Two Faces of Government–Business Relations During South Korea's Developmental Period*

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Abstract

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South Korea's economic development has been characterized as a miracle due to its unprecedented speed and success. However, it has also been noted that a high level of distributive equity and poverty reduction were achieved in parallel with rapid growth. This paper argues that the first-order development goals of the state throughout the 1960s and 1970s were pursued in such a manner so as to be maximally inclusive of citizens in the developmental project. It is further argued that the country's industrial conglomerates played a dual function as engines of economic growth and instruments through which citizen wellbeing was enhanced. This paper reviews the mechanisms by which the Korean government influenced business, and discusses Korea's multifunctional industrialization and labor policies. Finally, the deinstitutionalization of the business sector's multifunctional role is detailed, and future challenges for Korea's modern welfare state are suggested.

Key Words: Welfare State, Development Goals, Industrial Conglomerates, Labor Policy, Financial Crisis

* This study is supported by National Research Foundation of Korea(NRF-2011-330-B00195)

I. Introduction

South Korea's economic development has been characterized as a miracle due to its unprecedented speed and success. At the same time, controversies persist, with some criticizing Korea's developmental model as driven by an authoritarian government that suppressed the rights of citizens and favored a small minority of elites. Against this view, this paper argues that the first-order developmental goals of the state throughout the 1960s and 1970s were pursued in such a manner so as to be maximally inclusive of citizens in the developmental project. In other words, it is argued that Korea's industrial relations during the developmental era had two faces. On the one hand, state dominated union activity highly limited the rights of workers to organize, ultimately suppressing wages in order to provide a constant flow of cheap labor for the country's expanding industrial sector (Minns, 2001). These policies were directly in service of the state's industrial policy, which encouraged industrial expansion and diversification into new growth sectors (Lee, 2008). At the same time, the state also implemented a number of policies that, when coupled with rapid full time job creation, formed the foundation for an equally rapid increase in worker wellbeing for an expanding segment of the population. In particular, strong job protections and high levels of household savings extended significant security to large sections of the population, the value of which should not be underestimated given Korea's impoverished state at the time.

While this paper acknowledges that industrial relations during the development era were very much in service of industrial policy, we argue that a number of characteristics and policy patterns during the developmental era were highly conducive to a rapid improvement of general citizen, and particularly worker, wellbeing. Secondly, we argue that Korea's large business conglomerates were the primary vehicle through which these two objectives, industrial development and enhanced wellbeing, were pursued. The study proceeds as follows. First, major components of Korea's industrial policy during the early developmental era are reviewed. In this section, particular attention is paid to the mechanisms by which the state was able to discipline the business sector in order to drive economically motivated activity towards socially beneficial growth. The next section discusses key policies of the state aimed at workers. It is here detailed how these policies served the dual purpose of supporting growth–oriented industrial policy on the one hand and social wellbeing on the other. Next, the deterioration of Korea's mechanisms of hard power relative to business is discussed, and it is suggested that with this deterioration, a transition from the developmental model of inclusive growth to a modern social security system was made. Finally, some future challenges for social security and citizen welfare are suggested.

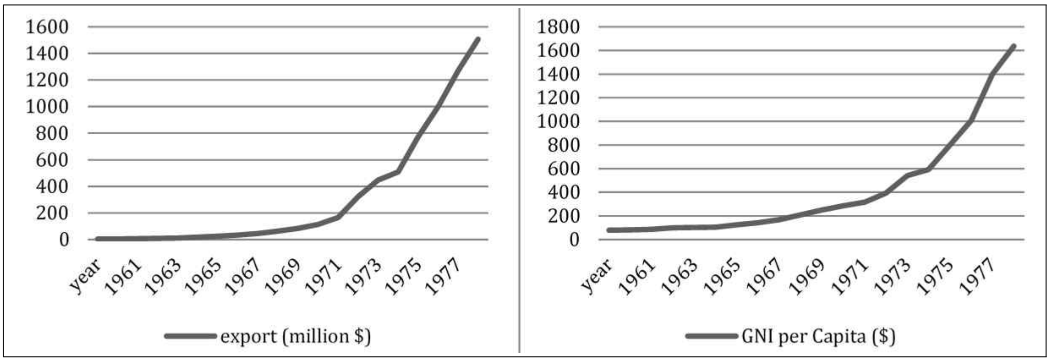
II. Government Power and the Quasi–Internal Organization

1. The rise of the Chaebol and early industrial policy

Beginning in the 1960s, the Korean economy began to grow at an exceptionally rapid rate, at times expanding above 10% annually. Particularly after a policy shift to export oriented growth in the mid 1960s, Korea's exports rapidly increased, with GNI per capita keeping pace (see figure 1). This transition into a high growth economy was a complex phenomenon, however the role of the hard state as a mechanism enabling a high level of discipline and coordination in the business sector has generally been acknowledged by scholars as playing a locomotive function (Amsden 1992; Chibber 1999). Before turning to policy specifics relevant to the theme of this study, this section discusses the mechanisms that fostered government power, as well as the quasi–internal relationship between government and business that resulted.

Following the coup d'etat in 1961, the Park Chung–hee regime moved quickly to consolidate power through the exercise of both coercive and legal measures. Commercial banks were quickly nationalized following the coup, with annual commercial budgets then subject to approval of the Finance Minister. In May of 1962, both the Monetary Board and the Bank of Korea were substantially reformed, greatly enhancing the power of the Minister of Finance and transforming the country's central financial institutions from independent bodies into extensions of the Ministry of Finance (Lee 1992). Coupled with tight limitations on foreign direct investment (FDI), these reforms essentially positioned the government as the primary lender for the country's industries, placing it in a position to reward those firms that acted in accordance with its wishes (Lee et al. 2002; Lee 1992).

Figure 1: Export and GNI per capital growth under the Park government (1961−1979)



Source: Statistical Office in Korea

The Park government recognized early that a program of rapid development had little chance of success without the support and cooperation of the country's business leaders. While the government initially adopted a number of intimidation tactics in order to force industrial leaders to comply, this policy was quickly abandoned in favor providing generous support of businesses where managerial capital was largely concentrated. This policy led to the rapid growth of the country's Chaebol groups, large conglomerates normally headed by a single family. Chaebol firms that met government criteria were encouraged to grow large and increase their production capacity through expansion into businesses outside of their core competency without needing to first provide any proof of competency in the new field. This kind of expansion provided first mover advantage resulting in market dominance based on vertical integration (Kim et al. 2004), and secondly the creation of internal markets from which to draw managerial and other scarce resources (Shin and Park 1999). As such, the economic growth of Korea throughout the development era was paralleled by the expansion of the Chaebol groups. From 1975 to 1978, for example, the sale of the largest 50 firms accounted for 52.9 percent of sales in the manufacturing sector, which recorded remarkable growth during this time (Chong, 1990). Many individual firms were affiliated with large Chaebol groups as subunits and were directly or indirectly controlled by the business plans of central Chaebol offices. For example, in 1970, 126 individual firms were controlled by the top 30 Chaebol groups and the number of controlled firms increased to 429 by 1979 (Lee, 1992: 189).

To account for how resources were allocated during this period, Lee (1992) proposed the concept of the 'quasi-internal organization,' where the government operates in a hierarchical relationship with private organizations in order to internalize transactions that might otherwise be dealt with by the open market. Under this system, the government and Chaebol exchanged market information via closed-door council meetings and discussion groups, with the government utilizing various additional instruments to control the behavior of business, such as financial auditing. Lee and Naya (1988) differentiated this type of system from the pure form of internal organization as the government developed no explicit legal ties with individual companies, who could be replaced if their performance failed to meet performance targets. The effectiveness of the quasi-internal organization as a mechanism of control and economic development was based on the existence of a hard state able to subordinate the business conglomerates for national development. In addition, the maintenance of a relatively transparent set of rules based on export performance was used as the basis of credit allocation, which helped prevent rent seeking behavior on the part of bureaucrats (Lee et al, 2002: 20; Chibber, 1999).

2. Job creation, labor policy, and industrial relations

The quasi-internal organization was highly effective as a mechanism to drive rapid industrialization. However, this arrangement was also highly successful in mass manufacturing jobs. Wide scale land reforms under the US military government (1945~1949) and the *Syngman Rhee* presidency (1948~1960) redistributed agricultural resources such that individual farmers were freed from a servile status to large landowners and given their own plots of land to develop. Consequently, a sharp rise in productivity created a situation where many rural households could afford to send their children to school instead of to the fields

(Kwon and Yi 2009). As a consequence, available human capital sharply increased, which provided both an opportunity and a challenge for government, as the labor market had to expand at a rapid pace.

As Figure 2 shows, the unemployment rate in Korea shows steady decline in the *Park Chung-hee* era from the early 1960s to late 1979. In 1963, the unemployment rate was 8.1 percent while in 1970s it decreased to around 3 to 4 percent. This trend continued well after Park's death, eventually reaching around 2 percent in 1990s until the Asian Financial Crisis dramatically reversed the trend. One factor driving the rapid expansion of employment was strict control of wages, which were kept below even the comparative developmental economies of Taiwan and Hong Kong, where wages were up to 80% higher than in Korea (Minns 2001). This was also a key factor for rapid development (Amsden 1991). The switch from import substation to export led growth led to a greatly reduced need for a strong domestic market, however, which in turn allowed wage suppression to function entirely in the benefit of development. Under an import substation model, rising domestic demand can be considered a necessary condition for economic success, but Korea's adoption of an export-led strategy essentially made such a requirement unnecessary.

Figure 2: Unemployment rate during the Park administration

Source: Statistical Office in Korea

Wages were kept low through the government's direct control, via the military, of the country's only legal trade union, the Federation of Korean Trade Unions

(FKTU), which had formed in 1960 with substantial support from the government (Kim 2003). The government here exercised an exclusive right to bargain with business over employment conditions and pay, which put workers in a weak position with which to collectively demand rise in wages, a situation which greatly benefitted the Chaebol (Minns 2001). While American-style labor laws were enacted in 1953 that guaranteed full collective bargaining rights for trade unions, throughout the 1960s and 1970s the law was revised frequently to place substantial restrictions on union activities, and strikes were prohibited until 1980. Instead, the FKTU, a state and military led union, functioned as the sole legal representative of the interests of labor. As was to be expected, the body generally did not resist the government's attempts to control the organization of labor (Lee and Kuruvilla 2001).

III. Distributive and Wellbeing-Oriented Functions of the Quasi-Internal Organization

This section examines how the quasi-internal organization of government-business relations resulted in a general enhancement of wellbeing for a large portion of the population during the development era. While it has widely been recognized that citizen wellbeing did expand rapidly during the developmental era, it has often been assumed that such gains were the result of pure trickle down effects rather than the result of specific policy. In favor of this view, moreover, is the fact that the developmental state offered little in the way of conventionally understood welfare, and that what little that was provided was done so only as a lubricant for greater economic development (Holiday, 2000). These observations have fostered a wholly negative view of the developmental government with respect of citizen wellbeing.

These views are not universally held. For instance, in an influential book, Campos (1996) argued that fundamental to the legitimacy of the development regime was the concept of shared growth, where citizens were offered a meaningful opportunity to share both in the process of development, as well as partake in its benefits. While recognizing that the political rights of workers were in many ways suppressed, Chang (2007) argued that the authoritarian government extended to the Korean population a type of 'developmental citizenship,' the primary component of which was security, which again should not be underestimated given Korea's state at the time.

This section examines three mechanisms by which the quasi-internal organization functioned as a driver of wellbeing for Korean citizens. In particular, suppression of labor rights is contrasted with the strong job protections promulgated by the government, and the implicit promise of lifetime employment. Secondly, it is argued that, while formal welfare spending was not significant, high levels of household savings could function as a working social safety net in the context of near full employment, as well as enabled high levels of human capital investment. Finally, we discuss how the government drove the expansion of employment not only into low paying menial jobs, but also worked to increase the overall share of more highly skilled work, while at the same time maintaining a relatively egalitarian distribution of wealth. Based on this analysis, we borrow a term from Kwon and Yi (2009), and argue that the quasi-internal organization was a multifunctional organization designed to serve not only the first-order goal of industrialization, but also the second-order goal of enhanced citizen welfare.

1. Policy foundations of citizen wellbeing in the quasi-internal organization

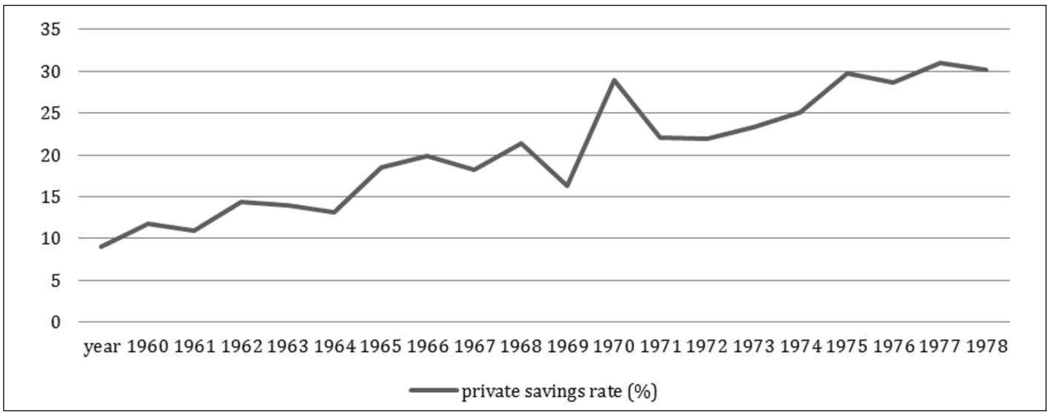
As noted, one of the major challenges for the development government was to create the jobs necessary to absorb Korea's increasingly mobile labor force. Non-agricultural employment rose rapidly as development progressed with combined employment in the manufacturing, mining and service industries increasing sharply year-over-year until becoming the dominant form of employment somewhere around 1973 (Kwon and Yi 2009). Jobs in these sector, however, were also predominantly full-time and carried with them an implicit guarantee of lifetime employment, if not generous wages.

However, this high level view disguises a number of important developments. Firstly, against the Kuznets hypotheses that with high growth comes greater inequality, Korea maintained a low level of inequality across society (You, 1998), which is made more remarkable due to the low levels of social welfare and formal redistributive policies in place. While low inequality was partly the result of a relatively equal (though thin) distribution of assets following the Korean war and land reforms, the rapid expansion of modern employment was a crucial factor in maintaining it. You (1998) points out that studies have found that improvements in overall human capital allowed non-labor intensive sectors expand as rapidly as those involving unskilled workers (Kim and Topel, 1995). This fact suggests that the government "did not simply rely on a free trade strategy of emphasizing labor-intensive exports based on comparative advantage" (pg. 46).

Despite labor suppression, the state also played a paternalistic role in relation to workers in the form of strict labor laws that protected them from losing their jobs in all but the most extreme circumstances. For example, the state promulgated a comprehensive and detailed legal framework as well as pursued direct state intervention in the labor market to protect the rights of Korean workers (Song, 2003). Laws and regulations covering individual workers' rights were in some cases more extensive in than those of Western countries, where union membership is generally much stronger and more independent. For example, establishments with five or more employees could not lay off workers without just cause and courts recognized layoffs only if there were no other way of solving business problems. Finally, fair and evenly applied criteria were to be used in the case where layoffs were necessary (Kim and Kim, 2003). Thus, although the rights and freedoms of workers were far from guaranteed under the developmental regime, most in the productive sector were able to experience a sense of employment stability provided by the quasi-internal organization.

In addition to this rapid expansion of high quality employment, household savings also rose substantially during this period. Government policy, such as employing tax breaks and promoting austerity among the population, was highly effective in channeling accumulated profits back into the development project, driving growth as well as high quality employment (Park, 1990; You, 1998). At the same time, however, such high levels of private savings could also function as a rudimentary but functional social safety net for workers, which provided a level of security for workers in the context of near full employment (Kwon, 2001; Morduch 1999). As such, despite low levels of formal social programs as well as relatively low wages, strong employment guarantees coupled with high levels of household savings could directly contribute to the wellbeing of citizens. Figure 3 shows the trend of household savings as a percentage of total savings over the period of the Park administration.

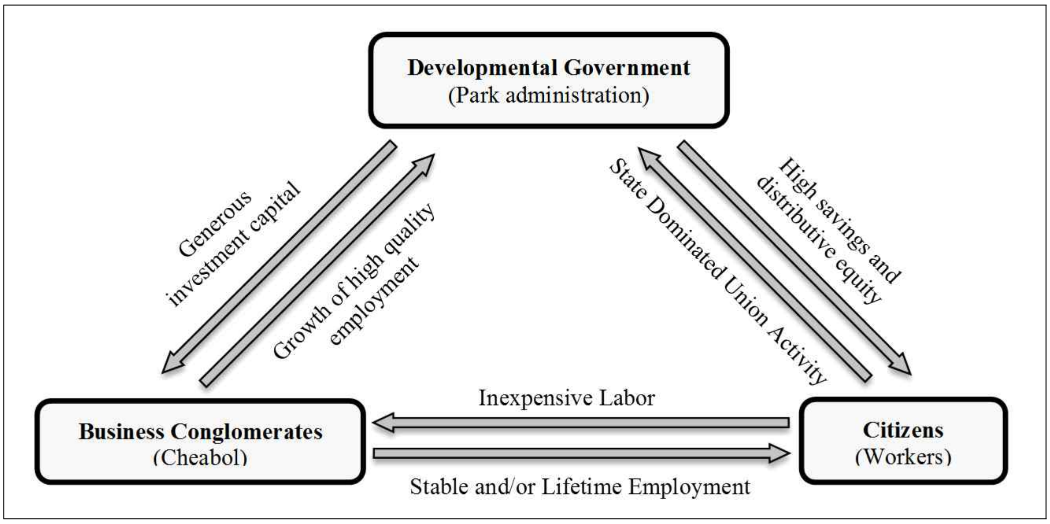
Figure 3: Trend of household savings



Source: Statistical Office in Korea

Figure 4 shows how quasi-internal organization functioned as a mechanism of both growth and enhanced social welfare. The government provided to Chaebol groups highly subsidized investment capital and often monopoly status in order to encourage them to diversify their businesses into new industries, often at great risk. In return, high quality jobs were able to be manufactured at a rapid rate. In this way, the government harmonized the interests of the Chaebol not only with its own first-order goals of industrial development, but also its second-order goals of enhanced wellbeing. Secondly, relative to the labor sector, the state dominated union activity and kept wages low, while at the same time fostering a working environment with a high level of distributive equity and high household savings, which in turn allowed families to invest in human capital accumulation. The state also used its power within the quasi internal-organization to structure labor relations in order to benefit both business through low wages as well as workers through strong job protections.

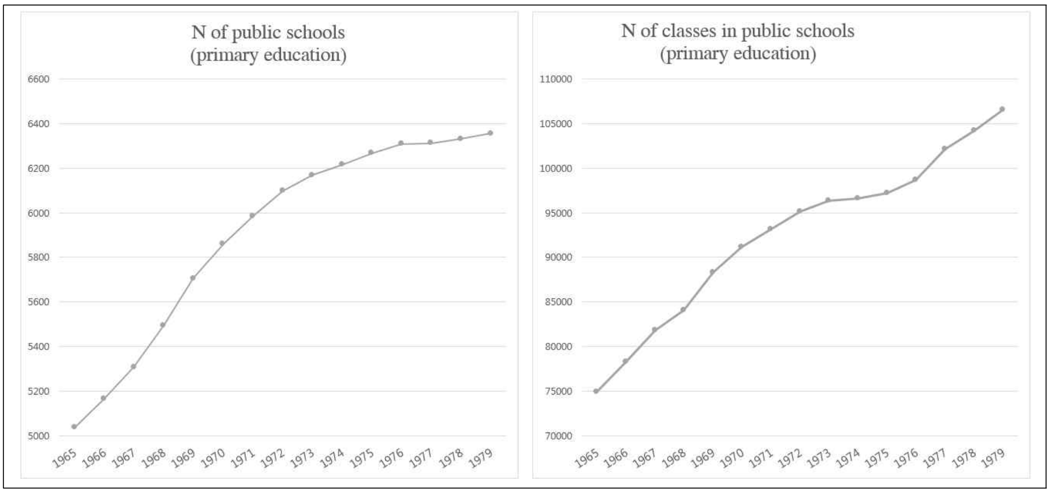
Figure 4: The two faces of government-business relations during the developmental era



IV. Discussion

Scholars have characterized Korea's economic developmental policy as highly "pro poor" (Kakwani and Pernia 2000), and Kwon and Yi (2009) have argued that Korea's successful strategy for poverty reduction was partly the result of innovative policy allowing institutions to perform multiple functions beyond their formal role. In commenting on the success of Korea and other East Asian economies in driving equitable growth, You (1998) points to a "virtuous circle" linking high levels of income equality and human capital development in the context of the government's success of "generating rapid growth in output and rapid accumulation of physical capital, embodying ever more sophisticated technologies that demand more educated workers" (pg. 55). This was accomplished in part by facilitating education access for children (see figure 5) on the one hand, as well as focusing on skills-based education at higher levels and establishing an extensive system of both public and subsidized in-house vocational training. These strategies provided the necessary outlet for the development of the country's human capital (Kwon and Yi, 2009), which was a strong focus of the government along with industrial development. These policies go well beyond the trickle down hypotheses of the enhanced wellbeing of Korean society during development.

Figure 5: Primary education development under the Park government



Source: Statistical Office in Korea

This paper has outlined some of the key initiatives by which the quasi-internal organization of government-business relations was able to drive both economic development as well as enhance the wellbeing of citizens. Also, Kwon and Yi (2009) argue that commonly institutions will resist policies that attempt to steer them toward goals which lie outside of their primary economic or political interests, and as such this study also detailed the mechanisms by which the government was able to shape the behavior of the country's large business conglomerates and harmonize their goals with socially relevant ends. The quasi-internal organization was the locomotive of this effort. However, a number of reforms following the Asian Financial Crisis of 1997 effectively neutralized the mechanisms by which the government was able to accomplish pursue multifaceted goals through business. While the decline of government power vis-a-vis business began gradually as the Chaebol came to increasingly dominate the economy, this study focuses on the Asian Financial Crisis as the culmination of this process, which has been recognized by others as the effective end of the developmental state (Chang, 2007; Lee and Han, 2006).

The 1997 financial crisis in Korea saw the sudden and mass flight of international capital from the country, and forced the government to seek a conditional loan from the International Monetary Fund (IMF) valued at 58 billion dollars. While a number of reforms meant to modernize and globalize Korea's business sector have been suggested as causes leading to the crisis (Krueger and Yoo, 2002), nevertheless financial reforms following the crisis effectively led to a conclusive weakening of the state vis–a–vis business. Specifically, the removal of investment ceilings on foreign direct investment in Korea in the name of transparent corporate governance effectively neutralized what power the government had over the development patterns of the Chaebol. Secondly, the restructuring of the labor market at the behest of the IMF and the business community removed the conditions necessary for the labor market to maintain a growing full–time productive sector. A third consequence of the crisis, however, was also the destruction of much of the privately held savings in the wake of rising unemployment, which essentially eliminated what functioned as an informal social safety net during the time of near full employment. As such, the crisis was devastating for the general population, with the poor being disproportionately affected (Kakwani and Pernia, 2000).

While the poorly synchronized deregulation of short–term versus long–term loans was one of the crucial factors leading to the economic crisis and enhanced the influence of Chaebol groups relative to the state (Lee et al. 2002), it was the *Kim Dae–jung* administration's response to the crisis that essentially forced the globalization of the Korean economy and fully loosed the Chaebol from government control. The expansionist policies of the Chaebol were enabled in part by the moral hazard created by the government's implicit guarantee of their debt (Krueger and Yoo 2002), and thus the government sought to make the Chaebol conform to conventional business practices, that is, the pursuit of profit over expansion, by eliminating investment ceilings in Korean stock market (Chang 2007). In December 1997 the national bond market was opened to foreign investors, and the ceilings on foreign shareholdings in major companies was abolished in May of the following year. In addition, a quarter of major business areas previously closed to foreign direct investment were opened, including prominent financial sector holdings. The enactment of the Foreign Investment Promotion Law in July 1998 signaled the unreserved embrace of FDI and its presumed advantages, with improved management, the introduction of foreign technology, and the potential for productive capacity increases major principles of the government's new position (Shin 2000). As can be seen by Table 1, the removal of investment ceilings resulted a large growth in the percentage of foreign stakes in Korean Chaebol. As the same time, the appearance of stronger fiduciary duty laws to protect minority shareholders (Baek et al. 2006) meant that the Chaebol could no longer function as an instrument of domestic labor policy. Rather, their role would now be relegated to the pursuit of profit alone.

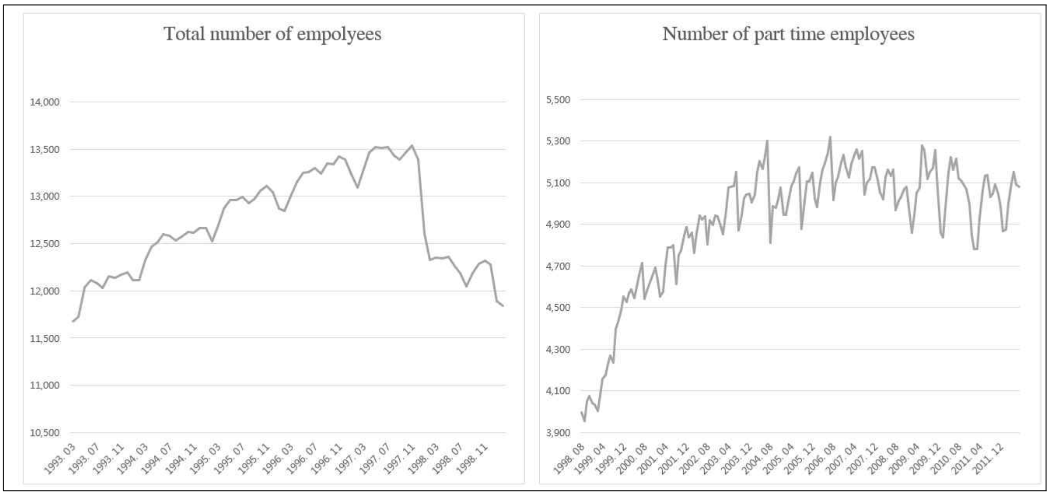
Table 1: Foreign ownership of major Korean Chaebol

Company	% of shares held by foreign investors
Samsung Electronics	47
POSCO	59
Shinhan Financial	61
Hyundai Motors	42
SK	45
Shinsegye	42
LG Electronics	36

Source: Chang (2007)

Secondly, the government, at the behest of the IMF and the Chaebol, were forced to abandon their strict domestic labor laws. In order to secure support for the controversial legislation, *Kim Dae-jung* convened a tripartite committee consisting of government officials, leaders of industry and the two main trade workers unions. However, despite this meeting representing something of an experiment in corporatism (Kwon, 2001), Chang (2007) points out that the outcome of the committee's decisions was of benefit only to the business community. The Federation of Korean Industries, an organization exclusive to Chaebol groups, in contrast organized labor, were enthusiastic supporters of the expansion of unemployment insurance, as they recognized the bill as a favorable compromise that would allow a more flexible labor market (Song, 2003). Indeed, the wake of the new flexibility applied to employment policy, the unemployment rate spiked to 8.6% in 1999, up from 2% in 1996, before the restructuring took place, and moreover the quality of employment also declined sharply, with part-time and daily workers making up more than half of the total workforce just one year after the crisis (Kwon 2001). Figure 6 illustrates these trends. Non-standard workers as a percentage of the total workforce increased from 45 percent immediately following the financial crisis to 55.4 percent (7.84 million persons) in 2003, 55.9 percent (8.16 million persons) in 2004, and 56.1 percent (8.4 million persons) in 2005, securing for Korea the number one ranking among 30 OECD countries in terms of its percentage of non-standard workers in the total workforce (Choi, 2006, in Park, 2008). The fact that non-standard workers account for the majority of the total labor force in Korea largely explains why national social insurance only covers approximately 50 per cent of wage earners, in spite of coverage having been rapidly expanded since the financial crisis (Park, 2008).

Figure 6: Total number of employees and number of part time positions following the crisis



Source: Statistical Office in Korea

The rapid increase of foreign direct investment also had major implications for human resources management in Korea, particularly as FDI brought with it increased exposure to international productive pressures (Kim, 2003). Business firms also began reducing company welfare programs. Management reduced or abolished entirely subsidized housing loans, school tuition subsidies for employees' children, gasoline subsidies, as well as food allowances, private insurance programs, and transportation (Song, 2003).

Finally, the viability of family savings as an institution of social welfare was also severely damaged. High social savings constituted the primary social safety net for workers during the developmental period; social saving also allowed the government substantial funds to reinvest into the private sector in order to produce growth in the economy and enhance the job market. However, while this policy was critical in achieving the primary objectives of the state during the development period, its weakness as a pure social policy was shown as personal savings were decimated in the immediate aftermath of the crisis, showing how unworkable such a system of social security is in a seriously damaged economy (Kwon, 2001).

While the post-crisis *Kim Dae-jung* government rapidly and significantly expanded social spending and welfare programs, strengthening unemployment insurance and initiating public works projects, this growth significantly slowed after the initial increase (Kwon, 2002). While the social welfare system has continued to develop and played a key role in cushioning the workforce from the 2008 economic crisis (Kwon, Dong, and Moon, 2010), nevertheless, from the perspective of this paper, the financial crisis eliminated the main instruments of social welfare, namely employment and personal savings, while at the same time laying the foundations for a massive upward redistribution of wealth. Moreover, Korea has taken first place among OECD countries for non-standard (contract and part-time) workers as a percentage of the total workforce (Choi, 2006, in Park, 2008). This would seem to imply that financial crisis of Korea in 1997 severely damaged the functioning of the quasi-social welfare system built up during development.

Despite the significant rise in social spending after the crisis, Korea continues to remain at the bottom of the OECD's list in terms of expenditure relative to GDP. While in the past, this strategy has been acceptable for the country as the economy was able to sustain almost full employment and across the board quality of job increases. However, as the mechanisms for achieving this balance have been almost entirely eliminated today, a more formal role for the state is necessary in order to secure further enhancements to the wellbeing of society.

V. Conclusion

This paper suggests that government–business relations during the developmental era had two faces, which challenges a fully negative perspective on the developmental administration's policy orientation. On the one hand, the government utilized the country's large business conglomerates to achieve the first order goals of economic development and industrialization. However, socially desirable ends were also achieved through the promulgation of labor laws that made it difficult for companies to lay off employees or hire them on short–term contracts, and secondly through the high level of personal savings facilitated by the state. Additionally, at considerable risk to business, the government applied continuous pressure to push companies into ever more sophisticated sectors, which helped diversify the economy and range of employment. The paternal relationship that government maintained with labor, which came to be a primary target of the IMF restructuring after the financial crisis, can be understood as a type of bargain, imposed by the state, between business and labor. While the government's leverage in relation to the Chaebol had declined as the country become more democratic over the decade leading up to the financial crisis, the reform program following the crisis which effectively neutralized the distributional function of the quasi–internal organization of state–government relations. The social consequences of these changes have been significant, and the government has recognized the need to replace the multi–functional institution with an independent, formal alternative (Kwon, Dong, and Moon, 2010).

The core argument of this paper, that the quasi–internal organization of business–government relations had a significant social component that distinguishes its policy approach from the laissez–faire, trickle down strategy, does not address a number of important issues. In particular, it is the case that another important social institution, namely, the family, also played a multifunctional role in Korean development, and was another foundation of informal social protection (Jones, 1990). While a growing gap between the country's full time and secure employment sector and non–regular workers persists following the crisis of 1997, Korea also has a very large gap between the median income of male and female workers, with women earning up to 39% less at the median level than men (OECD, 2012). Secondly, a high level of elderly citizens also subsist below the poverty line in Korea, with about 45% of the 65 or older population living on incomes less than 50% of the median level of disposable household income (OECD, 2011). On both of these metrics, Korea is the poorest performer among rich OECD countries. While Korea has increased its formal social welfare since the economic crisis in 1997, nevertheless these statistics suggest that much additional work remains to be done.

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