

Dee, Philippa S.

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Economic Policy Making and the Role of Special Interest Groups: Some Evidence for South Korea*⁺

by

Philippa S. Dee

Institut für Weltwirtschaft an der Universität Kiel

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Kiel Institute of World Economics
Department IV
Düsternbrooker Weg 120, 2300 Kiel 1

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I. Introduction

It is now generally recognized that special interest group influence on economic decision making is not in theory a phenomenon restricted to democratic capitalism. Governments which have attained power by non-democratic means must eventually seek legitimacy, either by populist appeals to the masses or by cultivating the support of important sectors (e.g. Lovell (1975)). They may therefore be no less immune to interest group lobbying than governments which face electoral scrutiny. Likewise, it has been argued that the incentive for interest groups to exert political pressure is in fact greater under socialism than under capitalism (e.g. Becker (1983)). The purpose of this paper is to present evidence on the role of special interest groups in economic policy making in the Republic of Korea (South Korea), a country which differs from a western capitalist democracy in at least one important respect.

The South Korean economy is by and large capitalist, although perhaps more than most economies so described it is subject to various forms of government intervention, regulation and guidance. However, for the last two decades Korea has had a highly centralized, authoritarian form of government. There have been constitutional provisions for the democratic election of both the President and representatives to the National Assembly, or parliament. Nevertheless, the overwhelming bulk of political power has rested with the President, while the function of the National Assembly has been primarily to debate, but ultimately to pass legislation initiated by the President.¹ Furthermore, the last two important transitions of Presidential power have not been by the electoral process but by military coup (President Park Chung-hee in 1961 and President Chun Doo-hwan in 1980).² Thus while electoral scrutiny might not

¹ See Wright (1975), Hahn (1975) and Korean Overseas Information Service (1981) for descriptions of the Korean constitution and authority structure. Jones and Sakong (1980) also provide a good description of the power channels of economic policy making through the Presidency and bureaucracy during the Park era.

² Park's Prime Minister Choi Kyu-hah served briefly as President in the transition period following Park's assassination in October 1979.

seem to have been a binding constraint on government policy making, the need for each military-turned-civilian government to gain legitimacy has potentially given interest groups an (additional) channel of influence.

From an economic viewpoint, it is important to identify interest group influence on government decision making in order to understand the constraints that political considerations may place on the economic policy making process. The prime concern of economists may be with policy packages which provide net gains to society as a whole. Special interest groups, whose primary concern is with the distribution of benefits rather than with the magnitude of the overall gain, can constrain policy choices in the following ways. Firstly, they can lobby decision makers to implement measures which benefit their group but impose a net loss on society. Secondly, they can lobby to block the implementation of measures which would hurt their group but benefit society as a whole. Thus government may adopt initiatives which are suboptimal from a purely economic viewpoint but nevertheless represent an equilibrium outcome in the politico-economic marketplace.³

In order to identify the existence of interest group pressure, however, it is not sufficient merely to identify the gainers and losers from a particular set of policy choices and to impute the outcome to successful lobbying on the part of the gainers. Even where policies do provide net gains to society, the benefits are rarely distributed evenly. More typically, some groups gain while others lose, although economists are usually careful to show that the gainers could potentially compensate the losers and still remain better off. Similarly, the adoption of policies which apparently impose a net efficiency loss may reflect a second best choice in the face of some existing, irreversible market distortion (including perhaps the implementation costs of a first best policy choice), rather than the influence of special interest groups.

³ See Stigler (1971), Peltzman (1976), Becker (1983) and our own paper Dee (1984b) for theoretical approaches to this process.

In addition to this general identification problem, there are several historical and cultural factors which make the search for evidence of interest group pressure doubly difficult in the case of South Korea. An important historical consideration is that, following the period of Japanese colonial rule in 1910-45 and the Korean War in 1950-53, South Korea was a country essentially starting from scratch, not only economically but also to a certain extent socially. In some country studies, a partial solution to the identification problem is possible by at least choosing groups whose existence is not owed to the current set of economic policies. Thus landlords or farmers with longstanding land ownership, or unions with a long history of association, become the objects of study. In the Korean case, this partial solution is largely unavailable. The traditional Confucian power structure from the Yi dynasty was already greatly weakened by power struggles within the top or yangban class (originally powerful scholars and officials with land ownership rights), the dilution of yangban status through the sale of titles and the emergence of a relatively wealthy, if not yet powerful, merchantile class (Hahn (1975), Lee (1978), Korean Overseas Information Service (1981)). Colonial occupation and war further acted as great social levellers, and were reinforced by two major land reforms in 1947 and 1949 which redistributed land away from former Japanese landlords and broke up larger peasant holdings (Brown (1973)). Thus many of the groups which are easily identified today are precisely those which began and thrived under the economic and social policies of the last two decades, or at least have not been harmed by them.

A second consideration is the extent to which social and cultural attitudes of the Yi dynasty have survived, even though the Confucian power and class structure has not. Paik (1978) discusses these attitudes as they affect relationships within Korean bureaucracy, but the idea has wider application. Paik examines six dimensions of the Korean value system - fatalism (including the desire to avoid risk), familism (loyalty to family, birthplace, kinsmen, school ties, province of origin), authoritarianism (a disposition

to look down on inferiors), emotional humanism (where maintaining continuous active relations with others becomes an end in itself, not a means to achieve cooperative goals), ritualism (a disposition to stick to customs and precedent) and anti-materialism (placing more emphasis on honour, prestige, integrity and virtue than on material reward). These dimensions can help to explain why Korean bureaucrats might place a low emphasis on problem solving, goal attainment and the modern organizational demands for impersonality, impartiality, rationality and the delegation of authority; instead, "rights and duties defined in terms of job description or job title are meaningless because the actual power always lies in the hands of some small clique formed around a powerful figure" (Paik (1978, p. 223)). Similarly, cliques may cut across institutional boundaries and the channels of power and influence between institutional groups may not be those displayed on an organizational chart, especially when those institutions are recent phenomena or have been borrowed from western culture.

Finally, while the economic policies of the last two decades have undoubtedly benefited particular groups, the overall record of the Korean economy over that period would not at first sight provide strong evidence that the favours accorded these groups have come at the expense of the economy as a whole. Economic policy making has encompassed two important areas of intervention,⁴ (a) in trade, where tariff barriers, non-tariff restrictions or outright prohibitions have been applied, particularly to imported consumer goods (Hong (1979), and (b) in finance, where bank interest rates have been administered at below-equilibrium levels, while available credit has been allocated to industry according to government-determined priorities (Cole and Park (1983)). At the same time, between 1962 and 1978 real GNP grew at an average annual rate of 9.9%, or 7.7% in per capita terms. Real exports grew at an average 27.4%,

⁴ Other areas have been left relatively free of interference or distortion, e.g. it is generally agreed that the exchange rate has been kept close to equilibrium levels, at least relative to the period of gross overvaluation prior to 1961 (Brown (1973), Hong (1979)).

not only giving a direct impetus to overall growth, but also providing the foreign exchange necessary for imports into capital formation (with 19.7% average real growth) and, to the extent permitted, into consumption (with 7.8% average real growth). Furthermore, inflation has been kept at moderate levels with the CPI rising at an average 15.0% during 1962-78, more than in Taiwan but less than in some of the newly industrializing Latin American countries.

Yet despite this impressive economic record, the most recent policy initiatives stress the need for liberalization in trade and finance, motivated by a recognition that the interventionist policies of the past have, in at least some instances, created artificial market distortions and imposed a loss of static allocative efficiency:

"... excessive government intervention in the private sector has discouraged private initiative and efficiency of investments which are vital to the growth of the market economy. Allocation of resources among industries was not, by and large, guided by the market mechanism, but rather, subject to priorities established by the government. The result was a lopsided distribution of limited resources in favour of large enterprises and heavy and chemical industries. The industrial incentive system was also ineffective both in promoting balanced industrial growth and in inducing entrepreneurial efforts to raise efficiency. Among the causes for this ineffectiveness were excessive protection of industries in the form of import restrictions, high import tariffs and institutional barriers to entry". (Economic Planning Board (1981, p. 8)).

Furthermore, there is a strong presumption in some Korean circles that those who gained from intervention did so by influence peddling:

"A persistent and deeply rooted problem, however, is that of corruption in the ranks of the government and the ruling political party, particularly that related to collusion with private enterprise". (Hahn (1975, pp. 309-10)).

"Perhaps more worrisome has been the reemergence of corruption and favouritism and their possible impact on income distribution ... Officials have been tempted to extract forced payments in return for favouritism. The Daewoo group started with modest capital and amassed billions within ten years. Illegal loans were obtained by the head of the Yulsan group of companies to finance exports through government influence. Moreover, the dominance of government over economic policy in the 1960s and 1970s has invited abuse". (Jung and Siegel (1983, pp. 48-9)).

Such comments warrant further investigation, which would be of interest not simply as an examination of the role of special interest groups in a centralized, authoritarian country. From a policy viewpoint, it is of interest to know whether the interventionist policies which have imposed at least some efficiency loss were shaped or used by interest groups who exerted political weight to override purely economic considerations. This would in turn give an indication of whether those same groups, who may have the most to lose from the current initiatives,⁵ are likely to use their political weight again to block the implementation of these initiatives. Therefore, in Section II we review the literature on interest groups in South Korea. This section essentially identifies particular groups visible in that country and notes the extent to which they have lost or gained from the economic policies of the last two decades. In Section III we examine the role of one group, Korean big business, in more detail in an attempt to resolve the identification problem - are the Korean chaebol (business conglomerates) big because they are successful in a productive sense, or are they successful because they are big enough and close enough to the centres of political power to obtain favours in the form of cheap bank credit? Our findings, subject to data limitations and the difficulties mentioned earlier, do not support the presumption that chaebol

⁵ This need not be the case. Elsewhere (Dee (1984a)) we show that those industries which benefit most from cheap bank loans would not necessarily contract, at least in the long run, were bank interest rates to be liberalized.

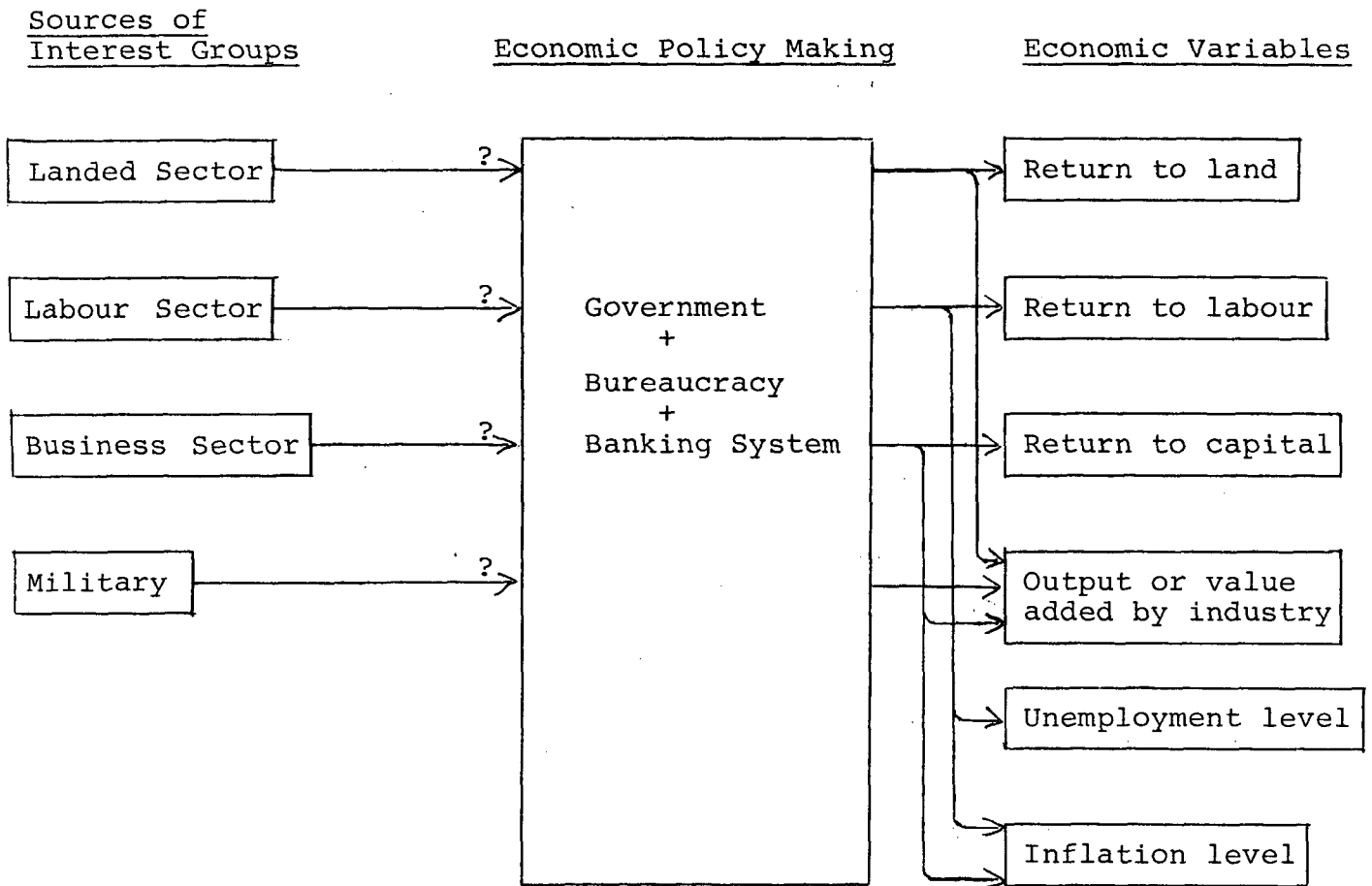
have obtained more cheap credit than is warranted by their economic performance alone, although there is limited evidence that political favouritism might have affected the use to which the credit they did obtain was put. Finally, in Section IV we present some tentative conclusions concerning the likely course of the Korean government's current liberalization effort.

Section II - (Interest?) Groups in South Korea

The exertion of political influence on economic policy making requires the formation or existence of coherent groups. In other countries, such groups normally form within sectors which have a common economic interest - the landed, labour or business sectors - although coalitions of diverse interests can also occur. In the first instance, however, we examine the landed, labour and business sectors separately as potential sources of coherent interest groups in Korea. The process of interaction between such interest groups and economic policy making can then be represented diagrammatically in Figure 1.

On the left hand side we have identified sectors from which groups might form to exert influence on government. On the right hand side we have identified the economic variables in which each sector has a stake. Where a group does form to influence government, then government's choice over economic policies is constrained by the policy effects on the associated economic variable. We have included both the bureaucracy and the banking system together with government as agents of policy making and implementation. This grouping reflects the power that bureaucrats and bankers in Korea have to formulate or to exercise discretion when implementing economic policy, but it is not a statement about their goals or objectives when doing so. Thus we recognize that an individual banker may be wealth maximizing when he accepts a bribe to make a favourable loan

Figure 1 - Interest Groups and Economic Policy Making in South Korea



allocation, but the course of economic policy is nevertheless altered accordingly. For this reason, we have included the military as a separate potential source of group influence on economic policy making, since current military leaders no longer exercise direct power over economic decisions but because of South Korea's strategic vulnerability to invasion by the North, they might have a particular stake in the outcome. We now review each sector in turn to see how it has benefited or been harmed by past policy actions and their economic consequences, and whether coherent groups have emerged as a result.

(i) Land Interests

At the outset we should note that the late President Park was born the son of a poor farming family in rural Kyongsang province, while President Chun was born in a rural part of Southern Kyongsang province (Kim (1981)). Yet on the government's side, a significant initial step to improving the lot of the poorest rural farmers had already been undertaken with the land reforms of 1947 and 1949. At that time, both tenant farming and ownership of more than 3 hectares were prohibited by law, so that 39% of Korea's farm families who had been tenants or landless labourers became landowners while another 23% were able to expand their holdings (Brown (1973)). In the early 1960s the incomes of farm and urban salary-wage earning households were roughly equal, but the relative position of farm households declined as industrialization progressed (Kim (1978)). Government then responded on two fronts. From around 1970, the government purchase price for rice, which had previously been set mainly to smooth seasonal price fluctuations, was raised systematically above the market resale price,⁶ while from 1968 both prices were increased substantially through government restrictions on imports (Kihl (1979)). Secondly, in 1971 the government instituted the Saemaul Undong (New Community movement), a wide-ranging program whose aims were stated in terms of Spiritual, Economic and Social Development. The main economic goals were to promote mechanization and technological innovation in farming practices, to expand the rural infrastructure and to begin developing sources of off-farm income, along Japanese lines. The government provided financial and material assistance for individual projects, and above all leadership, occasionally to the point of coercion (Kihl (1979)). Yet the keynote was self-help, in that selection and implementation of projects was left to individual communities, while the ultimate goal was to make the rural areas self-reliant and independent of further government assistance (Kim and Lee (1978)). The improvements in infrastructure have been substantial and the introduction of improved rice varieties has

⁶ The government purchase price for barley, the other main agricultural product, had always contained an income support component (Brown (1973)).

made possible yield increases of around 30%, although the attempts to develop small scale rural industry have not always been successful, farms remain less mechanized than in Japan and the smallest holdings continue at a subsistence level (Pak (1980)). But by 1974, farm household income had surpassed that of urban wage-salary earning households (Kim (1978)), and the incidence of absolute poverty is now no worse in rural than in urban areas (Hasan (1978)).

Korean farmers have generally played a passive political role, apart from occasional uprisings during the Yi dynasty and Japanese rule. Those farming organizations which exist today are generally the products of government-initiated programs and subject to government direction or scrutiny (Yu (1977), Kim (1978)). There is no doubt that the decline in rural support for President Park in the 1971 presidential election provided an incentive for the instigation of Saemaul Undong, but in 1972, Park also instituted a constitutional reform, since repealed, which effectively insulated him from further electoral embarrassments and assured him life-long tenure in office (Kihl (1979)).

Whether because of Saemaul Undong or the farmers' traditional independence, there does seem to be an acceptance, albeit grudging, of the need for rural self-reliance. The current government has begun slowly phasing out its price support programs, both to ease the burden on the government budget and to encourage diversification away from grains into livestock.⁷ Problems of the inefficiency of small units remain, but the government seems willing to pursue the Japanese model of developing off-farm income rather than pushing for consolidation, partly because of a continuing concern over the

⁷ In 1981 the cost of all agricultural subsidies had reached 20% of government's annual budget (Yoo (1983)). In 1983 the government froze the purchase prices of rice and barley, but allowed 3% increases in 1984. The deficit in the fertilizer management fund has been reduced by 76% since 1981, but subsidies are now being paid to promote feed-grain import substitution. Rice self-sufficiency has been finally achieved, partly through falling per capita consumption, but the growing demand for meat has already outstripped the capacity of Korea's livestock industry (Financial Times, 12 July 1984).

reemergence of absentee ownership and tenancy.⁸ Nevertheless, the consensus among policy makers appears to be that major assistance to agriculture is no longer necessary, while the promotion of industrial growth in rural areas is as much to ease the burden on the Seoul region as to provide continued growth of farmers' incomes.

(ii) Labour Interests

In 1963, South Korea was still a labour surplus economy, with almost two-thirds of the working population engaged in agriculture. With a series of policy moves, including a major currency realignment, President Park's government reversed the previous emphasis on industrialization by import substitution and began actively promoting the export of labour-intensive light manufactured goods. By 1970 Korea had reached relatively full employment - official statistics, which count as employed all those over fourteen who work for more than one hour per week, show unemployment had declined from 8.2% to 4.5%. At the same time, the agricultural share of employment had declined to about half. By 1977, when the government had begun its switch of emphasis towards the heavy and chemical industries, unemployment had declined to 3.8% and agriculture accounted for around 40% of total employment (Hong (1979)). Indeed, the main thrust of government's labour policy has been indirect, promoting employment opportunities through industrial growth. Other measures have included provision of vocational training centres to supplement mainstream education, the provision of job placement centres (largely unused) and the tacit encouragement of overseas employment, mainly for seamen and workers on Middle East construction projects (Bai (1980)). South Korea has no minimum wage legislation, unemployment insurance nor universal superannuation (Park (1979)).

⁸ See Economic Planning Board (1981). Brown (1973) notes that 1967 legal provisions to allow the use of land as security for mortgages never became operational because of concern over tenancy. Pak (1980) notes the adverse effect that absentee ownership and tenancy can have on the incentive to invest. However, the 3 hectare limit on farm size can be expected to become a more severe constraint on efficiency as livestock production expands.

Korea does have elaborate labour legislation governing the formation of trade unions, the settlement of labour disputes, collective bargaining and setting minimum standards for hours and conditions of work (Park (1979)). Yet Korean trade unions are largely government-controlled institutions and are not effective vehicles for voicing labour interests (Suk (1977), Won and Oh (1983)). Government has the power to scrutinize union formation and to order dissolution, reelection of executive officers or changes in union constitution where the union is judged likely to harm the public interest. Unions are prohibited by law from using their funds for political purposes (Park (1980)), while through an amendment based on Korea's latest (October 1980) constitution, most funds must now be spent directly on welfare programs rather than on union salaries (Financial Times, 12 July 1984). The procedures for settlement of both labour disputes and contract violations are at best tedious, requiring arbitration and extensive cooling-off periods before a strike or lock-out is permitted, while strikes are legally or practically impossible in industries deemed vital to the public interest, in foreign invested firms or on US military installations (Park (1979)). A recent amendment further restricts union operation to individual companies and virtually prohibits outside contact, including legal advice, during a dispute (Financial Times, 12 July 1984). Operation of both the dispute and collective bargaining provisions has periodically been suspended (from 1971-9 under Park and briefly again in 1980 under Chun). During these times, employers unilaterally set wage rates (Park (1979)). At other times, unions have negotiated "relatively poor contracts" (Won and Oh (1983)) and have had little success in establishing wage uniformity within or between industries (Park (1979)).⁹

The ongoing emasculation of union power can be partly traced to unions' earlier history of direct political involvement, first as the main centre of anti-Japanese sentiment and then as a group

⁹ See Park (1979), Luther (1980) and Koo and Hong (1980) for evidence on wage levels.

virtually indistinguishable from the ruling party of President Rhee prior to 1961. Worker demands for higher wages are still sometimes voiced in anti-government street demonstrations, often initiated by students, rather than through normal bargaining channels, and government fears of a coalition of political opposition have led to suppressive action against both groups (Olsen (1980), Yoo (1983)). A second reason is economic - government is aware that wage pressure can undermine Korea's international competitiveness, as happened in 1978-79 once wages rose, first in nominal terms to keep pace with government's own higher rice prices, and then in real terms as expansion of heavy and chemical industries began to create skilled labour shortages (Kuznets (1982)).¹⁰ The current weak state of organized labour is indicated by union membership, which fell from over 1 million in 1980 to under 800,000 in 1983 (Financial Times, 12 July 1984). The government has begun to investigate the possibility of including minimum wage legislation and unemployment benefits in the next five year plan beginning 1987, but as part of a general refocus of policy making towards social goals.

(iii) Business Interests

The growth of Korean business, like that of the economy as a whole, has not been generated from a base of accumulated wealth. The substantial industrial assets left by the Japanese in 1945 remained mostly in US, then Korean government hands, where they were "largely dissipated by a combination of maladministration and war" (Jones and Sakong (1980, p. 37)). Nor has business growth been based on acquisition of existing assets from other enterprises - business organization is viewed as a facet of the kinship structure and the scope for expansion through merger or takeover has been limited accordingly (Koh (1980)). Instead, most of the growth of industrial

¹⁰ Between 1974 and 1978, the Park government announced non-binding minimum wage "guidelines", demonstrating at least some concern on its part for the living standards of the poorest workers (Park (1979)). But following the period of overheating around 1980, when inflation reached 28.7%, the Chun government has been announcing average wage settlement guidelines to control wage pressure.

output since 1961 has been generated by the expansion of existing firms, originally from small beginnings, or the establishment of offspring firms, with ownership and control retained by a single individual or family (Jones and Sakong (1980, p. 169-76)).¹¹ The largest, individual or family-owned conglomerates whose affiliates now range widely across product and industry lines, are known as chaebol (sometimes jae-bul).¹² It is estimated that in 1975, the largest 46 chaebol conglomerates accounted for 13% of GDP, 19% of non-agricultural GDP and 37% of the value added in manufacturing, a degree of concentration less than in India or Pakistan, but still substantial (Jones and Sakong (1980, p. 266)). Furthermore, chaebol have been growing faster than the economy as a whole so that the degree of concentration has been increasing. It is estimated that between 1973 and 1978, the largest 46 chaebol increased their share of GNP at a rate of about 12% per year (Jones (1980)).

If chaebol have been growing faster than the economy as a whole, does this reflect their singular ability to influence the resource allocation decisions of government? Or does it merely reflect a more productive use of resources obtained without the exertion of political leverage? This is the heart of the identification problem mentioned in the introduction to this paper. Jones (1980) presents some evidence concerning the sources of chaebol growth and the extent of their market power, if not their political power. While there is little evidence to suggest chaebol enjoy particular technological economies of scale at the establishment level, they can at the conglomerate level exploit organizational economies of scale, particular with respect to training skilled manpower (a lumpy investment in human capital) and using entrepreneurial ability at the margin to initiate new activities. They do not enjoy sufficient natural econo-

¹¹ To date, foreign multinationals have played a minor role because of strict government controls on direct foreign investment, designed partly to avoid a reemergence of significant Japanese ownership.

¹² Chaebol differ from Japanese conglomerates (zaibatsu) in at least one important respect, by not having control of their own bank. Even when the Korean government began selling its shares in five banks in 1983, it determined that no single private shareholder could take up more than 7.5% of a bank. The reason was to deny chaebol the power of choosing bank management (International Herald Tribune, 22 November 1983).

mies of scale or command over cheap factors of production to monopolize the markets for their output, although each on average takes the "number one" position in roughly one-third of its product markets.

Nevertheless, it is widely believed that chaebol have privileged access to the cheap bank loans provided by the government-controlled banking system, and that cheap credit, combined with high debt-equity ratios (also perhaps tolerated by government), has allowed their rapid expansion on a highly levered basis. Again, Jones (1980) provides some evidence. The debt-equity ratios of large firms (chaebol affiliates and others) were indeed almost twice as high as those for small and medium firms (also including some chaebol affiliates) in 1975. But by 1978 the ratios for all but the smallest firms had risen to the same range as the large firms. While no direct comparison between chaebol affiliates and others was possible, Jones (1980) concludes that high ratios are more widespread than commonly thought, while lower ratios for the smallest enterprises are consistent with the greater riskiness of small undertakings. If indeed chaebol are no more highly levered than other firms, their faster growth could still be explained by privileged access to cheap credit. Information on the proportion of bank loans allocated to chaebol is one of the best kept secrets in Korea, but the proportion is undoubtedly high. While the government has established explicit rules or performance criteria for allocating certain types of loans, the rules regarding allocation of remaining available credit are also sufficiently vague to allow some discretion on the part of bank managers (See also Hong (1979)). Jones (1980) notes that small firms have no less of an incentive to offer bribes. However, there is some evidence that larger firms in general could potentially bring greater non-pecuniary pressure to bear, and at a higher level. In a survey which excluded the smallest firms, Jones and Sakong (1980) found that the entrepreneurs were predominantly the sons of the pre-industrial (especially the landowning) elite, while their own background in terms of province of origin, level of education and even educational institution closely matched that of their contemporaries in higher civil service positions. On the other hand, Koo (1976) found the average education level of small businessmen (shopkeepers, cottage

industry owners) in Chonju city to be lower than even that of middle level bureaucrats, while petty traders had the lowest average education level, below that of factory workers.

Given the importance that Koreans place on education and the benefits conferred by school ties, such evidence suggests that large business might have an advantage over small in its access to and dealings with government officials. Even so, it does not clearly establish that chaebol have greater potential access than large non-chaebol enterprises. Chaebol dominance of cheap credit, if indeed such is the case, could alternatively be explained by their greater ability to meet the explicit and implicit performance criteria established by government, or simply by the fact that government believes this to be the case. Jones (1980, p. 118-19) judges that "Building a shipyard and three tankers from scratch in nineteen months, as Hyundai did, is substantially harder than getting the government to provide the finance". In the next section, we present some further indirect evidence on chaebol dominance (or otherwise) of the market for bank credit. Here we pursue one further line of evidence in an attempt to resolve the identification problem.

What is required in principle to strengthen the argument of political influence is an example where chaebol have failed to live up to government's general performance criteria but have continued to receive favours in the form of cheap credit (or tariff and licence protection). Were this the case, one might expect to see the same company names over time on the list of largest chaebol. But as Jones (1980) notes, the fortunes of individual chaebol have shown greater instability than would be typical in the United States.¹³ Furthermore, at least one group appearing on the list of the top 46 in 1975 is widely regarded as an outsider, supposedly having purposefully kept government at arms length (Jones and Sakong (1980), Olsen (1980)).

¹³ He identifies reasons for the decline of 5 between 1973-78 as follows: one case of changing political fortunes, although open to other interpretation; one case of managerial incompetence; three cases of transition from first to second generation leadership.

Perhaps the most obvious recent failure amongst chaebol has been the trouble experienced by some of those involved in the heavy and chemical industry. Unfortunately, even this does not provide clearcut evidence, primarily because the chaebol expansion which occurred in these sectors in the mid and late 1970s and which provided much of the basis for their recent rapid growth was largely at the instigation and encouragement of government itself. To the extent that government subsequently extended extra support, this could be construed as government paying for its own past mistake, rather than as an instance of favours sought and obtained by chaebol through political channels. We nevertheless briefly review the recent history of policy moves in this case, judging them to be fairly typical of government-chaebol interaction.

In anticipation of a decline in the comparative advantage of Korean light manufactures on world markets,¹⁴ government in 1973 set a policy of expanding heavy and chemical industries, then turned to the chaebol as (willing) vehicles to carry it out. In the wake of two oil price shocks and a period of domestic overheating which was itself partly the result of particularly heavy private investment in heavy and chemicals expansion in 1977-78, the chaebol were then faced with falling real export demand in their traditional markets, little demand, either domestic or international, for those heavy equipment and petroleum products which had come on stream, while at the same time they faced a growing debt service burden from substantial domestic and foreign borrowing (Kuznets (1982), Yoo (1983)). In May 1979 "the Ministry of Commerce and Industry called for a meeting with representatives of the companies involved. The meeting, however, came to nought because the representatives did not accept the Ministry's recommendation that some of the companies merge or swap assets to reduce the financing burden and cut down the wastes of duplication... The Ministry gave the companies a voluntary self-adjusting period from June 1979 to September 1980. As many expected,

¹⁴ Korea has been facing increasing competition in textiles, for example, from such countries as Malaysia and the People's Republic of China.

no solution resulted. Finally, on October 7, 1980, the government took dramatic action to alleviate the problem once and for all, reducing the number of companies in each industry, eliminating duplication of products and lining up related producers in or between industries". (Yoo (1983, p. 137-8)). When the sole remaining producer of electrical generating facilities still could not manage its financial and marketing burdens, the government's solution was to turn the operation into a public enterprise, the Korea Heavy Industries Corporation (KHIC), which subsequently took over other troubled sectors of the industry. With the easing of world recession, the government has recently given approval for expansion in selected areas, has allowed some chaebol to again enter fields in competition with others and has returned some activities of KHIC to the private sector. KHIC retains the power generating equipment facility and remains heavily indebted, although it is now entering production of marine diesel engines in competition with a chaebol group (Financial Times, 12 July 1984).

Thus the most direct and obvious response of government was to use one of the tools at its disposal, the public enterprise, first to assume the most troubled portions of chaebol heavy and chemical operations, but later also to reintroduce elements of competition into the industry.¹⁵ Nevertheless, the government also in 1981 reversed a brief experiment in deregulation of interest rates on commercial paper (Lee (1984)), the reason given to the author being the vulnerability of the heavy and chemical industries to higher interest rates, at least at that point in time. Furthermore, the government has accompanied the recent removal of import prohibitions on selected consumer products with generous tariff increases, not all of which are obviously justifiable by infant industry argu-

¹⁵ Jones (1975) also notes the way that public enterprises have sometimes been used to counter potential monopoly power of chaebol.

ments.¹⁶ To the extent that these additional actions benefit chaebol, they are consistent with Jones' (1980) hypothesis that government will grant a favour to repay a debt elsewhere. For this reason, however, they cannot yet be interpreted as unambiguous evidence of political influence directed from chaebol to government.

(iv) Military Interests

Unlike Japan, Korea has no long history of military influence in government, since the Yi dynasty had neither the decentralized system of manorial feudalism nor the expansionist aspirations to provide warriors with an independent power base (Hahm (1975)). The military owes its current importance to the Korean war, following which the Korean peninsula was partitioned into North and South. North Korea currently maintains an army of roughly 750,000 troops, while the Republic maintains an army of 544,000, supplemented by the presence of 40,000 US troops. Since 1953 there have been sufficient incidents of infiltration from the North, together with assassination attempts on South Korean leaders (the most recent being in Rangoon, Burma in October 1983), to maintain the credibility of a threat of imminent invasion. South Korea currently spends roughly 6% of its GNP for defence. It is estimated that North Korean GNP is roughly one-third of the South, but that 25% is spent on defence (Lovell (1975), Kim (1983)).

The interests of the military have undoubtedly been served by economic success in general. In the original vision of President Park, rapid economic growth played a central role, not only as an end in itself but also as a means to achieve national security

¹⁶ The Korea Herald (3 March 1984) reports tariff increases on liberalized items from 20% to 90% for interoffice phones, from 40% to 80% for handheld telephones, from 40% to 75% for vacuum cleaners and from 40% to 70% for men's shirts. Jones (1980) reports that in 1978, the top 46 chaebol accounted for 82.7% of value added in the "fabricated metal products, machinery and equipment" industry, into which the first three items would fall. Although chaebol accounted for only 34.3% of value added in textiles, that sector was the primary source of Korea's initial export success.

against the external threat from the north (Park (1970a)). Rapid growth has also played a role in achieving security from internal threats, to the extent that rapidly rising incomes have satisfied the high expectations of an impatient populace and stilled communist or other anti-government voices at home.

Furthermore, the military has contributed on an ongoing basis to the economic success sought by ex-military leaders. In the early 1960s the army provided an important source of employment for surplus labour, particularly that migrating from rural to urban areas. All Korean males are required to undergo a period of military training, normally for three years. This process still provides an important first source of technical training for young people subsequently entering the work force. The career military widely engages in "civic action" activities, including assistance to farmers during rice planting and harvesting and construction of dams, roads and schools (Lovell (1975), Koh (1980)). Perhaps the greatest contribution the military has made in the past, however, will decline in importance over time. Beginning with the Korean War, the military provided perhaps the first hands-on organizational, managerial and leadership experience to an upper echelon who had previously been denied it under Japanese rule. It continues to be an important source of exposure to "modern" i.e. western goal-oriented organization and ideas, thus contributing to the breakdown of traditional Confucian values which some have deemed harmful to modernization and growth. Indeed, these factors are crucial in explaining why political and economic leadership arose from military ranks following the Student Uprising in 1960 (Lovell (1975)). Today, however, Korean business also provides organizational and leadership training and is (perhaps) an alternative source of future political leadership.

Thus the military has benefited from, and contributed to, Korea's general economic success. But does the military have a stake in the way that economic success is achieved, or is government

free to make its own judgements on strategies for economic growth?¹⁷ In the early 1960s, it was difficult to draw such a distinction, since many government decision makers were drawn directly from military ranks. With the growth of a competent, highly educated civilian technocracy, which made itself increasingly indispensable as the process of economic planning became more complex, the policy input of ex-military leaders fell substantially (Jones and Sakong (1980), Olsen (1980)). Olsen (1980) has argued that the perceived need for economic continuity was the main reason preventing the martial law authorities from assuming a more permanent role following Park's assassination. And while it is still true that retired military officers are disproportionately represented in the management ranks of public enterprises and may be rotated for political reasons with undue frequency, this has not prevented government from acquiring, divesting or even threatening to close down particular public enterprises according to its own priorities (Jones (1975)).

What stake do currently active military officers have in the form that Korea's economic success takes? To the extent that military hardware had to be imported, then an export oriented growth strategy which provided the requisite foreign exchange was not inimical to military interests. However, continued reliance on US financial aid could have achieved the same objective. Of more importance was the proposal in 1976 by the Carter administration to withdraw US troops from Korea. In view of this, development of Korea's heavy and chemical industries acquired additional importance as the basis for a home grown defense industry (Lee (1980)). The Reagan administration's recent assurances of a continued US presence and access to weapons systems and military technology have relieved the urgency, at least in the meantime. Two additional developments,

¹⁷ Clearly, the (ex)military is still an important influence on government's political decisions, especially as regards treatment of internal dissent. Kim (1981) chronicles the importance of this political influence in the events leading to Park's assassination.

neither assured at this stage, would further ease the situation - a reduction of tension with the North through greater political or trade contacts, or a greater role for Japan in the defense of the region. Otherwise, Korea must probably contemplate the further development of domestic military production capability as a long term proposition. This provides an additional reason why the government may not be willing to totally abandon the less successful sectors of the heavy and chemical industry in the near future, and further suggests that current assistance may not be solely due to chaebol influence.

(v) Summary

To the extent that the centralized, authoritarian governments which have ruled South Korea since 1961 have sought legitimacy for their actions, they have done so largely by appeals to "the masses" rather than by openly cultivating particular interest groups. What they have offered the masses has been economic success, measured in terms of Korea's phenomenal growth record over the last two decades. Open association with special interest groups is in fact seen by some segments of Korea society to undermine, rather than enhance, the legitimacy of government. The reasons for this are both historical and cultural. Influence peddling and corruption were seen as major flaws of the Rhee government which held power from 1948 to 1960. In addition, some aspects of the Confucian ethic which are opposed to the "modern" self-interested pursuit of power or wealth persist: "There is no inclination to establish an equilibrium by depositing power in the hands of the rulers and then constructing a "countervailing" force to oppose it. Koreans would rather demand that the rulers check themselves against greed and make efforts to discover what the demands of the populace are in order to have such demands reflected in their decisions... The elite status by definition signified a great humanness; and if an elite displayed lack of humanness, the Koreans could be devastatingly rebellious and anarchically disrespectful of authority" (Hahm (1975, p. 353)). For

those disaffected with or harmed by government policy actions, their dissatisfaction is still expressed as much through explosive demonstrations as through the power channels of interest group influence. The instigators have most frequently been students, whose reasons have sometimes been disaffection with economic policies or outcomes (as in the "Y.H. Incident" in 1979 - see Olsen (1980)) but more often disaffection with repressive political policy actions. They have then often been joined by workers and others with a more direct stake in economic policy outcomes. Such pressure, though not exerted through normal interest group channels, has not been without effect. However, it has not changed the course of economic policy making so much as lead, directly or indirectly, to changes in government.¹⁸

In their pursuit of general economic success, however, successive governments have implemented or maintained economic policies which have benefited particular groups. Foremost among these has been the policy of regulating bank interest rates at below-equilibrium levels, while allocating the available credit to particular business groups. It is widely believed that chaebol, the large Korean business conglomerates, receive the lion's share of such loans. It is doubtful that this policy was instigated at the behest of business. Instead, the threat of credit withdrawal was seen by government as an important method of controlling business (Jones and Sakong (1980)). It is possible, however, that chaebol, a subsector of business, have subsequently been able to use their greater access to government officials in order to obtain more bank credit than would be warranted by their economic performance alone. If such were the case, it would suggest that the Korean government's future economic policy choices might be more constrained than in the past. In particular, it could further explain what might

¹⁸ President Park's coup followed the Student Uprisings of 1960. Park's assassination, which paved the way for Chun's coup, was the result of division within the ranks of his political advisers, at least partly over methods to deal with student and worker demonstrations during the worst of the 1978-79 economic recession (Olsen (1980), Kim (1981)).

be interpreted as an uncharacteristic caution in the current government's implementation of its financial liberalization initiatives, at least with regard to the deregulation of bank interest rates. We now present some indirect evidence on the allocation of bank credit in order to determine whether chaebol have been receiving more than their "fair" share.

Section III - Chaebol and Bank Credit Allocation

Do chaebol receive cheap bank loans because they exert political pressure? Or is it because they can, or are believed to be able to, live up to government's general performance criteria governing bank loan allocation? In South Korea, the government's general, non-discretionary performance criteria are easily identified. The entire focus of government economic policy making has been, and continues to be, export and growth oriented.¹⁹ It is not necessary for our purpose to examine whether this strategy has actually promoted optimal allocative efficiency or maximized growth, nor whether chaebol have used resources more efficiently than other business enterprises. Export and growth performance are clearly the indicators used by government to summarize any underlying economic objectives in terms of efficiency or a possible growth-efficiency trade-off. They are therefore the criteria against which chaebol performance can be judged.

Data on bank loan allocations to chaebol are not available directly. However, bank loan allocation by industrial sector is available, as is chaebol representation by industrial sector. This information, together with sectoral export and growth performance,

¹⁹ Even the policy switch towards heavy and chemical industries in the early 1970s was apparently in anticipation of readily available export markets for these products, so that the discipline of international competition would bypass any "mere" import substitution phase (Yoo (1983)).

provides the basis for an indirect test of the forces governing bank loan allocation. In formal terms, we propose to estimate the following cross-sectional regression model:

$$B_i = \beta_0 + \beta_1 X_i + \beta_2 G_i + \beta_3 C_i + \beta_4 P_i \quad (1)$$

where i denotes industrial sector i

B_i measures the ratio of bank loans to total liabilities plus net worth for sector i

X_i is the proportion of sector i 's output which is exported

G_i is the growth rate of sector i 's real GNP

C_i is the proportion of sector i 's value added produced by chaebol

P_i is the proportion of sector i 's valued added produced by public enterprises

As defined, the dependent variable B_i will be larger (a) the greater is a sector's bank loan allocation relative to its overall asset size,²⁰ and (b) the smaller is a sector's equity, or the greater is its debt-equity ratio. The dependent variable therefore captures the two ways in which chaebol might be accorded favourable treatment through the official financial system.

If bank loan allocation or lenient debt-equity treatment were totally explained by government's general, non-discretionary performance criteria, then the general performance variables X_i and G_i would alone explain all of the variation in the dependent variable B_i . We would expect β_1 and/or β_2 , the coefficients of X_i and G_i , to be significant and positive, but not β_3 , the coefficient of the variable C_i which measures chaebol concentration in each sector. Chaebol might still receive more bank credit (or enjoy a higher debt-equity ratio) than other businesses, however, but only because they were better able to fulfil the performance criteria. In these circumstances, we would expect to see a high degree of multicollinearity between the performance variables X_i and

²⁰ The explanatory variables have also been corrected for size, where necessary, by appropriate scaling.

G_i and chaebol concentration C_i . If only performance matters, but if chaebol nevertheless perform, the resulting multicollinearity could produce insignificant coefficient estimates for all three variables. If, however, chaebol receive additional bank credit that is unrelated to economic performance, then chaebol concentration C_i should have some explanatory power independent of performance X_i or G_i . We would then expect β_3 , the coefficient of C_i , as well as β_1 and/or β_2 , to be significant and positive. Finally, we include the variable P_i , measuring the sectoral concentration of public enterprise, so as to correct for any special credit treatment of these institutions. Since public enterprises are themselves instruments of government policy, they cannot automatically be assumed to be subject to the same restrictive rules of credit allocation as private sector enterprise.

The above empirical model of Korean bank loan allocation, as it reflects a combination of general performance criteria and special interest group pressure, is related to the theoretical model of interest group pressure developed in Dee (1984b). In its simplest form, the theoretical model demonstrates the commonplace that when a single group exerts political pressure, it will receive greater favour than it would under government's general, social objectives alone. This result presumes, however, that the benefits accorded one group are not (completely) offset or nullified by favours accorded competing groups who also exert political pressure. In Dee (1984b) we examine in more detail oligopolistic behaviour by more than one pressure group and show that it can lead to a negative sum outcome in the market for political influence. Because of remaining social and cultural barriers to government access in Korea, however, we assume that it is reasonable to characterize chaebol as having a potential monopoly position, at least for favours (if any) which accrue through the financial system. We therefore ignore the impact that competing pressure groups could have on the relationship between chaebol influence and the favours received. We now summarize the data used to test the above simple model and then turn to the results.

(i) Data

Table 1 reports the data used for the explanatory variables of equation (1). The greatest constraint is imposed by availability of observations on the concentration of chaebol and public enterprise by sector. Chaebol concentration is taken directly from Jones (1980), who reports figures for 1978 across sectors corresponding to single digit SITC classifications, with a two-digit breakdown of the manufacturing category. Jones (1975) reports public enterprise concentration on a roughly comparable sectoral basis, but for 1972 rather than 1978. We choose 1978 as our reference year for cross-sectional observations, but nevertheless use Jones' 1972 data for the sectoral concentration of public enterprises on the grounds that 1978 figures would be not too different. The most important reason for difference is likely to be government divestiture or acquisition of enterprises. Important divestitures were made in 1967-9 and are already reflected in the 1972 figures, whereas important acquisitions of heavy and chemical operations were made in 1980, after the reference year. Nevertheless, there are likely to have been some changes in the interim that are not reflected in our 1972 figures.²¹

Sectoral growth rates are measured as five-year averages over the period 1973-78, on the grounds that growth is an indicator of longer-term performance. Export performance is assumed to be a shorter-term indicator, but because we wish to express total exports as a fraction of total output rather than value added, we are restricted to input-output sources which are available only for 1975 or 1978. In Korea, allocation of some types of short-term bank loans has been tied automatically to proof of current export performance. This contemporaneous influence is already taken into account

²¹ One could nevertheless argue that credit treatment of divested enterprises is not likely to differ greatly from their treatment while in the public domain, at least when divestiture is recent.

Table 1 - Data on Explanatory Variables of Regression Equation

<u>Sector i</u>	<u>Explanatory Variables</u>			
	<u>$C_i^{(a)}$</u>	<u>$P_i^{(b)}$</u>	<u>$X_i^{(c)}$</u>	<u>$G_i^{(d)}$</u>
1. Agriculture, Forestry, Fish	0.08	0.27	5.7	4.04
2. Mining & Quarrying	5.54	23.29	12.3	7.30
3. Food, Beverages, Tobacco	24.9	30.81	8.5	11.39
4. Textiles & Leather	34.3	0.41	37.0	13.88
5. Wood & Wood Products	73.2	0.09	39.9	12.12
6. Paper, Printing, Publishing	9.2	9.91	5.8	14.82
7. Chemicals, Petroleum, etc.	38.0	22.11	10.5	15.89
8. Non-metallic Mineral Prods.	70.1	0.61	13.4	12.26
9. Basic Metals	22.8	13.53	14.5	26.02
10. Fabric. Metal, Machinery, Equipment	82.7	10.73	30.3	30.43
11. Other Manufacturing	15.4	0.00	43.7	21.23
12. Construction	37.01	5.30	0.4	15.54
13. Electricity, Gas, Water	0.64	76.01	0.3	17.02
14. Transport, Communication	17.92	23.21	21.8	14.47
15. Trade, Hotels	4.63	2.43	9.2	8.78
16. Finance, Real Estate	32.17	57.06	1.5	13.79
17. Other Services	2.87	0.76	2.7	7.77

Notes: (a) Percentage shares of chaebol value added in sectoral value added for 1978, Jones (1980, P. 36,38).

(b) Percentage shares of public enterprise value added in sectoral value added for 1972, Jones (1975, P. 236-243 and P. 44-46).

(c) Percentage share of sectoral exports in sectoral output for 1975, Bank of Korea 1975 Input-Output Tables II, 1978.

(d) Average annual percentage growth rates of real sectoral GDP for 1973-78, National Income in Korea, Bank of Korea, 1982.

in the construction of data for the dependent variable of our regression equation, as we shall see. For the explanatory export performance variable, we therefore use 1975 export/output ratios on the grounds that a slightly longer history of exporting is likely to influence the discretionary component of bank loan allocation.

The most obvious source of data for the dependent variable of our equation is the Financial Statements Analysis (FSA) published by the Bank of Korea (BOK), which presents aggregate balance sheets for surveyed companies in each sector. For our purposes, there are two problems with this source. Firstly, its coverage does not include agriculture. Secondly, the reported data is subject to response bias, at least with respect to the share of bank loans in total liabilities. In 1980, for example, bank loans reported by all enterprises in the FSA survey add up to 13,553 billion won, whereas the BOK Economic Statistics Yearbook reports 1980 total bank credit outstanding to industry at only 11,656 billion won.²² The reason for the response bias in the FSA data is obvious. Given government regulations which produce an excess demand for bank credit, Korea has also developed an unofficial, unregulated (curb) money market serving predominantly short term needs. Since dealings in the unofficial market are illegal or at best frowned upon, business has an incentive to underreport loans from "Other Sources" and to overreport bank loans accordingly.

In Table 2, therefore, we present our method of calculating observations on the dependent variable from sources which are less likely to incorporate response bias. Since the BOK Economic Statistics Yearbook reports directly the allocation of total bank loans and discounts across industry, construction of observations on our dependent variable B_i therefore requires, in addition, an estimate of total liabilities plus net worth for each industrial sector. By

²² Comparisons for particular industrial sectors reveal further that the response bias is not uniform across sectors.

Table 2 - Data on Dependent Variable of Regression Equation

For column headings, see notes.													
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)=B _i	(13)=F _i
1. Agriculture	819.1	29.8	3.6	117.4	668.3	368.1	40.4	618.0	1621.3	2647.8	658.4	24.9	13.9
2. Mining	77.7	0.9	0.4	13.6	62.8	11.5	4.9	71.7	152.4	240.5	76.6	31.9	4.8
3. Food, Beverage	384.8	1.4	2.2	47.6	333.6	17.3	24.5	250.2	809.3	1101.3	274.7	24.9	1.6
4. Textiles	469.3	17.6	19.4	171.5	260.8	217.1	215.7	902.8	632.7	1968.3	1118.5	56.8	11.0
5. Wood & Prods.	58.6	0.7	5.4	18.7	33.8	8.2	60.1	98.1	82.0	248.4	158.2	63.7	3.3
6. Paper, Print	70.6	1.0	0.6	31.2	37.8	12.4	6.3	164.0	91.7	274.4	170.3	62.1	4.5
7. Chemicals, etc.	440.7	30.9	6.5	87.0	316.3	381.9	72.4	458.0	767.3	1679.6	530.4	31.6	22.7
8. Non-met. Min.	116.0	9.4	1.3	26.0	79.3	116.8	14.6	137.1	192.9	460.9	151.7	32.9	25.3
9. Basic Metal	169.8	28.5	3.5	50.9	86.9	352.5	38.1	268.0	210.8	869.4	306.1	35.2	40.5
10. Fabric. Metal etc.	488.0	24.3	17.3	110.0	336.4	300.1	191.5	578.9	816.1	1886.6	770.4	40.8	15.9
11. Other Manuf.	82.3	0.1	4.1	13.6	64.5	1.3	45.9	71.5	156.5	275.2	117.4	42.7	0.5
12. Construction	491.4	22.3	0.1	113.0	356.0	275.7	1.3	594.6	863.7	1735.3	595.9	34.3	15.9
13. Electricity	149.8	92.4	0.0	3.1	54.3	1142.0	0.4	16.3	131.7	1290.4	16.7	1.3	88.5
14. Transport, etc.	617.8	46.3	7.9	32.9	530.7	572.7	87.7	173.4	1287.5	2121.3	261.1	12.3	27.0
15. Trade, etc.	2876.0	0.0	5.6	92.8	2777.6	0.0	62.2	488.3	6738.5	7289.0	550.5	7.6	0.0
16. Finance, etc.	994.2	40.0	0.5	22.8	930.9	494.6	5.4	120.2	2258.4	2878.6	125.6	4.4	17.2
17. Other Services	522.7	13.6	1.1	77.6	430.4	167.8	11.8	408.2	1044.2	1632.0	420.0	25.7	10.3
Total	8828.8	359.2	79.5	1029.7	7360.4	4440.0	883.2	5419.3	17856.4	28598.9	6302.5		

Notes to Table 2:

- (1) Payments to Capital: "Operating surplus", trillion won, BOK 1978 I-O Table, except for agriculture, where 80% of operating surplus has been subtracted as payments to land. Because of land reforms and regulations on farm size, we assume mortgage loans are negligible and exclude land from assets accordingly. The 80% is arbitrary, but produces an implicit real rate of return to capital in agriculture within the range of estimates reported in Hong (1979). "Operating surplus" represents primary factor payments other than wages, depreciation and indirect taxes.
- (2) Foreign Debt Interest: "Net investment income payments" from 1978 Balance of Payments account, trillion won, BOK Economic Statistics Yearbook, which has been divided among industrial sectors according to figures on 1959-80 cumulative foreign loan inducement by industry provided by Ministry of Finance. Net investment income includes royalties etc. associated with direct foreign investment.
- (3) Export Loan Interest: Column (7) x 0.09, where 9% is 1978 interest rate on loans for exports from BOK Economic Statistics Yearbook.
- (4) Other Bank Interest: Column (8) x 0.19, where 19% is 1978 discount on commercial bills, call and one-year loan rate, BOK Economic Statistics Yearbook.
- (5) Other Loan Interest, Dividends: Calculated as (1) - [(2) + (3) + (4)].
- (6) Foreign Loans: Column (2) ÷ 0.0809, where 8.09% is a weighted average of 1978 Japanese call money rate and London Euro-dollar rate, weights taken from figures on 1958-80 cumulative foreign loan inducement by source provided by Ministry of Finance.
- (7) Export Loans: "Loans and discounts of deposit money banks for support of export", 1978, trillion won, from BOK Economic Statistics Yearbook, which has been divided among industrial sectors according to sectoral share of exports from BOK 1978 I-O Table.
- (8) Other Bank Loans: Calculated as (11)-(7).
- (9) Other Liabilities, Net Worth: Column (5) + 0.4122, where 41.22% is 1978 interest rate on curb market loans, average of quarterly rates, provided by Korea Development Institute [Curb market rates also available in Cole and Park (1983)].
- (10) Total Liabilities plus Net Worth: Calculated as (6) + (7) + (8) + (9).
- (11) Total Bank Loans: "Loans and discounts of deposit money banks by industry", 1978, trillion won, BOK Economic Statistics Yearbook.
- (12) Observations on Dependent Variable B_i: Bank loans as percentage of total liabilities plus net worth, calculated as (11) ÷ (10) x 100.
- (13) Observations on Alternative Dependent Variable F_i: Foreign loans as percentage of total liabilities plus net worth, calculated as (6) ÷ (10) x 100.

the balance sheet identity, the stock of capital assets in each sector equals the sum of stock liabilities and net worth. As an ex post proposition, the flow payments to capital also equal the debt service payments on various types of loans plus a residual return to equity holding. Total liabilities plus net worth can therefore be calculated by capitalizing the various debt service and equity return components of the sectoral flow payments to capital (taken from the BOK 1978 Input-Output Table) by their appropriate interest rates or ex post rates of return. In Table 2 we firstly separate foreign debt service payments and interest payments on domestic bank loans (both preferential export loans and normal loans) by sector, and capitalize these by their associated interest rates. The residual flow payments then represent sectoral interest payments on non-bank domestic loans, assumed to be mostly curb loans,²³ plus the residual returns to equity. These we capitalize using the curb market interest rate. We are therefore assuming that the curb rate can be used as a proxy for the rate of return to equity holding in each sector. This assumption is reasonable in an ex ante, opportunity cost sense (See also Cole and Park (1983)) but may be less so ex post.²⁴ We then use the sectoral sums of capitalized items as our estimates of total liabilities plus net worth for each sector. Observations on B_i are obtained, finally, by dividing sectoral bank loans by these estimates. We also calculate observations on an alternative dependent variable F_i , the ratio of foreign loans to total liabilities plus net worth for each sector.

(ii) Regression Results

Table 3 first reports the OLS estimates obtained for equation (1), in which sectoral bank loan allocation relative to sectoral asset size, B_i , is regressed against sectoral export and growth per-

²³ In 1978, official Korean non-bank financial institutions still played a minor role. In later years, particularly from 1980, our assumption would be increasingly untenable.

²⁴ Deviations of ex post from ex ante returns to equity across sectors can nevertheless be viewed as a type of measurement error which, because it occurs in the dependent variable of our regression equation, will be captured by the regression residuals but need not bias our results.

Table 3 - Domestic Bank Loan and Foreign Loan Allocation by Industrial Sector for Korea

Dependent Variable	Explanatory Variables (a)					\bar{R}^2	$F^{(b)}$
	<u>Const.</u>	<u>C_i</u>	<u>X_i</u>	<u>G_i</u>	<u>P_i</u>		
<u>B_i</u>							
(i)	23.019	0.301 (1.799) (0.092)				0.12	3.237 (0.092)
(ii)	17.693	0.138 (0.809) (0.432)	0.650 (2.085) (0.056)			0.28	4.154 (0.038)
(iii)	20.561	0.162 (0.868) (0.401)	0.677 (2.057) (0.060)	-0.271 (-0.386) (0.706)		0.24	2.651 (0.093)
(iv)	26.477	0.108 (0.639) (0.535)	0.370 (1.114) (0.287)	0.199 (0.296) (0.772)	-0.407 (-2.028) (0.065)	0.38	3.492 (0.041)
<u>F_i</u>							
(v)	-1.029	-0.052 (-0.265) (0.796)	-0.245 (-0.639) (0.535)	1.043 (1.342) (0.205)	0.545 (2.350) (0.037)	0.37	3.330 (0.047)
<u>C_i</u>							
(vi)	2.728		0.470 (0.889) (0.390)	1.439 (1.402) (0.184)	-0.185 (-0.569) (0.579)	0.16	1.998 (0.164)
<u>(B_iC_i)</u>							
(vii)	34.475	-0.053 (-0.506) (0.622)	0.846 (5.609) (0.001)	-0.334 (-1.361) (0.198)	-0.417 (-2.537) (0.026)	0.98	148.265 (0.000)

Notes: (a) Figures in parentheses are t statistics and significance of t. Where the second figure is less than 0.05, the associated coefficient estimate is significant at the 5% level.

(b) Figures in parentheses are significance of F. Where this is less than 0.05, the entire regression is significant at the 5% level.

formance X_i and G_i , together with the sectoral concentration of chaebol C_i and public enterprise P_i . Regression result (iv) shows that when all explanatory variables are included, they can together explain a significant portion of the variation in B_i . Neither the two performance variables nor chaebol concentration are individually significant, however, although their coefficients have the expected signs. Only public enterprise concentration appears to influence sectoral bank loan allocation. Its negative impact can be explained by considering result (v), where we use the same explanatory variables with F_i , the sectoral allocation of foreign loans relative to asset size. Public enterprise concentration has a significant positive effect on foreign loan allocation in Korea. The reason is fairly obvious - roughly 50% of foreign loans outstanding throughout the 1970s were public rather than commercial loans and these were channelled directly to public enterprise expansion, especially in the electricity and steel industries.²⁵ Where public enterprises were able to obtain their financing needs from foreign sources, their domestic bank loan requirements were correspondingly reduced. The negative coefficient of P_i in regression result (iv) simply reflects this lower demand by public enterprises for domestic bank loans. The result appears to have little to say, however, about the way in which bank loans to non-public enterprises were allocated.

Does the insignificance of the economic performance variables and chaebol concentration really reflect their unimportance, or does it reflect multicollinearity between these variables, given the significance of the overall regression? We examine the multicollinearity problem from two directions. Firstly, we enter the explanatory variables one by one to see whether the coefficient estimates display an instability which could indicate that multicollinearity was a problem. By comparing regression results (i) and (ii), we see that

²⁵ The public/commercial breakdown of foreign loans was provided by the Korean Ministry of Finance. See also Table 1 and 2 for public enterprise and foreign loan concentration by sector.

the coefficient of chaebol concentration changes markedly once export performance is entered. However, the coefficients of both these variables remain reasonably stable as growth performance and public enterprise concentration are entered (regression results (iii) and (iv)). Secondly, we regress chaebol concentration on the remaining explanatory variables. Regression result (vi) shows that the resulting \bar{R}^2 is lower than when the dependent variable is regressed on all the explanatory variables. Neither test, therefore, provides strong evidence that multicollinearity between chaebol concentration and economic performance is causing their insignificance.²⁶

How else can this apparent insignificance be explained? We tested results (iv) and (v) for heteroskedasticity of the residuals, using Goldfeld-Quandt tests applied to each of the explanatory variables in turn. While the results of these tests did not reveal any heteroskedasticity in result (v) for foreign loan allocation, they did suggest heteroskedasticity in result (iv) for bank loan allocation. Furthermore, the variance of the residuals in (iv) was shown to be related to the degree of chaebol concentration (but not any of the other explanatory variables), and decreased as chaebol concentration increased. In the same way that a positive relationship between error variance and a single explanatory variable can bias downwards the standard errors of all coefficient estimates, so a negative relationship can bias upwards these standard errors. This, then, is a further potential explanation for the insignificance in (iv) of not only chaebol concentration, but also the government's general economic performance criteria. In regression result (vii), we have corrected for this heteroskedasticity by multiplying (not dividing, since our heteroskedastic relationship was a negative

²⁶ This does not deny that some multicollinearity exists. The full matrix of pairwise correlations is:

	B_i	C_i	X_i	G_i	P_i
B_i	1.00				
C_i	0.42	1.00			
X_i	0.59	0.46	1.00		
G_i	0.20	0.45	0.37	1.00	
P_i	-0.62	-0.23	-0.44	0.10	1.00

rather than positive one) all variables in the equation, including the constant term, by chaebol concentration C_i . OLS estimation of this transformed equation produces weighted least square estimates of the original equation, where the errors associated with a low chaebol concentration are given an especially low weight. Although the \bar{R}^2 of result (vii) is not strictly comparable with that of result (iv),²⁷ the fact that the export performance variable now shows as strongly significant is reassuring. The coefficient of chaebol concentration (C_i^2 , since C_i now represents the transformed constant term) remains heavily insignificant. Our regression results of equation (1), once corrected for heteroskedasticity, therefore suggest that while export performance (also public enterprise concentration, for obvious reasons) weighs heavily in the allocation of all bank credit in Korea, the sectoral incidence of chaebol concentration does not have any independent effect, at least for those sectors where chaebol have some minimal visibility.

(iii) Regression Postscript

It is of interest to examine the pattern of residuals produced by the coefficient estimates taken from result (vii), where we corrected for heteroskedasticity. By applying these estimates to the original equation, we obtain a prediction for bank loan allocation to the paper and publishing industry which severely understates the actual allocation to this sector. This might reflect, inter alia, recent government promotion of textbook production for education purposes (see also Oh (1975)). In addition, we obtain predictions for allocation to agriculture, other (miscellaneous) manufacturing, transportation and trade which severely overstate the actual allocations made. The overestimation for transportation and trade is consistent with the Korean government's general tendency until now

²⁷ A comparable R^2 could be produced by recalculating residuals using the coefficient estimates of (vii) in the functional form of (iv). Result (iv) by definition produces the highest R^2 , however, although result (vii) produces more efficient estimates.

to stress commodity production sectors at the expense of services. Furthermore, the overestimation for trade occurs despite Jones' (1980) caution that his figure for chaebol concentration in that industry is suspiciously low. Our feeling is that while the chaebol trading company operations in that sector are highly publicized, the sector overall is still dominated by small wholesale and retail merchants.

While our results do not suggest that chaebol have received more bank credit than is their due, at least where they have some minimal visibility, a reexamination of the data in Table 1 and 2 hints that chaebol and public enterprise concentration might affect the use to which that credit is put. Although we have noted that the FSA data published by the BOK incorporates response bias with respect to bank loans, we could nevertheless use the FSA ratios of net worth to total assets in each sector to separate our estimate of "Other Liabilities plus Net Worth" (column (9) in Table 2) into its separate components. For example, in the electricity industry the net worth to total assets ratio in 1978 is reported at 37.4%. Applying this ratio to total assets (equivalent to column (10) in Table 2) gives a net worth of 482.6 trillion won, and subtracting this from column (9) in Table 2 leaves "Other Liabilities" for the electricity industry at -350.9 trillion won. Similar calculations give "Other Liabilities" of -5.7 trillion won for the basic industry, but positive "Other Liabilities" for all other sectors. Although the magnitudes may be questionable, the negative signs suggest that these sectors have been net lenders rather than net borrowers. The most obvious channel for this lending, at least in 1978, was the curb market. Furthermore, similar calculations for 1980 suggest that in that year, net lending might have been more widespread, particularly in the construction industry. Such net lending in 1980 would not have been surprising, given the generally depressed state of the Korean economy at that time. It is suggestive, however, that net lending appears to occur most heavily in industries with high chaebol and/or public enterprise concentration which, for this or reasons of performance, receive relatively large allocations of foreign or domestic bank loans.

On-lending of bank or foreign loans through unofficial channels at higher interest rates clearly occurs. Cole and Park (1983) hint at this, while the most recent Korean bank scandals of 1983 involved precisely such on-lending, with individual bank managers acting as go-betweens for an appropriate "fee" (International Herald Tribune, 22 November 1983). So while our regression results do not confirm that chaebol have used their greater potential access to bankers or government officials to influence the amount of bank credit they receive, our data does provide limited support for the proposition that both chaebol and public enterprise enjoy greater leeway in the use to which their credit is put.

Section IV - Summary and Conclusions

To the extent that successive military-turned-civilian governments in South Korea have, since 1961, sought legitimacy for their actions, they have done so by offering general economic success to the polity at large. They have not, in general, offered the opportunity to develop unfettered democracy. In pursuit of economic success, governments have followed an easily identifiable strategy. The entire focus of economic policy making has been export and growth oriented. This strategy has indeed produced a remarkable growth of real per capita income, but in the process, some groups have clearly benefited more than others.

There do exist organizations through which, in other countries, those who were harmed (relatively) by government policy would exert political pressure to improve their lot. Because of a culturally instilled reluctance toward "selfish" advocacy, reinforced at times by authoritarian government control, some of these institutions, particularly the trade unions, have not been effective vehicles for interest group pressure. Dissent has nevertheless at times found expression through other channels. Some groups, particularly students, have questioned whether economic success alone is sufficient

to bestow legitimacy and have periodically agitated for political reform. Student demonstrations have then been joined by workers and others whose grievances are more directly related to their economic situation. Pressure of this form has shown a remarkable ability to trigger changes of government in Korea, but has had less demonstrable effect since 1961 on the economic policies of the successors, except insofar as general economic performance was already faltering.

On the other hand, the government's general economic strategy has clearly benefited (relatively) particular groups. One of these has been the military. But while its interests have been served by economic success in general, the military now plays only a minor role in economic policy making and does not exert any major influence on the way that economic success is achieved.

Another group which has appeared to benefit is Korean big business, particularly the large conglomerates or chaebol. The question then arises as to whether chaebol have benefited from government policies, particularly government intervention in Korean financial markets, because they have brought political pressure to bear to manipulate regulation to their advantage, or whether they have benefited simply because they have made a major contribution to Korea's general economic success. An examination of the empirical evidence suggests that chaebol have not been able to obtain more cheap bank credit than was warranted by their economic performance alone, although there is limited evidence to suggest that they, together with public enterprise, might have been able to circumvent restrictions on the use to which bank (and foreign) credit can be put.

Nevertheless, the Korean government is showing a somewhat uncharacteristic caution in implementing its current liberalization initiatives, especially with respect to deregulation of bank interest rates. Does this suggest that chaebol, who nevertheless receive substantial bank credit because they do perform, have been able to exert political pressure to delay or block deregulation? At this stage, a more reasonable interpretation would be that government is

showing an unwillingness to burden some industrial sectors with higher interest rates at a time when these sectors are still vulnerable because of earlier, government encouraged over-expansion. These sectors, especially the heavy and chemical sectors, are ones in which chaebol are particularly heavily concentrated. Furthermore, we have shown elsewhere (Dee (1984a)) that interest rate deregulation, when undertaken from a position of initial disequilibrium, would cause short term adjustment problems that are severe and widespread enough to constitute a threat to economic performance in general, and not just to chaebol. However, there are also long term gains to be had, even for chaebol, and Korea's present circumstances would seem to offer a perfect opportunity for deregulation while inflation is low, bank interest rates are at least positive in real terms, and the extent of disequilibrium is probably less than at any time previously.

In summary, our examination of Korean interest groups does not provide strong evidence that economic policy making in Korea will be any more constrained in the future by interest group pressure than it has been in the past. We should, however, add a final proviso. President Chun has not been exercising the same degree of personal control over economic policy making as his predecessor. Decentralization of economic policy making authority provides an opportunity for interest groups to choose between branches of the bureaucracy. Furthermore, the Korean government is currently undertaking limited political, as well as economic liberalization. Chun has instituted a constitutional reform which limits him to a single seven year term in office and has pledged to seek a peaceful transition and a wider base of political support for his party before the next presidential election. It remains to be seen the extent to which this support will be purchased through economic policies.

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