CAPITALIZING ON DEMOCRACY:
THE MAINTENANCE OF THE KOREAN DEVELOPMENTAL STATE
AND THE PROMOTION OF SMALL & MEDIUM ENTERPRISES

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ABSTRACT

This study explores the relationship between democracy and the developmental state in Korea. It deals directly with two important puzzles: 1) If the developmental state has truly been dismantled, how can we explain the fact that it is continuing to identify strategic industries of the future and then finance and underwrite their development through industrial policy? 2) How can we reconcile evidence of strong, concerted state behavior with normal assumptions that democracy and the developmental state are incompatible? Typical studies have provided accounts of the litany of reform measures that have appeared as early as 1980, concluding that the developmental state is no more. This study goes beyond those, arguing that the reforms only tell us one side of the story. It takes for granted that the old Korean developmental state model is gone. Rather, this study begins from the premise that if the institution is to be pronounced dead, scholars must first determine finally that the state is no longer acting as a developmental state, that it has not adapted and transformed itself in such a way(s) as to continue to promote economic development beyond an Anglo-American model.

Unfortunately for celebrants at the developmental state’s funeral, the empirical evidence does not support a simple thesis of demise. This paper has two major findings: One, the Korean Developmental State is extant, that convergence with an Anglo-American model has not obtained and is unlikely to in the future. Two, assumptions of the incompatibility of democracy and the developmental state are unfounded, at least in the Korean milieu. These two conclusions are arrived at through a diachronic exploration of the South Korean political economy before and after 1987 and, specifically, by exploring the strengthening of state promotion policy for Small and Medium Enterprises after the 1987 democratic transition.
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CHAPTER ONE: INTRODUCTION

"The aim of reform is ambitious: to move Korea from a highly interventionist and authoritarian model of economic development to a market oriented and open model based on values of consumer choice, democracy, and rule of law"  
-2000 OECD Review: Regulatory Reform in Korea

"The changes might appear sweeping, but turn out to have been perilously superficial"  
-Donald Kirk, 2000

In the five years since the advent of the Asian financial crisis, we have been told time and again about the marvellous economic recovery in Korea and the model reform process that has transformed the state into a regulator that is in every sense classic Anglo-American. The Koreans have done it all: corporate restructuring, financial sector reform, government downsizing, deregulation, etc… . A senior U.S. political scientist has even gone so far as to ask, “why can’t the Japanese be more like the Koreans?”, in reference to the fact that the Japanese could not in twelve years accomplish what the Koreans did in barely three.¹ On the surface, this seems like a powerful question. Then we realize that the comparison is not really a fair one at all, that the scholar’s intention is not to gain a serious understanding of Korean politics, but rather to set up a straw man to score a point regarding his real subject: Japan. This is a blatant misrepresentation. More importantly, if the developmental state has truly withered away, why it still promulgating industry promotion policy? Why is it still financing and underwriting the development of new businesses? How can it still be identifying the key, strategic industries and sectors of the future? Why can we still find strong evidence to show that it continues to function much as it did in the heydays of the Korean development machine? And why is this evidence ignored?

That the evidence is at odds with normal assumptions about the relationship between democracy and the developmental state forms yet another puzzle. Since Korea’s relatively bloodless democratic transition in 1987, the Korean people have quickly moved
to make sure the new governance structure is the only game in town. The authoritarian structures formerly at the heart of the Korean developmental state's power and capacity, enabling it to control labour and coerce business, have largely been replaced or reformed. And as a consequence, state decision-making is now more accessible than ever: the media is strong, vocal and challenging; large business groups have gotten yet bigger and more politically powerful; and, civil society has burgeoned, exerting real control over political outcomes. And, as might be expected, issue after important issue faces legislative gridlock in Seoul. Yet how can we explain the concerted state action that began after the transition to strengthen its own capacity to actively and aggressively promote Small and Medium Enterprises (SMEs)? Why, in 1995 for instance, was there virtually no political or popular opposition to the creation of a new state agency to coordinate SME policy and promotion? Moreover, while the response was modest to start, state measures have become increasingly bold and pronounced such that by the end of the 1990s the state had developed a comprehensive web of interventionist institutions and promotional policies where none existed before. Is this the activity of a democratically reformed developmental state?

Interestingly, the state remains at the centre of discussion regarding Korea's political economy. This fact is itself at odds with the notion that the state has been marginalized. The current focus, however, is on its remarkable reformation. Contemporary literature is replete with description and analysis of the reform process, with the OECD quote above being both representative of and buttressed by the contemporary orthodoxy. The facts are hardly disputable. According to the 2000 OECD report, "...structural reforms have brought Korea closer to the mainstream of good practices in OECD countries". Citing the need to mitigate problems of efficiency, "moral hazard", and non-transparency, the country has completely restructured the financial sector while relinquishing political control over the central bank, allowed more foreign ownership, strengthened corporate governance, increased labour market flexibility, and "reduced the load of anti-market regulations that had accumulated".

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1 Kent Calder, "Why Can't the Japanese Be More Like the Koreans?" Public lecture based on an upcoming article given at UBC, February 28, 2003.
2 OECD 2000 Regulatory Reform in Korea, page 15.
3 Ibid., page 19.
Dissenters are few. As we will see below, even the most strident supporters of the developmental state model have been hard-pressed to explain how the developmental state in Korea will survive the dismantling of the strong state apparatus.

And so, more than a decade removed from the democratic transition, and after two and a half solid decades of economic reform capped off by an IMF-instituted neoliberal convergence program, it almost seems odd to assert that the state in South Korea is just as involved in the affairs of business as it was in the heydays of the "big state". Yet that is what this study aims to do. The evidence of reform marshalled by the OECD and a variety of scholars to show that the state has receded is potent, and cannot be ignored; unfortunately, it has also been exaggerated and misinterpreted. Worse, writers and analysts seem only to take note of those aspects they want or expect to see. As a result, the "reform process" itself has become so over-played in scholarly and journalistic analyses as to almost fully obscure other trends while presenting to those less informed a picture of an inexorable march toward convergence with "Western" models.

Convergence, however, is not a fait accompli and we should therefore be wary of these depictions. We should not disregard the fact that the government is also moving in other ways to promote industry and is doing so with as much—if not more—developmental zeal as ever before. There are a variety of examples that can be used to support this claim: ongoing political machinations revolving around chaebol\(^4\) reform, continuing protection afforded to strategically important sectors and large business groups facing financial difficulties; and, continuing state control over many commercial banks are just a few.

A more intriguing story is the ever-increasing government promotion of Korea’s Small and Medium Enterprises (SMEs). In fact, the SME story can tell us much about the contemporary Korean political economy and, as such, may be the most fascinating, overlooked story of all. Their historical plight in the face of clear state preferences for only the biggest companies is generally well-known, but more recent events suggesting a shift in state predilections have failed to garner much attention. Today, no fewer than nine laws exist to nurture SME development. These laws have guided the creation of a complex, maturing set of government-business relations held together with a variety of

\(^4\) Large, diversified business conglomerates.
industrial policy tools and, perhaps more important, a consensus between state and industry that nurturing SMEs is the right thing to do for the country. This consensus is strengthening not weakening.

What story must be told to reconcile these facts with the frequent assertion that Korea has once and for all forsaken *dirigisme* in favour of neoliberalism, that the developmental state model is dead? Also, how can we reconcile the facts of the democratic consolidation process with an ongoing, if not enhanced, state role in governing economic affairs? Indeed, is this a simple coincidence or is there a more subtle correlation between the advent of democracy and the maintenance of the developmental state?

The case of continued policy support for SMEs is an important one because it reveals an important, yet unexplained shift in the political economy. Promotion policy laws that amounted to mere lip-service prior to 1987, afterwards took on a new purpose and were pursued with increasing vigour. While we should expect Korea’s strong developmental state to undergo a devolution of power as it shifts from an authoritarian to democratic governance model, the empirical evidence does not fully cooperate. Moreover, while we can trace a clear trend line of decreasing support for the chaebol, the line is going in the other direction for the SME sector, particularly for firms attempting to develop competitiveness in certain state-identified high technology industries. Indeed a well-functioning, dynamic and diversified SME sector has come to be widely viewed as the cornerstone to future Korean economic success and strong state support for it marks a 180 degree turn from the previous preference for large enterprises. Evidence of this shift and the new support efforts suggest not a decline or withering of the developmental state, but an important adjustment that has been missed in the rush to pronounce the institution dead.

On the surface, it is difficult to see how strong doses of both political and economic liberalization at the same time can result in a persistently strong developmental state. On the one hand, political liberalization—democratization—should break down both the autonomy and coherence of the authoritarian state. On the other, economic liberalization should result in a visible reduction in state intervention in the economy. Neoliberalism works necessarily toward a smaller, less economically active government.
From this perspective, analysts might simply be inclined to look at two trends in order to measure the demise of the developmental state: one, an enhanced role for civil society—labour and interest groups—in the political economy; two, the deconstruction of developmental state capacity through deregulation, relinquishment of government control over financial levers, and a public disavowal of interventionism/dirigisme and industrial policy tools. In the case of Korea, the evidence of the existence of both trends appears to be extensive. Unfortunately, much of the contemporary work regarding Korean political economy examines only these trends. As such, the analysis is hardly conclusive of anything beyond what the writers expected to observe in the first place.

Beginning from two central propositions, this study takes an opposite tack: First, the government of Korea has not given up on the Korean developmental model, and suggestions to the contrary are one-dimensional. A more comprehensive look at trends aside from obvious neoliberal/political reformation should yield a more nuanced comprehension of both the political economy and the role of the state within it. Second, rather than leading to a simple dismantling of the developmental state, the introduction of electoral dynamics throughout the 1987-1997 period can be seen to strengthen its adaptation and continued existence. Loud, popular calls for less concentration of economic and political power and more equity and wealth distribution, have tipped the scale in the state’s favour, giving it an advantage in its long-standing struggle against chaebol power. With a clear eye on the ballot box, the state has changed its goals from pure growth, toward a more balanced approach and a change in the traditional government-business coalition away from large enterprises toward the more numerous SMEs. But these factors have led the state to alter the focus of its industrial policy and developmental state functions, not eliminate them. The government is clearly not as interventionist as in previous years, and the model is certainly not the same. Neither, however, has it become disengaged, as is often claimed. Instead, the core of the Korean state’s endeavours, the effort to transform and develop the economy continue.
**Mapping the project**

The goal of the second chapter is to begin an exploration of the validity of these two propositions by first defining precisely what is meant by a developmental state, then examining the contemporary discussion regarding appropriate methods for studying the state. The state cannot be viewed as an amorphous mass, and should not be considered in isolation from the society of which it is a part. This study will review the relevant literature and discuss the developmental state concept itself in an effort to refine the way it has come to be viewed.

The third chapter provides more detail regarding the dependent variable, the transformative project. The key questions are: what is a transformative project and how is it changing? Additionally, what is the ongoing role of the state in relationship to it. For several decades, the strong developmental state nurtured and drove this project. From 1961-1989, the goal of the project was to catch-up with the advanced countries of the world. The Korean cure for late industrialization was rapid growth based on state nurturing of large enterprises. In the 1980-87 period, a variety of political and economic factors caused the project to come off the rails. Since 1987, the focus has been on fostering economic diversification to reverse the strong degree of economic concentration that had resulted from the first big push. The proxy this time is a dynamic and diversified SME sector.

This shift can be explained in large measure by the change in governance structure. The democratic transition is an obvious, but important turning point. In fact, it signals the beginning of a marked shift in state attention away from the chaebol. What results in the post-1987 period is a new developmental alliance between the state and civil society. Whereas the old alliance between the developmental state and the chaebol was held together with coercion and strong state power, the glue of the new alliance consists of common goals and popular legitimacy derived through the developmental ethos and democratic mandates. By virtue of their size and importance to the economy, the chaebol, meanwhile, continue to wield significant economic and political power. They are, nonetheless, outside of the new coalition. The fourth chapter details these changes and introduces a new model to help understand it. In my view, the new alliance
is equivalent to a new social compact, the most significant development in the Korean political economy since Park Chung Hee took power.

The final section of the fourth chapter will discuss briefly the affect of the 1997/98 financial crisis on this new alliance, and provide some additional evidence showing enhanced state support in the post-1987 period, particularly after advent of the crisis. The most important outcome is an even stronger state, with enhanced capacity to continue to dismantle and regulate *chaebol* concentration while building up stronger SME promotion.

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CHAPTER TWO: A NEW VIEW OF THE DEVELOPMENTAL STATE

The purpose of this chapter is to review the important literature and set the stage for an exposition of the dependent variable in the second chapter. The overarching purpose is to come to a better understanding of the developmental state term, how it was originally defined, how it has come to be viewed, some of the key problems scholars face as they study it, and to begin to see how it has become more of a limited entity. Of the state in general, Durkheim wrote that “few words are employed with their meaning so ill-defined” as is the state. Discussions involving the “developmental state” in East Asia are quite often guilty of the same offence. This need not and should not be the case. Chalmers Johnson’s seminal work on the matter provides us with the essential canvas on which we can paint our diachronic comparison.

Johnson’s 1982 work outlined a new model to view the Japanese political economy and explain that country’s tremendous economic success. Tiberghien breaks Johnson’s model down into four levels. At the first level is what Johnson termed the Capitalist Developmental State, defined essentially as a political system with one clear priority—economic development—and a strategic goal oriented approach to realizing it. At the second level is an elite economic bureaucracy that can identify and choose the industries to be developed... to identify and choose the best means of rapidly developing the chosen industries... and to supervise competition in the designated strategic sectors in order to guarantee their economic health and effectiveness. These duties would be performed using market-conforming methods of state intervention.

At the third level is a pilot agency that is created to manage the industrial policy devised to undertake the industrial transformation. In the case of Japan, this was the Ministry of International Trade and Industry (MITI). It is MITI that creates the fourth and final level

6 Johnson, Chalmers (1982) *MITI and the Japanese Miracle: The growth of industrial policy, 1925-75*. Stanford: Stanford University Press. While the following paragraph draws on various sections from his book, the summary of Johnson’s work in the context of 4 distinct levels is courtesy of Yves Tiberghien at UBC.
of the model, the actual industrial policy. The goal of MITI’s industrial policy was two-fold: the focus was simultaneously on structural change and economic rationalization through efficiency and high technology.

Johnson’s contribution is immense; the developmental state term itself continues to shape the debate. But, acceptance of his approach was by no means unanimous. Okimoto, for example, has sought to downplay the Johnson’s emphasis on the capacity of state to shape economic outcomes through industrial policy. Under the rubric of a “Networking State”, Okimoto illustrates how close state-society ties in Japan actually result in state neutrality, upon which the state relies to achieve harmony, not confrontation, with business. Regarding industrial policy specifically, Okimoto argues that

Latecomer catch-up called for some degree of government guidance, but not the imposition of central planning commonly associated with socialist or dirigiste states. Notwithstanding images of “Japan Inc.”, the Japanese economy has never been, and is in no meaningful sense today, centrally planned.8

Okimoto obviously does not deny that the state has played an important role in the promotion of development. He recognizes the importance of state leadership in bringing the importance of development to the front of the political and social agenda. Where he disagrees with Johnson is over centrality and importance of the state guidance. The essential question is whether it directed industry or merely encouraged it.

In fact, this notion of Japan Inc. helps us to identify some of the difficulties in applying Johnson’s model to the Korean case. The state in Korea was more powerful than in Japan. It was much more capable of going beyond mere guidance to the issuance of directive. The most visible difference, therefore, is the nature of the state-society relationship in both countries. First, there is nothing really comparable in Japan to the Korean chaebol. The difference is not a matter of size, but of domestic political power, the ability to affect political outcomes. Japanese keiretsu were never as powerful as the Korean chaebol in this regard. Their capacity was undermined in the immediate post-

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7 Ibid., pages 314-15.
1945 period when predecessors to the keiretsu, the zaibatsu, were “unpacked”. The chaebol, meanwhile, have seen their power rise under the heavy-handed direction of the Korean state. State heavy-handedness is also a vital difference; the Japanese state never exerted the same degree of control as did its Korean counterpart. Whereas Japan has been a stable democracy since 1945, Korea has been governed autocratically, with civil rights suspended in favour of economic growth. In Japan, the MITI was constrained by inter-ministry disputes between itself and the Ministry of Finance. Also, political control of the LDP by business interests severely undermined MITI’s ability to execute its full developmental agenda. This was particularly true in the 1960s when MITI bureaucrats suffered massive defeats in the Diet. The Korean state, meanwhile, was controlled by a general who had taken power by coup, and maintained power after a rigged election by promulgating a constitution that merely served to cement his rule. Bureaucrats executing his development strategies had comparatively free reign. These differences have led some to suggest that Korea Inc. is a more apt moniker than Japan Inc.

This debate over the application of the concept in different jurisdictions notwithstanding, the use of the developmental state concept in general has been criticized for its aloofness from society. The failing of the concept is the tendency to depict it as a sterile, Weberian construct that hovers somewhere above society. Inside, there is a meritocracy of highly skilled and educated bureaucrats who are acting in concerted fashion to organize and lead the country below toward economic development. This belies the fact that there are often deep divisions within a developmental state. Moreover, Johnson’s model and its successors have always emphasized the strong state-society relationship that must obtain if the model is to succeed. With this in mind, a second wave of scholars has sought to bring the term back to earth by placing the state in the context of that relationship, focusing almost invariably on the “nexus” of government-business relations. Even then, however, it has too often been viewed as a static, amorphous mass that had but to continue its interventionism to obtain stellar growth results.

The recent willingness by leading developmental state scholars to describe its status as “in transition”, therefore, is a welcome breath of fresh air. Recognition of change in the developmental state is crucial. Although this paper argues that the developmental state in Korea has in many ways maintained its form and purpose, it most certainly does not argue that it is a static entity; it is changing. Nor should it be viewed as existing in idyllic isolation somewhere floating in the ether. Indeed, it is changing precisely because of its relationship with society. Many analysts of the developmental state in South Korea argue that it has reformed itself out of existence. This study will show a different outcome, that the state both acts and is acted upon and, as a direct result of that process of interaction with society, the state shifts. Rather than reforming itself out of existence, it has adjusted to maintain its relevance. Moreover, it has not embraced changed out of some deep-seated altruism or simple conviction in neoliberal tenet; on the contrary, it has listened to the signals sent by society and positioned itself accordingly.

This runs contrary to typical analyses which seem bent on placing the state-society relationship in zero-sum terms that depict the developmental state variously as retreating, withered, dismantled, or dead. Instead of zero-sum terms, the symbiosis of the relationship should instead be analysed. The state in Korea can be seen as both benefactor and beneficiary, at once leading society with the provision of distinctive public goods while adjusting to societal signals. Because of those adjustments, a recalibration of the developmental state term is in order. This will enable a more precise analytical framework and, hopefully, a more judicious application of the term.

* * *

More than just a stage

Analyses that focus on the state as an important actor provide an important alternative to the variety of methodological approaches, by their very nature, render irrelevant any detailed analysis of the state itself. The hegemony of those approaches made the study of the state obsolete because, as Colburn puts it, “everyone from Marxists to neoclassical economists sees politics as the result of choices based on calculated self-interest. And

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macro behaviour is just the sum of micro behaviour.\textsuperscript{11} For many years the predominant approach was to understand outcomes as resulting from individual, group or class behaviour. The debate between pluralists and Marxists in the 1960s and 1970s, for instance, was revolved the manner in which society controlled/used the state instead of focusing on the state itself.\textsuperscript{12} Why study the sum of all the parts, when the truly meaningful and causal activity take place on a more disaggregated level?

In fact, the state is more than a sum of its parts, more than just a stage; it is itself an independent actor worthy of study and reflection.\textsuperscript{13} The work of Evans, Skocpol, and Rueschemeyer, and many other scholars has led to a reinvigoration of state-centred discussion and debate that, in turn, has lent credence to the notion of the state as a complex multi-faceted actor capable of its own independent thought and action and, therefore, deserving of yet more scholarly attention. Of course, the centrality of the state in studying East Asian polities was never really absent. This is especially true after Johnson’s book on MITI. The disagreement has tended to revolve around how and how much the state has been involved.

**The limited state**
Moving beyond the conception of the state as merely a stage, to establish it as an independent actor is comparatively easy. Depicting the context within which it interacts with other actors and, specifically, identifying the precise mechanisms of the mutually transformative relationship between state and society is a much more vexing task. This problem is coupled with a desire to define further exactly what type of actor the state is and develop methodology to measure its autonomy and capacities, not to mention the overarching drive to provide answer to more normative questions regarding the proper role of the state, developmental or otherwise. These matters continue to constitute the vital ongoing problems for the state-centred analysis.

Regarding these, Joel S. Migdal echoes Durkheim by entreating scholars to “demystify” the state. He is not suggesting that we merely dissect the state apparatus, record what we see, and draw corresponding conclusions regarding political outcomes that puzzle us. He warns against such deterministic structural approaches. Migdal instead makes a case for a more pragmatic understanding of typical state roles. He too argues that we need to improve how we understand the state, its positioning vis-à-vis society, and how it affects and is affected. But Migdal steps further by arguing that observation of this interaction should lead us to see how the state is limited. Analysis of this process of interaction should lead to a more practical understanding of state roles and state limitations. He writes:

by understanding how the state’s sails have been trimmed through its engagement with such social forces, we begin to build a basis for a twenty-first century research agenda, one that starts with process rather than structure, a blueprint that focuses on a limited state.14

This prescription makes particularly good sense when regarding the Korean case. Initial writings on the state in Korea were far too sanguine about its ability to continue to act in the heavy-handed manner of the past. In a sense, the state was mis-characterized as too capable.15 Moreover, a strong state bent on bringing about economic development was never the only condition for that development to transpire. Unfortunately, subsequent analyses have tended to over-correct this by tilting too far in the opposite direction. As subsequent chapters will show, detractors of the developmental state have been far too quick to point to processes of developmental state dismantling. The truth about the developmental state in Korea lies somewhere between these two extremes. The evidence presented here will show that the state is still involved, but obviously not in the

15 While clearly the seminal text regarding the developmental state and its role in fostering industrial development in Korea, Alice Amsden’s South Korea: Asia’s Next Giant, was criticized harshly for implying that Korea could simply continue to be interventionist. For instance, scholars working on technology transfer issues—a key facet of Amsden’s story—disagreed that the state would be able to take the country to the next level of technological development, moving from imitation to innovation by continuing the relatively simply strategy of investing huge sums of money. The debate on technology is a subset of the more fundamental argument that the developmental state has outlived its usefulness in today’s complex internationalized economy. cf. Kim Lin Su (1997) Imitation to Innovation Boston: Harvard Business School Press and Soh Chang Rok (1997) From Investment to Innovation? Seoul: Global Research Institute/Korea University Press.

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ways expected by developmental state purists, and certainly not in any way resembling a Korean Inc. The state in Korea is no longer as powerful as it once was, and clearly is incapable of intervening in the ways it once did.

**On autonomy**

Measurement and understanding of state capacity and limitation necessitate a consideration of its autonomy. State autonomy—defined as the ability of the state to conceive of goals that do not necessarily reflect the interests or demands of the polity—is at the very heart of the matter regarding the developmental state. Discussion of the state has travelled far from the extreme notion of the “black box”, in and out of which measurable inputs and outputs neatly flow. Now when the state is discussed, we refer to its autonomous nature, its ability to shape outputs and, yes, the inputs according to its own objectives. As Skocpol has argued, the very existence of autonomy is the central case for the need to discuss the state as an important actor. Accordingly, analysis of the developmental state has quite naturally centred around this term.

Autonomy has been perceived as the prime endowment that the state has been able to parlay into the attainment of its development goals. Evans’ contribution to the understanding of the developmental state in general and on the Korean peninsula in particular is immense. His uses the term “embedded autonomy” to describe the political milieu in which successful industrial transformation can take place. In this setting, bureaucrats are embedded in a concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and renegotiation of goals and policies.

The true significance of his work, though, may in fact be in his recognition that the developmental state cannot do it alone. He writes further that

> either side of the combination by itself would not work. A state that was only autonomous would lack both sources of intelligence and the ability to rely on decentralized private implementation. Dense connecting networks without a robust internal structure would leave the state incapable of resolving “collective action” problems, of transcending the individual

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interests of its private counterparts. Only when embeddedness and autonomy are joined together can a state be called developmental.\textsuperscript{17}

The breakdown of Korean state autonomy during the country’s shift to a democratic governance model has been considerable and well-noted. This matter must be tackled head-on because, if Evans is correct, there should be no doubt regarding developmental state retreat. To what extent has the Korean state’s ability to autonomously formulate economic development policy actually been diminished? We know that it has lost strength vis-à-vis the chaebol, but does chaebol rise equal state decline? Moreover, is it possible that the democratic transition has actually granted the state autonomy by allowing it to shift its priorities and efforts away from the chaebol toward society as a whole? By shifting its goals, has this created merely a new degree of autonomy for the state, or different type of autonomy altogether?

The answers to these questions form the basis of chapters three and four and are at the heart of this thesis. To properly measure change in the developmental state, and to begin to make the case that the institution yet lives, it is essential to establish both its contours and how the basic shape is perceived. The existence of a variety of perspectives on the developmental state has caused it to be misconstrued and misrepresented. It is difficult to argue that the developmental state yet exists if both sides of the debate begin from differing conceptions of what exactly the term means. These differing conceptions have done more than clouded the waters surrounding the term. The fact that these perspectives have been largely informed by normative understandings of the appropriate role of the state, they have also led to a misunderstanding of how and why the state is changing.

\textit{The developmental state ethos}

In his explanation of Japanese economic success, Chalmers Johnson endeavoured to stake out a middle ground between traditional free-market and socialist perspectives. He did so first by stressing the consistency of the Japanese state’s emphasis on economic development over the 50-year period that he examines (1925-75). For him, the point is not about state intervention, because all states in some way play a role in their economy.

\begin{footnotesize}
\end{footnotesize}
The developmental state, however, through its more closely integrated relationship with the business sector, goes far beyond laissez faire-prone regulatory states. In Japan’s case, the government managed the relationship with Business by varying the degrees of control between what Johnson has termed “self control”, “state control” and “cooperation”. As he puts it, “none of them is perfect, but each is preferable to either pure laissez faire or state socialism as long as forced development remains the top priority.”

Although much celebrated, Johnson’s work has also been much maligned and misinterpreted. Perhaps the most important misperception is the belief that he assigned the lion’s share of credit for Japanese success to the role of the strong Japanese state, its industrial policy and that unfortunately crude phrase “picking winners”. Unfortunately, Japanese success and similar patterns of government involvement in other countries such as Korea have led scholars to infer from Johnson’s work a single-variable causal link between state intervention and rapid economic growth, when in fact the details of the story are much more eclectic.

More to the point, Johnson was concerned with the role of economic nationalism in supporting the concerted effort of state and business. Moreover, this economic nationalism, the very desire to develop and succeed economically, especially when placed in the global context, can be a powerful indicator of what the state is doing. The imperatives of coming to the industrialization party late have fostered the development of a catch-up mindset—a developmental ethos. This ethos is critical to the identification of a different set of requirements for development, an alternative way of conceiving and resolving the problems related to economic backwardness. With the deck already stacked against it by virtue of the West’s obvious economic advantages, the rules had to be bent in order to obtain success. In a retrospective defence of his own concept, Johnson points to the political legitimacy this popularly held belief has given to Japanese alternatives. He writes

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19 In a chapter published in Woo-Cumings 1987 *The Developmental State* titled “Odyssey of a Concept”Johnson reflects on the myriad ways his concept has been used and abused since he first published it.

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In the true developmental state... bureaucratic rulers possess a particular kind of legitimacy that allows them to be much more experimental and undoctrinaire than in the typical authoritarian regime. This is the legitimacy that comes from devotion to a widely believed-in revolutionary project.\(^{21}\)

Legitimacy is a term not normally associated with authoritarian regimes. But, legitimacy need not only be formed and expressed in terms of western representative democracy. If it is, then Johnson expresses doubt that the developmental state can ever be democratic, pointing out that

the source of authority in a developmental state is... revolutionary authority: the authority of a people committed to the transformation of their social, political, or economic order. Legitimation occurs from the state's achievements, not from the way it came to power.\(^{22}\)

In Korea, the state has drawn much of its strength from this Developmental Ethos. Even today, when asked, the average Korean believes that their country is still developing, a notion that flies in the face of its membership in the OECD and its status as the 12\(^{th}\) largest economy in the world. But the developmental imperative has both supported the state, and driven it. In one sense the state needed developmental success to legitimize its centralization of power, its heavy handedness in dealing with both industry and labour groups. In another, the desire on the part of the leadership to gain this legitimacy drove it to centralize power and undertake the concerted approach with the Big Business groups that helped sustain tremendously fast economic growth.

**The price is wrong in Korea**

Chang Ha-Joon points out that scholarly recognition of the importance of a strong state in the development process in late-industrializing countries is not a new thing. Developmental state economics derives its lineage from the German Economics School, best reflected in the works of Hamilton and List, Gershenkron’s (1966) theory of late development and the role of the state in industrial financing, Baran’s (1957) theory which showed that the lack of a nationalistic developmental state—such as in Europe or Meiji


\(^{22}\) Ibid, page 53.
Japan—has led to underdevelopment, or Myrdal (1968) who argued similarly that economic stagnation in many developing countries can be explained by the lack of a hard state capable of pushing aside various interests in the name of social reform and economic transformation. Chang even invokes Kuznets to show the need for a state to act as mediator of the winners and losers of the development process. Amsden’s empirical work on the Korean case built on these theories, coming to precisely the same conclusion regarding the importance of the Korean state in economic development. She provides strong “evidence for the proposition that if and when late industrialization arrives, the driving force behind it is a strong interventionist state.

Initial analysis in the 1970s and early 1980s of Korea’s success, however, was largely carried out by neoclassical trade economists. Their assertion is that it was the hands-off approach of the state that mattered most. The basic story is that state got the prices right by devaluing the currency and minimizing import barriers, thereby sending an important signal to exporters. Weiss and Hobson sum up this view as follows:

[Governments] did this, above all, it is alleged, by significantly opening up their economies to imports, by creating favourable exchange rates, and thus generally by allowing prices to reflect real scarcities. In short, the claim is that East Asian governments created a neutral trade regime that has allowed markets to work more freely than elsewhere, the effect of which has been to stimulate an exceptional export drive and virtually self-sustaining development.

The case would be more compelling, if it the empirical support for the otherwise rigorous economic methodology was not flawed and distorted. Alice Amsden’s charges typical neoclassical interpretations of Korean success with perpetrating a fallacy of identity.

26 Ibid, page 143. Weiss and Hobson support this assertion with their own evidence and an excellent summary (see pages 139-148) of a number of important cross-national studies that focus specifically on
They note only the liberalizing changes, and conclude that growth followed correspondingly. As such,

Korea’s economic success is attributed to a series of liberalizations introduced prior to ‘takeoff’. ...The events comprising liberalization occurred, but in conjunction with other policies, so that the logic driving Korean industrialization was not the freeing of markets.\(^{27}\)

To support her assertion, Amsden exposed the failings of the neoclassical analysis by showing that state policy did not allow prices to reflect true scarcities. The state got the prices wrong, particularly for the cost of long-term financing for favoured firms.\(^{28}\)

Control over access to credit was, of course, a crucial element to the mechanics of state-led development in Korea. Through this, it was able to cajole industry into not just entering state-preferred industries, but also to perform. The *Chaebol* knew that they would be supported if they followed the state dicta; they also knew that their access to continued financing would be cut off if they were not competitive and did not meet their targets. Amsden calls this the “disciplinary mechanism”. The power of this mechanism, however, has long faded, requiring a recalibration of our understanding of the Korean developmental state.

*Adjusting the lens*

There are essentially three versions of the state of developmental state in Korea today. The first is that it has reformed itself. The reform process began in the 1980s under the Chun regime, but really did not gain steam until the Kim Young-Sam government (1992-97). Under Kim, the banking sector was opened, the Economic Planning Board restructured into the Ministry of Finance, and crucial measures like the Real Name Financial system were promulgated.\(^{29}\) The reform process stalled in the latter half of Kim’s government, but was reinitiated under Kim Dae Jung with the advent of the 1997

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\(^{27}\) Amsden, page 141.

\(^{28}\) Amsden, page 144.

\(^{29}\) The reform process has been documented ad nauseam. For an early account, see: Moon Chung In (1988) “The Demise of the Developmental State?” in Journal of Developing Studies IV: 67-84. Two studies that cover the reforms of the early 1990s are Hahm & Plein (see note 28) and Lee Young Jo (1999) “The Rise and Fall of Kim Young Sam’s Embedded Reformism” in *Institutional Reform and Democratic*
crisis, the subsequent IMF austerity regime, and the renewed strength of the state. These factors enabled the Kim Dae Jung government to enact a sweeping set of reform measures that have largely remade the financial system and initiated a longer-term process to reform the Chaebol system.

A second, intriguing variant of this first version is that the developmental state has transformed itself into a "post-developmental" state. Hahm and Plein detailed the changes in Korean political economy during the late 1980s and early 1990s to show that the state is essentially going through an identity crisis. Previously repressed groups (labour, media) are now taking advantage of the democratic transition to make themselves heard on a variety of issues, and demanding change. At the same time, the chaebol have grown increasingly powerful and much less reliant on the state for financing. The implication of these factors was an acute breakdown in the state's embedded autonomy, a breakdown of the previously strong government-business relationship, and a consequent paralysis that has left the state incapable of dealing with democracy and the need for economic liberalization.\(^\text{30}\)

According to Hahm and Plein, this is a good thing. The previous state-society arrangement was good for the economy when the economy was comparatively simple. Because the authors' primary interest is in the evolution of technology policy and the role of a strong presidency, they know intimately that it will be difficult for the state to continue the heavy intervention that has served the country so well in the past. The rapid changes in technological development make central coordination a near impossibility. As such, they believe the former model should be pushed aside in favour of the Anglo-American model in which democracy and free market economics can work their magic together. Again, this is taken to be the natural course of events and, as such, good.

As such, the primary evidence for state demise is a combination of extensive neoliberal reform measures and the reality of a rapidly changing international marketplace in which no place is reserved for centralized state planning. What is especially captivating about these changes is that they were undertaken by the Korean

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state itself, despite the obvious fact that it was wall-papering itself out of existence. We should not, however, merely accept these as tantamount to developmental state demise. The real test of state demise should entail more than a stacking of reform measures such that all other activity is blocked from view. How, for instance, should we reconcile these reform measures with other empirical evidence of new promotion policies?

This situation is ripe for an injection of critical thinking so as to dig past the surface of the reforms themselves and note the existence of other possible motivations for the changes. My assertion is that those scholars predisposed to neoliberal economic tenet—those same scholars who misunderstood the role of the developmental state to begin with—are conflating neoliberal reform measures to mean simply that the state has withered. They do this in part because reform validates their normative standpoints and vindicates previous assertions that heavy state intervention was always going to be bad. This, after all, is the very nature of the crony capitalism debate which almost seems to imply that corruption does not take place in other jurisdictions. One can only conclude that these arguments are far too convenient, and wholly ignorant of a variety of other trends and possibilities.

A more appropriate assessment of the contemporary development state is that it is in transition, an argument put forward by Linda Weiss. At the core of her approach are the twin notions of state adaptation and state innovation. To be sure, she is not oblivious of the scope and breadth of the reform process. The strength of her argument, though, is her critical view of globalization/convergence theories which suggest that all economies are marching unchecked toward an Anglo-American economic standard. Regarding Korea’s case specifically, she makes two points. First, the logic behind the reform processes is not exogenous. Rather, “the momentum for change was primarily domestic-political in origin, long preceding external pressures for financial liberalization in the 1990s”. Second, “these changes have been neither unidirectional nor irreversible, sometimes suggesting a neoliberal direction, sometimes strengthening or creatively recomposing familiar institutional arrangements.”

After looking at developments in the political economies of Korea, Japan, and Taiwan, she concludes that instead of the

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expected picture of developmental state demise, what can be found is a more “mature” version of developmentalism that is no longer driven by the catch-up mentality. The new aims of the developmental state are transformative and continuous upgrading of the economy.

While Weiss’ empirical work on Japan and, especially, Taiwan enables her to make several strong conclusions about state adaptation and innovation in those countries, her defence of the Korean model is much less spirited. Her chief difficulty is reconciling her transition thesis with the impressive extent of economic and institutional reform brought about by the Korean state. She argues that any state interventions in the 1990s were comparatively mild, and attributable to a constant fear of economic crisis as opposed to a firm, long-term conviction to a transformative project. In other words, comprehensive state-directed economic development strategy has been replaced by emergency rear-guard tactics that are always ad-hoc in nature. Looking back, the state’s efforts at economic management in the immediate period leading up to the advent of the crisis certainly do little to dispel this assertion.

But what if the transformative project no longer had the Chaebol at the centre? No one can seriously argue that the Chaebol are no longer essential for economic development in Korea, or that they will not continue to receive the type of lender-of-last-resort support that has sustained them during the tough times of the 1990s and, particularly, since the 1997 crisis. Evidence of this can be found in recent high-profile bail-outs such as the Hynix corporation, and the ongoing state ownership and involvement in the banking sector. But, there is also serious recognition by everyone in Korea that the economy must be diversified away from the overwhelming dependence on the Chaebol. This, of course, necessitates the protection and nurturing the of a vibrant SME sector.

**Square pegs and round holes**
The following chapter will outline the altered shape of the transformative project and the new role for the developmental state in relation to it. Importantly, a transformative project yet exists and remains the central output of the developmental state. The new

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developmental state is a leaner version of its earlier self, absent the airtight control over the country’s finance system. Accordingly, the state will define its role as less a leader, and more of a supporter of industry. Much like in the past, it will play an informational role. It will continue to set goals for the economy, will continue to identify industries it deems strategic and worthy of development, and will continue to utilize a variety of traditional and innovative industrial policy tools to extend support to the business sector. That intervention is less intense and direct, but existent nonetheless, and goes beyond what might be expected in a simple Anglo-American regulatory state.

It is essential to remember, though, that the state is not alone in its pursuit of this goal. The economic and institutional reforms since the late 1980s have not occurred in a vacuum, nor are they merely the result of the elite’s conviction that globalization and liberalization are the best way forward for Korea. At the very least, the state in Korea has responded to the signals sent it by society, and duly shifted both its shape and its goals. Since 1987, the government has had to set out ballot boxes every few years to identify its mandate. This is a tremendous change, but it has not led simply to the dismantling of the developmental state as expected. In fact, we can see the opposite trend. The Korean people are upset with chaebol dominance in the economy and have called on their government to break its relations. This has led directly to a variety of measures that were aimed at reforming state support for chaebol, on the one hand, and enhancing state support for measures that foster equity and economic diversity on the other. Rather than leading to simply a renewal of strong state powers, this situation has led to a more limited, flexible state that is responding to a broader base of interests. At the same time, it is forced to continue to meet the strength of the chaebol, but now must also balance and temper its own policy preferences to appease an increasingly sophisticated and involved electorate.

In this way, we can reformulate our view of the developmental state in Korea. We can understand why it persists, why it will always be more than a regulatory state despite the weight of recent reform. But we can also understand why and how it is limited and, in the process, carve out a middle ground somewhere between its strong, authoritarian past and today’s nimbler, more responsive role. This rendition will also hopefully give pause to those attempting the equivalent of forcing a square peg into a

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round hole. The answer to the question raised at the outset of this thesis is two-fold. We must understand and appreciate the reforms that have taken place. But, we must also look beyond them at other trends. We will not come to a satisfactory understanding of the Korean political economy if we are not mindful of reforms and variations that do not fit our own normative understanding of the good economic order. The stark fact is that, although the economy and the government’s involvement in it is much reformed, convergence with an Anglo-American economic model has not obtained. As such, we should be much more critical when reading reports like the OECD country report quoted above.
Comparing the shape of the transformative project before and after the democratic transition will help to put the two central propositions of this study into an important context, and set the stage for the delineation of a new model of the Korean political economy in the next chapter. Whereas the initial transformative project was predicated on the creation and nurturing of large enterprises (LEs)\textsuperscript{33}, the most recent iteration is designed to cultivate a thriving, multi-faceted, and self-sustaining economic base of small and medium enterprises (SMEs).

The purpose of this chapter is to provide further detail and explanation to this notion of the transformative project and to show how the shape of the project was reformed and revitalized by the democratic transition in 1987. In the process, the chapter will also establish the ongoing importance and centrality of such a project in Korea. Notwithstanding the tremendous degree of change in the Korean political economy, and some fundamental shifts in the form of the project itself, the continuous drive to upgrade and develop further remains crucial to the functioning and development of the economy and, therefore, to improving the welfare of the Korean people.

The importance of the developmental state's relationship to the transformative project, moreover, should not be discounted. Indeed, by looking more carefully, by going beyond one-dimensional presumptions of state decline, we will find it difficult to imagine how the Korean economy in its current form would function without the involvement of the developmental state. It is not enough to simply take note of various neoliberal reform measures and assert the veracity of developmental state demise. We must also look for ways in which the state is still furthering development; if we find none, then a more credible case for developmental state demise can be made. An opposite finding must surely lead us to question the very basis of the decline thesis.

In fact, the growth of SME promotion policy since 1987 is an easy trend to spot and deals a very serious blow to celebrants at the developmental state's funeral. Not only has the state devised a complex, comprehensive system of tax incentives, credit guarantees, and direct start-up funding, it also created a new administrative institution to
coordinate and promote the sector, a move surely at odds with neoliberal prescriptions for state contraction and restraint. These new policies form the core of a new transformative project. By recognizing its existence, we can begin to obtain a more balanced picture of the Korean political economy and understand how and why the reformed developmental state continues to go beyond the type of reactive interventions described by Weiss. For the developmental state itself, the project represents a continued reason for being; for students of the Korean political economy, the project, and the developmental state’s relationship to it, represents the strongest piece of evidence to refute the state decline thesis.

* * *

On transformative projects
The basis of a transformative project lies in the rejection of traditional notions of comparative advantage. The central assertion of this theory is that nations should undertake only the economic activity in which it has a natural advantage in lower costs, and that free trade will eventually help countries achieve growth. Wade’s debunks this theory by exposing its weaknesses, arguing that there is yet no “causal mechanism linking realization of comparative advantage and higher growth”, and that traditional neoclassical explanations of East-Asian successes are specious as best. He rejects these explanations and the theory they are based on, showing that the state in East Asia is involved in the creation of growth through what he calls the governed market (GM) model.

He argues that the GM model is appropriate for explaining the Asian Miracle. It focuses on three central notions. First, there is a high level of investment that enables rapid and useful technology transfer. Second, this high level of investment, especially in strategic industries, would not have occurred without intercession by the state. Third, competitiveness of domestic industries was ensured by exposure to international markets. The state enacts policies to overcome risk, to guide resource allocation and to go beyond

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approaches that depend on comparative advantage to “produce different production and investment outcomes than would have occurred” simply by following free market policies.\textsuperscript{35}

Evans takes this type of state involvement as a given, arguing that “the appropriate question is not ‘how much’ but ‘what kind’”.\textsuperscript{36} He asserts that the state will become implicated in two important aspects of transformation. On the one hand, they must first aid in the process of wealth creation. The state must undertake a “transformative role”, insinuating itself in the process so as to encourage entrepreneurs who can and will create new productive competencies that can be capitalized upon for the further creation of wealth. But this necessitates a second involvement; the state must then undertake some responsibility for economic welfare. These two aspects, growth and welfare, are intertwined such that “growth remains a prerequisite to delivering welfare in the long-term.”\textsuperscript{37}

\textit{1961-1980: Big is best}
Under the tight control of General Park Chung Hee, the Korean state became heavily involved. It set in motion the initial transformative project and maintained real control over it until the mid to late 1980s. When he first came to power, Park’s goals were as much about reversing the years of economic disarray under the Rhee regime as they were about ensuring national security vis-à-vis the DPRK just to the north. But, economic nationalism was nonetheless at the centre of his agenda. One of his first targets was the corrupt businessmen whom he perceived as the root cause of continued economic backwardness and stagnation. He nationalized banks and used their financial capacity to coerce those businessmen into championing state development goals. As Amsden put it, the state then acted as an entrepreneur, a surrogate financier first corralling capital then directing it towards the investments it thought would pay off most handsomely for the country.\textsuperscript{38}

\textsuperscript{35} Wade, page 26.
\textsuperscript{38} Amsden, page 79.
Park made the clear choice to create a system that would support the development of large enterprises (LEs)\textsuperscript{39}. This preference for LEs was maintained throughout the 1960s and 70s and reflected the state's belief that bigger was better, a conviction informed by intimate knowledge of and interest in Japanese successes among the Korean political and economic elites, as well as simple political and economic reality on the Peninsula. The state needed rapid growth. To accomplish this, it had move away from the stabilization policies of previous regimes toward a more aggressive model. LEs were to be at the centre of a new model that could take advantage of Korea's numerous but idle labour force. As Lim puts it, the state knew that

in the 1960s Korea could have a comparative advantage only in light manufacturing, especially in low-value-added, standardized products. For the mass production of such standardized products the LEs were superior to the SMEs....\textsuperscript{40}

As such, the state made a clear choice, partnering with LEs to the exclusion of other socio-economic groupings like SMEs and Labour.\textsuperscript{41} The state had the upper hand in this partnership because of its ability to both discipline and reward firms that it favoured. As the economy developed, however, the power balance gradually reversed to the point that strong state control over finance was barely sufficient to even co-opt the chaebol, let alone coerce it.

By the end of the 1980s, the chaebol had become too vital to the functioning of the economy for the state to be able to control them consistently and effectively. Put

\textsuperscript{39} I draw a distinction between LEs and chaebol because the terms are not interchangeable. Chaebol is in fact a pejorative term used by Koreans to refer to the largest conglomerates and their ungainly accumulation of wealth and power. The state never set out to create such entities. It envisioned the creation of large enterprises that could act as engines of growth, serving as proxies for the state's development plans. Their transformation into political and economic monsters was a wholly unintentional by-product. When referring to initial state intentions regarding a transformative project, it is more appropriate to call them LEs.

\textsuperscript{40} Lim, pages 71-72.

\textsuperscript{41} To balance the partnership, the regime also included rural constituencies like farmers. The New Village Movement provided an additional source of legitimacy for the state and was crucial to helping the state achieve its goals. For a good discussion of this see the edited volume, Hagen Koo (1993) State and Society in Contemporary Korea, Ithica: Cornell University Press.
together, the revenue of the top ten *chaebol* at that time equalled roughly 75% of the Korean GNP.\(^{42}\)

Table 1: *Chaebol Growth 1981-1988*

<table>
<thead>
<tr>
<th>Rank</th>
<th>Chaebol</th>
<th>Number of Firms</th>
<th>Total Assets 1981 (in millions won)</th>
<th>Total Assets 1988 (in millions won)</th>
<th>Average Annual Growth Rate of Total Assets 1981-88 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Daewoo</td>
<td>21</td>
<td>4,017,518</td>
<td>13,385,536</td>
<td>18.8</td>
</tr>
<tr>
<td>2</td>
<td>Samsung</td>
<td>22</td>
<td>2,754,350</td>
<td>13,119,875</td>
<td>25.0</td>
</tr>
<tr>
<td>3</td>
<td>Hyundai</td>
<td>24</td>
<td>4,714,695</td>
<td>12,752,262</td>
<td>15.3</td>
</tr>
<tr>
<td>4</td>
<td>Lucky-Goldstar</td>
<td>20</td>
<td>2,999,7681</td>
<td>11,583,584</td>
<td>21.3</td>
</tr>
<tr>
<td>5</td>
<td>Ssangyong</td>
<td>11</td>
<td>1,997,913</td>
<td>5,500,089</td>
<td>15.6</td>
</tr>
<tr>
<td>6</td>
<td>Han Jin</td>
<td>12</td>
<td>1,737,506</td>
<td>4,962,023</td>
<td>16.2</td>
</tr>
<tr>
<td>7</td>
<td>Korea Explosives</td>
<td>15</td>
<td>935,861</td>
<td>3,951,553</td>
<td>22.9</td>
</tr>
<tr>
<td>8</td>
<td>Sunkyong</td>
<td>9</td>
<td>2,189,136</td>
<td>2,947,560</td>
<td>4.3</td>
</tr>
<tr>
<td>9</td>
<td>Dong Ah</td>
<td>12</td>
<td>1,331,328</td>
<td>2,419,521</td>
<td>10.5</td>
</tr>
<tr>
<td>10</td>
<td>Kia</td>
<td>6</td>
<td>402,054</td>
<td>1,998,642</td>
<td>30.5</td>
</tr>
</tbody>
</table>

Source: Kim Eun Mee (1997) page 86.

This concentration had obvious political and economic side-effects. Economically, the *chaebol* had become inflexible and ill-suited to the new realities of an international marketplace dominated by short product cycles. Their economic power also impeded the creation of that flexibility by effectively stunting the growth of a vibrant SME sector. On the political side, the *chaebol* became too central to the capacity of political leaders to stay in power. In describing this situation, Kang writes that “the growing indispensability of the *chaebol* to the political circles that controlled the machinery of the state ensured that the oligopolistic power of the big conglomerates would continue”.\(^{43}\) In the following paragraph, Kang relates an anecdote regarding Roh Tae Woo’s failed anti-big business campaign. After the campaign launch, the Federation of Korean Industries (FKI), a peak-association representing the *chaebol,* warned politicians of retaliation in the form of discretionary uses of political contributions with the chairman warning that “FKI would henceforth provide donations only to politicians willing to support and protect business freedom.”\(^{44}\)


\(^{43}\) Ibid. page 91.

\(^{44}\) Ibid. page 91. The quote is attributed to Koo Ja-kyung, chairman of Lucky Goldstar and the FKI and first appeared in Moon Chung-in (1994) “Changing Patterns of Business-Government Relations in South
1980-87 Cross Purposes—transformation derailed
No one can seriously deny that in a general sense, the chaebol system served Korea well economically. From the time Park took power to the end of his rule, Korea's growth rates were spectacular. In fact, prior to 1998, Korea endured only one year of economic contraction. This happened in 1979 when a volatile cocktail of domestic and international problems caused one year of decline. But while the state had clearly achieved its rapid growth objectives, it was also losing its grip on the process.

Park's assassination in 1979 marks the beginning of a period in which the state and its chosen partners worked at cross purposes, toward divergent goals. This effectively derailed the first transformative project during which the state had successfully forced the country's capital class to eschew short-term company profits and economic power in favour of long-term national development goals. When Chun came to power, however, the state changed its focus away from growth and support for LEs. At the same time, the Chaebol's ascendancy enabled them to revert to corporate goals and concentrate even more economic and political power. The two actors were clearly at a cross-roads, with the Chun regime attempting to stabilize (rationalize) and liberalize and the Chaebol striving to further their own growth. These seemed to feed off each other. The more Chun tried to undercut chaebol power by reforming the developmental state, the more the chaebol sought to capitalize and defy the state.

Chun's efforts to stabilize and liberalize the economy were in response to the extreme economic imbalances and overcapacity caused by the Park's rapid growth policies, particularly the state's heavy and chemical industries (HCI) drive of the 1970s. This new focus on rationalization can be traced quite clearly to a well-placed group of western-trained Economists for whom strong-state intervention was anathema. These economists had been gaining sway at the Blue House under Park and found a very sympathetic ear with Chun. The 1979 economic crisis and Park's overzealous HCI program which was partially to blame, provided much of their fodder. The only way to clean up the mess of overcapacity was a two-fold strategy to slow the pace of economic

growth, and proceed with the dual strategy of stabilization and liberalization. This is a fundamental shift for the developmental state which had previously based its legitimacy on growth, a conscious turn away from a 20 year project that was viewed widely and simultaneously as both successful and highly problematic.

The obvious problem was that the chaebol were becoming increasingly powerful and free and they had already begun to use this capacity to enter business lines that were not in alignment with state objectives. Worse, this was a clear case of them having their cake and wanting to eat it too. For instance, their forays into the financial services sector gave them further ability to circumvent state control over their operations by circumnavigating state control over credit allocation; they developed new, lucrative sources of revenue and help with cash-flow and intra-firm lending problems. At the same time, though, the chaebol continued to call on the state to provide labour peace and, perhaps more importantly, to continue to act as national underwriter for their ventures.

**Small is Beautiful: SMEs and economic diversification Phase I**

For the state, support of the SME sector represented an opportunity to reverse this situation, and accomplish a variety of important economic and political objectives. Politically, the state could use the SME sector to balance the chaebol and, thereby, regain a measure of its former importance. This aspect was less imperative initially as Chun came to power and installed neoliberals at the helm of the reform process. It became paramount later in the decade, though, as it was by then clear that chaebol growth and concentration remained essentially unchecked by the reform measures while, at the same time, the state's own power and autonomy was on the wane. As the decade progressed, rising democratic pressures and popular discontent with the chaebol and economic concentration offered the state the opportunity to reassert itself.

Economically, the state saw that the hazards represented by the chronic backwardness of the SME sector were critical and had to be addressed if the economy was to advance. For years, SMEs had been caught in a vice between the state and the LEs; the situation left them powerless and stunted. For its part, the state, helped create this situation by virtue of its preference for LEs. For instance, the state maintained or only slowly liberalized restrictions on new factories and did not extend capital
depreciation provisions. This encouraged expansion of existing firms rather than new entrants.\footnote{Cheng Tun-jen (1990) “Political Regimes and Development Strategies: South Korea and Taiwan” in Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia edited by Gary Gereffi and Donald Wyman Princeton: Princeton University Press, page 158.} At the same time, the chaebol were able to use their privileged position and the nature of their subcontracting relationship with the SMEs to squeeze the smaller firms, sometimes forcing them into unwanted business lines, sometimes compelling them to lower their already meagre profit margins and, when LE cash-flows were tight, often withholding payment on contracts. The other serious problem, of course, was the difficulty SMEs had to raise capital. The combination of these problems kept most SMEs on the edge, close to bankruptcy, never quite able to develop and thrive.\footnote{An interesting side-bar to this story is the rents created by the state for the LEs in this process. Because they were essentially blocked from easy access to credit, SMEs were forced to turn to the illegal “curb” market to obtain credit. Interest rates were much higher there than from legitimate sources and the pressure to perform and/or repay was often not unlike the loansharking business. The interesting part is that the LEs—often awash in cash from state allocated credit—became big players as lenders in the curb market. This provided them with yet another lucrative revenue stream and another method to dominate the SMEs.}

The result was an non-diversified economy typified by chronic technological backwardness and a resultant high degree of dependence on foreign producers for a range of intermediate goods. This problem was particularly noticeable in the auto and electronics industries. Recognition of this led the state toward less comprehensive transformative projects for the auto parts and IT sectors in the late 1980s and early 1990s. A more thorough transformation involved moving away from the ponderous chaebol system, toward the flexibility offered by a strong SME sector. The issue has been put best in terms of imitation and innovation. Various studies have documented Korean success at the imitation and diffusion aspects of the technology transfer process.\footnote{In addition to Amsden’s Next Asian Giant, see Kim Linsu’s Imitation to Innovation.} There was considerable scepticism, however, in the ability of the Chaebol to facilitate a dynamic national innovation system for the long term. Soh writes that,

The Chaebol remain focussed on the mass-production of standard products rather than the development of new technologies. Firms whose only advantage is lower factor costs rarely supplant previous industry leaders. Can the structure of industry be properly reorganized to satisfy the technological imperatives of high-tech industries?\footnote{Soh, Chang-rok (1997) From Investment to Innovation?: The Korean Political Economy and Changes in Industrial Competitiveness Seoul: Korea University Press, page 75.}
The answer is to be found in the promotion of the flexible production offered by firms of smaller size. Korea's political economy, however, could not be reorganized until state economic support mechanisms for LEs were fully dismantled and an appropriate level of backing achieved for the SMEs to redress the historical imbalance.

The stunted nature of SME growth, and its consequences for the Korean economy was widely recognized, particularly by the economists who were advising Chun. The only way to rectify the situation was to divert support away from the LEs and redirect it toward SMEs. SME support was accordingly written into all the plans. Table 1 lists the most important of these measures up to 1986. The 1980 Fair Trade Law, for instance, regulated LE concentration and LE control over SMEs by discouraging mergers and acquisitions. The state also introduced a measure compelling banks to provide a certain annual percentage of their new loans to SMEs. It also passed Fair Subcontracting at 1984, and gave limited tax exemptions to SMEs working in designated high-tech fields.50

<table>
<thead>
<tr>
<th>Year</th>
<th>State SME Promotion Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>Increase of Compulsory Lending Ratio</td>
</tr>
<tr>
<td>1980</td>
<td>Monopoly Regulation and Fair Trade Law</td>
</tr>
<tr>
<td>1981</td>
<td>Promotion of Purchasing SME Products Law</td>
</tr>
<tr>
<td>1982</td>
<td>Long-term Plan of SME Promotion</td>
</tr>
<tr>
<td>1982</td>
<td>SME Rationalization or Modernization Policy</td>
</tr>
<tr>
<td>1983</td>
<td>'Promising SMEs' Policy</td>
</tr>
<tr>
<td>1984</td>
<td>Fair Subcontracting Act</td>
</tr>
<tr>
<td>1985</td>
<td>'Leading Exporting SMEs' Policy</td>
</tr>
<tr>
<td>1986</td>
<td>Promotion of Parts and Components Supplier Industry</td>
</tr>
<tr>
<td>1986</td>
<td>Industrial Development Fund</td>
</tr>
<tr>
<td>1986</td>
<td>Small Medium Industry Start-up Support Law</td>
</tr>
</tbody>
</table>

Source: Lim Haeran, page 140.

Small had become beautiful again, but only up to a point. The main thrust of this new body of laws was fairness not favouritism, ensuring that those SMEs hoping for more comprehensive support would remain disappointed. For capital-starved SMEs, the problem with these measures in general is the shift away from sector specificity toward neutrality. Instead of picking the winning industries of the future and bankrolling their

Lim, Haeran page 87.
development as it had during the first transformative project, the state began to direct its resources toward broad endeavours like R&D activities that, if successful, could be diffused across a broad spectrum of industries. This neutrality was in line with the state’s new philosophical commitment toward economic liberalization.\(^5\) In other words, SMEs could not expect the comparatively high degree of state intervention in developing their sector that had obtained during the first transformative project. The state was not constructing a comprehensive system of SME support. It would help SMEs get out from under the LE yoke, but there would be no policy loans and the state would not institute anything like the government-business ties that had bound the state and LEs so tightly.

In any event, the state was too preoccupied with trying to reign in the *chaebol* to be able to go to great lengths to buttress the sector’s development. In the first half of his rule Chun was caught up first by the political changeover from the Park regime and the need to target and rationalize *chaebol* activity. The *chaebol* formed the core of the economy and could not simply be pushed aside. Attempts to organize SMEs were, therefore, half-hearted. For instance, although Chun initiated the Korean Federation of Small Businesses (KFSB), it never attained the importance of the LE equivalent Federation of Korean Industries (FKI). The goal of the KFSB was to develop and execute SME policy but, in reality, it never attained enough status for SMEs to be able to significantly affect state SME policy-making.

**Deeper problems for SMEs**

The preoccupation with the *chaebol* is emblematic of the gravity of the situation. The combined weight of the backwardness of the SME sector and the over-concentration of the *chaebol* ensured that any process of correction would be a long one. After 20 years of developing industrial policy and government-business relations tailored for the needs of LEs, it is not surprising that the state’s first efforts at realigning itself with SMEs would be less than spectacular. Indeed, it is difficult to interpret Chun’s attempt to co-opt the SMEs as anything but a failure. There had been a readjustment of lending priorities, but

\(^5\) Ibid, page 88.
this seemed only to benefit a small portion of the SMEs, specifically those who were operating in the state’s favoured parts and components sectors.52

At the same time, the Chaebol were rising and the state was falling. Under Chun, the state had dismantled many of the political tools it had used to control and coordinate the private sector. This was being driven in large measure by neoliberal economic convictions among senior economic bureaucrats, and a more specific desire to shift support away from chaebol. The upshot, however, was that it undercut its own efforts to create a comprehensive SME approach. Meanwhile, chaebol pressure was beginning to undermine state efforts on both accounts. More fundamental than forcing Roh to shut down his anti-big business campaign the chaebol also drove him to move “progressive reformers” like Cho Soon and Moon Hee Gap out of the key cabinet economic positions and replace them with more pro-business, pro-growth people, people who were less interested in stabilization and equality measures.53

Part of Roh’s problem was an economic “down turn” in 1989, downturn in quotes because the growth rate that year was 6.5%. It was perceived as a downturn because of steadily worsening macroeconomic figures. Inflation was on the rise, largely due to skyrocketing land prices. Also, the won was appreciating, undermining Korea’s export competitiveness and driving down export numbers. Finally, the Balance of Payments began to move into a deficit position, reaching $9.5 Billion by 1991. These problems led to a tight money supply policy, a devastating measure for SMEs. It led to a marked increase in bankruptcies, particularly amongst the smallest firms.54 In the hearts and minds of Koreans, this constituted a bona fide economic crisis.

1987-1997 Trying again: SME Promotion Phase II
Roh’s economic policy was erratic at best, meandering between progressive reform and a reinstatement of a pro-business attitude. This reflected a breakdown in the state’s ability to formulate effective policy.55 The coincidence of his policy reversals on important

53 Ibid., page 91.
54 Ibid., page 92.
55 Notwithstanding the obvious structural problems Roh Tae-Woo had to deal with, there were serious questions about his capacity as a leader. Referring to his penchant for fluid inconsistency, Koreans took to
economic matters with the advent of democracy seems to lend much credence to the notion that developmental states and democratic governance do not mix well. Yet, the Roh presidency also marks the beginning of a period of remarkably consistent growth in SME promotion policy. (please refer to table 3 below) Over time, the promotion tools have become increasingly potent and comprehensive. How can we explain this consistency regarding state SME after the transition?

referring to him as Mool Tae-Woo, the Water president. This inconsistency would dog his successor, Kim Young Sam also.
Table 3: New or Strengthened SME Support Policies after 1987

<table>
<thead>
<tr>
<th>State Measures</th>
<th>Date of Introduction or Amendment</th>
<th>Key Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Framework Act on Small and Medium Industries</td>
<td>January 5, 1995</td>
<td>Umbrella Act for all SME policy. High degree of presidential latitude in policy making. Mandates a new SME product purchasing policy for government. Calls for SME promotion in local areas. 1998 Amendment introduces annual report to the National Assembly and mandates and annual fact-finding role for the SMBA.</td>
</tr>
<tr>
<td>Promotion of SMEs and Encouragement of Purchase of their Products Act</td>
<td>December 22, 1994</td>
<td>An exceptionally broad act that has been moved under the SMBA for execution. Creates extensive government and public agency product purchase plan. Provides capital for joint academic-SME programs. Facilitates “business conversion” programs. Chapter Five mandates creation of SME Promotion Fund. Outlines Tax Incentives system. Inspection and reporting process for SMEs receiving support is instituted. Funding is made available for Science and Tech firms.</td>
</tr>
<tr>
<td>Support for SME Establishment Act</td>
<td>May 12, 1986 Wholly Amended in 1990, 19 Times Since</td>
<td>Since creation of SMBA in 1996, this gives executive power to loan/invest start-up funds. It applies only to industries identified by Presidential Decree. Amendment makes funding contingent on registration with SMBA.</td>
</tr>
<tr>
<td>SME Cooperatives Act</td>
<td>December 27, 1961 Wholly Amended in 1990, 19 Times Since</td>
<td>Provides incentives for SMEs to join cooperative associations to increase efficiencies. 1990 amendments enabled state funding for overseas offices. Outlines the SME Mutual Aid Operation Fund. Prohibits cooperatives from interfering with political process.</td>
</tr>
<tr>
<td>Act On Special Measures for Supporting the Structural Improvement and Stabilization of Small and Medium Enterprises</td>
<td>December 29, 1995 Amended January 13, 1997</td>
<td>Designed to aid structural improvements and ensure operational stability. Grants executive power to “change the economic environment to enhance competitiveness”. Outlines the Emergency Support Plan. Enables tax incentives for businesses joining the Mutual Aid Project Fund which was designed to strengthen industry and encourage entry to the Fund. The Fund Manager can underwrite additional loan guarantees with Ministry approval.</td>
</tr>
</tbody>
</table>

Capitalizing on Democracy 37
<table>
<thead>
<tr>
<th>State Measures</th>
<th>Date of Introduction or Amendment</th>
<th>Key Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Assistance to New Technology Business Act</td>
<td>December 31, 1988 Amended 4 times in the 1990s</td>
<td>Provides State funding for new technology businesses. 1997 Amendment created the Technology Credit Guarantee Fund. Applies only to SMEs and industries identified by Presidential Decree</td>
</tr>
<tr>
<td>Act on the Protection of the Sphere of SMEs and Promotion of their Coordination</td>
<td>January 5, 1995 and amended on December 13, 1997 and February 5, 1999</td>
<td>Enables government designation of crucial business sectors for promotion. State rationalization and industry definition powers. SMEs acquiring businesses through state-ordered rationalization are eligible for funding from Establishment and Technology Funds as well as tax incentives. LEs provided tax incentives to transfer businesses. LEs specifically prohibited market entry into certain sectors. SMBA Administrator can go directly to the FTC on behalf of SMEs if LEs violate rationalization or subcontracting orders. Promotion can be phased out by Presidential Decree</td>
</tr>
<tr>
<td>Act on Special Measures for the Promotion of Venture Businesses</td>
<td>August 28, 1997 and amended 5 times since</td>
<td>Designed to facilitate industrial restructuring and enhance competitiveness. Falls under SME Framework act and is applicable to SMEs only. Tax incentives are outlined. Priority is given to firms working in the high tech sectors identified by MOCIE.</td>
</tr>
<tr>
<td>Credit Guarantee Fund Act</td>
<td>December 5, 1974 Wholly amended in 1990 and 6 times thereafter</td>
<td>Provides credit guarantees to facilitate financing. Available only to SMEs with weak capacity to raise capital (95 amendment). Enables PM to force contributions to Fund from Financial Institutions (98 amendment). Primary contribution to the Fund is from the state. Guarantee limits are prescribed by Presidential Decree. Since 1998, MOFE has had significant latitude on Fund Operations</td>
</tr>
<tr>
<td>Industrial Development Act</td>
<td>Wholly amended February 8, 1999</td>
<td>Calls for balanced industrial development. Creates Industrial Foundation Fund run by MOCIE</td>
</tr>
<tr>
<td>Monopoly Regulation and Fair Trade Act</td>
<td>December 1984, wholly amended in 1990, 10 times since</td>
<td>Added transparency and enforcement measures. Protects SMEs from LE control. Increasingly strengthened throughout the 1990s. Violation can result in transfer of business, forced resignation of Officers, and cancellation of debt/credit guarantees</td>
</tr>
<tr>
<td>Transactions in Subcontracting Act</td>
<td>December 1984, wholly amended in 1990, 10 times since</td>
<td>Adds further protection for SMEs from LE control by regulating the pervasive subcontracting system. Works in concert with the Monopoly Regulation Act.</td>
</tr>
</tbody>
</table>

*source: Republic of Korea Statutes*
Typical analyses of Korean political economy either missed the various developments listed in Table 3 altogether, or merely mention them in passing without considering broader implications. Lee Young-Jo is a good example. In an edited volume by Larry Diamond and Shin Doh-Chul, Lee argues that Kim Young Sam's reform processes did not go far enough, and that this failure in large measure precipitated the financial crisis. But he only recorded half of the story. He duly underlines the continuing trend of stricter application of fair competition laws and various institutional reform as part of the effort to reverse economic concentration, yet makes no mention of SMEs and new state promotion programs.

The most important measure he missed was the creation of a new state agency to coordinate SME development. The Small and Medium Business Administration is a new central agency falling under the MOCIE umbrella. It opened its doors for the first time in 1996, less than one year after enabling legislation was passed. Although it was streamlined in 1999, it maintains a wide range of functions and is supported by a generous budget and important ties with the Blue House. Most of the measures listed above give the president and his executive a tremendous degree of latitude to formulate policy through presidential decree, and the SMBA is the prime executive body. In this role it administers SME policy and coordinates several financing tools to help SMEs. As the agency on the ground in closest contact with industry, it also advises the state on the formulation of new policy. To these ends, it operates four bureaus clustered around a main Planning and Administration Office.

The most important distinction between state-led SME promotion before and after the 1987 transition is the enhanced comprehensiveness and the interwoven nature of the newly enacted laws and institutions. The SMBA is at the centre but, as Table 2 above shows, it has at its disposal a wide range of laws that mandate its activity in a variety of areas, including start-up assistance, technology promotion, industry rationalization and targeting. Article Five of the Framework act, for instance, calls on the state to create “policy necessary for accelerating the start-up of the small and medium enterprises...”. To facilitate this, Chapter Five of the Promotion Act creates the Fund for Establishment and Promotion of SMEs. This Fund is operated for the SMBA by an offshoot organization called the Small and Medium Promotion Corporation. This arrangement lends an air of legitimacy and arms-length operation, but the Fund policies and procedures can be amended at any time by Presidential Decree. Most of the Acts listed above cross-reference articles in the other acts, and all refer back to the Framework Act itself. In other words, a tremendous effort has been made to coordinate legislation and create a comprehensive network of support.
Lawmakers have also endeavoured to create executive capacity to decree changes to these arrangements as required. The new laws also provide the state with enhanced means to define and discipline industry. The Framework act, for instance, leaves to the discretion of the president the determination of the scope of SMEs and, therefore, their eligibility status. Currently, firms with over 299 employees are not able to obtain SME funding. In various clauses in the Acts, though, the National Assembly gave the President the latitude to change the definition or simply to circumvent it as needed. Moreover, discipline measures have been built in. Access to start-up funding and credit guarantees requires registration with the SMBA and the obligation to submit to “inspection”. This is a measure to ensure that funding is properly allocated and expended. It also gives the state an information capacity.

The consistent growth of these support measures and the apparent agreement between the Presidency and the National Assembly on the need to promulgate them either belies notions of legislative gridlock and the incapacitation of coherent economic policy making by democracy or is emblematic of a deeper current of democratic consensus. Article 123 Section 2 of the Korean has long called on the government to “protect and promote” SMEs. This was mere lip-service until 1987. As Moon notes, what transpired is odd in light of our assumptions regarding democracy. He argues that “political and ideological dynamics underlying the promotion policies deviate from normal pluralist or bureaucratic politics”. There were no overpowering objections: In fact, the Federation of Korean Industries and all opposition parties strongly supported the measures. Regarding the creation of the SMBA specifically, only the Ministry of Finance and Economy was in opposition, their main objecting being that it conflicted fundamentally with what it perceived as the need for leaner government. But this opposition was defeated.

58 An obvious short-fall of this study is its reliance on secondary sources, website statistics, and the black and white letters of the Korean Statutes. A more interesting story regarding the power of the Korean state would almost certainly be uncovered with detailed interviews with members of the National Assembly and state bureaucrats. It is well-known that the President still initiates the lion’s share of legislation into the Assembly, while legislative apparatuses in the party system remain woefully under-developed.
60 Moon Chung-in (1999) page 18.
61 Ibid., page 18.
Toward a new model
The evidence in this chapter demonstrates the ongoing importance of the transformative project in Korea and the state’s continuing effort to foster it. One key difference before and after the democratic transition, however, may well reside in the centrality of the project. The first project was premised on rapid growth and development of the economy. It was the result of a strong alliance between the developmental state and the large enterprises it nurtured. Outside of national security concerns, from which the first project was in large measure conceived, there no issue was of more importance to the state. It had one goal and was able to focus almost exclusively on it. In the post-transition period, the strong alliance between the state and the LEs ceased to exist. And, while the emphasis of the state on economic development in general, and a transformative project in particular, has not diminished, it has had to divide its energy between competing issues and interests. Initially, the most pressing issue was the need to dismantle LE support networks and struggle to check the ever increasing power of the chaebol it had created. As such, while we can clearly see the contours of a new project forming from the beginning of the Chun regime in 1980, it took at least another seven years for it to take hold in any meaningful way. In the meantime, while the state was doing battle with the chaebol, the political economy was maturing and becoming more complex. The state also found itself confronted by an ever-diversifying set of demands from the Korean people themselves who, for the most part, focused their anger at the favourable ties between the state and the chaebol, and what they perceived as their disproportionate share of the riches of development.

Popular discontent with chaebol concentration and the continuing perception that the country has not yet joined the exclusive group of advanced countries has buttressed the state’s efforts on both ends of the state’s dual strategy. First, there is clear evidence of agreement within Korean society for the need to curb chaebol power and influence. On the other side, there has been little opposition—even amongst the chaebol—for more comprehensive SME support. Chaebol agreement with SME promotion is likely due to a cold calculation that a more dynamic sector will benefit them. For the people, SME programs represent a continued break with the past, a program more akin to equity and wealth distribution. Christopher Dent argues that there is a lingering cognitive-
ideological support to economic nationalism and neo-mercantilism. In extensive interviews with Lawmakers and policy analysts, even those advocates of the most neoliberal program admit two things: one, that the state needs to actively promote SMEs; and two, that there is too much public support for this type of state activity for the democratic developmental state not to undertake it.\textsuperscript{62}

That is not to suggest that the state is well-trusted. Most Koreans remain highly suspicious of collusive government-business ties. It is therefore nothing less than a contradiction to support strong-state support for SMEs. Or is it? Of this, two things can be said. First, the SMEs are part of the group that was left out of the first transformative project, putting them in a good position to benefit from considerable public antipathy toward the \textit{chaebol}. Second, the lack of public challenge to the state support for SMEs is based on the twin notions that this support will lead to a positive development for the economy as a whole,\textsuperscript{63} and the grant of legitimacy that the people continue to extend to the state to act in these matters.\textsuperscript{64} The next chapter picks up this matter of legitimacy because it forms part of the glue which holds a new Developmental State Alliance together.

\begin{thebibliography}{9}
\bibitem{Dent} Dent, page 143.
\bibitem{Johnson} Johnson (1999) page 52.
\end{thebibliography}
CHAPTER FOUR: A NEW SOCIAL COMPACT

In the midst of all these changes, what has happened to the developmental state? How has it been affected by the various pressures placed on it? Where does it stand in relation to the chaebol and the public? Has it simply withered away? If so, how can we explain the restructuring of the transformative project, and the creation of new, comprehensive industry promotion policies for SMEs?

The democratic transition provides the best starting point to answer these questions. The new mandate for the reinvigorated developmental state in Korea is to foster equity. This is a direct result of the state’s realization, based on its experiences immediately prior to and after 1987, that future success and political survival now depend on listening to and appeasing a wider constituency than just the LEs it had previously partnered closely with. The imperatives of democratic pressures have served to push the state toward active promotion of the SMEs. Sensing an opportunity to balance the increasingly powerful chaebol, the developmental state has capitalized on democracy to maintain its own relevancy.

Unfortunately, the transition’s effect on the developmental state has been misinterpreted to mean state decline. As a result, we have missed a very important outcome: the creation of a new developmental state alliance that constitutes a new social compact.

* * *

Reformation or renaissance?
This misinterpretation is a result of the mainstream assumption that democracy and the developmental state are incompatible. Lee points out that the tendency has been to equate developmental states with authoritarian political rule, implying that if democracy is injected, and markets liberalized, the outcome will necessarily be a dismantling of the developmental state. From that standpoint, evidence of neoliberal institutional and


market reforms are then easily conflated into proof of what is expected. In this way, state retreat from and reformation of the Korean financial sector provides good fodder for the state decline thesis. Never mind that it is the state itself driving the reform process. After all, the most effective industrial policy tool for the Korean developmental state historically was its capacity to allocate credit. Without this capacity, it can no longer control the process.

Viewed from another perspective, however, financial sector reform can also highlight the beginning of a course of state revitalization. Recall that the essence of Hahm and Plein's Post-Developmental State thesis is that the state has already reached its goal, its intervention no longer required and, by extension, the credit allocation system that so favoured LEs could be reformed without cost. It can also be argued that the economic and political problems in evidence at the end of the 1980s required a different, more measured and sophisticated state response than what had transpired under Park. It can be argued that what was required was not a total state dismantling but a state renaissance.

Since the late 1980s, the state has formulated this response on the basis of a dual strategy. First, it has undertaken to systematically take apart almost every vestige of state support for the chaebol that was remaining. This was the basis of Kim Young Sam's Sehgyewha policy. The country was ready to embrace international competitive forces and in so doing would climb the next rung in the development ladder. Industry would be free to conduct business. At the same time, the state has steadily enhanced its capacity to help SMEs in the ways outlined in the previous chapter, including the creation of a comprehensive and complex system credit allocation that is designed to encourage new SMEs to enter the market in the strategic industries that continue to be identified by the state.

The fact that the state no longer exercises the near-total control over the course or shape of the transformative project it once did is not discouraging for this thesis. Although the far-reaching effects of the changes in the Korean financial system have obviously undermined state capacity to coerce business into following its development.

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68 Internationalization policy.
plans, this should not simply be taken to mean that the state is no longer intimately involved with a developmental project, or that its actions have stopped going beyond those prescribed by the Anglo-American model. In its new role, the state will work more cooperatively with businesses, encouraging it into certain preferred sectors, and supporting the entrepreneurs who do so. The days of whole industries being mapped out by the state are long past. The economy is much too complex for that, as Hahm and Plein rightfully point out. Total control has now given way to even closer State-industry collaboration on planning, goal-setting and, even, favourable allocation of credit.

**Capitalizing on democracy**

Rather than forcing state retreat and obviating the state’s role as expected, the democratic transition has altered it, forcing the state to adjust its institutions and modify accordingly the requirements of its primary output, the transformative project. The 1985 National Assembly elections was a turning point for the state in this respect, because it highlighted the rising importance of the electorate—in particular the middle class—and the rapidly emerging need to appease it. It served as a wake-up call. Haggard and Moon argue that the Chun regime had gambled incorrectly on its stabilization and structural adjustment program, hoping that it would be enough to convince people that state-business relations had been reformed and “eventually bring political payoffs” at the ballot box. The election results disabused the ruling elite of its faith. The state was lacking popular legitimacy, a fundamental component of its former capacity. From that point, the political leadership recognized the need to take comprehensive action to mitigate the negative consequences of the first transformative project.

The results pushed the state to reformulate its strategy, forcing it to pay attention to the issue of equity and social justice. In the 1987 election, the platforms of all parties including the ruling Democratic Justice Party converged around the need to foster equity,

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to reverse chaebol concentration. The 7th Five Year Social and Economic Development Plan that was initiated after Roh’s inauguration was essentially a carbon copy of Roh’s election platform as outlined by the ruling Democratic Justice Party. But the DJP itself had very little to do with the creation of that platform. It had been developed by officials from the Economic Planning Board, Ministry of Commerce and Industry, and the Ministry of Finance. Because the agenda was being driven by the President himself with the full support of his main economic lieutenants, the usual inter-ministry rivalries were non-existent. In the end, the platform was adopted almost without change by the party at government-party meetings.\footnote{Lee} Whether the state leadership had been caught off-guard by the 1985 elections is not the issue here. The point is that it drove home in the most powerful way possible to politicians that the state’s policies had to change.

**A new social compact**

Choi puts the need for change in the context of serious societal cleavages. The most dramatic of these had opened up along lines of democracy versus authoritarianism and economic justice versus development. His main argument is that these rifts can only be reconciled by a dissolution of the “over-developed state”.\footnote{Choi, page 18.} But rather than simply dismantling its own institutions, the state seems instead to have grasped deftly at the opportunity presented by the obvious popular desire to see the chaebol checked. Faced with a tremendous and problematic increase in chaebol power and economic concentration on the one hand, and what gradually came to be seen as the inevitable rise of civil society and democratic pressure for change on the other, the state chose to not resist the democracy movement, instead co-opting it as a means to help balance and reform the chaebol. In so doing, the state managed to help itself by working to maintain its own relevance in setting a new transformative project into motion.
Figure Two shows how the alliance has shifted. Under the authoritarian system, the state was hard, and quite insulated. As outlined in previous chapters, it worked together with the chaebol toward the main goal of fast growth through industrial transformation. LE promotion and nurture was the cornerstone. At the same time, democratic pressures for political and economic reform were effectively held at bay, outside the alliance. Lim Haeran refers to this situation and period of time as the exclusive coalition. Within this coalition, the chaebol and the state locked horns. This was an unintended outcome for the state.

Instead of a one-way relationship in which the state always had the upper hand, what transpired was mutually transformative. As they became more powerful, particularly in the 1980s after the death of Park Chung Hee, they were able to assert their own authority more, and follow state directives less. Unfortunately, the modulating

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73 Lim, page 60.
strength of the state vis-à-vis the chaebol and vice versa cannot be placed on a neat continuum and mapped. Even while the chaebol were rising in the 1980s, the state was still able to exert tremendous authority. This most infamous example occurred in 1985 when Chun, in a pique because one conglomerate (the Kukche group) refused to contribute funds to his foundation, sent the message to banks to not roll over the group's loans. This caused the group to fail, at which time the state presided over its distribution among other business groups who had made political contributions.

By the mid-1980s, pressures for both political and economic reform had turned irresistible for the state. In her discussion of this period, Lim suggests that the exclusive coalition shifted to inclusive, with SMEs being brought in to join the state and the chaebol. In her work, she focuses on those early efforts by the state to redress the economic imbalance. This may be the best way to describe the government-business relationship during that time, but does not explain what transpired next. By the 1987 transition, the transformative project had been derailed; the state was no longer working in concert with the chaebol, but rather trying to liberalize and stabilize, regulating instead of promoting. Since 1980, it had been working to dismantle LE promotion policies while building up SME support. In 1987, these trends deepened, leaving the chaebol completely out, and the SMEs in.

The new coalition is broader than just SMEs and the state. The new developmental state alliance has had to take into account the wishes of a broader spectrum of the population. Labour groups, the middle class, and SME owners, are now on the inside pushing the state to enact more distributive policies that foster equity. As a direct result of democratic pressure, the capitalist developmental state has transition into a democratic developmental state. The focus is still on growth and development, as shown in the continuing transformative project, but with less economic concentration. Additionally, it is no longer a hard state, insulated from public pressure. The now-emancipated media has done much to ensure that. There is also been a tremendous

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74 Ibid., page 86.
75 Moon (1999), page 9.
increase in interest group participation. Most importantly, the state’s policies and achievement can now be held accountable at the ballot box.

My argument, though, is that this has not deterred the state from undertaking its responsibilities within the developmental state alliance. Its policies have been shaped by democratic pressures, and it has answered appropriately. Johnson has suggested that if judged only by Western notions of “state accountability”, then surely democracy and the developmental state cannot coexist. However, he continues:

the source of authority in the developmental state is...a people committed to the transformation of their social, political or economic order. Legitimation occurs from the state’s achievements, not from the way it came to power.

The glue holding the new developmental state alliance together is legitimacy. This is a fundamental distinction with the previous alliance. The state under Park drove the transformative project through a serious of sticks and carrots. Business leaders were rewarded for following, and disciplined for not. Even then, however, his goal was based on the need to legitimize his method of taking power and, subsequently, his continued dictatorial rule.

What has changed? The state continues to crave legitimacy, and it continues to find define it within the developmental ethos. The difference is the convergence of state and society goals. The state no longer needs to cajole entrepreneurs. It is less a leader of the project and more of a supportive team player. In this new role, the linkage between democracy and SME promotion is natural. SME ownership, for instance, represents a solid block of the middle class. Because of its obvious importance in Korean elections, it was essential for the state to cooperate with this group, essentially compelling it to promulgate SME promotional policies. Additionally, employment patterns were starting to shift. In 1980, the percentage of Koreans working at SMEs and LEs was roughly even.

77 Johnson (1999) page 53.
78 Lee, page 88.
By 1990, almost 62% of manufacturing workers were located in SMEs. These factors have led Moon to argue that “supporting [SMEs] is tantamount to promoting democratic reforms.” Facilitating stronger SMEs is seen as means to correct past economic and political mistakes and to begin to repair those societal cleavages.

**Another derailment?**

The new social compact and the state’s efforts to promote SMEs is only one side of the story. At the same time, the state had to do continual battle with the Chaebol. There were two problems. One was the ongoing concentration of chaebol economic power. The direct effect on the prospects of the new transformative project and, therefore, the new developmental state alliance, however, was the increasing interaction of capital in the political process. This undermined the future of the new alliance and almost derailed new project.

In the heyday of the strong state under Park, the chaebol stayed out of the political process. This was partly a result of the previous period under Rhee when capitalists pillaged public wealth at will. Under Park, the industrialists were brought to reckoning and forced to conform. As the political processes opened, the chaebol began to abandon the public neutrality, as demonstrated above when the FKI gave Roh an ultimatum regarding his anti-big business campaign. The most famous incident of chaebol jumping into the political process came in 1992 when Hyundai’s founder and patriarch, Chung Ju-Yung formed his own party and made a run at the Presidency. The fact that Chung’s interests were short-term and personal, as opposed to altruistic, is reflected in the fact that he disbanded his party shortly after defeat.

The chaebol are clearly threatened by the new alliance. Their answer has been to utilize their political power to influence the process of deregulation. The basis of their power lies in the increased reliance of politicians on chaebol for election financing. As Peter Wad points out, the costs of running an election in Korea are much higher than

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what can be obtained through legal means. The chaebol sensed this vacuum adroitly. As Wad puts it,

undoubtedly, the chaebol represent a new challenge to democratization because they possessed sufficient economic means to influence the mass media via ownership, advertisements, etc; to bribe politicians and bureaucrats if necessary; to fund political campaigns of political parties; or to establish and sustain their own party.

Wad concludes that it was this ability to influence the political process that helped the chaebol maintain their relevance. The result was an only-partial implementation of Kim Young Sam’s ambitious reform package. Essentially, the chaebol got what they were looking for, the freedom to roam international capital markets, without the burdens of supervisory restrictions.

It has been suggested that if those reforms had been implemented fully, the chaebol would not have been able to borrow and expand so recklessly, thereby precipitating the crisis. In retrospect, the chaebol may have wished for a forced regimen of financial prudence. In a sense, they lost a good opportunity to shape the creation of the new financial supervisory regime that was adopted after the crisis.

Crisis intervention
It is not the intention of this study to discuss the causes of the 1997/98 financial crisis that hit Korea and several other countries in the region. That has been taken care of admirably by a phalanx of economists and political scientists. Of more interest is the significant effect the crisis had on the new developmental alliance. In a nutshell, it strengthened glue that bonds together the democratic developmental state and civil society and further isolates the chaebol from the benefits of state industry promotion. In other words, the crisis has enabled the state to continue to pursue its dual strategy of economic diversification through SME promotion and Chaebol regulation. As to the

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latter, since the crisis the *chaebol* have been subjected to the pressures of increased corporate governance regulations and reform in the financial sector that has restricted their borrowing. At the same time, the crisis further underlined the need for state intervention to promote the SME sector. This need and various state responses can be defined in term of both immediate and long-term measures. Moreover, these measures took the form of both policy intervention and institution creation.

The most serious impact the crisis had on SMEs was the tightening of credit and subsequent tremendous rise in bankruptcies. From 1996 to 1997, the number of failed firms increased from 11,589 to 17,168. At the same time, the number of start-ups, which traditionally outpaces bankruptcies, fell to just 2756.  

84 This obviously reflected a frozen capital market and foreign-exchange crisis and implied that industry vitality was in serious trouble. More fundamental structural issues, however, are reflected in the increased dishonoured bill ratio. (see table 6)

<table>
<thead>
<tr>
<th>Year</th>
<th>National Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>0.17</td>
</tr>
<tr>
<td>1996</td>
<td>0.14</td>
</tr>
<tr>
<td>1997</td>
<td>0.40</td>
</tr>
<tr>
<td>1998</td>
<td>0.38</td>
</tr>
<tr>
<td>1999</td>
<td>0.33</td>
</tr>
<tr>
<td>2000</td>
<td>0.26</td>
</tr>
<tr>
<td>2001</td>
<td>0.21</td>
</tr>
</tbody>
</table>

Source: The Bank of Korea

The state response was quick and comprehensive. The first, most important measure, was to enable firms to continue financing their operations by injecting funds into the Korea Credit Guarantee Fund (KCGF) and the Industrial Bank of Korea (IBK). The KCGF has a long history, but had been realigned significantly in 1996 when responsibility for state contributions to the Fund was moved out of MOFE’s orbit to the SMBA. It is unlikely that the state could have responded as quickly as it did, given MOFE’s generally conservative policy line. As per the FUND’s enabling legislation, the State contributions are annual but subject to change depending on government budgetary considerations. Financial Institutions, however, must contribute a fixed proportion of the total annual loans they make. Additionally, the legislation set the maximum limit for aggregate outstanding credit guarantees at twenty times to total capital fund. This enables what the KCGF terms an “operation multiple”.

When the crisis hit, state contributions increased significantly. (see table 7) In January 1998, the KCGF set up a new Special Guarantee Program that was initiated “to assist SMEs suffering from temporary difficulties resulting from the crisis in the financial market”. To assist SMEs in the long-term, the KCGF in June 2000 set up the a special guarantee scheme which included two types of guarantees (Collateralized Bond Obligation; Collateralized Loan Obligation) to help firms obtain business capital through bond issues. Although the CBO and CLO schemes were designed primarily for medium and large firms, a credit ceiling for individual firms in the other funds was placed at 3 billion won (approx. USD 3 million) to ensure the benefit from the Fund’s capacity was widespread.85

Table 7: State and Financial Institution Contributions to the KCGF

<table>
<thead>
<tr>
<th>Year</th>
<th>State Contribution</th>
<th>Financial Inst. Contribution</th>
<th>Yearly totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992</td>
<td>870</td>
<td>1,466</td>
<td>2,336</td>
</tr>
<tr>
<td>1993</td>
<td>900</td>
<td>1,668</td>
<td>2,568</td>
</tr>
<tr>
<td>1994</td>
<td>2,400</td>
<td>1,963</td>
<td>4,363</td>
</tr>
<tr>
<td>1995</td>
<td>2,900</td>
<td>2,511</td>
<td>5,411</td>
</tr>
<tr>
<td>1996</td>
<td>3,500</td>
<td>2,834</td>
<td>6,334</td>
</tr>
<tr>
<td>1997</td>
<td>4,000</td>
<td>3,307</td>
<td>7,307</td>
</tr>
<tr>
<td>1998</td>
<td>28,810</td>
<td>3,515</td>
<td>32,305</td>
</tr>
<tr>
<td>1999</td>
<td>10,011</td>
<td>2,928</td>
<td>12,939</td>
</tr>
<tr>
<td>2000</td>
<td>5,100</td>
<td>3,238</td>
<td>8,338</td>
</tr>
<tr>
<td>2001</td>
<td>12,230</td>
<td>3,342</td>
<td>15,572</td>
</tr>
</tbody>
</table>

(source: 2001 KCGF Annual Report)

The Industrial Bank of Korea (IBK) also received an infusion of state money. In the wake of the crisis, and the state’s injection of 1.7 trillion won (approximately USD1.7 billion), rearranging once again earlier state attempts to dilute bank ownership.86 Like the KCGF, the IBK had also undergone a process of restructuring as part of earlier efforts by the state to promote SMEs. In 1994, the state decided to diversify control of the bank as part of its efforts to deregulate under the segyewha policy. It issued an Initial Public Offering which decreased its ownership in the IBK from 99.9% to 64.5%. This went

85 Korea Credit Guarantee Fund 2001 Annual Report
back to 98%, however, with the 1.7 trillion won. And, although by 2001 this figure was reduced again to 82.3%, the ownership structure this time merely shifted to other state-controlled banks such as the Korea Development Bank and the Korean Export Import Bank. Despite all the change in control, the state is still responsible if the IBK reserves are insufficient to cover annual losses.

The IBK has been an ideal facility for the state’s policy of fostering equity and balanced economic development. By the end of 2001, the IBK had extended close to 26 trillion won in loans to over 186,000 companies. Almost 80% of the loans are what the Bank terms “Working Capital Loans”. According to the 2001 Annual report, “these policy loans are extended at favourable interest rates compared with market funded loans, enabling the IBK to effectively finance SMEs in line with government policy”. In particular, this means favouring firms that are operating businesses in the areas of technology development, facility automation or activities that foster productivity improvements. More importantly, 63.7% of its total loans go to companies with less than 30 employees. (see table 5 below)

<table>
<thead>
<tr>
<th>Number of Employees</th>
<th>Number of Companies</th>
<th>Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 or less</td>
<td>157,271</td>
<td>84.5%</td>
</tr>
<tr>
<td>11-20</td>
<td>13,944</td>
<td>7.5</td>
</tr>
<tr>
<td>21-30</td>
<td>5,221</td>
<td>2.8</td>
</tr>
<tr>
<td>31-50</td>
<td>4,590</td>
<td>2.5</td>
</tr>
<tr>
<td>51-100</td>
<td>1,748</td>
<td>1.6</td>
</tr>
<tr>
<td>100+</td>
<td>2,056</td>
<td>1.1</td>
</tr>
<tr>
<td>Totals</td>
<td>186,126</td>
<td></td>
</tr>
</tbody>
</table>

(Billions of won, %)

The state also created a new standing institution to deal with the crisis and promote the SME cause. In 1998, it set up the Presidential Commission on Small and Medium Business. The purpose of the commission is to help SMEs overcome the crisis and to help them restructure and strengthen. From the structure of the commission and its location within the executive branch, it seems clear that this is a vehicle for the President to get directly involved in the policy making and mediate inter-ministry disputes. It is comprised of Vice-Ministers from the SME related ministries, as well as experts from the sector itself. The Chairman reports directly to the President. Essentially a product of Kim Dae Jung’s Blue House, it will be interesting to see how the new president interacts with it, particularly whether it will be marginalized or bolstered. According to the website, the President’s intention was “to create efficient and effective policies for SMEs and to coordinate cooperation, mitigate market bottlenecks, and conceive of national

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86 All material in this section is available on the IBK website (www.ibk.co.kr) and the Korean Statutes.
solutions for submission to the President”. For the immediate problem, the Commission helped by stepping in to mediate disputes between SMEs and other state institutions. According to its website, 380 such problems had been resolved by the end of 2002. It also had encouraged the purchase of 42 trillion won worth of SME products by 79 public agencies.

While these measures have had the desired short-term effect, it remains to be seen whether they will in the long term continue to be seen as an effective means for SME promotion. The best way to demonstrate this is the quick turn-around in the start-ups/bankruptcies statistics, and the dropping ratio of dishonoured bills. Table six above shows that the National Rate of dishonoured bills peaked in 1997, 1998, and 1999 before failing dramatically the following years. This is reflective of the improved capital flow, but is also due to more specialized programs created by the state for restructuring and insurance of commercial bills. Table 9 below also shows a reversal of fortune for new and old SMEs. While the number of new corporations actually doubled from 1997/98, the number of bankruptcies has fallen below pre-crisis numbers.

Table 9: Start-ups and Bankruptcies

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>New Firms</td>
<td>17,245</td>
<td>19,264</td>
<td>21,057</td>
<td>19,277</td>
<td>29,976</td>
<td>41,460</td>
<td>19,846</td>
</tr>
<tr>
<td>Bankruptcies</td>
<td>13,992</td>
<td>11,589</td>
<td>17,168</td>
<td>22,828</td>
<td>6,718</td>
<td>6,693</td>
<td>2,860</td>
</tr>
</tbody>
</table>

Source: Small and Medium Business Administration

While the short-term effects of this intervention are clear to see, the longer-term implications are more complicated. There are still serious problems with the subcontracting system in Korea, and it remains to be seen whether the strengthened Fair Transactions and Subcontracting Act will have the desired effect. What is clear is that there will be a continuance of close government-business relations in this area. Now in place, these measures will not be repealed easily. The new Roh Moo Hyun administration has not made any major announcements regarding SME promotion. However, given his focus on economic and social justice, the state will likely continue to operate in the same fashion.

Statistics are from two IBK reports: the 2001 Annual Report and the SMEs In 2001 Report.
CHAPTER FIVE: CONCLUSION

The arguments in this paper have revolved around two propositions. First, Korea has not abandoned the Developmental State model. Second, rather than leading to the developmental state's demise, electoral imperatives have served as an important opportunity for the state to reinvent itself, re-establish its relevancy, and carry on with the business of fostering economic development and industrial transformation. Both of these assertions run counter to mainstream assumptions and conclusions about what is transpiring in the Korean political economy.

The most important of these is the general assumption that democracy and the developmental state cannot coexist. The developmental state is the quintessential "strong" state, with significant capacity to formulate and implement policy and create political institutions that interact with business to foster economic development and industrial transformation. Within this depiction, it seems reasonable to suggest a priori that a democratic transition would dilute this capacity. To many who study Korean politics, this might seem obvious. Prior to the transition, the Korean state was at best authoritarian, and at worst, brutally dictatorial. The economic decision-making was insulated, a factor that in part facilitated a high degree of cohesiveness in the formulation of policy. If the hard state is made permeable, it seems natural to assume that policy and promotion functions will be less cohesive and that the developmental agenda of the state will be at risk, either by competing political interests or, worse, by capture by the business sector. It is not surprising, therefore, for predominant sentiment to be that the Korean developmental state is dead and to ignore the probability of an opposite trend while conducting research.

Even Linda Weiss, one of the most noted, ardent proponents of the other side of the debate is sceptical of the Korean case. Her best defence is to suggest, first, that it is Koreans themselves who are endeavouring to change their system, that the neoliberal reforms are mostly endogenous in origin. Moreover, and more importantly, she argues that the changes themselves are by no means irreversible. This is true enough, but even Weiss has missed some important trends. Disappointingly, her analysis was written and
published in 2000, when the state was at the height of its reinvigoration after the financial crisis. The developmental state is indeed adapting and innovating as Weiss suggests, but she is incorrect to argue that it does so only because of the continuous need for upgrade and innovation. In fact, the Korean developmental ethos, the catch-up mentality, still exists, and is one of the primary motivating forces behind renewed state efforts to build a dynamic, thriving SME sector. Weiss’ argument that state activity now is only reactionary belies the progressive build-up of new SME promotion policy since 1987. This is one of the primary points against the convergence thesis.

The assumptions regarding democracy and the developmental state has led to a dearth of analysis regarding its potential role in the reinvigoration and maintenance of the Korean developmental state. Moon’s analysis of SME promotion touches the political and economic motivations of the state, correctly hitting on the fact that protecting and encouraging SMEs is now a “democratic mandate” for the state. But he stops short of drawing the more fundamental implication that this democratic mandate is also a mandate for the state to continue to play a leading role in economic development on the peninsula. This democratic mandate effectively summons the state to continue to actively promote business and is yet one more reason why we should not jump to conclusions about convergence; rather we should continue the close form of government-business relations that have existed for years in Korea to continue well into the future.

The contours of the new developmental state are much different from the old one, however, and we should not expect it to interact with business as in the past. The state’s new clothes have been tailored by the state-society relationship. In this regard, the Korean developmental state has indeed been limited as Migdal’s theory would suggest. It no longer controls most aspects of the political process, and its ability to shape economic outcomes has also been curbed. This situation might be best placed in the terms of the old “leader” vs. “follower” debate. Wade might argue that what we see now is a situation of “big followership”. The state is clearly acting in many ways that bring about production and investment that would not occur in a purely free market. But it is no longer capable of forcing business into particular directions and, indeed, may no longer

wish to play this role entirely. The state today encourages and supports, identifying important business activities that should be developed and making the financial resources available to the entrepreneurs who can develop. The state is no longer an entrepreneur. Many have described the Korean state as a victim of its own success, the so-called grave-digger thesis in which the state created highly successful LEs that made Korean economic advancement possible, but which then turned into chaebol monster who haunted the state until it simply gave up and dismantled. This depiction is a good one, but only for the period leading up to 1987. From then on, a larger swath of societal forces has come to bear on the state. These forces have not diluted chaebol importance in the political economy, but they have served to shape a reincarnation of the developmental state that could move to affect that dilution.

I argue that the 1987 democratic transition embodies the beginning of a new epoch for the Korean developmental state. It marks the beginning of a new social compact in which the developmental state must play a role. Democratic pressures have led to a definition of that role. The new social compact that has developed comprises a new developmental state alliance, one that includes civil society and excludes the chaebol. The state has undertaken this role with a dual strategy designed to simultaneously promote SME development, and foster further regulation and dilution of chaebol power. The democratic developmental state is indeed limited in this role by the political dynamics inherent in a democratic governance system, but democracy in and of itself does not preclude the state from undertaking its role. Indeed, it is democracy that has led it to carve out this dual strategy. The democratic developmental state does not have at its disposal the tremendous financial resources and industrial policy tools that made the first transformative project possible. As the evidence above show, however, a solid case can be made to suggest that the state is moving slowly, but sure, to recreate that capacity. Future Korean presidents will not be as powerful as Park Chung Hee in this respect, but they will not need to be. The new developmental alliance is held together by a new breath of legitimacy, a legitimacy that is based on common goals, rather than the sticks and carrots.
This study also posed a question about the lack of analysis about this new type of state activity. Why is evidence of ongoing industry promotion policy and non-neoliberal institutional reforms ignored when considerations of developmental state vitality are made? Specifically, why have the tremendous changes in the government-business relationship between the state and the SME sector and their larger implications been ignored. In part, the answer lies in the assumption above regarding the compatibility of democracy and developmental states. In a sense, conviction as to the veracity of the assumption has led to academic laziness; theory seems borne out by strong empirical evidence of neoliberal reform. These empirical patterns appear to sync so well with accepted theory that it almost seems scholars do not feel compelled to explore the other possibilities.

A more interesting reason why SME promotion goes on unseen may be due to the simple fact that the government-business relationship between the state and the chaebol has a higher profile. While chaebol transgressions dominated the discussion in the popular media and in academic circles, the plight of the SMEs makes them look like victims. There also seems to be a strong consensus that righting past wrongs that have left the SMEs stunted is the correct course of action. As such, SME promotion has essentially gone on under the radar, getting essential neutral billing in the press and almost no critical analysis from scholars. No one has suggested, for instance, that these new policies constitute a new form of “crony capitalism”. This may change as the strength of the promotion policies grow. My assertion is that the neoliberal reform package as a whole provides a good smokescreen for developmental state maintenance and revitalization. The state clearly does not trumpet its institutional and policy reforms favouring the SMEs in the same way that it trumpets any measure aimed at enhanced corporate or financial sector governance. The almost-daily mailings from the Ministry of Finance and Economy listserv are replete with neoliberal propaganda regarding these measures. Moon has suggested that these new state arrangements for SMEs will eventually anger other members of the WTO on the basis the Uruguay Round settlement.\[89\]

\[89\] Ibid., page 16.
Finally, what this new movement in SME policy shows is that we need a more balanced approach to understanding Korean political economy. This requires going beyond the creation of simple lists of neoliberal reform measures to actively looking for contemporary evidence of state industrial policy or other vestiges of the developmental state model. If we cannot find these, or if the evidence is of such little weight that it cannot balance the undeniable gravity of the neoliberal reform measures that have been undertaken since 1980, then we must conclude that the developmental state has been dismantled and no longer extant. If we do not search for reform trends that do not fit the neoliberal model, then hardly anything is proved. The growth of SME promotion policy since 1987 clearly shows that the state and the Korean people themselves have not entirely given up on the developmental model that has made their economy growth so quickly.
EPILOGUE:

How well has the state acquitted itself in its new role within the developmental state alliance? Has the new alliance been a good thing for the Korean people? It is surely too soon to tell, but some early indications are not too encouraging. Bearing in mind that in 1987 equity was at the centre of their demands of a newly democratized state, the important questions to be asked are: Have they gotten it? And, do they perceive that equity has developed? On the latter, unfortunately, recent polls show that most people perceive there to be an ever widening gap between the rich and the poor, that the middle class is getting squeezed out of existence. Many rank this as their most pressing concern. Their perception is not far from reality. The Gini-coefficient shows a widening income disparity. The disparity was at its lowest point in 1993 (stats began to be compiled in 1985) when the coefficient was 2.83. In 2000, it was 3.20.\^90

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Capitalizing on Democracy 65


