

RESTRUCTURING REVISITED: FLEXIBLE KOREA AND RIGID JAPAN*

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Korea has successfully undergone economic restructuring, as compared to Japan. The “flexibility” of Korea and “rigidity” of Japan are strongly related to the differences between developmental strategies the two countries adopted. Although Korea adopted the Japanese developmental state model, it excluded workers from the development coalition. Whereas excluded workers had been a source of instability in the Korean system, the well-found coalition of government, business, and workers in Japan had guaranteed stability of the system. This difference was not conspicuous before the economic crises; strong performance of the Korean economy and a heavy-handed government had silenced discontented Korean workers. When the crisis occurred, Korean workers demanded the overhaul of the system, while Japanese workers did not. While Japan attempted to protect the system, Korea dismantled it due to the lack of support of the disenchanted Korean people, in addition to pressure from IMF and foreign countries. Though Korea has been successful in revamping its economic system and regaining economic growth since restructuring after the economic crisis of 1997, the new system is not stable. Workers, still not fully represented in national decision-making processes, are calling for revision of the system, and are frequently expressing their anger. Japan, reluctant to accept an Anglo-American economic model, is struggling to get out of a sluggish economy, but it still enjoys a relatively stable social system.

INTRODUCTION

South Korea has undergone serious economic restructuring since the economic crisis of 1997. It restructured its financial institutions and dismantled rigid employment practices within a year after the economic crisis. It also sold many state owned companies and reduced the number of public servants.¹ These substantial changes occurred within three years after the eco-

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¹ Lim Hyun-Chin and Hwang Suk-Man. 2002. “The Political Economy of South Korean Structural Adjustment: Reality and Facade.” *African and Asian Studies* 1(2).

conomic crisis of 1997. In contrast, the necessity of economic restructuring in Japan has also been raised internally and externally, due to the prolonged economic recession since the early 1990s (Ohmae, 1990; Dore, 1998; Porter et al., 2000). However, Japan has been unsuccessful in restructuring its economy since the beginning of the recession in the 1990s. It is still debating whether to overhaul its financial institutions since the downturn of the country's economy in the early 1990s (Dore, 2000; Cabinet Office, 2002).

For a long period, Korea and Japan have shared a relationship in economic development (Cumings, 1984; Eckert, 1991; Kim, 1997). Korea has successfully entered the world economy based on the Japanese economic development model, i.e., export-oriented industrialization with a developmental state apparatus. The two countries seem to share similar development strategies and problems in their economies; they are facing challenges against developmental state models in the era of globalization. Despite their differences, both countries are similar in social structure and culture (Kim, 1997).

It is intriguing why these two developmental countries show different responses to the given external pressures to change. Under external pressure to change, Korea has been "flexible," but Japan has been "rigid" in changing its economic structure and practices. Why do two similar countries show different responses to seemingly similar economic problems? This paper attempts to address this question by focusing on external and internal factors; the former is related to the severity and speed of the economic recessions and the latter examines the institutions in each country. We, however, put more emphasis on the institutional differences between the two countries. It is true that external pressure is a significant leading factor for change in societies. The different responses of Korea and Japan suggest why and how external pressure directs the course of change (Haggard, 1990; Haggard and Kaufman, 1994; Nelson, 1990; Zysman, 1983). These responses have important implications for globalization. As globalization is spreading, the nation-state appears to be a pawn in the invisible hand of the global market (Weiss, 1998: *x*); however, the impact of external economic pressures on national economies and public policies depends to a large degree on the strength or weakness of domestic institutions (Haggard and Kaufman, 1994; Weiss, 1998: *xj*).

In comparing the internal institutions of both Korea and Japan, this paper attempts to explain differences based on socio-political factors: development coalition, production systems and policy formation. It will review why and how two countries formed different development coalitions. Development coalition has a strong affinity with production system and policy formation.

These factors, in turn, explain how people in two countries evaluate the current political and economic system. This paper assumes that differential evaluation coupled with different institutions in two countries have resulted in different responses to external pressures. This paper pays special attention to the development coalition; it shows how the beneficiaries and losers of the development react to the necessity for change and determine current restructuring. We argue that the differences between the two countries in supporting a development model, especially differences in development coalitions, are factors which have played an important part in determining the speed and magnitude of restructuring.

COMPARING DEVELOPMENT STRATEGY IN KOREA AND JAPAN

The two countries have similar development strategies (Kim, 1997). This similarity may be because industrialization was initiated under the Japanese rule and/or South Korea was constantly under the influence of Japan, especially after the start of rapid industrialization in the 1960s (Eckert, 1991; Kim, 1997). Korea established an economic development strategy based on the Japanese development model and imported technology from Japan.² However, the two countries have very different political systems supporting development. The South Korean state, a comprehensive developmental state, is authoritarian, while the Japanese state, a limited developmental state, has a relatively democratic political system (Kim, 1997). This political difference is an important variable determining development coalitions, production systems and policy formation.

Development Coalition

Clearly, there is a difference between the development coalitions of both countries. The Japanese coalition includes all the stakeholders of society, including the state, business and labor, although the state has been more important in the decision-making process. In contrast, the Korean coalition is made up of state and business, and excludes labor.

A. Japanese Coalition

The Japanese development coalition has developed since the Meiji Restoration of 1868. Economic development in Japan emerged from the struggle against the foreign threat. The Japanese government realized that

² Amsden (1989) points out that late developing countries, including Japan, always learn from developed countries.

modernization of the economy was the only way to cope with the threat when it was forced to open its doors to foreign countries. Therefore, it pursued rapid industrialization under government initiatives.³

However, the government led development strategy soon met with many problems due to the lower efficiency and corruption in state owned companies. To cope with this problem, the Japanese government began to encourage private businesses to take over public corporations, beginning around 1910. The government retreated from direct involvement in the economy, and the private sector grew. As some private companies became larger, they started to organize into business groups, *zaibatsu*. They expanded their power and tried to influence government through politicians. Often the successful businessmen themselves became politicians. As a result, an alliance among government, politicians and business was formed, even though the government economic policy was based on the *laissez faire* economic principle.

A new development partner emerged during the 1930s: the military. The military gained power during the 1930s, following assassination and military revolt. Even though military leaders hated businessmen and politicians, they realized that they needed business for their war efforts. The development coalition in this period was dominated by military leaders. Politicians lost much of their influence in the coalition, and businesses held on to their power, but they were at the mercy of the military. During this period, most Japanese citizens were excluded and their voice was relatively weak.⁴

This developmental coalition experienced an abrupt change after World War II; the military was completely eliminated from the coalition and experienced business leaders were also purged due to their war effort. Most of the important pre-war politicians were also pre-empted. Only economic bureaucrats survived the purge.⁵ Experienced bureaucrats who had coped with various economic challenges since early industrialization took control of rebuilding the Japanese economy after the war.

The bureaucrats' power bases were varied; they established a tradition of

³ Government was the only actor at the beginning of modern industry building: it built everything ranging from economic infrastructure such as roads and harbors, to social infrastructure including schools and training institutes. As a consequence, the government dominated the economic realm.

⁴ As improved labor laws showed in this period, there were some positive attempts to accommodate people's interests, but these were far from satisfactory.

⁵ The American occupation force did not disassemble the economic apparatus when they attempted to re-configure Japanese society during their occupation. Bureaucrats were untouched due to their necessity for the Allied Occupation Force; they needed Japanese collaborators who could help them manage the post-war Japanese economy (Johnson, 1982).

independence from politicians and business, therefore, they earned the reputation of being impartial to the development of Japan. After the war, new or surviving politicians who lacked knowledge of the economy could not influence the economic decision-making process. Retired bureaucrats moved to important positions in the private sector. Bureaucrats-turned-politicians were quite influential in the process, and were supportive of the bureaucrats.⁶ Even legal institutions respect the Japanese bureaucrat's authority to deal with economic matters (Johnson, 1982). Japanese bureaucrats have been unchallenged national leaders in economic building since the War.

Compared to the previous period, the government had drawn general support from the people in this period. It had legitimacy to plan and implement economic policies, even though state power was not as strong as it had been during the War. Japanese people were more or less unified under government guidance; they accepted government guidance in the economic development and acknowledged that the intervention of the state was necessary. Japanese bureaucrats are considered to be the best and brightest in Japan; they have been recruited from the most prestigious educational institutions. Thus, the power base of Japanese bureaucrats is more or less based on the consensus of Japanese society. They were the only trained and experienced specialists able to deal with the post war Japanese economy, and they succeeded in achieving economic development that allowed them to be the legitimate leaders of the Japanese economic revival. Japanese bureaucrats also have a very good track record; they have led miraculous economic development since WWII. The system has been very successful for all incumbents of society. Although Japanese people were critical of their society, economic success was sufficient to satisfy war torn Japan.⁷

B. Korean Coalition

The Japanese economic development system has influenced the Korean economic system in many ways. Some researchers argue that the origin of Korean industrialization can be traced to the period of Japanese occupation between 1910 and 1945 (Eckert, 1991; Cumings, 1984). Therefore, they are similar in many respects, but they have different development coalitions.

⁶ Various laws also guaranteed their right to intervene in private economic activities. In addition, Japanese bureaucrats also know how to use their un-written power under the name of the "private-public corporation," or administrative guidance.

⁷ One of the successes of the Japanese economy is the introduction of "total employment," which stabilized Japanese society at the macro level, and improved labor relations at the work level (Gao, 2001:40).

The Korean coalition has been exclusively formed between government and big business, excluding workers and farmers, whereas the Japanese coalition is inclusive of all stakeholders.⁸ The Korean coalition has become more inclusive of small and medium sized businesses and the middle class, as economic development progressed. Even so, basic coalition is still between the state and big business.

This coalition formation is closely related to the colonial legacy. Eckert (1991) traces the origin of the Korean economic model to Japanese rule in Korea, while Cumings (1984) believes that the Korean model is based on the Manchurian model under Japanese rule.⁹ Eckert points out that the Korean model inherited many characteristics from Japanese rule, including the overwhelming predominance of the state in economic affairs, and the subordination of Korean capitalism to its Japanese counterpart. He argues that the Korean bourgeoisie never possessed a liberal birthright under Japanese rule.

The leader of the economic development was a former Japanese military officer, Park Chung Hee, and many of his leading deputies were Japanese trained bureaucrats. He had come of age in Manchuria in the midst of depression, war and overwhelming change. He had witnessed a group of young military officers organize politics, and a group of young Japanese technocrats quickly build many industries. These technocrats included Kishi Nobusuke, who later became prime minister of Japan (Cumings, 1997).

Korea and Manchuria under Japanese rule shared similar characteristics; government, especially under the military rule, coordinated the development of the economy, and all sectors were under the control of government. Economic growth was the ultimate goal, and no other voice was heard.

To achieve this economic success, the state intervened in private economic activities. An example is the state intervention in labor control. Eckert argues that harsh labor control during industrialization was evident during the colonial period (Eckert, 1991). Workers were tied to factories under unfair contracts, and were forced to work in uncomfortable and dangerous working environments. Even Japanese factory laws, which barely protected the labor rights of Japanese workers, were not applicable to workers in colonies, including Korea.

After 1931, there was an intensification of police control (Eckert, 1991). Labor was subjected to stringent regulation by the Government-General. After 1938, as a part of the overall government effort to keep the wartime

⁸ Ironically, farmers who contributed to the establishment of industrialization in Korea were excluded from the coalition (Shin, 1998).

⁹ Japan invaded Manchuria, northeastern China and established a puppet government, Manchukuo, in 1931.

economy functioning at maximum efficiency, the police found themselves in the business of preventing, as well as ending labor disputes.

The colonial practices were taken over by the newly created South Korean government. The Korean state was considered to be repressive from the beginning of independence. Tension between the state and most Korean people was resolved only after the bloody Korean War, which wiped out dissidents and created an over-grown state (Choi, 1993; Cumings, 1984). Using this over-grown state apparatus, the Korean government could have exerted their power at their own will. The military regime, which assumed control of the government following a coup, exerted even greater power than the previous government. They exerted this power without the consent of the people.

When Park Chung Hee, himself a product of colonial training, decided to launch an economic program of rapid industrial development, he had a core of veteran businessmen, many of whom had been tempered not only in the economic reconstruction of the 1950s, but previously in the rapid industrial growth of the late 1930s and early 1940s (Cumings, 1997). However, important components of Japanese industrial practices, such as lifetime employment, and harmony between workers and owners, which worked well in promoting worker-owner solidarity, were omitted in the Korean model. Instead, the state virtually took over the role of monitoring and controlling workers;¹⁰ big business did not have to pay much attention to controlling their workers.

Most of Park's economic deputies were Japanese trained bureaucrats. Some had training experience in Manchuria, where one of the most successful planned economic developments by Japanese bureaucrats was witnessed. Many Korean collaborators in Manchuria later held important positions in the South Korean government. As a consequence, Japanese trained bureaucrats dominated Korean bureaucrats, and formulated economic development plans which business had to adopt.

Business continued its relationship with the government established during Japanese occupation; they cooperated with anybody who held power. Korean capitalism experienced its first great burst of growth and prosperity under the repressive Japanese state structure, and by 1945 the Korean bour-

¹⁰ Ironically, the Korean officers who took power in 1961 were simultaneously anti-capitalist and desperate to build up Korea's national strength. The junta leadership had a peasant's suspicion of the wealthy. It was really the Manchurian model of military-backed, forced-pace industrialization that Park had in mind (Cumings, 1997). Park made a deal with ten major business leaders: they would make good on their "fines" by investing the money in new industries, and by donating "shares" to the government.

geoisie had become thoroughly conditioned to work within an authoritarian political framework (Eckert, 1991). Under Japanese rule, the Korean bourgeoisie found its political position within the native society increasingly unstable, and they began to rely more and more on the oppressive powers of the Government-General. After the liberation, it supported the minor, but American backed political faction that eventually came to power. In return, business gained various benefits. These included favorable conditions to take over Japanese properties and to obtain import licenses for scarce materials such as sugar and flour. This relationship solidified after Park's economic development initiatives. The Park regime believed that economies of scale would help attain economic development faster than if it established state-owned enterprises or chose to work with small and medium-sized enterprises (Kim, 1997).

The power of the *chaebol* grew substantially after the demise of military rule. The coalition between government and business had not been changed, but large *chaebol* were yielding considerable influence in the political arena.¹¹ One reason is that the state must rely on a certain degree of autonomy from the capitalists in the process of economic development; therefore, the state has difficulty in retaining its supremacy over businesses (Kim, 1997). The other reason is the growing influence of business on politicians through various means, such as building family ties and making political contributions. Civilian politicians who needed large sums of money for their political activities became more dependent on *chaebol*. The state rewarded the *chaebol* who had contributed large sums to various funds created by the President's cronies.¹² Top government officials were no longer the insulated elites, who appeared to make decisions without being influenced by business leaders (Kim, 1997); many politicians used their influence on the policy making process on behalf of business.

The Korean state has evolved from a coercion based government to a limited consensus based government, after achieving rapid economic success. At the beginning of the economic development, a coalition was created between the state and a small number of businesses that were beneficiaries of government policies for economic development. However, as the fruit of rapid economic development started to trickle down to the middle class, the

¹¹ Frequent attempts by businessmen to run for public offices, including president, signifies changing relationships between politics and business.

¹² When Kukje *chaebol* was bankrupted and disbanded, government provided incentives to assist the takeover of insolvent companies. Typically, the incentive included a mix of diverse measures (Kim, 1997). With these favorable conditions, businesses which were chosen by the government to take over the insolvent companies had everything to gain and nothing to lose.

coalition started to extend its base. Although the share of the national wealth was not as generous as in Japan, a substantial number of white-collar workers benefited from this development. This coalition was extended to some manual workers in core industries, such as heavy industry and the chemical industry. The power of workers in core sectors also increased due to democratization; *chaebols* were forced to make concessions to well organized workers in core sectors, but they compensated for this loss by squeezing small and medium sized companies that were totally dependent on them.¹³

Still, vast numbers of workers in the peripheral sectors and unemployed workers were marginalized and socially excluded. Excluded people were workers in peripheral sectors, and the unemployed and peasants, whose interests were long sacrificed for the sake of development. Workers have been tightly watched and controlled by the government's oppressive apparatus, including police, secret police and military.

When the military took over, they need to rationalize their power base. The necessity of rationalization came from the fact that Korea had a nominal democracy (Weiss, 1998); therefore, the military regime desperately needed rationalization, and the ideology of development was chosen. Military rulers who had a strong affinity with the Japanese military during the occupation chose the "old" Manchurian style development, and made a coalition with business that excluded labor. This comprehensive developmental state is presented as an inherently unstable and transitory state structure, since it has limits embedded in its construct: conflict with the excluded groups such as workers and peasants.

C. Comparison of Coalition Bases Between Japan and Korea

The Japanese coalition has been very stable (Gao, 2001). The stability comes from the fact that it has been an inclusive coalition, guaranteeing the interests of all participants. This becomes more evident when the Japanese and Korean coalitions are compared. The Korean coalition had seemed to be stable, but its legitimacy has been questioned by labor and other excluded people. Therefore, the coalition in Korea was unstable by nature.

The relationship between business and government appears similar in both countries; however, they are different in terms of their legitimacy. The Japanese model drew support from people because the relationship is considered to be in the public interest; or at least Japanese people acknowledge

¹³ As a result, the wage disparity between large firms and small and medium sized firms has been increasing.

the relationship to be more or less a necessary vice because it was a part of a system that produced Japanese economic success. Therefore, even though the ruling Liberal Democratic Party has been dominant in most periods since the war, and the party has a strong connection with business and its constituents, it has enjoyed support from the Japanese people for a long time. In contrast, the Korean political system continued to experience a legitimacy crisis, and it often had to rely on sheer force — military and police — to quell the opposition. Due to the lack of legitimacy, the Korean political system needed astronomical amounts of money to function. As a result, most politicians have been directly or indirectly linked to business in order to receive political contributions.¹⁴ Businesses welcomed the requests for political contributions, as far as they brought in kickbacks. When they thought the contribution did not bring in what they wanted, there was tension between government and business. As a result, there have been an increasing number of *chaebol* owners who ran for public offices, including the President. This is an example of the ever-growing power of business over the state.

In addition, the humble life-style of Japanese managers and their sympathetic attitude toward workers drew Japanese support for the economic system. In Korea, however, most business owners do not get the respect of the people; they are thought to be rich, either due to the favor of government or by exploiting workers and small and medium sized companies. In addition, Korean people have a long memory of the historical reality that Korean business cooperated with Japanese imperialists and Korean dictators. The *chaebol* system has long been criticized; it did not get much respect from people, especially from intellectuals; therefore, the Korean economic system has long faced the call for restructuring. Even government officials have long complained about the ever-growing power of *chaebol* and its abuse of power for economic interest, at the expense of Korean economic efficiency.

This stability of coalition is especially important in the economic crisis. Zysman (1983) showed that economic crisis during the 1970s almost derailed democracy in many countries. However, Japan did not experience anything close to political crisis resulting from economic crisis, due to its stable coalition. In the following section, we will discuss how the differences in stability of the models between Korea and Japan influenced the responses

¹⁴ Ironically, the dependency of politicians on business has grown after the “democratization” of Korean society. Under the authoritarian government, politicians received direct monetary, information and even police services from the government in elections and day-to-day political activity. However, politicians had to raise money and manage their own organizations and political activities, thus becoming more dependent on business.

to the economic crises.

a. Production Systems

Production systems in both countries appear similar, but differ essentially. Products and technology are similar, but the way production is organized differs significantly. Government led economic development strategies and similar products produced similar factories. The similarity may come from the fact that Korea imported and copied Japanese economic development technology. Government has been a strong actor in the Japanese production system, as in the Korean system. In Japan, at the macro level, the state had dictated business; what industries should be developed and the direction industry should take (Johnson, 1982). Macro level guidance was closely related to the production method at the micro level: a production system with total employment. The system is an amalgamated one with government, business and labor. Micro level considerations on employment also dictated decisions at the macro level of financial and monetary policies (Gao, 2001). This system reflected the characteristics of the Japanese coalition; it secured the interest of all stakeholders: government, business and labor.

This Japanese corporatism has worked successfully. Although industrial relationships are paternalistic, worker's rights are relatively well protected and workers are endowed with relatively high wages and job security. Work norms are enforced with a certain level of consensus. The wage difference between white-collar and blue-collar workers is relatively small. In addition, managers' wages are not excessively higher than workers, and are related to the wage increase of workers (Dore, 1998). Therefore, this system did not create an antagonistic relationship between management and workers at the micro level, and it did not create serious challenges against the system at the macro level.

The Korean production system differs from the Japanese system, reflecting the difference in the coalition. It only guarantees the interest of government, business and small numbers of middle class and core workers. The origins of difference can be traced to the colonial era; many South Korean businesses emulated the Japanese business practices of the period, and adopted features of the *zaibatsu* — the only form of modern business they had known (Kim, 1997). Many *chaebol* owners gained their first experiences in modern enterprises by working as low-level technicians or clerical workers for the *zaibatsu*. When they took over their former employer's businesses, they crudely imitated the practices of the *zaibatsu*. The Korean system also inherited the labor practice of *zaibatsu* during occupation: exploitation

of workers (Eckert, 1991).

This micro level production system is strongly related to the macro level development strategy of Korea: development first. The state decided that labor should be sacrificed for development. The authoritarian government chose business as its coalition partner, excluding labor (Choi, 1993). The abuse of labor rights was clear throughout the development period, before the demise of the authoritarian regime. The secret police and other state agents were used to discipline and control workers until the advent of democratization in 1987.

After the collapse of military rule in 1987, several labor practices were introduced in core sectors, such as lifetime employment and widening company welfare privileges. Even then, only few workers in lucrative companies belonging to *chaebol* enjoyed the benefits; many workers in small and medium sized companies were excluded from the benefits of democratization. Labor law protection and welfare benefits had not been provided to most workers in small and medium sized companies, and working conditions for them were not acceptable in many cases.

Democratization after 1987 put pressure on the Korean production system. Although the state had been a supporter of capitalists in Korea, capitalists complained of having little support. They needed the state protection in labor disputes, and from foreign competition in domestic markets, but abhorred direction from the government on how to manage business. They demanded "selective control, especially control of the labor movement and of wages (Kim, 1997)." Excluded from the coalition but newly invigorated, labor also demanded more welfare and more protection of worker's rights from the state. In addition, labor also wanted the state to control and to limit the increasing power of the *chaebols*. However, their demands were mostly ignored.

Unlike the Japanese production system, the Korean system was based on the coercion of workers by the state, which required a high level of monitoring. The state had faced ever-increasing pressure from both business and workers after the collapse of the authoritarian regime, and could not satisfy both of them. As a consequence, it became an unstable system before the economic crisis hit Korea.

b. Policy Formation

Japan changed economic policies as it experienced many economic difficulties since the start of industrialization. It experimented with various economic policies, from a *laissez faire* economic policy to state intervention, but eventually settled on developmental policy. After a brief period of state

owned companies led economic development, Japan adapted a *laissez faire* policy. Inefficient and corrupt public companies became burdens of the state, so the government privatized most public owned companies and stepped back from direct intervention with the economy.

This market-oriented policy did not last long as the economic recession hit; Japan began to adopt the German-style government intervention model. It attempted to reduce excessive competition by allowing industry to form cartels. The government also attempted to modernize industry by offering economic incentives. All these measures were labeled industrial rationalization (Johnson, 1982).

The other line of intervention policy was a fine-tuned allocation of scarce resources by the government. This policy originated from Japan's war effort experience during World War II, but continued after the war. In order to cope with material shortage caused by the war, the Japanese government intervened in the allocation process. It continued to do so after the war, when they faced severe shortages of materials (Johnson, 1982). Even after the economy started to grow, it continued its role, as there were constant shortages of scarce resources due to the high growth of the economy.

An important feature of the Japanese policy formation is that it is based on broad social consensus. Although bureaucrats and government elites have leading roles, politicians and business leaders who share similar orientations also participate in the policy making process. However, checks and balances among politics, the executive branch and business prevent cronyism in Japan, even though politicians, bureaucrats and business are interrelated by education, local and family backgrounds. As a result, policies in Japan have been stable and consistent.

The Korean state held stronger power than the Japanese state. It could plan the development strategy, and enforce economic actors to follow. The Korean government's use of financial institutions to obtain its goals supports this point. A core element of the Korean model was finance controlled by government, as was in Japan. If the firm's performance was poor, or the firm did not do whatever the state expected, government had the power to bankrupt the firm the next day by a phone call to the financial institutions, since the government had total control of financial institutions. This gave the state tremendous power over companies on investment patterns, mobility into new industries, and simple day-to-day corporate performance (Cumings, 1997). The firms that received policy loans were quasi-state organizations that had common interests with the government, that sank or swam by following government dictate, and whose leaders were personally connected to the ruling elites.

Whereas Japanese bureaucrats are relatively independent, their Korean counterparts are not. Korean politics dictate bureaucracy in Korea; therefore, the autonomy of bureaucrats is limited and the locus of power resides in the political arena. Business people are relatively weaker than politicians and bureaucrats, because most companies are heavily dependent on loans from banks that are controlled by bureaucrats. Politicians, however, depend on business. Although they hold an edge over bureaucrats and business, they need large amounts of political contributions to manage political activities, and to run their political apparatus. There has been widespread speculation that some *chaebols* have influenced politicians and government bureaucrats with bribes and through personal and familial relationships. The 1989 Hearings for the Fifth Republic at the National Assembly revealed that many of the largest *chaebol*, including Hyundai, were accused of bribery and political kickbacks (Kim, 1997). As seen in many political scandals, Korean politicians have often been found to interfere with the government decision-making process on behalf of business. As a consequence, policy making in Korea is often a result of haggling among three parties: bureaucrats, politicians and *chaebols*. The process has been murky, and lacked legitimacy.

Democratization, along with increased power of organized labor, could have increased the possibility to include labor in policy formation processes; however, the state and business have kept labor from the process. This exclusion created tension in policy formation. Labor, with increased power, received some wage increases, but could not influence the process. Labor became hostile towards the alliance between the state and businesses, and many policies were not supported by the people, regardless of their merits.

In sum, bureaucrats monopolized policy formation at the beginning of industrialization during the 1960s, reflecting the interests of the state and business. The power of business has grown in the process of industrialization. This practice resulted in the coalition between the state and business, at the exclusion of labor. It faced challenges after the demise of the authoritarian government during the late 1980s, and strained the alliance between politicians and business, and labor.

SOURCE OF AND RESPONSE TO ECONOMIC CRISES

The Japanese and Korean economic crises appeared similar, but differed in speed and length. The differences may have called for different responses. In addition, although there were similar imperatives for change, the institutional difference could have created different responses. Korea and

Japan might have responded to the crises based on their own socio-political characteristics, and this could have led to different economic changes.

Japan experienced various economic crises since the beginning of industrialization in the late 19th century, and it had responded to them more or less successfully with varying development policies. However, lingering economic recession during the 1990s, the focus of the current discussion, is an exception. The long record of success in Japan satisfied the broad interests of most Japanese, and may have also made the Japanese reluctant to adopt a new economic system. Korea also experienced many crises since the independence of 1945, and had overcome economic difficulties, but primarily by sacrificing and excluding most workers and farmers. Therefore, when the role of the Korean economic system was in question, most workers and farmers demanded change. Without the coalition supporting the system, the Korean economic system could not be preserved.

Japanese Economic Crisis

Porter et al. (2000) illustrate how deep the recent Japanese economic recession is: "Real estate prices have plummeted by as much as 78%. The Nikkei stock price index, which peaked at 38,915 yen in December 1989, had only recovered to the 20,000 range by early 2000. Unemployment hit a record high in 1999, topping the U.S. jobless rate for the first time." They argue that internal factors are related to the crisis; first, the burst of the bubble economy of over-valued equities and real estate in the early 1990s. The collapse of asset prices hit the banking industry hard, resulting in a credit crunch. As the value of collateral plummeted, all economic actors were in debt, which suppressed consumption and investment. Second, over-regulation and overprotection by the government distorted and undermined business competition. Third was mismanagement of macroeconomics by the government, including untimely tax raises, failing to stimulate domestic demand and clinging to a policy of export-led growth. Krugman (1994) summarized the causes of the problem as input driven economy; government intervention in the economy created unnecessary competition in some markets and over-protection of the domestic market without increase in productivity. This inefficient economy would eventually stagnate.

Other studies show that external factors also contributed to the crisis, in addition to internal factors. Late-late developers such as Korea and Taiwan emerged, began to compete with Japan, and eroded Japanese market share in the world (Johnson, 1982). Japan was squeezed by late-late developers like Taiwan, South Korea, Hong Kong, Singapore and China, and by

advanced countries with niche markets such as Germany and other European countries (Ohmae, 1990). Changes in international politics also negatively influenced the Japanese economy (Cumings, 1997; Johnson, 2000). During the Cold War, the U.S. reluctantly accepted the loss from trade deficits, and encouraged the growth of allied countries such as Japan, Korea and Taiwan. However, after the collapse of Communism, the U.S. no longer accepted this situation. The U.S. pressured Japan to open its markets, and to take other measures allowing U.S. companies access to Japanese markets, thus contributing to the demise of Japanese dominance in world markets.

Gao (2001) recognizes the importance of external factors, and how Japan has responded to these factors. However, he pays more attention to domestic institutions. He notices that the state, business and labor built a closed system. In return for support from the state, business offered permanent employment and other forms of company welfare for labor, which, in return, secured political stability. Therefore, "the Japanese economic system may contain the seeds for stagnation. As the interests of each major distributional coalition are locked into the present economic structure, the political system loses the dynamics to break the equilibrium in support of reform (Gao, 2001)."

The Major Obstacles to Change in Japan

Most Japanese accept that change is needed (Dore, 1998). Almost every politician, professor or pundit talks about the need for restructuring, and most can produce their own "radical" plan (*Economist*, December 13, 2001). Suggestions for restructuring can be divided into two mandates: abandon the developmental state and restructure financial institutions. Financial institutions have been tools of the developmental state; the state used them to implement its policies, including industrial policies. Porter et al. (2000) argue that government should not guide business, and should make the economic system more flexible. Foreign observers argue that much privatization, deregulation and fiscal restructuring are needed for the re-start of the Japanese economy, along with efforts to lift the huge burden of bad debts off the shoulders of commercial banks (For example, *Economist*, December 13, 2001). Despite these recommendations, progress in economic restructuring has been slow for two reasons: the urgency is not sufficient, and 'a closed system' of interrelated interest groups of Japanese economic blocks also needs economic restructuring.

Although Japan experienced economic recession, it is not desperate yet. The unemployment rate was 5.4% as of 2001; this rate is very high com-

TABLE 1. THE UNEMPLOYMENT RATE IN JAPAN (%)

Year	1970	1975	1980	1985	1990	1995	2000
Unemployment rate	1.1	1.9	2.0	1.56	1.34	2.10	3.20

Source: Labor Force Survey, Statistics Bureau, Management and Coordination Agency.

pared with previous figures, but it is still acceptable in most other countries. Although the current unemployment rate is high for many Japanese, it does not threaten the stability of the Japanese system yet. Also, the still performing economy and deflation alleviates the pain from rising unemployment. Economists report that “unemployment has risen, but only to 5.4% of the workforce. Incomes have been declining, but only gently, and there have been higher rewards for the most talented. ... With prices falling by around 1% a year, life is becoming more affordable (*Economist*, December 13, 2001).”

Considering that the current economy is worrisome but not desperate, the pill of restructuring the economy is hard to swallow; restructuring requires overhaul of the system, which has successfully protected the interests of all participants. Current development was possible and is sustained by the Japanese development model (Cumings, 1984; Johnson, 1982; Gao, 2001). This successful system is tightly knitted; therefore, change of one system causes change in the other sectors. Although this system is facing serious challenges, economic actors will hesitate to reform as it has been so successful for so long. The change will be expensive and painful for most, and it is not clear whether it would bring in further economic prosperity for all stakeholders. Therefore, the old system itself hinders economic restructuring in Japan.

Korean Economic Crisis

Economic crisis hit Korea by surprise in 1997. Both supporters and critics of the Korean development model did not expect such a sudden and severe economic crisis (Krugman, 1998). This crisis resulted from the combination of various internal and external factors. Internal factors are related to ‘crony capitalism’: resource allocation by favoritism. Critics of the Korean model argue that the developmental state is closely related to this problem. Although crony capitalism has been criticized, Korean economic development was successful with cronyism before the economic crisis; therefore, cronyism alone cannot explain the crisis (Radelet and Sachs, 1998). However, it is true that corruption and cozy relationships between government and chaebol contributed to a less efficient economy in the long run

(Krugman, 1998).

External factors are presented in a context of changed international relationships. Korea was a major recipient of American aid and was allowed free access to U.S. technology and markets (Cumings, 1984; Johnson, 1982; Vogel, 1991). The collapse of Communism, however, drastically reduced the importance of Korea as a bulwark against the expansion of Communism. Korea could no longer expect favorable treatment as before from the U.S. and Japan. Instead, it was forced to open domestic markets and to 'self regulate' the ceiling of export for some goods to the U.S. When the Japanese economy was in trouble, the U.S. allowed Japan to depreciate Japanese currency against the U.S. dollar. The depreciation of the Yen caused serious economic disturbance among Asian countries. They lost competitiveness due to the relative appreciation of the domestic currency, and Korea was one of these troubled countries (Johnson, 2000; Wade, 2000). This account based on external factors cannot explain why the crisis started in 1997, but it gives us information on the external pressures that the Korean economy faced.

The Korean economy fell into serious trouble as South East Asian countries began to experience economic crises. Foreign investors who lost confidence in this region began to pull out of Korea, causing a foreign currency crisis: the stampede of foreign investors (Radelet and Sachs, 1998). As most Korean companies depended on over-loans from banks, economic crisis was unavoidable when foreign capital began to move out of Korea. The foreign currency crisis ushered in the crises of financial institutions and companies, and eventually the crisis of the Korean economy.

Even though the causes of the Korean crisis were varied and seemed to be external, Korean people believed that incompetent bureaucrats and inefficient *chaebols* caused the crisis. They blamed the developmental state model. Unlike the Japanese model, the Korean development state model had faced criticism and at best it had been considered as a necessary, but transient vice. Therefore, people demanded the demolition of the development state when they faced the economic crisis. Ironically, the restructuring was supported by the people, but its result reflected the structure of the old development coalition.

The state implemented restructuring with the help of *chaebol*; the end result is the preservation of state power and protection of *chaebols'* interests. Facing economic crisis, the Korean government began to restructure the economy. The restructuring includes the financial, corporate, public and labor sectors. The financial sector was hit hard; almost 40 percent of workers were laid off. Several measures were taken in the corporate sector for transparent and efficient management, including specialization and change of

governance systems. Several state-owned companies in the public sector were privatized, and the number of workers in the public sectors was reduced. Despite reform in the public sector, the power of bureaucrats, however, remains strong. Corporate reform also maintained market share and the importance of *chaebol* in the Korean economy.

Although the demand of the people for restructuring was the dismantling of the development state, the results have been strengthening business and preserving bureaucratic power. The major culprits of the crisis, the *chaebols*, were forced to run transparent management and to lower the ratio of loans to total assets. However, in return, they received flexible employment and less interference from government, and overall are the beneficiaries of the reform.

The most successful restructuring was observed in the labor sector. Several legal clauses that prevented lay-offs were abolished, and the use of temporary workers in most sectors was allowed for more flexible employment. As a result, many workers lost stable jobs and became either unemployed or temporary workers. At the beginning of restructuring in 1998, organized labor was reluctant to change the labor laws for fear of increased unemployment, atypical workers and losing the power base of trade unions.¹⁵ The change of labor laws for 'flexible employment' has taken away stable employment. The evident losers of economic restructuring are workers with stable employment.

Facilitators of Korean Restructuring

Factors that facilitated the restructuring of the Korean economy originated from the incomplete alliance among major economic actors. Coercion has been a necessity to sustain the Korean development model, since repression was required to subdue labor (Cumings, 1997; Choi, 1993). The Korean system has been intrinsically unstable, but it could have existed as far as it continued to grow and trickled down the fruit of economic development to the middle class and workers in core sectors.

The altered economic and political environment had also demanded change. The growing trade deficit between the U.S. and several East Asian nations increased pressure from the U.S. and other countries to implement a series of economic liberalization and internationalization measures¹⁶ (Kim,

¹⁵ Most Korean trade union memberships are composed of workers with stable employment in *chaebol* companies and state owned companies.

¹⁶ Gao (2001) calls this a correction of "asymmetric corporation" between U.S. and ally countries.

1997). Korea was protected by the U.S., but this protection had been removed after the collapse of Communism. Democratization also contributed to the demise of the model. The military's loss of power after the June 1987 civil revolt reduced the power of state. Mandates to change the economy seemed to be more evident after the establishment of successive civilian governments.

The lack of legitimacy of the Korean model also called for change; there has been consistent criticism of the state led economy. Without government restraint, *chaebol* exhibited avaricious appetites for domestic markets, at the price of small and medium sized companies. As a result, their behavior had been deplored by the Korean people.

The newly emerged bureaucrats who were influenced by "free market" theorists in Kim Young Sam's government¹⁷ had different views on the old role of government. They blamed the previous regime's state-led, over-investment in heavy industries for the negative growth of the 1980s. They argued that the *chaebol* based Korean economy should be modified. Radical scholars were especially critical of the model, labeling the Korean economy as a system just for *chaebol*, and not for the people.

The sole pillar supporting the system was the successful economic performance of the system. Government and business were on the lifeline of economic performance without legitimacy. The majority of Koreans, with the exception of a small percentage of the emerging middle class, resented the concentration of the economy in the hands of *chaebol*. However, they, especially middle class, accepted the economic structure, as they could not find any successful alternative. Therefore, government and business alliances, with a small proportion of the growing middle class coalition, had been resilient to the criticism.

When the economy was near collapse in 1997, however, everybody either demanded dismantling the old system, or withdrew their support. Korea easily reached consensus that the old system was seriously flawed, and needed to be abandoned. Just after the foreign currency crisis of 1997, the opposition party candidate won the presidential election, for the first time in Korean history. The new president had long been a critic of the old economic model, and had promised swift economic reform if he was elected.

An important point is that although serious economic problems and a new government surely influenced the change of the system, what really brought the change was public opinion against the Korean development coalition. People who had been excluded from the coalition had lost confi-

¹⁷ The government before Kim Dae Jung's current government between 1993-1997.

dence, and regarded the model as a major cause of economic catastrophe. Facing a landslide of changing opinions about the Korean model, economic bureaucrats and business could no longer protect the system.¹⁸

CONCLUDING REMARKS: PROSPECTS FOR RESTRUCTURING IN TWO COUNTRIES

Korea has restructured its economy relatively more successfully than Japan did. There are various explanations why Korea was more successful. One explanation is the differential level of urgency of economic crisis that each country experienced. Although the Japanese crisis has lingered over 10 years, it is not as severe as the Korean crisis. The sudden and severe crisis in Korea allowed swift and broad restructuring. Facing disastrous economic downturn, no actors in the economy could resist the restructuring. The new president from the first horizontal change of power in Korean history after the crisis, who was considered relatively progressive in Korean politics, was also believed to have helped lessen labor resistance, which was considered a major opposition to restructuring. President Kim Dae Jung had persuaded labor in pushing his restructuring agenda.

This paper, however, argues that the single most important factor for the change came from the flaw of the development coalition in the Korean economic model. Other contributing factors to the crisis have existed since the start of industrialization in Korea; however, the Korean model continued to be resilient with these flaws. The discontented majority who were excluded from the development coalition discredited the Korean model long before the crisis, but remained dormant due to coercion and later, to a lack of alternatives to the developmental model. Facing sudden and severe economic crisis, people demanded the demolition of the system, and the state and *chaebol* coalition could not defend the system.

The argument that the flaws of the Korean coalition contributed to the rapid change of the economy is indirectly supported by the Japanese case. Although lingering recession is real and necessary for restructuring, the current economic system is still performing and serving the interest of the Japanese people relatively well (Gao, 2001). The transition will be long and painful, and may make the system unstable. In addition, the result of

¹⁸ The Korean economy is heavily dependent on the world economy. It cannot survive without the support of foreign countries, especially of the USA. These countries demanded change of the Korean economic model. During the crisis, Korea had to accept the demand. This weak position of Korea in the world economy may partly explain the difference between Japan and Korea, in addition to institutional characteristics of the Korean economic system.

change is uncertain; the change of the system does not guarantee new prosperity for all. As a consequence, change is and will be slow, unless Japan faces sudden and severe downturn as South Korea experienced in 1997, which is strong enough to dismantle the current development coalition.

Old institutions have inertia. Old Korean economic institutions still influence the new direction of change. The Korean government attempted to reform four major sectors of the Korean economy: the financial, corporate, public and labor sectors. Among these, labor reform was most successful. The flexibility of labor was very successful, such that Korea has become one of the most flexible countries in employment, with the highest proportion of temporary workers. For example, in the financial sector, more than 40 percent of employees were laid-off. In contrast, *chaebols* are still expanding; corporate sector reform is constantly criticized by foreign news media (*New York Times*, 2001). As was with the old coalition, labor has become the scapegoat, and *chaebols* are still holding their power.

The state is not losing its power. Though many critics argue that the government in Korea should reduce its role in the economy, Korea still needs government guidance. *Chaebols* are rampant, and need to be checked by government. The role of the government should be changed, but the direction is still unclear. One line of argument is that it should incorporate more regulatory state functions, but some argue that government should maintain the developmental function.

Regardless of the future role of the Korean state, if the new Korean model aims to achieve stability, two goals should be achieved: severing cozy relationships between politics and business, and including labor into the coalition. It is clear that without change of the Korean political structure and practices, successful restructuring of the Korean economy seems impossible. Politics that can influence bureaucrats are under the influence of business. Korean politicians need a lot of money to manage their political organizations, and much of the money is distilled from business, legally and illegally. If this practice is not changed, Korean politicians will not give up their efforts to influence the policy-making process in favor of business. Changes influenced by politicians will be distorted to preserve politicians' power to influence the economy.

Korean workers have been excluded from decision-making processes, and it has been a source of the instability of the Korean model. Korean workers' militancy could be an important factor in determining the future of the new economy. Although labor has been somewhat subdued, it can be reinvigorated when workers feel that they are not treated justly, especially under the corrupt and pro-*chaebol* government. Therefore, the stability of the system

can be influenced by the decision of whether or not to include labor as a new coalition partner.

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