

# Partisanship and South Korea's Trade Policy: New Soul Searching between Neo-developmentalism and Neo-liberalism\* \*\*

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## Abstract

South Korea's mercantilist trade policy traces back to its developmental period that started in the early 1960s and led to the successful story of export-oriented industrialization, often dubbed the "miracle on the Han River" in the 1970s. This study argues that it was a good example of developmental mercantilism. However, the political economic conditions, both external and internal, that underpinned South Korea's traditional trade policy paradigm came under heavy pressure at the end of the 1990s. Among other things, the outbreak of the Asian financial crisis of 1997-98 shattered the illusion of South Korea's unstoppable economic growth. South Korea's departure from its traditional, top-down trade policy centered on export promotion and import protection can be best illustrated by its active pursuit of FTAs.

**Key words:** trade policy, free trade agreement, developmental mercantilism, developmental liberalism, side payments

## I. Introduction

For the past two decades, South Korea has undergone fundamental transformation in its trade policy due to domestic partisan turnover in the government as well as an ever widening, ever deepening globalization. In an era of maturing democracy, the rapidly changing electoral and legislative dynamics has structured trade policy choices in South Korea. Underlying the structured choices are the difficult challenges confronting policymakers who now have to satisfy not only domestic constituents but also international communities including foreign governments and international organizations. South Korea's departure from its traditional, top-

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down trade policy centered on export promotion and import protection can be best illustrated by its active pursuit of free trade agreements (FTAs) with its trading partners, both small and large, and both geographically close and distant.

How electoral and legislative politics interact with South Korea's new trade policy strategy which seeks to strike a right balance between neo-developmentalism and neo-liberalism? How institutional configurations of domestic political players and the structure of international bargaining affect eventual policy choices? From 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 characterized by a policy mix of import protection and export promotion. Second, it 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 South Korea's liberal but state-centric nature, South Korea's unique partisan politics has led its FTAs to be 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 neoliberal economic goals in a political vacuum. South Korea's new FTA-centered trade policy is hardly insulated from societal pressures and electoral politics. South Korean policy elites have made it no secret that they intend to use FTAs to improve their country's industrial and economic competitiveness. At the same time, generous side-payments to those who may be disadvantaged by greater trade openness aptly illustrate the manner in which partisan politics has structured the dynamics between state elites and protectionist veto players, thus resulting in new policy equilibrium between liberalization and social protection.

This study aims to examine domestic and international sources of South Korea's dramatic shift from its mercantilist trade policy toward more liberal but still elite-driven strategy centered on FTAs. The remainder of this study unfolds as follows. Section II outlines the origins of South Korea's mercantilist trade policy from a historical perspective. Section III analyzes the transformation in South Korea's trade policy in an era of democratization and globalization. This section highlights that generous compensation measures designed for potential losers of free trade were an outcome of South Korea's unique partisan politics, which has structured the dynamics between trade policy elites and affected interest groups. Section IV summarizes the key argument and draws policy implications.

## **II. Origins of South Korea's mercantilist trade policy**

South Korea's mercantilist trade policy traces back to its developmental period that started in the early 1960s. In May 1961, a military coup led by General Park Chung-hee overthrew the fledgling democratic regime that had replaced Rhee Syngman's in the previous year. Park felt

a strong urge to improve his country's economic relations with Japan and the U.S. Among others, President Park realized that he could not delay the negotiations for normalizing South Korea's relations with Japan any longer and, in October 1962, sent his right hand man, Korean Central Intelligence Agency (KCIA) Director Kim Jong-pil, to Tokyo as a chief negotiator to conclude prolonged negotiations. To be sure, the path to the final agreement was not an easy one. In their second meeting in November, Kim and his Japanese counterpart, Foreign Minister Masayoshi Ohira, reached a secret agreement on the amount of a financial reparation package.<sup>1)</sup>

The 1962 Kim-Ohira secret agreement was a breakthrough in the stalemated talks, but left many problems. The diplomatic atmosphere between South Korea and Japan became dangerously charged with mutual suspicion when the Kim-Ohira memorandum was released in January 1963. In South Korea, the secretive manner in which Kim had handled the issue sparked public fear of a national sellout in return for Japan's economic aid or "gift for Korean independence," instead of "reparations" for Japan's past atrocities. The revelation touched off South Korean nationalism, leading to nationwide demonstrations against normalization talks (Koo 2009a: 74).

President Park had to contend with the public's growing sense of indignation. He sent Kim again in March 1964 to Tokyo as presidential envoy to resume the stalemated talks. The announcement in Tokyo that a treaty draft was imminent drew allegations in South Korea that Kim had secretly cut another deal with his Japanese counterparts by conceding South Korea's negotiating position in exchange for vast amount of Japanese funds for his own profit and ruling party coffers. Although Park removed Kim in the middle of the Tokyo negotiations, domestic protests continued to attack Kim's association with widespread corruption in the ruling Democratic Republican Party (DRP), in which Kim held the party chairmanship. In addition, factions developed within the ruling party between pro- and anti-Kim forces, threatening the stability of the entire government. The entire turmoil resulted in Kim's resignation from the DRP chairmanship in June 1964 and his departure for the U.S. on an extended leave of absence (Lee 1990: 169-70; Lee 1995b: 200-1; Cha 1996: 135).

Despite the complex domestic power dynamics, geopolitical conditions began to change dramatically towards South Korean-Japanese rapprochement. It is widely held that the U.S. created the necessary momentum for the conclusion of normalization treaty in 1965. Until 1963, the U.S. maintained a somewhat indifferent position towards the normalization talks. While reconciliation between Seoul and Tokyo would be beneficial to U.S. security interests in the region, the issue did not hold a high priority in Washington except among regional experts. By 1964, however, increasingly intense Cold War competition in East Asia prompted a significant

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1) The Kim-Ohira memorandum states: (1) Japan would pay \$300 million as a grant over the following ten years; (2) Japan would loan a further \$200 million, from the Overseas Economic Cooperation Fund, over the following ten years with a repayment schedule of twenty years at 3.5 percent interest deferred for seven years; and (3) Japan would arrange for private loans over \$100 million through its Ex-Im Bank (Lee 1995a: 124-5).

change in the U.S. approach.<sup>2)</sup> In face of growing regional uncertainties, a stable relationship between America's two major allies, South Korea and Japan, became the highest priority. Against this backdrop, the U.S. began to strongly push for a conclusion of prolonged normalization negotiations. America's hegemonic position certainly assured that potential bilateral tensions between South Korea and Japan took place within certain confines. U.S. President Lyndon Johnson reiterated his unconditional backing of a South Korea-Japan settlement and its importance not only for the two countries, but also for the anticommunist front in East Asia. Johnson also confirmed in conversations with Park that American military and economic assistance to South Korea would remain intact after normalization (Lee 1995b: 249-50, 351-2; Cha 1996: 131-5, 141).

Aside from the realities of the Cold War containment network and the overriding demands of alliance politics, the high priority given to a stable economic relationship motivated both South Korea and Japan to normalize their bilateral relations. In particular, the Park government faced a near-desperate situation as the first five-year development plan (1962-66) failed to overcome persistent economic troubles of poverty and low development. A steady decline in U.S. economic aid further exacerbated the grim situation, as it reached a sixteen-year low in 1965. President Park decided to "live or die" with the normalization issue. South Korea's *chaebol* also lobbied strongly for normalization. Especially appealing to these groups was the prospect of acquiring Japanese technology and manufacturing capabilities in industries vacated by Japan's ascension up the product cycle. In government white papers for 1965 and numerous public statements, the Park government stressed the pragmatic need to overcome historical animosities and to normalize ties with Japan (Lee 1990: 170-1; Cha 1996: 128-9).<sup>3)</sup>

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2) In the early 1960s, the Chinese communist threat loomed large. Beijing's geopolitical divorce with Moscow, its signing of a mutual defense treaty with North Korea (1961), and its support for Southeast Asian communist movements strongly indicated to U.S. policymakers that an Asian communist front was being consolidated. China's successful nuclear tests in October 1964 and May 1965, coincided with its aggressive rhetoric on Taiwan, further exacerbated threat perceptions in the rest of the region. The security outlook in Southeast Asia appeared even less promising. In April 1965m U.S. commitments to a deteriorating situation in Indochina became much more complicated with the decision to send U.S. troops into the conflict (Cha 1996: 131-42).

3) In Japan, political elites were aware of their strengths concerning South Korea's desperate economic needs. Prime Minister Sato and the elder LDP politicians, particularly former Prime Minister Kishi, decided to take full advantage of a strong but relatively pro-Japan Korean dictator to accelerate the negotiation process (Lee 1990: 169-70). Voices within the Ministry of Foreign Affairs (MOFA) also pressed strongly for a settlement. As a 1965 MOFA White Paper noted, the re-establishment of ties with South Korea was a "historical inevitability" and Park's urgent need for foreign capital and political legitimacy offered relatively low cost for a normalization agreement with South Korea. The Sato government faced additional pressure from the powerful Japanese business lobby. South Korea was becoming an increasingly important export market for Japan. Park's second five-year plan (1967-71) would offer Japanese firms a plethora of large-scale projects, all of which could be underwritten by the financial package to be followed by normalization settlement (Bridges 1993: 32-3; Cha 1996: 129-30).

Foreign Ministers Etsusaburo Shiina and Lee Tong-won finally signed the Treaty on Basic Relations and four other agreements in Tokyo on June 22, 1965. The normalization treaty provided a fledgling South Korean economy with much-needed foreign capital: an \$845 million package of government and commercial loans, grants-in-aid, and property claims. The treaty also cleared the way for an extensive expansion of trade relations that helped Japan to surpass the U.S. as South Korea's number one trading partner within just a year. Also, South Korea became increasingly important to Japan as its market grew to import a greater quantity of Japanese goods (Cha 1996: 124). During the period of 1961-65, South Korea's exports to Japan increased from \$19 million to \$44 million, while its imports increased from \$69 million to \$167 million. As a result, South Korea's trade dependence on Japan as a share of its GDP jumped from 3.77 percent to 6.98 percent. Although the conclusion of the normalization treaty stood on somewhat shaky ground, it was certainly a big step forward towards the restoration of amicable relations. On top of the overriding demands of alliance politics at the height of the Cold War, the high priority given to a stable economic relationship motivated both South Korea and Japan to make the conscious choice to normalize their diplomatic relations (Koo 2009a: 77-8).

South Korea's dramatic economic takeoff resulted from export-oriented industrialization (EOI) together with heavy protectionism under the auspices of America's Cold War strategy. Following in the footsteps of Japanese developmental model, South Korea's active promotion of the export sector allowed the once reclusive country 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 (Koo 2006: 142-3). In the political vacuum left by the assassination of President Park in October 1979, General Chun Doo-hwan (1980-88) seized power through a military coup, which overthrew the interim government in December 1979, and had himself elected as president in August 1980. The Chun administration and his successor, Roh Tae-woo (1988-93) continued to take an EOI strategy.<sup>4)</sup>

The story of South Korea's successful export-oriented industrialization, often dubbed the "miracle on the Han River," is a good example of developmental mercantilism.<sup>5)</sup> The institutional

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4) In the 1980s, South Korean GDP grew rapidly at an average rate of 8.6 percent. In particular, the three year period of 1986-88 witnessed an unprecedented economic boom with an average GDP growth rate of 10.8 percent thanks to the so-called Three Low's (low oil prices, a low yen, and a low exchange rate). South Korea experienced trade surpluses for the first time with a three year total of \$18 billion. Its trade dependence on Japan remained significant at double digits throughout the 1980s although its trade deficit against Japan fell from the peak of \$5.4 billion in 1986 to \$3.8 billion in 1988. Deeper bilateral economic relations were reinforced by the rise of government aid and FDI, particularly after the 1985 Plaza Accord that pushed the value of the yen to nearly double its value against the U.S. Dollar (Bridges 1993: 102-3).

5) In his analysis of the regime shift in Japan, T. J. Pempel demonstrated 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 such a perspective, the political tensions that had divided postwar Japan were

marriage of developmentalism and mercantilism quickly spread throughout the country. It was brokered by the social embeddedness of industrial and trade policies.<sup>6)</sup> The South Korean developmental state successfully managed to industrialize and expand the national economy at a pace that could attract almost all economically motivated citizens. Its policy focus was on creating jobs and improving incomes as rapidly as possible. Yet it clearly lacked the comprehensive social security system found in the West (Chang 2007: 67). As elsewhere in the world, South Korea's societal interests have been divided along sectoral lines between competitive and uncompetitive industries, while the relative scarcity of land has made the urban-rural cleavage a permanent feature of the country's political economy. Although the South Korean government made some efforts to establish a comprehensive social protection system, its social welfare policies predominantly consisted of social insurance programs: People were required to pay contributions prior to entitlement to social benefits. As a result, only those who had formal employment had access to social protection, leaving those who were self-employed or informally employed outside the system. The social policies in the early developmental period were geared for economic development and covered only a narrow section of the population. Against this background, South Korea's developmental state provided minimum safeguards for uncompetitive sectors and rural areas through multilayered formal and informal trade barriers, although they were largely exploited in favor of competitive, export-oriented sectors and urban areas (Koo 2010).

With the advent of civilian rule in 1993, traditionally disadvantaged groups became better organized and more vocal, thus making it even harder for the government to 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 of 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 roots in rural areas despite large-scale migration to urban areas. Before the UR negotiation, agriculture had been completely excluded from the free trade debate. Although South Korea had to agree to open its agricultural market under the UR agreement, its sensitive agricultural sectors such as rice and dairy remained largely outside

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substantially reduced not through Keynesianism, inflation, or corporatism, but through rapid growth that relied on domestic protection, industrial policy, and export promotion. The resultant conservative regime that emerged in Japan in the 1960s looked distinctly different from those of other advanced industrialized democracies (Pempel 1998: 5-10).

- 6) 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. In this respect, "developmental mercantilism" is closely associated with "embedded mercantilism." For more discussions about South Korea's developmental state, see Amsden (1989) and Woo-Cumings (1999).

the global competition.<sup>7)</sup>

### III. Democratization, partisanship, and policy transformation

The political economic conditions, both external and internal, that underpinned South Korea's traditional trade policy paradigm came under heavy pressure at the end of the 1990s. Among other things, the outbreak of the Asian financial crisis of 1997-98 shattered the illusion of South Korea's unstoppable economic growth. In addition, the 1999 World Trade Organization (WTO) Ministerial Meeting in Seattle failed to launch a new round of trade talks, thus making South Korea's top policymakers recognize that the mediocre performance of the WTO and increasing competition in its traditional export markets could hurt export-dependent South Korea (Cheong 1999; Sohn 2001).

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 austerity program imposed by the International Monetary Fund (IMF) (Chang 2007: 69). 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>8)</sup> It became clear that developmental mercantilism alone was not able to cope with the unprecedented economic hardships. In response to the financial and economic turmoil, the Kim government implemented the so-called IMF reforms, which substantially altered Korea's development path.

Some scholars believe that these reforms led to the demise of "Korea, Inc.," the symbiotic relationship between government and business that was at the heart of the country's developmental state (Lee and Han 2006). Even with changes, however, the reform process reflected the legacies of the developmental state, with the state still playing an important role in planning, implementing, and sustaining economic reforms (Lim 2010). Under President Kim's strong executive power and public support for liberal restructuring, the new FTA initiative went unchallenged, if not unnoticed, by traditional protectionist interests. The Kim government

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7) Under the UR agreement, South Korea received a 10-year exception to tariffication of rice imports in return for establishing a Minimum Market Access quota. Under this quota, South Korea's rice imports grew over 10 years from 0 percent to 4 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 Minimum Market Access arrangement expired at the end of 2004, but South Korea successfully negotiated a 10-year extension. South Korea also established tariff-rate quotas that were intended to provide minimum access to previously closed markets or to maintain pre-UR access (United States Trade Representative 2006).

8) 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 (MOFE 2005).

took the initiative in shifting South Korea's policy away from its earlier focus on access to the U.S. market through global multilateralism and the protection of uncompetitive domestic industries (Koo 2009b: 186-8). In November 1998, the government's Inter-Ministerial Trade Policy Coordination Committee announced that South Korea would start FTA negotiations with Chile, while conducting feasibility studies with other prospective FTA partners such as the United States, Japan, New Zealand, and Thailand (Sohn 2001).

Although the link 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. This liberal shift of the state was an integral part of its resuscitated developmentalism focused on export industries. The Kim administration wanted to ensure the survival of most of South Korea's major export firms, but at the same time clearly understood that post-crisis external conditions would not allow South Korea to free-ride on others' market any longer. It was the beginning of an irreversible transformation of South Korea's trade policy paradigm (Koo 2010).

The policy shift toward FTAs under President Kim did mark a dramatic departure from South Korea's developmental mercantilist policy. Yet it was not until President Roh entered office in 2003 that the road map for FTAs and detailed action plans for its multitrack FTA strategy were completed (Lee 2006; MOFAT 2006). In contrast to its rather peripheral status on 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 first glance, it appears that Roh inherited his predecessor Kim's economic policy agenda. If we look beneath the surface, however, Roh further expanded it by completing a road map for South Korea's multitrack FTAs and adopting comprehensive side payments to adversely affected groups.

The nature and scope of South Korea's shift in trade policy focus under Roh is best illustrated by the KORUS FTA. Initially, the Roh administration's move toward the KORUS FTA came as a surprise because, according to its original FTA road map, a comprehensive FTA with a large economy like the United States was a long-term goal, while deals with light trading partners such as Chile, Mexico, and Canada had top priority. This change in the sequence of FTA partner selection meant an implicit but noticeable emphasis on strategic value in South Korea's FTA equations. Certainly, South Korea expected handsome economic gains from an FTA with the United States. South Korea's top policy elites believed that an FTA with the United States 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>9)</sup> On this score, South Korea's then trade minister, Kim Hyun-chong,

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9) In a speech to the Korea Chamber of Commerce and Industry on March 28, 2006, 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 U.S. market by concluding a KORUS FTA" (quoted in Koo 2009b: 190).



was particularly enthusiastic. He made it no secret that the KORUS FTA would be an effective way to transform the structure of the Korean economy, departing from its replication of the Japanese developmental model and adopting an American-style liberal economy (interview with Minister Kim Hyun-chong, May 2009, quoted in Sohn and Koo 2011).

Ultimately, President Roh made the final decision. He became a champion of the FTA as a diplomatic tool to strengthen strategic ties with the United States. President Roh supported Minister Kim's ambitious idea at the expense of his loyal constituents, including progressive civil groups, labor unions, and farmer groups. He clearly understood the strategic utility of the FTA. Equally important was the fact that Roh became a true believer in free trade and market opening as a key to economic growth (interview with Minister Kim Hyun-chong, May 2009, quoted in Sohn and Koo 2011). This was in stark contrast to his supposedly anti-American, populist background. Amidst the controversy over the costs and benefits of the KORUS FTA, he publicly identified himself as a "leftist liberal"—leftist because he desired a self-reliant, nation-first (*minzok useon*) Korea, and liberal because he believed in the power of free trade.<sup>10)</sup> More notably, he rejected the Japanese "flying geese" model of development,<sup>11)</sup> saying that it had already outlived its utility for South Korea. His assertion, instead, was that South Korea should find its economic future in high-tech and service industries, shifting away from its traditional focus on heavy manufacturing. Economic nationalism was critical to the rise of the developmental state approach in South Korea, although this time it took the form of liberalism rather than mercantilism.

Institutionally, the empowerment of the Office of the Minister for Trade (OMT) emonstrated renewed enthusiasm and commitment under Roh as the once beleaguered institution took firm root within the government with its mandate to initiate and negotiate FTAs.<sup>12)</sup> As a champion of liberal economic ideas, the OMT is relatively insulated from pressure from special interest groups, which in turn prevents it from obtaining sufficient public support for FTAs.<sup>13)</sup>

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10) In the forum arranged for the third anniversary of his inauguration on February 5, 2008, Roh argued: "Some label me as leftist, others liberal. What is important is adopting necessary policies for our economy. In that sense, my government could be called leftist liberals."

11) 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 flight pattern of 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-Prosperty Sphere. Later 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 (Yamazawa 1990).

12) As a result of the 1998 government organization reforms, which were intended to consolidate institutional support for President Kim's reform agenda, the OMT was formed under the Ministry of Foreign Affairs and Trade (Koo 2006, 148).

13) OMT's neoliberal policy orientation was further highlighted by the appointment of its third trade minister,

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 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, the FTAs, would only worsen the economic polarization in South Korea, rather than providing an opportunity to upgrade its economy to a more advanced level (Lee 2006: 6). 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 "the second IMF-imposed liberalization" (National Emergency Conference 2007). This observation confirmed the findings in the broader literature on post-crisis economic reforms in South Korea.<sup>14)</sup>

As a result, the Roh administration was forced to combine generous side payments with its market opening commitments in order to cushion citizens from the vagaries of the international economy in return for public support for openness. Many FTA-related side payments were pledged by the Roh and Lee governments. Among others, the ratification of the Korea-Chile FTA in February 2004 was followed by the passage of a special law designed to make up for its potential financial damage to the farming and fishing industries. Despite criticism of 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 (MOFAT 2004). Other examples include a series of pledged side payments in the form of government subsidies and grants-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 as compensation for cutting South Korea's annual screen quota in favor of the United States.<sup>15)</sup> The Roh government also committed itself

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Kim Hyun-chong, in July 2004, as well as the promotion of its first trade minister, Han Duk-soo (1998-2004), to 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 advocated neoliberal economic policies, but also because he grew up in the United States and was trained there as a lawyer, which, they argued, undermined his nationalist credentials (Koo 2009: 189).

14) For instance, Lim (2010) found that the relationships among politics, bureaucrats, and interest groups have been altered so that interest groups' relative power has been strengthened vis-à-vis politicians and bureaucrats in the fields of manufacturing, information technology, and finance.

15) South Korea's screen quota system was designed to stem a flood of Hollywood blockbusters. South Korea originally had a quota of 146 days or 40 percent reserved for domestic films; this was cut to 73 days or 20 percent starting July 1, 2006 (*Chosun Ilbo* 2006a, 2006b).

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.<sup>16)</sup>

The conservative Lee Myung-bak administration, which took office in February 2008, has made a dramatic break with the progressive policies of the preceding 10 years. The FTA strategy is one of the few areas in which the Lee administration has followed in the footsteps of its predecessors. Despite huge political adjustment costs due to the U.S. beef imports controversy in the first half of 2008,<sup>17)</sup> the Lee administration has remained committed to the multitrack FTA strategy originally designed by the Roh administration. On December 3, 2010, the South Korean and U.S. governments reached an agreement to modify the KORUS FTA by resolving bilateral differences over beef and automobile issues. During the additional negotiations held in Columbia, Maryland, from November 30 to December 3, 2010, South Korea made additional concessions to the U.S. in the automobile sector, while gaining American concessions in the areas of beef, pork, pharmaceuticals, and visas. The conclusion of FTA deals with major economies like India and the EU during Lee's presidency also proves the point. At the ceremony for the conclusion of Korea-EU FTA negotiations on July 13, 2009, President Lee expressed his hope and belief that South Korea's lagging service industry would benefit from freer trade with the EU as a powerhouse of the global service industry, accounting for 46.5 percent of global trade in services (*Chosun Ilbo* 2009).<sup>18)</sup>

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16) To boost investment in agriculture, the Roh 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 Roh government would also offer low-interest loans to businesses that lose more than 25 percent of their sales due to the KORUS FTA, and make them eligible for subsidies of up to 75 percent of their payroll for one year if they switch to another industry or relocate their employees. The government also pledged to provide cash incentives of up to \$600 a month to companies that hire farmers and fishermen who have been dislocated from their work (*Chosun Ilbo* 2007).

17) In April 2008, the Lee administration announced that it would lift the ban on the importation of American beef, supposedly the final barrier to the ratification of the KORUS FTA. Imports of American beef had been virtually halted since 2003 after the detection of mad cow disease in the United States. The Bush administration claimed that it had resolved the disease problem and that U.S. beef was now safe to consume. Key U.S. lawmakers signaled that ratification of the KORUS FTA thus hinged on the lifting of the South Korean ban. The announcement that U.S. beef imports would resume, with some restrictions on the types of meat that would be allowed, sparked a series of mass demonstrations across South Korea. This seriously damaged the legitimacy of the then new Lee administration (Hundt 2008: 508-9). As large scale candlelight demonstrations and protests, along with anti-FTA sentiments, flared up, in June 2008, the government had to postpone its announcement on the safety conditions of U.S. beef import. President Lee also reversed his previous stance against renegotiations, announcing that "if it is the wish of the people then we will not import beef from cattle over 30-months-old." On June 21, 2008, the Korean and U.S. governments confirmed a voluntary private sector arrangement that excluded import of beef from cattle over 30-months-old, as well as beef product from brains, eyes, spinal cord and cranial bones of cattle (Jurenas and Manyin 2010: 8).

To summarize, the multitrack FTA initiative of the Roh and Lee governments adopted developmental liberalism: greater trade openness in favor of internationally competitive sectors and generous side payments for those who might be hurt by trade liberalization. The Roh and Lee governments envisaged the KORUS FTA as a means for South Korean firms to benefit from the economies of scale which access to the U.S. market would allow and thus to upgrade their competitive edge. In what has been dubbed a version of new industrial policy, South Korean firms could thus compete with their Chinese and Japanese counterparts (Woo 2007: 126-7). 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. Even with these changes, the most important feature of South Korea's FTA strategy is that the reform process continues to reflect the legacies of the developmental state, with the state still playing an important role in planning, implementing, and sustaining economic reform.

#### **IV. Conclusion and policy implications**

South Korea's mercantilist trade policy traces back to its developmental period that started in the early 1960s and led to the successful story of export-oriented industrialization, often dubbed the "miracle on the Han River" in the 1970s. This study argues that it was a good example of developmental mercantilism. However, the political economic conditions, both external and internal, that underpinned South Korea's traditional trade policy paradigm came under heavy pressure at the end of the 1990s. Among other things, the outbreak of the Asian financial crisis of 1997-98 shattered the illusion of South Korea's unstoppable economic growth. South Korea's departure from its traditional, top-down trade policy centered on export promotion and import protection can be best illustrated by its active pursuit of FTAs. South Korea has led the race toward FTAs in East Asia since it concluded the first cross-Pacific free trade deal with Chile in 2002. This trend took its most pronounced turn when South Korea concluded an FTA with

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18) The continuity of the FTA strategy can be traced to the Lee administration's grand foreign policy goals. With the slogan Global Korea, President Lee has urged his people to practice not just passive liberalization but ever more proactive globalization. He has thus increased South Korea's foreign assistance, encouraged internationalization among its people, demanded that Seoul become a hub international city, and sought to be a more active participant in global governance mechanisms such as the G-20. Since his electoral victory in December 2007, Lee has been promoting "global" projects and emphasizing inward foreign investment. Indeed, Global Korea has become a centerpiece of Lee's foreign policy initiative, both domestically and internationally (Lee and Hewison 2010).

the world's largest economy, the United States, in 2007. The global economic crisis of 2008-09 has not reduced the speed or scope of South Korea's FTA initiative, as demonstrated by the conclusion of trade agreements with India in 2009 and the European Union in 2010. The tale of South Korea is particularly intriguing because the country has not only been one of the principal beneficiaries of postwar multilateral trading regimes, but has also been criticized for its allegedly protectionist policies.

From 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 characterized by a policy mix of import protection and export promotion. Second, it has been shaped by a top-down political initiative rather than a bottom-up demand from business groups and the general public. South Korea's dramatic embrace of FTA policy thus 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. And finally, despite South Korea's liberal but state-centric nature, South Korea's unique partisan politics has led its FTAs to be closely embedded in the country's social fabric, both competitive and uncompetitive. 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. Such a paradigm shift remains the main feature of the incumbent Lee administration.

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

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