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## IS THE KOREAN DEVELOPMENTAL STATE A MODEL TO FOLLOW?

## CZY KOREAŃSKI MODEL PAŃSTWA ROZWOJOWEGO JEST WZOREM DO NAŚLADOWANIA?

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**Summary:** Dynamic industrialisation process that started in the 1960s changed South Korea from poor and underdeveloped economy into one of the largest economic and export powers with high GDP per capita. The developmental state was the fundamental determinant of success and *spiritus movens* of modernisation process. While taking enforcement measures, repressions against workers and society, as well as strong interventions in industry, farming and financial sector, the visible hand of state targeted the development and implemented ambitious economic goals. The policy affected the contemporary economy of South Korea. The goal of the paper is to explain the essence of Asian developmental state, show the most important actions implemented by Korean developmental state as well as disputes arising from these actions in the period of modernisation and the impact of these actions on contemporary socio-economic system in Korea.

**Keywords:** developmental state, South Korea, model of East Asia growth, Park Chung-hee regime.

**Streszczenie:** Dynamiczny proces industrializacji, który rozpoczął się w latach 60. XX wieku, sprawił, że Korea Południowa z biednej i słabo rozwiniętej gospodarki stała się jedną z największych potęg gospodarczych i eksportowych z wysokim PKB *per capita*. Zasadniczym kreatorem sukcesu i *spiritus movens* procesu modernizacji było państwo rozwojowe (*the developmental state*). Widzialna ręka państwa, stosując środki przymusu, represje wobec pracowników i społeczeństwa, silną interwencję w sektorach przemysłowym, rolniczym i finansowym, ukierunkowywała rozwój i realizowała ambitne cele gospodarcze. Polityka ta nie pozostała bez wpływu na współczesną gospodarkę Korei Południowej. Celem artykułu jest wyjaśnienie istoty azjatyckiego *the developmental state*, wskazanie najważniejszych działań podjętych przez koreańskie państwo rozwojowe, a także zarówno kontrowersji wynikających z tych działań w okresie modernizacji, jak i wpływu tych działań na obecny system społeczno-gospodarczy Korei.

**Słowa kluczowe:** państwo rozwojowe, Korea Południowa, wschodnioazjatycki model wzrostu gospodarczego, reżim Park Chung-hee.

## 1. Introduction

Deliberations concerning economic success of South Korea are consistent with a broad discussion focussed on the development of some Asian countries that in the 1960s and 1970s surprised the world with high and continuing dynamics of not only growth, but also socio-economic development. The sources of rapid growth were mainly sought for in stable macroeconomic foundations, high level of domestic savings, private domestic investments and rapidly growing human capital. While explaining the conditions of growth of the region, Terutomo Ozawa stated that “East Asian economies’ social capabilities are neither innate nor manna from Heaven but have been created and governed by the governments” [2003, p. 710]. Although in the case of a group of East Asian states it is difficult to show one development model, the developmental state can be identified as their distinctive feature. Contrary to neo-classical approach based on a strong belief in efficient market mechanism, it performed a key role in activating and orienting the development of business activity and economy building.

Economic success of Korea in recent decades can be attributed to many determinants that constitute the result of not only an invisible hand of the market, but also visible hand of the state. Some actions conducted by Korean developmental state were supposed to be based on compulsion, some also had a repressive nature. The policy exercised in this way left long-term effects for Korean economy.

The main purpose of the paper is to discuss whether the Korean Developmental State is a model to follow? To answer this question, it is necessary to explain the essence of the Asian developmental state at first and then to show the most important actions undertaken by Korean developmental state. The most important controversies resulting from these actions in the period of modernisation and their consequence results for contemporary South-Korean economy must be also presented.

## 2. The developmental state as a concept

The concept of developmental state proposed by Chalmers Johnson, recognising strong power of the state both over business entities and the society to be a distinctive feature, was supposed to be an effective alternative for universal recommendations of neoclassical economics promoted within neo-liberal ideology. Since the post-war expansion of Japanese economy, the developmental state has been the synonym of East-Asian economic miracle and the symbol of specific economic management. Promoting and supporting development approached as a combination of high economic development and structural changes in production system, both in internal relationships and in links with global economy, has become the fundamental principle of operation of the state [Beeson 2009; Castells 2010, p. 287; Johnson 1982; Wade 1990].

The concept of developmental state that has been extensively studied in the literature [Amsden 1989; Beeson 2009; Evans 1989; Johnson 1982; Wade 1990]. It emphasises high autonomy of states [Amsden 1989; Evans 1989; Levi-Faur 1998], but also specific economic nationalism that is the background for pursued economic policy aiming at the protection of domestic economy [Stubbs 2009].

Orienting economy development by the government constituted the major mechanism of industrialisation and development of key sectors in the region. Economic policy focused its target on the protection of domestic enterprises, support for their development and the creation of conditions for building domestic business that would be competitive on global markets. The first, short strategy stage of import substitution was replaced by pro-export strategy. Industrial policy that oriented investments and capital inflow to key sectors was supported by neo-mercantilist commercial policy oriented on the maximisation of export and the minimisation of import, as well as other government operations (e.g. aiming the subsidies, currency manipulations, control over financial sector) that implemented determined targets. Financial system, mainly based on banking system, was also controlled by the state. The government restricted the autonomy of financial institutions, controlled the method of mobilisation and the allocation of capital while orienting savings and capital inflow in compliance with adopted strategy [Levi-Faur 1998, p. 70-78].

International context had an enormous significance for shaping the model of developmental state. Since World War II until the 1970s political instability and uncertainty, as well as internal conflicts were typical of the region of Eastern Asia. Cold war tensions, including political and military confrontations of the USSR and the USA, the superpowers of that time (in Korean or Vietnamese war), as well as conflicting interests of regional superpowers of the USSR and China in the region of Asia determined the operations of governments [Krasilshchikov 2008, pp. 187-189; Castells 2010].

East-Asian miracle would not have been possible without the establishment of post-war *Pax Americana* and the predominant role of the United States in economic sphere, the initiatives of which allowed for shaping of global environment that was conducive to exchange, investments and structural modernisation [Ozawa 2003, p. 701]. East-Asian economies devastated by wars and geopolitical tensions, deprived of natural and energy resources, with no industrial tradition, technological basis and internal markets managed to transform into highly competitive producers and global exporters. East-Asian model based on developmental state emerged from the need for survival. Development and forced modernisation of economies became the way to neutralise many external threats [Castells 2010, p. 278]. International context forced fast industrialisation for the purpose of maintenance of autonomy of economies. Industrialisation process demanded improvement in export competitiveness, and engagement in the promotion of local industrial capital development was to favour industrialisation process.

Strong developmental state determined the direction of transformation and industrialisation process, while focusing more on the path of development rather than social cohesion. Specific conditions determined the formation of relationships linking the capital and state [Evans 1989, p. 575]. Thanks to building close relationships and correlations between political and administrative elites and large businesses, the states pursued the policy of high growth.

Generally speaking, instead of applying typical solutions compliant with neo-liberal ideology, the developmental state oriented economic growth while using various mechanisms of political, economic and social pressure.

### **3. The developmental state as a creator of South Korean's success**

The growth of South-Korean developmental state model started after the end of Korean War in 1953. American intervention was of the key importance for the establishment of foundations for modern South-Korean economy. The implementation of agricultural reform, military support for South Korea and enormous financial aid became the cornerstone for reconstruction and survival of the state after the conflict on the peninsula [Kim 1997, p. 30]. Initially, economy development relied on external financial aid, mainly from the USA, but also international organisations. Between 1946 and 1976 South Korea obtained aid in the amount of USD 15 billion, including 8.6 billion of economic aid, and USD 6.9 billion of military aid [Cameron 1986, p. 17; Kim 1997, pp. 19-21].

Economy largely owes its success to the developed actions of the state that performed a strategic role in economy industrialisation [Wade 1990]. The intensification of the process of accelerated industrialisation of Korean economy was associated with the takeover of power by the general Park Chung-hee following the coup d'état in 1961. Unlike his predecessor, Ree Syng-Man, the President Park attached greater importance to economic rather than political actions, especially to the economic growth [Rodrik 1995, p. 85].

In the 1950s shortly promoted stage of the strategy of substitution of import with the high level of protection for internal trade and limited financial risk transformed into the strategy of export-oriented growth [Rodrik 1995, p. 55; Dornbusch, Park 1987, p. 405].

The efficient implementation of export strategy was determined by external factors such as new international labour division resulting from moving production to the East and supporting western sales markets among others. Financial support provided by the United States for the process of modernisation of Korean economy, support for local elites in the creation of capitalism, or facilitating access to American market for Asian export production were to constitute the counterbalance to the expansion of Maoist and Soviet influence. Between 1953 and 1961, around 70% of Korean import was financed through foreign aid [Kim 1997, p. 19]. Export-oriented strategy brought growth in incomes, savings, internal investments and productivity.

This rather orthodox approach does not emphasise clearly enough the role of the state in stimulating economic growth.

Inside the economy, the change of strategy into pro-export strategy was achieved through five-years' plans implemented since 1962 under the auspices of Economic Planning Board. Within economic plans, the government determined strategic axes of national development. Authoritarian regime supported exporters while creating conditions supporting export production. Through subsidies, trade restrictions, administrative guidelines, formation of public enterprises and credit institutions, the government shaped comparative advantages in expected directions. Detailed extremely "dirigiste" policy was the driving force for the economic development.

Following the model of Japanese *zaibatsu*, Korean authorities supported large family conglomerates, the so-called *chaebols*. Within industrial policy, the development of large sectors based on diversified *chaebols* that included many industry branches, banking sectors and financial institutions was stimulated. The government encouraged strong concentration of industry and capital, while contributing to the formation of giant financial empires. Large *chaebols* were taking over small companies producing goods for domestic market while becoming the driving forces for export [Krasilshchikov 2008, p. 226]. Oligopolistic competition became the feature of Korean internal market. Individual export targets were set out for *chaebols* [Amsden 1989, pp. 115-130]. Those, that implemented ambitious tasks were awarded by the state; they could count on government support, subsidies, tax advantages, preferential loans, loan guarantees or export compensations. They were also supported by specialised state agencies that facilitated the establishment of contacts with international buyers. The state conditioned the continuation of support not on the size of company profit, but on the achievement of individually determined targets of foreign sale. The lack of results in the attainment of the export size brought sanctions from the state. Enterprises that did not show the willingness to cooperate were harassed, prevented from taking loans or refused subsidies, which often brought their collapse.

Credit-based system was the instrument supporting the formation of *chaebols*. The system that partially was in the state ownership, was strictly controlled by the state, and banks were subordinated to economic bureaucracy. The nationalisation of banks provided the government with the possibility to control loans and enabled orienting the economic policy. Enabling large industrial groups to prolong loans, with low or often negative real interest rates was the major form of subsidies. Interest rate of preferential export loans was around 6%, while the standard interest rate was 24% [Cameron 1986, p. 16]. Low or negative interest rates forced the necessity of rationing the loans. If in the period of Rhee regime, political criteria were the major criterion of granting the loan, during Park's rule, economic criterion related to the desired trend of business activity had a decisive role. Criteria associated with the size of the company, type of activity, planned investments, applied technology or foreign relationships, favoured the companies of strong position on market. It was only viable to make capital investments in new sectors.

Personal relationships between political decision-makers (bureaucrats of the highest level) and the owners of large conglomerates were used to direct financial flows [Krasilshchikov 2008, p. 226; Wade 1990, pp. 306-325]. In this way, financial and banking institutions subordinated to industrial strategy were controlled even in a larger degree than industrial sector [Krasilshchikov 2008, p. 226].

Export production was approached as a strategic sector. *Chaebols* focused efforts on export, but at the same time on improvement of the quality of production. This allowed for the growth of competitiveness on the international arena. Loan, tax and currency policies were subordinated to this goal. The state protected domestic production through customs duty, and it granted licences for the production of specific goods. It determined export amounts, granted loans to entrepreneurs implementing government plans, and established government agendas supporting enterprises in export execution. Government operations focused on strengthening national capabilities while also applying restrictions concerning foreign direct investments (FDI) for the protection of national conglomerates [UNCTAD 1996, p. 132].

“Export first” ideology fuelled the export of industrial goods while becoming the driver that changed Korean economy into the leading world exporter. At the end of the 1960s and at the beginning of the 1970s, changes in domestic production were mainly the result of export rather than investments. The impact of export on changes in production was around 30% whereas in investments it was around 19% [Amsted 1989, p. 57].

#### **4. Controversies of Korean developmental state model**

The basis of domestic capital, financial aid that was largely allocated to investments, and the policy of ruling the state through administrative guidance were the fundamental impulse for the economic development of Korea.

A lot of controversies were brought by radical agrarian reform implemented in a repressive way. The modernisation of agriculture based on compulsion was proceeding through the expropriation of owners from large agricultural areas, most often without any compensation [Toussaint 2006]. The state imposed production volumes that farmers were obliged to achieve, and then bought farm produce at lowered prices.

To mitigate the growth of anti-government atmosphere, the program of moving people from rural areas to urban ones was implemented at the end of the 1960s. At the beginning of the 1950s agricultural population constituted 75%<sup>1</sup>. Population coming to cities was to become cheap labour force on which the modernisation process was based. Rapid urbanisation of the state brought changes in population structure; the share of urban population grew from 27.7% in 1960 to 56.7% in 1980. Urbanisation

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<sup>1</sup> Unless otherwise indicated, the data is from [The World Bank].

process lasted for the next decades. Currently, the rate of urban population in total population reaches 82.6%.

The approach of Korean government to labour force management was controversial. Two powerful processes of modernisation and urbanisation of the state affected a rapid growth in the number of industrial workers and proletariat. In 1963 in Korea there were around 600 thousand labourers, in 1973 – 1.4 million, and in 1980 over 3 million people [Cameron 1986, p. 18]. The intense concentration of workers in big factories managed in a restrictive way, legal ban on establishment of trade unions, ban on strikes, the implementation of repressive actions towards workers, as well as poor working and living conditions of labourers brought controversies [Castells 2010, p. 268]. The labourers did not have social protection or paid leaves, they often spent 6 – 7 days a week at work. Elementary safety rules were not observed [Cameron 1986, p. 18].

While supporting export policy of large conglomerates, the government limited the security of fundamental workers' rights and allowed for keeping wages on a low level. The cost of salaries in 1979 was USD 1.14 per hour. For comparison, in Japan it was USD 5.58, in France USD 8.17 and in the United States USD 9.09 [Cameron 1986, p. 19]. Low labour costs were one of the factors explaining high competitiveness of Korean industry and export.

Therefore, intense economic development was taking place at the cost of the workers who used to get little money, worked in poor working conditions and their average working week was over 54 hours. The working week was one of the longest in the world, which was especially visible in comparison with OECD countries. In 1980, an average Korean worked for 2864 hours a year whereas the average number of hours falling on OECD worker was 1909 hours. Although nowadays the average number of hours falling on OECD worker is smaller than 40 years ago, an average Korean still works longer (2069 hours per year) than an average worker in OECD countries (1763 hours) (OECD)<sup>2</sup>.

Despite the considerable growth in productivity, low wages resulted in the rapid growth of GDP per capita, from USD 158 in 1960 to USD 1770 at the end of 1970<sup>3</sup>. A significant increase in wages occurred only in the 1970s when social tensions started to grow [Amsden 1989]. They were caused among others by increase in income inequalities. Apart from concessions from the state in the sphere of growth in wages, a minimum social protection that had not existed before was introduced.

In the period of intense modernisation, continuous development of Korean industry needed financing for investments. The implementation of ambitious investment targets forced increase in society savings. In the 1950s the share of savings in Korean GDP was only 3.3%, whereas investments reached 10% GDP. However, 2/3 of gross domestic investment was financed from foreign savings

<sup>2</sup> Data of [OECD].

<sup>3</sup> In 2016, Korean GDP per capita was USD 27.5 thousand; data of [The World Bank (access: 4.10.2018)].

[UNCTAD 1996, p. 110]. To reduce investment gap, the state supported domestic savings (campaigns promoting the habit of saving) and implemented actions aiming at limiting the domestic consumption (restrictions in the access to luxury goods and ban on trade in some products or foreign tourism, among others). The state policy in connection with traditional Confucian values, caused enormous growth in savings. Nowadays, the level of domestic savings reaches USD 35.7% GDP [The World Bank]. However, high national savings result in low internal consumption. In 2016, the final consumption expenditure expressed in the percent of GDP was less than 64%. In the situation of slowdown of economic growth dynamics in recent years, there is a real threat that the Korean economy will start to drift along the economic path of stagnation, similarly to the Japanese economy at the beginning of the 1990s.

Strong developmental state exercised control both over the economy and society. Enormous exploitation of labourers can be explained with the lack, or repressive restrictions regarding political and union trade rights, society militarisation and strong pressure on wages caused by the inflow of population from the sector of agriculture [Cameron 1986, p. 19].

Economic growth performed the most vital role in the process of Korean modernisation, whereas social cohesion formed distant and neglected background. Until now social expenditure in South Korea is the lowest among all OECD countries. In 2016 it was 10.4% GDP, whereas the average for OECD group was 21% GDP [OECD].

Since the very beginning of modernisation process, Korean government maintained complicated relationships with *chaebols* that performed a significant role in the reconstruction and modernisation of South Korea. A specific agreement concluded between the government and *chaebols* strengthened *status quo* and guaranteed privileges to *chaebols* as long as they implemented economic goals of the state. In this way *chaebols*, managed by big families were growing in economic, financial and political power, while becoming strong competitors on the international arena. Personal relationships between the sector of power, business and administration formed informal channels of influence. This huge industry emerged through high taxes and American aid that was redistributed for creating industrial capitals, firstly in the period of Rhee and then Park Chung Hee regimes. As it is stated by Eric Toussaint: “Korean bourgeoisie is developing in the shadow of the state” [2006, p. 4], that supported and protected large conglomerates.

Authoritarian governments pursued the state policy oriented on economic targets, while supporting programs encouraging the development of industrial family conglomerates, that frequently restricted citizens’ rights. Under Special Law Dealing Act, Park’s regime arrested many leading businessmen accused of illegal accumulation of assets or conducting speculative operations during the rule of previous governments. The release of entrepreneurs was conditioned by their declaration and promise of the implementation of specific investments. In this way,

Park forced and directed production investments but not actions aiming at *rent seeking* [Rodrik 1995, p. 85].

Private capital owned by business was engaged in economy development. While applying presented actions, *chaebols* achieved export expansion, and they also became a problem for the Korean economy. *Chaebols* grew so much that no financial institution in the country could meet their enormous demand on loans. Therefore, they started to borrow abroad. Due to unclear capital relations within *chaebols*, the companies could guarantee loans to each other. Strong engagement of the state in economy was fostering corruption and shaping of the so-called culture of *crony capitalism*. Corrupted officers provided government guarantees that allowed for deriving practically unlimited profits from foreign loans. Consequently, indebtedness of *chaebols* was many times higher than their value.

The crisis of 1997 showed weakness of socio-economic system, especially lack of transparency caused by adopted corporate order, that was reliant on close relationships and interdependencies between managers, business organisations and ruling elites rather than on business logic. Chaos that erupted after 1997 revealed complicated and vague relationships that were observed between public sector, banking sector and enterprises.

Development successes of Korea did not protect it against corruption. The gift-giving culture has been deeply rooted in the Koreans' mentality. Corruption is a serious obstacle to democratic development of the state. Despite efforts undertaken by government anti-corruption agendas, bribery, extortions, nepotism, favouritism, patronage and misappropriation are still observed in political, business and everyday life. According to the Corruption Perceptions Index that assesses the states by their perceived levels of public sector corruption according to experts and business people, South Korea is ranked on 51<sup>st</sup> place among 180 economies. On the turn of 2016 and 2017, Korean society stood against legal authorities again. Crowds of Koreans demanded the resignation of the President, Park Geun-hye (the daughter of Park Chung-hee general, suspected of non-transparent relationships with *chaebols*, abuse of authority and corruption), as well as review of the constitution that would restrict the power of states while strengthening civil society.

It seems that after many years of strong influence of *chaebols*, Koreans are ready to dismantle these huge industrial conglomerates managed by big families, accused of using and abusing political influence, and financial scandals with authorities in the background. The need of reforms allowing for improvement in the financial transparency of conglomerates that might also enable to reduce tax-related crimes seems to be necessary.

However, the problem of *chaebols* does not concern only the issue of transparency and links with political and administrative authorities. *Chaebols* have a large share in export that Korean economy is dependent on, and they generate a third of Korean GDP. According to Korea Fair Trade Commission, in 2016 a total sale of 31 largest concerns reached around USD 1.1 billion, i.e. over 80% of national GDP. 55 largest

business groups in 2010 generated 29.1% of the total sale in the national economy and gave employment to 8% workers [Lee 2014]. In short, *chaebols* can be perceived as “too big to fail”. Concentration of economic power of Korean business groups is rather high. As a result, large conglomerates use their position of the major generator of GDP and considerable employer to be treated in a privileged way. However, government strategy supporting *chaebols* has brought the *status quo* that hampers further development of Korean economy.

Growth in the size of proletariat as well as emergence of middle-class and young educated population were the social results of accelerated industrialisation. In the second half of the 1980s, trade union movement started to develop slowly. Protests against authoritarian rule of military dictatorship initiated by students were supported by mass protests of workers opposing to government operations. Faced with repressions and authoritarian government operations, the process of radicalisation of new social groups rapidly growing in number began, and mass recovery forced the process of democratisation. Free elections permitted by Chun Doo Hwan dictatorship in 1987 were its first manifestation. They transformed the tradition of three decades’ long authoritarian rule into democratic system.

Although South Korea, especially in the period of Rhee Syng-man and Park Chung-hee regime was perceived as less “cruel and predatory” rather than “developmental”, historic legacy of Rhee regime became the canvas for further success. Linking historic bureaucratic tradition, changes in social structure with decimated farming elite, disorganised industrial groups and industrial capital, for which the state apparatus became the sewage system, as well as the state autonomy in post-war period resulted in the exceptional position of authorities [Evans 1989, pp. 572, 575]. In conditions of authoritarian political system that preserved until 1987, the state modernisation was taking place at political, social and economic restrictions. However, these actions helped to transform the state into one of the largest world economies and the leading exporter.

## 5. Conclusions

The concept of developmental state in which the state was the *spiritus movens* of socio-economic development, gained researchers’ interest firstly because of its specific conditions and not universality. The concept could be successfully implemented in Asian economies, which allowed some of them, including South Korea, to escape from the poverty trap. “Miraculous” economic results of South Korea were the effect of both authoritarian and interventionist operations among others, conducted within the developmental state. It was consistently implementing export-oriented strategy of economic development while supporting the success of family conglomerates brought by government contracts, institutional, legislative, financial and credit support. The answer to the question formulated in the title of the paper cannot be unequivocally affirmative.

It is true that Korean developmental state became the creator of economic success. Impressive business results were translated into the improvement of living conditions, wage growth and decline in the rate of population living at the poverty line. Social transformation that has taken place and has translated into changes in social structure, especially the emergence of middle-class, changes in education and employment structure, as well as accelerated urbanisation made Korea closer to the level of highly-developed countries. However, these results were achieved in the period of dictatorship regime that implemented repressive operations both towards businesses and the society. Authoritarian and demanding economic plans, workers' exploitation, poor working conditions, maintenance of wages on low level, limiting internal consumption to support domestic savings, repressions towards society, price and banking system control, strong state intervention in industrial as well as agricultural and financial sectors, constituted fundamental instruments of economic policy of Korean developmental state. The results of this policy both in economic as well as in social dimension constitute the element of contemporary Korean economy.

The answer belongs to the domain of the normative economics. However, in the light of the indicated arguments, the constraints of the model are evident. Although economic results can be impressive, developmental state implemented by authoritarian regime, based on repressive actions and compulsion may not be presented as a model of socio-economic development to follow.

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