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Introduction

The brutal impacts of the financial crises in Asia in 1997/98 have called into question what had earlier been regarded as an infallible engine of growth, the Asian Development Model. Many of the features which earlier had drawn widespread approval – close cooperation between governments and the private sector, monitoring of investment flows to encourage chosen growth industries, the linking of economic and social plan targets, and even the preference for broader social stability over concern for individual human rights – are now interpreted as major sources of weakness and contributors to the crisis. The triumphalism of some of the more fundamentalist disciples of the free market was to be expected, but what has been more surprising perhaps is the rapid loss of confidence in Asia itself after so many years of unprecedented growth. It seems hardly credible that those Asian strengths that were analysed at such length in all those books on the “miracle” could have been transformed so quickly into such fatal weaknesses. Hence, there is a need for careful analysis of the causes of the crisis as well as critical evaluation of the new directions being proposed, otherwise there is a real danger of throwing out the baby with the bath water.

In this chapter I want to take a broad view of the crisis in Korea and its consequences, and present a more comprehensive evaluation of the various reform measures that have been implemented or are being proposed. While the timing and severity of the crisis confounded many critics, for more than 10 years questions had been raised about the need for restructuring in a number of Asian economies, including Korea (see, for example, Garnaut, Grilli & Riedel, 1995; McKay & Missen, 1995). These problems related to: economic structures, the organisation of production, the effectiveness of the financial system and its relationship with the organisation of production, the development and access to new technology, and a range of labour issues. None was simply a question of economic efficiency, but reflected complex interactions between economic, political and social factors, and in many cases involved consideration of regional and global forces of various kinds.
In particular, the focus here will be on three key questions. First, while the developmentalist state had been very effective in generating unprecedented growth rates in Korea, it was clear after the mid-1980s that the system could not continue in its old form. To what extent can the onset of the crisis in Korea be traced to the management (or lack of it) of the processes of restructuring that were clearly needed after 1986? Secondly, if some variant of the original Asian model seems to be the most effective way of generating growth in the early stages of development, what can other nations learn from the recent experience of Korea? Can such a process be managed effectively, or are the risks of longer term instability and crisis too great? Thirdly, how can Korea be brought back on track? I tie these complex questions together within a theoretical framework drawing its inspiration from the concepts of regime dynamics and regime shift.

Regime Dynamics and Regime Shift

Interest in the concept of regimes has been stimulated by the simple question of why individual economies continue to differ from one another, and why these differences persist rather than converging on international ‘best practice’. Certainly national systems undergo change, even fundamental transformation, but this also raises some questions about the mechanisms of such change and about the relative strengths of local and international factors. Cheng (1990; 1993) has argued that regime dynamics, which are the basis of differing national systems, may be thought of as the relational manoeuvres of leading businesses and government that take place in changing political and economic contexts and which are designed to increase political legitimacy and to consolidate political power. Social pressures for restructuring accompany growth, exacerbated by changes in the global economy. Capital and the state adjust their authority patterns and legitimation strategies to these changing environments, but within previously established social contexts. Pempel (1998) argues that a regime is composed of three key elements: socio-economic alliances, political-economic institutions, and a public policy profile. These components are overlapping, and reinforce each other, and each is essential to the stability of the total system. In some situations the elements may be unstable, coalitions may come and go, and new institutions may disappear quickly. But within the post-war industrialised democracies, stability has been the general rule.

Within the industrial sphere, Soskice (1999) has explored the ways in which production systems in different countries have diverged in the 1980s and 1990s, in spite of the multiple influences of globalisation. He suggests that there are two major variants of modern industrial economies. The liberal market economies operate on short-term time horizons, allow high risk taking, have deregulated labour markets and strong competition requirements. By contrast, the business co-ordinated market economies have financial systems allowing the long-term financing of companies, co-operative industrial relations systems, a strong emphasis on vocational training, and encourage co-operation on technology and standards. This second category includes Germany and Sweden, but he argues that Japan and Korea make up a distinct sub-group of group co-ordinated
economies. In the case of Korea, the chaebols are the key co-ordinating component (Soskice, 1999, p.106).

These national systems have all evolved, often over long periods, to meet the needs of the local conditions and the heritage of unique institutional configurations. Boyer and Hollingsworth (1997) emphasise that there is no single optimum institutional configuration for the modern economy, rather a very large array of possible arrangements. The best choice depends upon the external environment and the precise nature of the societal problems that need to be solved. They argue that not even the market should be regarded as the ideal and universal institutional arrangement for co-ordinating economic activity, and numerous problems can arise if efforts are made to organise the world exclusively in terms of markets. All institutional arrangements have their own strengths and weaknesses, and the best choice at any time will depend on the precise context. Hence no new institution can simply be borrowed and implemented in any given social setting. It is not just the nature of the individual institutions that varies between nations, it is the unique configuration of these components in the entire economic system that is important (Gao, 2001, p.18).

Perhaps the most difficult task in this kind of analysis is to understand how and why regimes change. Pempel (1998) argues that any regime is faced with a variety of pressures for change, but not all changes will destabilise a regime: some will merely cause minor readjustments. He recognises three levels of disturbance in any system. First order changes are confined to just one of the components of the regime. Adjustments are made, but the essential nature of the regime is unchanged. Second order changes involve shifts in two of the three domains. These pressures are more severe, but again do not bring about a fundamental transformation. It is only third order changes, involving all three dimensions – institutions, coalitions and public policies – that bring about a true regime shift. Gao (2001) suggests that such a shift may take some time, as the forces for change gather strength and the fundamental contradictions in the existing regime are revealed, and as a new regime emerges, made up of some new elements and some remaining fragments from the old system, but combined in a unique new configuration.

Several authors have highlighted two key dilemmas that must be faced in the development of appropriate institutional structures. The first is the trade-off that seems to be inevitable between co-ordination and control of the entire economy and the monitoring and control of individual companies. Historical evidence suggests that no nation has ever been able to perform both functions effectively at the same time, and has been forced to concentrate on one or the other. Gao (2001) has suggested that Japan has preferred strong co-ordination, resulting in weak control and monitoring mechanisms, and I will argue that the same has been true of Korea. The second dilemma is the choice between the competing demands for economic and social stability and the need to upgrade the economic structure. Japan has opted for stability, but at the cost of an economic system that has become increasingly uncompetitive.
I also want to take a methodological point from this emerging body of literature. Gao has adopted an interesting method of “reverse thinking”. Rather than simply looking at how the Japanese model became obsolete, Gao analyses the key institutions that sustained the economy during the critical bubble period of the 1980s, and asks whether these structures were also present during the earlier period of high growth. If they did exist, why did they not cause similar serious problems earlier?

The broad concepts of regime dynamics and regime shift also include the more familiar phenomenon of industrial restructuring. In a series of earlier papers with a number of other colleagues, I have argued that restructuring is more than just structural change or technical innovation inserted within the existing relationships of the economy. Rather, restructuring is a deliberate process of re-making of such relationships with respect to an idealised future (Clark, McKay, Missen and Webber, 1991; 1992; Webber, Clark, McKay and Missen, 1991). Particularly important here is the realisation that restructuring is a highly contested and difficult process, and successful strategies for change may involve considerable amounts of persuasion, exhortation, idealisation or even coercion.

Korea’s Growth and Development Regime, 1961-1986

The nature of the political and economic system that produced in Korea one of the most dramatic industrial transformations ever achieved has received an enormous amount of attention. Some of these analyses have been economic, others cultural or political. Some commentators have highlighted local, internal factors, while others have stressed the nature of the particular economic or strategic environments of the period. It is not my intention here to present an extended review of all this literature. Rather, I want to interrogate this large body of earlier work to identify the essential characteristics of this remarkable successful regime.

Cumings (1987) has noted the similarities in the basic structures of Japan, Taiwan and Korea. All three of them during their initial growth phases were characterised by: relative state autonomy, central co-ordination, bureaucratic short-and long-range planning, high flexibility in moving in and out of industrial sectors, private concentration in big conglomerates, exclusion of labour, exploitation of women, low expenditure on social welfare, and militarisation and authoritarian repression. Similar themes have been taken up by Amsden (1989), who has emphasised the role of three key facets of growth: the government as entrepreneur, government economic policies, and the generation of high levels of productivity. In particular, she has praised the government’s willingness to rise above the short-term market signals and deliberately get the prices “wrong”. Woo (1991) has also taken up the dynamics of “the big push”, highlighting the centrality of the links between the state, the chaebol and the financial system. More recently, Kong (2000) has characterised this period as one dominated by the developmentalist alliance of state and chaebol, a pervasive objective of economic nationalism and an authoritarian system that excluded labour but achieved a remarkable transformation of living standards.
In my analysis I want to pay particular attention to these generally agreed regime features, but also following the methodological lead of Gao (2001) ask whether the factors identified later as causing problems leading to the financial crisis of 1997 were problematic in this earlier era. I also want to introduce some key features of the industrial production system that appear to have been neglected by other writers. In particular, I want to concentrate on three key questions about the regime and its effectiveness: First, how did the various elements of the regime fit together to produce a unique and coherent whole? Secondly, in what ways was the regime particularly successful in supporting the dominant development goals of the Korean state at that time? Thirdly, how was this unique regime structure translated into an equally distinctive production system, supported by a set of particular financial institutions?

The Coherence of the Korean Developmentalist Regime

The regime that was progressively implemented in the 1960s was a unique and highly successful developmentalist system, very clear in its goals and remarkably single-minded in their pursuit. In the literature on the Korean “miracle”, great emphasis has been given to certain elements of the Korean system, in particular the role of the government and the chaebol. However there have been strong differences of opinion on just how effective was this intervention in creating development beyond what would have occurred through simple market-led processes. Until recently we lacked any detailed evidence on just what the government of Park Chung Hee was aiming to achieve in its approach, and how it thought about and planned its interventions. However, a pioneering study by Kim Hyung-A (1996), who has analysed detailed records from this era, and in particular has gained access to some of the key officials then at the core of the programme and its implementation has provided the answers. Her results make it clear just how detailed was the planning, particularly in the phase of heavy and chemical industrialisation after 1972. This was not just a plan for the economy, but involved all parts of the society, and also included in its scope foreign and defence policy. The vision was to create a prosperous, strong and self-reliant nation, free from outside interference, especially from the United States, and able to defend itself effectively against any threat from North Korea. The creation of new industries was the immediate aim, but in order to achieve the planned targets it was essential to transform the nation through broad economic reconstruction, development of skilled manpower, national land development and the creation of a strong national defence. The planning approach used was very precise, even scientific. O Wonch’ol, the key official in charge of the programme, argued that his aim was to leave as little as possible to chance, using an engineering approach that left no room for either politics or emotion. He also suggested that an authoritarian approach to government was essential, at least in the short term, to give the technocrats a free hand to implement agreed plans. Thus, to O Wonch’ol the repressive Yusin constitution was an integral and necessary part of the drive to industrialisation.

Space does not allow any more detailed discussion of this fascinating story, but the basic point I am trying to highlight, one which is entirely consistent with regime theory, is that there was a strong and essential coherence in the Korean system from 1961 into the 1980s, and especially after 1972. The government was quite clear how all the
pieces fitted together to create a working whole, and this included areas well beyond the reach of many concepts of economic planning.

Implications for the Production System

Given the comprehensive and unique nature of this development regime, it is hardly surprising that the production system that emerged should have some very distinctive features. An obvious feature, and one that has been much discussed in relation to the financial crisis, is the extreme dominance of the chaebol, the large, diversified, predominantly family-owned conglomerates. The rates of growth for these conglomerates were truly remarkable, especially in the era of heavy and chemical industrialisation. During these decades of economic expansion, the role of the small and medium enterprises (SMEs) was markedly peripheral to that of the chaebol (McKay and Missen, 1995).

All of these features are in sharp contrast to the structures found in Taiwanese industry. The predominant actors here have been the SMEs, which have become the country’s exporters of a large range of industrial products. The rise of the SME as a competitive and flexible exporter depended on three processes: small firm sensitivity to and early entry into niche markets before retreating or diversifying investment into other industries, what has been called ‘guerrilla capitalism’ or ‘industrial nomadism’; a labour force involving complex subcontracting relations amongst small firms, in which flexibility compensated for small scale; and labour-intensive products and technological upgrading (rather than the ‘technological leaping’ that characterised Korea) that were within the scope of the small firm.

The consolidation of the Korean production system produced in turn a number of more detailed characteristics in the economy, some of which were related to the nature of the chaebol themselves, while others were the result of the extensive power over the entire system exerted by the conglomerates. Many of these features have also been indicted by some researchers as contributing to the crisis of 1997. A number of writers (for example, Kim, 1997; Kong, 2000) have noted that the chaebol were generally highly diversified, much more so than Western companies. Intense competition between the industrial groups meant that each tried to do everything, and was not willing to concentrate on a small number of truly excellent lines. There was a strong emphasis on gaining the benefits of economies of scale through concentration on large-scale production, but this benefit was generally lost through the insistence of the chaebol in getting into each new attractive market, resulting in serious overcrowding in key areas. Individual subsidiaries of the conglomerates were sometimes small and technologically backward, and there was frequent cross-subsidisation between subsidiaries. If one company was ailing, it was usually taken over by a healthy one within the same group, effectively weakening the entire structure. Virtually all of the chaebol had rather fragile financial positions and high levels of debt, partly reflecting the desire of the family to keep control of the group. A strong sense of economic nationalism tended to keep out foreign capital, especially foreign direct investment. There was, however, a heavy dependence on borrowed technology. This facilitated rapid expansion into new areas, and
allowed risk to be spread, but resulted in a continued and chronic dependence on Japanese machinery and parts. As the conglomerates grew, there was a widely held belief that the government could not afford to let any fail, given the massive size of potential financial and employment effects. But it was the creation of a uniquely structured financial system, and in particular that part of the financial sector designed to support the production goals of the economy, that needs to be given special attention in terms of future effects and vulnerabilities.

During the 1970s in particular, Korea embarked on a massive and ambitious programme of investment. In part this was financed through the mobilisation of local savings. When corporate and government savings are added, total domestic savings rose from 10 per cent in the 1960s to 21 per cent in the 1970s, and a massive peak of 38 per cent in the 1980s (Kim & Leipziger, 1997). These local resources were extremely important, generally accounting for the bulk of investment. But this still left a significant gap, which had to be filled through foreign borrowings (Woo, 1991). Korea entered the international loan market in a significant way around 1973 and by 1984 owed $43.4 billion on the private money market. The vast majority of this private funding went into new industrial development. Woo (1991, pp.153-4) has estimated that by 1981, the manufacturing sector absorbed some 60.3 per cent of all private loans, and if one adds in spending on infrastructure to support these new industries, the figure rises to 97.8 per cent. By 1981, total funding through special programmes, the so-called “policy loans” accounted for 45.7 per cent of all domestic loans. These loans were especially attractive because of their extremely low rates of interest. In 1974, for example, export loans were charged at 9 per cent, compared with the curb loan rate of 40.6 per cent and an inflation rate of 29.5 per cent. The vast majority of these special loans were directed to new export industries, especially those in heavy industry, and all of these industries were dominated by the chaebol.

There were several important implications of these clear policy directions. For the conglomerates themselves there was the opportunity for spectacular rates of growth, and for diversification into a range of new industries. However, this expansion of the big business groups was achieved at the cost of extraordinarily high levels of corporate indebtedness, something that was to remain to haunt the Korean economy leading to the 1997 crisis. By the mid-1980s, the top 50 chaebol had average debt/equity ratios of more than 500 per cent. The implications for the rest of the economy were also profound. The expansion of large-scale industries generating significant economies of scale was generally predicated on the building of Japanese-style production chains of sub-contractors supplying component parts. However, the SMEs expected to fulfil this role were seriously starved of capital, had poor access to new technologies, and were generally not able to attract a well-trained labour force (McKay and Missen, 1995).

*The Development Regime in its Societal Context*

How then did this development regime intersect with the wider society that was emerging during this period of very rapid growth? How did the single-minded pursuit of growth sit with the broader aspirations – social and political, as well as economic – of the
Korean people? To what extent did the problems that were to become an issue at the time of the 1997 crisis cause any discomfort at this stage?

To some extent, the government itself anticipated some of the problems inherent in the development regime, notably the problem of excessive power wielded by the chaebol, and tried to develop some safeguards. In particular, the government attempted to make sure that in return for all of their favourable treatment the conglomerates lived up to their primary task of creative effective and viable new export industries (Woo, 1991; Amsden, 1989). Poor performers were penalised, and only good ones were rewarded.

One defining component of the development regime was that government-business relations were so close that in some ways it was impossible to define clear boundaries between the two entities. The government saw the chaebol as essential to its purpose, and subsumed them as part of the state’s purpose. This process included the absorption of the risks involved in assigning too much power to the conglomerates, and accepting the distortions created by excessive debt levels inherent in the financial system used to promote industrialisation. The regime clearly had its problems, and could not hope to survive into the longer term. It was undemocratic and statist, but as a means of generating a decisive push towards industrial development it was clearly very successful.

Reforming the Developmental Regime 1986-1997

The developmental regime was faced with a whole series of pressures for change as the country entered the 1980s. Indeed, some commentators have argued that the regime in its purest form did not really survive beyond the end of Park Chung Hee’s rule in 1979. Kong (2000), for example, has argued that even before Park’s death, neo-classically-trained economists were gaining more influence within policy-making circles. These tendencies were intensified by the impact of the 1979-80 economic crisis, itself seen by many as being exacerbated by the distortions flowing from the drive to heavy industry, and resulted in many calls by local commentators and a range of international institutions for less interventionist approaches (Corbo and Suh, 1992). The banks were privatised in 1981-2, and interest rate reform was implemented to reduce the level of selectivity between different types of borrowers (Kong, 2000). More generally, there were moves to allow business greater choice in its sources of loans: the old reliance on banks was gradually replaced with opportunities for raising funds through equity and corporate bond issues. But, in other ways the system remained substantially unchanged, and throughout the 1980s the government retained very tight controls over the financial system. It was not until the later in the decade, especially in the period after 1986 that much more significant pressures for reform began to emerge.

Pressures for Restructuring after 1986

Strong pressures for change within both the political and economic systems were manifest around 1986, and were essentially the direct result of the successes of the earlier
years. In the economic sphere, rapid growth rates and significant trade surpluses produced upward pressures on the Korean currency. The Won appreciated significantly, rising 16 per cent against the US$ in 1988 alone, with serious implications for the competitiveness of Korea exports. During this period labour unrest also increased as workers demanded a bigger share of the nation’s success. Labour shortages appeared in many sectors and for the first time in three decades, wage increases outstripped productivity gains (McKay and Missen, 1995).

More fundamentally, Korea began to face the problem of making the difficult transition from a developing to a more mature economy. Central here was a question of technology, as currency revaluations and wage increases necessitated the movement to a more sophisticated industrial base. In the competitive situation of the 1990s, access to new technology from overseas was often restricted (or prohibitively expensive) as advanced nations feared the competition from newcomers such as Korea. The generation of home–grown technology was difficult and slow, given the still poorly-developed state of basic science in Korea. Even more fundamental was the question of social change and the movement towards democracy. The Korean population had made significant sacrifices in the national interest, and was now demanding new political freedoms as well as increased living standards. Thus, the successes of earlier years created the conditions and forces to engender significant changes, transformations that could not be accommodated within the parameters of the old regime. The stage was set for a necessary shift to a new regime. I want to argue that the inability to manage that regime shift in an effective way led directly to the crisis of 1997.

Revitalising the Production System

Throughout its drive to development, the modern Korean state had depended more than anything else for its success on its strong production system. However, by the late 1980s it was increasingly clear that while this system still had some fundamental strengths, it was in real need of revitalisation. The problems of export competitiveness that derived from wage rises and currency movements have already been noted. At the same time new low-cost competitors, notably China, appeared to challenge Korea’s traditional role in several sectors. Even in the areas in which Korea remained very competitive, in electronics in particular, there were wild fluctuations in demand and price. The result was a serious and growing balance of payments problem. In 1988, Korea recorded one of its largest trade surpluses in history, a total of $8.885 billion, but by 1989 this surplus had dwindled to practically nothing, and there followed progressively larger deficits during the 1990s. This was largely made up of two components: a growing deficit with Japan, reaching $15.7 billion in 1996; and a reversal in the former surplus with the US, a large deficit of $15.7 being recorded in 1996. These deficits were partly offset by a growth in trade with the rest of the world, and in particular with the rest of Asia, but this was not nearly enough. These patterns clearly illustrated the problem of technological dependence on Japan discussed earlier. There was also clear evidence of the failure of several decades of policies designed to increase the strength and capacity of SMEs to provide high-quality component parts at competitive prices, and dependence of the small companies on the chaebol remained a problem.
The major strategy adopted by the larger firms (and even some of the medium-sized ones) at this time involved a combination of approaches to gain access to new markets and technology, and to reduce production costs. All of these measures were also designed to generate still further economies of scale and to increase market share, long-term strategies that were given precedence over more immediate issues of corporate profitability. Significantly, these approaches also had the effect of generating still higher levels of company debt. Companies embarked on very bold programmes of asset acquisition. Often these purchases of assets and the construction of new production facilities were in areas of traditional focus for Korean companies, especially in Western Europe and North America. But there were also moves into countries and regions that even at the time appeared to be very risky, such as Central Asia, Eastern Europe and parts of Latin America. There were also large-scale relocations of factories into various parts of Asia in sectors that were losing competitiveness. As well as putting even more pressures on corporate financial resources, these initiatives also exposed some severe problems in Korean management systems and even basic knowledge about how to operate in different cultures.

In this frantic attempt to become global and to acquire increased market share, there was a distinct lack of careful analysis and planning. Basic problems, notably access to new technology and the reform of the industrial structure, were not addressed in any systematic and strategic way, and where plans did exist the level of implementation was simply not up to the standards of the past. These, I would argue, were clear signs of an old regime having unravelled, but without any clear new system having yet emerged to take its place.

The Growing Power of the Chaebol

During the 1980s, two trends became clear in relation to the key issue of the role and power of the chaebol. The conglomerates continued to be at the core of the Korean system, and indeed were able to extend their power and influence. They were indispensable to the continued export effort, and indeed they were able to point to some impressive successes, especially in the boom years leading up to 1988, when the economy grew at a staggering 12 percent. But the second trend was particularly important: during the 1980s the conglomerates consolidated their power to such an extent that the old subservience to the state was outgrown and replaced by a new interdependence in which the chaebol exercised considerable leverage.

In part, these results were fostered by the very mode of reform that was implemented by successive governments. The emphasis was on gradual rather than abrupt reform, Korean industry was still protected from outside competition in most sectors, and there was still a strong emphasis on encouraging business by severely curtailing the rights of workers and of unions (Kong, 2000; Cotton, 1995). During this period of change, however gradual, it was essential to keep growth and exports moving, and the big companies were the key to that. The net result of these reforms was that in spite of repeated government statements about the need for chaebol reform and for the
revitalisation of the small business sector, the conglomerates in fact increased their power. One particular loss in this period was the old ability of the government to discipline big business, and there was a perception that the chaebol were out of control, and this had important political ramifications in the move towards democracy.

**Problems in the Transition to Democracy**

Political commentators have long argued that the Korean system suffers from a number of very serious structural problems: notably regionalism, lack of an effective party system, and over-identification of parties with the personal ambitions of individual leaders (Kim, 2000; Shin1999). But it has also been argued that the way in which a particular form of democratisation has emerged has caused particular problems for the whole system, including the economy, and could even be regarded as a contributing factor to the onset of the crisis.

In general terms, it is clear that the transition from authoritarian rule to some form of democracy in Korea has been difficult, largely because it requires a complete shift in political culture. A number of studies have suggested that this process still has a long way to go (Shin, 2000). In such a political climate, good policy formulation and implementation becomes difficult. This is doubly so if opposition politicians become obstructionist in their approaches to government proposals. Mo and Moon (1999) argue that this is exactly what happened in the lead up to the economic crisis of 1997. In their view, the Korean economy had suffered from more than a decade of policy gridlock, the direct result of an immature democracy. This is not to suggest that democracy itself is an obstacle to good policy-making, but rather that the particular manifestation of democratisation in Korea in 1997 suffered from serious shortcomings. One of the points I made earlier about the success of developmental regime related to the clarity of goals and the precision of implementation. A return to the authoritarian rule of an earlier era is neither possible nor desirable, but in an intensely competitive world policy gridlock can be fatal, as events of 1997 demonstrated.

**Kim Young Sam’s Globalisation Agenda**

During the period of Kim Young Sam’s government, especially between 1994 and the onset of the crisis, an ambitious attempt was made to transform Korean society yet again, but this time in the image of a new globalised future. This segyehwa strategy aimed to use the forces of globalisation to transform and modernise all aspects of Korean society (Kim, 2000; Moon and Mo1999). In terms of the reform of the production system, which is my concern here, there were a whole series of targets. These included financial and corporate reform, labour reform, public sector restructuring, educational modernisation, knowledge-intensive industrial policy, economic diplomacy and OECD membership. There were however some fundamental weaknesses in the government’s approach. Whereas in earlier periods there had been detailed strategic planning of both
problems and proposed solutions, the *segyehwa* approach was extremely vague, and seemed to be based on the assumption that if Korean society was simply opened up to outside influences the resultant democratic liberal market system would solve all difficulties that might be encountered on the road to a modern future. There was no analysis of the existing systems and institutions and the ways in which these might be used, transformed or swept away. Given this staggering level of naivety, it is hardly surprising that so little was really achieved. Membership of the OECD was certainly gained, but even the process of gaining acceptance into this club of the successful nations generated some serious policy and reform blunders that can even be linked to the events of 1997. Some authors have dismissed this programme as somewhat frivolous and now irrelevant bit of Korean history, but I would argue that these years represented a serious loss of opportunity to find solutions to some pressing problems.

**Fundamental Problems of Financial Reform**

Since the events of 1997 in Korea have generally been labelled a *financial crisis*, it is not surprising that a great deal has been written about the financial system and its weaknesses, and the various programmes of reform both before and since the crisis (see for example, Lee and Orr, 1999; Cho, 2001; Cho & Hong, 2001; Kim & Park, 2000; Choi, 2000). Here I want to highlight a number of key points around my theme of the production system and the various supporting structures which are essential for its health.

One of the major problems of the 1990s, and one which was not addressed in the largely wasted years of that decade, was that the old system was not adequately replaced. Government withdrew to a large extent from the process hence the old co-ordinating mechanisms ceased to exist. But new mechanisms of monitoring or control were not put in place to regulate the new market driven practices. Thus, in regime terms neither the systems of co-ordination nor monitoring were working effectively. Thus, I would argue that the crisis was not essentially financial in nature, but was more systemic and involved a total regime failure.

Part of the failure of the financial reform programme involved an unsystematic approach to dealing with some of the problems inherited from the old system. The high levels of *chaebol* debt have already been discussed, and there was a failure to deal with this legacy. One approach might have been to underwrite corporate debt while embarking on thorough and speedy reform. Another, would have been to give the conglomerates target dates by which certain levels of debt/equity ratio targets would have been met. But government did none of these things, but succeeded only in confusing the international markets. There had been an expectation of continued government support for the *chaebol*, but the sudden repudiation of any responsibility in the case of the Hanbo crash, caused panic in the markets.

Another fundamental problem concerns the sequencing of financial reforms (Cho, 2001). There was no attempt to differentiate between financial instruments of a long-term nature and those of a short-term nature. The result was that there was a rapid expansion of short-term financing before any reforms had been put in place to strengthen
the financial structure of corporations. General financial infrastructure, including an adequate regulatory framework, was not built up as a first step. The domestic financial system was deregulated before anything had been done about corporate debt or the development of equity markets. International capital flows were deregulated before the local capacity to deal with them was in place.

The Failure of Regime Shift and the Onset of the Crisis

To sum up my argument, the Korean crisis of 1997 was not simply a financial or currency crisis. It was a failure of the system more generally. The old regime which had served Korea so well for so many years was no longer viable, but the process of a shift to a new regime was badly managed by a series of governments, culminating in the idealistic but simplistic globalisation campaign of the Kim Young Sam administration. The old regime had number of key features that were essential to the development of the country. There was careful planning and co-ordination, goals were clearly addressed and articulated, there was an almost fanatical attention to the detail of implementation. The production system, its growth targets and export goals came first, and other systems were designed to support this priority. In particular, a financial system was developed to feed the needs of the production complex.

When internal and external pressures demanded a fundamental transformation of the system, this proved to be very difficult. The serious problems in the areas of financial reform, chaebol governance and structure, industrial restructuring, revitalisation of the small business sector, and in a number of other areas I have highlighted, were not addressed. Nor was there any real vision of how the new regime might fit together in its totality. The flawed nature of democratic reform produced a political system and a style of leadership that was just not up to the task. The result was a progressive crisis in the system, beginning in the mid-1980s if not earlier, and this led inevitably to the crash of 1997.

This does not mean that the Korean system itself was or is a failure – as I said at the beginning, let us not over-react or throw out the baby with the bath-water. Many of the fundamentals of the Korean economy were quite sound at the time of the crisis, and in many ways the country did not deserve to be punished so severely by the international markets. I certainly do not support the argument that what Korea needed to do both before and after the crisis was to implement thoroughgoing market reform, perhaps using a big bang approach. Modern approaches to questions of international competitiveness do not support the idea that market liberalisation can by itself produce everything that is necessary. This is especially true for middle-sized powers such as Korea with problems of how to generate new technology to keep their production systems competitive. Nor can reforms ignore the historical and institutional legacies of earlier periods. The aim then is to create a new regime to meet the new circumstances and challenges, and yet be compatible with the society and its heritage. What such a regime will or might look like for Korea is a new challenge that will require some extremely creative thought, but the
legacy of the old developmental regime might not be so irrelevant as some commentators might have us believe.

References


