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**Embracing Free Trade Agreements, Korean Style:  
From Developmental Mercantilism to Developmental Liberalism**

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**Abstract:** This study analyzes how and to what extent South Korea has embedded developmental liberalism into its FTA initiative, departing from its traditional focus on developmental mercantilism. In the wake of the global economic crisis of 2008-10 and the subsequent expansion of government interventionism across the world, the developmental state model has attracted renewed scholarly attention. The developmental state approach offers a useful conceptual framework to examine how a particular set of arrangements between the tradable and non-tradable sectors in South Korea has shifted from “developmental mercantilism” to “developmental liberalism.” The significance of South Korea’s FTA initiative is three-fold. First, it constitutes a notable policy shift to liberalism, departing from a mercantilist approach with a policy mix of import protection and export promotion. Second, the embrace of FTAs has been shaped by a top-down political initiative rather than a bottom-up demand from business groups and the general public. And third, despite its liberal but state-centric nature, South Korea’s FTAs are closely embedded in the country’s social fabric, both competitive and uncompetitive.

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## **I. Introduction**

South Korea has led the race toward free trade agreements (FTAs) in East Asia for the past decade, which opened with the signing of the first FTA between East Asian countries, Japan-Singapore economic partnership agreement, in 2001. It took its most pronounced turn when South Korea concluded an FTA with the world's largest economy, the U.S., in 2007. The speed and scope of South Korea's FTA initiative has not been slowed down by the global economic crisis of 2008-10, as illustrated by the conclusion of such agreements with India (2009) and the European Union (2010). The tale of South Korea is particularly intriguing because the country has not only been one of the most loyal supporters and beneficiaries of post-war multilateral trading regimes, but also been criticized for its allegedly protectionism policies.<sup>1</sup>

South Korea's active pursuit of bilateral and minilateral FTAs in hopes of securing access to much-needed export markets needs to be understood in the context of the way in which domestic structures have underpinned such a dramatic shift under the rubric of free trade. The neglect of the domestic foundations of FTA policies warrants critical analysis, as there is a growing lacuna in the literature on the post-crisis capitalism in East Asia. From such an analytical point of view, the significance of South Korea's FTA initiative is three-fold. First, it constitutes a notable policy shift to liberalism, departing from a mercantilist approach with a policy mix of import protection and export promotion. Second, the embrace of FTAs has been shaped by a top-down political initiative rather than a bottom-up demand from business groups and the general public.

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<sup>1</sup> Min Gyo Koo (2009), "South Korea's FTAs: Moving from an Emulative to a Competitive Strategy," in Mireya Solis, Barbara Stallings, and Saori N. Katada, eds., *Competitive Regionalism: FTA Diffusion in the Pacific Rim*, New York: Palgrave Macmillan.

And third, despite its liberal but state-centric nature, South Korea's FTAs are closely embedded in the country's social fabric, both competitive and uncompetitive.

It would be preposterous to argue that South Korea's policy elites have embraced FTAs as a tool to promote purely neo-liberal economic goals in a political vacuum. South Korea's new trade policy centered on FTAs is hardly insulated from societal pressures. South Korea has made it no secret to use FTAs to promote its industrial and economic competitiveness. At the same time, generous side-payments to those potential losers of greater trade openness aptly illustrate the manner in which the dynamics between state elites and protectionist veto players has resulted in new policy equilibrium between liberalization and social protection.

The developmental state debate provides a natural starting point for an analysis of mercantilist trade policies once prevalent in South Korea, and the nature of new FTA strategy in the aftermath of two economic crises, one regional and one global.<sup>2</sup> In the aftermath of the Asian financial crisis of 1997-98, the developmental state model became the main target of blame for the birth of crony capitalism and the forced divorce of the

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<sup>2</sup> A dominant view in the literature is that the Japanese use of market conforming mechanisms for developmental purposes has been successfully emulated in other countries in East Asia. The most important early examples include South Korea, Taiwan, Singapore, and Hong Kong. During the 1990s, China and Southeast Asian countries also began to adapt the institutions of Japan's developmental state model to their economies. Of course, none of the East Asian cases is a clone of the Japanese experience. Some followers improved on the Japanese model—for example, state control of *chaebol's* entry in banking sector in South Korea—and others ignored Japanese-type controls on unchecked growth and paid the consequences—for example, repeated bouts of inflation in mainland China. Nonetheless, all the East Asian cases reflect particular forms of state guidance as first demonstrated by Japan (Chalmers Johnson (1999), "The Developmental State: Odyssey of a Concept," in Meredith Woo-Cumings, ed., *The Developmental State*, Ithaca: Cornell University Press: 40).

state and market. Yet in the wake of the global economic crisis of 2008-10 and the subsequent expansion of government interventionism across the world, the developmental state model has attracted renewed scholarly attention.

It is too early to tell whether the return of developmental state debate will become a Cinderella or an ugly duckling tale that starts as a tragedy but ends with a happy surprise. However, the developmental state approach offers a useful conceptual framework to examine how a particular set of arrangements between the tradable and non-tradable sectors in South Korea (and more broadly in East Asia) has shifted from “developmental mercantilism”—or “embedded mercantilism” in T.J. Pemepl’s term—to “developmental liberalism.”<sup>3</sup>

The remainder of this paper is structured as follows. Section II outlines the conceptual and empirical background of developmental mercantilism and developmental liberalism as well in the context of growing pressure of globalization. Sections III and IV analyze how and to what extent South Korea has embedded developmental liberalism into its FTA initiative, departing from its traditional focus on developmental mercantilism. Section V summarizes the main argument and findings and draws broader regional implications.

## **II. Developmental mercantilism, convergence thesis, and developmental liberalism**

Since the publication of Chalmers Johnson’s seminal work *MITI and the Japanese Miracle* (1982), the developmental state model has been one of the most compelling

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<sup>3</sup> This paper uses the two terms—“embedded mercantilism” and “developmental mercantilism”—interchangeably, because the social embeddedness of state often goes hand in hand with developmentalism in East Asia.

explanations for the economic success of East Asia. Linked to Gerschenkronian theories of late development, the developmental state model challenged a variety of widely accepted models of economic development, from the “plan-irrational” socialist model to liberal modernization. The adherents of “plan-rational” developmental state model argue that the East Asian states have been successful because they have acquired control over a variety of things critical to economic success such as capital, national economic plan, scarce resources, industrial policies, political insulation, etc.<sup>4</sup>

The rise of economic nationalism is critical for understanding the advent of the developmental state in East Asia. East Asian countries’ economic nationalism took the form of mercantilism, while attempting to catch up with the economic development of the West. In his analysis of the regime shift in Japan, T.J. Pempel notes that public policies of “embedded mercantilism” were pursued in the 1960s to promote macroeconomic success—budgets were typically balanced, inflation was held low, and any corporatist bargaining took place at the corporate, not the national, level. From this perspective, the political tensions that had divided Japan at the end of World War II were significantly reduced not through Keynesianism, inflation, or corporatism, but through rapid growth that relied on domestic protection, industrial policy, and export promotion. The

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<sup>4</sup> Alice Amsden (1989), *Asia’s Next Giant: South Korea and Late Industrialization*, New York: Oxford University Press; Chalmers Johnson (1982), *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, Stanford: Stanford University Press; T.J. Pempel (1999), “The Developmental Regime in a Changing World Economy,” in Meredith Woo-Cumings, ed., *The Developmental State*, Ithaca: Cornell University Press; Robert Wade (1990), *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton: Princeton University Press; Meredith Woo-Cumings (1999), “Introduction: Chalmers Johnson and the Politics of Nationalism and Development,” in Meredith Woo-Cumings, ed., *The Developmental State*, Ithaca: Cornell University Press.

resultant conservative regime that emerged in Japan in the 1960s looked distinctly different from the other advanced industrialized democracies.<sup>5</sup>

The institutional marriage of developmentalism and mercantilism quickly spread throughout East Asia. It was brokered by the social embeddedness of industrial and trade policies. East Asia scholars tend to use the term “embeddedness” in a proactive manner. They argue that, when combined with the autonomous developmental states, embeddedness allows states to go beyond welfare states as defined by the traditional “embedded liberalism” literature.<sup>6</sup> In particular, Peter Evans uses the term “embedded

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<sup>5</sup> T. J. Pempel (1998), *Regime Shift: Comparative Dynamics of the Japanese Political Economy*, Ithaca: Cornell University Press: 5-10.

<sup>6</sup> The core of the embedded liberalism idea is that governments will limit the costs and distribute the benefits of open markets through some kind of government intervention and spending in order to garner public support for liberalism. In his seminal work *The Great Transformation*, Karl Polanyi argues that West European capitalism in the 19<sup>th</sup> century was characterized by economic liberalism and social protection against economic dislocation. Yet, according to him, the political-economic meltdown in the early 20<sup>th</sup> century can be attributed to the undirected, too fast socio-economic change wrought by the “self-regulating market” or “laissez-faire liberalism” (Karl Polanyi (2001 [1944]), *The Great Transformation: The Political and Economic Origins of Our Time*, Boston: Beacon Press). John Ruggie uses the term, embedded liberalism, to characterize the post-World War II Western economic system. The system promoted and institutionalized liberalism (i.e. the GATT), but, at the same time, allowed individual states to practice autonomy in domestic economic affairs—i.e., social welfare programs. Because trade causes economic dislocations and exposes workers to greater risk, it generates political opposition that democratically elected leaders can ignore only at their peril. Thus, according to Ruggie, one important implication of the post-war free trade system is that political leaders have to be aware of and actively manage public support for economic openness. To do this, governments have exchanged welfare state policies that cushion their citizens from the vagaries of the international economy in return for public support for openness (John Gerard Ruggie (1982), “International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order,” *International Organization* 36(2): 379-415).

autonomy” to demonstrate that successful developmental states in East Asia tend to be immersed in a dense network of ties that bind them to groups or classes that can become allies in the pursuit of societal goals. According to Evans, embeddedness provides sources of intelligence and channels of implementation that enhance the competence of the state. In his logic, therefore, the idea of the state as midwife comes to the fore: States foster industry by changing social structures, by assisting in the emergence of new social groups and interests.<sup>7</sup> From this view point, the impressive institutional constructions that went with embedded autonomy in South Korea are contrasted to the often inconsistent state efforts by Brazil and India to generate local entrepreneurial groups in the 1960s and 1970s.<sup>8</sup> Although not further articulated in his comparative analysis, such embeddedness allowed the South Korean government to catch two pigeons with one bean: promoting competitive export industries while pacifying less competitive sectors.

The so-called convergence thesis poses a direct challenge to the East Asian developmental state model, in which state autonomy is particularly crucial. The convergence thesis is based on the observation that the authority of the governments of all states, large and small, strong and weak, has weakened as a result of rapid

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<sup>7</sup> Peter Evans (1995), *Embedded Autonomy: States and Industrial Transformation*, Princeton: Princeton University Press.

<sup>8</sup> More specifically, the colonial experience and existence of communist enemies allowed the South Korean government to dominate over societies, in exchange for economic development. It enjoyed an advantage in adopting state-corporatist solutions because it already possessed well-organized bureaucracies with established traditions. Moreover, on the eve of its developmental push, it was a “strong” state, with systems of government that were largely autonomous from, and relatively immune to, interest-group pressures (Pempel 1999).

globalization. The logic behind this hypothesis is that the more a national economy is integrated into global markets, the higher the costs of a national policy which is not compatible with global market demands such as deregulation and market liberalization. In a world of highly integrated economies, owners of capital, highly skilled workers, and many professionals are highly mobile to take their resources where they are most in demand. Anticipating this flight of capital and skills, governments have to cut taxes and dismantle the welfare state before the migration gets under way. The result is a growing convergence of national economic policies toward neo-classical liberalism and trade liberalization.<sup>9</sup>

Following the unprecedented economic success, the late 1990s provided a painful litmus test for the validity and utility of developmental mercantilism. In the wake of the Asian financial crisis, the illusion of East Asian economic miracle miserably shattered. The developmental state model was now called corrupt crony capitalism, vulnerable to moral hazard. The imposed solution, in the so-called Washington consensus, was transparency in corporate governance and retreat of the state. Many predicted that a convergence toward the Anglo-American liberal market economies would be inevitable when it comes to corporate governance, at the center of which was the fad for marketization and financialization.<sup>10</sup> More importantly, many Western countries, particularly the U.S., became less tolerant of East Asian countries' mercantilist

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<sup>9</sup> Peter A. Hall and David Soskice, eds. (2001), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford: Oxford University Press; Susan Strange (1996), *The Retreat of the State: The Diffusion of Power in the World Economy*, Cambridge: Cambridge University Press.

<sup>10</sup> Ronald Dore (2000), *Stock Market Capitalism: Welfare Capitalism: Japan and Germany versus the Anglo-Saxons*, Oxford: Oxford University Press.

policy. Under the rubric of fair trade or the level-playing-field idea, the U.S. demanded an “asymmetrically reciprocal” opening of East Asian markets.<sup>11</sup>

The rise of South Korea’s FTA strategy was primarily a response to the formidable market force. Under the competitive pressure of globalization, trade dependent South Korea had to radically modify, if not completely abandon, its mercantilist policy to secure the benefit of international trade bilaterally and/or minilaterally. Unlike the traditional multilateral mechanism of the GATT/WTO, FTAs often make it less likely to free-ride on others.<sup>12</sup> Nevertheless, South Korea’s fear of exclusion from free trade—especially with a country that has “go-it-alone-power”—motivates the former to voluntarily choose to form an FTA with the latter, even if the former prefers the *status quo*.<sup>13</sup> The South Korea-U.S. FTA (KORUS FTA) illustrates that the fear of exclusion in the U.S. market played a significant catalyst role in South Korea’s decision to start an FTA negotiation with the U.S. despite serious concerns about the dominant position of the U.S. in the global economy.<sup>14</sup>

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<sup>11</sup> At the turn of the new millennium, the Bush administration began to pursue “asymmetric reciprocity” that advantageously opens markets for U.S. traders and investors, while rewarding and supporting domestic market-oriented reformers and advancing democratic institutions (Richard Feinberg (2003), “The Political Economy of United States’ Free Trade Arrangements,” *The World Economy* 26(7): 1019-1020). For the interplay of free trade and fair trade ideas in American trade policy decision-making, see Judith Goldstein (1988), “ Ideas, Institutions, and American Trade Policy,” *International Organization* 42(1):179-217.

<sup>12</sup> Vinod K. Aggarwal and Shujiro Urata, eds. (2006), *Bilateral Trade Agreements in the Asia-Pacific: Origins, Evolution, and Implications*, London: Routledge.

<sup>13</sup> Lloyd Gruber (2000), *Ruling the World: Power Politics and the Rise of Supranational Institutions*, Princeton: Princeton University Press.

<sup>14</sup> The rise of South Korea’s FTA initiative has been remarkable in its speed and scope. South Korea has concluded FTAs with Chile (2002), Singapore (2004), the European Free Trade

In the meantime, the structural changes in the post-Asian financial crisis period significantly contributed to cognitive changes and the diffusion of new policy ideas that a bilateral and minilateral liberalism is not only complementary to multilateral liberalism, but is also a crucial element of economic survival. In addition, the crisis effectively gave the South Korean government broad public tolerance for executive initiative for more liberal trade policy. The economic crisis muted the country's once rigid protectionist voices, thus providing the government with favorable atmosphere for liberal economic reform and for the adoption of FTA policy.<sup>15</sup>

However, it would be a mistake to conclude that South Korea's turn toward FTAs demonstrates its blind pursuit of neoliberal trade liberalization. At a first glance, the embrace of FTAs indicates that its mercantilist trade policy, and its developmental state model more broadly, might have outlived its utility under the growing pressure of globalization. If we look beneath the surface, however, the South Korean government's social embeddedness persists in two different but related domains: competitive export sectors and uncompetitive import-competing industries. South Korea's decision to pursue an FTA with one of its largest trading partners—the U.S.—initially prompted

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Association (EFTA, 2005), ASEAN (2005), the U.S. (2007), India (2009), and the European Union (2010). South Korea has also been negotiating FTAs with Japan, Canada, Mexico, and Australia. In addition, a number of feasibility studies are under way with China, South Africa, Russia, the Gulf Cooperation Council (GCC), Mercosur, and many other countries.

<sup>15</sup> Koo (2009); Jongryn Mo (1999), "The Politics of Economic Reform," in Carnegie Economic Reform Network, ed., *The Politics of the Economic Crisis in Asia: Consensus and Controversies*, Washington, D.C.: Carnegie Endowment for International Peace; Jongryn Mo and Chung-in Moon (2003), "Business-Government Relations under Kim Dae-jung," in Stephan Haggard, W. Lim, and E. Kim, eds., *Economic Crisis and Corporate Restructuring in Korea: Reforming the Chaebol*, New York: Cambridge University Press.

mercantilist outcry that it would serve only neoliberal interests. However, it turned out that the deal would most likely benefit its competitive sectors such as automobiles and textiles, while a variety of side-payments—instead of blind protectionism—would effectively mitigate the pains to be held by potential losers from greater trade openness. Therefore, South Korea’s FTA initiative can be characterized as a tool for developmental liberalism rather than developmental mercantilism or neoliberalism.

The neoliberal view argues that states should not have vertical or sectoral industrial policy, as opposed to horizontal or genuine interventionist policy. Yet the latest global recession has induced serious skepticism of neoliberal policy prescriptions and opened the renewed debate about the role of state in development. In major economies, industrial policy is now back in fashion again. For instance, Japan’s Prime Minister, Naoto Kan, said in April 2010 that the Japanese government intended to create a new “Japan, Inc.,” deepening the links between business and the state. It was not a coincidence that the Ministry of Economy, Trade, and Industry (METI) announced a strategy to combat the “increasingly aggressive” industrial policies of the U.S., the U.K., China, France, Germany, and South Korea.<sup>16</sup> The universal race to create green jobs is a good example. Led by China and America, support for green tech is rapidly becoming one of the biggest industrial-policy efforts ever.<sup>17</sup> Although it is still early to tell whether this new fashion in industrial policy can be characterized as developmental liberalism, it is notable that all these countries have been active in pursuing FTAs as their most important trade policy initiative. Set against this backdrop, the following two

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<sup>16</sup> The Economist (2010), “Picking winners, saving losers,” August 7<sup>th</sup>.

<sup>17</sup> The Economist (2010), “Leviathan, Inc.,” August 7<sup>th</sup>.

sections analyze the rise of developmental liberalism in South Korea with a focus on its FTA initiative.

### **III. The fall of South Korea's developmental mercantilism**

Since its dramatic economic take-off in the 1970s, South Korea has benefited from export-oriented industrialization under the auspices of the multilateral trading regime of the GATT/WTO. Since its accession to the GATT in 1967, South Korea's active promotion of the export sector has allowed the once reclusive country in Northeast Asia to aggressively participate in the global market. As a trade-dependent country, South Korea's full integration into the world trading system was not a matter of choice, but of survival.<sup>18</sup>

As elsewhere in the world, South Korea's societal interests have been divided along sectoral lines between competitive and noncompetitive industries, while the relative scarcity of land has made the urban-rural cleavage a permanent feature of the country's political economy. In the past, South Korea's developmental state provided minimum safeguard measures for uncompetitive sectors and rural areas through multi-layered formal and informal trade barriers, although they were largely exploited in favor of competitive, export-oriented sectors and urban areas.<sup>19</sup>

With the advent of civilian rule in 1993, the traditionally disadvantaged groups became better organized and louder, thus making it harder for the government to

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<sup>18</sup> Min Gyo Koo (2006), "From Multilateralism to Bilateralism? A Shift in South Korea's Trade Strategy," in Vinod K. Aggarwal and Shujiro Urata, eds., *Bilateral Trade Agreements in the Asia-Pacific: Origins, Evolution, and Implications*, London: Routledge: 142-143.

<sup>19</sup> For more discussions about South Korea's developmental state, see Amsden (1989) and Woo-Cumings (1999).

negotiate free trade deals that would adversely affect uncompetitive and import-competing industries. During the Uruguay Round (UR) of trade talks, for instance, the South Korean government made desperate efforts to protect rice and other agricultural and fishery products at the expense of consumers and South Korea's international reputation as a free trading country. The relatively short history of South Korea's industrialization since the 1970s means that many South Koreans still have their family roots and ties in rural areas despite large-scale migration to urban areas. Before the UR negotiation, agriculture had been excluded from the free trade debate, allowing South Korean agriculture to enjoy market protection. Under the UR agreement, however, South Korea had to agree to open its agricultural market.<sup>20</sup>

In the wake of the Asian financial crisis of 1997-98, the illusion of its unstoppable economic growth was severely shattered. Furthermore, as the 1999 WTO Ministerial Meeting in Seattle failed to launch a new round of trade talks, South Korea's

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<sup>20</sup> Yet South Korea received a ten-year exception to tariffication of rice imports in return for establishing a Minimum Market Access (MMA) quota. Under the MMA quota, South Korea's rice imports grew over ten years from zero percent to four percent of domestic consumption during the base period. The South Korean government, through state trading enterprises, exercised full control over the purchase, distribution, and end-use of imported rice. The original MMA arrangement expired at the end of 2004. However, South Korea successfully negotiated a ten-year extension of the MMA arrangement. South Korea has also established tariff-rate quotas (TRQs) that were intended to provide minimum access to previously closed markets or to maintain pre-UR access. In-quota tariff rates may be very low or zero, but the over-quota tariff rates for some products—such as natural and artificial honey, skim and whole milk powder, potato and potato preparations, and popcorn—are prohibitive. In order to protect domestic agricultural, fishery, and plywood producers, South Korea also uses “adjustment tariffs” and compounded taxes to boost applied tariff rates. For more details, see United States Trade Representative (USTR) (2006), *2006 National Trade Estimate Report on Foreign Trade Barriers*, Washington, D.C.: USTR..

top political leadership came to recognize that the mediocre performance of the WTO and increasing competition in its traditional export markets could hurt export-dependent South Korea.<sup>21</sup> In the immediate aftermath of the Asian financial crisis, South Korea's protectionist veto players such as labor unions and farmers' organizations were temporarily disorganized due to President Kim Dae-jung's (1998-2003) liberal reform and the International Monetary Fund (IMF)-imposed austerity program. Although some farmers' groups and labor unions remained militant, their political influence eroded significantly, as both their absolute and relative shares in the economy continued to decline.<sup>22</sup> Under President Kim's strong executive power and public support for liberal restructuring, the introduction of new FTA initiative went unchallenged, if not unnoticed, by traditional protectionist interests.

The Kim Dae-jung government took the initiative in shifting South Korea's policy focus away from its earlier position centered on the access to the U.S. market through global multilateralism and the protection of uncompetitive domestic industries.<sup>23</sup> In November 1998, the government's Inter-Ministerial Trade Policy Coordination Committee formally announced that South Korea would start an FTA negotiation with

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<sup>21</sup> Inkyo Cheong (1999), "Korea-Chile FTA: Economic Effects and Implications," *Journal of International Economic Studies*, 2(4); Chan-hyun Sohn (2001), "Korea's FTA Developments: Experiences and Perspectives with Chile, Japan, and the U.S.," a paper presented at a conference, "Regional Trading Arrangements: Stocktake and Next Steps," Trade Policy Forum, Bangkok, June 12-13.

<sup>22</sup> The share of agriculture, forestry and fisheries in South Korea's total employment decreased continuously from 17.9 percent in 1990 to 8.1 percent in 2004. The three sectors' share in South Korea's GDP was less than 4 percent in 2003 (Ministry of Finance and Economy of Korea (2005), *Economic Bulletin* 27(11), November 22).

<sup>23</sup> Koo (2009: 186-188)

Chile, while conducting feasibility studies with other prospective FTA partners such as the U.S., Japan, New Zealand, and Thailand.<sup>24</sup> Although the linkage between FTAs and domestic reforms was not clearly defined, Kim's FTA policy was largely designed as a liberal strategy to address the dire need for economic liberalization under the growing pressure of globalization.

#### **IV. The rise of South Korea's developmental liberalism**

In many respects, the policy shift toward FTAs under President Kim did mark a dramatic departure from South Korea's traditional embedded mercantilist policy. Yet, it was not until President Roh entered office in 2003 that the roadmap for FTAs and detailed action plans for its multi-track FTA strategy were completed.<sup>25</sup> In contrast to its rather peripheral status in President Kim's economic and strategic agenda, the FTA policy became a core element of President Roh's economic policy reform and regionalist vision. At a glance, the Roh administration inherited his predecessor Kim's economic policy agenda. If we look beneath the surface, however, Roh further expanded it by completing a roadmap for South Korea's multitrack FTAs, on the one hand, and adopting comprehensive side payments to adversely affected groups, on the other.

The nature and scope of South Korea's shift in trade policy focus under Roh is best illustrated by the KORUS FTA. At a first glance, the Roh administration's move

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<sup>24</sup> Chung (2003: 74); Sohn (2001: 7)

<sup>25</sup> Seungjoo Lee (2006), "The Political Economy of the Korea-U.S. FTA: The Korean Government's FTA Strategy Revisited," a paper presented at a spring 2006 convention of the Association of Korean Political and Diplomatic History, April 21 (in Korean); Ministry of Foreign Affairs and Trade of Korea (MOFAT) (2006), *Key Initiatives of Year 2006*, Seoul: The MOFAT.

toward the KORUS FTA came as a surprise because, according to its original FTA roadmap, an FTA with the U.S. was listed next to bilateral deals with Mexico and Canada in North America. Such an unequivocal change in the order of FTA partner selection meant an implicit but noticeable inclusion of, and emphasis on, strategic values of FTAs in South Korea's FTA equations. Of course, South Korea expected handsome economic gains from an FTA with the U.S. In particular, South Korea's top policy elites believed that an FTA with the U.S. would accelerate South Korea's market-oriented reform process and upgrade its economy, thus helping overcome the likely scenario of a Korea "sandwiched" between Japan and China.<sup>26</sup> On this score, South Korea's then trade minister, Kim Hyun-chong, was particularly enthusiastic. He made it no secret that the KORUS FTA would be an effective way of transforming the fundamental structure of Korean economy from a Japan-oriented developmental model to an American style liberal model.<sup>27</sup>

Ultimately, it was President Roh who made the final decision. He became a champion of FTA as a diplomatic tool to strengthen strategic ties with the U.S. President Roh supported Minister Kim's idea at the expense of his loyal constituents including progressive NGOs, labor unions, and farmer groups. He clearly understood the strategic nature of FTA. Equally important was the fact that Roh became a true

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<sup>26</sup> On various occasions, President Roh asserted: "China is surging. Japan is reviving. Trapped between China and Japan, South Korea desperately needs to develop a strategy to cope with current challenges. One of the most effective ways to accomplish this goal is to improve our country's competitive edge against China and Japan in the US market by concluding a KORUS FTA" (A presidential speech delivered to the Korea Chamber of Commerce and Industry on March 28, 2006, quoted in Koo 2009: 190).

<sup>27</sup> An interview with Minister Kim Hyun-chong, May 2009.

believer of free trade and market opening as a key to economic growth.<sup>28</sup> This was in stark contrast to his allegedly anti-American, progressive background. Amidst the controversy over the costs and benefits of the KORUS FTA, he openly identified himself as a “leftist liberal”—a “leftist” because he desired a self-reliant, nation-first (*minzok useon*) Korea, and “liberal” because he believed in the magic of free trade.<sup>29</sup> More notably, he rejected the flying geese pattern of development based on the Japanese model,<sup>30</sup> and insisted that such economic development strategy had already outlived its utility for South Korea. His assertion, instead, was that South Korea should find its economic future in service industries, departing from its traditional focus on manufacturing.<sup>31</sup> As noted in Section II, economic nationalism is critical for understanding the rise of developmental state approach in South Korea, although this time it took the form of liberalism rather than mercantilism.

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<sup>28</sup> An interview with Minister Kim Hyun-chong, May 2009.

<sup>29</sup> In the forum arranged for the 3<sup>rd</sup> anniversary of his inauguration on February 5, 2008, Roh argued: “some label me as leftist while others liberal. What is important is adopting necessary policies to our economy. In that sense, my government could be called leftist liberals.”

<sup>30</sup> The concept of “flying geese” was first used by Japanese economist Kaname Akamatsu (1937). Akamatsu found that the process of industrialization in the Japanese Empire in the 1920s and 1930s followed three stages: import of new products, import substitution, and export. This process appeared as an inverse “V” shape, resembling the wild flying geese migrating between Japan and Siberia. Akamatsu’s product cycle theory was used to justify the hierarchically organized division of labor in the “Greater East Asia Co-Prosperity Sphere.” For the adherents of the flying geese model, South Korea and Taiwan in the 1960s, and the later developers Thailand, Malaysia, and Indonesia in the 1990s, grew rapidly as a result of technology and process transfer through the investment and outsourcing of Japanese companies, as these companies followed low-cost production in the later stages of product cycles (Petri 1993; Yamazawa 1990).

<sup>31</sup> *Yonhap News*, August 9, 2006.

Institutionally, the empowerment of the Office of the Minister for Trade (OMT) demonstrated the renewed enthusiasm and commitment under Roh as the once beleaguered institution took firm roots within the government with its mission and mandate to initiate and negotiate FTAs.<sup>32</sup> As a champion of liberal economic ideas, the OMT is relatively insulated from the pressure from special interest groups, which in turn prevents this government agency from obtaining sufficient public support for FTAs.<sup>33</sup> Nevertheless, the top-down nature of South Korea's FTA initiative as promoted by the OMT indicates that its FTA strategy is inherently developmentalist in its tone and scope. In addition, its liberal leanings notwithstanding, Roh's FTA strategy in fact built upon the longstanding embeddedness of the state.

Under these circumstances, it is not surprising that South Korea's uncompetitive sectors felt more victimized by their government's FTA initiatives with potentially stronger liberal overtones. For those skeptics, the government's effort to restructure the economy by inviting external pressure, i.e. FTAs, would only worsen the issue of economic polarization in South Korea, rather than providing an opportunity to upgrade its

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<sup>32</sup> As a result of the 1998 government organization reforms that were intended to consolidate institutional support for President Kim's reform agenda, the OMT was formed under the Ministry of Foreign Affairs and Trade (MOFAT) (Koo 2006).

<sup>33</sup> OMT's neoliberal policy orientation was further highlighted by the appointment of its third Trade Minister, Kim Hyun-chong, in July 2004 as well as the promotion of its first Trade Minister Han Duk-soo (1998-2004) to the Deputy Prime Minister and Minister of Finance and Economy. For the critics of neoliberal economic policy as well as hardcore Korean nationalists, Trade Minister Kim was a bad choice not only because he advocates neoliberal economic policies, but also because he grew up in the U.S. and was trained as a U.S. lawyer, which allegedly undermines his nationalist credential.

economy to a more advanced level.<sup>34</sup> The debate surrounding the KORUS FTA illustrated the point. In contrast to their temporary disorganization during the Kim Dae-jung period, traditional protectionist groups under Roh Moo-hyun recovered from the shadow of financial crisis and began to work closely with anti-globalization NGOs and anti-capital labor unions. Some radicals even dubbed the implicit linkage of the KORUS FTA to neoliberal reforms meant “the second IMF-imposed liberalization.”<sup>35</sup>

As a result, the Roh administration was forced to combine generous side payments with its market opening commitments in order to cushion its citizens from the vagaries of the international economy in return for public support for openness. For instance, the ratification of the Korea-Chile FTA in February 2004 was followed by the passage of a special law designed to make up for the potential financial damages of farming and fishing industries due to FTAs. Despite criticism for the government’s excessive financial commitment to declining sectors, over \$80 billion of public and private funds have been earmarked for farming and fishing rescue programs over a 10-year period.<sup>36</sup>

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<sup>34</sup> Lee (2006: 6)

<sup>35</sup> The National Emergency Conference to Urge to Stop the Rushed Korea-US FTA Negotiation, “Appeal to the Korean People,” [Online, cited September 12, 2010]. Available from <[http://www.demos.or.kr/bbs/view.php?id=english&page=1&sn1=&divpage=1&sn=off&ss=on&sc=on&select\\_arrange=headnum&desc=asc&no=74](http://www.demos.or.kr/bbs/view.php?id=english&page=1&sn1=&divpage=1&sn=off&ss=on&sc=on&select_arrange=headnum&desc=asc&no=74)>

<sup>36</sup> See MOFAT, “Ja-yoo-moo-yuk-hyup-jeong che-gyul-eh dda-reun nong-eo-eop-in deung-eui jiwon-eh gwan-han teuk-byul-beop (rules regarding the special law to support farmers and fishermen as a result of FTAs),” [Online, cited September 12, 2010]. Available from <[http://www.fta.go.kr/pds/data/200407224131655\\_자유무역협정체결에따른농어업인등의지원에관한특별법시행규칙.pdf](http://www.fta.go.kr/pds/data/200407224131655_자유무역협정체결에따른농어업인등의지원에관한특별법시행규칙.pdf)>

Other examples include a series of side payment pledges in the form of government subsidies and grant-in-aid during the KORUS FTA negotiations. In March 2006, the Roh government pledged to provide the Korean movie industry with a government fund amounting to \$400 million instead of cutting South Korea's annual screen quota in favor of the U.S.<sup>37</sup> The Roh government also committed itself to provide cash allowances for seven years to compensate for up to 85 percent of income losses of farmers and fishermen once the KORUS FTA goes into effect. Aside from this, Korean farmers and fishermen would receive government subsidies for five years if they went out of business due to the KORUS FTA. Furthermore, to boost investment in agriculture, the Korean government promised to encourage the creation of private agricultural investment funds, and agriculture-related companies would be allowed to bring in CEOs from outside the industry. The government would also offer low-interest loans to businesses that lose more than 25 percent of their sales due to the KORUS FTA, while they are eligible for receiving subsidies of up to 75 percent of their payroll for one year if they switch into other industries or relocate their employees. The government

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<sup>37</sup> “su-ku-rin-quo-ta hu-sok dae-chaek sil-hyo geo-dul-kka (Will the post-screen quota measures be effective?),” *The Chosun Ilbo*, January 27, 2006. [Online, cited September 12, 2010]. Available from <[http://spn.chosun.com/site/data/html\\_dir/2006/01/27/2006012770343.html](http://spn.chosun.com/site/data/html_dir/2006/01/27/2006012770343.html)>. South Korea's screen quota system was designed to stem a flood of Hollywood blockbusters. South Korea cut the quota from 146 days or 40 percent reserved for domestic films to 73 days or 20 percent starting July 1, 2006 (“Screen Quota Cut Clears Way for Trade Deal with the US,” *The Chosun Ilbo*, January 6, 2006. [Online, cited September 12, 2010]. Available from <<http://english.chosun.com/w21data/html/news/200601/200601260013.html>>).

would provide cash incentives of up to \$600 a month to companies that hire farmers and fishermen who have been dislocated from their work.<sup>38</sup>

In sum, the multitrack FTA initiative of the Roh government adopted a developmental liberalism: greater trade openness in favor of internationally competitive sectors and generous side payments for potential losers from trade liberalization. Such a policy shift nicely captures a different kind of dualism—that is, proactivism when selecting FTA partners and embeddedness when garnering domestic political support. On the one hand, the OMT has institutionalized the idea of pursuing economic reforms and cementing strategic partnerships through FTAs. On the other hand, the success of its proactive negotiations has been achieved by social embeddedness consisting of generous compensation packages to support those who suffer damages from FTAs.

**Note: An analysis of Lee Myung-bak government in the wake of the global economic crisis is to be added in the next stage.**

## **V. Conclusion and policy implications**

In the field of international political economy and comparative politics, it has been vigorously debated whether or not globalization undermines national economic sovereignty, particularly social welfare policy. The puzzle is whether states remain autonomous and central in setting foreign economic and social welfare policy goals in a global network of transnational actors and institutions. Do increased participation at a distance and greater approximation of complex interdependence imply the end of

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<sup>38</sup> “Government to Pay Farmers, Fishermen for FTA Losses,” [Online, cited September 12, 2010].

*The Chosun Ilbo*, June 29, 2007. Available from

<<http://english.chosun.com/w21data/html/news/200706/200706290022.html>>.

politics? This paper investigated South Korea's embrace of FTAs that has illustrated the dramatic shift from embedded mercantilism to developmental liberalism in its trade policy orientation.

South Korea's dramatic embrace of FTA policy has largely been shaped by a top-down political initiative rather than a bottom-up societal demand. In that respect, it contains a developmental state characteristic. But it also incorporates liberal elements. The economic crisis of 1997-98 contributed to the rise of reform-minded Kim Dae-jung. In pursuit of his diplomatic and economic vision, President Kim was drawn to bilateral and minilateral FTAs, thus shifting South Korea's trade policy focus from global multilateralism to regional/cross-regional bilateralism and minilateralism. President Kim's grand regionalist vision and liberal economic reforms inspired President Roh Moo-hyun. Yet, in the face of South Korea's vocal protectionist interests, the Roh government chose to provide generous side payments to pacify them. As a result, South Korea's FTA initiative combines developmental embeddedness and liberalism.

If we broaden the geographical horizon to South Korea's giant neighbors, Japan and China, we can find a similar, if not uniform, pattern. Japanese political economy has undergone a fundamental regime shift since the 1990s, departing from its earlier position centered on embedded mercantilism. In the presence of a dualist Japanese economy of protected inefficient firms and highly competitive exporters, the game of winners and losers has become much more complicated than elsewhere in the world and the political cost of liberalizing the protected industries has been prohibitively high. Given the scale of Japan's economic troubles, the government has proceeded with a broad program of reform, a part of which is its FTA initiative. But politicians and

bureaucrats have sought to maximize the symbolic impact of reforms while still managing the liberalization process so as to minimize the harm to important domestic groups. As such, new policy equilibrium is emerging in Japan's pursuit of FTAs: developmental liberalism rather than embedded mercantilism or neoclassical liberalism.<sup>39</sup>

As in the case of South Korea and Japan, a top-down approach has characterized China's newfound interest in FTAs. While having been a vigorous global trader since the 1970s, it was not until recently that top political leaders in Beijing have begun pursuing FTAs vigorously with its trading partners, both usual and unusual. As with South Korea and Japan, China's FTA strategy contains both liberal and embedded developmental elements, albeit less conspicuously. Chinese leaders are increasingly recognizing that public support for economic liberalism hinges upon the willingness and ability of the government to mitigate the social effects of economic openness through trade adjustment and side payment measures.<sup>40</sup> South Korea's experience shows that

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<sup>39</sup> Steven K. Vogel (1999), "When Interests Are Not Preferences: The Cautionary Tale of Japanese Consumers," *Comparative Politics* 31(2): 187-207; T. J. Pempel and Shujiro Urata (2006), "Japan: A New Move toward Bilateral Trade Agreement," in Vinod K. Aggarwal and Shujiro Urata, eds., *Bilateral Trade Agreements in the Asia-Pacific: Origins, Evolution, and Implications*, London: Routledge; Mireya Solis and Saori Katada (2007), "The Japan-Mexico FTA: A Cross-Regional Step in the Path towards Asian Regionalism," *Pacific Affairs* 80(2): 279-302.

<sup>40</sup> For instance, a sticking point in the FTA negotiations between New Zealand and China was been dairy trade. China was concerned that the removal of dairy tariffs could harm its incipient dairy industry. The issue has profound political implications for China, particularly regarding the widening wealth gap between rural and urban areas. A major challenge to China has been the 'three rural problems'—peasants, agriculture, and rural areas. To remove dairy tariffs would run against Beijing's efforts to alleviate low incomes in the countryside (Stephen Hoadley and Jian Yang (2007), "China's Regional and Cross-Regional FTA Overtures: In Search for

the success of China's FTA initiatives may depend on how effectively devise side payment measures for those who are left behind in the global and regional rush toward FTAs.

To conclude, the developmental state model, and its embedded mercantilist variant, may not valid and will not serve well in the future. However, South Korea, and more broadly East Asian countries', social embeddedness persists in their top-down pursuit of FTAs. Although the right balance between embeddedness and laissez-faire policy may continue to evolve across time and space, this paper shows that the developmental liberalism is increasingly becoming an important feature of South Korea's trade policy.

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Comprehensive National Power," *Pacific Affairs* 80(2): 327-348).