" (Evans 1995: 33; North 1990: 36). He then goes on to argue that "institutional frameworks" are "the critical key to the relative success of economics" (Evans 1995: 33; North 1990: 69) and to lament that "we have paid a big price for the uncritical acceptance of neoclassical theory" because "allocation was assumed to occur in a frictionless world, that is, one in which institutions either did not exist or did not matter" (Evans 1995: 33; North 1990: 131). In a nutshell, the changing view of North can presented as a good example of the retreat from the neo-utilitarian vision.

Although North's work shows moral support for a comparative institutional political economy, it does not provide a clear empirical benchmark of how such an economy should be carried out. As a model of how an analysis can leave neo-utilitarian assumptions behind and replace them with a more institutionally sophisticated perspective, Robert Bates' work can be regarded as a great example. Bates (1981) made it clear that the results he observed were produced by a specific, historically grounded institutional context, not an inevitable general logic of how states work (Bates 1981).

But his work should be regarded as genuine political economy, not simply an application of economic logic to political institutions, because, using case studies of newly independent African countries, he showed that historically institutionalised bureaucracy can be an obstacle to the efficient allocation of resources. In his later work, he offers a very different analysis of the consequences of bureaucratic intervention in agricultural markets. He argues that an intensive infusion of bureaucratic regulation makes it possible to secure the capital input necessary for the reconstruction of peasant agriculture (Bates 1989: 80). However, this is not to say that the state has become the primary engine of development in his work. To the contrary, the kernel of his argument revolves around the interaction of the state and its private counterparts (Evans 1995,:35). Bates' work, as summarised by Evans (1995), is crucial because it practically shows that the state is analysed not as a generic entity whose economic impact can be deduced from the inherency of bureaucracy, but as a historically contingent creation whose properties depend on specific institutional endowments and the character of the surrounding social structure. In addition, he also presents a real example that shows that, under certain historical circumstances, state intervention in the process of accumulation may be an essential ingredient in the promotion of growth and transformation. Finally, his work empirically shows that states and societies are mutually constitutive.

In contrast to Evans' evaluation of Bates, the perspective of historical institutionalists such as Thelen, Kathleen and Sven Steinmo shows that Bates should be regarded as a representative scholar of the neo-utilitarian vision because his research was mostly concentrated on a rational choice model at a distance from a historical approach.

However, a different evaluation of Bates' theories is not really important. More worthy of attention is the fact that historical institutionalists share a common theoretical project and research strategy with the comparative institutional approach or new comparative political economy propounded by Evans. In a similar manner to the historical institutional approach, the new comparative political economy emphasises all factors (the players, their interests and strategies and the distribution of power among them) in context, showing how they relate to one another by drawing attention to the way political economic situations are structured. While many theories achieve elegance by pointing to particular variables that are alleged to be decisive, this theory focuses on illuminating the ways that different variables are linked. Thus, the new comparative political economy has allowed this researcher to capture the complexity of the real political and economic situations of the Korean developmental state without sacrificing theoretical clarity. One of the great attractions and strengths of this approach, as highlighted by Thelen and Steinmo (1992), is the way that it strikes this balance between necessary complexity and desirable parsimony (Thelen and Steinmo 1992: 13).

It is true that the Korean developmental state was shaped by specific historical, political, economic, geopolitical and international situations. Hence, in order to answer the main questions of this thesis ("How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?"), it is absolutely essential to investigate the changing features of these fundamental factors. However, this investigation should focus on examining how changing factors are linked to influencing the transformation of the Korean developmental state and the changing role of that state, rather than seeking to achieve a generic theory by pointing out particular variables that may be alleged to be decisive.

Therefore, it is worth reiterating that the new comparative political economy allows this researcher to capture the complexity of real political, economic situations in Korean developmental states, but not at the expense of theoretical clarity.

3.3. Analytical framework and strategy

On the basis of theoretical debates about the new comparative political economy, this section will present the analytical framework and research strategy of this thesis. As the major aim of this research is to investigate the changing role of the state in the transformation of the Korean developmental state after the 1997 financial crisis, it is firstly crucial to identify variables that influence the process of transformation in the Korean developmental state (developmental state → the crisis of developmental state → the reorganisation of developmental state). However, there will be obstacles for this researcher when executing systematic analyses to satisfy the aims of this research. This is because the existing arguments were mostly focused on a general tendency to explain the process of transformation in developmental states. More specifically, it can be said that the existing arguments not only placed too much emphasis on 'domestic factors' in explaining the crisis of developmental states with a failure to notice the importance of the World system's factors, but also focused too little on differences in different states in the process of reorganisation in developmental states. Consequently, it is necessary to constitute an alternative analytical model to make up for the weak points in the existing arguments.

3.3.1. Analytical framework and strategy

First of all, this thesis will utilise the standpoint of new comparative political economy (Evans and Stephens 1998: 730)[47] for the analytical framework and strategy.

Because it emphasises the fact that economic, political, and social developments cannot be explained purely in terms of "a predeterminate single process" or "constant causes," it instead places more emphasis on "different causes" and "historical causes" in the historical context to explain different types of developments in different countries (Yoon 1997: 211).. More specifically, this approach puts a methodological basis on the conjunction of ① the historical complexity of "class dynamics," ② the concept of the state as "actors," and ③ the interaction between a nation's developmental dynamics and the world system.

[47] As explained earlier in this chapter, it is essentially similar to 'comparative institutional approach (Evans 1995)'.

The whole idea of “joint projects,” which is central to the vision of Gerschenkron, Hirschman, Amsden, and Wade, makes close connections to key economic, political, and social groups fundamental to developmental efficacy (Park 2008: 42). This view also makes intuitive sense. Peoples usually discuss capitalist societies in which either investment or production cannot be implemented without the cooperation of private actors. The idea that states operate most effectively when their connections to society are minimised is no more plausible than the idea that markets operate in isolation from other social connections. Just as, in reality, markets work only if they are “embedded” in other forms of social relations, it seems likely that states must be “embedded” in order to be effective (Evans 1995: 41).

However, the question of how autonomy and embeddedness could be effectively combined in Korea and how they changed after the 1997 financial crisis are further complicated by the fact that many factors mutually influence each other.

Therefore, analytical generalisations must be grounded in an analysis of specific historical evidence. In other words, this thesis must examine the joint interactions of state structure, state-society relations and developmental outcomes in Korea. From the theoretical perspective of the new comparative political economy, this research utilises the following analytical strategies.

First, the change in the state-led developmental system, also called the crisis of developmental state, should be understood in the context of both the world system and domestic political and economic situations. Therefore, changes in the bureaucracy and economic system of Korea, especially the financial system, must be investigated; however, Korea's position in the world system and the impact of changes in international economic circumstances on Korea must also be considered.

Second, the state should not be regarded as a passive actor that accepts changes in domestic and international situations unconditionally. In other words, developmental states take policy actions in order to overcome or delay the changes that might affect their structural foundations to break down. However, the range of policy actions and policy choices is restricted by the context of the world system and domestic political and economic situations.

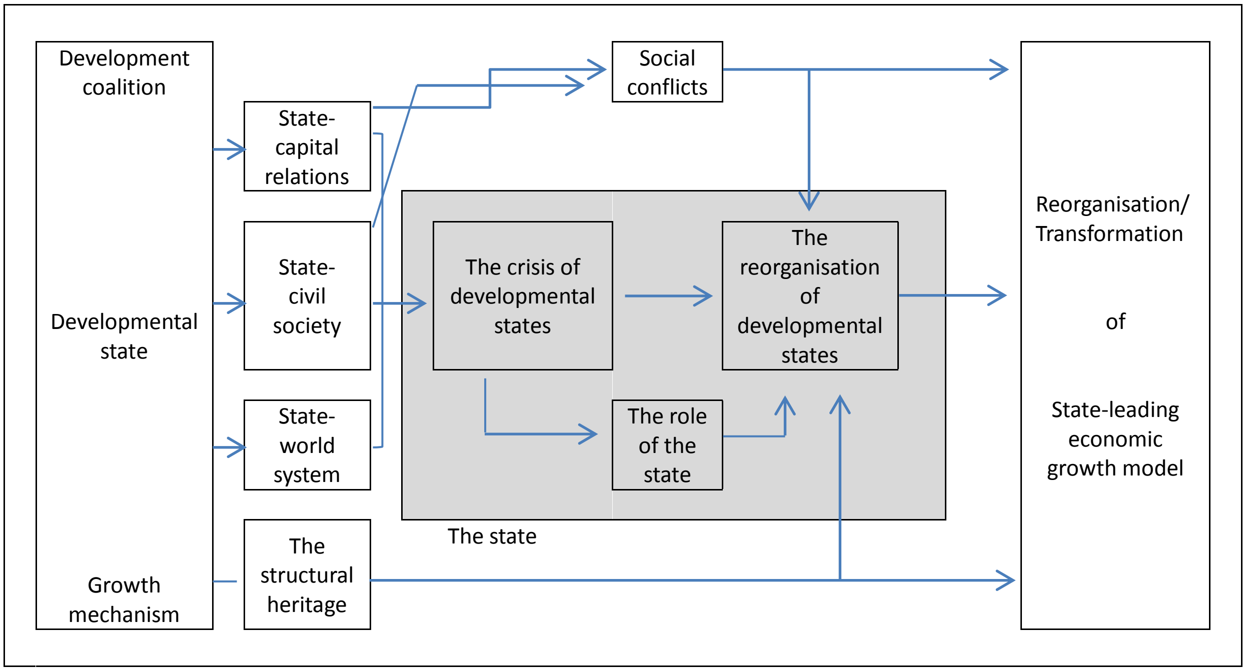
Third, the growth model of developmental states includes the processes of reorganisation and transformation influenced by the crisis of developmental states and the results of policies implemented to overcome it. The path of reorganisation depends on the degree of change, the pertinence of the states' policies and the patterns of social groups' reactions to policy actions.

Based on these analytical strategies, this thesis has identified various explanatory variables as structural factors of the crisis of developmental states. Three variables influence state autonomy: ① changes in the state-world system relationship, ② changes in the state-civil society relationship and ③ changes in the state-capital relationship; the main variable that weakens state capacity is the internal disturbances within the state's bureaucracy.[48]

Meanwhile, this research has also assumed that there are some factors that define 'the processes of the reorganisation of developmental states'; four elements are included as possible explanatory variables: ① the intensity of the crisis of developmental states, ② the role of the state (the efficacy of the state's policy actions to the crisis), ③ the response patterns and reactions of social groups, and ④ the structural heritage based on the judgment that the processes are inevitably 'path-dependent' and similar to the former growth mechanism. Accordingly, 'the crisis aspect and the reorganisation processes of Korean developmental state' can be dependent on the contents in each explanatory variable.

[48] These explanatory variables were actually mentioned in Introduction of this thesis in more abstract terms; " It can be said that there are three fundamental variables that affect the changing process of the Korean developmental state before and after the crisis: 1) the changes taking place among institutions that deal with financial systems, 2) politics between elite bureaucrats and financial policy administrations, 3) the situational factors that pull or push the state to abide by a certain change (such as globalization, industrialization, liberalisation and democratization)."

By the synthesis of contents above, the analytical framework of this thesis can be schematised as follows:



<Figure 3.1> Analytical Framework

However, the crucial point that should not be overlooked is that the analysis of the 'changing role of the state in transformation of developmental states: the crisis and reorganisation of developmental states' can be often criticised by abstract and storytelling explanations in this framework. Accordingly, it is this researcher's firm belief that a careful analysis of the above-mentioned explanatory variables is necessary in order to answer to the following core question: "*How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?*"

3.3.2. The structural factors of the crises of developmental states (explanatory variables)

The crisis of developmental states refers to the crises of the state-led economy and the state's strategic intervention in markets. But, this research mainly regards this as the weakness and decay of the autonomy and capacity of developmental states, which has led to miraculous economic growth for decades.

In this particular section, various structural factors (also known as explanatory variables) have been identified for the crises of developmental states: changes in the state-world system that weaken the external autonomy of states, changes in state-civil society and state-capital relations that decrease the internal autonomy of states, and the decay of internal cohesiveness in bureaucracy that weakens the state capacity. Unlike the three explanatory variables that lead to changes in state autonomy from outside of states, factors that decrease the state capacity are only within-nation elements. The details of the explanatory variables to be examined can be presented as follows:

Firstly, the emergence of world system's pressure structure is established in terms of changes in the state-world system. The creation of unfavourable external circumstances to East Asian developmental states can be included, such as the pressure of market opening and economic liberalisation by developed countries, protectionism of developed countries, the growth of the least among less developed countries, and so on. In fact, the Korean financial liberalisation program of the 1980s was mainly derived from such external pressures.

Secondly, the process of democratisation is set up in terms of changes in a state-civil society. The retreat of the authoritarian regimes of developmental states as influenced by democratisation can be simply illustrated by the retreat of developmental state's legitimacy (economic growth distribution of wealth), the intervention of public opinion and parliamentarism in the process of policy decision, and "state-capture" by interest groups (capital, labour). In a nutshell, democratisation has weakened the state's internal autonomy by occupying its decision territory.

Third, "the growth of private capitals" is established as the core indicator in terms of changes in state–capital relations. Because it is decisively important that developmental states implement policies and structuralise their policy networks, state–capital relations must be dealt with separately. State–capital relations have been changing from the vertical structures of the past to more recent horizontal and symbiotic ones in accordance with the political and economic growth of private capitals. With an equivalent status as the state, private capitals have played a leading role in weakening the legitimacy of developmental states' market intervention and also in refusing interventionists' policy instruments via the strong requirements of deregulation and liberalisation.

Fourth, "internal disturbances of the state bureaucracy" is established as the main indicator to investigate the changes in internal cohesiveness in bureaucracy that possibly declines the state's capacity. The creation of internal situations unfavourable to "strong, effective, efficient, and cohesive bureaucracy," "embedded autonomy," and the developmental state itself include an increase in the difficulty of mediating between different economic policies and controlling such policies by the increase of complexity of economic structures, the emergence of conflicts and rifts in the ruling bloc, disputes and factionalism between the government’s financial departments, and the conflicts and oppositions between neoclassical new bureaucrats and developmental-oriented old bureaucrats.

By the synthesis of structural factors of the crisis of developmental states above, explanatory variables to examine in this research for the aim of this thesis can be summarised as follows:

<table>
<tr><th colspan="2">Structural foundations of developmental states</th><th>Factors of the crisis of developmental states</th><th>Specific aspects of the crisis of developmental states</th></tr>
<tr><td rowspan="3">State Autonomy</td><td>External Autonomy</td><td>World system’s pressure structure
(state-world system)</td><td>- The pressure to open markets and pursue economic liberalisation enforced by developed countries
- Protectionism of developed countries
- The growth of the least-developed countries
- The pressure of industry restructuring</td></tr>
<tr><td rowspan="2">Internal Autonomy</td><td>The fulfilment of democratisation
(state-civil society)</td><td>- The retreat of the developing state’s legitimacy (economic growth and distribution of wealth)
- The intervention of public opinion and parliamentarism with the process of policy decisions
- State capture by interest groups(capital and labour)</td></tr>
<tr><td>The growth of private capital
(state-capital relationships)</td><td>- The pressure of turning a state-led economy into a privately led economy
- The pressure of economic liberalisation and deregulation
- An increase in the state’s dependency on capital</td></tr>
</table>

State Capacity	Internal disturbances within state bureaucracy	- Conflicts and rifts in the ruling bloc - Disputes and factionalism between governmental financial departments - An increase in the difficulty of mediating between different economic policies and controlling said policies - The conflicts and opposition between new neo-classical bureaucrats and older developmentally-oriented bureaucrats

<Table 3.1> Structural factors of the crises of developmental states: Explanatory variables

3.4. Analytical model

In this section, there will be proposition for an analytical model to examine the changing role of the state in transformation of Korean developmental state. To investigate the main theme of this research and to answer the main questions of its thesis, this researcher will suggest key elements of this model to influence the process of the crisis and reorganisation of the Korean developmental state: the state, capital and society as actors on the one hand and three variables to influence on the state autonomy and the main variable to weaken the state capacity as factors on the other hand. Three possible variables to influence on the state autonomy are ① the change in the state-world system relation, ② the change in the state-civil society relation, and ③ the change in the state-capital relation and the main possible variable to weaken the state capacity is ④ internal conflicts in state bureaucracy.

The general relationship between actors and the factors, as well as the action and reaction between them, is an essential part of shaping a casual model of the changing role of the state in the developmental state thesis. In addition to this, the specific relationship between actors and the factors of the financial reform in Korea after the 1997 crisis is believed to be a kernel for answering the main question of this thesis: “How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?” With this question in mind, the analytical model of this thesis will be decided.

3.4.1. The changing role of the state

The analysis of the changing role of the state can result in abstract and apparent outcomes because the role of the state itself cannot be easily defined or restricted by various foundations. By considering the complexity of dynamics, this thesis will adopt a method to investigate the changing role of the state by examining the changing features of the Korean developmental state at each period.

Accordingly, this thesis will introduce some actors and factors, as explained above, that can show changing features of the Korean developmental state at each period. Most of all, this researcher supposes that the features of the Korean developmental state at each period results from some specified relationship between the actors and factors and the ways in which they mediate changes in those relationships.

Although the main focus of this thesis is to investigate the changing role of the state through examining the changing features of the Korean developmental state via the "transformation of bureaucracy and financial system" after the 1997 financial crisis, the analysis for the classical period (1960-1997) is also essential to satisfy the aim of thesis more objectively and plausibly. Therefore, the summary of the changing role of the state—the changing features of the Korean developmental state with various changes in financial sectors during the classical periods—will be added before the analytical sections (Chapter 4: Korean developmental state's antecedent).

In a nutshell, this research will investigate the factors of the Korean developmental state's transformation and its effect on the relationship between actors and factors, and it specifically examines the "changing role of the state," especially after the 1997 financial crisis. Additionally, the perspective of a "new comparative political economy" or a "comparative institutional approach" will be used to investigate all the factors and relationships between actors and factors.

3.4.2. Korean bureaucracy

According to Chibber (2002), the core of a developmental state is the 'functional nature' implemented by the bureaucratic system of the developmental state, which means that the goal of a developmental state can be achieved if such functional nature is implemented well (Chibber

2002: 951-953). In other words, it is difficult to regard the Korean state as developmental if the bureaucratic system cannot fulfil its functions properly. Additionally, if the financial reform promoted by the Korean state after the financial crisis in 1997 was not successful, the reasons can be found in the bureaucratic system.

Hence, an analysis of Korean bureaucracy will be provided in order to review the way in which the direction of the change of Korea's bureaucracy, which had begun before the financial crisis, proceeded after the financial crisis, and at the same time examine which direction the Korean developmental state has changed and whether such changed were originally intended by the Korean state. This analysis will be simply the process of answering to the question of, "What was the role of economic bureaucrats during the miraculous periods of economic growth in Korea?" "When did bureaucracy start to change? How and why did it change?", then "What was the role of bureaucracy during the IMF regime?" "Is there any significant change in Korean bureaucracy after the 1997 crisis? What and why did it change?"

3.4.3. Change of financial system (financial reform after the 1997 financial crisis)

The Korean "miracle" of economic development since 1960s has been mainly explained by the concept of the "developmental state" (Johnson 1999: 38). The features of Korea as developmental state can be compactly illustrated by two main factors: "the regulation of industrial capital through financial support" (Amsden 1989: 13-14), and "the economic discipline based on politically independent bureaucracy" (Amsden 1989: 11-18; Wade 1990: 195-227; Evans 1995: 43-73).

Actually, the state-led financial system is at the core of developmental state strategies (Park 1994:129-133). Whether the state has the capacity and autonomy to allocate financial resources into certain industries is a crucial condition for consideration in a developmental state.

Accordingly, examining the changing features of the Korean developmental state in accordance with changes to the financial system after the 1997 crisis is the proper way to research the changing role of the state. All factors in the process of financial reform will be examined, including three variables that influence state autonomy: 1) changes in state-world system relations, 2) changes in state-civil society relations and 3) changes in state-capital relations; the main variable that weaken state capacity, such as internal conflicts in state bureaucracy, and those changing variables are also expected to show the changing features of the Korean developmental state. The procedures for financial reform after the 1997 financial crisis are expected to clearly show formal changes to the main features of the Korean development state: state capacity, state autonomy, internal cohesiveness and embedded autonomy. The changing role of the state should be obvious and is expected to show. Nevertheless, the main features of the Korean developmental state are still too abstract, although an examination of those features aids the investigation of the state's changing role following the crisis. This thesis will use case studies to clarify the changing features.

Briefly speaking, state capacity and state autonomy are mainly expected to be investigated by the case study on the public fund, and internal cohesiveness and embedded autonomy are mostly supposed to be examined by the case study on the Financial Supervision System after the 1997 financial crisis.

① The public fund

To examine the change in the state autonomy and capacity of the developmental state after the 1997 financial crisis, there will be the case study of the public fund. The state autonomy and the state capacity are shown when the state can direct financial institutions as to their structure /operations/use of funds. And the public fund was a pivotal measure given to the state in the name of overcoming the crisis and restoring the economy. Therefore, the process of mobilising, injecting, monitoring, and recovering the public fund is the proper yardstick for evaluating the state's autonomy and capacity. This process affects not only the internal state bureaucrat, but its relationship with financial and industrial capital.

This process can be divided into two parts: the injection of the public fund into insolvent financial institutions, and the recovery of the public fund from them. The former shows the degree of the state's autonomy because it means the financial support of the state to the domestic capital. Meanwhile, the latter can be used as an index to evaluate the degree of the state's capacity because it indicates the state's ability to supervise and discipline the domestic capital to cooperate with the state's capacity. To pursue the change of state autonomy, this case study will focus on not only the quantitative analysis of the public fund, but the qualitative analysis—the process of attaining the controls over the financial resources and therefore, strengthening its dominance over the industrial capital. After the 1997 financial crisis, by the analysis, the possible answer will be expected to be found whether the mobilisation and execution of the public fund make the typical relationship (between the state and the financial capital, industrial capital) be sustainable as the model of developmental state, or not.

The subsequent analysis of state capacity will be presented as divided into two parts: the internal and external capacities of the state. First, regarding internal capacity, an analysis of bureaucratic cohesion and the arrangement of authority among the bureaucratic bodies will be executed during the IMF regime. Second, regarding external capacity, an analysis of control and supervision over the financial institutions supported by the public fund will be carried out. If there are poor results in the recovery of the public fund, it can be regarded as the absence of discipline over the domestic capital, that is, the external capacity.

② Restructuring of financial supervision system

To evaluate the direction of the financial supervision system reform after the 1997 economic crisis in Korea, and to address the question of whether the direction matched the goal pursued by the state, the case study of the financial supervision system will be used. As an implemental method to overcome the financial crisis and improve the financial structure, *the public fund* was regarded as an effective and suitable solution. However, the positive effectiveness brought by *the public fund* could not appear well at a time when the state capacity to supervise and regulate the financial market had been weakened significantly. Accordingly, the financial supervision system began to change after the financial crisis.

This case study attempts to analyse what kind of success was achieved by the financial supervision system changes made to meet this condition at a time when the strengthening of the supervisory regulation of the financial market was recognized as essential after the financial crisis. To determine this, Korea's financial supervision system changes after the 1997 financial reform will be examined, and then it will be determined whether, as a result thereof, the state capacity (to supervise and regulate the financial market) was strengthened. It will review and evaluate not only the political alignment of the stakeholders in the financial supervision system reform, but also the role that Korean bureaucrats played in the reform process. Also, by citing a few cases to evaluate whether reforms were executed well, the process and result of the reform will be evaluated.

Additionally, the financial supervision system can be regarded as not only well structured but also as working well when high bureaucratic rationality and strong internal cohesiveness are present in the system. Hence, the changing features of the Korean developmental state ('strong, effective, efficient, and cohesive bureaucracy' and 'embedded autonomy') are also expected to be found in the FSS case study concerning the process of overcoming the financial crisis. In other words, the analysis is also expected to answer the question of whether the restructuring of the financial supervisory system will make the typical features of the Korean developmental state (well-organised bureaucracy and strong internal cohesiveness) sustainable with the model of developmental states or not.

3.4.4. Analysis

To clearly answer the large and small questions of the thesis by integrating and analysing the results of the case studies, the chapter of analysis will be presented. In other words, the synthesis of the results derived from case studies (Korean bureaucracy, the public fund and the Financial Supervision System) is expected to be useful in answering the main question of this thesis, "How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?", and two subordinate issues of, "Whether state's purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the 1997 crisis was successful or not" and "what was the direction of the financial supervision system reform after the 1997 financial crisis in Korea? And was the direction matched the goal pursued by the state?"

It is undeniably true that there is an assumption that all the changes can be expected to show clearly at critical junctures like the financial crisis, but the findings of this thesis must answer the question, “How did the explanatory variables that had changed the Korean developmental state into a ‘post-developmental state’[49] before the financial crisis in 1997 influence the change of the Korean developmental state in the process of overcoming the crisis, through ‘financial reform’ after the financial crisis? ”

3.5. Methodology

The analysis of the transformation of Korean developmental state, and its impact on a changing role of the state after the 1997 financial crisis, can be categorised in the properties of macro analysis. It is therefore reasonable that many explanatory variables and various research materials must be considered. Accordingly, this research will use many materials: first of all, as primary resources, this research uses empirical data, documentary literatures and archives from the government and parliament of Korea, Official statistical data, policy information and policy reports, published by the Ministry of Finance and Economy[50], the National Statistical Office, the Bank of Korea and the Financial Supervisory Service, will be included. Also, reports and statistical data from main research institutes such as Korea Development Institute (KDI) and Korea Institute for International Economic Policy (KIEP) will be used for this research.

[49] In this thesis, a post-developmental state is a state that institutionally shows weakened characteristics of the existing developmental state due to a rupture within bureaucracy and the abolition of leading agencies and at the same time still maintains the characteristics of a developmental state with new types of institutional devices and hidden policy mechanisms. In terms of internal and external relationships, Neoliberal globalization and the appearance of a strong society serve to weaken the tendency of a developmental state to a certain degree, but at the same time a post-developmental state maintains the unique pattern of a developmental state quickly adapting to environmental changes. In addition, in relation to policy, a post-developmental state mostly engages in discourses related to neo-liberal globalization. Such discourses have a somewhat limited social mobilization effect compared to the various ideological elements of the developmental state of the past, but it cannot be denied that they are still a powerful political ideology. In short, a post-developmental state can be described as a type of transitional state that combines the characteristics of a developmental state and Neo-liberalism.

[50] In 2008, the Ministry of Finance and Economy was actually merged with the Ministry of Planning and Budget, so it is now the Ministry of Strategy and Finance.

However, in order to satisfy the main aim of this thesis, the analysis should be focused on not only the state itself, but also dynamic relationships between the state, capital and social groups. Because these mutual dynamics cannot be simply investigated by statistical data, economic indicators, and official research products, various research products, based on formal and informal data to correctly show political, economic and social context in policy decisions and policy changes, are essential to more objectively understanding such dynamics.

Accordingly—on the primary research basis by references and contemporary literature from various interdisciplinary departments of politics, economics, and social studies to mainly explain Korean developmental state—this research will try to find political, economic, and social contexts to achieve the aim of this thesis, through examining the 'transformation of financial system and bureaucracy'. More specifically, the detailed analysis of 'Korean bureaucracy', 'the public fund', and 'the financial supervisory System', and semi-structured qualitative interview[51]s to understand the experience of political elites/bureaucrats in terms of the financial system will be presented in later chapters in order to satisfy the aim of this research and to enrich the explanation.

3.6. Conclusion and Emerging Issues

The Korean developmental state was shaped by specific historical, political, economic, geopolitical and international situations. Therefore, in order to answer the main question of this thesis, "How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?" it is absolutely essential to investigate the changing features of these fundamental factors. However, such an investigation should focus on examining how these factors are linked to the transformation of the Korean developmental state and the changing role of the state, not on seeking to achieve a generic theory by pointing out particular variables that may be alleged to be decisive. As previously stated, the new comparative political economy has allowed this researcher to capture the complexity of the real political and economic situations in the Korean developmental state, but this has not come at the expense of theoretical clarity.

[51] See Appendix 1, 2, and 3

To satisfy the main objective of this research, it is crucial both to discover some variables that influenced the process of transformation in the Korean developmental state (developmental states → the crisis of developmental states → the reorganisation of developmental states) and to investigate the changing role of the state in Korea affected by those variables. Accordingly, this thesis uses the new comparative political economy approach for the analytical framework and research strategy because it shows that economic, political and social developments cannot be explained purely in terms of a predeterminate single process or constant factors. This approach places more emphasis on different historical factors within the historical context to explain different types of development in various countries.

Based on this analytical framework, to investigate the main theme of this research and to answer the main questions of its thesis, this researcher will suggest key elements of the model to influence the process of the crisis and reorganisation of the Korean developmental state: the state, capital and society as actors on the one hand and three variables to influence on the state autonomy and the main variable to weaken the state capacity as factors on the other hand. Three variables to influence on the state autonomy are ① the change in the state-world system relation, ② the change in the state-civil society relation, and ③ the change in the state-capital relation and the main variable to weaken the state capacity is ④ internal disturbances of state bureaucracy.

The general relationship between actors and the factors, as well as the action and reaction between them, is an essential part of shaping a casual model of the changing role of the state in the developmental state thesis. In addition to this, the specific relationship between actors and factors through the financial reform in Korea after the 1997 crisis is believed to be a kernel for answering the main questions of this thesis, “How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?”, “What was the process of changes to the financial system and developmental state of Korea before and after the 1997 crisis?”, “How did the role of bureaucracy change within this transformation? Accordingly, the detailed analysis of ‘Korean bureaucracy’, ‘the public fund’, and ‘the financial supervisory system’ and semi-structured qualitative interviews to understand the experience of political elites/bureaucrats in terms of the financial system will be presented in later chapters in order to satisfy the aim of this research and to enrich the explanation.

Emerging Issues

The crisis of developmental states, in this research, means the former growth mechanism or 'state-led economy' loses its validity, and the 1997 financial crisis accelerates this crisis to the forefront. So, developmental states started to reorganise their systems and structures in order to overcome the crisis and reconstitute a 'new growth mechanism'. The process of the reorganisation of developmental states can be classified as 'Post-developmental states' that have strong features of a 'market-led growth mechanism' or 'Flexible developmental states' that keep relative features of a 'state-led growth mechanism'; classified by the main criteria of "whether the state still has a capability in leading or controlling economic growth by economic and industrial policies" and "the degree of relative importance of state and market in economic management".

So, the important issues are re-emerging although these issues have already been mentioned in Chapter 2.

- How can the transformation of the Korean developmental state be categorised? 'Post-developmental states' vs. 'Flexible developmental states'
- What is the role of the state in 'Post-developmental states' and 'Flexible developmental state'?

In this end, the procedure to find answers for the main question of this thesis: "*How did the financial crisis transform the Korean developmental state and how did it influence the role of the state? in finance as well as the structure of the state bureaucracy*" is strongly related to these issues.

Chapter 4
KOREAN DEVELOPMENTAL STATE'S ANTECEDENT

4.1. Introduction

Chapter 4 mainly presents historical reviews of the Korean developmental state, including specific explanations about the industrial policy, the state-led financial system and unique institutions which can be specific characteristics of the Korean developmental state. However, it will be more focussed on the formation and change of the state-led financial system to explain the change of the Korean developmental state. This occurs on the basis of the belief that a focus on the restructuring of the financial system before and after the 1997 crisis can provide a clue not only to investigate the transformation of developmental states and the changing role of the state but also to identify the political dynamics shaping economic, political, and social reformation. In short, this chapter primarily provides background on Korea's developmental state and financial control before the 1997 financial crisis.

In this chapter, it will primarily present an interpretation about the development of the Korean economy by focusing on the unique institutions established by the state, and analyse the changes that led to the crisis. To promote economic development, the Korean state created the state-led financial system and on the basis of this formed unique relations between the government, banks, and business, which had the characteristics of regulation, discipline and cooperation at the same time. These specific institutions were produced by combining the mechanisms of the market and the state, and enabled rapid economic growth by allocating financial resources to selected industries and companies.[52] However, the growth of the private sector and the changes in the relations between the government and companies due to economic development resulted in a breakdown of this unique institution, and made existing problems increasingly serious. Nonetheless, there was no substantial reform of the institutions, and the deregulation and the rash

[52] These specific institutions built by mixing the state and the market mechanism functioned as a kind of quasi-internal organization on the whole economy (Lee 1992: 188-189).

opening of the financial market starting in the 1990s brought down the previous institutions, causing the economic crisis in 1997.

This chapter will be organized as follows. In section II, it will examine specific institutions and their operation in Korea with reference to an industrial policy and financial system. And in section III it will show the change of the Korean developmental state with the change of the financial system and the degeneration of institutions. In this process, there will be expectations to get some suggestions for the answer of the main question of this thesis, "How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?" and also raise the requirement of "redefinition of a new role of the state for further development". Finally, in section IV, it suggests summaries and implications of this chapter.

4.2. Korean developmental state and its operation

In the process of decolonization, the Korean state was departed as 'overdeveloped state' which state has overwhelming advantage, due to the historical and political characteristics of the national division, war and the Cold War structure. In this situation, the Korean state could secure the state autonomy which is one of the structural conditions of the developmental state formation. After that, before and after 1960s developmental state's ideological foundations could be arranged by the political system based on the state legitimacy which identifies itself with the economic growth. At the same time, the Korean state could also secure the state capacity which is another structural condition of the developmental state formation with the establishment of competent and cohesive bureaucracy which can be regarded as organizational and institutional foundations of the developmental state.

Under these historical, political and economic situations, the Korean developmental state has started to run the state-led growth regime in earnest from 1960s.

4.2.1. The industrial policy

It is true that the Korean government implemented a powerful industrial policy to foster specific industries and achieve economic development that went beyond simple management of the macro economy. While the intervention of the state with industrial policies is justified by the widespread market failure due to transaction costs and coordination problems, it can lead to serious failure of the state, such as rent-seeking and the problem of information asymmetry. In Korea, these problems could be alleviated through regulation and cooperation between the state and the private sector (Amsden 1989: 8-11; Chang 1994: 3-5). Various measures such as entry regulation, protection from imports, and tax benefits were mobilized for the implementation of the industrial policies, but the most important tool was preferential financing based on the state-led financial system[53].There are various phases in industrial policy in Korea: export promotion policy since 1964, heavy and chemical industrialization Big Push during 1973-1979, state-led rationalization programs during 1979-1982, various liberalizations after the mid-1980s and high technology promotion policy after the late 1980s(Kim and Hong 1997: 99-101). This section will analyse the phase and content of industrial policy focusing on financial measures below.

Korea's industrialization began with the adoption of an export promotion policy by the military government, which made economic development the highest priority. The Park Jung-Hee government implemented export-oriented industrialization, with the background of a reduction in foreign aid, a lack of foreign exchange, and the limitation in the industrialization for import substitution, and adopted power tools for financial assistance to achieve the goal[54]. The government introduced the short-term export credit program in 1961 to automatically provide a discount benefit to exporters who obtained a letter of credit, and later expanded the scope of beneficiaries to include those who imported raw materials. In 1972, various measures were integrated into the Regulation of Export Financing to increase the scale (Table 4.1).

[53] In fact, it can be said that such diverse policy measures were operated in a systematically integrated manner to promote the goal of industrial policies. Moreover, such policies as policy loans, export promotion, sophistication of industrial structure, etc. were all related. In this regard, the evaluation of the industrial policies by World Bank, which interprets the industrial policies narrowly as sophistication of industrial structure, is not appropriate (Singh 1995).

[54] The various measures included an exchange rate cut, exemption from tax and tariff, and political support and administrative guidance, but the rate of financial support and fiscal support for exports from 1965 to 1980 reached 7:3 (Cho and Kim 1997: 18-21).

<Table 4.1> Export loans in Korea (%)

	61-65	66-72	73-81	82-86	87-91
EL/Total Loans by DMB	4.5	7.6	13.3	10.2	3.1
EL/Total policy loans	n.a.	n.a.	20.4	16.5	4.5
EL by BOK/Total EL	n.a.	66.3	73.0	64.5	45.3
EL interest rates (1)	9.3	6.1	9.7	10.0	10-11
General loan interest rates (2)	18.2	23.2	17.3	10-11.5	10-11.5
(2) – (1)	8.9	17.1	7.6	0-1.5	0-0.5

Note: EL means export loans and N.A. means not available.
Source: Bank of Korea, Economic Statistics Yearbook, various issues; in Cho and Kim (1997:32)

The volume of export credit and subsidy for interest were considerable, and the consequent rent increased from 0.3% of GNP in 1963 to 1.7% in 1970, 3.0% in 1975, and 4.7% in 1980 (Cho 1997: 220). This changed the incentive structure for the private sector, and as a result Korea's exports increased rapidly. Meanwhile, the export credit was both a strong regulation mechanism and a subsidy, as the government allocated financial resources according to the previous performance in exports. In addition, the government and companies cooperated closely in the implementation of various financial measures for the promotion of exports, such as export credits (Amsden 1989: 70-72; Sakong and Jones 1980: 16-20).

Entering the 1970s, the Park Jung-Hee government ambitiously began to promote heavy and chemical industries which had big growth potential, considering the limitations of labour-intensive industrialization, the changes in the international economic environment, considerations about national security, etc. That is, the Korean government planned to develop the steel, chemicals, non-ferrous metals, machinery, shipbuilding, and electronics industries, using various tools such as policy loans, tax support, and the construction of industrial complexes (Stern et al. 1997: 25-28). In the process, the government emphasized large-scale investment and the prevention of excessive competition, which resulted in fostering mainly large companies which are called *chaebols*. Here too, we can see that the core tools were financial measures such as the new establishment of the National Investment Fund and the expansion of policy loans, and the rediscount of the Bank of Korea. Through the provision of financial support, the government attempted to facilitate large-scale investments by companies that had been hesitant to invest due to uncertainties. The National Investment Fund was established on the basis of the savings at private financial institutions and the issuance of bonds. In 1973, the fund was allocated to heavy and chemical industries at long-term, low interest. In the latter half of the 1970s, the fund occupied 25% of total loans for heavy and chemical industries and 70% of the total investment in facilities. In addition, the government expanded the rediscount related to the heavy and chemical industries sector by revising the Bank of Korea Act in 1970, and concentrated policy loans, including the fund of Korea Development Bank and foreign capital, in this sector. Eventually, the state-led development financial system was completed during the 1970s for the promotion of heavy and chemical industries, and the proportion of the policy loans for heavy and chemical industries increased from 44% in 1970 to 68% in 1980 (Lee 1996: 402-403).

In this process, too, there were regulation mechanisms, such as the strict screening of investment and permission of entry by the export promotion policy (Kim and Hong 1997: 34-38). As a result of these efforts, the investment in heavy and chemical industries grew rapidly, the structure of industries and international trade became more sophisticated, the technological capabilities of companies were enhanced, and the serious deficit in the current account of heavy and chemical industries was alleviated (Amsden 1994: 630-631; Singh 1995; Lall 1997: 650-651). While the increase in the investment in heavy and chemical industries and the quantitative economic growth were successful, it must be pointed out that the ensuing growth of *chaebols* and the aggravation of the problems in the financial sector were problematic.

In addition to ex ante promotion of investment, the Korean government made great efforts for ex post management of investment through the state-led industry rationalization programs implemented several times in the early 1970s and the early and mid-1980s. In 1979, faced with a recession that occurred after the active promotion of heavy and chemical industries, the government forcibly merged many companies and reinforced entry regulation to resolve the problem of surplus facilities, and the core tools used at this time were also financial measures. That is, measures such as preferential loans, debt-stock swap by Korea Development Bank, and even temporary suspension of payment for bank loans were mobilized. While these measures are also understood as a kind of regulation mechanism (Chang 1994: 3-5), the power of the chaebols increased even more after then, as such measures were taken mainly in the form of an external acquisition by a third party. Such a policy shows that the government shifted the responsibility for the industrial sector to the financial sector if necessary, and directly intervened with the economy on behalf of the market.

The keynote of the industrial policy since the 1980s was macro stability policy, and the intervention of the government was reduced by the import liberalization in 1984 and the investment liberalization through the adoption of the Industrial Development Act in 1985. Since then, support for small & medium corporations (SMCs) and technological policies was stressed (Leipziger and Petri 1993: 12-15). It is noteworthy that financial measures were mainly used in such a situation. The government continues to strongly regulate the industries for rationalization after the liberalization of investment, but the *chaebols* rapidly increased their investment since the 1990s when the rationalization period ended.

Ultimately, the Korean state intervened with the industrial sector through various types of industrial policies for the promotion of investment and economic development, and proper regulation and cooperation between the government and companies enabled the growth of companies and economic development. Such intervention was mainly based on financial measures, and would have been impossible without the state-led financial system. However, despite the success of rapid industrialization, it aggravated the serious problems of the financial sector and reinforced the economic power of the *chaebols*.

4.2.2. The state-led financial system

While financial repression theorists point to the harm of the financial control of the government, the recent financial restriction hypothesis asserts that intervention in the form of interest rate regulation, policy loans, etc. can be effective for economic development (Stiglitz and Uy 1996: 267-270; Cho 1997: 215-218). In fact, the financial market is intrinsically incomplete due to the problem of asymmetric information, and state intervention is important for economic development in the long-term point of view (Hellman et al. 1997: 205-206). The Korean government was much more powerful in financial intervention, and was also very active in creating new financial markets, such as non-monetary institutions and capital markets, designed to absorb the capital in the market. That is, the state-led financial system established by the Park

Jung-Hee government in the 1960s and reinforced during the 1970s played the role of mobilizing funds to the maximum and allocating them to specific sectors according to industrial policy.

Various policies have been implemented by the government since the 1960s to control finance. First, the Commercial Bank of Korea was nationalized in 1961 by transfer of stocks and ownership, and the currency policy began to be controlled by the government in 1962 after the revision of the Bank of Korea Act, which clearly states that the president of the Bank of Korea is appointed by the government and that the authority over foreign exchange control belongs to the government. In addition, Korea Development Bank was established in 1961, Kookmin Bank in 1963, and Korea Exchange Bank in 1967 as the financial institutions that manage policy loans. In 1962, the role of Korea Development Bank increased by expanding its capital, guaranteeing foreign currency loans, expanding long-term loans, etc. Meanwhile, the government increased its control over the finance and corporate sectors by strengthening its control of the inflow of foreign capital. After taking various measures such as the Foreign Capital Attraction Facilitation Act in 1966, which allowed Korea Development Bank and special banks to give an assurance for loans from foreign countries to the private sector, the proportion of payment guarantee for overseas loans in the loans of savings banks and the proportion of foreign debts against GNP increased rapidly: 6.1% in 1964 to 15.1% in 1967, 27.1% in 1969 and 33.9% in 1972(Choi 1996). As it was only possible to get overseas loans with the approval of the government's 'Overseas Capital Attraction Committee,' the government exercised strong control to concentrate such loans in specific sectors.

Meanwhile, the government implemented a broad-scale financial liberalization policy in 1965, which included readjusting interest rates to a realistic level, and as a result personal savings and bank loans rapidly increased. Though the government claimed to be following market principles, its goal was to attract funds from the private money market to the banking sector, and this strengthened the government's control over financial institutions, as banks were already controlled by the government. In reality, there were many exceptions related to special loans, such as export loans and agricultural loans, and the private money market was frozen by the 8.3 measure in 1972 after the recession, with the government returning to a low interest rate policy. This low interest rate policy and preferential loans were adopted to support the industrial sector, and continued to the 1980s.

To allocate the financial resources to preferential sectors, the government used policy loans such as export loans, loans for SMEs, and housing loans[55]. Excluding the discount for the Commercial Bank of Korea, policy loans represented more than 65% of total loans between 1961 and 1970, and over 60% of the loans of savings banks between 1973 and 1991(Choi 1996: 23-27). Until the mid-1980s, export loans and the machinery and facilities loans concentrated in heavy and chemical industries and foreign loans took the largest share (Ibid.). In the process, the close cooperation between the government and companies and the regulatory system called 'competition' were distinguishing features, but ultimately the policy loans supported large companies, which controlled exports and heavy and chemical industries.

With control over the financial sector, the government made efforts to mobilize private funds in the private money market through the establishment of non-bank financial institutions such as short-term finance companies and mutual savings financial companies, and by expanding the capital market after 1972. Faced with the recession and a lack of funds, the government made efforts to freeze the private money market and develop non-monetary institutions in order to mobilize funds without weakening its control over the bank sector and raising interest rates, and as a result the non-bank financial institutions (NBFI) grew rapidly (Cho and Kim 1997: 30-34). In addition, the government attempted to develop the capital market and inhibit excessive borrowing by companies from banks through the capital market promotion act in 1968, the public offering facilitation act in 1972, and the 5.29 measure in 1974 that stipulated the strong regulation of non-public enterprises. That is, in Korea, the financial markets other than the bank sector were also established through the active measures of the government, and they weakened the government's control over financial institutions.

Meanwhile, the government shifted the risks of the industrial sector to the financial sector through various measures for the relief and merger of companies, which accompanied the preferential loans. Faced with recession in 1972, the government had close discussions with companies and attempted to relieve the companies that were deep in debt through economic

[55] Policy loans in the narrow sense include specific loans of savings banks such as export loans, facilities loans, and housing loans and the loans of Korea Development Bank. In a broader sense, policy loans include automatically rediscounted commercial bills, foreign currency loans, and the loans of EXIM Bank in addition to the aforementioned loans.

emergency measures that stipulated the temporary freezing of companies' debts to the private money market, extensive rescheduling of bank loans, reduction of interest rates, etc. Even after the 1980s, the government took steps to relieve insolvent enterprises by putting pressure on creditor banks to repay non-performing loans, provide preferential interest rates, and extend debt maturity. In this way, the financial system of Korea played the role of facilitating the sharing of risk between the government and companies.

Ultimately, Korea's state-led financial system played an important role by mobilizing funds and allocating them to specific sectors to increase investment and reduce risks in the private sector. Though such a system laid the basis for the government to regulate companies, it promoted the rapid growth of the chaebols, which had high debt rates and weak corporate governance, and deepened the problems of the bank sector, such as non-performing loans and a lack of managerial autonomy.

4.2.3. The state's institutional measures to achieve its aim

Despite many problems, the industrial policy based on the state-led financial system to facilitate and manage investment in high-priority sectors was successful in facilitating economic growth. The government built a specific institution that performed the role of internal capital market called 'quasi internal organization'[56] that included the government, big business and the banks. In this institution the government acted like a headquarters of a company using financial institutions like a financial department and firms ran a business like an operation division of so called Korea Inc. (Shin and Chang 2003: 11-16). Each sub-organization or agent in the institution, including big businesses and banks, adapted themselves to this specific institution in constraints the institution made. So, this particular section will examine the operation of each sub-organization and the relationship between them in Korea like below.

Institutions are usually understood as the rules of the game of a society composed of the formal

[56] Some theorists find the specific institution in Korea at the whole economy and call it 'quasi internal organization' (QIO) according to Williamson's theory about hierarchy. They argue that a kind of QIO was constructed that was constituted by the government and large enterprises in which there were hierarchical relationships and a set of implicit contracts (Lee 1992: 188-189).

rules and the informal constraints and the enforcement characteristics of each (North 1990: 36). More broadly they are defined as a set of constraints which govern the behavioural relations among individuals or groups, including formal or informal organization, markets, contracts and cultural rules (Nabli and Nugent 1989: 1334-1335). The function of a system is to overcome market failure by solving the collective action and coordination problems within the economy through reducing transaction costs and the problem of information asymmetry. In developing countries, rule of law and good bureaucracy are essential for economic development (Rodrik 1996: 91-93). Institutions not only complement the market but are also a mechanism for economic coordination by itself, and thus we will have to pay attention to the structure of the organizations which coordinate the economy, including the market, which are organized by the institutions (Samuels 1995: 571-572). Here, the role of the state is the most essential in that as a central part of institutional complex, it can construct specific institutions and further determine the path of development, given its ability to enact or enforce the rules of the game. Also, the relationship between the state and the society, the so-called the embedded autonomy of the state or power relationship between agents in institutions makes a significant effect on the formation and operation of institutions, as East Asian countries show (North 1989: 1326-1329; Khan 1995: 75-77). Meanwhile, the organizations within institutions attempt to adapt themselves to the institutions and also change them, and as a result there is a mutual dynamism between the institutions and the organizations (North 1995: 22-24).

First, the Korean state had powerful administrative capabilities and strong autonomy, with the characteristic of a typical developmental state. Based on land reform and certain social and historical conditions such as a relatively equal distribution of income, the Korean state was able to reduce the rent-seeking behaviour of the private sector without being captured by interest groups and the long tradition of bureaucracy and reforms increased the government's capacity to execute policy (Leftwich 1994: 405-407). However, the characteristics of the Korean state were that it was not a 'predatory state,' and at the same time it closely coordinated and cooperated with the private sector (Evans 1995: 51-53). Also, political pressures such as the Cold War and the strong will of the national leader were important factors that went into the development-oriented state (Amsden1989: 35-38). These embedded autonomy and capacity of the state were the basis for the state-led financial system, and the unique relationship between the government, banks, and companies, and the state played a role in establishing and operating institutions.

Through its control over finance, the government was able to regulate companies that were dependent on loans, and at the same time supported and grew large companies in cooperation.

Large companies in Korea were fostered with the massive financial support of the government. The Chaebols in Korea, which have diversified corporate structures and an internally concentrated ownership structure, grew with the government's facilitation of exports and the strategy of promoting heavy and chemical industries (Lee 1997: 20-23). Since the 1970s, they increased their investment in sectors deemed high priority according to government policy, enhanced efficiency through the regulation of the government which linked them with external markets and the internalization of production factors and at the same time cooperated closely with the government's economic policy through the policy consultative committee. In short, Korean large companies grew with the support and regulation of the government the specific institution including the state led financial system (Wade 1995: 306-309; Amsden 1992: 55-58). However, the state-led financial system, which supported industrial investment by creating inexpensive credit, made large companies vulnerable to recession by increasing their dependence on debt.

Also, large companies obtained more credit using the method of cross-payment guarantee, and pursued maximum growth and diversification rather than profit maximization in order to reduce their risk of bankruptcy, based on an expectation of government support. In particular, the corporate governance of chaebols typically had weak internal and external monitoring mechanisms, such as director and auditor system and the monitoring of the capital market and financial institutions, due to the limited surveillance of companies by financial institutions in the concentrated and distorted ownership structure and the state-led financial system. In the diversified corporate structure, the effort of chaebols to obtain more credit deepened the concentration of ownership, and such an ownership structure increased the power of the heads of large companies in their negotiations with the government. This problem became more serious as the financial power of the chaebols strengthened, and the government could not regulate the chaebols effectively.

In this institutional setting, banks, as the institutions that virtually carried out the industrial policy of the government, played the role of mobilizing and distributing funds and taking the risks of the industries. Such a method of fund distribution was effective in the early stage of economic development when the financial market had not developed sufficiently, and banks were supported by regulations and assistance such as entry regulation, interest rates, policy loans, and the rediscount and special loans from the central bank. However, the banks were not able to monitor companies due to a lack of managerial autonomy in the powerful regulation and support of the government, and thus asked for collateral in the process of making loans. Credit was offered to chaebols in concentration, which could become a serious problem if the government's regulation weakened without proper reform. Meanwhile, the immense burden of the banks led to the demand for financial liberalization.

Ultimately, it can be said that the Korean government established a specific institution by mixing the state, which controlled finance and supported and regulated large companies, with the market mechanism. In such an institution, a unique relationship existed between the government, banks, and companies: the government regulated and controlled large companies, and at the same time supported them and cooperated with them on the basis of its control over banks. The problems with this system and the conflicts among the principal agents were aggravated by the government's weakening control of the finance and regulation of companies. In fact, the system had to change due to its own success and Korea's economic development.

4.3. Korean developmental state's change: the changes in the financial system and the relationship between the state and business

In Korea, the state constructed specific institutions in which the government allocated financial resources to specific sectors to promote large private investment. The government disciplined businesses reducing rent-seeking activity by the peculiar mechanism of subsidy based on performance. For the operation of this institution the government's hegemony over business with control of finance was essential and the state-led financial system was the most important factor of these institutions (Zysman 1983: 286-288; Woo 1991: 123-125).[57] In this way, the state

[57] The state intervention in this process was not replacing the whole market but building specific institutions compounding the state and the market mechanism and operating them. The government intervened into financial market and allocated financial resources distorting market prices but at the same time this preferential allocation was based on performance in the market. .This mechanism is called 'contest' mixing competition and test or 'contingent rent' (World Bank 1993; Aoki et al. 1997).

succeeded in fostering large companies called ‘chaebol’ and achieving economic growth, but at the same time its policy produced weak corporate governance and capital structure and problems in the financial sector. In the meantime, the changes in financial system and the growth of chaebols with economic development aggravated such problems, preventing the previous institutions from operating effectively. However, it was impossible to substantially reform the institution due to the resistance of chaebols, and the vast deregulation and opening of the financial market that began in the 1990s dismantled the previous institutions, causing the economic crisis of 1997. So, this section will specifically analyse changes in the state-led financial system and institutions, in order to show the changes of the Korean developmental state.

4.3.1. The change of the financial system in Korea

(1) The development of financial liberalization after the 1980s

In the early 80s, serious problems of overcapacity in HCIs, unbalanced growth between large and small firms, and vulnerability in financial sector in recession of world economy appeared (Corbo and Suh 1992: 327-328). In response to this crisis, the government adopted stabilization policies and at the same time deregulated the financial sector and introduced liberalization measures, such as the easing of interest rates and entry regulation, reduction of policy loans and privatization of banks. However, the banks’ managerial autonomy was not established in this process, and the government’s intervention in the financial sector continued. The opening and liberalization of the financial sector was rapidly accelerated beginning in 1993.

Within the financial liberalization program, the government first sold out its share of the Commercial Bank from 1981 to 1983 within the possession limit of chaebols. Subsequently, joint ventures of Korean and foreign banks were allowed in 1982 and 1983, and the restrictions on entry into the financial industry were eased several times: for NBFI in 1982, for insurance companies in 1987, and for local financial institutions in 1989, as well as the conversion of short-term financial companies into banks in 1991. At the same time, the government eased regulations on the business of banks and NBFI, NBFI grew remarkably in competition, and the control of the government weakened further. The most important financial deregulation was the one on interest rates and policy loans. In 1982, the government unified the preferential interest rate applied to various policy loans such as NIF or export loans at 10%, and allowed financial institutions to decide their own interest rates beginning in 1984. However, the interest rates were lower than the market interest rates throughout the 1980s and the gap in interest rates between banks and NBFI was also maintained. In 1988, most regulations on interest rates, including those for corporate bonds and commercial bills, were alleviated, and the range was expanded in 1991. However, the government kept intervening to maintain the interest rates as lower than the market price in order to promote investment in industries (Amsden and Euh 1993: 382-383). In the '3-stage financial reform plan' adopted in 1993, in an environment that included weakened banks, changes in the financing pattern of companies, and international pressure, the government clearly stated its intent to alleviate regulations on interest rates in all sectors from 1993 to 1997, and actively implemented the deregulation of interest rates from 1993 for all loans, long-term savings, and corporate bonds, excluding policy loans.

While the proportion of policy loans was still very high throughout the 1980s, their structure changed substantially. Most significantly, large companies with a current account surplus were no longer allowed to be beneficiaries of export credit from 1988, and the automatic rediscounting of the commercial bills of large companies was prohibited in 1989 to reduce the export credit substantially (Cho and Kim 1997: 35-39).

Meanwhile, democratization and the consideration of social equality affected the structure of policy loans. Policy loans for SMCs increased considerably, and SMCs saw more benefits as a result of the reinforced administration of the funds supplied to large companies[58]. Actually, the proportion of SMCs in the total loans made by savings banks increased from 31.5% in 1985 to 48.1% in 1988 and 55.5% in 1990. In addition, the policy loans for the sectors of agriculture and housing also increased. This change in the structure of policy loans meant that the influence of the government on large companies through financial control was reduced (Ibid.).

But the government still made efforts to maintain its control over banks after financial liberalization. In addition to its intervention with interest rates, the government strengthened

[58] SMCs benefitted from various measures, such as the increase in loans for SMCs, and the automatic rediscounting of export bills and commercial bills related to SMCs.

direct control over banks in the process of the disposal of 78 insolvent enterprises between 1986 and 1988. Responding to the aggravation of the poor management of the construction industry and shipbuilding industry, the government attempted to solve the problem by intervening with the management of individual companies; to encourage the M&A led by the state, the government provided various kinds of financial support to the purchasing companies via banks, such as the grace period for bank debt, exemption of the payment of interest, special loans, etc. The total amount of support reached KRW 7.2 trillion, equivalent to 2.3% the GNP of Korea, and in the process the banks received government support such as special loans from the Bank of Korea beginning in 1985. So the government responded to the problem of the sectors of the industry and finance through an approach of controlling banks that was established in the previous period, hindering the practical reform of the bank sector.

In relation to the opening of the financial market, the government kept taking gradual steps throughout the 1980s (Park 1996: 250-251). After the adoption of several measures including the basket peg exchange rate system in 1980 and the interest currency swap in 1984, the opening of the financial market was expanded with the current account surplus. In 1990, the market average exchange rate system was introduced, and the management of foreign exchange was changed into a negative system. In 1988, the obligations of Article 8 nations of IMF were observed, and then beginning in 1992 foreigners were able to buy Korean stocks and foreign securities companies were allowed to do business in Korea. Notably, the government signed an agreement with the US government in 1992 on a plan for a 3-stage opening of the financial market, and announced a 3-stage financial reform plan that included the clear statement that the financial market would be open by 1997, accelerating the liberalization of finance.

Korea’s financial liberalization since the 1980s can be described as a ‘regulated deregulation of the financial system,’ and extensive financial liberalization and opening began after 1993 (Dalla and Khatkhate 1995: 18-28). But the state attempted to maintain its control over the banks, which made it difficult to reform the financial system in any substantial way (Ibid.). As a result, the banks did not have managerial autonomy for loan appraisal or the appointment of a bank’s president, and no new monitoring mechanism for chaebols was implemented. The Korean experience here is a good illustration of how difficult it is to carry out true reform and establish a new institution if the government remains dependent upon the previous methods of economic management. However, at the same time, the control of the government over companies was weakening with the change in the structure of policy loans and the financial market. As a result, while the state tried to maintain its control over the financial market, the state-led financial system was already on the wane.

(2) The change of the structure of the financial sector and financing of firms

In addition to financial liberalization, the change of the financial market itself with economic development further weakened the state's control over financial institutions and companies. The growth of NBFI and the stock and bond markets changed the financing pattern of companies and shrunk the sectors controlled by the government. Paradoxically, this was another result of the active policies of the government implemented to procure funds from the market and solve the problem of excessive debt of companies.

First of all, the NBFI sector grew rapidly, to account for more than half of the financial market after the latter half of the 1980s. There are various kinds of NBFIs in the short-term financial market, including investment and finance companies and mutual savings companies. These were approved by the government in 1972 to procure funds from the private money market, and grew significantly in the process of financial liberalization. The relatively weaker regulations on them in terms of interest rates and policy loans made it possible for them to hold an advantageous position over banks, and weakened government control over them, as they were mainly controlled by chaebols (Leipziger and Petri 1993: 21-23).

<Table 4.2 > Banks' and NBFIs' share of deposit and loan markets (%)

	72	74	76	78	80	82	84	86	88	90	92
Deposits											
Banks	81.7	77.3	76.1	74.5	69.1	64.3	56.3	49.4	44.3	40.5	36.2
NBFIs	18.3	22.7	23.9	25.5	30.9	35.7	43.7	40.6	45.7	59.5	63.8
Loans											
Banks	77.4	75.5	74.4	67.8	63.8	62.2	57.9	56.3	51.5	49.7	48.3
NBFIs	22.6	24.5	25.6	32.2	36.2	37.8	42.1	43.7	48.5	50.3	51.7

Source: Bank of Korea, Monthly Bulletin, various issues.

The direct financial markets, such as the bond market or the corporate bond market, also grew considerably through the efforts of the government. To attract savings and solve the problem of high corporate debt, the government continuously implemented the regulation on debt-stock ration and promotion of public offering of companies beginning in the 1970s, and in the 1980s implemented tax incentives, support for stock market agencies, and regulation on speculation for the growth of the stock market (Amsden and Euh 1993: 389-390; Choi 1996: 35-37). As a result, the direct financial market grew rapidly, and in particular, the stock market grew explosively in the late 1980s with the current account surplus and the increase in personal income. Though their trend of growth slowed down after the 1990s due to the recession, and companies still preferred external borrowing, the proportion of such markets in the whole economy has increased (Table 4.3).

<Table 4.3> Growth of capital market in Korea (billion won)

	1980	1985	1987	1989	1990	1991	1992
Stocks							
Companies listed	352	342	389	626	669	686	688
Capital stock	2421	4665	7591	21212	23982	25510	27065
Market value (A)	2526	6570	26172	95447	79020	73118	84712
A/GNP (%)	6.9	8.4	24.7	67.7	46.1	34.1	35.5
Value of stock traded	1134	3620	20494	81200	53455	62565	90624
Stock price index	106.9	163.4	525.1	909.7	696.1	610.9	678.4
Corporate bonds							
Issuers	434	1213	1457	1504	1603	1862	2070
Face value	1649	7623	9973	15396	22068	29241	32696
Value of bonds traded	246	660	5327	4378	2455	1394	453

Source: Korea Securities Dealers Association

This change led to a change in the financing pattern of companies. Korean companies depend highly upon external borrowings and preferred external funds, even after the 1990s, but the structure has changed. Indirect financing, which is borrowing from financial institutions, continues to be high, but borrowing from banks has decreased significantly with the growth of NBFI. On the other hand, the portion of direct financing, such as the stock and corporate bond market, has been increasing since the mid-1980s, and chaebol companies are introducing various ways of financing, including commercial bills. Borrowings from abroad, which were made possible by the guarantee of the government, have decreased rapidly since the 1980s, and instead the borrowings from abroad in the form of the issuance of overseas bonds without government guarantee have been increasing since the late 1980s with the enhanced credit standing of private companies. As a result, the portion of what can be controlled by the banks and the government, such as the borrowings from abroad, has decreased, weakening the influence of the government significantly (Table 4.4).

<Table 4.4> Change of external fund financing in corporate sector in Korea (%)

	1970	1975	1980	1985	1988	1990	1992
Indirect finance	39.7	27.7	36.0	56.2	27.4	40.9	36.3
Borrowing from banks(A)	30.2	19.1	20.8	35.4	19.4	16.8	15.1
Borrowing from NBFIs	9.5	8.6	15.2	20.8	8.0	24.1	21.1
Direct finance	15.1	26.1	22.9	30.3	59.5	45.2	41.4
Treasury bills	0.1	0.8	0.9	0.8	5.3	3.1	3.3
Commercial paper	0.0	1.6	5.0	0.4	6.1	4.0	7.6
Corporate bonds	1.1	1.1	6.1	16.1	7.5	23.0	12.5
Stocks	13.9	22.6	10.9	13.0	40.6	14.2	15.9
Foreign borrowings(B)	29.6	29.8	16.6	0.8	6.4	6.8	5.0
Others	15.6	16.4	24.5	12.7	6.7	7.1	17.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(A) + (B)	54.8	48.9	37.3	36.2	25.8	23.6	20.1

Note: Others include government loan and corporate credit.
Source: The Bank of Korea, Understanding of capital circulation in Korea

Meanwhile, the financial power of the chaebols has increased remarkably. The influence of chaebols on finance has further increased since the late 1980s with current account surplus, increase in foreign borrowings without government guarantee, and the control over most NBFI. As a result, the government no longer effectively influences their investment decisions and financing. Chaebols have concentrated credit on the basis of mutual payment guarantee, and have continuously asked for financial liberalization and deregulation in the belief that government control over finance is a barrier to investment decisions. In addition, the chaebols wanted to have direct ownership of banks. This demand of the chaebols was fully reflected in the process of financial liberalization after the 1990s.

After the late 1980s, the changes in the structure of the financial market resulting from the government policy and economic development weakened the state's control over finance and companies. The end of the state-led financial system changed the relationship between the state and companies from one of control and cooperation to one of conflict, and the previous institutions did not operate properly any more.

4.3.2. The degeneration of institutions in Korea

In order to cope with the restriction on the direct intervention of the state, the Korean state attempted to convert the growth system gradually, beginning in the mid-1980s. The direction of conversion originally planned by the state was, as shown in the various macro policies in this period, which the initiative of the state cannot be given up in the industrial restructuring into technology-intensive industries and in the macroeconomic management while the state conforms to economic liberalization and external opening. In other words, the state planned to achieve a soft landing of the growth system of the developmental state amidst the reinforcement of market-oriented economic operation by retaining the basis and policy measures for the indirect intervention of the state that could complement and correct it.

However, the rearrangement of Korea's growth model after the mid-1980s seems to be the retreat of the developmental state. In some regard, this was forced by structural constraint factors, but above all, the primary reason was attributed to the state itself. That is, it took the route of 'neo-liberalism' or 'total retreat of the developmental state' due to failure of the state's political countermeasures. Therefore, the change of the Korean developmental state, or more specifically, the decline of the developmental state, was mainly influenced by the degeneration of the state's institutional capacity.

(1) The change of bureaucracy

A strong, effective, and cohesive bureaucracy with embedded autonomy has been the most important institution of the Korean developmental state. However, the collective cohesiveness and policy coordination ability of the state's bureaucratic organization decreased considerably after the mid-1980s. First, under the authoritarian system (Park Jung-Hee government or Chun Doo-Hwan government), bureaucrats were responsible only to the president, and the president protected the bureaucrats from congress and the public[59]. On the other hand, the Roh Tae-Woo government in the 6th Republic had a stronger tendency of decentralization than the previous governments. President Roh delegated much of the power to the bureaucrats concerned, including the responsibility for economic matters. Such decentralization made bureaucrats vulnerable to the demands of various groups and weakened their conviction about the rationality of economic policies. As a result, the autonomy of economic policies weakened and lacked consistency. Second, in the 6th Republic, delegation of power to the lower class encouraged factionalism within the state's bureaucratic organization. Such factionalism made it more difficult to achieve consistent policy coordination, and required bureaucrats to pay attention to non-departmental affairs. When policies were not linked to the policies of the entire nation, it was easier for things to fall by the wayside. Thus, even though the power for economic affairs was delegated to the lower class, the sovereign ruler should have coordinated in person, or made a coordinating mechanism, when there were conflicts between departments. However, there was no such mechanism or an effort to make it[60]. On one hand, such changes mean that the influence of the congress and public opinion was increased. But on the other hand, it proves that the institutional capacity decreases due to conflicts among economic departments and factionalism (Jeong 1992: 158-160).

In addition, the collective cohesiveness of economic bureaucratic organization was considerably damaged by the frequent reshuffling of the organization of the state. The bureaucratic organization of the state was reshuffled whenever there was a change of political power, and

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[59] Chalmers Johnson emphasizes such characteristics of the developmental state. In his study of Japan, he included the statement "Politicians reign and bureaucrats rule" as the prerequisite for a developmental state (Johnson 1982: 17-34). Ahn Byung-Young (1990: 71) also points out that technocrat's value technical rationality or methodological rationality while ignoring political rationality. So in general, they prefer the authoritarian system, which blocks political pressure and embraces bureaucrats efficiently.

[60] Also, hierarchy and cohesiveness of the organization was considerably weakened throughout the entire bureaucratic organization of the state during the Roh Tae-woo government. When there were conflicts caused by internal problems of the bureaucratic organization, 'collective protests' or factional conflicts would sometimes occur (Ahn Byung Young 1990: 79).

economic departments in particular were subject to a great deal of organizational change. The Ministry of Commerce & Industry and the Ministry of Energy & Resources were combined and then changed to the Ministry of Commerce & Industry and to the Ministry of Industry & Resources. The Ministry of Construction and the Ministry of Transportation were combined into the Ministry of Construction & Transportation. In Dec. 1994, the Economic Planning Board and the Ministry of Finance were integrated into the Ministry of Finance & Economy and the leading organization disappeared.

In addition, the weakened cohesiveness of the economic bureaucratic organization can be explained by the conflict between economic development models. Specifically, the bureaucrats who were educated during the Japanese colonial rule retired from major government positions, and were replaced in their positions at major governmental research institutes and high-ranking public offices by academics who had studied neo-classical economics overseas, which naturally affected conflict regarding the model of development (Kim 1993: 142). Those who were in major economic positions before the 1980s were educated during the Japanese colonial rule, either in Japan or in Korea. They had personally experienced the state-led development model of Japan. On the contrary, all those who were in major economic positions during the 1980s had received doctoral degrees in neo-classical economics in the US, which emphasized market principles and did not accept that state regulation could play a positive role. Moreover, while in the 1970s 5 out of 6 ministers of the Economic Planning board and the Ministry of Finance were actually professional bureaucrats; during the 1980s 8 ministers out of 12 were not professional bureaucrats but were outside personnel. This inflow of neo-classical economic theory changed the mind-set of bureaucrats and their recruitment pattern, bringing about conflicts among bureaucrats and changes in policy. These new bureaucrats spread the belief that market intervention by the state was inefficient and undesirable, weakening the will of the national policy to penetrate into the society and economy.

Moreover, the number of neo-liberal technocrats in the state's bureaucratic organization was geometrically increasing. As of Oct. 1994, during the Kim Young-Sam government, 73 officials out of 156 on the Economic Planning Board above the secretary (fourth grade) level had earned a Master's degree or a Doctoral degree in the US. In the Ministry of Finance, 40 out of 78 officials above the fourth grade had studied in the US. In the Ministry of Commerce & Resources, which is practically in charge of industrial policies, 93 out of the 124 officials above the fifth grade level who had the experience of studying abroad had studied in the US (Korea Economic Daily 1994: 21).

This pattern of change within the state's bureaucracy acted as one of the factors in weakening the state's capabilities, which triggered the decline of the developmental state.

(2) The change of the government-bank-business relationship in Korea

Institutions in Korea were initially run well based on the dominance of the government over finance and business but not free from conflicts, which grew serious when the power relationship changed. The government and companies had an interdependent relationship, requiring each other for financial support and economic growth, respectively, but at the same time there were strategic interactions and conflicts between them while adjusting to the institution and attempting to change the institution to fit their interest (Schelling 1980: 3-4). After all, what decided the direction of the change of the system was the strategic interaction between principal agents that were dependent on each other's resources (Kim 1988: 116-120). There were no serious conflicts, and the institution worked well when the government had strong power and resources upon which companies depended, But as the economy and financial system changed, former institution and relationship based on the dominance and discipline with cooperation could not be sustained. After the 1980s, the conflicts and strategic interaction between the government and companies over regulation policy became serious, and the existing institution did not work well. Such conflicts and strategic behaviours did not emerge until the late 1970s. They appeared in the process of the implementation of the programs designed for the restructuring of heavy and chemical industries, and were reinforced in the process of the regulation of chaebols in the 1980s (Rhee 1994: 75-77). Some researchers claim that the relations between the government and companies changed into relations of control and symbiosis, and the autonomy of the government is maintained (Lee 1997: 138-139; Kim 1988: 120-121), but the government's regulation of chaebols failed after the late 1980s and the chaebols began to hold a dominant position after 1993.

Above all, chaebols grew much more on the basis of various types and volumes of financial support (Table 4.5).

<Table 4.5> The share of sales and value added of chaebols in Korea (%)

		1977	1981	1985	1990	1994
Sales	Top 5	15.7	21.5	23.3	21.4	24.6
	Top 10	21.2	28.4	30.6	27.1	32.1
	Top 30	34.1	39.7	40.8	35.0	39.6

Source: Korea Development Institute

To cope with the concentration of economic power in the chaebols and their excessive dependence upon debt, the government continuously reinforced the system of administration of supplied funds and regulation through the main bank system throughout the 1980s (Lee 1997: 55-57; Nam 1996: 280-282). This strong regulation reduced the portion of the bank loans of the 30 largest chaebols, but the loans of NBFI for chaebols and the direct financing were increasingly concentrated in chaebols, and the situation of excessive debt and diversified corporate structure was not improved (Nam 1996: 283-285). Eventually, the state's financial regulation of the chaebols was not effective after the financial system changed. Based on such growth, chaebols demanded various kinds of deregulation in the banking sector, such as the abolition of the restriction on ownership of banks, financial opening, and easing of the system of administration of supplied funds for independent decision on investment free from government regulation. Actually, the system of administration of supplied funds was eased after the recession in 1990, ostensibly to strengthen competitiveness, and the process of financial liberalization after 1993 fully reflected these demands.

Meanwhile, banks became weaker compared to NBFIs, and despite financial liberalization and the end of the state-led financial system, the state attempted to use banks as a tool of economic management through policy loans, etc. Throughout the 1980s, the rate of return of banks was very low. The banks were able to survive through the support of the government, and their poor business in the industrial sector worsened the problem of non-performing loans (Park 1996: 248-249). The most serious problem was that the banks did not have managerial autonomy and could not establish a mechanism for monitoring the business management of chaebols. Though there was a system for the administration of supplied funds and the main bank system, the government only applied a cursory regulation on the decision of investment by chaebols in this system, and the main banks merely provided the government with the information for regulation as subsidiary organizations of the Bank Inspection Board. That is, unlike the system in Japan, the relationship between banks and companies was not autonomous or cooperative (Nam 1996: 302-303). Moreover, most of the shares of banks were already possessed by major chaebols.

Finally, with the change of the financial system, the relationship between the government and companies in Korea changed from one of regulation and control accompanied by cooperation on the basis of financial control, to one of conflict. Chaebols continued their uncooperative approach to business administration, asking the government for more deregulation, and the government could no longer regulate them properly. Despite such changes, the government failed to establish an appropriate mechanism for monitoring chaebols, such as effective corporate governance or surveillance by banks. As a result, the government could no longer discipline or regulate chaebols effectively. What the changes in the financial system and the relationship between the government, banks, and companies required was the establishment of a new institution.

(3) The further deregulation and dismantling of the institution since 1990s

However, the policy of the new government that came to power in 1993 was the simple deregulation of chaebols and financial institutions, dismantling the previous system in the name of the logic of the market.

First, the keynote of the policy on chaebols changed from regulation and suppression of the concentration of economic power to deregulation and support for chaebols by the power of chaebols and the market ideology. In 1993, credit restrictions on core businesses were eased and the targets for credit restriction were narrowed from the 50 largest chaebols to 30 largest chaebols. In 1996, the targets for credit restriction were reduced to the 10 largest chaebols and the regulations on the purchase of real estate and the ratio of stocks were also abolished. In addition, the government adopted policies that supported the strengthening of chaebols' control of the financial sector. In 1994, the 'universal banking system' expanded the ceiling of stock ownership excluding chaebols, but in reality there was no one who could own banks except chaebols, and thus it heralded the ownership of banks by chaebols. Moreover, in 1996, the government made it easier for higher-ranking chaebols to enter various kinds of NBFI, including insurance companies, general financing companies, and investment trust companies[61]. Meanwhile, faced with recession in 1996, the government also alleviated the regulation of chaebols through the fair trade act, including the abolition of the system of mutual payment guarantee. Though several measures were taken in 1996 to reform chaebols' corporate governance, such as strengthening the rights of minority shareholders and introducing external directors, these were a mere formality.

In the financial sector, too, the government implemented extensive financial liberalization and market opening after 1993 without an appropriate regulation system. Between 1994 and 1996, the government expanded its licensing of general financing companies, which mainly handled short-term foreign exchange, without proper supervision. Also, with the decision to join OECD in 1993, the extensive opening of external capital accounts was announced in the 'financial reform blueprint' (Dalla and Khatkate 1995: 18-19). According to the plan, the government introduced various measures in Dec. 1994, including the permission for companies' commercial foreign loans; expansion of the limit of the issuance of foreign bonds by Korean companies; allowance of the issuance of foreign bonds linked to stocks; expansion of foreign investment in domestic bonds; and the easing of regulations on foreign borrowings related to exports. In 1995, the foreign exchange concentration system, with which the central bank controlled all foreign exchange, was practically abolished, and the government announced that the financial market would be opened more rapidly than had been planned. Such measures greatly expanded foreign borrowings by chaebols and banks, and the foreign funds that came in through the private sector were no longer being handled effectively by the government (Table 4.6). This foreign capital could flow out instantly in the event of a small shock in the international financial market, creating a very risky situation when the chaebols and banks were still vulnerable.

[61] The so-called universal banking system that was introduced in 1995 lowered the ceiling of stock possession from 8% to 4%, and allowed the universal banker to possess up to 15% of the stocks of banks. But there was no applicant under this system, and after the economic crisis, the Korean government allowed chaebols to own banks in 1998 (Hwang et al. 2000: 23-25)

<Table 4.6 > The share of foreign capital in financing

	1990	1991	1992	1993	1994	1995	1996
Corporate sector	6.8	4.1	5.0	-2.2	4.9	8.4	10.2
Financial sector	1.2	6.6	1.2	-0.4	4.8	9.2	10.7

Source: The Bank of Korea.

Ultimately, the Kim Young-Sam government did not establish a new effective institution but completely dismantled the existing institutions through further deregulation of the chaebols, while rashly pursuing financial liberalization in a changed financial system as the power of the chaebols grew. That is, through the government's decisions, the previous development model, in which the state properly regulated and supported companies while managing the flow of foreign funds being integrated strategically with the world economy under the state-led financial system, was completely discarded. In this dangerous situation, in which a new institution did not appear after the previous regulation of chaebols broke down, the short-term foreign debt that arose with the opening of the financial market did not roll over following the bankruptcy of the chaebols and the crisis in Southeast Asia, and this brought about the financial crisis of 1997.

4.4. Concluding Remark

The Korean developmental state emerged in historical, political, and economic context, and the state-led growth system was operated in earnest from the 1960s. First of all, the state set up mid- and long-term industrial strategies and consistent economic policy through the economic development plans, and encouraged private companies to participate in productive investment and the main sectors of the economy by systematically mobilizing various industrial policies, financial policies, and fiscal policies such as policy loans, tax exemptions, and various incentives for exports prepared to achieve the goal of economic growth and the promotion of exports

As a result, Korea achieved the sequential industrialization of export-oriented industrialization (EOI) with labour-intensive industries during the 1960s and EOI deepening with heavy and chemical industries during the 1970s, and was able to successfully achieve a rapid pace of growth that was unmatched in the world. However, as Korea mainly used expansive and concentrated industry fostering policies with a growth-first policy direction, the nation's industrial structure was eventually concentrated in the chaebols.

After the 1980s, the general direction of the change of the Korean developmental state seems to be progressing into a post-developmental state in which the policies and systems of the developmental state retreat and the economic power of chaebol companies and private participants is strengthened. In particular, during the period of the Kim Young-Sam government, the character of the state and the characteristics of the growth system appear to be closer to a neo-liberal regulation state or an 'Intermediate State' (Evans 1995: 60-70) than a developmental state, which appeared typically during the period of the development years. As a result, the growth system was led more by the market than the state.

Such a pattern of change of the developmental state is greatly different from what was planned by the state. Initially, the intent of the state was, as is evidenced by the various economic policies during this period, to not surrender its initiative in the restructuring of industry into technology-intensive industries and in macroeconomic management, while moving in a direction of economic liberalization and external opening. That is, the state planned to make a soft landing of the growth system of the developmental state while reinforcing market-oriented economic operation, by retaining the basis and policy measures for the indirect intervention of the state that could complement and correct the market.

However, the economic policy of the state was not implemented well due to the opposition and resistance of the chaebols and social forces, degeneration of the political and institutional capabilities of the state, which led economic growth. In the process, many of the state's economic policies and industrial policies failed or did not have good results, and the method of state-led growth hit its limits. In particular, after the Kim Young-Sam government (1993-1997), the state could not establish a stable controlling coalition that could continue its keynote economic policy, and there were no social forces supporting the state. As a result, the influence of the Korean state waned, becoming an object of opposition or conflict or rent-seeking activities of social forces. In this environment, the structural contradiction that led to the financial crisis of 1997 was nurtured and developed.

Korean experience offers a couple of lessons about the institution, its changes, and the appropriate role for the state to play in economic development. First, institutions constructed by mixing state and market mechanisms plays significant role in economic development, and the relationship between the principal agents, including the government and companies, is very important. Secondly, the efficiency of institutions changes and sometimes degenerates according to economic development and the change in power relations, and in this case it is essential to create a new institution for economic development. Here, the role of the state is to construct a unique institution and relationship between the government and companies, and also to restructure this according to the changing situation. For that, it is also imperative for the government's efforts to overcome the resistance of the vested interest groups based on mobilization of nation people's demand. But, the Korean state has not appropriately performed such roles since 1980s; it seems to be main reason for progressing into post-developmental state.

However, the aforementioned 'post-developmental state' should not be fully identified with the British-American completely neo-liberalistic regulatory state. The deterioration of state-led growth and the emergence of market-led growth in Korea was not defined with the concept of a 'regulatory state' but was analysed with the concept of a 'post-developmental state' in order to emphasize its transitional character, as the transition and restructuring of the growth system was still in progress (before 1997). Thus, in a sense, it indicates that there were various possibilities according to the dynamic composition and mutual response between the state and the society and the state and capital during the process of overcoming the financial crisis.

Chapter 5
KOREAN BUREAUCRACY

5.1. Introduction

As was examined in Chapter 4, the Korean developmental state was changing together with the change of the financial structure and the degeneration of the previous system. As the Korean state experienced the financial crisis in 1997 in the process of such a change, the direction of change of the developmental state of Korea can be suggested if we look closely at the process of overcoming the crisis. Therefore, in this chapter I will examine the directions of bureaucratic reform, which was the most distinctive institutional change made in Korea after the financial crisis in 1997, in order to define the direction of change of the developmental state in Korea. In short, this chapter will be the procedure of answering to the questions of "Could/did bureaucrats/the political elite retain features of the DS or not? And what were the consequences?"

According to Chibber (2002), the core of a developmental state is the 'functional nature' implemented by the bureaucratic system of the developmental state, which means that the goal of a developmental state can be achieved if such functional nature is implemented well (Chibber 2002: 951-953). In other words, it is difficult to regard the Korean state as developmental if the Korean bureaucratic system cannot fulfil its functions properly. Additionally, if the financial reform promoted by the Korean state after the financial crisis in 1997 was not successful, the reasons can be found in the bureaucratic system. Therefore, this chapter will provide in-depth research on the formation, the development and the changes of the Korean bureaucratic system.

Previously, most research on Korea's bureaucratic system has mainly considered the political, economic, and social changes made by Korea's bureaucratic system during the process of industrialization led by government officials after the 1960s, and has not paid much attention to the changes inside the bureaucratic system that could have accompanied such a process. That is to say, the theoretical discussions on Korean bureaucracy have generally been focused on the character of the bureaucracy as an independent variable in the transformation of the Korean developmental state, while little attention has been paid to the character of the bureaucracy as a dependent variable. The reason for this focus is that it is difficult to pay attention to the changes inside the bureaucratic system while one is overwhelmed by the bureaucratic system, which wielded absolute power with the protection of an authoritarian political power. In fact, research on industrialization and the bureaucratic system in Korea only evaluated the bureaucratic system in terms of the role it played in the implementation of industrialization, and did not take much interest in the changes that occurred inside Korean bureaucracy as a result of industrialization (Kim Kwang-Woong 1986: 21-56; Johnson 1987: 136-164). In addition, though the role the bureaucracy played during the process of industrialization can be easily observed, the changes inside the bureaucratic system are not as easily exposed. While the former can be described as external changes in the bureaucratic system resulting from industrialization, the latter can be referred to as internal changes in the bureaucratic system affected by the influence of the social and economic changes after the successful industrialization of the Korean bureaucracy. In other words, it can be interpreted that the external changes in the bureaucratic system occurred during the process of industrialization led by government officials, while the internal changes in the bureaucratic system were influenced by the changes in Korea's social and economic structure after industrialization.

To examine these external and internal changes in the Korean bureaucracy, this chapter is composed of the following parts: Part II mainly reviews the external and internal changes in the Korean bureaucracy until 1997 by focusing on the establishment of the Korean developmental state and its bureaucratic system, the role of the leading organization, and the resulting pattern of changes in the developmental state and the bureaucratic system In part III, the changes that external and internal reforms carried out after the financial crisis in 1997, during which the country experienced a transformation process, brought to Korean bureaucracy will be studied, and the question of whether the changes were consistent with the government's aims will be examined based on the data obtained through field work. Part IV summarizes this chapter and suggests some implications for following chapters

5.2. Korean developmental state and bureaucracy

An autonomous, able, and efficient national bureaucratic system is the most important organizational and systematic dimension of a developmental state. In the discussion of a developmental state, an efficient and cohesive bureaucratic system is said to be the primary and essential condition for economic growth. In fact, since the early 1960s, Korea has established economic growth as the basic ground for the justification of the state, and at the same time has strengthened the institutional basis for economic growth and improved the state's ability to mobilize resources and implement policies through a vast reform of the organizations of the government. In particular, leading organizations such as the Economic Planning Board (EPB) have played a pivotal role in this process.

5.2.1. Reform of the bureaucracy and establishment of a developmental state system

The Park Jung-Hee regime launched an extensive reform of the organization of the state immediately after the military coup under the pretext of a governmental reshuffle, purging corrupt civil servants, and establishing national discipline. While the main purpose of such action was for the military elites who led the military coup to practically take over and control the organizations of the state directly, it was also aimed at destroying the symbiotic relationship between the Liberal Party, entrepreneurs, and large companies that lasted throughout Rhee Syng-Man government, hindering economic growth. Immediately after the military coup of 1961, much of the military elite were hired by bureaucratic organizations during the period of military rule, which lasted until 1963. In addition, new technocrats advanced into core economic departments en masse, resulting in a coalition system between the military and bureaucratic elite after the transfer of power to a civil government in 1963 (Park Jong-Cheol 1988: 142-143). In particular, the expertise and experience of the technocrats who worked in the Research Department of the Bank of Korea and the Industrial Development Committee of the Economic Revival Department were treated as important,[62] and in addition, many bureaucrats were hired

[62] Haggard appraised that the Economic Revival Department and the Research Department of the BOK were the only enclaves with a certain degree of development-oriented ideology and manpower in the Rhee regime, which he and others have characterized as a "predatory government" (Haggard 1994: 99).

from outside the bureaucratic organization through special hiring. Through this process, the members of the military elite who had developmental ideology and the technocrats who had professionalism based on rationalism were well harmonized to establish the human basis for the developmental state. The reform and restructuring of the bureaucracy that was promoted during the Park Jung-Hee developmental state system has the following characteristics:

Firstly, a professional bureaucratic system which hired bureaucrats based on their ability was established (Kim Byung-Kook 1996: 303-310), making it possible for competent technocrats to take over important positions in the organization of the nation. For an example of how this system functioned, we can look at how the qualifications for bureaucrats were strengthened through the 'Higher Civil Service Examination'. This system contributed to securing smart and homogenous human resources early from among the graduates of distinguished colleges, fostering cohesive medium-level bureaucrats. The previous government of both the Liberal Party and Democratic Party did not deny the necessity and appropriateness of a professional bureaucratic system, but they tried to secure political positions for their followers by minimizing the hiring of people who passed the Higher Civil Service Examination, preferring 'special hiring.' In contrast, during the Park Jung-Hee regime, the portion of government officials who were hired after passing the Higher Civil Service Examination increased by more than two times during the 1960s, and by more than four times during the 1970s, as it had become urgent to establish an administrative system that could mobilize human and material resources on a large scale.[63]

Secondly, in relation to the reshuffling of the government organizations, the division and specialization of government organizations increased remarkably in the departments that were closely related to the economic development plan during the 1960s, including the Economic Planning Board, the Office of Monopoly, the Department of Agriculture & Forestry, the Rural

[63] Of course, there was still a considerable level of 'special hiring' through nepotism during the Park Jung-Hee regime. Some of the special hires were done to give intellectuals like professors and specialists the opportunity to participate in public policy, but most were conducted to hire the military elites who were the core base of the military regime. What was important was that the people who came from the military were placed in public security departments such as the Department of Defense, the Department of the Interior and the Central Intelligence Agency, or in secondary departments in economic departments such as the Department of Construction or the Department of Transportation. That is, the core economic organizations (the Economic Planning Board, the Ministry of Finance, the Ministry of Commerce, and the Chief of Economy in the Blue House) were mainly operated by technocrats, and this did not change throughout the Park Jung-Hee regime (Kim Byung-Kook 1996: 314-315).

Development Administration, the Department of Construction, and the National Railroad Administration. The 7 bureaus in economic departments which were in charge of 12 jobs in 1959 were divided into 3 offices and 22 bureaus by 1967 (Park Jong-Cheol 1988: 147-151). It is also noteworthy that the planning, research, and management work of government organizations were emphasized in economic departments, and cooperation and coordination between departments was increased.

Thirdly, as economic development was pursued in earnest, not only the division of governmental organizations or cooperation and coordination between departments but also hierarchies and structures supporting the organic division of labour within the governmental organizations were established systematically. In particular, a thoroughly consistent policy execution system was set up between the Economic Planning Board and the actual economic departments with property role allocation. The Park Jung-Hee regime gave the Economic Planning Board the power to coordinate with special favour in personnel affairs so that other related departments and government agencies would recognize the Economic Planning Board as the operator in charge, solidifying the hierarchy in governmental departments. A structure for the systematic division of labour among actual economic departments was also set up in such a hierarchy. The Department of Finance limited its role as the supplier of industrial funds for growth rather than speaking for the interest of financial capital. The Department of Agriculture, Forestry & Fisheries and the Department of Labour did not try to solve the conflicts between urban and rural areas and between labour and management caused by industrialization in the foreign dependent growth strategy from the viewpoint of farmers and labourers. Rather, they set the price of agricultural products and wages to help companies to reduce their production costs (Kim Byung-Kook 1996: 337). The Department of Commerce & Industry, which took charge of the manufacturing sector as the driving force of economic growth, opened a way to maximize accumulation of wealth for its ‘customers,’ capitalists so to speak, by selectively controlling the process of production and distribution and unfolding the ‘administrative map.’ That is, the power of approval of the Department of Commerce & Industry and the administrative map were used to encourage new investments by the *Chaebol* and support the exploration of overseas markets.

Fourthly, the size of the bureaucratic organizations of the nation expanded with the establishment of a professional bureaucratic system and the division and expansion of economy-related governmental organizations. As a result, the number of civil servants increased dramatically and steadily, despite the purge of government officials immediately after the military coup on May 16, 1961. The number of civil servants, which was 237,500 in 1961, increased to 305,316 in 1965 and then to 417,348 in 1970, which means that 15,000~20,000 civil servants were added every year (Kim Byung-Kook 1996: 303-310).

Fifthly, with the implementation of the economic development plan in earnest from 1962, the volume of the national finance kept increasing as well. While the general expenses, the funds for public projects, and the expenses for social welfare were maintained at a certain level, the economic expenses for financial investments and loans kept increasing consistently, contributing significantly to the expansion of the national finance. The financial investment and loan in 1961 was 19% of the total national finance, but it increased to 44% in 1981 (Park Jong-Cheol 1988: 147-164).

While the reform and alignment of the bureaucracy was the primary stepping stone and a prerequisite for state-led economic growth, it played an important role in strengthening the bureaucracy as the volume of the national economy increased with the passage of time (Kim Byung-Kook 1996: 333). On the basis of the technocrat system, the Park Jung-Hee regime was able to put its economic strategy and ruling strategy into a certain orbit after implementing an export-led development strategy and an industrialization strategy focused on heavy and chemical industries. On this basis, the Korean economy diversified its overseas markets and made its industrial structure more sophisticated, increasing its dependency on the world's capitalistic market. As a result, Korea was faced with a very complicated economic challenge of flexibly responding to the market, which could not be solved by the personal leadership of the president of Korea or the leadership of the ruling party. In turn, the existence of the bureaucratic system of the nation was brought into relief and reinforced as a tool for the solution of such problems.

5.2.2. The status and role of pilot agency

Together with the existence of a Weberian bureaucratic system, embedded autonomy, etc., the approach of a developmental state has emphasized the importance of the 'pilot agency,' examples of which include MITI (Japan), EPB (Korea) and CEPD and IDB (Taiwan), as a core element for growth in East Asia (Johnson 1982; 1987; Haggard 1990; Haggard, Kim and Moon 1991; Evans 1995; Choi Byung-Sun 1990). In the experience of East Asian nations, the pilot agencies played the role of selecting core strategic industries of the nation and provided civil capital with a stable and predictable environment for somewhat risky long-term investment projects (Onis 1991: 122). In short, the agencies were the core think tanks and ‘economic headquarters’ for the implementation of strategic industrial policies. The pilot agencies in East Asian nations played an important role for overcoming the tension between the autonomy and the responsibility of bureaucrats which face all bureaucratic organizations and achieving good balance between them (Ibid.: 114-115).

Notably, Korea’s EPB was an organization that had the most powerful official status and authority in comparison to the pilot agencies in Japan and Taiwan. In the development state of Korea, the minister of EPB was also the deputy prime minister taking charge of economic issues. It held full power regarding the preparation of budgets, and screened, planned and coordinated economic policies, thus reducing the ability of other governmental departments to lead projects independently. Lying outside the authority of the national assembly, the EPB of Korea almost monopolized economic policies (Haggard 1994: 108). While the developmental state was the centre of economic growth, the centre of the developmental state was the EPB.

The tasks of the EPB were focused on the three areas of preparing an economic development plan, budgeting and mobilizing and operating the funds including foreign loans required for development, and putting together general economic policies. In addition, the EPB presided over the meeting of economy-related ministers which was created in 1961 as an institutional device for taking the lead in economic development. Since 1963, the minister of EPB has also held the post of deputy prime minister and presided over the Monthly Meeting for Economic Trend Report for the management of overall economic policies, as well as supervising various consultations and committees chaired as the deputy prime minister (EPB 1982: 12-14).

The EPB was able to play an important role in economic development and industrial policies for the following reasons (Kim Byung-Kook 1988: 55-95; Park Jong-Cheol 1989: 184-185). Firstly, with respect to legal status and power, the EPB both had the power to control the social sector and had autonomy, by controlling budgetary right and the power to introduce foreign capital at the same time. Secondly, the EPB fostered professional economic elites mainly in the planning bureau and the budget bureau, who increased their influence in other economic departments, playing the role of a general coordinator when conflicts occurred among the departments. Thirdly, most of the bureaucrats studied in the same several distinguished universities and passed the Higher Civil Service Examination, and this homogeneity guaranteed consistent economic policies and their competent implementation. Fourthly, the EPB did not have any subordinate affiliate agencies, which made it possible for it to be free from direct connection with social interest groups and maintain a high degree of isolation and autonomy. Fifthly, the decisive factor in the maintenance of the autonomy of the EPB in the establishment and execution of economic policies was that the president of Korea, who had the supreme power, guaranteed the independence of the EPB from the pressure of political parties and other government departments, actively protecting the specialty areas of the bureaucrats.[64]

In short, the experience of Korea as a developmental state proves that the establishment of an 'isolated and able bureaucratic organization of a nation' asserted in the state-centred approach of Johnson, Evans, Skocpol and others is the most important prerequisite for an efficient market intervention of the state. The existence of elite technocrats who can implement the national goals of economic growth presented by the national elites, their organizational basis, and in particular the existence of a pilot agency, were the primary basis which made it possible to achieve capable usage of policy tools and the best policy results in the policies for the macro economy, finance, industry, labour, etc. in a developmental state like Korea.

5.2.3. Change of bureaucratic system and the development state

After the 1980s, Korea experienced a change in the developmental state. That is, the strategy was gradually shifting from traditional state-led industrialization to market-led industrialization. Meanwhile, the most important factor in the shift of this growth model and the change in the

[64] However, the status and role of pilot agencies like the EPB should not be overstated. In fact, western scholars (advocates of a developmental state) have tended to idealize the pilot agencies of East Asian nations, bringing only their positive aspects into relief. But in reality, there have been failed policies and trial and errors as well as successful ones in the economic policies prepared and executed by the pilot agencies. In addition, the status of the organization was not always powerful (Yoon Sang-Woo 2001: 168-171).

developmental state could be found inside the bureaucracy.

The active and direct intervention of the state was quite efficient during the early stage of Korea's development, but by the 1980s the efficiency and appropriateness of the intervention of the state was gradually weakening as a result of decades of economic growth, and it was recognized to some degree that this was an unavoidable trend. Therefore, even before the autonomy of the state was damaged to a great degree and the development state system was changed in earnest due to the internal pressures of the growth of capital and social forces and the external pressures to minimize state intervention, the bureaucracy already predicted this direction of change and sought a possible policy response. However, the process was not always smooth within the direction and scope originally planned by the bureaucracy. Rather, the actual policy is visualized by going through the division and policy confrontation between the bureaucratic organizations of the nation and the process of contradictory trial and errors. Thus, in this part, the internal aspects of the changes in the developmental state and the change in the internal dynamics of the bureaucracy before the financial crisis in 1997 will be reviewed with the policy changes in different periods in order to examine the characteristics and changes of the bureaucracy of Korea.

• **Division of government bureaucrats in Korea**

During the Park Jung-Hee regime, which corresponded with Korea's development period, the bureaucracy was the key institution of the developmental state, mobilizing all policy tools and resources available under the flag of a 'growth first' agenda. Then, at the end of the Park Jung-Hee regime, in the late 1970s, officials inside the bureaucracy began seeking to break away from this policy focus and reform the growth model. That is, the industrialization focused on heavy and chemical industries that was aggressively promoted in the 1970s was creating serious side effects and after-effects, including excessively overlapped investments, deteriorated balance of payments, unstable prices and inflation, which threatened the national economy, and thus the EPB recommended and implemented the 'Economy Stabilization Policies' in order to overcome this economic crisis. The essence of this policy was achieved in the 'April 17th Comprehensive Policy Measures for Economic Stabilization,' which were announced in April of 1979. The specific policy measures included a return to austerity policy, lowering the goals of economic growth and exports, adjusting over-heated or overlapped investments in heavy and chemical industries, and reducing or putting off other political projects (EPB, 1982: 323-324).

(1) The 5th Republic (Mar. 1981 ~ Feb. 1988)

The 'Economy Stabilization Policies' pushed forwarded by the EPB gained more momentum after the new army group of Chun Doo-Hwan seized power in 1980, and were fully adopted as essential economic policy during the first half of the 1980s. The Chun Doo-Hwan regime came to power without political legitimacy and in the worst economic situation, but it did not seek popularity by developing an expansion policy, and undertook the difficult task of long-term reform of economic policy through economic stabilization and changing the growth model. There must have been political considerations in such a decision, but it is thought that the policy analysis and advice of the technocrats of the EPB and others was adopted (Choi Byung-Sun 1989: 37). As we examined in Chapter 4, the 5th Republic (Mar. 1981 ~ Feb. 1987) did not have much external autonomy and had to accept the demands of advanced nations and international financial organizations for economic liberalization and stabilization. However, the change of the key economic policy is not explained by only the power of forces outside of the nation, in that the oppressive and authoritative rule by the military group was fully restored so that the level of internal autonomy was recovered to the level of that of the Park Jung-Hee regime. Therefore, though the national autonomy shrank gradually, it was very unique that the bureaucracy itself sought to restructure the change of the growth model and weakened the developmental state system in terms of its power relative to social forces. However, this significant change in keynote economic policy was not possible without conflicts, and the primary point of confrontation and conflicts was inside the bureaucracy.

President Chun Doo-Hwan of the 5th Republic was not as good as his predecessor, Park Jung-Hee, in terms of enthusiasm for economic growth, leadership, and professional knowledge (Lee Jang-Kyu 1990; Jeong Jeong-Gil 1992: 154-155). He simplified the core economic stabilization policy through price stabilization and maintained a consistent policy to achieve his goals in any circumstances. But he often made contradictory decisions when it came to the details of policies, and his power of command of the bureaucracy was weaker than that of his predecessor. This confusion about policy details was caused not only by the qualification of the president but also by the decentralized opposition between bureaucratic groups. The reason for the confrontation was the lack of detailed knowledge on the part of non-bureaucratic leaders and their insufficient control of professional bureaucrats, but the fundamental reason was the opposition of economic development models (Kim Yeon-Cheol 1993: 139-140). There were conflicts between the secretaries and some ministers who had studied abroad and were in favour of opening the economy, and the professional bureaucrats who were supporting the traditional development model with the intervention of the state. It was not easy for the president, who did not have sufficient economic knowledge, to confidently choose a consistent policy when there was such conflict over the basic development model. The attempt to change to a market-oriented development model was led by Kim Jae-Ik, the chief of economy in the Blue House, Kim Ki-Hwan, Director of KDI, and Kang Gyeong-Sik, the Minister of Finance (Lee Jang-Kyu 1990: 72-75). The department that supported it the most actively was the EPB, while the Ministry of Finance and the Ministry of Commerce & Industry were opposed. The confrontation between the EPB and the Ministry of Commerce & Industry over the issue of import liberalization came to the fore in the spring of 1983 with the announcement of opposing policies of their respective affiliated institutes of KDI and KIET (Ibid.).

As mentioned previously, the change of the growth model resulting from the bureaucratic reorganization of the nation during the 5th Republic is generally shown in the key macro-economic policy of economic stabilization and economic liberalization, but the specific policy expression is seen more clearly in the ‘Industrial Development Act’ enacted in 1986 (Kim Yong-Bok, 1996: 173-174). The Industrial Development Act was a general and functional law on industrial policy designed to adjust the industrial structure and support industrial rationalization in a comprehensive manner, and abolishes all kinds of special laws in every industrial sector that were enacted during the Park Jung-Hee regime in the 1970s in order to implement selective industrial policies and support and foster strategic projects (Ibid.). With this law, the state did not select strategic industries or attempt to lead economic growth. Rather, the assumption is that the civilian sector will lead economic growth and the state will address market failures or structural problems later.

In a sense, such a change of policy was 'innovative'. But no social forces, including politicians, private capital forces, the press, the working class, and other outsiders could not have an influence during the process of change, and there was nothing but conflict within the bureaucratic organization over the scope and character of the bill. During the process, the position of the Ministry of Commerce & Industry, which originally drafted the bill with the intention to secure the ground for the intervention of the state, was considerably weakened, and it took almost 3 years to enact the law officially.[65]

(2) The 6th Republic (Mar. 1988 ~ Feb. 1993)

As examined earlier, there were conflicts within the bureaucracy over the future economic development model (state-led vs. market-led) during the 5th Republic, but it seems that bureaucrats recognized that economic stabilization and liberalization were an irreversible trend of the age, and consistently prepared for a gradual change of the economic development model. In contrast, during the rule of the 6th Republic of president Roe Tae-Woo which was launched in 1988, such leadership of the bureaucracy was remarkably weakened and there was a great deal of division and conflicts within the bureaucracy, as well as confusion and trial and errors while implementing policies. As a result, the merits and efficiency of the developmental state of Korea that had led the development age were seriously damaged, and the inconsistency of the growth model and keynote economic policy was amplified.

Such aspects of the bureaucracy during the 6th Republic are closely related with the new socio-political and economic situation, which did not exist in the previous regimes. The Roe Tae-Woo government came to power by a direct election system, which was restored after pro-democracy demonstrations in June 1986. As such, the state could not exercise authoritative and oppressive measures and control power as it had before in relation to the various demands of social forces

[65] The government spent 24 months in total on the Industrial Development Act - 19 months for drafting by the Ministry of Commerce & Industry (Sep. 1983-Mar. 1985), 4 months for discussion and adjustment by related departments (Apr. 1985-Aug. 1985), and 1 month for finalization of the government's bill. Then the law was publicly announced on Jan. 8, 1986 after a special consultation meeting between the administration and the ruling party (1 day), legislation period in the national assembly (2.5 months), and hearing public opinions (6 months) (Kim Yong-Bok 1996: 173).

which occurred during the process of transformation into democracy, and the autonomy of the bureaucracy was weakened significantly during this period (Gong Jae-Wook 1994: 129-131). In fact, there was no big difference between the physical aspects – organization and human resources - of the bureaucracy of the 6th Republic and those of the previous government. However, the organizational cohesiveness and the competence in policy execution of the bureaucratic organization were incomparably damaged for several reasons.

Firstly, under the authoritative ruling system of the Park Jung-Hee regime or the Chun Doo-Hwan regime, bureaucrats mainly followed the directions of the president, which meant that the president protected them in the national assembly, or took the blame if the people were dissatisfied. In contrast, the Roe Tae-Woo government of the 6th Republic was more decentralized than previous governments. President Roe delegated a great deal of authority to the bureaucrats concerned, a practice he also observed with economic matters. This decentralization made bureaucrats vulnerable to the demands of various interest groups. A further problem was that the bureaucrats themselves often did not have firm confidence in the rationality of economic policies. As a result, economic policies lacked autonomy and lost consistency (Jeong Jeong-Gil, 1992: 158-160; Lee Jang-Kyu et al. 1995).

Secondly, the delegation of authority during the 6th Republic fostered more factionalism within the bureaucracy. This factionalism made it more difficult to coordinate policies and drove bureaucrats to pay attention only to matters inside their department. Policies that were not linked to the broad national policy direction were liable to drift easily. As such, even though the authority on economic matters was delegated to subordinate departments, the supreme ruler should have worked as the coordinator or made a coordination mechanism when there were conflicts among departments. However, there was no such mechanism during the Roe Tae-Woo government, nor was there any effort to create one.

Thirdly, the status of the EPB which used to supervise and support industrial policies was gradually weakened, and it became an important factor in reducing the ability of the government for policy coordination (Kim Jeong-Yeol, 1995: 232). The status and role of the EPB, which used to take initiative for overall growth management with its strong policy coordination ability, became limited to the management of macro-economic coefficients, which intensified the policy conflicts between industrial policy supervising departments such as the Ministry of Commerce &

Industry and the Postal Service ministry. The intensified conflicts between bureaucrats due to differences in the opinions of government departments resulted in weakened autonomy of governmental organizations.

In this way, the cohesiveness and competence of the policy implementation of bureaucratic organizations was remarkably weakened during this period, which meant that even the details of keynote economic policies were redundantly implemented, put off, or cancelled according to the changing situation.[66] This inconsistency and lack of principles in policy implementation naturally had negative effects, as it decreased trust in economic policies and the bureaucracy, and added confusion to the general economy. More importantly, many policy tools of the developmental state that had previously led economic growth were lost in the midst of confusion over policies due to the division of the bureaucrats of the nation. It is especially significant that many of the measures that could encourage *Chaebol* groups to make investments and regulate them were undermined.

(3) The Civilian Government (Mar. 1993 ~ Feb. 1998)

The relationship between the political power and the bureaucrats came to a turning point with the emergence of the civilian government of President Kim Young-Sam. That is, the new democratic political power meant that the bureaucrats who used to work under authoritative military regimes had to be reborn, in a manner of speaking. To differentiate itself from the authoritative military regimes of the previous 30 years and realize various reform policies that suited the era of the civilian government, the new government had to reform the bureaucrats who had existed from the previous regimes and control them (Lee Jong-Bum 1996: 162-169). As a result, the political power and the bureaucracy experienced extreme conflicts. The bureaucrats weakened the momentum of various government policies by claiming exceptions for their departments, changing policies to make them favourable to their departments, or intentionally postponing the execution of policies to formalize the content of policies (Ibid.). It is thought that such conflicts

[66] The representative examples are the process of introduction and abolition of the real-name financial transaction system, the public concept of land ownership, the liberalization of interest rates, and the revision of the labor relations act.

were partly responsible for the incapacitation of the ambitious policies prepared for the reform and regulation of *Chaebols* during the early stage of the civilian government, and shifted the essence of policies to be pro-chaebol, reinforcing the sweeping liberalization and opening of the economy through deregulation.

In addition, the economic theories of the neo-classical school were adopted in earnest, changing the mind-set and recruitment pattern of bureaucrats and bringing about conflicts among bureaucrats and changes in policies. They spread the belief that state intervention in the market is inefficient and undesirable, and weakened the will of state to make policies that penetrated into social and economic realms.

Moreover, the number of neo-classical technocrats in the bureaucracy was increasing geometrically. As of Oct. 1994, 73 out of 156 higher officials – secretary (4^{th} grade official) and higher positions – working in the EPB received masters or doctoral degrees in the U.S., and 40 out of 78 higher officials in the department of finance studied abroad in the U.S. In the Ministry of Commerce & Industry, which was the actual department in charge of industrial policies, 93 out of 124 officials who had studied abroad held a US diploma (Economy team, Korea Economic Daily, 1994: 21).

Looking at the results, then the bureaucracy has lost cohesiveness and could not exert its function of market control in such circumstances. In this process, Korea was faced with the tragic situation of a financial crisis in 1997.

5.3. Aspects of the Changes to Korean Bureaucracy after the Financial Crisis

As was described earlier, during Korea's transition from a "developmental state" to a 'post-development state,' 1) conflicts continued to increase within the bureaucracy, 2) the leadership of the bureaucracy was significantly weakened, greatly impairing the organizational cohesion and competence of policy implementation, 3) conflict with political power was deepened, and 4) the number of neo-liberal technocrats was exponentially increasing. In other words, the key institution of the 'developmental state' of Korea, 'an effective and cohesive bureaucracy,' was suffering from internal conflicts because of the changes in the domestic environment such as industrialization and democratization, and the global trend of neo-liberalism worsened this conflict. The conflict weakened the internal cohesion of the state bureaucracy and lowered the effectiveness of policy implementation. These were the circumstances in which Korea faced the financial crisis.

If this situation before the 1997 financial crisis was summarized according to the concept of a developmental state, it can be said that 'embedded autonomy' and 'internal cohesiveness' within the bureaucracy in Korea was being seriously weakened through contradictory processes of division, policy conflict, and trial and error. Therefore, the reform of bureaucracy after the financial crisis must have aimed to meet the demands of the IMF externally, while addressing these weakened properties internally. But were these goals successfully achieved by bureaucracy reform?

This section will examine the direction of the reform of the bureaucracy after the financial crisis, considering the question of whether the implicit target of the reform set by the country (restoring the important role of the bureaucracy within the country by strengthening weakened embedded autonomy and internal cohesiveness) was achieved, to determine which direction the Korean state has changed.

5.3.1. Direction of reform of the bureaucracy after 1997

At the end of 1997, Korea faced a serious economic crisis, which was the financial crisis. To address this, a full-scale reform was carried out to overcome the financial crisis described by then-President Kim Dae-Jung as "Korea's biggest national crisis since the Korean war." Especially noteworthy was the fact that there was a prevailing perception that the Korean government was a problem that should be addressed, rather than the entity that could propose solutions to this crisis. There was a widespread consensus that in order to overcome the economic crisis, public sector reform must first take place. In this situation, and at the request of the IMF, Korea could not help but pursue sweeping public sector reform; in particular, reform of the bureaucracy based on the so-called NPM: New Public Management was suggested.

New Public Management (NPM) was rapidly introduced to Korea by the Kim Dae-Jung government. Even though several government reforms based on NPM had previously been conducted, the NPM reform by the Kim Dae-Jung government can be seen as externally enforced because it was pursed as a part of public sector reform required by the IMF during the foreign exchange crisis. Along with this external force, a unique situation in Korea, which is criticism against the growth of enlarged bureaucracy, was also a reason for the introduction of New Public Management. Korean bureaucracy was a powerful force that led economic growth during the authoritarian military regime in the 1960s and 1970s. However, as enlarged government, huge government spending, and lax administration after the IMF foreign exchange crisis were pointed out as a problem of Korean bureaucracy, a direction of reform was set as small government. However, this neo-liberalistic reform of transition to “small” government was devised to solve the problem of state deficit caused by the excessive welfare spending in western countries (Dunn and Miller 2007: 346). It was not enforced by external forces, as it was in Korea. Thus, it can be seen that applying the NPM reform to Korea had problems in terms of its workability. In addition, although it can be confirmed that the NPM reform improved some of the inefficient practices of bureaucracy, there were problems caused by the introduction of neo-liberalism (neo-liberal ideology), which espouses the market economy and side effects of selfish rationality (Cho Seong-Han 2000: 6-7).

However, reform of the bureaucracy based on New Public Management was carried out based on the logic that suggests that when other conditions are the same, pursuing efficiency in internal organization management should be a top priority, as well as the claim to introduce the market principle to the organization and leave the inefficient parts of the state bureaucracy in the hands of the private sector (Kwon In-Seok 2004: 33-34). In addition, the introduction of private sector management methods to the public sector in order to enhance the responsiveness of public officials to citizen customers through market mechanism and efficient supply of public goods was emphasized. In this, it can be said that new public management was broadly applied to the reform of Korea’s bureaucracy after the financial crisis. Eventually, it can be said that three keywords of New Public Management (Marketization, Disaggregation, Incentivization) (Clark 1996: 24) were most importantly applied to bureaucracy reform in Korea.

In this way, the key concepts of New Public Management applied to Korea’s bureaucracy reform after the financial crisis can be summarized as follows.

<Table 5.1> Key concepts of New Public Management

Classification	Contents
Marketization	Introduction of market principle of competition into production of public services - Separating the roles of buyer, regulator and supplier - Creating a type of competitive market among administrative organizations, private companies, NPOs, etc. - Making the principle of competition almost mandatory
Disaggregation	Separating the policy function and enforcement function to enhance the role of the country - Strengthening the role of the country in the policy formation and resource allocation system - Decentralization, which grants responsibilities for each of the implementation tasks to the decentralized subjects - Transition of evaluation system from process evaluation to result evaluation
Incentivization	Granting incentives to high performing parts in order to encourage entrepreneurial actors, reduce cost and enhance the efficiency of organization - Differentiating salaries of individuals, differentiate organizational units - Measuring performance and efficiency using quantitative methods - Using human resources management strategy - Denying the distinctiveness and prestige of public sector workers (administrators)

Korea's bureaucracy reform was devoted to such concepts, which can also be seen in the administrative reforms of other OECD countries, so areas in common can be seen as the limited expansion of government, flexible government system, enhancing accountability through performance management, efficiency enhancement efforts, neo-liberalism as the ideological background, etc. (OECD 1995: Cho Seong-Han 2000: 9). In addition, in Korea's bureaucracy, the model of traditional administration and career bureaucracy was shifted to one of 'managerial bureaucracy' based on the experience and the operating principles of a private company, and in this sense the culture of public service as well as the identity of public servants changed, as well as the administration system. Du Gay (1996) called such fundamental re-structuring an identity project (Horton 2006: 533).

It is no exaggeration to say that reform to Korean bureaucracy after the financial crisis was carried out very ambitiously in terms of goals, without such theoretical concerns. But looking at it from the field, the changes witnessed paled in comparison to the declared goals. The reason seems to be that the Korean administrative culture or bureaucracy is significantly different from the situation suggested in the New Public Management. If this is true, questions can be raised regarding each of the three elements of New Public Management suggested above. The first question can be as follows: ‘Were the conditions for market principles prepared in the Korean bureaucracy?’ For example, at the end of 1996, manpower supplementation systems based on market principles called “Open employment of public servants” started to be introduced to Korean bureaucracy. This was a system in which vacancies were filled by hiring civilians or public servants from other departments through an open competitive employment process instead of internal promotion and the new employee works for a certain period of time. It is the opposite of the previous system of closed public servant employment, in which vacancies were filled by internal promotion through screening for promotion or test. (Lee Sang-Yun 2002: 234-235).

However, this recruitment method would never be welcomed by the public servants themselves, who view their positions as “jobs for life.” In fact, A, who serves as an officer in a public organization, said in an interview[67] with the researcher, "Actually, there would be no one who is happy about external experts coming into the organization. We do this because the country says we must, but I am not convinced of its usefulness." Korea’s bureaucracy does not have a condition for market principle. The second question related to the problem of the separation of

[67] See Appendix 1, 2, and 3

planning and execution is not easy, either. First, the question of whether or not policy planning and policy implementation can be separated in Korea's bureaucracy is controversial. Therefore, transferring authority and responsibility to local governments, special local administrative bodies, private committed agencies, or civil societies is likely to cause complex problems. Third, the logic of granting incentives within the bureaucracy to enhance effectiveness is not that simple in reality. A senior official B said in an interview, “As long as the characteristics of the traditional bureaucracy still exist, I’m not sure that introducing competition and financial incentives to bureaucracy will make the officials work harder. Moreover, Korean bureaucracy cannot change in a day, it is like an organism in which decades of tradition and customs are embedded.” Whether financial incentives will increase the effectiveness of the bureaucracy or not is unknown.

<Table 5.2> Problems of New Public Management Reform

Classification	Example	Problem
Marketization	Open employment of public servants	- Are the conditions for market principles prepared in the Korean bureaucracy?
Disaggregation	Executive agency	- Is separation possible? Is the authority transferred?
Incentivization	Incentives	- Is financial incentive so important as to be the basis of bureaucracy operation?

Therefore, it can be said that Korea’s bureaucracy had various inherent obstacles to the introduction of New Public Management due to the administrative culture and the characteristics of the organization. However, Korea's bureaucracy reform after the 1997 financial crisis was carried out based on the key concepts of NPM, without finding a solution to these problems. Considering this, now seems like an appropriate time to examine what changes actually occurred inside the bureaucracy.

5.3.2. Examples of NPM Bureaucracy Reform after the Financial Crisis in 1997

So far, the direction of the changes Korea's bureaucracy has been studied. This chapter will discuss the internal changes that actually occurred inside the bureaucracy after the financial crisis, along with the problems.

Bureaucracy needs rigidity in some areas due to the nature of the work. Unlike profit-seeking companies, which have a clear and simple goal, there are many cases in which bureaucracy must pursue complex and ambiguous goals, as the aim is to satisfy the complex demands of society. However, the new public management reform of bureaucracy applies the principles of profit-seeking companies to bureaucracy, and as a result, conflicts occurred between organizational structure and behaviour. Most notably, in the operation of bureaucracy in Korea, hierarchy is likely inevitable, and there are a number of advantages to this structure. However, NPM considers hierarchy to be a highly negative thing, and sees breaking it as the best way to reform bureaucracy. A horizontal organizational structure is considered to be the ideal system, and this has been the direction pursued in reform to the bureaucracy. The introduction of the team system and position classification system to bureaucracy is a representative example of NPM reform. However, there are questions regarding the legitimacy of the team system in Korea. First of all, there are many cases in which a team system was introduced for performance improvement or customer satisfaction, but in the case of Korea's bureaucracy, it is no exaggeration to say that the team system was introduced simply to show that reform was being carried out. The reason for the introduction of team system is not simply to introduce a team system, but to introduce a system of team-oriented thinking. (Wellins et al. 1994; Kim Gwi-Young 2007: 59) However, Korea's bureaucracy is already operated not in an individualistic way, but collectively, which is in a group-oriented way but hierarchical group's way. In an interview with a researcher, senior official L said, "In government (bureaucracy) organizations, segregation of duties is done only for sections and larger teams, and duties of individual officials are sometimes not clearly marked. This means that work was already done in a team in Korean bureaucracy. With firmly established systems such as consultation with superiors, vertical teamwork is stronger than horizontal teamwork. Therefore, teams tend to be team egoistic. However, looking at the smallest unit such as a section, the characteristics of the team system can be seen. Also individual officials' segregation of duties is flexible. When there is additional work, someone does it, even if it is not on his/her list of duties. This proves that the introduction of the team system was unnecessary.

In addition, Kim Gwi-Young (2007: 57-63), who analysed the behavioural changes before and after the introduction of the team system to the Ministry of Government Administration and Home Affairs, said, “The team system was introduced to simplify the hierarchy, but perfunctory reduction of ranks with the ranks under the bureau · section system still existing reduced the meaningfulness of the ranks reduction. There were many cases even of members of the same team having different ranks. This situation eventually reduced the validity of the team system. These limits were generated because of a misunderstanding of Korea’s unique hierarchical culture." Ultimately, it became hard to avoid the criticism that the team system was mere political rhetoric and resulted in expanding the top spots in the hierarchy.

Another example of NPM bureaucracy reform is the introduction of the position classification system. Job analysis, the basis of the position classification system, is an American system, and emphasizes professionalism. It is based on a "machine model" that considers each position as a part in a machine. Some analyse that introducing such position classification system to Korea, which is based on ‘human model’ that puts stress on generalists and human relations is only to show they work in a scientific way and to be seen as differentiated. Even some people analyse that the position classification system was introduced to Korea, which is based on the ‘human model’ that puts stress on generalists and human relations in administration because they wanted to show they work in a scientific way and to be seen as differentiated. (Cho Seok-Jun 2004: 12-13) In addition, in an interview administration officer M stated, "In fact, in Korea's bureaucratic organizations officials who adapt well to the hierarchical organization are better recognized than excellent officials with outstanding expertise." There are also some advantages to Korea’s hierarchical structure, along with disadvantages.

Cho Seok-Jun (2004) says the Korean bureaucracy is like a family. Large organizations such as the bureau and office have the structure of a clan village. In this structure, there is a pecking order, and those who are more privileged take more responsibility. He also thinks characteristics of Korean culture like static relationships, a 'we' consciousness, a culture of connection, and emphasis on reputation and gratitude have an impact on the overall bureaucracy (Cho Seok-Jun 2004: 57-69). In particular, Korean familism, and its idea of 'Presence of son is absorbed by the father,’ have a major influence on administration in Korea. This has led to the strong tendency of considering the chief of the organization as possessing all rights, and actually being equivalent to the organization itself. Therefore, when a delegation of authority occurs as a national project, ministers give only not so important authorities to subordinates. And the not so important authorities given to subordinates will be collected back by the ministers later. Therefore, if there is a national project of delegation of authority, ministers give less important authorities and collect most of them back later, and the subordinates return these without resistance (Cho Seok-Jun 2004: 114-115). Korean officials focus more on their roles as members of the organization than on expertise in their jobs. Therefore, it is reasonable to have questions regarding the effectiveness of position classification in this situation.

As part of the NPM reforms, a job performance evaluation system was also introduced to the bureaucracy. An individual appraisal system including job performance rating, which is to assess an individual's job performance, incentive schemes, bonuses, and annual salary were introduced, however due to the nature of Korea's bureaucracy they could not help but be operated carelessly. Incumbent senior official T said, "Given the situation in Korea where people work collectively in a family-like atmosphere with systems like consultation with superiors, performance evaluation can only be performed in a very basic way. In addition, superiors in charge of performance evaluation become mechanical when they have to do the evaluation because they worry about breaking the unity of the team." In Korea, objective criteria were often insufficient in many situations, and therefore, the effect of introducing job performance evaluation could not be positively evaluated.

So far, three major aspects of NPM bureaucracy reform after the financial crisis, including the team system, position classification, and job evaluation system, have been briefly explained, and related problems were described, regardless of the effectiveness. Ultimately, the NPM reform is considered to have had the intention of dismantling and individualizing the internal structure of bureaucracy to increase the competition among the individual members and evaluate the results. However, it is true that there were too many difficulties in applying the NPM reform given Korea's cultural traditions.

So, could the government's purpose in implementing NPM reform be achieved? Although the answer is uncertain, this is a question that absolutely needs to be examined.

5.3.3. Changes as a result of bureaucracy reform: were the planned goals of the government achieved?

Thus far the external direction of the reform of Korean bureaucracy and internal changes that actually occurred after the financial crisis has been examined, and the characteristics and problems were also described. This section will examine whether or not the inherent goal of the NPM reform set by the government was achieved. Also, the question of whether the goal was achieved or not will be determined based on the information (examples) acquired from field work. The information is about the changes that appeared as a result of bureaucracy reform.

(1) Worsened inter-department power relationship: weakening 'Internal Cohesiveness' due to the exercise of power by the Ministry of Administration and Reform

Bureaucracy reform after the financial crisis was led by the Ministry of Planning and Budget Authority, the Ministry of Government Administration and Home Affairs, the Civil Service Commission, and various presidential committees. The Ministry of Planning and Budget led the reform by the means of various reforms relating to the budget, the Civil Service Commission spearheaded the personnel system reform, while the Ministry of Government Administration and Home Affairs was in charge of administrative innovations. Senior official C said in an interview, "The Ministry of Planning and Budget wielded the power of money from the budget appropriation according to the results of reform to the budget allocation. The Civil Service Commission took the lead in personnel system reform with the aim of pleasing the government rather than putting the brakes on inappropriate personnel management by the government, based on ensuring the Chairman's term of office. The Ministry of Government Administration and Home Affairs is acting as an advance guard for reform. It can be interpreted as the stronger power of the "Ministry of Administration and Reform."

These organizations have something in common. They led the minimization of organizations for efficiency improvement, but they expanded their own organizations. C said in an interview, "They claimed to promote more autonomy for ministries and a performance-oriented rather than process-oriented system, but what actually happened was centralized management of reform, such as fine control over the process and report form control. In fact, individual departments wasted much time trying to meet the standards set by the officials, and individual departments also wanted specific instructions from them." As a result, those staff organizations responsible for money, organization, manpower management, and control from the perspective of government became larger, to control departments in charge of providing direct services to the public. In addition, they didn't take responsibility for their exercise of power. There was a continuous gap between their power and responsibility.

As authoritarianism could not be eliminated within the inter-department relationship in bureaucracy, the operation of the departments inevitably faced many obstacles. Inter-department agreements became more difficult, and controversy over 'authority' and 'responsibility' intensified. D, who served as an official, said in an interview with our researcher, "In fact, one of the causes of the financial crisis in 1997 was the Ministry of Finance and Economy, which mitigated various financial regulations. But after the financial crisis, they became the main agents of various financial reforms. This gave me a chance to think about 'authority' and 'responsibility' once again."

Ultimately, the NPM reform after the financial crisis resulted in more power being concentrated in the Ministry of Administration and Reform. This further exacerbated the internal cohesiveness within the bureaucracy as a result.

(2) Politicization and transformation into no personal opinion of senior officials: weakening 'Embedded Autonomy'

Korean bureaucracy has a personnel system that gives preferential treatment to people with many years of service through promotion or salary increase. The seniority system is a system or a practice under which people receive fixed starting salary according to their rank when they start working at the organization and are given preference for salary or position depending on the length of service or age. (Chae Han-Su 2001: 357-359) The seniority system has an advantage of enabling officials to come up with policies independently from society, yet is also linked to society by granting them job security. However, it also has disadvantages. Officials may become complacent and less creative in policy development, and their efficiency may decrease. However, in 1998 the government abolished the seniority system and adopted a performance-based payment system based on the annual salary system as a part of bureaucracy reform. In other words, with an emphasis on the shortcomings of the seniority system, the NPM personnel evaluation system was introduced, and became the basis of a personnel management system.

This reform brought chaos to officials, shaking up the career civil service system. In particular, despite the fact that it is difficult to evaluate senior officials who are required to develop long-term policies, they were assessed using arbitrary yardsticks such as innovation capability. As a result, (senior) officials focused on creating short-term policies that could be helpful in the personnel evaluation rather than making autonomous and independent policy, or they were carried along by the political atmosphere. E, who was a senior official of the Financial Supervisory Service, said in an interview, "As a result of (New Public Management) bureaucracy reform after the financial crisis, rapid politicization occurred among high ranking officials seeking a promotion. ‘Politicization' here does not means the acquisition of ideology of party politics, but the ‘ability to transform’ according to the intention of a man in power along with the phenomenon of "no personal opinion.' Guarantee of position felt by senior officials could not help but be weakened gradually.” As a result of the reform, the politicization of the bureaucracy was intensified.

State officials must be people who think of the country through a long-term perspective. To enable this, 'embedded autonomy' should be guaranteed to the officials (Evans 1995: 51-53). In other words, officials have to be professionals who can create embedded autonomous policies that are autonomous from society, yet work in conjunction with it. Like Max Weber, Schumpeter also thought about calculating attitude toward society and believed that only a government of experts could lead the country’s administrative body (Held 1987: 183). However, NPM focused too much on the disadvantages of the bureaucracy, and only cared about the accumulation of exogenous systems, failing to provide substantial conditions to restore the weakened 'embedded autonomy.' As a result, the politicization of the bureaucracy began to intensify from the senior officials, inhibiting the specialization of officials and long-term thinking/developmental focus in that sense professionalism.

In this way, NPM reform after the financial crisis deepened the politicization of the bureaucracy, further weakening the ‘embedded autonomy’ of the officials.

(3) The Officials' Identity Crisis

NPM reform created opportunistic officials that lacked conviction and were self-conscious, rather than working for the sake of achieving excellence. As incumbent official F said in an interview, "People who took the lead in reform and praised it, regardless of their beliefs, succeeded, while others were disadvantaged. As a result, officials always doubt their identity and feel anxious about their position." NPM reform caused an identity crisis among officials.

In addition, NPM reform tended to consider officials as essentially being no different from employees of a private company. F said, "Producing public goods and merit goods for people to distribute and redistribute resources, while regulating people who are steeped in self-interest or used to tricking the government is our role. However, the reform induces us to consider all people as masters or customers, and provide the services they demand. The reform denounces all officials as disabled and the subject of reform, and hurt their pride." Under these circumstances, the identity of these officials could not help but be shaken.

Thus, Milward (1996) argues that NPM has weakened the affinity of individual public officials with their organization, and made them no longer search for the identity of the organization, ultimately destroying the bureaucratic organization. (Horton 2006: 537) It is certainly true that the officials should try to meet the people's needs and provide quality services. However, due to the differences between the nature of government service and that of private companies, it is difficult for bureaucracy to provide service flexibly, but equally and strictly. (Suleiman 2003: 310-311). Usually rule of law has the important goal of protecting the weak from the community as a whole. Therefore, officials need to enforce the laws rigidly. In other words, as the spirit of the law is to regulate the abuse of power by the strong, it is important for countries with many cases of abuse of power to prescribe the laws and regulations in detail and enforce them stiffly (Im Do-Bin 2007 : 43). From this, it may be interpreted that NPM reform cannot be applied to all cases.

In Korea, the NPM was regarded as a cure-all for bureaucracy reform and introduced blindly. As a result, the identities of the officials were weakened, and the officials became “servants” of politicians, increasing the public’s distrust in the government after the reform. However, the lower level of trust in government was not only related to the inefficiency of the bureaucracy, but also was due to the adverse effects of NPM reform on the identity of the officials and their roles. After all, public distrust of the bureaucracy eventually led to distrust of the country or the government. Slovic (1993) pointed out that while trust is formed gradually, one mistake can rapidly destroy trust, and a long time is required to recover trust to the original level. In some cases, that recovery was impossible (Slovic 1993: 675-677). Unfortunately, Korea's bureaucracy was having a hard time promoting national policy because it failed to earn the trust of the public.

5.3.4. Evaluation

Thus far, we have looked at the external direction of Korean bureaucracy reform, internal changes in bureaucracy that actually occurred after the financial crisis, and the characteristics and the problems. In addition, we looked at the question of whether the imminent goals the government planned to achieve through the reform of bureaucracy were achieved.

Since the introduction of the New Public Management model to Korea, efficiency has become the most important factor in the bureaucracy. Despite the fact that democracy depends on a stable bureaucracy, all the reforms aim at completely getting rid of the bureaucracy. Competition among administrative agencies according to the logic of the market, expanding profits and reduced costs, exchange with the private sector, and outsourcing not only became widespread but also were indiscriminately accepted (Ahn Byung-Young 2007: 114).

In addition, due to dominant views in Korea such as "Government officials are lazy, incompetent, irresponsible, and have no soul," “Government officials are corrupt despite their high salaries and pensions,” “Due to the job security of the government officials, government productivity is low and the government excessively interferes in the market, inhibiting the development of the country," (Kim Byung-Seop 2009: 3), the bureaucracy was selected as a main target for reform when NPM was applied. However, Korea's bureaucracy cannot be viewed as having a lower level of quality compared to the bureaucracy in other countries. Outstanding talent was already coming into bureaucracy, enabling the bureaucracy to secure the excellence of officials when they entered the bureaucracy, as well as motivation. Also, despite the criticism that the government's productivity is low, it should be remembered that it was the bureaucracy that actually led Korea through the age of development, not the private sector (Haggard 1990: 108).

Officials are able to do things that cannot be done by the private sector in the long run. However, this strength of Korea was overlooked and NPM was applied to bureaucracy reform.

As seen above, in bureaucracy reform in Korea, countless idealistic reforms featuring experimental systems not yet generally used were carried out without contemplating the preconditions of the reform. It can be evaluated as a testing ground devoid of even the logicality (Cho Seong-Han 2000: 24-25). Also, the NPM reform in Korea can be assessed as having the limitation of changing the function in terms of micro-management, rather than a structural reform to realize democratic administration by weakening the back-scratching alliance of government and businesses or de facto privileged classes. (Ahn Byung-Young 2002: 206).

Ultimately, NPM bureaucracy reform in Korea was full of "how" to reform but there was no fundamental discussion on 'for what', 'to whom'. As such, the NPM was not in accordance with Korean administrative culture and the organizational characteristics from the beginning.

5.4. Concluding Remark

In the 1980s, state bureaucracy in Korea realized that to some degree the effectiveness and validity of government intervention had been reduced and reform in the method of growth was inevitable because the economy had become complex and expanded and the industrial structure was advanced as a result of decades of economic growth. Therefore, as the national autonomy was largely damaged and the developmental state system made a full-fledged transition due to the growth of domestic capital and social power and external checks and pressures on government intervention, the state bureaucracy had already predicted the direction of changes and sought political countermeasures. Nevertheless, the process before 1997 was not smooth within the scope and direction planned by the organization. Rather, there have been divisions and policy conflicts within the state bureaucracy, and a contradictory process of trial and error. Eventually, bureaucracy in the country lost its cohesion under such conflicts and the market control didn’t work well. As a result, Korea was confronted with the tragic situation of the financial crisis in 1997.

In other words, it can be considered that Korea's economic crisis in 1997 occurred because the state bureaucracy, experiencing the accumulated problems of rapid economic development led by bureaucracy under the authoritarian military regime, failed to respond properly to the internal and external environmental changes of democratization and neo-liberalistic globalization. In fact, the core institutions of the developmental state of Korea suffered from internal environmental changes such as industrialization and democratization, and the global trend of neo-liberalism made the situation more serious. This situation weakened the internal cohesiveness. If the embedded autonomy is weakened as well, the effectiveness of policy implementation would be reduced. Under such circumstances, Korea faced a financial crisis.

Korean bureaucracy was changing, and during the transition, the internal cohesiveness and policy implementation ability of the bureaucracy were reduced. Since the transition was occurring under the small neo-liberalistic government, it was difficult to expect powerful and impulsive bureaucracy, as seen in the case of developmental state. After the 1990s, it in fact was more important to build a Korean bureaucracy capable of properly dealing with the internal democratization and external neo-liberalistic globalization. In addition, the painful economic crisis Korea experienced in 1997, the turning point of a century, required people to reflect on the methods by which bureaucracy operated, and fundamentally consider the desirable way for bureaucracy to operate. However, Korea carried out NPM reform without contemplating the Korean situation or the prerequisites for reform. There were many discussions on how to carry out reform, but the fundamental discussion on ‘for what’ and ‘to whom’ was not properly held.

Since 1997, Korean bureaucracy has changed in a manner following the direction of NPM reform, and team system, position classification system, and job evaluation system were introduced to the bureaucracy. However, after the reform, the planned goal was not achieved because: 1) 'internal cohesiveness' was further weakened after the reform because of some enlarged departments of bureaucracy, and 2) embedded autonomy was weakened because officials were more swayed by the political power, and 3) as the officials faced an identity crisis, ‘bureaucratic rationality' was not found, and accordingly, trust in government was reduced.

In the end, the government’s attempt to restore the attributes of the developmental state through reform of the bureaucracy failed. In fact, this misguided reform shook up the stability of the bureaucracy of Korea. As such, it can be concluded that the state bureaucracy, who should have been acting as a major player in all reforms after the financial crisis, was faltering for various reasons, which can be the most fundamental reason for the success or failure of financial reform which will be analysed in Chapters 6 and 7.

Chapter 6
PUBLIC FUND

6.1. Introduction

As examined in Chapter 5, the direction of change of the Korean state after 1997 accelerated the loss of the positive attributes of the developmental state according to the change of the bureaucratic system, which is the biggest institutional characteristic of a developmental state. In other words, as 'internal cohesiveness' and 'embedded autonomy,' which had begun to be reduced even before the financial crisis, did not recover despite the reform of the bureaucratic system, the 'regulatory state' which had progressed before the financial crisis did not change its direction and speed despite the intention of the state. Given this situation, Chapter 6 will examine the recovery of 'state autonomy' and 'state capacity,' the representative attributes of a developmental state, through the spending of the public fund, so as to examine the influence of the public fund on the change of the developmental state. In addition, the question of whether the goal of the Korean state was achieved through the process will also be examined.

Accordingly, to empirically examine whether the state's purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the financial crisis of 1997 was successful or not, this chapter will mainly focus on tracing how the high degree of state autonomy and capacity that appear in the model of a developmental state actually changed amidst the foreign exchange crisis. This occurs on the basis of the belief that state autonomy and state capacity are shown when the state can direct the financial institutions as to their structure/operations/use of funds. To do this, this chapter examines the two opposing viewpoints about the change of the Korean developmental state through an analysis of the formation and execution process of the public fund, which was the core policy tool used to cope with the foreign exchange crisis. State autonomy and state capacity are shown when the state can direct the financial institutions as to their structure/operations/use of funds. And the public fund was the most direct and core financial policy tool for the government to intervene with the market at the time of the foreign exchange crisis. Therefore, the processes of the formation, input, retrieval, follow-up management and supervision of the public fund are a good basis for an evaluation of the autonomy and capacity of the state. This is even truer because the processes were not merely internal problems of the bureaucracy of the government but had great influence on the relationship between the government, financial capital and industrial capital.

For analysis and examination, this chapter divides the processes of ‘input’ and ‘retrieval’ of the public fund. The input of the public fund refers to the input of an emergency fund by the government into the financial institutions that were suffering from financial pressure due to the foreign exchange crisis. The retrieval of the public fund refers to the process of management and supervision by the government for the managerial normalization of the financial institutions that received benefits. The reason for dividing the two is that the formation and input of funding through policy-making is the process of “financial support” that reveals the ‘autonomy of the state,’ while the management and retrieval of the fund through the evaluation of policies shows the ‘discipline’ ability to supervise and guide the players in the market according to the judgment of the state, i.e., the ‘capacity of the state.’

To trace the changes in the internal[68] autonomy of the state, this chapter goes beyond merely analysing the quantitative volume of the public fund, but also analyses the changes in qualitative relationships in the process where the state secured control over financial capital and industrial capital through the public fund. Through this effort, it is possible to determine whether the formation and execution of the public fund since 1997 maintained the relationships among the state, capital and industrial capital as the same as those in the model of a developmental state, or changed them.

[68] Such an approach focused on the issue of the control and regulation of the domestic capital by the state through the public fund, and it had the shortcoming of limiting the object of analysis to the internal aspect of the autonomy of the state. To complement this, it is possible to analyse, even partially, the aspect of external autonomy through the cases of inputting the public fund to overseas financial institutions. But the amount put into overseas financial institutions is no more than 1.4% of the total amount of input of the public fund. It is also possible to estimate the external autonomy of the government through the foreign loans from overseas organization included in the public fund. Yet the actual loans of 1.7 billion dollars from overseas organizations (200 million dollars from ADB and 1.5 billion dollars from IBRD) only represented 0.92 % of the public fund. Therefore, it is insufficient to estimate the changes in external autonomy through the amount of inflow of the public fund from abroad. For this reason, the focus will be placed on the changes in the internal autonomy of the state through the public fund.

Next, the level of the capacity of the state is divided into the problem of the bureaucracy inside of the state and the relationship of the ruling class (capital) outside the state. First of all, an analysis will be performed on the cohesion of the government bureaucracy and the systematic arrangement of authority, which are highlighted as the core internal conditions of the capacity of the state. If there is not high cohesiveness and political effectiveness in the governmental organization related to the public fund, this suggests that the internal capacity of the state is being weakened. Meanwhile, the external capacity of the state can be evaluated with the ability to manage and supervise the financial institutions that received the public fund. If the input fund is not properly retrieved, it suggests that the ability of the state to regulate capital is being weakened.

6.2. Formation and input of the public fund: Reinforcement of state autonomy

The formation and input of the public fund associated with the financial crisis of 1997 actually ended in late 2001 when the restructuring of large insolvent financial institutions was almost completed. Then, the focus in 2002, related to the public fund was moved to the recovery, post-management and repayment of the public fund. After that the *'Public Fund Repayment Countermeasure'* was introduced and the investigation activities of the 'Joint Control Authority of Public Fund Corruption' ended in 2005, and the transition of government issued guaranteed bonds also known as contingent debt was finalised in 2006. So, this section will thoroughly investigate the public fund based on the resources up until 2006.

6.2.1. Scale, financial resources, and method of support of the public fund

The public fund is funding created through policy consultation with the International Monetary Fund (IMF), which supplied emergency foreign currency liquidity to prevent the bankruptcy of the financial sector at time of the foreign exchange crisis in 1997. The 'Public fund' defined in Article 2 of the [Special Act on the Management of the Public Fund] include a) deposit insurance fund established by Depositor Protection Act, b) a non-performing bond fund based on the act on effective dealing of non-performing assets of financial institutions and the establishment of Korea Asset Management Corporation, c) the public capital management fund based on the Public Capital Management Fund Act, d) national assets defined in laws on in-kind investment of national assets, e) the investment of the Bank of Korea in financial institutions based on the Bank of Korea Act, and f) the fund supported for the restructuring of financial institutions by public loan, etc. based on the laws on the introduction and management of public loans (Ministry of Strategy and Finance &Public Fund Oversight committee 2002: 3-9; Lee In-sil, et al. 2002: 72-74). The public fund was made through a combination of four kinds of funds according to the financial resources. The first was the 'fund created by issuing bonds' made by issuing deposit insurance fund bond and the non-performing loan disposal fund bond with the agreement of the National Assembly. The second was the 'retrieved fund,' which means the reuse of the funds retrieved from among the amount supported by issuance of bonds. The third was the 'public funding' such as loans (from ADB, IBRD, etc.), national assets, and public funding management fund. Finally, there is 'other funding,' which includes the funding supported by Korea Deposit Insurance Corporation[69] and Korea Asset Management Corporation[70] with loans from financial institutions, as well as the funding supported by Korea Deposit Insurance Corporation with the premium for deposit. The size of the public fund summarized by the character of the financial resources is shown in <Table 6.1>.

[69] Korea Deposit Insurance Corporation is a government-investment agency that was established in Dec. 1995 to protect depositors from the bankruptcy of financial institutions and maintain the security of the financial system. Its main responsibilities are ① procuring funds for deposit insurance, ② settling non-performing financial institutions, ③ collecting public funds, ④ investigating and calling to account those involved with insolvency (www.kdic.or.kr).

[70] Korea Asset Management Corporation was established in April of 1962 under the 'Korea Development Bank Act' and the 'Decree on the Korea Asset Management Corporation.' On Dec. 31, 1999, its name was changed from the 'Adjustment Corporation' to the current Korea Asset Management Corporation with the amendment of the act on the corporation. According to the amendment to the act on the corporation made in 1999, its main responsibilities include ① management and operation of the fund for settlement of non-performing bonds, ② acquisition and settlement of non-performing assets of financial institutions, ③ supporting the revival of acquired insolvent enterprises, and ④ management of national assets and settling arrearage tax as a Bad Bank (www.kamco.or.kr).

<Table 6.1> The public fund status by financial resources (1997 ~ 2006)

Unit: Trillion won

	Issuance of bonds	Recovery funds	'*Public*' fund	Other funds	Sum
Amount of money	102.1	42.0	19.9	4.3	168.3
%	60.7	25.0	11.8	2.6	100.0

Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2006).

So, how was the public fund in each financial resource mobilized? First, in the case of the public fund used for the issuance of bonds, the Ministry of Strategy and Finance estimated the amount of public funds required, submitted a proposal to the National Assembly for the agreement to the guarantee of the government for the amount of the bonds to be issued, and then the public fund was created after a resolution by the National Assembly. In this process, the intervention of the National Assembly with the proposal of the government was very formal and procedural, and the state autonomy was not restricted at all. After all, the government had the actual power over the decision on the public funding of this type, and the National Assembly only gave ex post facto approval.[71] As a result, the state was able to accomplish its preference and decide policy priority in the process of making plans related to the issuance of the bonds. The 'retrieved fund', which represents the second largest portion, was a fund whose usage could be decided by the administration without the approval or agreement of the National Assembly. Therefore, the government could exercise absolute autonomy over this type of public fund.[72] Thirdly, in the

[71] For example, on Aug. 28, 1998, the Strategy and Finance Committee in the National Assembly unanimously passed the bill submitted by the government to create the public fund of 64 trillion won, which was also passed in the plenary session unanimously on Sep. 2 of the same year. In a manner of speaking, the bill was passed within one week after it was introduced in the National Assembly. Most of the financial resources for public funds were approved by the National Assembly as special accounts for financial loans to be used by the Ministry of Strategy and Finance for financial restructuring.

[72] The matter of the reuse of the retrieved fund was pointed out several times in the Special Committee for Parliamentary Investigation. It is necessary to take note of the following data (The secretariat of the National Assembly 2000: third, 21). Congressman Bang-Ho Lee: "This data shows that the amount of retrieved public fund reused is 18 trillion and 600 billion won. Once the public fund is retrieved, isn't it necessary to have the approval of the National Assembly for it to be used as a financial resource for the repayment of bonds? I don't think it can be used at will" (Other remarks omitted.) Minister of Strategy & Finance Jin Nyeom: "It may differ depending on your point of view. The National Assembly consented to the public fund, and if there are urgent things that happen, it may be spent usefully until the deadline of repayment. Please kindly understand."

case of ‘public funding,’ the ‘Public Fund Oversight Committee’ was established for the deliberation and resolution of matters related to the operation and management of the fund concerned, and the Minister of Strategy & Finance presided over the committee. So this funding, too, was under the supervision of the administration and was used according to the will and preference of the government. In general, it can be interpreted that all public funds were mobilized by the government without the intervention or opposition of other groups. In other words, the public fund is a direct index that shows the increased autonomy of the state.

Next, let’s take a look at the autonomy of the state shown in the process of the input of the public fund. There are various types of public funding support to the financial sector according to the judgment of the management quality of the financial institutions and the prospect of managerial normalization. Specifically, the methods of support are divided into ‘equity participation,’[73] ‘contribution,’[74] ‘deposit payoff,’[75] ‘asset purchase,’ and ‘non-performing loan purchase’[76] (White Paper on Public Fund Management 2003: 37-38). The public fund has mainly provided support in the form of contribution and deposit payoff in case of liquidation or bankruptcy of financial institutions, while the methods of equity participation or asset purchase are used for the financial institutions with high possibility of managerial normalization. Of the various methods

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[73] The method of equity participation was used by the Public Fund Oversight Committee if it judged that the liquidation or bankruptcy of the institution concerned may cause the instability of the system, or the management can be normalized by itself through sale or self-help effort. In particular, equity participation is a kind of investment that allows the acquisition of a share of the cooperative or company corresponding to the amount of equity participation, with the acquisition of rights and responsibilities as a shareholder. Therefore, the government shall have control of the financial institution commensurate to the amount of equity participation.

[74] Contribution means the input of fund by the government to the acquiring financial institution in the form of contribution for the shortage of asset when a financial institution is transferred to another financial institution due to bankruptcy or liquidation. The rights and responsibilities for the contributed fund will be given to the acquiring financial institution, and the contributed fund may not be returned.

[75] Deposit payoff is used to protect the money of depositors if a financial institution is liquidated or becomes bankrupt. Korea Deposit Insurance Corporation pays for the savings as an insurance payment.

[76] Through the methods of asset purchase and non-performing loan purchase, the government purchases the assets and non-performing loans of financial institutions as stipulated by laws. The purchasing prices for assets and non-performing loans will be decided based on market prices, referring to the values appraised by appraisal and assessment organizations such as Korea Appraisal Board for collateral for non-performing loans or assets for non-business use.

of support, equity participation is a means used by the government to obtain the substantial rights and responsibilities for the financial institutions concerned as a shareholder. In comparison, contribution, deposit payoff, and purchase of asset or non-performing loan are only temporary support for liquidity, not a way used by the government to secure direct control of the concerned financial institutions.

So, who decides which of the various types of input is appropriate? The body that had the absolute influence on the judgment of this matter was the 'Public Fund Oversight Committee'[77] of the government, which was co-chaired by the Minister of Strategy & Finance and a member of the committee elected by mutual vote. Whether the public fund was input, and if so, which method of input would be chosen, were key issues that could determine the survival in the market of the financial institutions concerned. In this context, the state had almost absolute autonomy over financial capital.

Ultimately, the formation and execution of the public fund became the financial basis for the possibility of the government's independent actions, or the autonomy of the state, from the intervention of various forces, including financial capital and the National Assembly. Furthermore, the public fund was a resource that enabled the government to map out the related policies according to its preferences and use the necessary financial resources as freely as possible. In that sense, the huge amount of the public fund, 170 trillion won, was a clear indicator that plainly revealed the tremendous rise in the internal autonomy of the state.

So, how much the public fund was left to the government's discretion, in terms of the absolute and relative volume? As shown in <Table 6.2>, the total volume of the public fund contributed from 1997, when the foreign exchange crisis broke out, to 2006, was 168.3 trillion won. The amount of input differs from year to year. The input is concentrated in the 4 years just after the beginning of the foreign exchange crisis, and was decreased starting in 2002.

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[77] See 6.3.1 and <Figure 6.2> of this chapter for the composition and role of the 'Public Fund Oversight Committee'.

<Table 6.2> The volume of the public fund and the national finance (1998 ~ 2006)

Unit: Trillion won

	1998*	1999	2000	2001	2002	2003	2004	2005	2006	Sum
The public fund(A) (%)	55.6 (33.0)	35.5 (21.1)	37.1 (22.0)	27.1 (16.1)	3.7 (2.2)	2.1 (1.2)	3.9 (2.3)	2.9 (1.7)	0.3 (0.2)	168.3 (100.0)
Central government finance (General accounting)(B)	73.2	73.2	80.5	98.7	108.9	117.2	118.2	135.2	144.8	949.9
A/B (%)	76.0	48.5	46.1	27.5	3.4	1.8	3.3	2.1	0.2	17.7

Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2006).
* Inputs in 1998 also include the public fund that injected in 2 months since Nov. of 1997.

The weight of the public fund in the national economy can be clearly seen if the size of the public fund is compared with the size of the general government budget. As shown in the table, from 1998 to 2000 a huge amount of money, almost half of the national budget, was put into the financial sector at the discretion of the government. The input of such a huge volume of the public fund demonstrates that the autonomy of the state was expanding significantly. In particular, with the decrease in credit standing due to the foreign exchange crisis, the public fund was the only financial resource available for the financial sector, and thus it played the role of a lifeline for financial capital.

6.2.2. Realignment of the financial capital through the public fund

What change did the state's input of the public fund bring to Korea's financial market? A financial institution receiving public funding had to sign an MOU with the government to begin restructuring in earnest. <Table 6.3> and <Table 6.4> show the status of the restructuring of the entire financial sector and the support granted with the public fund. Specific processes of restructuring differed according to the characteristics of the financial institutions concerned. In particular, there were differences in the restructuring of the banks and the non-bank financial institutes. Let's take a look at the processes of financial reform implemented with the public fund by comparing the restructuring processes of banks and non-bank financial institutes.

Beginning in the first half of 1998, the government implemented a drastic restructuring of banks.

As a result, as shown in <Table 6.3>, the number of banks, which was 33 at the time of the foreign exchange crisis, was reduced to 18 by the end of June 2006. In addition, as shown in <Table 5.4>, 86.9 trillion won, 51.6% of the public fund, was provided to banks. As the majority of the public fund supplied was provided to banks, the banks experienced a relatively acute restructuring. Also, compared to other financial institutions, a greater portion of the public fund put into banks was provided in the form of equity participation rather than contribution or deposit pay-off which led to liquidation or bankruptcy. As mentioned before, the type of equity participation meant that the state had direct ownership of the financial institutions concerned. Through this, the state laid the basis for direct intervention with the corporate governance and management of banks.

<Table 6.3> Financial restructuring status (2006)

Financial Institutions		Total institutions in the end of 1997 (A)	Restructuring status					Newly established, etc. (C)	Total institutions in 2006 (A-B+C)
			Revocation of license	Merger	Dissolution, bankruptcy, business relocation, etc.	Subtotal (B)	Weight (B/A)		
Bank		33	5	11	—	16	48.5	1	18
Non-Bank Financial Institutions	Merchant Bank	30	22	7	—	29	96.7	1	2
	Securities Company	36	5	7	3	15	41.7	19	40
	Insurance Companies	50	10	6	4	20	40.0	21	51
	Investment Trust Companies	32	7	6	—	13	40.6	30	49
	Mutual Savings Bank	231	107	28	1	136	58.9	15	110
	Credit Unions	1666	2	124	530	656	39.4	15	1025
	Lease	25	11	3	1	14	56.0	9	20
	Subtotal	2070	164	180	539	883	42.7	110	1297
Total		21035	169	191	539	899	42.7	111	1315

Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2006).

<Table 6.4> The public fund status by financial institutions (2006)

Unit: Trillion won

Financial Institutions		Equity participation	Contribution	Deposit payoff	Asset purchase (including loans)	Non-performing loan purchase	Total
Bank (%)		34.0 (20.2)	13.7 (8.3)	—	14.4 (8.6)	24.6 (14.6)	86.9 (51.6)
Non-Bank Financial Institutions	Merchant Bank	2.7	0.7	18.3	—	1.3	23.0
	Securities Company	0.9	—	0.0	—	0.1	1.0
	Insurance Companies	15.9	3.1	—	0.3	1.8	21.2
	Investment Trust Companies	10.0	0.3	0.0	1.9	8.4	20.6
	Mutual Savings Bank	—	0.4	7.3	0.6	0.2	8.4
	Credit Unions	—	—	4.8	—	—	4.8
	Subtotal (%)	29.5 (17.5)	4.6 (2.7)	30.3 (18.0)	2.9 (1.7)	11.8 (7.0)	79.1 (47.0)
Etc. (Foreign financial institutions, Lease, etc.)		—	—	—	—	2.4 (1.4)	2.4 (1.4)
Total (%)		63.5 (37.7)	18.5 (11.0)	30.3 (18.0)	17.3 (10.3)	38.8 (23.1)	168.3 (100.0)

Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2006).

The input of public funding brought about drastic changes in the corporate governance of banks. Before the foreign exchange crisis, of all the ordinary banks the government had shares only in Kookmin Bank and Housing & Commercial Bank (The Bank of Korea 1998: 75).[78] However, as shown in <Table 6.5>, the ownership structure of ordinary banks in 1998 after the provision of public funding shows that the concentration of the general ownership of the government was well in excess of 4%, the stock ownership ceiling of banks in principle. The government participated in the ownership of 7 out of the 11 commercial banks that stayed in operation, with a high portion of ownership of the stocks of the banks by the government and Korea Deposit Insurance Corporation, which are not restricted in the ownership of the stocks of banks.

In 2003, when the input of public funds and restructuring were almost completed, the

[78] It is strictly prohibited for the same person to own the stocks of ordinary banks. This rule was established to prevent banks from becoming personal safe houses for industrial capital. The regulation on the ownership of the stocks of banks by individuals was first introduced in Dec. 1982, and has been reinforced gradually. Now, according to the Banking Act amended in Jan. 1998, the ceiling of the ownership is within 4% of the total number of stocks issued, in principle (The Bank of Korea 1999: 73).

government possessed considerable stock in the banks. Various governmental organizations had shares in 4 out of the 8 commercial banks that remained in operation, and the share of the government was decreased only in Choheung Bank and Kookmin Bank. In short, with the progress of the input of public funds and the restructuring of banks, the ownership of private capital in ordinary banks rapidly decreased, while the ownership of the government rapidly increased. Finally, through the public funding, the state put the commercial banks, which had been privatized after the 1980s, back under its control.

Ultimately, at a time when the banks were securing autonomy through continuous privatization after the 1980s, the state secured direct control of the banks by taking the foreign exchange crisis of 1997 as an opportunity. Of course, if such ownership of the shares by the government had been a nominal and temporary phenomenon that led to autonomous restructuring rather than participation in the management of banks, despite its position as the largest shareholder, such indicators would not be the proof that reveals the autonomy of the state from financial capital. However, no one thinks that the restructuring of banks at that time was done autonomously among the banks on the basis of market principles. It was surely done by the intervention of the government.

For example, when the Daewoo Incident occurred in July 1999, the government induced banks to buy the bonds of Daewoo Corporation, and as a result the Peace Bank of Korea, which had already been facing a liquidity crisis, was dealt a decisive blow and was later merged with Woori Bank (The Secretariat of the National Assembly 217th session 6th meeting: 19).[79] It has been observed from the early stage of the input of public funding that the drastic mergers & acquisitions of banks, not only the Peace Bank of Korea but also Hana Bank, Kookmin Bank, and Choheung Bank, were forced by the government rather than being autonomous decisions by the banks (The Secretariat of the National Assembly 216th session 3rd meeting)

[79] The direct intervention of the state in the management of banks is shown in the following Q&A in the public hearing related to the public fund (The secretariat of the National Assembly 217th session 6th meeting: 35). Congressman Ahn Taek-soo: "As a foreigner, in common sense, what do you think of the request the Korean government made to the president of Korea First Bank, which is managed by an independent American company, to buy or not to buy the corporate bond of Hyundai Electronics? Wilfred y. Horie, President of Korea First Bank: "The Financial Supervisory Service requested all banks to buy the bonds of some large companies, which seemed weak to us. So what I asked at that time was that they would allow us to decide independently whether we would participate in such measures."

<Table 6.5> Government shareholding status in banks

		1996	1997	1998	1999	2000	2001	2002	2003
Commercial Bank	Woori						New	KDIC (87.7)	KDIC (86.8)
	Hanbit	0	0	KDIC (94.8)	KDIC (74.7)	KDIC (100.0)	KDIC (100.0)	Merger	
	Sangup	—	—	Merger					
	Choheung	0	0	KDIC (91.1)	KDIC (80.1)	KDIC (80.1)	KDIC (80.1)	KDIC (80.1)	0
	Korea First	0	0	MOSF (46.9) KDIC (46.9)	KDIC (96.9)	KDIC (45.9)	KDIC (45.9)	KDIC (45.9)	KDIC (48.5)
	Seoul	—	—	—	GOV (46.9) KDIC (46.9)	Merger			
	KEB (Korea Exchange Bank)	BOK (47.9)	BOK (47.9)	BOK (33.6)	KEXIMB (18.2) BOK (17.8)	KEXIMB (18.2) BOK (17.8)	KEXIMB (18.2) BOK (17.8)	KEXIMB (18.2) BOK (17.8)	KEXIMB (14.6) BOK (6.4)
	Kookmin	GOV (17.1)	GOV (15.2)	GOV (8.2)	GOV (6.5)	GOV (6.5)	GOV (9.6)	GOV (9.3)	0
	Housing & Commercial	GOV (46.8)	GOV (22.4)	GOV (16.1)	GOV (14.5)	GOV (14.5)	Merger		
	Shinhan	0	0	0	0	0	0	0	0
	Hanmi	0	0	0	0	0	0	0	0
	Hana	0	MOSF (46.9)	MOSF (46.9) KDIC (46.9)	KDIC (97.8)	KDIC (100.0)	KDIC (100.0)	KDIC (27.8)	KDIC (21.7)
	Peace	0	0	0	0	KDIC (100.0)	Merger		
	Daedong	0	0	Bankruptcy					
	Dongnam	0	0	Bankruptcy					
	Donghwa	0	0	Bankruptcy					
	Boram	0	0	Merger					
	Long Term Credit	0	0	Merger					
	Hanil	0	0	Merger					
		1996	1997	1998	1999	2000	2001	2002	2003
Local Bank	Daegu	0	0	0	0	0	0	0	0
	Busan	0	0	0	0	0	0	0	0
	Gwangju	0	0	0	0	KDIC (100.0)	Woori (99.0)	Woori (99.0)	
	Chungcheong	0	0	Bankruptcy					
	Gyeonggi	0	0	Bankruptcy					
	Chungbuk	0	0	0	Merger				
	Gangwon	0	0	0	Merger				
	Jeju	0	0	0	0	KDIC (97.7)	KDIC (44.7)	KDIC (32.0)	KDIC (31.9)
	Jeonbuk	0	0	0	0	0	0	0	0
	Gyeongnam	0	0	0	0	KDIC (100.0)	Woori (99.99)	Woori (100.0)	—

Specialized Bank	Korea Development Bank(KDB), Korea EXIM Bank(KEXIMB), Industrial Bank of Korea(IBK), National Agricultural Cooperative Federation (NACF or NongHyup), National Federation of Fisheries Cooperatives (Suhyup), Bank of Korea (BOK)

Source: www. klca.or.kr (Korea Listed Companies Association).

* KDIC: Korea Deposit Insurance Corporation, MOSF: Ministry of Strategy and Finance,
KEXIMB: Korea Export-Import Bank, BOK: Bank of Korea, Woori: Woori Finance Holdings Co., Ltd. GOV: Government.

** Woori Finance Holdings can be regarded as a nationalized financial institution because KDIC actually secures 87.7% of equities.

*** "—" means that there is no available data.

In addition, the government made Hanbit Bank a super-large national bank by contributing a tremendous volume of the public fund to the M&A of Hanil Bank and Korea Commercial Bank. Initially, the nationalization presupposed privatization after managerial normalization, but the M&A of the two problem banks made privatization more difficult because the amount of money needed for the acquisition of large banks increased astronomically, making it more difficult to find able and willing investors and making the banks a more risky investment for potential investors (Lee In-sil et al. 2002: 160-165).

This policy of the government further ruled out the participation of private capital in the financial sector, making it more difficult to privatize the banks. In general, the state was able to strengthen the rule and control of the financial capital of banks with the input of the public fund. As well, the policy structuralized the long-term control of financial resources by the state, rather than promoting the privatization and autonomy of the banks with the ultimate goal of managerial normalization.

So, what was the process of the public fund in non-bank financial institutes, and the accompanied restructuring? Non-bank financial institutes include merchant banks, securities companies, insurance companies, investment trust companies, mutual savings banks, and credit cooperatives. The types of restructuring of these so-called non-monetary institutions differ based on their relationships with industrial capital and the differentiated capital liquidity. It is necessary to understand the structure of the Korean financial market in order to understand the restructuring of non-bank institutions through the public fund.

Many studies on Korean companies have pointed out that the expansion and business diversification of large Korean business groups, represented by the *Chaebol*, was possible through active management that was based on loans, particularly short-term loans (Ahn 2001: 454-455). As shown in <Table 6.6>, prior to the foreign exchange crisis companies depended heavily on short-term finance. From the perspective of the companies, long-term financial measures such as stocks or bonds were difficult to issue, and their volume was also too limited.[80] For this reason, they preferred using short-term financial tools such as direct loans or rediscounts because they could be used more easily. Thus, companies depended upon nonmonetary institutions that provided short-term loans.

<Table 6.6> Borrowings Composition Trend in top 30 conglomerates by year

Unit: % (Billion won)

	Short-term borrowings			Long-term current liability (%)	Long-term borrowings (%)	Corporate bonds (%)	Total borrowings %(Total)
	Promissory note borrowings	The others	Subtotal				
1991	10.99	37.96	48.95	13.69	27.77	20.57	100.0 (70,001)
1992	12.05	41.78	53.83	16.30	24.94	16.98	100.0 (84,798)
1993	14.82	42.48	57.30	14.52	23.92	19.08	100.0 (92,413)
1994	14.51	41.73	56.24	13.81	23.50	20.96	100.0 (105,338)
1995	16.74	42.82	59.56	14.66	21.16	21.36	100.0 (129,870)
1996	17.56	41.67	59.23	14.01	22.02	22.31	100.0 (166,112)
1997	8.72	41.69	50.41	13.89	22.78	21.64	100.0 (228,851)
1998	6.89	31.44	38.33	16.77	18.41	33.38	100.0 (240,882)
1999	3.73	26.45	30.18	22.59	20.61	30.35	100.0 (170,986)
2000	3.56	27.03	30.59	30.32	17.34	25.31	100.0 (144,426)

Source: Korea Investors Service (www. kisrating.com).

Of course, the most desirable scenario for the companies was to directly own a financial institution that could make such short-term loans. However, there were strict conditions that

[80] The volume of the issuance of corporate bonds is limited to within 4 times the amount of the current net assets in the possession of the company. To be eligible to go public and issue stocks in the stock market, a company must have been in operation for more than 3 years, have more than 5 billion won in capital and 10 billion won in equity capital, and record more than 15 billion and 20 billion won in the recent 3-year average sales and the latest-year sales, respectively. There are other tricky conditions that need to be met, including conditions on the rate of distribution of shares and the number of minority shareholders (The Bank of Korea 1999: 273-278).

needed to be satisfied in order for companies to own a financial institution due to the government's principle of the separation of financial capital and industrial capital. So the companies tried to cover the demand of short-term finance by directly owning nonmonetary institutes that were relatively less regulated. As a result, as shown in <Table 6.7>, the rate of ownership of industrial capital is generally high at financial companies, except in life insurance companies, as the regulation of industrial capital's participation in stocks is the most difficult in this sector.[81]

<Table 6.7> Industrial capital's participation in equities of non-banking sectors

	1999.6				2002.4			
	Total (A)	Top 5 *Chaebols* (B)	6-30 *Chaebols* (C)	(B+C)/A (%)	Total (A)	Top 5 *Chaebols* (B)	6-30 *Chaebols* (C)	(B+C)/A (%)
Life Insurance Companies	24	2	4*	Over 25.0	35	2	2	11.4
General Insurance Companies	13	3	3	46.15	12	1	3	33.3
Securities Company	32	7	6	40.62	44	3	5	18.2
Merchant Banks	11	7		63.63	3	2		66.7
Investment Trust Companies	24	10		41.67	32	7		21.9

Source: Korea Listed Companies Association (www. klca.or.kr), Financial Supervisory Service (www.fss.or.kr), Bank of Korea (www.bok.or.kr), * 6~10 *chaebols* are just included.

81 Regarding the restriction on the ownership of life insurance companies; the 5 largest chaebols were temporarily restricted from entering the life insurance industry until March of 2003. The restriction on the participation of large companies in the life insurance industry began in 1989. When the restriction was introduced in 1989, the 15 largest chaebols were prohibited from owning stocks of life insurance companies established after Feb. 1988, and the rate of ownership was restricted to less than 50% for chaebols in the 16th ~ 30th ranking. Subsequently, in May 1996, an adjustment was made to reduce the scope of chaebols prohibited to own these stocks to the 5 largest chaebols, and the chaebols in the 6th ~ 10th ranking were restricted to owning less than 50% of shares. An issue of fairness was raised, as there was no regulation imposed for the 6 companies established before Feb. 1988. So, in Aug. 1997, the 5 largest chaebols were allowed to enter the market by acquiring poorly-managed life insurance companies, and the regulation on the shares of the 6th ~ 10th largest chaebols was abolished. In July 1999, the regulation on the 5 largest chaebols was toughened again to allow new entry only if they M&A two poorly-managed life insurance companies, created a joint venture or observed the agreement on improvement of the financial structure, promising that they did not have dominant managerial rights if the market share exceeds 5% after the M&A, and if the M&A was made with their own capital, not loans (The Bank of Korea 1999: 156).

However, when the foreign exchange crisis occurred, the unreasonable management by loans through such short-term finance and the advancement of industrial capital into financial capital that was supporting it were denounced as the main culprit in the crisis. As a result, banks with a higher ownership portion of industrial capital and banks that offered more capital liquidity to industrial capital became targets of intense financial restructuring. In Korea's financial market, the representative financial industry that fulfilled this role was the merchant bank.

Merchant banks mainly offered companies' high-liquidity, short-term finance.[82] Due to the nature of their business, investment trust companies, securities companies, or insurance companies operate assets that are more focused on investment in marketable securities compared to merchant banks, and thus the portion of their business that is short-term finance is relatively limited. Also, considering the regulation on the ownership of financial institutions, the institution that was the easiest target for direct ownership by industrial capital was also the merchant bank (The Bank of Korea 1999: 131-137). After all, the sector that shrank the most as a result of the restructuring of financial institutions through the public fund was merchant banks. As shown in <Table 6.3>, the number of merchant banks in Korea dropped from 30 in 1997 to 4 just 4 years later in 2001, and their total assets were reduced to 7 trillion won from 77.9 trillion won. As of 2006, only 2 merchant banks were still in business.

The original purpose of restructuring the financial sphere was to alleviate the high debt ratio of companies by eliminating the unreasonable management practices involving excessive loans, so that the resulting risk to banks, which was highlighted as the cause of the foreign exchange crisis, would be reduced. For this reason, the banks that were the most accessible to companies and that offered them high liquidity were the targets of intense restructuring and liquidation. It was in this political and economic context that the president proclaimed a new principle of restructuring, "blocking the control of banks by large companies," in his congratulatory address on the 8·15 liberation day in 1998. As a result, the direct control of financial resources by industrial capital

[82] The financial market of Korea can be largely divided into a short-term financial market and a capital market. The short-term financial market refers to a financial market, in which financial assets of less than 1 year of maturity are traded, and the capital market means a market in which long-term bonds with more than 1 year of maturity or stocks with no expiration date are traded. The items traded in the short-term financial market include call money, corporate bills, certificates of deposit, repurchase paper, cover bills, and monetary stabilization bonds, while stocks, national bonds, corporate bonds, and financial bonds are traded in the capital market (The Bank of Korea 2002: 11-16).

was apparently blocked, as the equity participation of large business groups, or *chaebols*, in financial capital and their dependence upon short-term finance were restricted.

However, <Table 6.3> shows that while the number of financial institutions in most categories decreased after the restructuring, the number of investment trust companies and securities companies, which mainly deal with corporate bonds and marketable securities, increased. In particular, comparing the types of the public funding support and restructuring of investment trust companies and merchant banks, the initial purpose of financial restructuring was being neglected. With the goal of solving the problem of unreasonable management of companies with excessive loans and potential insolvency, public funding was put into merchant banks with the prerequisite of their liquidation, and most of the merchant banks were cleaned up. However, investment trust companies, which had similar roles in the financial market, actually expanded their business power through the public funding, though their volume was the largest among non-bank financial institutes. As a result, what had been the role of merchant banks was transferred to investment trust companies, tarnishing the original purpose of the financial restructuring. Considering that the issue terms of bonds and marketable securities are generally more favourable to large companies than small & medium enterprises, the process of restructuring paradoxically turned out to be more favourable to large companies. Meanwhile, the size of credit cooperatives or mutual savings banks, which are much more significant to the economic activities of ordinary people and local economies, was remarkably decreased. This confirms that the restructuring of the financial sector after the input of public funding rearranged the financial market to make it more favourable to industrial capital, especially large companies.

6.2.3. Rearrangement of industrial capital by financial capital

So, what influence did the structural change in financial capital after the input of the public fund have on industrial capital? <Table 6.8> shows the details of financial debts in the entire business sector from 1997 to 2003.[83] As shown in the table, loans, long-term bonds, government loans, and equity participation represent a large portion of total debts. Here, the three items other than

[83] The actual input of the public fund (92.2% of the total public fund) ends in 2001. So the situation of financial debt in the corporate sector has been summarized until 2003 considering the time difference.

loans are fixed assets with relatively low liquidity, and thus they are less burdensome to companies. In contrast, loans have high liquidity and are actually traded much more, being directly connected with the managerial situation of companies.

As shown in <Table 6.8>, the portion or volume of loans among the debts of companies is generally decreasing. But among the detailed items of loans, the portion of loans from savings banks has continuously increased, from 48.0% in 1997 to 60.9% in 2002. In an environment in which most of the financial debts are decreasing except for some items that show a slight increase, the only item that is showing a relatively considerable growth rate is loans from savings banks.

<Table 6.8> Corporate sector's financial liability status by year

Unit: Billion won

		1997	1998	1999	2000	2001	2002
Loans	BOK (%)	0.0 (0.0)	0.4 (0.1)	0.4 (0.1)	0.4 (0.1)	0.6 (0.2)	1.0 (0.3)
	Deposit Bank (%)	161.1 (48.0)	156.3 (50.1)	170.7 (54.6)	185.0 (56.6)	188.8 (57.6)	229.5 (60.9)
	Insurance (%)	26.5 (7.9)	20.8 (6.6)	21.0 (6.7)	22.2 (6.8)	20.7 (6.3)	21.3 (5.6)
	Short-term Loan (%)	18.3 (5.5)	12.1 (3.9)	10.8 (3.4)	4.9 (1.5)	3.9 (1.2)	4.1 (1.1)
	Others (%)	129.8 (38.7)	122.6 (39.3)	109.7 (35.1)	98.7 (30.2)	97.3 (29.7)	103.3 (27.4)
	Specialized credit institution (%)	0.0 (0.0)	0.0 (0.0)	0.0 (0.0)	15.7 (4.8)	16.6 (5.1)	17.7 (4.7)
	Subtotal(100.0)	335.8 (100.0)	312.3 (100.0)	312.6 (100.0)	326.8 (100.0)	327.9 (100.0)	376.9 (100.0)
Long-term bond		173.9	216.4	213.1	200.4	218.5	213.1
Government loan		7.3	8.2	9.9	14.7	15.3	16.5
Equity participation		25.1	26.3	28.9	33.6	39.6	42.5
Other liabilities		390.6	375.3	409.4	458.1	490.3	538.1
Total liabilities		932.6	938.4	973.8	1033.7	1091.6	1187.0

Source: Bank of Korea (www.bok.or.kr).

This tells us that the dependence of companies upon bank saving is growing. In particular, as mentioned earlier, the short-term loans from nonmonetary institutions other than savings banks had to be restricted through the general bankruptcy and liquidation of the financial sector, and companies depended more upon loans from savings banks. Of course such a situation was a predictable result of the financial restructuring. It seems that companies can take either one of two alternatives, as the short-term loans from nonmonetary institutes are restricted. The first is loans from savings banks, and the second is the issuance of bonds. However, there is a ceiling for the issuance of bonds, and thus there was no additional increase in this area, which temporarily increased in 1998. The increased dependence of companies upon savings banks can be a channel for the government, which has been increasing its actual control over commercial banks, to raise its power to control industrial capital through indirect methods.

The input of the public fund into the financial sector, and the deepened subordination of companies to the financial sector (especially savings banks) that we have reviewed thus far show the reestablishment of the model of ‘the state’s control of finance and control of industrial capital through it,’ which is a model of a developmental state. It is noteworthy that the typical characteristic of a developmental state, that is, the concentration of economic power, is reproduced as a result of the financial reform taking place with the input of the public fund. As shown in <Table 6.9> and <Table 6.10>, the phenomenon of the concentration of economic power becomes noticeable after the input of the public fund and the reform of the financial market, and seems to be an indirect result of the market intervention by the state through the public fund. In <Table 6.9>, it shows that the portion of the assets of 20 largest business groups in the assets of all companies grew rapidly in 1999.

Meanwhile, <Table 6.10> shows that the portion of net profits of the 5 largest companies and 20 largest listed companies has been increasing steadily as a result of the state’s effort to solve the credits and liabilities of insolvent companies in possession of the banks by contributing the public fund. At the same time, it can be interpreted as a result of the effect of a greater concentration of economic power in large business groups as the procedures and screening for loans from financial institutes became more complex with the financial restructuring and the financial institutes preferred large business groups to small and medium enterprises which had a higher risk in investment and loans.

<Table 6.9> Top 20 firms' asset change trend

Unit: Billion won

	1996	1997	1998	1999
Total assets of all firms (A)	348,246	417,786	509,572	433,069
Total assets of top 20 firms(B)	54,831	61,343	59,232	96,732
B/A (%)	15.74	14.68	14.46	22.33

Source: Bank of Korea (www.bok.or.kr) Fair Trade Commission (www.ftc.or.kr).

<Table 6.10> Top 5 & 20 listed firms' occupancy rate of net profit

Unit: %

Year	1996	1997	1998	1999	The first half of 2000
Top 5 firms	38.7	41.6	40.8	43.7	44.6
Top20 firms	58.2	61.6	65.1	66.3	70.0

Source: Samsung Economic Research Institute, 2000.

The public fund was not merely contributed to solve the liquidity crisis of the financial sector that occurred in 1997. More fundamentally, the macro-purpose of the application of the public fund was to systematically prevent the concentration of economic power in chaebols and reform the Korean economy by solving the problem of unreasonable management of large business groups, or chaebols, which had been criticized as the core reasons for the foreign exchange crisis, with excessive loans and high debt ratio. Then, how should we interpret the phenomenon of the reappearance of the concentration of economic power in chaebols, which was highlighted as a problem of the Korean economy, as a result of the contribution of the public fund for the opposite purpose?

This can clearly be interpreted as a failure in the structural reform of Korean society, including the policies related to the public fund. But at the same time, it can be interpreted as a process of reinforcing the path dependence of the model of a developmental state in which the state secures indirect control over industrial capital with the financial resources of the public fund, or the state restricts the beneficiaries of financial support to a few companies according to the political preference of the state by strongly intervening with the market based on the increased internal autonomy of the state.

So, did the autonomy and control of the state over financial capital, which reappeared after the foreign exchange crisis, bring with it a level of effectiveness equal to the developmental state before the crisis? If the results of the market intervention after the foreign exchange crisis are clearly different from that of the era of the developmental state, what are the reasons why? In other words, what are the reasons why efficiency in general industry has not been secured despite the reestablishment of the alliance of the 'state, finance, and industrial capital' in the model of the developmental state through the contribution of the public fund after the foreign exchange crisis? The matter of the capacity of the state that can be seen in the process of the retrieval of the public fund gives a clue to the answer to this question.

6.3. Supervision and retrieval of the public fund: Weakened capacity of the state

In 2002 large insolvent financial institutions were almost restructured, so that the focus related to public funds was moved towards repayment measures, therefore the repayment measure of public funds was actually enforced in earnest from January 2003.[84] However, at the time of the financial crisis, the fundamental problem about the public fund operating system was distortions in the incentive structure. In other words, there was a problem for those government agencies involved such as MOSF. The FSC operated public funds even though they were actually responsible for policy failures and supervisory failures that caused the injection of public funds. Externally KDIC and KAMCO were responsible for the operation of public funds, but in reality it was actually difficult to escape the decision making vertical relationship these agencies had, because the KDIC is an agency of MOSF and KAMCO is an agency of FSC. Since public funds management special laws were enacted in December 2000, the Public Fund Oversight Committee[85] had had the final authority over the operation of public funds but the reality was

[84] The repayment measure was actually established after several public hearings in 2002.

[85] It is a public-private cooperative organization.

not changed significantly. The PFOC was established as an agency of MOSF, the Minister of Strategy and Finance was in the position of co-chair with one other civilian member, and the secretariat consisted of officials from MOSF. Consequently, this researcher believes it is the best idea that supervision and recovery of the public fund can be well described by whether bureaucratic coherence was well managed or not.

6.3.1. Internal capacity of the state: lack of bureaucratic cohesiveness

The distribution and concentration of power and the bureaucratic cohesiveness among the various organizations of the government in charge of the operation of the public fund and the restructuring of the related financial and corporate sectors are examined to see the capacity of the state, especially its internal capacity. Chibber explains that the differentiated systematization of the distribution of power functions to ensure the consistent implementation of the policies set by the government to maintain bureaucratic cohesiveness, by minimizing the conflicts and inefficiencies among the departments or organizations in the government that may occur due to limited resources (Chibber 2002: 956).

For this, it is necessary to divide the periods of analysis into two parts, since the process and the main agent of the general operation of the public fund are discontinuous before and after the establishment of the Special Act on the Management of Public Funds. So, who was the main agent of the execution of policies in each period, and what was the systematic arrangement of the related organizations and the bureaucratic cohesiveness?

The system of operation of the public fund before the establishment of the Special Act on the Management of Public Funds was a transitional one designed to cope with the crisis at hand. Therefore, either the guidelines for the general and long-term operation or the legal standards and the agent in charge to support them were unclear. At that time, to cope with the sudden unprecedented national crisis, the government established new organizations and tried to find solutions to the various economic problems, which included the use of the public fund. The meeting of economic ministers presided over by the Minister of Strategy & Finance and the Deputy Prime Minister was abolished, and instead the ‘economic measures coordination meeting’ was established in the Blue House in March 1998, to be directly presided over by the President.[86] This means that the Blue House directly took charge of economic affairs, with the President taking on the task of comprehensive coordination of economic policies.

Chaired by the President, this organization was comprised of the Minister of Strategy & Finance, the Minister of Commerce, Industry & Energy, the Minister of Labour, the Chairman of Committee of Planning & Budget, the Chairman of the Financial Supervisory Commission, the President of the Bank of Korea, the Senior Secretary for Policy Planning and the Senior Secretary in the Blue House, and two civilian experts appointed by the President (Cho Jun-Sang 1998: 15). The meeting was a council in which experts in each area discussed various pending economic matters and suggested policy directions, and it was not an organization with legal rights. For this reason, there was no obligation to take official minutes.

However, all the important policy ideas during the Kim Dae-Jung government were decided in this meeting to lead the initial responses and measures in the early stage of the foreign exchange crisis. The policy measures decided in the 'economic measures coordination meeting' were submitted by the Ministry of Strategy & Finance to the Cabinet meeting afterward and sent to the National Assembly for its agreement. <Figure 6.1> shows the hierarchy and arrangement of the system of the governmental organizations related to the public fund at that time, including the economic measures coordination meeting. As shown in the drawing, the related policies were drawn up by the economic measures coordination meeting, the Ministry of Strategy & Finance, Financial Supervisory Commission, etc. and the policies were executed by the Financial Supervisory Service, Korea Asset Management Corporation, and Korea Deposit Insurance Corporation. So the roles and power were distributed.

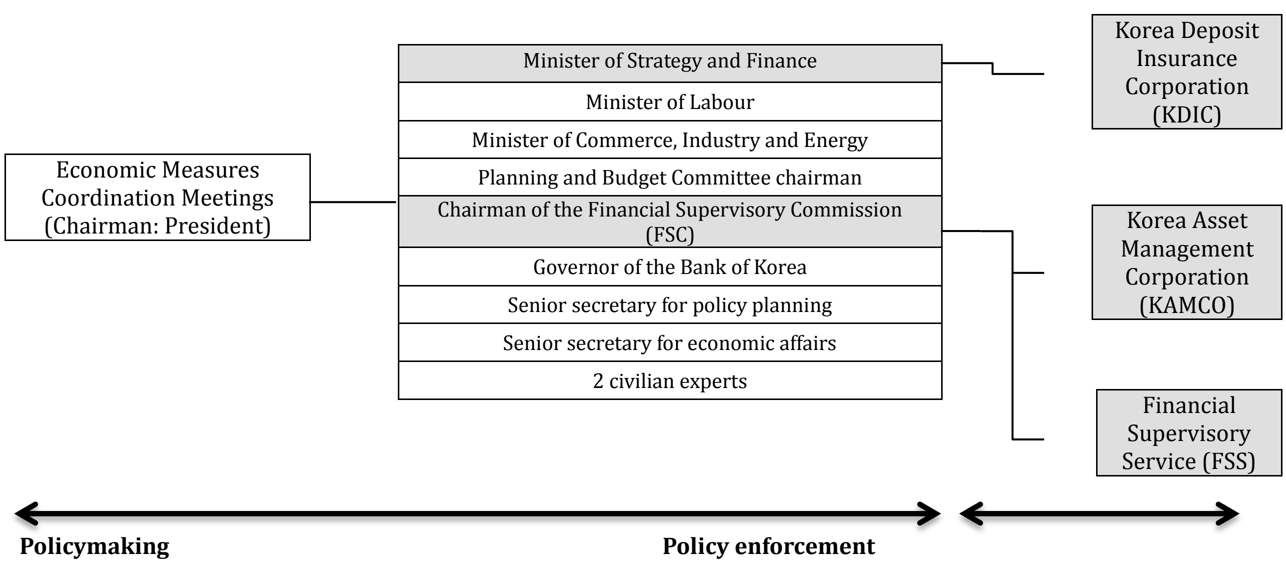
The biggest problem in the systematic arrangement of the governmental organizations during this period was that there was no official organization that could take responsibility for the decision and execution of the governmental policies related to the public fund. The economic measures coordination meeting of the Blue House, which had the greatest authority, was a council that dealt with the basic directions for comprehensive economic policies in addition to the public

[86] This organization was modelled on the National Economic Council of the U.S. during the Clinton administration.

fund, and thus it could not devote itself to the single matter of the policy of the public fund. Moreover, the operation of the public fund at the time was done on the basis of the laws stipulating the establishment of each governmental agency that had existed before the foreign exchange crisis, such as the Financial Industry Structure Improvement Act, Asset Management Corporation Act, and the Depositor Protection act. So there was no system that could supervise the public fund in a comprehensive manner.

Furthermore, even though the economic measures coordination meeting was the most important player in policy decision-making, it could not manage or supervise the results of the usage of public funds due to its status as a non-official council. This lack of a responsible organization resulted in various problems. With the participation of a non-official council directly under the Blue House, the arbitrary judgment and intervention of the government were reflected in policy without filtering, which affected political confusion later. A good example is the treatment of the insolvency of Daewoo Corporation that occurred in late 1999. Poor Daewoo corporate bonds should have been treated by the thorough application of the market principle. But the Korean government intervened in the market by the political logic of the Blue House and it eventually created unfortunate ripples in the Korean economy.

<Figure 6.1> Institutional arrangements of organizations related with the public fund before Special Act.



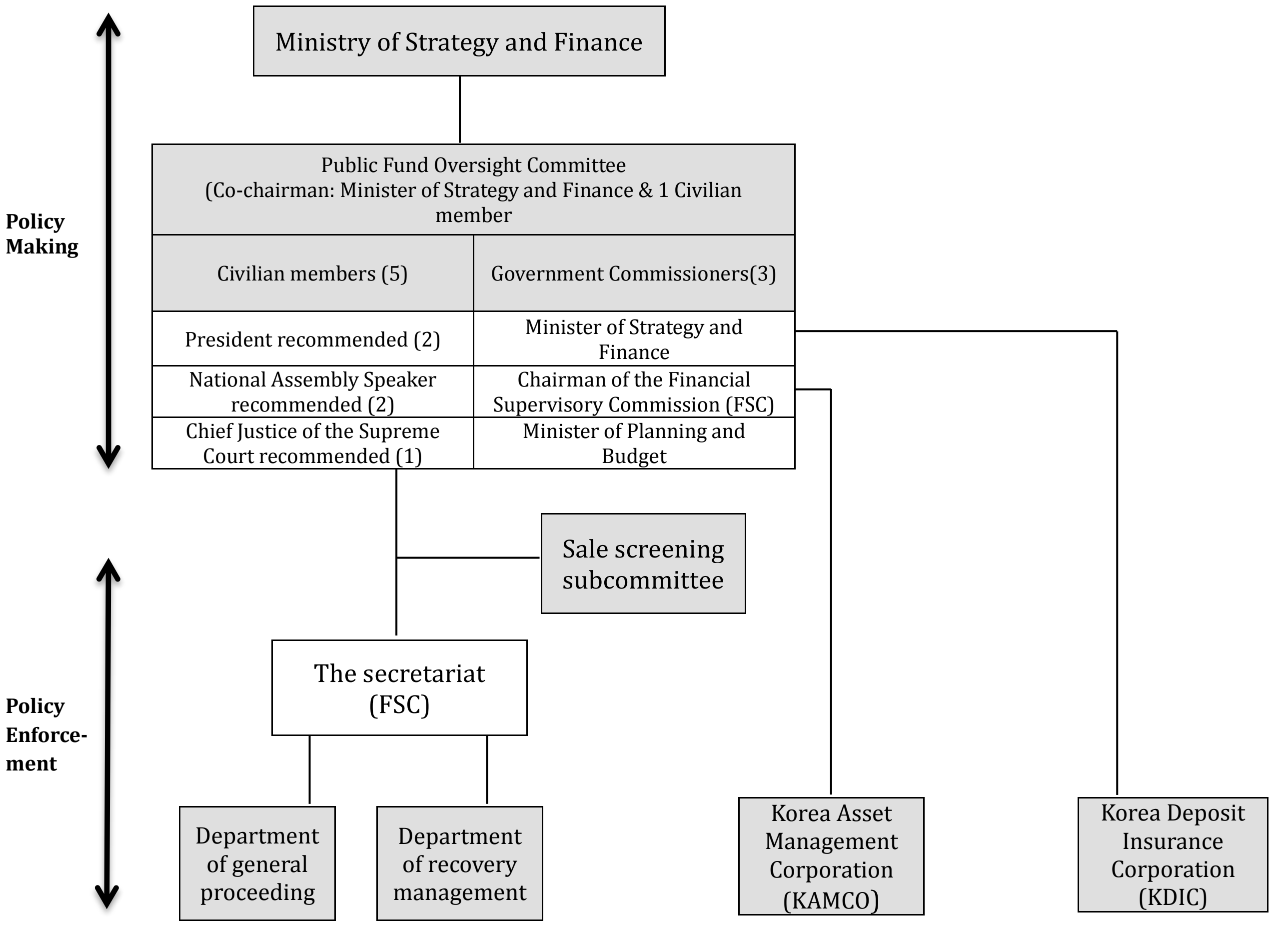
Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2001).

Meanwhile, before the general election in 2000, the Kim Dae-Jung government was forced to abandon the principle of the input of the public fund associated with restructuring being pushed by the political logic of optimists (Kwon Young-Joon 2002: 233-236). As a result, the money market tightened due to the restructuring policy, resulting in a loss in confidence, and throughout 2000 the financial market drifted away with failed corporate restructuring. Without question, this failure in the operation of the public fund in the early stage was affected by the absence of a nodal agency that could fulfil the responsibilities and duties according to policy priorities, and it shows that the system of government related to the public fund was far from complete.

This confusion showed that there was a necessity to establish a more official organization and prepare a system later to make clear and objective decisions on this basis. In addition, it was pointed out that an organization independent from the government that was able to make objective evaluations was needed to manage and supervise the operation of the public fund by the government, as the National Assembly could not investigate the operation of the public fund one by one (Ministry of Strategy and Finance & Public Fund Oversight Committee 2001: 233-235).

To address this problem, the Special Act on the Management of Public Funds was finally enacted in Dec. 2000. With the act, the general responsibilities and rights for the support, appraisal of the amount of insolvency, retrieval, etc. of the public fund, which had previously been dispersed to various organizations, were integrated under the "Public Fund Oversight Committee" (See Figure 6.2). The white paper on the management of the public fund describes the division of roles and cooperative system related to the Public Fund Oversight Committee as follows, to clearly state that the rights and responsibilities are differentially distributed among related organizations, and at the same time, the Public Fund Oversight Committee is the nodal agency that supervises all the related organizations: "Though the Ministry of Strategy & Finance is in charge of the creation and general management of the public fund, it is necessary to hold mutual discussions with the Financial Supervisory Commission, etc. and decisions on the specific input and execution of the public fund is made by the Financial Supervisory Commission, Korea Asset Management Corporation, and Korea Deposit Insurance Corporation on the basis of the relevant laws" (Ministry of Strategy and Finance & Public Fund Oversight Committee 2001: 28-32).

<Figure 6.2> Institutional arrangements of organizations related with the public fund after Special Act.



Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2001).

However, to compare the specific management of the public fund before and after the enactment of the law, it can be seen that the responsibilities for and powers over the policies related to the public fund became horizontal and dispersed rather than concentrated. Most significantly, the Minister of Strategy & Finance and a civilian member take joint responsibility for structuralizing the dispersal of authority. In addition, the committee is composed of 3 members from the government (Minister of Strategy & Finance, Minister of Planning & Budget, and the chairman of Financial Supervisory Commission) and 5 civilian members (2 members recommended by the President, 2 members recommended by the Chairman of the National Assembly, and 1 member recommended by the Chief of Justice) thus making it difficult to reach an agreement in opinions.

While such a composition of the committee has an advantage in that the pan-national collection of opinions is necessary for the establishment and execution of policies, at the same time it is doomed to have shortcomings, as it presupposes professionalism and consistency. The 3 members from the government and the 2 members recommended by the President may share the direction and contents of the policies in some degree, but the members recommended by the National Assembly, especially by the opposition party, and the one recommended by the Supreme Court may have an opinion on policies that is totally different from the opinions of other members. From the perspective of bureaucratic cohesiveness, this dispersion of authority and responsibility exposes the possibility of conflicts among related departments, and the limitations on the effective implementation of policies.

Meanwhile, in relation to the execution of policies, Korea Asset Management Corporation operates under the Financial Supervisory Commission and Korea Deposit Insurance Corporation operates under the Ministry of Strategy & Finance. For this reason, there is a possibility of conflicts of interests between the executing agencies. Moreover, the right to decision of Korea Asset Management Corporation and Korea Deposit Insurance Corporation, which have bureaucratic professionalism, was considerably weakened after the establishment of the act to make them simple executors of policies. It is true that the responsibilities and powers that used to be distributed in each stage of the creation, input, and retrieval of the public fund were integrated into the single organization of the Public Fund Oversight Committee after the establishment of the special act. But the internal composition of this committee was too broad to avoid the problem of inefficiency due to differences in policy orientation. As a result, it is unclear who to blame when the operation of the public fund fails.

This type of problem clearly occurred in the under-priced sale of Korea Exchange Bank to Lone Star, a foreign investment fund.[87] It was found that a high-ranking bureaucrat of the Ministry of Strategy & Finance wilfully lowered the indicator of soundness of the Korea Exchange Bank to sell it at a cheap price to the foreign investment fund. But the incident is not a mere matter of

[87] This incident refers to the case of the “cheap” sale of Korea Exchange Bank to Lone Star, a speculative foreign capital company whose intention of long-term investment or professionalism had not been confirmed, by wilfully setting the BIS of the bank as lower than the standard (8.0 %), in 2003 due to a conspiracy by some parties involved, including the then-chief of the division of financial policy of the Ministry of Strategy & Finance (Byun Yang-ho) and the president of Korea Exchange Bank (Lee Gang-won) (Seoul Daily, April 25, 2006; Kookmin Daily, June 20, 2006; Hankyoreh, Dec. 7, 2006).

personal corruption or the moral hazard of some bureaucrats. Rather, it plainly reveals the problem in the systematic arrangement of the government organizations related to the public fund at the time that enabled such an incident.

The sale of the bank was decided by the independent judgment of the Ministry of Strategy & Finance when Korea Asset Management Corporation and Korea Deposit Insurance Corporation, which had bureaucratic professionalism, were downgraded to being mere agencies for execution. It seems that during the 5 months when meetings on the sale were being continuously held, no one discussed the will of the Ministry of Strategy & Finance with a sense of responsibility. All of them preferred a short-term recovery of the public fund by selling the problematic financial institution as soon as possible, despite some doubts about selling to a speculative foreign capitalist rather than a long-term solution that needed efforts for managerial normalization through cooperation with the problematic financial institution. For them, it was more important to avoid the responsibility at hand than to achieve the long-term managerial normalization of the financial institution.

When the issue of the cheap sale of Korea Exchange Bank was publicized, the responsibility was dispersed, to the extent that the authority among the organizations in charge of decision-making was fragmented. All the responsible members of the Public Fund Oversight Committee insisted that they did not make a specific intervention and that they were not related with the incident. This type of controversy over "cheap" sales was not unique to the sale of Korea Exchange Bank. It also emerged in the cases of Choheung Bank and Korea First Bank, etc. for which the government secured shares through the input of the public fund at time of foreign exchange crisis and privatized them again.[88] Finally, the structure of fragmented authority and responsibility resulted in the outflow of a tremendous amount of national wealth.

From the viewpoint of the structure of the governmental organizations related to the public fund, it is difficult to see an organization assigned the preferential authority systematically to coordinate the interests of the market as well as other economic organizations to fit the direction

[88] Refer to Dong-A Daily (Oct. 30, 2002), Kyunghyang Daily (Sep. 4, 2004), and Hankook Daily (Jan. 7, 2005) for information on the "cheap" sale of Chuheung Bank and Korea First Bank. Also, see the information package for the foundation debate (Aug. 2004) of the Speculation Capital Monitoring Centre (http://www.specwatch.or.kr).

of policy priorities set by the state. The Public Fund Oversight Committee was established after the special act for this purpose, but it did not overcome the low bureaucratic cohesiveness among the related organizations, and ultimately revealed the limits of the general internal capacity of the state.

6.3.2. External capacity of the state: lack of discipline

Prior to the input of the public fund, it was essential to have the supervising ability to conduct due diligence on the insolvent financial institution and choose a rational means of support on this basis, to manage the contract on managerial normalization of the supported company, and to call the insolvent financial institution to account. This function to recover the public fund is an indicator that shows the ability of the state to manage what is outside the state, that is, the market, as it can confirm the ability of the state to regulate financial capital and industrial capital.

① Irresponsible behaviour of insolvency stakeholders

Firstly, the recovery of the public fund should have been started by holding insolvency stakeholders to account for their actions, but supervisory functions could not work well because of the lack of state capacity. The fundamental purpose of calling insolvency financial institutions and distressed debt firms to account, is to prevent future moral hazard through strict sanctions for past mismanagement practices. This intent was stipulated in the equitable risk-sharing principle cited in the Public Fund Management Special Act Article 14. In order to achieve this objective, civil and criminal investigations for individuals involved in insolvent financial institutions: current and former employees, shareholders and insolvency business owners, should take place quickly (Ministry of Strategy and Finance & Public Fund Oversight Committee 2005: 161-162). In the light of this requirement, the Korean system of holding insolvency stakeholders to account was actually very lax. Thus, this slack system was further complemented by the amendment to the Depositor Insurance Act in 2000, but there were still a lot of room for improvement in the system.

Conversely, the Korean legal system lacked measures for calling insolvency stakeholders to account and for the recovery of the public fund from providers causing insolvency. By the Depositor Protection Act Revision in December 2000, KDIC was finally able to undertake investigations into the business and property situations of insolvent debtors as well as insolvent financial institutions. The scope of the investigation was eventually extended to insolvency associates by the Law Revision in December 2002 and the investigative powers for interested parties[89] could be finally authorised by the Law Revision in March 2006. However, the scope of the survey was limited, making it difficult to make a full and thorough investigation into the wealth concealment of insolvent associates; the reality was that there were too many restrictions in KDIC's rights to request financial transaction information.

In December 2001, on the other hand, the Supreme Prosecutor's Office had set up a 'Special Investigation Headquarters for Public Fund Corruption' (SIHPFC) as the chief Central Investigation Manager and constituted the 'Joint Control Authority of Public Fund Corruption'[90] as an agency of SIHPFC. It had made a thorough investigation into corruptions of insolvent business owners and employees of insolvent financial institutions until December 2005. As a result, a total of 290 people were charged with crimes, 106 people of those were prosecuted and 172 of them were charged without physical detention. In the investigation process, 214.4 billion won of insolvent associates were tracked as concealing properties, so 56.86 billion won was collected by KDIC in accordance to the notice of restitution.

However, during the prosecutor's investigation process there were serious difficulties in obtaining investigation materials and evidence. The documents and data from banks and corporations were often discarded as they exceeded their in service limits and had been destroyed, and many of the main insolvency businesses involved had fled the country. It was an inevitable result because there was not a thorough enough investigation into insolvency associates before the public fund were injected into the economy and this was due to the fact that related institutions were incomplete and investigation intentions were insufficient. In addition, there

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[89] A spouse and lineal ascendant and descendant of insolvent associates, people receiving direct benefits from insolvent associates by a legal action for the purpose of property rights, and people related with insolvent associates' wealth concealment.

[90] It is composed of 7 organisations: National Tax Service, Korea Customs Service, Korea National Police Agency, Financial Supervisory Service, KAMCO and KDIC.

were many cases: even if there were Prosecutors' indictments, many of these decisions were indicted without detention; despite these court convictions, many persons were released for various reasons.

To summarise, in short, the lack of discipline due to the lack of state capacity eventually resulted in failures to supervise insolvent associates which caused the public fund having to be injected into the economy.

② Recovery of the public fund

The recovery of the public fund is directly connected with the type of support of the fund. Most of the public funds supported in the form of contribution or deposit pay-off cannot be retrieved, as they are to compensate the damage caused by insolvency and the preservation of the savings of depositors based on the premise of the liquidation of the financial institution. In this case, retrieval is limited to bankruptcy dividend, and thus has no direct relationship with the management or supervision of the state after granting the support. Also, the public fund used for the purchase of assets and 'non-performing loans' can only be retrieved with the profits made by selling the assets or credits of the company being acquired. Thus, in this case, too, the retrieval of the public fund will depend upon the market price of the assets or bonds concerned, and has little to do with the efforts made by the state or the company for managerial normalization.

On the other hand, the retrieval rate of the public fund supported in the form of equity participation can vary depending on the cooperation between the company and the state in improving corporate efficiency and managerial normalization as well as the continuous management and supervision of the state, as this support is in the form of investment. In this regard, the performance of retrieval in the sector of equity participation becomes the basis for an evaluation of the state's management and supervision of companies; that is, its ability to regulate and guide them. In this context, the performance of retrieval in the sector of equity participation is a meaningful indicator that shows the capacity of the state.

However, it can be seen in <Table 5.11>, which summarizes the status of retrieval of the public fund in general, that the retrieval rate of equity participation, which is the index for managerial normalization, is the lowest. As shown in <Table 6.4> earlier, the largest portion of public fund support was in the form of equity participation (63.5 trillion won, 37.7 % of the total public fund). However, the amount of equity participation retrieved by Korea Deposit Insurance Corporation and the government was 14.7 trillion won, 18.4 % of the total amount of retrieval. Rather, most retrieval of the public fund was done through asset sales (39.8%: 6.6% and 33.2% by Korea Deposit Insurance Corporation and Korea Asset Management Corporation respectively) and bankruptcy dividends (20.5 %). As mentioned earlier, these two types of retrieval were used to weed out financial institutions from the market in a method that was not related to the management performance of the financial institutions or the management function of the state.

Looking at the situation of retrieval in each financial sector, it is noteworthy that the retrieval rate for the banks was the highest. However, a closer look shows that the public funds were retrieved more by selling the assets of financial institutions than by retrieval of the equity participation, which could have been regarded as a result of managerial normalization and resolution of debts. Ultimately, this shows that the ability to achieve the general management and supervision of the public fund in the sector of equity participation was inadequate.

The low performance of retrieval in the sector of equity participation can be interpreted in two ways. Prior to the support of the public fund, the authorities need to conduct a due diligence and exert the ability for investigation of the insolvency of the financial sector. If the state does not have the ability to do this, the business of a company that really should disappear from the market as early as possible will be extended by the support of public funds in the form of equity participation to an object with no possibility of revival, leading to inefficiency in the financial market. Meanwhile, if the public funds are provided to a company with the possibility of revival in the form of equity participation and the retrieval rate is low, it means that the state is not fulfilling the role of management and supervision of the company consistently for managerial normalization. Either interpretation ultimately signifies that the state lacks external capacity.

<Table 6.11> Recovery situation of the public fund (2006)

Unit: Trillion won, %

Financial Institutions		Amount of Support (A)	Korea Deposit Insurance Corporation (KAMCO)			Korea Asset Management Corporation (KDIC)		Government		Recovery	
			I.R.	B.D.	A.S.	R.R.	A.S.	I.R.	S.D.P	Amount of Recovery (B)	Rate of Recovery (B/A)%
Bank		86.9	10.3	1.7	4.4	9.3	18.4	1.7	6.6	52.4	60.3
Non-Bank Financial Institutions	Merchant Bank	23.2	0.0	6.4	—	0.7	0.6	—	—	7.7	33.2
	Securities Company	1.0	—	0.0	—	0.0	0.1	—	—	0.1	10.0
	Investment Trust Companies	20.6	1.1	0.3	0.7	0.0	4.5	—	—	6.6	32.0
	Insurance Companies	21.2	1.4	0.4	0.2	0.3	1.5	—	—	3.8	17.5
	Mutual Savings Bank	8.4	0.2	4.4	—	0.1	0.1	—	—	4.8	56.9
	Credit Unions	4.8	—	3.2	—	0	0	—	—	3.2	66.7
Others		2.4	—	—	—	0.0	1.3	—	—	1.3	54.2
Total		168.3	13.0	16.4	5.3	10.4	26.5	1.7	6.6	79.9	47.3

Source: Ministry of Strategy and Finance · Public Fund Oversight Committee (2006).
* I.R. = Investments Recovery, B.D. =Bankruptcy Dividend, A.S. =Assets Sale,
R.R. =Repurchase Release, S.D.P. = Subordinated Debt Purchase.

6.4. Concluding Remark and Further Issue

The restructuring during the Kim Dae-Jung government, which had to cope with the foreign exchange crisis, shows stark duplicity (Kim Kyun and Park Sun-Sung 1998: 225-227). On one hand, the state allocated resources to the banks and companies based on the policy and preference of the state, just like in the developmental era. On the other hand, it insisted on the withdrawal of the state, saying that the redirection of the allocated resources to the financial sector or companies must be put into the intrinsically imperfect or temporarily failed market mechanism (Kim Myung-Su 1999: 3-6). In other words, the state strongly intervened with the market by providing support to financial institutions and companies with a certain plan and policy preference. But at the same time, it chose relatively weaker intervention or negligence in terms of the management, supervision, and regulation of the financial institutions or companies that received such support, and in terms of securing economic efficiency through such an intervention. (You Seok-Chun and Chang Sang-Chul 2001: 295-297). It was a new type of experiment of "support without regulation," which differed from its previous developmental state, which used the mechanism of "regulation according to support."

This characteristic appeared more clearly in the process of the operation of the public fund. From the perspective of the autonomy and capacity of the state, the Korean state secured control over financial resources after the foreign exchange crisis, just like in the developmental state of the past, and increased its internal autonomy against the ruling class, reinforcing the power of control of industrial capital. But while the developmental state before the crisis regulated the market and managed the efficiency of companies through direct and powerful intervention with industrial capital on the basis of its high level of internal autonomy, the state after the crisis affected the policy failure of inefficient operation of the public fund due to insufficient capacity despite increased internal autonomy.

This chapter points out the two main reasons for such failure from the viewpoint of the capacity of the state. Firstly, from an internal viewpoint, the examination of the bureaucracy showed that the cohesiveness and arrangement of authority among the political organizations related to the public fund were not adequately achieved. Secondly, from an external viewpoint, the capacity of the state fell short of regulating the companies supported with the public fund. In brief, the failure occurred due to intervention by the state which supported but could not regulate, or which had autonomy but did not have enough capacity.

Such research results provide a certain implication for the controversy over the function and role of the state, which has emerged in the trend of internationalization and globalization. Despite the trend of globalization, some people insist that it is still important for the state to have an active role (Chang Ha-Joon, 2006: 53-54), while others stress that the role of the national state must be reduced and the function of the market should be vitalized instead (Lee Yeon-Ho et al. 2002: 199-204).

The results of the analysis in this chapter support the stance of the former viewpoint, because it has been discovered that the claim that globalization will reduce the role of the state is only a myth (Weiss 1998: 212; Wade 1996: 87-88). In particular, this chapter clearly shows that the changes in the external environment during the foreign exchange crisis became an opportunity to raise the internal autonomy of the state. In addition, as was clearly revealed in the FTA negotiations in progress, active inclusion in the open economy according to globalization makes us take an interest in the role of the state that is leading the process.

But at the same time, this chapter shows that if the internal and external capacity of the state that will enable it to exercise such autonomy effectively is not secured, it can be an element of crisis that can erode the autonomy that had been maximized by the change in the external environment. Though the state secured control over the financial sector by creating an opportunity from crisis, it could not help but manage the public fund poorly due to a lack of bureaucratic cohesiveness and the capacity of the state. Furthermore, the state handed over the control of the financial sector to foreign and domestic capital. Ultimately, the autonomy of the developmental state represented by the control of financial capital was affected by a lack of the capacity of the state itself, not by the pressure of foreign capital.

In conclusion, the Korean state's purpose, which was to reinstate its important role by restoring the attributes of a developmental state through the public fund after the financial crisis of 1997, could not be achieved. In other words, the financial crisis became an opportunity to raise the state autonomy, and 'injection' of the public fund actually increased the internal autonomy of the state. But, this increased state autonomy was finally eroded by the seriously weakened state capacity after the financial crisis. In this situation and by this reason, it was a matter of course that the Korean state could not succeed its own goal.

Further Issue

By this empirical evidence, we cannot help but actively accept the hypothesis that the autonomy of the state is decided by the capacity of the state at the national level, even in this era of globalization. As globalization has progressed, many scholars have made efforts to weigh the opportunity cost of the route change to a regulatory state with the sunk cost of the maintenance of the characteristic of a developmental state. Now, 17 years after the foreign exchange crisis, I think that the scale is inclining toward the maintenance of the developmental state, because globalization does not necessarily reduce the role of the state. Rather, globalization is creating a new demand for more active intervention by the state. A developmental state can be effective not only for the globalization that is oriented toward the exploration of overseas markets, but also for another kind of globalization for opening the domestic market. Of course the precondition of securing the capacity of the state must be satisfied. In relation to this matter, the question of the ‘possibility of recovery of the capacity of the state’ can be raised; the point is that it is necessary to have earnest discussions on the reasons for the disappearance of bureaucratic cohesiveness and regulation of the developmental state, and to ask whether these can be recovered. However, this chapter is just satisfied with elucidating that the autonomy of the state was eroded by showing that the capacity of the state of Korea seriously weakened after the foreign exchange crisis. And the next chapter will be presented to investigate whether the capacity of the state is recovered or not through the restructuring of financial supervision system after the 1997 financial crisis.

Chapter 7
RESTRUCTURING OF FINANCIAL SUPERVISION SYSTEM

7.1. Introduction

As was examined in the previous chapters, in the process of overcoming the financial crisis the Korean developmental state failed to alter the direction of change, which had been underway since before the financial crisis, or to slow down the speed of change. In other words, Chapter 5 showed that the Korean state did not succeed in recovering the weakened 'internal cohesiveness' and 'embedded autonomy' by changing the bureaucracy, and Chapter 6 concluded that the input of the public fund failed because the 'state autonomy' reinforced by the input of the public fund was eroded by the weakened 'state capacity.' Given this situation, Chapter 7 will examine the reform of the financial supervision system, which was another reform implemented together with the input of the public fund in the process of overcoming the financial crisis, to finally examine the influence of the reform of the financial supervision system on the change of the Korean developmental state. The question of whether the goals intended by the Korean state were achieved through the process will also be examined. So, the main purpose of this chapter is to evaluate the direction of the financial supervision system reform after the 1997 economic crisis in Korea, and to address the question of whether the direction matched the goal pursued by the state, which is to recover the state's capacity by strengthening the supervisory regulation capacity over the financial market.

Basically, the crisis in Korea occurred due to the outflow of the foreign capital that had entered the country rapidly after 1993 with the opening of the financial market in the form of foreign borrowings. In short, it can be pointed out that the decisive factor in the crisis was the rash liberalization and opening of the financial market, which was undertaken without proper regulations. In other words, it can be said that the economic crisis of 1997 in Korea was the result of the indiscriminate opening of the financial sector under the 'neo-liberal ideology,' at a time when the supervisory regulation capacity over the financial market had been weakened significantly. So, after the 1997 financial crisis, the Korean state launched the restructuring of its financial supervision system for the purpose of strengthening its weakened supervisory regulation capacity.

The Korean state, which had managed the entire financial market by controlling the Bank of Korea which had the function of supervising banks, acknowledged the need for the Bank of Korea to have more independence after the reform, and expressed its position that it would not directly intervene in the financial market anymore. Also, Korea, with the goal of 'strengthening the supervisory regulation capacity' over the financial markets, created the Financial Supervisory Commission, an integrated financial supervisory agency. This change in the financial supervision system in Korea reflected the 'neo-liberal reform,' required by the IMF. Reform of the financial supervision system (setting up a financial supervisory agency independent from the government) ended up in lack of a control tower (de-facto overseer of the above) with the Financial Supervisory Commission in charge of domestic financial policy, the Ministry of Finance and Economy in charge of international finance and exchange rate policy, and the Financial Supervisory Service in charge of financial market supervision. The Bank of Korea's role was limited to the implementation of monetary policies, while the roles of the above-mentioned agencies were also focused on the easing of regulations that hindered the financial market's liberalization, and the state's financial market regulation capacity itself was even in question.

The purpose of this chapter is to determine whether the changes in the financial supervision system after the 1997 financial crisis served the goal pursued by the Korean state. This chapter attempts to analyse what kind of success was achieved by the financial supervision system changes made to meet this condition at a time when the strengthening of the supervisory regulation of the financial market was recognized as essential after the financial crisis. To determine this, Korea's financial supervision system changes after the 1997 financial reform will be examined, and then it will be determined whether, as a result thereof, the supervisory regulation capacity was strengthened. This chapter will review and evaluate not only the political alignment of the stakeholders in the financial supervision system reform, but also the role that Korean bureaucrats played in the reform process. Also, by citing a few cases to evaluate whether reforms were executed well, the process and result of the reform will be evaluated.

This chapter will be organized as follows. In section II, after reviewing the changes in Korea's financial supervision system due to financial reform, and explaining the political conflict among the bureaucrats, politicians, etc. who played important roles in the financial reform process, the problems apparent in the patterns of financial supervision reform in Korea will be evaluated. In section III, to analyse whether the series of financial supervision system changes implemented after 1997 actually served the state’s goals, explanations will be offered with a few cases. Section IV, in conclusion, suggests summaries and implications of this chapter.

7.2. Restructuring of financial supervision system

The Korean state established the following principles when it implemented the financial structure reform after 1997 (Ministry of Strategy and Finance · Financial Supervisory Service 2000: 18-20).

1) The principle of minimum costs: Select and support the financial institutions that can survive.
2) Self-responsibility and establishing market principles: The financial institutions shall definitely collect and return the public fund granted to them.
3) Secure objectivity through internal-level accuracy and systemization: Strict international criteria shall be applied for the selection of the institution to be supported, and the state shall refrain from making wilful decisions.
4) Implement plans boldly and quickly, minimizing market confusion.

<Table 7.1> The main principles for financial structure reform

Ultimately, the role of the state became the most important, and as a result reinforcing the supervisory regulation capacity over the financial market was the most urgent matter. The reform of the financial supervision system began for these reasons. So, in what direction was the reform of the financial supervision system for the reinforcement of the supervisory regulation capacity implemented? First, let me review background of the financial supervision system changes.

7.2.1. Background of the financial supervision system changes

There are various opinions on the cause of the 1997 financial crisis. Among the factors mentioned thus far are: weakened overseas competitiveness and poor financial structure of

Korean companies; poor operation and improper lending management by financial institutions; the government's failure to respond to changes in the global environment; delay in economic system reform; failure to establish a democratic market economy and deepening moral hazard; and failure of financial supervision in the liberalization process (Moon and Mo 2000: 4-7; Chang 1998: 1556-1559). Of these, the failure of financial market supervision in the rapid financial liberalization process is considered crucial (Ibid.).

With neo-liberal reform spreading around the world from the 1980s and launch of the WTO in 1995, the international economy became rapidly globalized. The Kim Young-Sam government, upon its inauguration in 1993, had initially carried forward the economic policies of the previous Roh Tae-Woo government (e.g., introducing the real-name account system and the real-name property system), but with its participation in the APEC Summit in 1994, rapidly shifted to globalization and liberalization. By defining the 'New Economy,' which it had advocated since its launch, as an 'economic system in which the participation and creativity of all people' were the driving forces of development, the Kim Young-Sam government clarified its focus on economic democratization (Korean government 1993: 5-8), and despite having set the achievement of conditions for OECD membership as its goal, had not made plans to achieve OECD membership within its term. But the Kim Young-Sam government, by suddenly and actively striving for OECD membership, tried to achieve globalization and liberalization.

The government rather hastily proceeded with the opening of the domestic financial market to earn OECD membership, and by focusing only on opening while overlooking the importance of regulation and supervision, failed to establish a financial supervision system that could respond to crisis. For example, the same-person lending limit[91] in the US was 25% of the bank's equity capital, while in Korea it was as much as 45%. This lax supervision standard was the main reason why Korea's large companies were allowed to have a monopoly on bank loans (Ministry of Finance and Economy & Financial Supervisory Commission 2000: 13). As well, in lending management by financial institutions, there were frequent mismatches between the procurement period and the management period. For example, 64% of the loans borrowed from overseas by

[91] Limit on the amount of loan which a financial institution can make to the same person or corporation. Its purpose is to prevent finite financial assets from being monopolized by a specific person or company, and to maintain the stability of financial institutions.

merchant banks were short-term, but 85% of such short-term overseas capital was loaned to businesses in the industrial sector on a long-term basis (Chang 1998: 1556). The resulting rapid increase of short-term foreign debts occurred against the backdrop of the strict regulation of long-term capital, a preference for short-term foreign debts by companies and financial institutions expecting a drop in the domestic interest rate and a rise in the credit rating, and in particular, an increase in the number of merchant banks mainly engaged in short-term borrowing and long-term lending (Chang 1998: 1558). The Kim Young-Sam government licensed 9 merchant banks in 1994 and 15 in 1996, but these were poorly managed and were not subject to proper supervision. In summary, under the goal of financial liberalization, financial institutions diversified their business and attempted to globalize asset management. Also, without sufficient preparation for crisis and liquidity management, domestic financial institutions introduced excessive short-term funds from overseas financial institutions. In this situation, several companies went bankrupt in 1997, and combined with mistakes made by the Korean government in its policy response to the crisis (e.g., errors in exchange rate and foreign exchange management) and a broader financial crisis in Southeast Asia, foreign financial institutions began to call in their loans and domestic financial institutions were faced with a liquidity crisis, leading to the financial crisis.

The problem was that there was no thoroughly prepared supervision system to prevent this domino-type effect and deadly financial crisis. After 1988, the government made efforts to strengthen the financial supervision system, but due to conflict among the related agencies, did not achieve notable results. Finally, on Jun 16, 1997, the government came up with an approach to financial system reform, the gist of which was the creation of the Financial Supervisory Commission and the Financial Supervisory Service. It also made plans to clarify the financial supervision system. But it was too late to supervise and control the financial institutions, which had been under lax management due to the economic liberalization. The supervision system, late as it was, actually began to be implemented in April 1998 after the launch of the Kim Dae-Jung government.

As shown above, in a situation in which the financial sector has been opened, as it was in Korea after 1993, a systematic supervision system to properly regulate the financial sector and foreign exchange flow, not just the easing of regulations, is very important. That is, the state should have considered ‘ex-ante regulation,’ as well as ‘ex-post regulation,’ of the financial sector. In such situation, the Korean state, focusing on financial supervision system changes as well as on financial crisis resolution, endeavoured to increase its supervisory regulation capacity over the financial market.

7.2.2. Reform of financial supervision system

Variables in the financial supervision system changes due to the 1997 crisis and the cause of crisis have a number of points in common. With a weak supervision system being pointed to as the cause of the 1997 crisis, a more sweeping system reform was emphasized. Thus, the changes in the financial supervision system began with the amendment of the ‘Bank of Korea Act’ and the enactment of the ‘Act on Establishment of Financial Supervisory Agencies.’

• Changes in the financial supervision system

Firstly, the 6th amendment of the Bank of Korea Act was a result of the financial supervision reform carried out after the 1997 crisis. Actually, earnest discussion of the independence of the central bank began in the late 1980s with the wave of globalisation and after 1993, the year Korea joined the OECD, Korea was recommended by other OECD member nations to guarantee the independence of its central bank (Jeon Hong-Taek 2002: 522). However, despite such fervent discussions on the independence of the central bank, the discussion proceeded with difficulties due to a difference in opinion between the Bank of Korea and the Ministry of Finance & Economy. Eventually, an amendment to the Bank of Korea Act was hastily agreed to on Dec. 31, 1997, just after the outbreak of the foreign exchange economic crisis (Jeong Woon-Chan 1997: 133).

In the 6th amendment to the Bank of Korea Act, the Bank of Korea lost the function of bank supervision, and secured autonomy in the operation of currency credit policy through the legal guarantee of its neutrality. The revised law stipulated that the governor of the Bank of Korea will chair the Monetary Policy Committee, replacing the Minister of Finance & Economy who will no longer even be a member of the Committee, and the portion of Committee members nominated by the government will be reduced. The right of the Minister of Finance & Economy to inspect the working of the Bank of Korea was also eliminated. Also, the prices stabilization goal system was introduced instead of the intermediate objective management system for the operation of the currency credit policy, and the Bank of Korea was required to report to the National Assembly one or more times per year on the situation of the execution of its currency policy, thus strengthening its responsibility. As such, in the 6th amendment to the law, there was considerable progress in terms of guaranteeing the neutrality of the Bank of Korea, but as the Bank of Korea came to have only the right to ask banks to submit the data necessary for the fulfilment of currency credit policy as well as the right to join the inspection of banking institutions, the goal of the Bank of Korea was reduced to price stabilization.[92]

As soon as the Bank of Korea Act was amended, the government enacted the 'Law on the establishment of financial supervisory organisation, etc.' and merged the supervisory functions scattered amongst the areas of bank, stock, insurance, and credit management fund as part of its institutional efforts to reduce the concentration of power in the Ministry of Finance & Economy and reinforce the financial supervisory system by separating the financial supervisory function from the financial policy function (Yoon Seok-Heon et al. 2005: 404). In 1997, when the IMF strongly recommended the establishment of an organisation for the supervision of all financial institutions, including special banks, the IMF advised the Korean government to first guarantee the operation and budget autonomy of the organisation; secondly, to provide the organisation with all the power and authority necessary for the effective handling of insolvent financial institutions; and thirdly, to prevent the occurrence of blind spots in supervision and examination in order to avoid large-scale financial crises, and reinforce prompt follow-up management (Kim Dae-Sik et al. 2005: 202). Accordingly, the Korean government transferred responsibility for bank supervision from the Bank of Korea to the Financial Supervisory Commission, limiting the role of the Bank of Korea to the adjustment of the money supply. As a result, the Financial Supervisory Commission took full charge of the approval and licensing of the management of financial institutions, examination and sanctioning of financial institutions, managing, supervising, and monitoring the stock & futures market, and instructing and supervising the

[92] The Bank of Korea Act, Ordinance No. 5491, Entirely amended on Dec. 31, 1997

Financial Supervisory Service.[93] That is to say, the Financial Supervisory Commission came to control all financial supervisory works except the enactment and amendment of finance-related laws performed by the Ministry of Finance & Economy, giving it a stronger power than any other organisation in financial supervision (Yang Jae-Jin 2005: 9-12).[94]

• The distinct features in changes of the financial supervision system: Independence of financial supervisory organisation

After the crisis in 1997, the independence of the Bank of Korea in charge of financial policies was strengthened and the Financial Supervisory Commission was established to independently take charge of financial supervision. It seemed that the Korean government was addressing the demands of the IMF, which emphasized a neo-liberalistic financial reform. However, what are important are not only the legal and institutional changes that were implemented, but whether they produced actual changes according to their original plan.

1) Bank of Korea

After the amendment of the law, the independence of the Bank of Korea was clearly increased despite the existence of several restrictions. The independence of the central bank can be divided into the legal independence stipulated in the law on the central bank and the real independence of the bank, which is shown in the actual behavioural system of the central bank. If a central bank can decide policy measures without the prior consent of other actors, and the policy measures are not completely controlled by other actors for a certain period of time, the central bank is independent in its form (Kim Hong-Beom 1998: 90-92). First of all, though inflation targets certainly contribute to the improvement of the independence of the Bank of Korea, the 6th

[93] The Financial Supervisory Service was created through the merger of the Bank Inspection Board, the Securities Supervisory Board, the Insurance Supervision Board, and the Credit Management Fund.

[94] The Law on the Establishment of Financial Supervisory Institution, Ordinance No. 5490. Refers to the establishment and amendment on Dec. 31, 1997.

amendment of the law clearly stated that when the Bank of Korea decides a target rate of inflation it should discuss the matter with the government. In addition, though the president of the Bank of Korea has a concurrent position as the chairman of the Monetary Policy Committee according to the amendment, even with the amendment of the law the budget of the Bank of Korea has to be approved by the Minister of Finance & Economy, and the majority of the members of the Monetary Policy Committee are from the Ministry of Finance & Economy, which restricts the independence of the Bank of Korea. Making the Bank of Korea independent meant creating an institutional framework for it to use the intrinsic policy autonomously as the central bank to recover the market function of finance and secure the stability of the financial system.

In this sense, the power and cycle of replacement of the governor of the central bank and the central bank's contribution to the currency policy are generally used to judge the acquisition of independence of the central bank from the government. Therefore, whether the independence of the Bank of Korea was actually reinforced through the concurrent position of the governor of the Bank of Korea as the chairman of the Monetary Policy Committee and the introduction of the currency policy of inflation targets, which were the main items of the 6th amendment of the law, can also be judged by the actual cycle of replacement of the governor of the Bank of Korea and the achievement of inflation targets. The replacement rate of the governor of the central bank can be an indicator that shows how much institutional autonomy from political power the central bank enjoys (Byeon Young-Hak 2010: 127-129). Before reforms, the average tenure of the governor of the Bank of Korea was no longer than 2.4 years, and only 4 governors from the first governor (Koo Yong-Seo) to the 20th (Lee Kyung-Sik) worked until the last date of their term, as the Bank of Korea was recognized only as a subsidiary of the government and many bank governors were replaced during cabinet shuffles or due to personal conflicts or external political powers. However, bank governors Jeon Cheol-Hwan and Park Seung, who were inaugurated to 4-year terms of office in 1998 and 2002, respectively, served until the last day of their 4-year terms, demonstrating how the Bank of Korea has changed. (See "50 Years' History of the Bank of Korea"). One thing to remember is that the low replacement rate of the governor of BOK does not necessarily indicate the strong independence of the central bank. This is because the president of a subordinate central bank who faithfully responds to the request of the government that wants to mobilize financial resources may be guaranteed a full term by the government.

Therefore, it is necessary to check whether the independence of the central bank actually produced commensurate policy results (Byeon Young-Hak 2010: 130-133). The currency policy of the central bank can contribute to the economy by maintaining cheap and predictable prices, and it is actually the purpose of foundation of the Bank of Korea written in Chapter 1, the general rules, of the Bank of Korea Act (Lee Young-Gu 1993: 163). The reason for the emphasis of the independence of the Bank of Korea is that the central bank should achieve price stabilization by setting up and executing currency credit policy, without the intervention of the government or politicians. Thus, in the case of Korea, whether or not the independence of the Bank of Korea improved can be judged by watching how the degree of stability of prices has changed since 1997 with the 6th amendment of the law. While there had been 20 governors of the Bank of Korea that served over 48 years before the 6th amendment of the law, both of the 21st and 22nd governors who were sworn after the amendment served full 4-year terms, showing the change after the amendment of the law.[95] In addition, the consumer prices in Korea, which fluctuated between approximately 5% and 9% per annum, have continued to record less than a 4% increase since 1998-1999, making a stable curve.[96] This means that since the 6th amendment of the law, the governors of the Bank of Korea have been protected from political influence with guaranteed terms, and exercised their increased power. In addition, the effective stabilization of prices, which is the goal of the currency policy of the Bank of Korea, proves the increased effect of the independence of the Bank of Korea.

As a result of changes in financial supervision, the Bank of Korea's independence increased but conversely the state's 'supervisory regulation capacity' could be seen as being decreased. Changes of the financial supervision system created an institutional framework for it to use the intrinsic policy autonomously as the central bank to recover the market function of finance and secure the stability of the financial system, but this also meant that it resulted in less power for the public authorities or the state in finance. The independence of central bank meant that it has autonomy to carry more market neutral policies, which also implies less autonomy of the state as a whole.

[95] See "50 Years' History of the Bank of Korea".

[96] See related statistics at e-Nara Index (http://ww.index.go.kr/gams/default.jsp).

2) Financial Supervisory Commission

In addition to the reinforcement of the independence of the Bank of Korea, the establishment of an integrated financial supervisory institution is a very important and noteworthy aspect in the financial reform of Korea.[97] Especially, as the political intervention with the process of supervision, probation of regulation, and weak regulatory supervision due to the lack of independence of the financial regulatory organisation were highlighted as the major cause of the financial crisis by the IMF, it was expected that an independent integrated financial supervisory organisation free from either political or industrial influence would appear after the reform. In other words, after the establishment of the Financial Supervisory Commission it was expected that the independence of the commission in all the processes of financial supervision including licensing, soundness supervision, sanction, and crisis management would increase greatly (Jeong Woon-Chan et al. 2007: 675-676; Quintyn and Taylor 2002: 259-261). Independence here means independence in the selection and execution of the means used to achieve the goals set by legislation processes; that is, independence of means. The independence of a financial supervisory organisation includes regulatory independence, which is the independence of the supervisory organisation in the enactment and revision of regulations; supervisory independence, which means the independence of the supervisory organisation during the process of execution of supervisory activities; and budget independence, which is an autonomy of the supervisory organisation differentiated from the administration and the judiciary. Of these, regulatory independence and supervisory independence are the core of independence of means, and the organisation independence and budget independence support regulatory independence and supervisory independence (Kim Hong-Beom 2006: 16-17; Jeong Woon-Chan et al. 2007: 678-679; Quintyn and Taylor 2002: 288-289).

However, despite such intentions, though the Financial Supervisory Commission was newly established in the name of maintaining the soundness of financial industry by separating the financial supervisory function from the central bank and the government, it can be regarded that it actually has not been operated independently from the government. The Financial Supervisory Commission is a collegiate administrative agency operating under the Prime Minister and an

[97] The independence of both the central bank and the financial supervisory organisation means independent tools, that is, independence in operation (Jeong Woon-Chan et al. 2007: 675).

organisation of civil servants, which was launched on Apr. 1, 1998 based on the ‘law on the establishment of financial supervisory organisation, etc.’ enacted in late 1997 (Kim Hong-Beom 2006: 35-43). As the highest decision-making organisation in the area of financial supervision, the Financial Supervisory Commission is operated together with the Financial Supervisory Service, which is a supporting private organisation, and the secretariat (Planning & Administration Office when the organisation was first launched), which is a public organisation taking care of administrative work (Ibid.).

However, it is ironically said that the division of the Financial Supervisory Commission and the Financial Supervisory Service, as well as the existence of the secretariat of the Financial Supervisory Commission, resulted in the lack of independence while carrying out supervisory works, and this result is deeply related with the fact that basically the Financial Supervisory Commission and its secretariat are composed of civil servants who can be affected by the government (Kim Hee-Kyung 2010: 148-151). For example, according to interview with Mr. Im, a bureaucrat with the Ministry of Finance and Economy at that time, the 1999 revision of the National Government Organisation Act the main contents of which were the readjustment of the works and responsibility of the Ministry of Finance & Economy and the Financial Supervisory Commission, as well as the composition and function of the subordinate organisations of the Financial Supervisory Commission, provided the basis for determining the size and function of the civil servants organisation affiliated to the Financial Supervisory Commission by the Ministry of Finance & Economy, a department outside the Financial Supervisory Commission. In particular, by changing Article 15-1 of the ‘law on the establishment of financial supervisory organisation, etc.’ to read “the matters necessary for the organisation and fixed number of employees of the Financial Supervisory Commission shall be determined by the President of Korea,” the grounds were prepared for the Ministry of Finance & Economy to regain the control of financial supervisory power simply by consulting with the Ministry of Government Administration & Home Affairs, even without the approval of the National Assembly. As a result, the Planning & Administration Office, which had 19 staff members when the commission was launched, was transformed into a secretariat with as many as 70 civil servants in 2001(Kim Hong-Beom 2006: 50-55). In its function, the Financial Supervisory Commission came to possess an organisation similar to that of the Financial Supervisory Service, controlling whole areas of financial supervisory policy. Consequently, under the situation as the influence of the

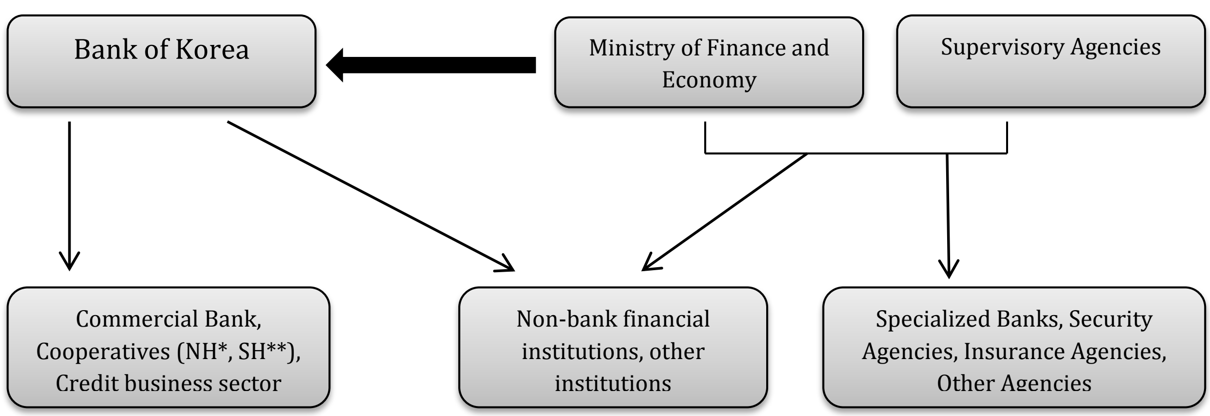
Ministry of Finance & Economy on the Financial Supervisory Commission kept increasing and a practice of regular personnel exchange between the Ministry of Finance & Economy and the Financial Supervisory Commission occurred, it could be regarded that the practical power of the Financial Supervisory Commission became concentrated in the Ministry of Finance & Economy, and this damaged the independence of the newly established supervisory organisations(Kim Dae-Sik et al. 2005: 210-212).

Consequently, it is regarded that the independence of the Financial Supervisory Commission from the government has not increased substantially even after the 1997 crisis and the reform. But, this paradoxically shows that though the state cannot directly influence the financial market as it did before the reform, such an influence is still possible through the window of the Financial Supervisory Commission.

7.2.3. Evaluation (criticism) of the financial supervision system changes

Changes were made in Korea's financial supervision system after 1997 to strengthen the Bank of Korea's independence and establish a new financial supervisory agency. As a result, the figures below show changes to the financial supervision system in Korea with the financial reform.

<Figure 7.1> Korean Financial Supervision System (Before the 1997 financial crisis)[98]

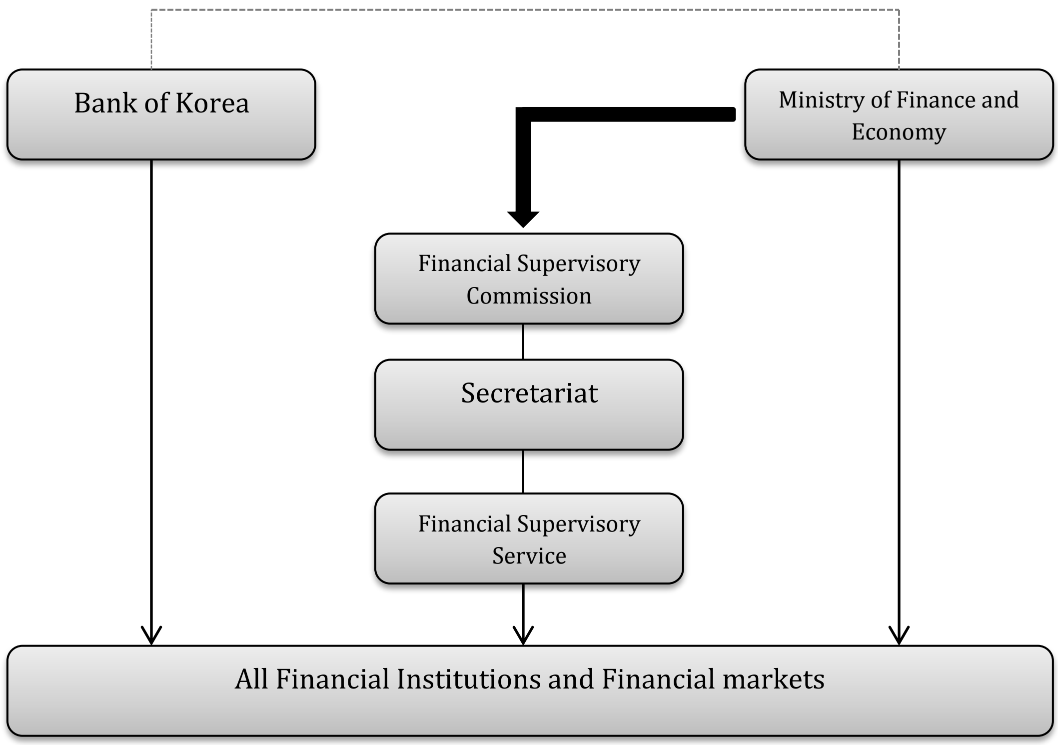


Source: Kim Hong-Beom (2006: 32)

* NH: National Agricultural Cooperative Federation, **SH: National Federation of Fisheries Cooperatives.

[98] Though the exertion of supervisory power of the Bank of Korea is drawn in thin lines in the figure, it was actually very restricted.

<Figure 7.2> Korean Financial Supervision System (After the 1997 financial crisis)



Source: Kim Hong-Beom (2006: 57)

※ In <Figure 7.1> and <Figure 7.2>, the bold arrow represents exertion of influence, the broken line indicates independent cooperation, and the thin arrow shows the supervision of each agency.

As described above, the focus of the central bank was restricted to monetary policies, so it actually lost most of its financial supervision functions. Accordingly, it can be said that the defining characteristic of the financial supervision system created immediately after 1997 is its tripartite structure. The Financial Supervisory Commission was established in 1998 as the highest decision-making institution on financial supervision. In 1999, the Financial Supervisory Service was set up by merging the financial supervision functions that had been divided between the Bank Inspection Board, the Securities Supervisory Board, the Insurance Supervision Board, and the Credit Management Fund. Considering that the Ministry of Finance & Economy retains the authority to revise the laws on financial supervision, it can be said that financial supervision in Korea is conducted on a tripartite basis.

These financial supervision system changes can be criticized in three respects. First, the reform, rather than focusing on strengthening the financial supervision function, emphasized the ‘independence’ of each financial supervisory agency too strongly. In particular, the emphasis on the Bank of Korea’s ‘independence’ can be interpreted as preventing bureaucrats from intervening in the Bank of Korea’s interest rate policy. As mentioned above, with the amendments made to the Bank of Korea Act in 1997, bureaucrats with the Ministry of Finance and Economy, which is currently called the Ministry of Strategy and Finance, were completely banned from participating in the Monetary Policy Committee, which was the Bank of Korea’s interest rate-setting body. Mr. A, a high-ranking financial bureaucrat at that time, said in an interview, “After 1997, there were only four occasions on which the vice-Minister of Finance and Economy participated in the interest rate-setting meetings (once in 1998, three times in 1999). But under Minister Yoon Jeung-Hyun (2009 ~ 2011), the successor to Minister Kang Man-Soo (2008 ~ 2009), the Vice-Minister of Strategy and Finance attended the interest rate-setting meeting for the first time in 10 years, and thereafter attended on a regular basis. However, Korean economists advocating market reform joined forces to criticize this as an ‘outrage’ threatening the Bank of Korea’s independence.” Actually, the Federal Reserve, the central bank of the US, has two official goals: price stabilization and full employment. That is, when joblessness in on the rise, there is room for low interest rates, as full employment is preferred to price stabilization. But after the reform, the Bank of Korea Act only set price stabilization as its goal. This is the model most desired by Milton Friedman (architect of neo-liberal economics). On the other hand, full employment is the responsibility of Ministry of Strategy and Finance. Unlike the US, price stabilization and full employment are responsibilities of different agencies. Considering this, isn’t it necessary, before enforcing a policy affecting the overall economy, such as an interest rate increase, for the Bank of Korea to consult with the Ministry of Strategy and Finance? If government cannot even intervene in a major policy issue such as an interest rate increase, what is the role of government? Does reform mean leaving everything to the market? What is noteworthy here is not the extent to which this financial supervisory agency has actually become independent from the government, but the fact that the most critical element in the changes to the financial supervision system after the financial crisis seems to be this independence. In other words, did the focus on the part of financial supervisory agencies on stronger independence from government as the goal of reform mean that their goal was to weaken the state’s capacity to intervene in the financial market?

Secondly, due to its plural execution system, financial supervision in Korea was continuously being disturbed by various problems including overlap, confusion in policy, a lack of clarity regarding responsibility, and corruption in supervision. Immediately after the crisis in 1997, the reshuffling of the financial supervisory function began with the reason to integrate the financial supervisory function, but it can be said that it only decreased the efficiency of financial supervisory function due to the inefficiency of the internal structure of supervision and governance. In particular, it was a problem that the government had handed over the financial policy, which used to be the responsibility of the Ministry of Finance & Economy, to the Financial Services Commission to enhance the efficiency of financial policy and supervision, and separated the heads of the Financial Services Commission and the Financial Supervisory Service. Also, according to interview with Mr. B, a bureaucrat with the Ministry of Finance and Economy at that time, in the plan for the division of roles between the Financial Supervisory Commission and the Financial Supervisory Service, the secretariat of the Financial Supervisory Commission is called “the Financial Supervisory Commission” and the real Financial Supervisory Commission is separately titled “the committee,” weakening the actual authority of the Financial Supervisory Commission and the Financial Supervisory Service. This problem is clearly shown by positions of the individual agencies that appear in the arguments surrounding discussions of these changes. The position of the Ministry of Finance & Economy is that it is only possible to implement a consistent policy if the macroeconomic tools such as government finance, taxation, and banking are concentrated in the Ministry of Finance & Economy. The position of the Financial Services Commission is that it should absorb the international finance and foreign exchange policies of the Ministry of Finance & Economy to expand the Commission into the Ministry of Banking, and the Financial Supervisory Service should remain a subordinate organisation of the Commission. The Commission also emphasizes that it is not easy to make the financial market of Korea move in perfect order with only domestic financial policy measures, and thus it is necessary to transfer the national treasury function to the Financial Services Commission so that they can simultaneously support the domestic financial industry by implementing international financial policies. On the other hand, the Financial Supervisory Service thinks that it should become an independent private organisation with a public character so that it is able to conduct supervision according to the logic of the market, without being influenced by the government. Civic groups, for their part, stress that ordinary financial supervision should be carried out by a private supervisory organisation that is completely independent from the influence of government officials. In this way, each department and interest group is making assertions that reflect the interests of their organisation. Thus, reforms were conducted by a structure wherein there was no clear division of roles among financial supervisory agencies, only conflict among differing interests. Moreover, there was a lack of ability to harmonize the positions of the actors. In conclusion, it was a structure in which each financial supervisory agency stressed its own independence, while macro-financial supervision was not achieved.

Third, discussions on the changes in financial supervision did not even include enacting a statute to prevent the new political-business collusion between financial supervisory agencies and financial institutions. Generally in Korea, it has been considered that 'political-business collusion' or illegal dealings only occurs between bureaucrats and chaebols. But, according to an interview with Mr. C (working in the financial sector), a new type of political-business collusion emerged after the 1997 financial crisis, which seems even more problematic. He said, "These days, foreign private equity funds operating in Korea, large foreign investment banks, etc. are creating new types of corruption and collusion, and the monetary stakes here are much bigger than before. At the time of the financial crisis in 1997, foreigners called capitalism in Korea 'crony capitalism,' where insiders collude and take everything for themselves, but in reality a global-level crony capitalism is in full bloom.' For example, an official of a financial supervision agency helps a financial institution while in office, joins the institution after retirement and earns an enormous amount of money there. Under the current Public Service Ethics Act, a retired official joining a for-profit private company with 'equity capital of 5 billion Won or more and annual external turnover of 15 billion Won or more is subject to a review of employment. But a financial institution, which does not need capital equipment, has low equity capital, so retired officials are not subject to review, no matter how high its sales may be. There should have been a statute enacted that bans bureaucrats engaged in financial supervision from joining financial institutions, accounting firms, etc. in the same field. In the past, since socially prominent chaebol chairmen colluded with bureaucrats or judges, the facts were relatively visible and social sanctions were possible as well. But the new forms of corruption often occur between shady entities (e.g., faceless private equity funds) and bureaucrats, and thus are harder to discover, making social sanctions difficult. 'Ex-ante regulation' as well as 'ex-post regulation' should have been included in the statute, but there was not even an attempt to have such discussions in the financial supervision changes at that time.

To put it simply, the changes in financial supervision immediately after the 1997 crisis were made to meet the IMF's demands, and conformed to a neo-liberal ideology. Given the intended purpose of strengthening financial supervision, the fact that such changes served an ideology of liberalization is significantly ironic.

7.3. Empirical Analysis: Did such changes to the financial supervision system strengthen supervisory function?

A series of financial supervision system changes were made after 1997, with the purpose of strengthening the weakened financial supervisory function. This, seen from the developmental state perspective, was an attempt to strengthen or recover the weakened *state capacity*. So, did the new financial supervision system actually work well? Was the strengthened financial supervisory function (the original goal) achieved well after reform? To answer this question, a few actual cases will be examined. The cases listed here will be based on news articles and interviews at that time and materials personally collected by the author hereof.

Did 'neo-liberal economic reform' really strengthen the state's capacity to supervise and regulate the financial market?

7.3.1. Credit card crisis in 2003

The 'credit card crisis,' a big social problem in the early years of the Participatory Government, ended up creating 4 million credit delinquents, and was the biggest financial system crisis after the 1997 financial crisis. When LG Card[99] was faced with initial default in Nov 2003, cash advance services for its 12 million members were temporarily suspended, leading to a financial market fluctuation. It was estimated that the bankruptcy of LG Card would be in the amount of a few trillion Won, causing creditor banks astronomical losses and leading to the acceleration of

[99] LG Card Co., Ltd was Korea's biggest credit card and consumer credit provider before the credit card crisis in 2003. LG card is merged into Shinhan Card Company in 2007.

due dates for corporate and household loans, and that the financial market would experience a chaos it had never seen before (e.g., corporate and household bankruptcy increasing steeply). An interview with Mr. D (high-ranking financial bureaucrat at that time) gives a picture of that situation. He said in the interview, “at that time financial supervisory authorities found that tens of trillions of Won corporate bonds issued by credit card companies, i.e., credit card debts, were held by banks. Banks bought the credit card debts as a means of asset management. In that situation, sticking to market logic would have meant telling the individual banks to act on their own. Individual banks would have attempted to collect funds by selling the corporate bonds they held as quickly as possible. But had all banks acted in that way, the entire credit card debt market would have collapsed and resulted in a financial crisis amounting to tens of trillions of Won.” The government, after considering this structural risk, not only prevented individual banks from selling their credit card debts but basically forced the banks to lend more to credit card companies experiencing a liquidity crisis, thus preventing a financial crisis. At that time, the government had the Industrial Bank of Korea acquire LG Card, and also came up with a plan in which LG Group and creditor banks provided 4.66 trillion Won by converting loans to equity, etc. (Maekyung Economy, Jul 4, 2004)

• Cause[100]

The 2003 credit card crisis occurred because the Kim Dae-Jung government, to stimulate the economy, took widespread de-regulation measures and encouraged credit card use. In particular, their abolition of the monthly limit (700 thousand Won) on cash loans was a direct cause of the credit card crisis. Credit card companies, which became referred to as the `golden geese,' issued credit cards to people with no income (college students, unemployed people, etc.), regardless of their credit rating, through `on-the-street membership drives.' The cash advance limit was increased without restriction (Yoon Sun-Hee, Apr 24, 2011, Yonhap News article). People with low credit `actively' used cash advance services, which were available anytime without collateral or a credit rating, despite maximum fees amounting to 30% of the principal. Many people had multiple credit cards, leading to widespread over-consumption (amount of cash advance exceeding that of income). As a percentage of private-sector consumption, credit card payments

[100] All numerical data in this part can be found at Korean Statistical Information Service http://kosis.kr/index/index.jsp

only accounted for 5.6% in 1990, which rose to 24.9% in 2000, and 45.7% in 2002. The number of credit cards per economically active person increased from 1.8 (1999) to 4.6 (2002), while the total number of issued credit cards increased from 38 million 993 thousand to 104 million 807 thousand. The amount of credit card use, 90 trillion Won in 1999, amounted to 623 trillion Won in 2002.

However, as more and more people failed to pay credit card debts, credit card companies' bad debts snowballed. The government belatedly imposed some regulations, such as banning on-the-street membership drives, but these were not enough to prevent things from getting worse. The actual default rate of credit card companies rose to 28.3% in 2003, and the number of credit delinquents amounted to 4 million. Meanwhile, the equity capital ratio of credit card companies, which used to be 13%, fell to negative 5.4%. Finally, with credit card companies facing possible bankruptcies, KB Card was merged into its parent company (KB Bank) in 2003 as a division thereof, and both KEB Card and Woori Card were merged into their parent banks in 2004. Samsung Group injected 5 trillion Won into Samsung Card and LG Group put LG Card in the hands of creditors. It was in this situation that the '2003 credit card crisis' or 'LG Card crisis' occurred.

• Responsibility

In 2004, the Board of Audit & Inspection, after conducting a special audit to determine the cause and responsibility for the credit card crisis, decided to hold accountable the Ministry of Finance and Economy, Financial Supervisory Commission, Financial Supervisory Service, and Regulation Reform Commission (Munhwa Daily editorial, Jul 13, 2004). This meant that the government or the state could not avoid responsibility for its lack of proper control over the development of the credit card crisis, as well as for its policy choices that led to excessive competition among the credit card companies.

7.3.2. Savings bank[101] crisis in 2011

This crisis began when the Financial Services Commission issued a business suspension on 7 savings banks from Feb 17 through 22 of 2011. After that, the government announced the 'Savings Banks Management Normalization Measures for Second Half of 2011' on Jul 4, which had the purpose of establishing sound foundations for mutual savings banks, and subsequently, on Sep 18 designated seven savings banks with a BIS (Bank for International Settlement) ratio below 1% (including Jeil Savings Bank and Tomato Savings Bank) as bad financial institutions and issued six-month business suspensions (Kim Sang-Jo 2012: 2-3). Due to the business suspensions, depositors with 50 million Won or more and holders of subordinated bonds could not avoid loss of principal. Under the Depositor Protection Act of that time, deposits of up to 50 million Won (principal and interest combined) per person were 100% protected, but deposits of more than 50 million Won were only protected up to 50 million Won through the Deposit Insurance Fund. For amounts over 50 million Won, the remainder after the liquidation of bad savings banks was to be paid according to priority. Savings banks that were issued six-month business suspensions were granted 45 days of self-normalization efforts, but if self-normalization was deemed impossible, sale to a third-party or contract assignment to bridge savings banks owned by Korea Deposit Insurance Corporation was pursued.

The number of victims of this crisis was estimated as at least 40 thousand. 1.5 trillion Won was injected by the government at that time to solve the problem, but some claimed that an additional 7 or 8 trillion Won was needed (Choi Young-Joo 2012: 197-198). The fact that 8,000 savings bank employees lost their jobs in an instant and most of the victims were ordinary people (the masses) shows the severity of the crisis (Jung Dae 2013: 28-29).

• Cause

The 2011 savings bank crisis occurred because the government, to stimulate the economy, significantly eased financial market regulation and encouraged savings banks to engage in commercial banking business, not their original business. Actually, savings banks were originally

[101] Savings banks in Korea differ greatly from general banks. While commercial banks belong to the primary financing sector and have indirect financing as their main business, savings banks belong to the secondary financing sector and have direct financing, in which funds are directly financed to consumers from suppliers, as their main business.

called ‘mutual savings and finance companies’ (Kim Young-Pil 2012: 5-6). Mutual savings and finance companies were introduced in 1972 to provide easy credit to ordinary people and medium/small companies. Since ordinary people and medium/small companies had difficulty using general commercial banks due to their strict lending criteria and high interest rates, the introduction of mutual savings and finance companies lowered the threshold for bank use (Ibid.). Mutual savings and finance companies were subject to strict statutory obligations by the government to provide 50% or more of loans to ordinary people and medium/small companies, and had been growing thanks to significant government support. But their business began expanding to risky loans or investment with the easing of financial regulations and the change of their category name to ‘mutual savings bank’ in 2002, followed by ‘savings bank’ in 2010, putting them in competition with commercial banks (Kim Dong-Yeol and Han Sang-Beom 2012: 200–202). Savings banks, which could only attract deposits by paying more interest than commercial banks, had to produce yields as high as stock investments, and thus launched into high-risk, high-yield project financing (PF).

PF is an investment method based only on the ‘business potential of real property,’ without even collateral or any safety mechanism. That is, savings banks employed a ‘high-risk, high-yield’ strategy using customers’ deposits. Savings banks, earning high yields thanks to the overheated real estate market after 2000, fell into crisis through the sub-prime mortgage crisis in the US and the global recession in 2008. But, since savings banks were attracting large amount of deposits by offering higher interest rates than commercial banks, they had to stick to a ‘high-risk, high-yield’ strategy. And the lax management of savings banks, where the government’s supervision was looser than that of commercial banks, ultimately led to the ‘savings bank crisis.’

• Responsibility

In 2013, the Board of Audit & Inspection, after conducting a special audit to determine the cause and responsibility for the savings bank crisis, decided to hold the Financial Supervisory Service accountable (2nd Audit of Government-owned Financial Companies’ Management, Apr 3, 2013). The Board explained, “The Financial Supervisory Service investigated savings banks’ PF sites three times from 2008 to 2011 and then established and executed real estate PF loan plans. In the process, the Financial Supervisory Service underreported, to the Financial Services Commission, the entire amount of PF debts by 3.6 trillion Won, and the amount of bad PF debts by 1.5 trillion

Won." Also, the Board explained, "The Financial Supervisory Service not only failed to evaluate PF's business potential properly but failed to inform KAMCO of the investigation's result, i.e., improper soundness supervision (PF site investigation, etc.)."

This meant that the government or the state could not avoid responsibility for its lack of proper control over developments that led to the savings bank crisis, as well as for its policy choices that led to the 'high-risk, high-yield' strategy on the part of savings banks.

7.3.3. Evaluation

As shown in the above cases, it seems that the changes to the financial supervision system after the 1997 financial crisis did not work well. In other words, it can be deemed that a strengthened financial supervisory function (original goal) was not achieved by the reform. It is true that in both cases, the initial responsibility belonged to credit card companies and some savings banks that had lax management. But a bigger problem was the fact that the government did not enable them to avoid the above-mentioned 'rational choice.' The government, to stimulate the economy, abolished the cash advance limit and tolerated the indiscriminate card issuance by credit card companies and the financial authorities' eased regulation so that savings banks could engage in over-competition with commercial banks instead of pursuing their original business. These two factors played a more significant role in the crisis.

In short, it might be possible to say that financial supervisory agencies in charge of financial supervisory function focused on 'ex-post regulation,' and there were no prior objections whatsoever to the 'easing of financial market regulation.' Maybe there was a belief that the financial supervision system changes of 1997 would work well. But it turned out that the belief was unfounded, and a stronger financial market regulation capacity was necessary. One financial bureaucrat said in an interview, "The current financial market is changing rapidly, and is becoming more and more complicated. The fact is that regulatory statutes are too slow-paced, and are not responding to the speed of changes. Given the current situation and the current supervisory function, it will be difficult to prevent another financial crisis." This has important implications.

7.4. Concluding Remark

The main purpose of this chapter was to evaluate the direction of the financial supervision system's reform after the 1997 economic crisis in Korea, and determine whether the direction matched the goal pursued by the state, which is to recover the state's capacity by strengthening the supervisory regulation capacity over the financial market. The financial supervision system changes immediately after 1997 proceeded in the direction of accepting neo-liberal norms and principles, as per the IMF's demands. And there was a belief that the changes could strengthen the weakened financial supervisory function. But this chapter well illustrates that Korea's financial reform, which planned to strengthen the government's supervisory regulation capacity over the financial market through a neo-liberal approach, brought about changes that did not match the original goal.

Actually, it seems Korea's financial supervision system changed after the 1997 financial crisis in a direction that served neo-liberal reform and the IMF's demands. However, a closer look at the subsequent process of change shows the ways in which the legacy of the developmental state persists. In Korea after the crisis in 1997, some elements of the finance-related authority and functions that had become concentrated in the former Ministry of Finance & Economy were distributed to the Bank of Korea and the Financial Supervisory Commission. In other words, the previous concentrated structure was converted into a structure of division of labour. As a result, an integrated supervision system was created to enable a single supervisory authority to control financial supervision. The Bank of Korea increased its legal independence, while the Ministry of Finance & Economy took charge of economic policies and policy coordination. However, while the state seemed to reduce its dominance role over the financial market, it prepared a channel to influence the financial market by securing leverage over the operation of the Financial Supervisory Commission. That is to say, Korea installed an integrated financial supervisory organization with limited independence, to accept the neo-liberalistic demands for financial reform after transforming them.

It seems that the changed financial supervision system has problems in many respects. First, the reform, rather than focusing on strengthening the financial supervision function, placed too much emphasis on the 'independence' of financial supervisory agencies. Second, due to its plural execution system, financial supervision in Korea was continuously being disturbed by various problems including overlap, confusion in policy, and a lack of clarity regarding responsibility, and corruption in supervision. Third, discussions on financial supervision change did not even include enacting a statute to prevent the new risk of political-business collusion between financial supervisory agencies and financial institutions. Thus, reforms were conducted by a structure wherein there was no clear division of roles among financial supervisory agencies, only conflict among differing interests. Moreover, the ability to harmonize the actors' positions was completely lacking. In conclusion, it was a structure wherein each financial supervisory agency only stressed its own independence, and macro-financial supervision was not enabled, resulting in a failure to achieve the original goal of recovering 'the state's capacity by strengthening the supervisory regulation capacity over financial markets.'

In Korea, financial supervisory agencies became independent as per the IMF's demand to overcome the 1997 crisis and to better supervise the rapidly-changing financial market, and despite the criticism of a continued developmental state legacy, an organization called 'Secretariat' was set up to ensure that the state had a minimum level of coordinating ability. But, as shown in actual cases after 1997, Korea's financial supervisory function did not work well, due to policy confusion or the unclear division of responsibilities between the 'Secretariat' and other financial supervisory agencies and an overlap in financial supervision (Kim Hong-Beom 2006: 60-65). But the reason why the changes in the financial supervision system did not work well was not that interference by 'bureaucrats' or 'the state' hampered the independence of supervisory agencies, but that 'governmental intervention' itself was regarded as wrong due to the framework of the neo-liberal reforms. Neo-liberal financial reform, stressing de-regulation and a minimal role of the state rather than 'state control through bureaucracy' was wrong from the beginning.

In conclusion, the Korean state's goal, which was to recover the state's capacity by strengthening the supervisory regulation capacity over the financial market, could not be achieved through neo-liberal reform.

• Appendix

Financial Supervision Agency in Korea (1997 ~)

	1997 ~ 2007			2008 ~	
	Financial Supervisory Commission	Financial Supervisory Service	Ministry of Strategy and Finance	Financial Services Commission	Financial Supervisory Service
Responsibility	•Establishment of supervision policy •Licensing •Sanctions •Enactment and Revision of Regulation on Supervision	•Supervision and Inspection on Financial Institutions •Enactment and Revision of Regulation on Supervision and Sanctions •Investigating unfair trade practices	•Establishment of financial policy •Enactment and Revision of law	•Establishment of supervision policy and financial policy •Licensing •Sanctions •Enactment and Revision of Regulation on Supervision and law	•Supervision and Inspection on Financial Institutions •Investigating unfair trade practices
Affiliated Organisations	KAMCO	.	KDB, IBK, KOREAEXIM, KDIC, KCGF, KHFC, KoFIU, etc.	KDB, IBK, KOREAEXIM, KDIC, KCGF, KHFC, KoFIU, KAMCO, etc.	.
Features	• It is possible to cross-check between agencies, because there is separation between policy functions and supervisory functions. • The inefficiency of the policy enforcement by three-tier structure. • The Director of Financial Supervisory Commission (FSC) is the Governor of Financial Supervisory Service (FSS).			• Increasing the effectiveness of policy implementation •Enlarged bureaucracy. •It is hard to cross-check between policy and supervision agencies. •The director of FSC is not the Governor of FSS.	

Source: Financial Services Commission

* KAMCO: Korea Asset Management Corporation, KDB: Korea Development Bank, IBK: Industrial Bank of Korea, KOREAEXIM: Korea Exim Bank, KDIC: Korea Deposit Insurance Corporation, KCGF: Korea Credit Guarantee Fund, KHFC: Korea Housing Finance Corporation, KoFIU: Korea Financial Intelligence Unit.

Chapter 8
ANALYSIS

8.1. Introduction

There was a general recognition that the Kim Dae-Jung government, which came to power just after the foreign exchange crisis in 1997, would aim at a 'neo-liberalistic reform.' However, according to my research so far, the Korean state made efforts to recover the positive elements of a developmental state, such as state capacity, state autonomy, and internal cohesiveness, which had been weakened due to various factors, in an attempt to restore the political and institutional leading abilities of the governmental organization. I have conducted a number of case studies in an attempt to make a judgment on the success of such efforts: if the Korean state had a DS bureaucratic *structure* then the state might have managed neo-liberal *policies*? Or if the Korean state had a DS bureaucratic *structure* then the state might have shaped the content of *policies*?

While I have previously been focused on the individual case studies, it is now important to return to the starting point and answer the questions of the thesis. Therefore, in this chapter, I intend to answer the large and small questions of the thesis by integrating and analysing the results of the case studies (Chapter 5: Korean Bureaucracy, Chapter 6: Public Fund, Chapter 7: Restructuring Financial Supervisory System) conducted so far, and the process will be analysed from the viewpoint of 'new comparative political economy,' as I stated in Chapter 3.

In other words, I have performed case studies to examine the following questions: What the change process did the restructuring into a 'post-developmental state' before the foreign exchange crisis in 1997 ultimately result in during the process of overcoming the financial crisis? In short, how has the Korean developmental state changed since the financial crisis? And how has this change influenced the role of the state? But the 'post-developmental state' should not be identified with the British-American model of the completely neo-liberalistic regulatory state. The deterioration of state-led growth and the emergence of market-led growth in Korea was not defined with the concept of a 'regulatory state' but was analysed with the concept of a 'post-developmental state' in order to emphasize the transitional character; specifically, that the transition and restructuring of the growth system had still been in progress (before 1997). Thus, in a sense, it indicates that there were various possibilities according to the dynamic composition and mutual response between the state and society and the state and capital during the process of overcoming the financial crisis. In other words, Korea could have recovered its attributes of a developmental state or quickly taken the path to becoming a 'neo-liberalistic regulatory state,' moving in the direction of a 'post-developmental state'.

How did the explanatory variables that had changed the Korean developmental state into a 'post-developmental state' before the financial crisis in 1997 influence the change of the Korean developmental state in the process of overcoming the crisis, through 'financial reform' after the financial crisis? This is the question that this chapter will answer. Part II which follows will summarize the questions raised in the thesis and the framework of analysis and methodology that has been prepared to answer the questions. In Part III, the situation before the financial crisis will be summarized briefly, and the questions on the change in the character and role of the state during the process of overcoming the financial crisis in 1997 will be answered, along with an integrated analysis of the results of many case studies. Finally, Part IV will summarize the chapter and suggest some implications as conclusions.

8.2. The Main Focus of this Thesis. Why, What, and How?

Before the 1997 crisis, Korean developmental state had already been changing in many ways; the success of economic development raised the issue of different roles of the state to previous 'strong', 'economy-centred' and 'coercive' role of the state. However, it is true that the financial crisis accelerated this issue as a crucial subject of the developmental state theory. As Korea has been transformed to different type of state, the changing roles of the state have been inevitably required after the financial crisis. Additionally, in this thesis, there was a certain belief that a focus on the restructuring of the financial system after the 1997 crisis can not only provide a clue to investigate "the transformation of developmental states and changing role of the state" but also help identify the political dynamics in shaping economic, political, and social reformation.

8.2.1. Questions (Main Questions and many sub-questions)

The major aim of this research was to investigate the changing role of the state in Korea after the financial crisis of 1997. Considering the complexity of Korean dynamics in this period, the changes in the financial system and the country's developmental state have been the main points of focus. In order to analyse the main focus of thesis, the research was simply the process of answering to the questions of, "What has been essential to both state definition and finance in Korea?" and, therefore, "How essential is the state's definition and the role of the state in finance when examining how far the Korean state has changed in the aftermath of the 1997 financial crisis?"

In this thesis the core question was this: How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?" In Korea, as a representative structure of developmental states, the financial system was the kernel of the state-leading developmental policies; in other words, it is how the state could control 'capital' and execute 'industrial policy' for the state's aim of economic development. Hence, two subordinate issues therefore need to be raised to figure out the outline of the process of the changing role of the state before and after the financial crisis: "Whether state's purpose to reinstate its crucial role by restoring the attributes of a developmental state through the public fund after the 1997 crisis was successful or not" and "what was the direction of the financial supervision system reform after the 1997 financial crisis in Korea? And was the direction matched the goal pursued by the state?" It is true that the Korean developmental state was shaped by specific historical, political, economic, geopolitical and international situations. Hence, in order to answer the main questions of this thesis, it was absolutely essential to investigate the changing features of many fundamental factors. However, this investigation had to focus on examining how changing factors were linked to influencing the transformation of the Korean developmental state and the changing role of that state, rather than seeking to achieve a generic theory by pointing out particular variables that might be alleged to be decisive.

In a nutshell, the implementation of economic, political and institutional arrangements to overcome Korea's 1997 financial crisis by examining the 'transformation of bureaucracy and the financial system' can be satisfied with the main objective of this thesis, *"the changing role of the* *state in Korea after the financial crisis in 1997"*, and possible answers to the following core question: "*How has the Korean developmental state changed since the 1997 financial crisis? And has this change influenced the role of the state in finance as well as the structure of the state bureaucracy?*"

8.2.2. Analytical Framework and Methodology

First of all, this thesis used the new comparative political economy approach for the analytical framework and research strategy because it shows that economic, political and social developments cannot be explained purely in terms of a predeterminate single process or constant factors. This approach places more emphasis on different historical factors within the historical context to explain different types of development in various countries. Additionally, new comparative political economy puts a methodological basis on the conjunction of ① the historical complexity of "class dynamics," ② the concept of the state as "actors," and ③ the interaction between a nation's developmental dynamics and the world system (see Chapter 3). So, it allowed this researcher to capture the complexity of real political and economic situations in Korean developmental states, but not at the expense of theoretical clarity.

Based on this perspective, to satisfy the main objective of this research, it was crucial to discover some variables that influenced the process of transformation in the Korean developmental state and to investigate the changing role of the state in Korea affected by those variables. Accordingly, this research utilised key elements of the new comparative political economy model to explain the influences on the process of crisis and reorganisation in the Korean developmental state. So, this researcher suggested key elements of this model to influence the process of the crisis and reorganisation of the Korean developmental state: the state, capital and society as actors on the one hand and three variables to influence on the state autonomy, including ① the change in the state-world system relation, ② the change in the state-civil society relation, and ③ the change in the state-capital relation; on the other hand, the main variable to weaken the state capacity is ④ internal disturbances of state bureaucracy as factors. In addition, this research assumed there were various factors that would affect the processes of reorganisation in developmental states. Four factors were included as explanatory variables: ① the intensity of the crisis of developmental states, ② the role of the state (the efficacy of the state's policies in response to the crisis), ③ the response patterns and reactions of social groups and ④ the structural heritage based on the judgement that these processes are inevitably path dependent in a manner similar to the former growth mechanism. Accordingly, the crisis aspect and the reorganisation processes of the Korean developmental state could be either unique or general depending on the impact of each explanatory variable; therefore, the role of the state is also investigated using these procedures.

A study of the relationships between actors and factors, as well as their interactions, is necessary for shaping a casual model of the changing role of the state in the developmental states thesis. In addition, the question of how autonomy and embeddedness could be effectively combined in Korea and how they changed after the 1997 financial crisis are further complicated by the fact that many factors mutually influence each other. Also, the analysis of the changing role of the state could result in abstract and apparent outcomes because the role of the state itself cannot be easily defined or restricted by various foundations. By considering the complexity of dynamics, this thesis adopted a method to investigate the changing role of the state by examining the changing features of the Korean developmental state at each period. Accordingly, this thesis introduced some actors and factors, as explained above, that could show changing features of the Korean developmental state at each period. Most of all, this researcher supposed that the features of the Korean developmental state at each period results from some specified relationship between the actors and factors and the ways in which they mediate changes in those relationships. Hence, in order to investigate the 'changing role of the state', the analysis had to be focused on not only the state itself, but also dynamic relationships between the state, capital and social groups. However these mutual dynamics could not be simply investigated by statistical data, economic indicators, and official research products, it could be said that various research products, based on formal data to correctly show political, economic and social context in policy decisions and policy changes, were essential to more objectively understanding such dynamics.

Accordingly—on the primary research basis by references and contemporary literature from various interdisciplinary departments of politics, economics, and social studies to mainly explain Korean developmental state—this research tried to find political, economic, and social contexts to achieve the aim of this thesis, through examining the 'transformation of Korean bureaucracy and the financial system' in order to investigate changes of Korean developmental state and changing roles of the state since the 1997 financial crisis. More specifically, the detailed analysis of 'Korean bureaucracy', 'public fund', and 'the Financial Supervisory System', and semi-structured qualitative interviews to understand the experience of political elites/bureaucrats in terms of the financial system were presented in earlier chapters in order to satisfy the aim of this research and to enrich the explanation.

In a nutshell, this research investigated the factors of the Korean developmental state's transformation and its effect on the relationship between actors and factors, and it specifically examined the "changing role of the state," especially after the 1997 financial crisis through the case studies: internal cohesiveness and embedded autonomy were mostly supposed to be examined by the case study on '*Korean Bureaucracy*' and '*the Financial Supervisory System*' and state capacity and state autonomy were mainly expected to be investigated by the case study on '*the public fund*'.

8.3. Analysis

Due to a number of factors, it was inevitable that the Korean developmental state would be required to change, and thus the state attempted to induce the change it planned. The state aimed to enable a "soft landing" for the growth system of the developmental state by reinforcing market-oriented economic operation while still securing the grounds for indirect intervention of the state and the political tools that could complement and correct it. But the plan of the state was not achieved effectively. Before the financial crisis, there had been a direction of a 'post-developmental state' which accommodated changes without abandoning the attributes of a developmental state, and the occurrence of the financial crisis provided a good opportunity to recover such attributes or reconsider, ironically, a shift to an indiscriminate regulatory state.

What about the situation prior to the financial crisis? And how did the explanatory variables which had changed the Korean developmental state into a 'post-developmental state' before the financial crisis in 1997 influence the change of the Korean developmental state in the process of overcoming the crisis through 'financial reform' after the financial crisis? And how did such changes influence the role of the state? These questions will be answered through an integrated analysis of the results of the many case studies conducted so far.

8.3.1. Changes in the character and role of the state (before the IMF crisis)

(1) Overall analysis

The process of Korea's industrialization, which began in earnest in the early 1960s, was a 'state-led growth' method that was based on strategic market intervention by a developmental state. The state of Korea enjoyed a high level of autonomy from society owing to its special historical situation in the process of decolonization, and it combined this with a highly capable and cohesive bureaucracy and effective policy tools to establish a developmental state. However, the economic growth that the developmental state achieved produced a conflicting trend that eroded its structural basis. This trend appeared in all areas related to growth including economic, political, social, and world system. In the process, the state's autonomy, which had been the structural basis of Korea as a developmental state, was weakened, and as the state's capacity decreased, the developmental state gradually faced a crisis. The 'crisis of the developmental state' was a 'crisis of the growth model,' which internally implied the need for a 'shift in the growth method.' In fact, since the mid-1980s, when the crisis of Korea's developmental state began to appear, the state attempted to find means for a gradual restructuring and shift of the 'system of growth promoted by a developmental state.' As evidenced in the economic development plans or various macro-economic policies during this period, the direction of the shift that was initially planned by the state was to preserve the initiative of the state in the restructuring of the industrial structure into technology-intensive industries and management of macro-economics, while complying with economic liberalization and opening the economy to foreign business. That is, the state planned to reinforce market-oriented economic operation, while securing the grounds for indirect intervention of the state and the political tools that could complement and correct it in order to make a 'soft developmental state' or a 'regulatory state with superior governmental intervention,' rather than a 'neo-liberalistic regulatory state.'

However, the process of restructuring and the shifting of the growth model did not proceed as smoothly as the state had planned. The intensity of the crisis of the developmental state in Korea was very serious, the state's countermeasures failed, and the systematic and political capacity of the state deteriorated significantly. As a result, the developmental state model rapidly deteriorated beginning in the mid-1980s. In addition, the fierce competition and conflicts between the state and social forces (mainly *Chaebol*) over the shift in the growth system resulted in a 'post-developmental state' that served the interests of *Chaebol* during the latter part of the Kim Young-Sam government. So, the path of the restructuring and shifting of Korea's growth model since the mid-1980s can be defined as a 'post-developmental state' because of the macro-economic policies, the character of industrial policies and policy tools, and the status and role of leading organizations and economic bureaucratic organizations. It became virtually impossible for the state to lead economic growth with macro-economic policies in the path of the 'post-developmental state' of Korea, and the state's industrial policies no longer had the ability to encourage and control private companies to comply with the policy direction due to the change in the character of industrial policies and the radical reduction in the policy tools available. Furthermore, economic bureaucratic organizations lost their collective and systematic cohesiveness and their capacity for policy coordination, and the Economic Planning Board, which had been a leading organization, was abolished in 1994.

The important variables that influenced the path of restructuring and the shifting of Korea's growth model seem to be the structural heritage of the development age, the success or failure of the state's capacity and policy countermeasures, and the dynamics of social forces. As Korea adopted the 'concentrated industrialization strategy' which focused on fostering large companies in strategic industrial sectors based on a selective industrialization policy and discretionary policy tools (financial policy) for growth during the growth age, the scope and intensity of the crisis of the developmental state was naturally comprehensive and profound. In addition, Korea could not control the sector of *Chaebol*, which had fattened due to the deterioration of the autonomy and capacity of governmental organizations, and did not firmly establish the social and democratic basis for government policies due to the lack of democratic reform of the ruling coalition despite the transfer to democracy. As a result, the shift of the growth model ended up in a post-developmental state, which corresponded with the interests of the *Chaebol*.

(2) In-depth analysis of the period following the 1980s

Launched in 1980, the 5th Republic declared the policies of economic stability and economic liberalization as its central and core macro-economic policy. However, in reality, there was another core economic policy, which was the industrial restructuring policy, manifested in initiatives such as investment coordination in the heavy chemical industry and the settlement of insolvent companies. Accordingly, there were 3 main categories in the economic policy of the 5th Republic: ① industrial restructuring policy, such as investment coordination in the heavy chemical industry and the settlement of insolvent companies, ② economic stability policy to suppress inflation, and ③ economic liberalization policy, which can be summed up by market opening and financial liberalization. Of these, the economic stabilization policy and economic liberalization policy were far from the policy direction of the previous developmental state, and can be considered as the type of economic policies pursued by a regulatory state. However, the industrial restructuring of the 5th Republic can be analysed and evaluated as a defining policy of a developmental state, in that it was done by the compulsory arbitration by the state and the active and suppressive intervention of the state, not by market arbitration. That is, while in its outward appearance the economic policy of the 5th Republic was a mixture of two aspects - specifically, the policy orientation of a developmental state and that of a regulatory state - it was actually closer to that of a developmental state.

But the situation of the 6th Republic was much different from that of the 5th Republic, as President Roh Tae-Woo took office at a time when the pressure for market opening was intensified and the growth of the working class and the civic society as a result of the transfer to democracy combined to shrink the internal (domestic) and external autonomy of the state. The focus of the economic policy of the 6th Republic consisted of the following three items: ① acceleration of economic liberalization and market opening, ② economic democratization and regulation of *Chaebol*, and ③ complete industrial restructuring and conversion into technology-intensive industries. Of these, the former two key policies of economic liberalization and economic democratization were significant policies during the early stage of the 6th Republic, while the policy of industrial restructuring was a key policy implemented since the 1990s, during the latter part of the 6th Republic. As such, the three keynote policies were actually contradictory in their character, and presupposed conflicting roles of the state, and thus it was actually impossible to accomplish all of them simultaneously. While economic liberalization and market opening were policies of a regulatory state aiming to reduce the intervention of the state and activate the market system, the policies of economic democratization and regulating *Chaebol* had the characteristic of a welfare state being oriented toward a redistribution policy. In addition, industrial restructuring and conversion to technology-intensive industries showed the will of the state to lead the strategic industries of the future, and had the character of policies pursued by a developmental state. Therefore, it was unrealistic to set the three types of policies as keynote policies and attempt to achieve them all simultaneously, as such a policy combination was doomed to fail from the beginning. Though such a contradictory policy combination was not planned originally by the state, it was the biggest reason for the loss of the character of a developmental state during the 6th Republic.

After the state of the 6th Republic began to free itself from the attributes of a developmental state, the civilian government strengthened Korea's attributes of a regulatory state in earnest. The attributes of a regulatory state Korea showed during the early stage of the civilian government was closer to EU regulatory state (Majone 1993; 1996) rather than a British-American neo-liberalistic regulatory state, in that it reinforced fairness in the market system and allowed for the intervention of the state in the form of short-term economic stimulation and industrial adjustment while aiming at a market-oriented growth system. And during the latter half of the civilian government, the state clearly became a post-developmental state, with the stronger aspect of a regulatory state. As a result, the state parted completely with the distribution coalition aiming at a developmental coalition with *Chaebol*, had taken an inferior position within the developmental coalition and was about to be captured by capital almost totally. Finally, by the mid stage of the Kim Young-Sam government, the state actually lost all of its tools for regulation of *Chaebol*, and the economic and industrial policies of the state drifted, corrupted by the rent-seeking behaviours of companies, so it became one of reasons for leading to the tragic result of the economic crisis.

(3) Role of the state

How was the role of the state changed during the process of shifting into a post-developmental state until the financial crisis? As the name 'regulatory state' implies, before the financial crisis the role of the state was significant, despite the tendency of a 'post-developmental state.' As Chang Ha-Joon said, if we divide the role of the state into 'entrepreneur' and 'conflict mediator,' the role of 'conflict mediator' was still being emphasized before the financial crisis, though the importance of the 'entrepreneur' was weakening somewhat (Chang Ha-Joon 2006: 106). In other words, given that the existing system was deteriorating, the state should have made more efforts to create a new system to prevent the financial crisis. To accomplish this, the priority should have been the active role of the state, rather than the market which had already been controlled by *Chaebol*, but this was not easy given that the *Chaebol* had held the balance of power since the 1990s. Furthermore, there was a need to establish a systematic supervision system for proper regulation of the flow of the financial sector and foreign exchange rather than the simple easing of regulation, given that financial opening had progressed since the 1980s. The state should have worked to set up a new relationship between the state, banks and companies through the reform of the industrial sector, including the *Chaebol*. Ultimately, the role of the state should have been focused on constructing a new and appropriate system once again, and this would have been possible had it been based on the elements possessed by the previous developmental state of Korea. However, the attributes of a developmental state had been disappearing for a long time due to various factors: weakened state autonomy eroded state capacity, and a lack of internal cohesiveness in the bureaucracy. For this reason, it was difficult to expect 'embedded autonomy.' This made it impossible for the state to play a proper role, and ultimately led to the financial crisis. Thus, it can be said that the process of overcoming the crisis of the state was one of recovering the various elements of the developmental state.

8.3.2. Changes in the character and role of the state (after the IMF crisis)

Once again, the aforementioned 'post-developmental state' should not be fully identified with the British-American completely neo-liberalistic regulatory state. The deterioration of state-led growth and the emergence of market-led growth in Korea was not defined with the concept of a 'regulatory state' but was analysed with the concept of a 'post-developmental state' in order to emphasize its transitional character, as the transition and restructuring of the growth system was still in progress (before 1997). Thus, in a sense, it indicates that there were various possibilities according to the dynamic composition and mutual response between the state and the society and the state and capital during the process of overcoming the financial crisis. In other words, Korea could have recovered its attributes of a developmental state or quickly taken the path into a 'neo-liberalistic regulatory state,' moving in the direction of a 'post-developmental state'.

However, as seen in the basic analysis and in-depth analysis below, it can be determined that Korea quickly took the path to becoming a 'neo-liberalistic regulatory state' instead of recovering the attributes of a developmental state moving in the direction of a 'post-developmental state.'

(1) Basic Analysis

Coming to power in Korea after the foreign exchange crisis, the Kim Dae-Jung government attempted to bring the state into relief again as the central actor in the operation of the economy, and reverse from the shift to a neo-liberalistic regulatory state by rearranging the damaged policy tools of the state and institutional devices. The aim was to get results and overcome the financial crisis by implementing various initiatives. In this process, the role of the state was not to be shrunken but to be shifted to emphasize coordination, and this could only be reinforced by the increased autonomous participation of civil society and recovery of their trust in bureaucrats.

In fact, after the financial crisis in 1997, the Korean government implemented overall economic reforms based on the policy recommendations of the IMF, such as macro austerity policy, micro restructuring and liberalization. These policies were particularly focused on the financial sector, and included the quick liquidation of insolvent financial institutions, the opening of the capital market, facilitation of M&A, the changing of the financial supervision system, etc. And, I conducted case studies in previous chapters to examine the changes in the character and role of the state in this policy-making process. But, in conclusion, it seems that such policies only emphasized liberalization and market opening, and overlooked the special characteristics of the Korean system, the appropriate relationship between banks and companies, and the proper role of the state (government).

The main purpose of Chapter 5 was to examine how bureaucracy actually changed since 1997 financial crisis. To look at it from the viewpoint of a developmental state, it was an investigation of changes in internal cohesiveness, embedded autonomy and bureaucratic rationality. Since 1997, Korean bureaucracy has changed in a manner following the direction of NPM reform. However, after this reform, the state's goal was not achieved because: 1) 'internal cohesiveness' was further weakened after the reform because of some enlarged departments of bureaucracy, and 2) embedded autonomy was weakened because officials were more swayed by the political power, and 3) as the officials faced an identity crisis, 'bureaucratic rationality' was not found, and accordingly, trust in government was reduced. This situation actually accelerated the shift to a 'neo-liberalistic regulatory state,' in which the role of the state is desirably minimized.

In addition to this situation, as examined in Chapter 6, while the most important purpose of the state when it put in the public fund was to quickly liquidate insolvent financial institutions and minimize the damage to the financial market, the internal autonomy of the state increased, as the state naturally became the main agent for financial support in the process and the state could direct the banks/financial institutions as to their structure/operations/use of funds. Nevertheless, despite the increased internal autonomy, the public fund was not recovered well, due to the limited capacity of the state. Though the state was required to take an active role at that point in time, the division of the bureaucrats and the imperfection of the financial supervision system affected a lack of state capacity, which led to the failure of the input of the public fund. After all, while the internal autonomy of the state increased with the input of the public fund, this in itself cannot be regarded as meaning that the input of the public fund was successful. Thus, the increase of state autonomy that was not based on state capacity ended up in policy failure. It did not influence any change in the character of the state, and the role of the state was also not reinforced.

Furthermore, as shown in Chapter 7, the financial supervision system was changed with the provision of the public fund, assuming that the weakened 'supervisory regulation capacity' had been the reason for the weakened state capacity. Thus, the financial supervision system was restructured as a method to strengthen the state's capacity for supervisory regulation of the financial market, and the state planned to reinforce the state's overall capacity in the process. However, as such reform was done based on the demands of the IMF and the beliefs of the neo-liberalistic bureaucrats, financial supervision institutions that were 'too independent' were established and it was hard to achieve a more ‘thorough regulation’ of market opening and liberalization. It can be seen that the reform, which did not consider the relationship between financial institutions, companies and bureaucrats, as well as the special situation of Korea, resulted in a greater weakening of the state’s capacity. After all, the plan of the state to reinforce the state capacity according to the neo-liberalistic paradigm accelerated the shift to a more ‘neo-liberalistic regulatory state.’

So, as seen in various case studies, the role of the state tended to be minimized in the process of overcoming the financial crisis, when it should have been emphasized and reinforced. The role of the state was more important in retrieving the public fund than putting it in the insolvent financial institutions, but the public fund was not sufficiently retrieved. The restructuring of the financial supervision system was finally done with the aim of minimizing the intervention of the state, and the bureaucrats could not give trust to citizens by their wrong behaviours. ‘State autonomy,’ ‘state capacity,’ ‘internal cohesiveness,’ ‘embedded autonomy,’ and ‘bureaucratic rationality’ had all been weakened compared to the period before the financial crisis, degrading the status of the state from a market regulator to one of the economic units playing in the market.

I am not saying that the Korean developmental state should have aimed at the form of an ‘intermediate state (soft developmental state)’ mentioned by Peter Evans (Evans 1995: 60-70) or that it should have refrained from shifting into a ‘regulatory state.’ However, if we examine the causes of the financial crisis and review the case studies conducted so far on the new type or role of the state pursued by Korea in the process of overcoming the financial crisis, it becomes clear that the plan of the state was not to quickly shift into a ‘neo-liberalistic regulatory state.’ However, as has been examined in many case studies, the plan of the state was not accomplished, and the role of the state was minimized naturally.

(2) Linkage

The basic analysis that has been performed so far showed the failure of many policy and structural reforms that were carried out after the financial crisis to show that the reform policies the state of Korea attempted as a way of overcoming the 1997 financial crisis could not succeed to accomplish the plan of restoring the characteristics of developmental state and therefore reestablishing the role of the state. Rather, Korea seemed to have experienced a quick transition into a "neo-liberal regulatory state." In other words, three case studies all reached the same conclusion. So, do those studies have any linkage? The linkage found in the basic analysis might provide the answer to the following question: "How far the NPM reforms in the Korean bureaucracy had an impact on the public fund management and the financial supervision implementation/policy choice?"

The reform policies that were the biggest external issues since the 1997 financial crisis were the stabilization of the financial market by injecting the public fund and the strengthening of the supervisory function over the financial market by the restructuring of financial supervision system. Therefore, this thesis examined these two policies. Also, the researcher found that the state of Korea had the plan of strengthening the characteristics of a developmental state, which are 'state autonomy' and 'state capacity,' as these had been weakening even before the financial crisis through those two policies. However, as mentioned above, those policies could not succeed. Therefore, the fundamental reason for the failure was thought to be a weakening of other important characteristics of the developmental state within the organization that was leading those two policies, including 'internal cohesiveness', 'bureaucratic rationality', and 'embedded autonomy,' and thus the Korean bureaucracy was firstly examined. As a result, it was found that Korea's bureaucracy carried out NPM reform, and the characteristics of the developmental state, which had become compromised by the reform, could not be restored.

Ultimately, it can be said that the connecting point at which the results of each individual empirical analysis are connected into one can be found from the change of Korean Bureaucracy because of the following reasons. First, the largest reason why the policy of the public fund was evaluated as unsuccessful was because the public fund management committee, which was in charge of managing the injection and withdrawal of the public fund, failed to overcome the problem of low bureaucratic cohesiveness. However, chapter 5 revealed that the reason for the weakening internal cohesiveness among bureaucratic organizations was the "NPM reform" implemented after 1997, showing that the change of Korean Bureaucracy can be seen as one of the reasons for the failure of the public fund policy.

Second, chapter 7 concluded that the largest reason why reorganization of the financial supervisory system after 1997 is evaluated as unsuccessful is because it was implemented based on the standards and principles of neo-liberalism in accordance with the IMF's request to strengthen the weakened supervisory function. In addition, chapter 5 shows that the change of Korean bureaucracy can be connected to the fundamental factor of the failure of financial supervisory system reorganization by discussing how economic officials consisting of the financial advisory system largely lost 'bureaucratic rationality' and 'embedded autonomy' because of the NPM reform.

In short, such connecting points show that the change in Korea's bureaucracy was the most important factor in the failure of the financial reforms implemented after the 1997 financial crisis. The reason for the failure of the many policies implemented by the state of Korea after the financial crisis to recover the characteristics of the developmental state can be found in the Korean bureaucracy, which didn't have the characteristics of a developmental state. In particular, as the ratio of the officials who believed in the 'neo-liberal' paradigm had increased (Korea Economic Daily 1994: 21), the officials no longer placed the public interest ahead of private interests, as they did in the past. Therefore, it can be inferred that the change of bureaucracy played a very important role in the transformation of the state of Korea. In other words, the change of bureaucracy was one of the major factors that sped up Korea's transition into a 'post developmental state' that had been underway even before the financial crisis.

(3) In-Depth Analyses

The in-depth analyses below are based on the basic analysis, and it is meaningful to examine how the variables that shifted the state of Korea in the direction of a 'post-developmental state' before the financial crisis influenced the change in the character and the role of the state during the process of overcoming the financial crisis with the results shown in chapters 5, 6 and 7. In short, it will more precisely analyse the situation in which the plan of the state to prevent the shift into a 'neo-liberalistic regulatory state' did not succeed as analysed so far.

- **Internal disturbances of state bureaucracy and Changes of Ruling Coalition**

If the mechanism of "intervention for development and regulation of intervention" of the developmental state system could no longer operate due to globalization and the increased economic volume, a new institution of any kind should have been prepared. It can be considered that the economic crisis in 1997 occurred as a result of the attempt to combine the existing institution with financial liberalization and financial opening, without attempting to make a new institution. Thus, it was natural for the restructuring and reform after the foreign exchange crisis to aim beyond the limitations and problems of the existing state system. However, the results in chapters 5, 6, and 7 show that they did not overcome the limitations in a situation in which the internal divisions of the old ruling system involving *Chaebol*, finance, and bureaucrats was not resolved. In addition, while a new institution was actively introduced in the process of reform and restructuring after the foreign exchange crisis, it does not seem that the ability to establish and manage the institution was greatly increased.

The vested interests centring around the bureaucrats of the old system did not oppose the introduction of an institution based on neo-liberalism and the global standard, and did not hesitate to introduce various institutions related to the social safety net and social welfare. However, as seen in chapters 6 and 7, it can be considered that they placed a greater emphasis on liberalistic restructuring and reform. Originally, the aim of liberalistic reform is to realize the principle of 'democratic accountability,' and it also means that corporate and financial reform should enforce accountability, mutual monitoring, and the democratic principle for the core agents that operated the Korean economy. However, this principle was not observed well in reality, as seen in chapters 5, 6, and 7, as the division in the ruling coalition was not resolved and the internal cohesiveness disappeared.

The establishment of a related financial system that prevents opportunism and improves effectiveness in resource distribution through economic intervention, supervision, and checks by bureaucrats based on the laws and institutions was the main task of the reform that was implemented after the financial crisis. It can be considered that the direction of the shift of the state of Korea was decided with the belief that a thorough plan to react to the neo-liberalistic market opening can be prepared when such a reform is carried out faithfully. In other words, an attempt was made to achieve a shift to a state that could restrict neo-liberalism, rather than neo-liberalism restricting the state.

However, there are many examples in chapters 6 and 7 that show the voice of neo-liberalistic bureaucrats increased greatly in the bureaucratic organizations of the state after the financial crisis, and took initiatives in the decision-making process. Having experienced these processes many times, the neo-liberalistic bureaucrats took an amount of hegemonic control sufficient to transform the character of the state system completely. Thus, though many economic issues that needed strong intervention by the state continued to occur during the process of overcoming the financial crisis, the issues could not escape from the neo-liberalistic hegemony in the process.

So the internal division of the new ruling coalition or the bureaucrats was not resolved even after the financial crisis, and the neo-liberalistic bureaucrats ascended to a position of controlling the state system. After all, as such phenomena led to a policy combination that achieved a shift of the state in the direction of 'neo-liberalism,' it is analysed that the plan of the state to prevent a quick shift into a 'neo-liberalistic regulatory state' did not succeed.

• Political and Social Analysis (The state-civil society relation)

Any economic 'reform' policy will be influenced by political conditions (Haggard and Kaufman 1995: 151-154; 309-312). The shift of the essential nature of developmentalism into an open-door policy began to be visualized after the ascendance of the Chun Doo-Hwan regime in 1980. But paradoxically, the political illegitimacy of that government made it difficult to accelerate the policy of economic opening, because the open-door policy itself triggered changes in the domestic political and social relationship, which had been adjusting to the existing protective structure, and provoked resistance in various sectors of society. In this respect, a regime with weak political legitimacy usually slows down the implementation of an economic opening policy, or must take a detour due to political considerations. On the other hand, the Kim Dae-Jung government which began after the financial crisis in 1997 implemented a higher level of the policy of 'open development' and market-oriented development based on its political legitimacy and the demands of the IMF, which was virtually managing the Korean economy, resulting in privatization, market opening, and expansion of foreign investment. This is why some people say that 'Almighty Foreign Capital' and 'Almighty Privatization' captured the Kim Dae-Jung government, and complain that the government leaned toward so-called 'subordinate neo-liberalism.'

With its character of a government led by the former opposition party, the Kim Dae-Jung government could have shifted the direction of the change of the state, and implemented policy change. Actually, as we can see in chapters 5, 6, and 7, Korea attempted to slow down the speed of its shift to a 'post-developmental state' or adjust the direction by recovering the attributes of a developmental state through reforms to the financial system after the financial crisis. But it is a paradox that the government of the party that had been in opposition for 50 years intensified the nation's shift to a 'post-developmental state' which had begun with previous governments due to the imperfect policy of the Kim Dae-Jung government and the external restrictions imposed by the "IMF Crisis." In fact, during the Kim Dae-Jung government, many banks and state-owned companies were privatized, the market was widely opened in the process of privatization so that foreign capital could exercise controlling power, and the capital market and stock market were dramatically opened in the name of overcoming the foreign exchange crisis.

It is very interesting that the Kim Dae-Jung government, which was regarded as 'progressive,' took a more open policy than any other country in East Asia and 'faithfully' followed the policies recommended by the IMF in the foreign exchange crisis. This could have been due to various factors working complexly together, including Korea's prevalent pro-American consciousness due to its strong tradition of anti-communism, the narrow ideological terrain where the 'demand for re-negotiation' for the conditions of IMF for the relief loan was decried as anti-national, the social movement which agrees to developmentalism, and the political topography in which a post-nationalistic opposition party exists that demands a more faithful compliance with the IMF policy.

However, despite the difficulty of such conditions, it is also clear that the Kim Dae-Jung government tried to slow down the shift to a 'post-developmental state' which had proceeded quickly up to that point by emphasizing the role of the state as a 'strategic' choice of the state. In fact, in relation to the reasons for the 'IMF Crisis' (the financial crisis in 1997), the failure of the state, government, and bureaucrats should have been made an issue together with market failure and the moral hazard of *Chaebol*. However, the 'timely' transfer of power marginalized this failure of the state, government, and bureaucrats and brought the market failure and the moral hazard of *Chaebol* into relief, and as a result, the reform of the market, *Chaebol* and the economy became the main issue in the process of reform that followed. So, while the previous intervention of the state was expressed by the trade-off between favourable support and creation of performance, it was expressed by reform-oriented intervention for the reform of the market and *Chaebol* during the process of overcoming the financial crisis. Of course, this strengthening of the role of the state did not pursue forceful integration, as it had in the past. This was because the cohesiveness of the ruling bloc of the past had been broken, and a strong level of heterogeneity and differences in opinions existed among various sectors within the ruling bloc. In that sense, we can notice a tendency to emphasize the role of the state in the relationship with the market-oriented society, presupposing a diversified ruling bloc.

In addition, the discussion on the role of the state, which was relatively neglected between the resignation of the authoritarian regime in 1987 and the appearance of the Kim Dae-Jung government in 1997, began to intensify while Korea overcame the foreign exchange crisis and continued through the government of the former opposition party, which had political legitimacy. The economic crisis and the appearance of a government of the former opposition party which had political legitimacy brought about a perception of the role of a state that could lead the reform of a distorted market and restore the initiative of the state which had weakened due to the criticism of the state-led economy of the past.

The combination of this open and market-oriented developmentalism with nationalism is seen in the various policies that were implemented while overcoming the financial crisis, especially in the reform of the financial sector. As shown in chapters 5, 6, and 7, the method that was applied to overcome the crisis was to follow the neo-liberalistic methodology while emphasizing the role of the state in the process. However, this combination was a contradictory policy from the beginning, an inconsistency that showed that the decision-making process depended not on economic rationality but on political (ir-) rationality, and the state's capacity to take the economic lead was in fact seriously deteriorating. In addition, implementing various keynote policies simultaneously meant the potential of failure, and ultimately resulted in the erosion of the state's autonomy and its capacity. Furthermore, the relationship between the state and civil society became more complicated given the combination of contradictory policies, and the resistance from various sectors of society increased. This situation in the state and civil society served as an element that weakened the internal autonomy and capacity of the state after the financial crisis, and it can be analysed that the state ultimately did not succeed its plan.

• **Economic Analysis (the state-capital relation or the state-world system relation)**

① **The state-world system relation and the state-capital relation**

Korea could be characterized as an ‘exportist regime of accumulation,’ which was a typical regime of accumulation for East Asian nations (Sum 1998: 42-43). It can be analysed that the ‘developmental state’ in Korea meant a pattern of adjustment by intervening with the overall aspects of the society to maximize the input of production factors necessary for Mercantilist accumulation activities. To compare it with Fordism, which has the basic characteristic of stable circulation between production and reproduction, the exportist regime of accumulation is an unstable and incomplete regime of accumulation[102], and as such the developmental state which adjusts it is an unstable and incomplete system that lacks the hegemony to modulate the reproduction of the national economy and the relationship between classes entirely (Cho Myung-Rae 1999:24-27). In addition, while the process of adjusting the exportist regime of accumulation is basically made by the coalition between the ‘capital’ that is in charge of export and the ‘nation’ that controls accumulation activities socially, it is led by adjustment, which is the exclusive role of the state, which newly forms and develops production power and production relations(Ibid.).

It is considered that the development state of Korea underwent two important changes through the financial crisis. Firstly, the crisis occurred in the circulatory domain, which includes financial capital, and Korean capitalism was combined with global capitalism (the process of global capital circulation) more closely (Cho Myung-Rae 2000b: 123-125). Being combined with the global capitalism system, which has the mechanism of finance, the service sector, and the logic of market competition which restricts value realization, it can be analysed that the Korean capitalism experienced a reperipheralization which strengthened its identity as a state with low wages, price competition, and labour control. Secondly, being forced to play such a role, the developmental state, which had led the overall development of society by maximizing the input of production factors, shifted its role to one of readjusting the accumulation activities according

[102] The characteristic of the ‘exportist regime of accumulation’ is a separated accumulation process in which the value production of core products is done by a trans-border network of division of labor and much of the value realization is done by the circulating sector of advanced nations.

to competition and market logic (Lee Yeon-Ho 1999: 45). This change in role was primarily due to the pressure of international organizations like the IMF, but secondarily, the Korean government voluntarily and drastically restructured its industrial structure or economic structure, which had been protected by the government, in order to overcome the crisis by complying with ‘market principles.’ In other words, the management of the state after the crisis presupposed giving up and changing the role of the developmental state, which was one factor of the crisis, and thus the change of the developmental state was thought to be essential.

This shift in the role of the state was accompanied by significant changes in two areas. Firstly, being restructured as a sub-global regime of accumulation, which took charge of a part of the global accumulation activities (globally integrated production-consumption network), the exportist regime of accumulation was combined with the accumulation process of other economic blocs more organically (Cho Myung-Rae 2000a: 22-25). As a result, the development state’s role of adjusting the national economy shrunk from intervening in the entire industrial production process (agriculture, manufacturing, financial service, labour activity, etc.) to concentrating on selective sectors such as the knowledge-based industry, venture industry, financial industry, and innovative technology sectors, and the purpose of adjustment changed from realizing the ‘national interest’ to supporting the competitiveness of private entities. Secondly, the change in the pattern of adjustment resulted in the rearrangement of the relationship among the forces surrounding it. The principal agents invited to the ‘post-IMF governance’ were not capital, labour or the state but the main agents participating in the market, such as financial decision-makers, stock investors, decision-makers in the financial sector, venture capitalists, and civic organizations (which monitored market participators) (Kang Min and Kim Ok-Kyung 2000: 54-57). While the relationship between the forces under the developmental state was based on the coalition and competition of classes, it changed after the crisis to be based on strategic coalition and competition among individual agents.

Thus, it can be analysed that after the IMF crisis Korea significantly lost its previous role as a developmental state and took on a new role of a sub-adjustor in the global regime of accumulation, which competitively supported and catalysed the accumulation activities in certain sectors (direct production sectors) in the accelerating global flow of capital with financial capital.

② **The state-finance relation**

It can be evaluated that the financial system was one of the main reasons for the economic crisis. As such, it was quite natural that the reform of the financial system was one of the core objects of restructuring after the crisis. The main content of the reform of the financial sector was conversion into a financial system that can adjust to market competition by merging the banks whose management could not be normalized or rationalized due to high amounts of bad loans. The reform of the financial sector was very important because the fair rules of the market cannot be applied to the whole macro economy if the financial system is not friendly to the market as the adjustor of the macro economy. Thus, as we can see in Chapter 6, the Kim Dae-Jung government spent huge amounts of public funds in coping with insolvent finance companies and creating a market-friendly financial system after the financial crisis, and was also deeply involved with reforming the ownership structure and management structure. In addition, as shown in Chapter 6, an attempt was made to strengthen the financial supervision function of the state in order to improve the transparency and competition of the banks.

As far as intervention is concerned, it can be evaluated that the reform of the financial sector by the Kim Dae-Jung government after the crisis was not much different from previous interventions by the developmental state in the financial sector. However, the intervention was different from that of the developmental state in that it was done through political coordination and control rather than compelling market principles and transparency of management. First of all, the restructuring of the financial sector was an important condition of the IMF. This condition was intended to open and standardize the general structure of the financial industry so that international financial capital could be transferred into the financial industry of Korea. Meanwhile, the Korean government judged that the financial system could not support transparency and rationalization in the real sector due to the excessive debts in the financial sector and the anti-market management system of the financial sector that could not be sustained. Based on this judgment, the government tried to create a global level market-friendly financial system by putting in a huge amount of public funds in order to eliminate the bad management structure through write-off of debts and actively pushing forward mergers of the main banks as well as purchasing and mergers by foreign financial institutions. Thus, it can be analysed that the financial reform implemented during the Kim Dae-Jung government aimed at strengthening the financial sector's capacity for autonomous management and control of the real economy by promoting the transparency of the financial market and the rationalization of the financial industry instead of pursuing a direct intervention in the financial sector like a developmental state.

As shown in chapters 6 and 7, the state put its strongest emphasis on introducing the principle of market competition and transparent management when it reformed the financial sector after the financial crisis, and its ultimate goal was to make it possible for the financial sector to regulate the industrial sector, which had been done by the state in the past. In other words, it was widely recognized that unlike the economy of the developmental state, the economy of that time that was globally opened after the crisis should be adjusted autonomously by the market of financial capital rather than through the political control of the state. In this respect, it can be analysed that the financial reform implemented by the Korean government after the financial crisis aimed at changing the economic intervention, especially the intervention with the real economy (industrial capital), by the developmental state into the control of the financial capital or a market controlled by financial capital. In this respect, it can be said that the macro-economic control of the Kim Dae-Jung government was replaced by the market, which is an important characteristic of neo-liberalistic control.

As shown in analyses ① and ②, the role of the Korean state in the financial market was naturally minimized in the process of overcoming the financial crisis, and the portion of the state in the world system was minimized, too. In addition, the financial market was further opened in the process of overcoming the financial crisis, and the status of the state was reduced to that of an agent that only took charge of neo-liberalistic control. Moreover, the opened market made the state a mere player in the world market within the global system. This situation weakened the 'state's capacity to regulate the market' and eroded the 'state's autonomy to address market failure through intervention in the market'. In such a situation, the state's goal of preventing Korea from shifting to an overly 'neo-liberalistic regulatory state' by recovering the 'state capacity' and 'state autonomy' which had already been significantly eroded before the financial crisis did not succeed, and the role of the state was minimized naturally.

8.3.3. Summary

To sum up the discussion so far, the change in the character of the state of Korea after the crisis can be summarized as a significant tendency to escape and deviate more from its character as a developmental state (compared to before the crisis). By the tendency in the change of the characteristic of the state, it can be analysed that the state of Korea has been moving toward the type and character of a 'neo-liberalistic post-developmental state' following the crisis. The following are the characteristics of the neo-liberalistic post-developmental state that appeared after the financial crisis in Korea, which are described in chapters 5, 6, and 7 and also in my analyses so far.

Firstly, the neo-liberalistic post-developmental state aims to improve the welfare of its citizens not by distributing production factors for quantitative growth and development or by maintaining the relationship of social classes, as Korea has done in the past, but by improving the efficiency of the whole social system so that the national economy can increase the country's international competitiveness in the era of market opening.

Secondly, the pattern of adjustment follows the so-called neo-liberalistic tendency, as the role of the state emphasizes respecting and realizing market function and the principle of competition. The developmental state of the past also respected the market order, but its type of intervention was based on an anti-market approach or direct intervention to 'form the market order' itself. In contrast, the 'neo-liberalistic post-developmental state' depends on market competition or indirect intervention to 'activate market function'.

Thirdly, though the prevailing ideology of Korea as a neo-liberalistic post-developmental state is one of neo-liberalism, the market order and market function are maintained by a certain degree of state intervention, unlike the neo-liberalism of some Western countries, which depends on market autonomy. As the market order and market function are maintained not by the autonomous adjustment of the market itself but by the media of the intervention and adjustment of the state, it can be said that the neo-liberalism of the post-developmental state is not the same as British-American neoliberalism. The reason why the market is regulated by the state in the principle of market is that the trust of the market is incomplete and it is thought that the market itself is not ready to play a fair game. In this respect, the 'neo-liberalistic post-developmental state' is thought to be similar to the so-called 'regulatory state,' which regulates the rules and order of the market.

Fourthly, the maintenance of the order and standard of the market by the media of state intervention ultimately aims at improving the competitiveness of the export economy in the global economy. As it presupposes market competitiveness, the adjustment of the 'neo-liberalistic post-developmental state' has an element of 'adjustment of the market' and 'adjustment for the market'. While the former is a heritage of the developmental state, the latter is a reflection of the tendency of moving to an adjustment system by the market itself, escaping from the heritage of the developmental state. In this respect, the neo-liberalistic state in Korea seems different from the regulatory state, which is a type of neo-liberalistic state in the West. That is, the tendency of the neo-liberalistic state in Korea is one of a middle and transitional state that is using market adjustment on the basis of nationalism (interventionism).

The neo-liberalistic post-developmental state means that the state has a weakened or shrunken role, but at the same time fulfils another role of actively adjusting the production and distribution of its products in the era of global competition. While the former presupposes the shrinkage of the role of the state through reinforced 'Globalization,' the latter presupposes the resurrection of nationalism, which reinforces the role of the state as 'market manager' or 'competition facilitator' for the maintenance of the global competition system (Jessop 2002: 460-464). Though Korea after the crisis appears to be shifting to become a 'regulatory state' or to adopt a 'type of globalism,' the questions of this thesis remain open.

8.4. Concluding Remark

In order to answer the main questions of this thesis - How has the Korean developmental state changed since the financial crisis? And how has this change influenced the role of the state in finance as well as the structure of the state bureaucracy? – this chapter mainly carried out a basic analysis based only on the results of chapters 5, 6, and 7, as well as a more detailed in-depth analysis based on the basic analysis.

The developmental state in Korea had been changing even before the financial crisis in 1997, in the direction of a shift to a 'post-developmental state.' However, as we can see by the fact that the change of the Korean development state cannot be explained by the concept of the 'regulatory state,' the direction of the 'post-developmental state' can be explained based on the premise that the characteristics that the 'state capacity' and 'state autonomy,' which had been evaluated as positive elements of the Korean developmental state, were weakening; the weakened 'internal cohesiveness' and 'embedded autonomy' among the sectors existed in the fundamental background; and the 'bureaucratic rationality' of bureaucrats was diminishing. The financial crisis occurred during this change, and thus the recovery process[103] can be described as a process of recovering the various positive attributes of the developmental state. In other words, the 'bureaucracy reform' and the 'financial reform' that were implemented in Korea mainly to overcome the financial crisis was ultimately a process of recovering the positive attributes of the developmental state.

However, as suggested in the basis analysis in this chapter, the 'changes of Korean bureaucracy could not satisfy the plan of the state and the results of the 'input of the public fund' and the 'reform of the financial supervision system' did not meet the purpose of the state as well. . That is, the state's efforts to strengthen its own role by recovering the attributes of the developmental state in the process of overcoming the financial crisis did not succeed, and the role of the state tended to be minimized. Korean bureaucracy was changed with the form of 'NPM' in the direction of minimizing the role of the state. Although the role of the state was more important in retrieving the public fund than in putting it in, the public fund was not retrieved well. And, the restructuring of the financial supervision system was eventually done in the direction of minimizing the intervention of the state. Additionally, all the results of case studies can be linked by the facts that the Korean state had not a DS bureaucratic structure so the state couldn't not only manage neo-liberal policies but also shape the content of policies. 'State autonomy,' 'state capacity,' 'internal cohesiveness' 'embedded autonomy,' and 'bureaucratic rationality' all were weakened compared to the period before the financial crisis, degrading the status of the state from one of a market regulator to one of the economic units playing in the market.

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[103] There was a general recognition that the Kim Dae-Jung government, which came to power just after the foreign exchange crisis in 1997, would aim at a 'neo-liberalistic reform.' However, according to my studies, they made effort to restore the political and institutional leading abilities of governmental organization.

According to the in-depth analysis, which considers such results in greater detail, the elements that had accelerated the shift to a ‘post-developmental state’ before the financial crisis had a much stronger influence on the direction after the financial crisis, and ultimately became a decisive factor in changing Korea into a ‘neo-liberalistic post-developmental state,’ which was strongly tending toward a ‘neo-liberalistic regulatory state.’ Above all, the internal division of the new ruling coalition or the bureaucrats did not improve in the process of overcoming the financial crisis, and the neo-liberalistic bureaucrats ascended to a position of controlling the state system. Ultimately, as such phenomena became a policy combination that shifted the state in the direction of ‘neo-liberalism,’ it is considered that the state’s goal of preventing a quick shift to a ‘neo-liberalistic regulatory state’ was not achieved. In addition, the dynamics and mutual response between the state and the (civic) society, the state and the global system, and the state and finance in the process of overcoming the financial crisis did not serve to recover the ‘state capacity’ and ‘state autonomy,’ which had already been greatly eroded before the financial crisis, and instead accelerated the shift to a ‘neo-liberalistic regulatory state’. Thus, it is analysed that the state’s plan of restoring the elements of the developmental state to some degree did not succeed.

Ultimately, the analysis in this chapter reaches the conclusion that during the process of overcoming the financial crisis, the developmental state of Korea did not ‘complement and correct’ the process of changing into a ‘post-developmental state,’ which had begun before the financial crisis, but shifted to an accelerated path toward becoming a ‘neo-liberalistic regulatory state,’ and in this process of change the role of the state was naturally minimized.

Chapter 9
CONCLUSION

The main purpose of this chapter is to 1) summarize the results of the research thus far, 2) mention its significance and limitations, and finally 3) add finishing touch to this thesis by describing the researcher's thoughts on the 'role of neo-liberalism and the state' and 'government control' in Korean society.

9.1. Summary of Research Results

Thus far, I have conducted studies on the shift of the developmental state in Korea that occurred after the financial crisis in 1997, and its influence on the role of the state. The first conclusion of this study was that during the process of overcoming the financial crisis, the developmental state of Korea did not 'complement and correct' the process of changing into a 'post-developmental state,' which had begun before the financial crisis, but shifted to an accelerated path toward becoming a 'neo-liberalistic regulatory state.' To reach such a conclusion, this thesis traced the evolution of the Korean developmental state before the financial crisis in 1997, and also verified the plan of the state to prevent a quick shift into a 'neo-liberalistic regulatory state' by recovering the 'eroded the attributes of the developmental state' through empirical study of the 'Korean bureaucracy', as well as reform of the 'financial supervision system' and the 'public fund.' In the process of such examination, this research was able to reach its second conclusion, which is that the role of the state was naturally minimized. In reforming the financial system after the financial crisis in 1997 – through improvement of the financial structure with 'the public fund' and the establishment of financial supervisory systems such as 'Financial Supervisory Commission' and 'Financial Supervisory Service' – the state had a hidden aim of reinforcing the role of the state. However, the analysis in this thesis shows that this hidden plan of the state failed, and supports the conclusion that the role of the state was naturally minimized.

In Chapter 4, it was shown that the differentiation in policy orientation, industrial structure, and class structure created by the economic growth during the development age in Korea acted as a major limiting factor that affected particular results and defined the reorganization path when the Korean developmental state entered into a phase of crisis and transition after the 1980s, despite the condition that enabled the country to secure strong state autonomy and state capacity during the formative years of the Korean developmental state. Chapter 4 also revealed that with such limiting factor, the Korean state could not play the proper role, which became the major factor of Korea's transition to the post-developmental state - political retreat and systematic retreat of the developmental state and the strengthening of chaebols' and private actors' leadership of the economy. In other words, it was found that the Korean developmental state aimed to provide a soft landing of the growth system of the developmental state by securing a reason for indirect intervention to supplement and correct the strengthening market-oriented economic management and policy means. However, it was found that the structural legacy of the economic growth in the development age and the Korean characteristics shown in the development process of the developmental state were more favourable to a retreat of the state than to the survival of the developmental state. Above all, chapter 4 found that as the economic policy of the state faced a backlash and resistance from chaebols and social forces and was damaged and neutralized, the political and systematic capacity of the state that had led economic growth declined, enabling us to identify the factors of the transformation of the Korean state into the post-developmental state.

In Chapter 5, the change in the bureaucracy that was playing the most important role in the formation and growth of the Korean developmental state was investigated, in order to examine which direction the Korean developmental state has changed and whether such changes were originally intended by the Korean state. Examine. In the process, it was found that Korean bureaucracy was already undergoing fragmentation, policy conflicts, and a contradictory process of trial and error even before the 1997 financial crisis. Accordingly, the state bureaucracy lost cohesiveness, and its control over the market did not function properly. In other words, chapter 5 showed that conflict between new economic officials who returned to Korea after studying in the United States and the old officials that adhered to the state-led growth strategy weakened the internal cohesiveness of bureaucracy, and as a result the control over the market and chaebol were also lost. However, what is even more important is that this chapter found that the 'new public management reform (NPM reform) of Korean bureaucracy that was carried out after the 1997 financial crisis further weakened the function of bureaucracy, which was the most important frame of the developmental state. In other words, it was shown in chapter 5 that NPM reform of bureaucracy represented by introduction of the team system, position classification system and performance evaluation system failed to accomplish the original plan of the state, which was to strengthen the internal cohesion of bureaucracy and control over the market, and rather caused problems that weakened the functions of Korean bureaucracy: 1) expansion of some bureaucratic departments further weakened the internal cohesiveness after the reform, 2) as the bureaucrats were more affected by the political power, embedded autonomy was also weakened, 3) as the bureaucrats were facing an identity crisis, 'bureaucratic rationality' could not be found, accordingly, providing the cause for weakening confidence in the government. Eventually, chapter 5 revealed that the effort to recover the most important characteristics of the developmental state, 'strong, effective, efficient, and cohesive bureaucracy with embedded autonomy (Evans 1995: 43-54)' or 'coherent, meritocratic bureaucracy with embedded autonomy (Sonn 1998a: 158)' through NPM reform failed. Further, a tentative conclusion was reached that the state bureaucracy, which had to lead all the reforms but was in fact unstable, might be the most fundamental factor of the failure of financial reform as described in the chapters 6 and 7.

In Chapter 6 it was shown that after the 1997 financial crisis the Korean state was able to secure control over financial resources as developmental states did in the past, and through this it strengthened the control over industrial resources while increasing the internal autonomy of the ruling class. Meanwhile, it was also discussed that despite such heightened internal autonomy after the 1997 financial crisis, the Korean state experienced the policy failure of inefficient operation of the public fund because of a lack of capacity. This chapter identified two reasons for the policy failure: the first reason, revealed through identifying the internal problems, was that cohesion was lacking and assignment of power among the policy institutions related to the public fund was not done properly. The other reason, which was identified through studying the external problems, was a lack of capacity to supervise and discipline companies that received the public fund. In other words, this chapter clearly showed that the change in the external environment through the foreign exchange crisis became an opportunity to heighten the internal autonomy of the state and at the same time showed that if internal and external capacity to effectively exercise the autonomy is not secured, it can be a factor for crisis that will erode the maximized autonomy because of the external environmental change. The conclusion reached in chapter 6 is that the state's plan to re-establish an appropriate role for itself by restoring the characteristics of developmental state (strengthening of the state autonomy and capacity) through injecting the public fund was a failure.

Chapter 7 examined the direction of the reorganization of the financial supervision system and whether the reorganization has been flowing in a direction that is compatible with the plans pursued by the Korean state. As a result, it was found that the reorganization of the financial supervision system after 1997 was implemented in a direction that accepted the norms and principles of neo-liberalism, and it shows a changing process of an aspect different from what was originally planned by the Korean state. In this process, problems of the reorganized financial supervision system were revealed. First, the reorganization didn't focus on strengthening the function of financial supervision to place an excessive emphasis on 'independence.' Second, after the reorganization, too many supervisory organizations sprang up, causing problems such as policy confusion, policy duplication, unclear locus of responsibility, and increasing corruption of supervisory institutions. Finally, registration to prevent new cosy relations between financial supervisory institutions and financial institutions was not even included in the discussion about financial supervisory reorganization. After all, it was found that reorganization was carried out without clear role sharing, and resulted in a structure where there were only conflicts of interest. Also, it was found that the capacity to mediate the attitudes of each actor was nowhere to be found. In the end, the divided financial supervisory bodies only emphasized their independence from each other, creating a structure in which macro financial supervision did not work well and thus failed to achieve the original plan of strengthening the state's supervisory regulatory power. In conclusion, it was shown also in chapter 6 that the plan of the state to re-establish its proper role by recovering the characteristics of the developmental state through financial supervisory system reform – strengthening the state's supervisory regulatory power – failed.

Chapter 8 summarized the empirical analysis that has been carried out thus far, and connected the most important factor of the failure of attempts to strengthen the supervisory function over financial market through financial market stabilization and financial supervisory system reform by injecting the public fund, which is the most representative reform policy after the financial crisis to the change of bureaucracy. Through the analysis, the change of bureaucracy was found to be one of the most important factors that sped up Korea's transition into a 'post-developmental state' that it had been undergoing even before the financial crisis. In addition, it was found that many variables influenced Korea's transition from a developmental state into a 'post developmental state' even before the 1997 financial crisis, such as internal conflicts of the state bureaucracy, changes of the ruling coalition, the state-civil society relation, the state-world system relation, the state-capital relation, and the state-finance relation, and these also worked to speed up the transition, and therefore the fact that the state of Korea was changed into a state with stronger 'neo-liberal' characteristics than before the financial crisis was highlighted. The researcher of this thesis named it a 'neo-liberal post-developmental state'.

Accordingly, this study shows that the state of Korea is changing into a 'neo-liberalistic post-developmental state[104]' that is on an accelerated path toward becoming a 'neo-liberalistic regulatory state[105],' and as a result the role of the state is being minimized naturally. This may not be 100% accurate, but what is clear is that such a situation is in progress, to the extent that it can at the very least be considered as a 'tendency'. This thesis attempted to consider this tendency based on the concept of 'recovery of the attributes of the developmental state,' and traced the 'process of change of the developmental state' through empirical research.

In examining the shift of the developmental state in Korea after the financial crisis and the ensuing changes in the role of the state, it should be stated clearly that the research results of this thesis do not contain normative judgment. Though in reality the policies and strategies of the state are selected and implemented based on the strategic judgment of the state organization or social behaviours, whether they proceed and achieve the originally expected results is a matter of another dimension, because the selection and implementation of strategies or policies may be restricted or facilitated by the structural situation and international context of the society. Therefore, while it is possible to make a normative judgment on the appropriateness and validity of the 'selection of a certain policy or strategy,' I certainly think I cannot make a normative judgment on 'the process or results of the choice of such a policy or strategy.' As mentioned earlier, the counterstrategy of the state of Korea after the financial crisis was to restore the political and institutional leading abilities of government by recovering the attributes of the

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[104] It can be defined as the state of which attributes of the developmental state still remains in, although many of the neo-liberal elements are introduced into the market operation.

[105] It can be defined as the state of which attributes of the developmental state are completely destroyed, by introducing neo-liberal elements in the whole economy and society.

developmental state while complying with the demands of the IMF. However, in the case of Korea, this strategy was weakened or incapacitated due to the domestic and international political and economic conditions and structural restrictions that were unfavourable to the state. Therefore, such results indicate that the focus should be on an analysis of the socio-structural conditions that restricted or facilitated the strategic choice of the state rather than on the 'normative judgment' about the choice.

The model of a developmental state in Korea is a historical product formed by the state's unique domestic and international political situation. That is, the growth method of the developmental state was not merely enabled by the choice of the supreme power of the state of a couple of institutional apparatuses, but was the result of the complex dynamics and mutual interactions of social behaviours. The change of the developmental state or the ensuing change in the role of the state should be understood in the same context. It is a dynamic politico-economic process, and furthermore, is a process of change that is framed by fierce conflict and competition among the state, society, and the global system.

9.2. The significance and limitations of this thesis

In the area of developmental economics and theories on economic development, there are vast and diverse theoretical and empirical studies on the economic growth of Korea. However, most of them are concentrated on the initial industrialization stage and the development age, when the country's rapid economic growth was at its peak, and thus cannot present clear answers regarding the present position of Korean developmental state and its future direction.

This study paid attention to the process of change of the state of Korea after the financial crisis in 1997 and the changed role of the state, which have not been researched systematically, and presented my own interpretation of these as an opportunity to examine theories on the growth of East Asia, developmental economics, and comparative political economics, in order to make further progress both theoretically and empirically. In addition, this thesis intended to prove that in the real world, the way of economic growth, path of development, and the situation of overcoming a crisis are reproduced in many types by the structural and behavioural elements of the society concerned, with continuous change and reformation. The opinions that are discussed in this research still have many theoretical and empirical limitations, and must be re-examined and complemented continuously through additional studies in the future. Nevertheless, this thesis will be significant enough if it can be positioned as raising more questions about the theory on the economic growth of Korea (or East Asia).

However, if we look at the significance of this thesis more closely, the following two points can be added. First, this thesis supports Evans' contention that the core concept of the developmental state is 'embedded autonomy.' Evans found that the developmental state's key to successful industrial innovation is a balance between autonomy and embeddedness. He insisted that autonomy cannot be a quality of a developmental state, nor a sufficient condition. Embeddedness in society, especially in industrial capital, must co-exist with autonomy. When those seemingly contradictory concepts of embeddedness and autonomy are connected, the basis for successful state intervention for industrial innovation can be built, and therefore the state can be called developmental (Evans 1995: 12). To sum up, his contention is that the embedded autonomy is a driving motive of developmentalism as it is a mirror image of an autocratic predatory state with no cohesiveness (Evans 1995: 50). In addition, he mentioned the importance of bureaucracy, emphasizing the embeddedness. In other words, Evans insisted that the developmental state is very similar to Weber's bureaucracy because it attracts organizational cohesiveness based on meritocracy, but the developmental state is also in contrast with Weber's bureaucracy because it maintains specific embeddedness (Evans 1995: 12), the systemized path connecting to the society, in which re-negotiation with phenomena surrounding goal and policy is continued; i.e., embeddedness means that Weber's bureaucratic autonomy is densely connected with the surrounding social structure (Evans 1995: 50). However, my research showed in many chapters that the state of Korea after the financial crisis no longer has embeddednees or embedded autonomy, reaching the conclusion that the state of Korea is changing to a 'neo-liberal post developmental state' that has minimized the role of the state. As a result, this thesis can be said to precisely explain the process of disbanding embedded autonomy after the financial crisis and give the state of Korea a description other than 'developmental state' to reach the conclusion that supports Evans' contention that the most essential ideology of the developmental state is embedded autonomy.

Second, Evans examined the transformation of the real developmental state of Korea and insisted that the most important challenging force can be a coalition between capital and neo liberal officials (Evans 1995: 230-231), and this thesis presented the contention through practical examples. This thesis showed that the growth of the capital forces and the neo-liberal officials who supported the forces played an important role in the change of the developmental state of Korea before the 1997 financial crisis. It was shown that the financial crisis faced in the process can be considered as having started because of the incompetency of the coalition between these two partners. Above all, this thesis showed the reason why financial reform implemented in the process of recovery from the financial crisis did not proceed as planned and the reason why the process of the state converting into a ‘post developmental state,’ which started before the financial crisis, was accelerated as the role of the state minimized at the neo-liberal bureaucracy. Ultimately, this thesis reaches the conclusion that the most important factor that transformed the developmental state before and after the financial crisis along with the change of bureaucracy to prove the Evans’ contention.

Thirdly, this thesis shows that an attempt to change the direction or speed of change of the state caused by policy change is bound to fail if the character of the state is changed due to institutional change.

Additionally, I would like to summarize this study by mentioning the limitations of the thesis.

Firstly, this thesis aims at making a macro analysis of cause and effect, as the object of its research is the shift of the state achieved by economic growth and overcoming a crisis and the ensuing change of the role of the state. Thus, its weakness is the lack of detailed discussion due to the vast object and scope of research. Thus, in future research it will be necessary to set a middle-range object of analysis in order to show the cause and effect more precisely.

Secondly, there was a limitation in preparing research materials. Though I added materials such as interviews, as the object of research was the economic policy of the state and the overall industrial policy, there was a clear limitation in my capacity to secure all statistical data and policy materials.

Thirdly, due to the limitations of various research materials this study mostly limited its scope and object of research to the period immediately after the economic crisis in 1997. As such, it is definitely necessary to conduct additional research on the period from that time to the present.

9.3. Implications for Neo-liberalism, the Role of the State and 'Government Control'

• Neo-liberalism and the Role of State

This thesis continuously raised the question of how 'neo-liberalism' influenced the shifting of the developmental state and the role of the state following the financial crisis. However, it was difficult to conduct research on this matter in earnest, as the objects of this thesis concentrated on the shifting of the developmental state and the ensuing change in the role of the state examined through the reform of the financial system. Here, I will briefly mention several implications for neo-liberalism and the role of the state.

Enjoying a platinum age for the last 20 years, neo-liberalism completely changed the conversation surrounding the role of the state (Chang Ha-Joon 2006: 107-144). Under neo-liberalism, the state was no longer accepted as a fair and omnipotent guardian of society. Rather, the state was even regarded as 'pillagers' or a tool used for the sectarian interests of politically strong groups (composed of politicians or bureaucrats). According to neo-liberalism, the behaviour of any economic unit was regarded as having no other motive than maximizing its material interest, an assumption that was also applied to the state, which is the economic unit in the 'public domain.' Accordingly, the role of politics was considered as a legal tool used to change the decision of the market, using the excuse of the 'collective will'. As a result, the 'Minimal State' prevailed, which meant that advocates of state intervention were constantly required to tussle with their opponents, even if they were making a good case, while critics of state intervention had the "wind at their backs," so to speak. In such a situation, discussions on the role of the state, state autonomy, and state capacity were naturally diminished.

However, the role of the state was considered very important even in the U.K., which believed that the occurrence of the market was very natural. This is a message that is highly significant to Korean society, which places a taboo on mentioning the 'role of the state' itself. In his classic book 『The Great Transformation』, Karl Polanyi said that the authorities (the government of Great Britain) had to keep watching for the free operation of this system (the liberal economy). And as a result, not only those who desperately wished the state to be freed from all unnecessary duties but also those who demanded the restriction of state activities with their entire system of thought had no choice but to hand over the mission of the establishment of a new power, a new organization, and a new system necessary for a state of free non-interference to the very state which they hated so much (Polanyi 1957: 140). So the role of the state was a very important issue.

Nevertheless, there is a prevailing belief in Korean society that problems cannot be solved by the state, and can only be solved by the private sector. Such a belief is closely related to the discussion of de-politics, which is a neo-liberalistic proposal. The discussion of de-politics, a neo-liberalistic proposal, ends up in the restriction of the 'role of the state,' but the principal problem with this discussion is as follows: the 'rationality' that the neo-liberalist attempts to save from the influence of corrupt politics can be defined meaningfully only in terms of its relationship with the contemporary institutional structure. But the institutional structure itself is a product of politics. After all, the basic institutional categories of the economic sector have been realized by an 'irrational' political process, and will continue to be realized in the same manner. For this reason, it is thought to be useless to insist on taking the economic process away from politics on the basis of 'rationality.'

There is another problem in the discussion of de-politics. This is that the politics of de-politics is disguising its identity. The theories advocating de-politics obtain public persuasiveness by positioning de-politics as protecting the 'silent majority' from greedy politicians or powerful interest groups. However, de-politics will narrow the realm in which politics can work to maintain its legitimacy, and in such a situation the socially vulnerable lose the political influence necessary to correct the results of a market that is unfavourable to them.

As examined so far, the purpose of the neo-liberalistic agenda, de-politics of economics, is to resurrect the old liberalistic politics in a disguised form. Like the new liberalists, the old liberalists also believed that giving political power to those who 'don't have a share' in the current system will lead to revising the social results or system achieved through the market. So the old liberalists were publicly opposed to democracy. However, the new liberalists are not in a position to object to democracy itself. So the anti-democracy strategy attempted by the new liberalists, externally, is to propose to reduce the influence of 'untrustworthy politicians,' while making assertions against 'general politics.' However, their ultimate goal is to reduce democratic control itself (as seen in the ‘independent’ central bank or the demand for the regulatory authorities).

In short, the role of a minimized state is a conclusion that was reached through the process of overcoming the economic crisis while being captured by the global trend (neo-liberalism), which became a reason for the financial crisis through the discussion of its role. The prevailing logic in society is that the role of the state should be minimized, as the intervention of the state is regarded as anti-market or non-market activity from the frame of ‘neo-liberalism,’ which elevates the market to an almost ethical level. It is very interesting that such an insistence, which is the basic logic of Western market fundamentalists who criticize the East Asian model, is accepted in Korea, which achieved one of the world’s most successful and effective examples of economic development through the intervention of the state. And in the Korean society, the discussion on the ‘minimized role of the state’ led to the ‘criticism of government control.’

• Criticism of Government Control

In the financial sector, for example, the minimum role of the state that is required in our society now will be to reinforce the public character of financing, strengthen the rights of consumers of financial services, and improve financial stability. This role of the state, however minimized it has become, is possible thanks to government control in the system of democracy. Therefore, we should think again before picking up on the criticism of government control that has become contagious in Korean society.

First, let’s examine where the controversy over government control is appropriate. Max Weber points out that an important characteristic of modern society is the ‘bureaucratic system.’ I don’t think that ordinary political and economic scientists would insist on the abolition of the bureaucratic system itself. From such a viewpoint, I think that the concept of government control itself is ‘void.’ It is the same even if the phrase is replaced by the word ‘MOFIA’[106]. The complete emptiness of the concept is well revealed by posing a question from a ‘practical’

[106] The term ‘MOFIA’ was coined by combining MOF, the abbreviation for “Ministry of Finance,” with the word “Mafia.”

viewpoint. So let's pose that question. What is the opposite of 'government control'? If government control is wrong, as the neo-liberals insist, what is the opposing concept that is right? I think the concept of government control itself is a term created by 'economic' liberalists (regardless of the good will of those who use the term) because the opposite concept to government control will inevitably be 'market autonomy,' or laissez-faire market.

In most academic circles, including political and economic circles, it is agreed that the alternative will be an 'adjusted market economy system,' which opposes both laissez-faire neo-liberalism and socialism. So the 'intervention of the state' is admitted in the relationship between the market and the state. Then, the biggest characteristic of the state is that it has a 'bureaucratic system' and thus the intervention by the state in the market means the 'intervention by bureaucrats in the market.' Excluding 'intervention by bureaucrats' while admitting 'intervention by the state in the market' is nothing but a logical contradiction, like a round square. That is why 'criticism of government control' is inevitably a term created by economic liberalists.

The concept of government control in Korea needs to be interpreted 'restrictively' in discussions regarding the autocratic government of President Park Jung-Hee. Insisting to 'rule out the government' during the military dictatorship is in the same context as demanding the economic retirement of the military dictatorship. The concept of government control itself was used as part of the opposing discussions of the economic circles left out of power in the 1970s, and it is not compatible with the direction of 'adjusted market economy system'. Today, in an era of democracy, 'criticism of government control' inevitably ends up being 'criticism of state intervention' and advocating a 'minimal role of the state'.

For the sake of convenience, let's divide the groups of economic actors under a democratic system into the market, bureaucrats, and the state. 1) The market is basically a private sector, in which laissez-faire operates, 2) Bureaucrats are the system of civil servants obeying the state, and 3) The biggest characteristic of the state is that it is the 'power elected' by the people. If we aim for an 'adjusted market economy system,' the process of its realization means 1) the elected power 2) intervenes with the market 3) via the bureaucratic system. What is important here is the clear division between the subject, the tool, and object. Precisely speaking, the bureaucratic system is nothing but a 'tool.' The bureaucratic system itself does not have the 'power to make the final decision' at all because in a democratic system the final decision can only be made by the ‘elected power.’ I interviewed some debaters who worked for the Roh Moo-Hyun government and who insist that the Roh Moo-Hyun government failed “due to MOFIA,” but this is highly strained logic. Because, the 'elected power' controls the bureaucratic system; the opposite is not true. If it is true, it only proves the ‘inadequacy’ of the elected power. Therefore, the key point of debate is not government control, bureaucrats, or MOFIA itself, but whether the elected power has the ability to rule. Thus, the correct point is not to criticize government control, bureaucrats, or MOFIA, but to evaluate the ability of the current government, whether it is the government of Kim Dae-Jung, Roh Moo-Hyun or the current government, to rule. If they say the government failed due to the government or MOFIA, it is like saying that the crisis of the Conservative Party and the Democratic Party was caused by the ‘party workers,’ not by the representative of the party (or the party leaders). This does not correspond with the principles of democracy.

The matter of ‘MOFIA,’ which suggests a cartel, needs to be watched closely in relation to the role of the state. The term ‘MOFIA’ was coined by combining MOF, the abbreviation for “Ministry of Finance,” with the word “Mafia,” and this term became popularized during the Kim Dae-Jung and Roh Moo-Hyun governments. So, at least once we must raise this question: Why did the so-called ‘MOFIA’ dominate during 10 years of democratic government or left-wing government? To provide the answer, the ‘personnel policies’ of the Kim Dae-Jung and Roh Moo-Hyun governments were themselves ‘neo-liberalistic’. One of the biggest characteristics of neo-liberalism is a dichotomous view of the economy and politics. The core of neo-liberal doctrine is that “The economy should handle with economic logic” or the “Economy should be handled by economic experts,” rather than treating the economic realm as an object of ‘democratic control.’ And regrettably, for the past 10 years of democratic government in Korea, the control of economic departments was commissioned to government officials who had already worked in economic departments for a long time. It is no wonder that this cartel of economic experts was formed, in a place where ‘democratic control’ had disappeared. In a sense, it was an inevitable conclusion.

Then, what is the right way to solve the problem of the ‘MOFIA,’ a bureaucratic cartel? It is to appropriately follow the principle of ‘democratic rule’ in the economic area. That is, the ministers of economic departments must be politicians who are fully aware of the task of economic reform in our times. Of course, it will be better to pick politicians who have worked well in many standing committees in the economic area.

The core of the philosophy of ‘economic democratization’ and the ‘role of the state’ that is required in our times is to control the market domain, where 1 vote is given to 1 won[107], with the principle of democracy, which gives 1 vote to 1 person. And the principle of economic democratization can be realized in the ‘personnel policy’ through the control of economic departments by elected power. Then, the mistakes made by past governments can be corrected by understanding ‘democracy’ properly and operating it well. The ‘ability to rule the bureaucratic society’ is the key to the state being able to adequately play its role.

But in modern society, the lack of this ability to rule often leads to an inappropriate choice of bureaucrats, and becomes the basis of claims that the role of the state should be minimized. Of course, the primary responsibility should be borne by the bureaucrats who prioritized the pursuit of ‘private interest’ over ‘public interest,’ but the supervisory organization that did not supervise or regulate the behaviours of bureaucrats and the state will have to take greater responsibility. I am saying that the intervention of the state in the bureaucratic system is not a problem, and that a greater problem is when the state lacks the political ability to manage, supervise and regulate bureaucrats properly. In other words, the criticism of ‘government control’ is the wrong point for debate, and the essence of the problem is whether the ‘elected power’ can appropriately fulfil its political function. Thus, in the debate on the role of the state, it is more appropriate to criticize the ‘wrong politics’ than ‘government control.’ In doing so, it will be possible to establish ‘adequate role of a state’, rather than ‘minimized role of the state’.

[107] Korean currency unit.

Appendices

Appendix 1: Interviews

- **Interview questions**

1) How did the current financial system in Korea emerge and develop?

2) Did globalisation bring about changes to the financial system, and if so, in what ways?

3) What role did the state play in resolving political, social, and economic problems in the aftermath of the 1997 financial crisis under the financial reforms?

4) What did economic bureaucrats do to overcome the 1997 financial crisis, and how was the financial reform processed?

5) How did capital confront the restructuring of the financial market in the aftermath of the 1997 financial crisis?

- **Methods of data collection**

Semi-structured qualitative interviews were conducted using elite-interviewing techniques. Understanding and exploring the ideas and experiences of political elites, economic bureau crats, and scholars in national research organisations was central to this research, and the decision to adopt a qualitative methodology was closely linked to its fundamental goals a nd concerns.

Specifically, this research adopted the semi-structured in-depth interview method because it provided enough freedom for the interviewees to speak freely about topics related to their interests. The semi-structured interview also assisted the researcher in maintaining sufficient structure to address topics related to the research. In addition, this provided the opportunity to compare and contrast the different perspectives of interviewees. For instance, it was possible to examine how and why economic bureaucrats (or political elites), scholars thought similarly or differently about the same topics.

- **Recruitment of participants**

The total number of interviewees was around 20, composed of 10 elite bureaucrats (politicians or scholars) and 10 semi-bureaucrats in the Financial Supervisory Service (FSS)

The interviewees was selected on the basis of their expertise in government and financial regulation system such as the FSS from among high-ranking officials who were involved in the reform of the financial system and from those involved in the implementation of specific policies.

To recruit interviewees, I have approached a former vice-governor of the FSS and an elite economic bureaucrat to arrange appropriate interviewees. I have requested whether he recruit experienced bureaucrats and semi-bureaucrats who had played a role in the reform of the financial system. Potential interviewees were approached by sending a letter of invitation, an information sheet, and a consent form via e-mail and then contacted by the researcher by phone to determine those that were interested in taking part in the research. Single interviews were conducted and took about one hour. Before the interview, participants were asked to sign the consent form that they received by e-mail.

All interviews were audio-recorded using a digital recorder, transcribed, and translated. A topic guide of a core list of questions at each interview was prepared. Although all interviews employed a list of questions specifically tailored to the interviewee, where interviewees were believed to be in possession of similar knowledge, there was some overlapping of questions between interviews.

▪ **Anonymity**

I ensure the 'anonymity' of interviewees by re-labelling their names. I informed interviewees of the following: "Your name will not be used in my thesis or in other papers. Your name will be written as A, B, C or P1, P2, P3". All interviewees were briefed as to how data was collected and stored in accordance with Data Protection Legislation. All published data used these codes and the participant's identity will not appear in any published work.

The digital recorder audio recording was transferred to my laptop computer and was encrypted with a personal identification number immediately after each interview was completed. The audio recording on the digital recorder was then removed. The audio recordings held on my laptop computer were deleted once they have been transferred and stored on York University's Filestore after my return to York.

The audio recordings on my laptop were transcribed into Korean using MS Word and were then translated into English. During this process, no printed copy of these was made, and only the electronic versions of transcripts, translations, and code sheets were stored on my secured laptop computer. All field notes made during the interviews were scanned and stored as PDF files, and the original field notes were destroyed. During the journey from Seoul to York, all research materials remained in my possession at all times and were checked in as hand baggage.

For organising the audio recordings into written data, each interviewee was given an individual code number, which was printed on a separate sheet, and only the researcher had access to this coding sheet. All written data was presented using these codes, and no reference to a participant's actual identity appeared in any written material. All data, related documents, and transcripts were kept in electronic form on my laptop. As with the audio recordings, all data and documents in electronic form were encrypted and stored on the University's central storage drive, Filestore, and those on my laptop were deleted.

Written forms of data were printed and used only in my PhD student office at the University of York and were stored in a locked drawer in the office. The key to the locked drawer was accessible only to the researcher. It could only be opened with the researcher's key.

Appendix 2: Information sheet

Title: The Nature of and Changes in the Financial System and Bureaucracy in Korea

Dear Sir/Madam,

My name is Wonseop Song, and I am currently undertaking research for my PhD course at the University of York in the UK. If you could take part in this interview, it would be a great help in developing my research. In order to assist your understanding my research project, I would like to introduce the aims of my research and the purpose of the interview in which you will participate.

The Aim of the Project

The main aim of the research is to understand the experience of political elites and economic bureaucrats in terms of the Financial System. The research concerns examining transformation of financial system and bureaucracy in order to investigate changing roles of Korean developmental state after the 1997 financial crisis – the implementation of economic, political and institutional arrangements to overcome Korea's 1997 financial crisis. The specific aims of the research are as follows:

1) How did the current financial system in Korea emerge and develop?
2) Did globalisation bring about changes to the financial system, and if so, in what ways?
3) What role did the state play in resolving political, social, and economic problems in th
e aftermath of the 1997 financial crisis under the financial reforms?
4) What did economic bureaucrats do to overcome the 1997 financial crisi
s, and how was the financial reform processed?
5) How did capital confront the restructuring of the financial market in the aftermath of t
he 1997 financial crisis?

Project Methods

The research is a qualitative study and will primarily comprise face-to-face interviews. Elite bureaucrats and bureaucrats will be interviewed. The total number of interviewees will be around 20, composed of 10 elite bureaucrats (politicians or scholars) and 10 semi-bureaucrats in the Financial Supervisory Service (FSS)

All interviews will be audio-recorded using a digital recorder. The basic structure of the interviews is similar, but the wording of interviews and the questions asked might differ in accordance with the differing role of each group or interviewee.

Time, Length, and Venue of the Interview

An interview will generally take about an hour, and you have the right to stop the interview at any time if you do not wish to continue. You may make your preferred interview venue known to the researcher. The only stipulation on the researcher's part is that it is quiet enough to record the interview.

Use of the Interview

The audio recording of the interview will be transcribed, coded, and analysed by the researcher. The data generated by this procedure will be primarily used for my PhD Degree thesis, which will include findings based on the information collected from you. The findings may be used for other academic papers and publications.

There may be times when some of your statements from the interviews will be quoted in my thesis and academic articles. However, your anonymity and the security of private information will be guaranteed. The transcript and audio recording of the interview will not be available to anyone except the researcher. In addition, they will be removed from my personal computer and any other memory device after transferring the data to York University central storage drive, which is secured and encrypted by private security number and the university's security system.

All data, both written and recorded (including the coded sheets), will be anonymised. Your anonymity as an interviewee will be guaranteed by re-labelling your name. The interviewee will be given a code number, which will be noted on a separate sheet, and only the researcher will have access to this coding sheet. All written data will be presented via these codes, and no reference to a participant's identity will appear in any written material.

Researcher Contact

If you would like to know more about the research and interview, you can contact me by any of the following methods:

Telephone:+44-7917-096270 (UK); +82-10-3363-7154 (Korea)
E-mail: ws531@york.ac.uk   swsons@hotmail.com
Address: 506 Westgate Apartments, Leeman Road, York, UK, YO26 4ZP

Many thanks and Best wishes

Wonseop Song
PhD candidate
School of Politics, Economics and Philosophy
The University of York, UK.

Appendix 3: Interview consent form

THE UNIVERSITY of York

INTERVIEW CONSENT FORM
인터뷰 동의서

The Nature and Change of the Financial System and Bureaucracy in Korea
연구 제목: 한국 금융체계와 관료제의 성격과 변화

I consent to participate in an interview for the research project on 'the nature and change of the Financial System and Bureaucracy in Korea'.

나는 '한국 금융체계와 관료제의 성격과 변화' 연구를 위한 인터뷰 참여에 동의한다

I fully understand that this interview is confidential, and the transcript and tapes will not be opened by anyone except by the interviewer, Wonseop Song.

나는 이 인터뷰 내용이 기밀에 부쳐지고, 인터뷰를 정리한 내용과 녹음한 카셋트 테이프가 연구자 송원섭씨 외에는 누구에게도 공개되지 않을 것임을 충분히 이해한다.

I agree to the interview being tape-recorded. I can request a copy of the cassette recording of the interview and a copy of the interview transcript.

나는 이 인터뷰를 카세트 테이프에 녹음하는 것을 허락하지 않고, 인터뷰 녹음 파일이나 그 내용을 정리한 것의 복사본을 요청할 수 있다.

In addition, I fully understand that I have the right to withdraw from the interview at any time I want, and any data I have provided will be destroyed.

또한, 나는 인터뷰 도중에 내가 원하면 어느때든지 인터뷰를 중지시킬 수있으며 내가 제공한 어떤 정보도 파기시킬 수 있음을 충분히 인지하고 있다.

Signed 사인(Interviewee)…………………………

Date 날짜 ………,…………,……….

Glossary

Chaebols (Korean) -- family-owned conglomerates

Newly Industrialising Countries (NICs)

Bank for International Settlements (BIS)

Forward Looking Criteria (FLC)

Mergers and Acquisition (M&A)

Developmental State (DS)

Ministry of International Trade and Industry (MITI) in Japan

Korea Development Institute (KDI)

Bank of Korea (BOK)

Financial Supervisory Service (FSS) in Korea

Korea Institute for International Economic Policy (KIEP)

Small & Medium Corporations (SMCs)

Non-Bank Financial Institutions (NBFI)

Export Loans (EL)

Quasi Internal Organization (QIO)

Heavy and Chemical Industries (HCIs)

Export-Oriented Industrialization (EOI)

Economic Planning Board (EPB) in Korea

Korea Development Bank (KDB)

Industrial Bank of Korea (IBK),

National Agricultural Cooperative Federation (NACF or NongHyup),

Asia Pacific Economic Cooperation (APEC)

Korean Won (KRW)

Note Insurance Facility (NIF)

Domestic Businesses (DMB)

Ministry of Strategy and Finance (MOSF) in Korea

Financial Supervisory Commission (FSC) in Korea

Korea Deposit Insurance Corporation (KDIC)

Korea Asset Management Corporation (KAMCO)

Public Fund Oversight Committee (PFOC) in Korea

Memorandum of Understanding (MOU)

Asian Development Bank (ADB)

International Bank for Reconstruction and Development (IBRD)

International Monetary Fund (IMF)

World Trade Organisation (WTO)

Project Financing (PF)

Asia Pacific Economic Cooperation (APEC)

Organization for Economic Cooperation and Development (OECD)

New Public Management (NPM)

National Federation of Fisheries Cooperatives (Suhyup),

Korea Export-Import Bank (KEXIMB)

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