

# 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 free trade agreement (FTA) initiative, departing from its traditional focus on developmental mercantilism. In the wake of the global economic crisis of 2008-09 and the subsequent expansion of government interventionism across the world, the developmental state model has attracted renewed scholarly attention. It offers a useful conceptual framework to examine how a particular set of arrangements between the competitive and uncompetitive sectors in South Korea has shifted from developmental mercantilism to developmental liberalism. South Korea's FTA initiative constitutes a notable policy shift to liberalism, departing from a mercantilist approach with a policy mix of import protection and export promotion. It has been shaped by a top-down political initiative rather than a bottom-up demand from business groups and the general public. Despite South Korea's liberal but state-centric nature, its FTAs are closely embedded in its social fabric.

**Keywords:** developmental mercantilism, developmental liberalism, industrial policy, free trade agreement

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## INTRODUCTION

South Korea has led the race toward free trade agreements (FTAs) in East Asia since it concluded the first cross-Pacific free trade deal with Chile in 2002.<sup>1</sup> This trend took its most pronounced turn when South Korea concluded an FTA with 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 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 (Koo 2009).

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 light 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 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 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, its 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 neoliberal economic goals in a political vacuum. South Korea's new FTA-centered trade policy is hardly insulated from societal pressures. 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 the dynamics between state elites and protectionist veto players have resulted in a new policy equilibrium between liberalization and social protection.

The developmental state debate provides a natural starting point for an analysis of

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1. For more details about the proliferation of East Asian FTAs at the turn of the new millennium, see Aggarwal and Koo 2005, Aggarwal and Urata 2006, Dent 2006, Katzenstein and Shiraiishi 2006, Lincoln 2004, Pempel 2004, and Solis, Stallings, and Katada 2009.

mercantilist trade policies once prevalent in South Korea, and the nature of the 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 state and market (Chang 2007; Dittmer 2007; Ha and Lee 2007; Lee and Han 2006). Yet in the wake of the global economic crisis of 2008-09 and the subsequent expansion of government interventionism across the world, the developmental state model has attracted renewed scholarly attention (Lim 2010; Stubbs 2009).

It is too early to tell whether the return of the 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 competitive and uncompetitive sectors in South Korea (and more broadly in East Asia) has shifted from developmental mercantilism (or embedded mercantilism in T.J. Pempel's term) to developmental liberalism.

The next section of this article surveys the conceptual and empirical background of developmental mercantilism and developmental liberalism in the context of the growing pressure of globalization. The following two sections analyze how and to what extent South Korea has embedded developmental liberalism in its FTA initiative, departing from its traditional focus on developmental mercantilism. The final section summarizes the main argument and findings and draws broad regional implications.

## **DEVELOPMENTAL MERCANTILISM, THE 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 explanations for the economic success of East Asia. Linked to Gerschenkronian theories of late development (Gerschenkron 1962), 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 the plan-rational

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2. 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 (Johnson 1999, 40).

developmental state model argue that the East Asian states have been successful because they have acquired control over a variety of factors critical to economic success such as capital, national economic planning, scarce resources, industrial policies, and political insulation (Amsden 1989; Johnson 1982; Pempel 1999; Wade 1990; Woo-Cumings 1999).

Understanding 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 as they attempted to catch up with the economic development of the West. In his analysis of the regime shift in Japan, 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 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).

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>3</sup>

In particular, Peter Evans uses the term "embedded 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

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3. In his seminal work *The Great Transformation*, Polanyi (2001 [1944]) argued that West European capitalism in the nineteenth century was characterized by economic liberalism and social protection against economic dislocation. Yet, according to him, the political-economic meltdown in the early twentieth century can be attributed to the undirected, too rapid socio-economic change wrought by the "self-regulating market" or "laissez-faire liberalism." Ruggie (1982) used the term "embedded liberalism" to characterize the post-World War II Western economic system. This system promoted and institutionalized liberalism, but at the same time allowed individual states autonomy in domestic economic affairs—for example, to establish social welfare programs that cushioned their citizens from the vagaries of the international economy in return for public support for trade openness.

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 and by assisting in the emergence of new social groups and interests (Evans 1995). From this viewpoint, 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>4</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 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 that 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 and can 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 neoclassical liberalism and trade liberalization (Hall and Soskice 2001; Strange 1996).

Following the unprecedented economic success of the previous decades, the late 1990s provided a painful litmus test for the validity and utility of East Asia's developmental mercantilism. In the wake of the Asian financial crisis, the illusion of the East Asian economic miracle was shattered. The developmental state model was now called corrupt crony capitalism, vulnerable to moral hazards. 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 came to corporate governance, at the center of which was the fad for marketization and financialization (Dore 2000).

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4. More specifically, the colonial experience and existence of communist enemies allowed the South Korean government to dominate society 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).

More importantly, many Western countries, particularly the United States, became less tolerant of East Asian countries' mercantilist policy. Under the rubric of fair trade or the level playing field, the United States aggressively demanded an "asymmetrically reciprocal" opening of East Asian markets.<sup>5</sup>

South Korea's FTA strategy was primarily a response to this 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 or minilaterally. Unlike the traditional multilateral mechanism of the GATT/WTO (General Agreement on Tariffs and Trade/World Trade Organization), FTAs between partners of unequal or asymmetric bargaining powers often make it less likely that one partner will get a free ride on the other's market, as illustrated by substantial concessions given by South Korea (or Mexico) to the United States to conclude an FTA (Aggarwal and Urata 2006). Nevertheless, the South Korea-U.S. FTA (KORUS FTA) clearly shows that the fear of exclusion from the U.S. market played a significant role in South Korea's decision to start FTA negotiations with the economic superpower despite serious concerns about that country's dominant position in the global economy.

In addition, the structural changes that followed the Asian financial crisis contributed significantly to a growing belief that bilateral and minilateral liberalism is not only complementary to multilateral liberalism but also a crucial element of economic survival. The crisis effectively gave the South Korean government broad public tolerance for executive initiative for a more liberal trade policy. The economic crisis muted the country's once rigid protectionist voices in favor of liberal economic policy reform including the FTA initiative (Koo 2009; Mo 1999; Mo and Moon 2003).

Under these circumstances, the speed and scope of South Korea's FTA initiative has been truly remarkable (see table 1). South Korea has thus far concluded eight FTAs—with Chile, Singapore, the European Free Trade Association, the Association of Southeast Asian Nations (ASEAN), the United States, India, Peru, and the European Union (EU). If all of these eight agreements were fully implemented, over 38 percent of South Korea's total trade would be covered by a bilateral or minilateral FTA. Most notably, South Korea is the only country that has concluded bilateral or minilateral FTAs with three major economies among its top five trading partners. These partners,

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5. "Asymmetric reciprocity" advantageously opens markets for U.S. traders and investors, while rewarding and supporting domestic market-oriented reformers and advancing democratic institutions, an agenda that the Bush administration began to pursue at the turn of the new millennium (Feinberg 2003). For the interplay of free trade and fair trade ideas in American trade policy decision-making, see Goldstein 1988.

in order of significance, are China, ASEAN, the EU, Japan, and the United States. South Korea has also been negotiating FTAs with Japan, Canada, Mexico, New Zealand, Australia, Colombia, Turkey, and the Gulf Cooperation Council. In addition, feasibility studies are under way with China, South Africa, Russia, Mercosur, Vietnam, and many other countries.

**Table 1.** South Korea's Multitrack FTAs

Geographically concentrated FTAs	
Bilateral	Minilateral
Japan (10.81%, negotiations since 2003)* China** (24.85%, under study)	Japan and China (35.66%, under study)
Geographically dispersed FTAs	
Bilateral	Minilateral
Chile (0.88%, 2003, 2004) Singapore (3.51%, 2005, 2006) United States (9.81%, 2007, pending) India (1.50%, 2009, 2010) Peru (0.20%, 2010, pending) Canada (1.13%, negotiations since 2005) Mexico (1.14%, negotiations since 2006) Australia (2.61%, negotiations since 2009) New Zealand (0.23%, negotiations since 2009) Colombia (0.17%, negotiations since 2009) Turkey (0.47%, negotiations since 2010) South Africa (0.47%, under study) Russia (2.28%, under study) Israel (0.22%, under study) Vietnam (0.96%, under study)	European Free Trade Association (0.64%, 2005, 2006) ASEAN (10.93%, 2005-2009***) EU (11.06%, 2010, pending) Gulf Cooperation Council (9.60%, negotiations since 2008) Mercosur (1.40%, under study)

Source: IMF 2009.

\* Percentages indicate the value of trade as a portion of South Korea's total trade (export and import) in 2008. The figures after the percentages indicate the year of signing and the year the agreement came into force.

\*\* Includes Hong Kong.

\*\*\* Korea has the following agreements with ASEAN: framework agreement on comprehensive economic cooperation, signed in 2005; agreement on trade in goods, signed in 2006 and came into force in 2007; agreement on trade in services, signed in 2007 and came into force in 2009; agreement on investment, signed in 2009 and came into force in 2009.

It would be a mistake to equate South Korea's turn toward FTAs with a blind pursuit of neoliberal trade liberalization. At first glance, the embrace of FTAs indicates that South Korea's mercantilist trade policy, and its developmental state model more broadly, have outlived their 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 United States—initially prompted a mercantilist outcry that it would serve only neoliberal interests.<sup>6</sup> 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 losses resulting 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 a vertical or sectoral industrial policy, as opposed to a horizontal or genuinely interventionist policy. Yet the latest global recession has induced serious skepticism about neoliberal policy prescriptions and opened a renewed debate about the role of the state in development. In major economies, industrial policy is now back in fashion. 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 of Japan announced a strategy to combat the “increasingly aggressive” industrial policies of the United States, the United Kingdom, China, France, Germany, and South Korea (Economist 2010a). The universal race to create green jobs is a good example. Led by China and America, support for green technology is rapidly becoming one of the biggest industrial-policy efforts ever (Economist 2010b). All these countries have also been active in pursuing FTAs as their most important trade policy initiative.

Although it is still too early to tell whether this new fashion in industrial policy can be characterized as developmental liberalism, many East Asian scholars agree that East Asia's developmental states are today less autocratic, more globalized, and less blatantly corrupt, but no less powerful (Dittmer 2007, 833). The following two sec-

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6. For instance, during the final stage of bilateral negotiations in March 2007, a coalition of vocal anti-globalization and anti-American civil groups in Korea issued the following statement with crisis overtones: “The victims of the blindfold opening are 47 million Koreans. We the people should come forward to stop the Korea-US FTA, the second financial crisis. The Korea-US FTA is the second IMF crisis to bring us to even further economic polarization. A ‘high-level inclusive FTA’ as admitted by the Korean government will cause a sweeping social and economic ‘Americanization.’ Opening without proper preparation will only worsen Korean society's polarization, weaken Korean industry's competitiveness, and deprive Korean people of their right to choice for public service fit for Korea” (National Emergency Conference 2007).

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

## **THE FALL OF DEVELOPMENTAL MERCANTILISM IN SOUTH KOREA**

Since its dramatic economic takeoff 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 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, 142-43).

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>7</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.<sup>8</sup>

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7. For more discussions about South Korea's developmental state, see Amsden 1989 and Woo-Cumings 1999.

8. Kwon (2005) defined such a welfare system as the "developmental welfare state," which is compatible with this author's conceptualization of developmental mercantilism. In a similar vein, Chang (2007, 68) characterized South Korea's pre-crisis political economy as "develop-

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. 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 the global competition.<sup>9</sup>

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 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

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mental citizenship.”

9. 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).

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>10</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 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 2009, 186-88). 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.

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10. 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).

## **THE RISE OF DEVELOPMENTAL LIBERALISM IN SOUTH KOREA**

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>11</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 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 2010).

Ultimately, President Roh made the final decision. He became a champion of the

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11. 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 2009, 190).

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 2010). 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>12</sup> More notably, he rejected the Japanese "flying geese" model of development,<sup>13</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. As noted earlier, 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) demonstrated 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>14</sup> As a champion of liberal economic ideas, the OMT is relatively

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12. 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."

13. 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).

14. 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).

insulated from pressure from special interest groups, which in turn prevents it from obtaining sufficient public support for FTAs.<sup>15</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 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>16</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; some prominent examples are summarized in table 2. 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 crit-

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15. 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 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).

16. 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.

icism 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).

**Table 2.** Major FTA-Related Side Payments Pledged by the Korean Government

Relevant FTA	Target groups	Payment	Reason for payment
Ratification of the Korea-Chile FTA (2004)	Agriculture and fishery industries	Over \$80 billion of public and private funds over a 10-year period	Partial opening of agriculture and fishery markets
Negotiation of the KORUS FTA (2006-07)	Movie industry	\$400 million government fund	Cutting of annual screen quota in favor of the United States
	Agriculture and fishery industries	Cash allowances for seven years	Up to 85 percent of income losses
		Government subsidies for five years	If they go out of business
	Manufacturing and service industries	Low-interest loans	If they lose more than 25 percent of their sales
		Subsidies of up to 75 percent of payroll for one year	If they switch to another industry or relocate their employees
Cash incentives of up to \$600 a month		If they hire dislocated farmers and fishermen	

Source: Koo 2009, 191.

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>17</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.

17. 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 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).

The relationship between government spending and public support for trade has puzzled many scholars in the field of international political economy. A central assumption in the globalization literature is that trade openness generates economic insecurity and volatility. Based on this assumption, scholars have proposed that globalization bolsters, rather than undermines, the welfare state by increasing public demand for social protection against economic insecurity and volatility.<sup>18</sup> One of the most recent studies found that individuals employed in import-competing sectors are the strongest opponents of free trade, but unemployment insurance and active labor market programs can moderate their opposition. This study looked at nine advanced countries: Australia, Germany, the United Kingdom, the United States, Austria, Norway, Sweden, New Zealand, and Canada (Hays 2009).

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>19</sup> the Lee administration has remained committed to the multitrack FTA strategy originally designed by the

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18. Some scholars are skeptical about the openness-volatility link; see Kim 2007 and Down 2007.

19. 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, 508-09).

Roh administration. The conclusion of FTA deals with major economies like India and the EU during Lee's presidency 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).

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).

A recent Japanese commentary on the Lee government's foreign economic policy illustrates the point. Over the past several years, South Korea has gained a growing reputation as a serious competitor with Japanese businesses. It was not a coincidence that NHK, the largest public service broadcaster in Japan, aired a special TV program titled "Reading Asia: South Korea's Leapfrogging Economy and its FTA Strategy" on October 29, 2010. NHK attributed South Korea's V-shaped recovery from the latest global economic crisis to its proactive FTA strategy. In addition, it highlighted that President Lee's Global Korea strategy has helped Korean firms to weave a global business network, as best exemplified by its dense FTA connections with both small and large economies across the globe. NHK urged the Japanese government to learn from its South Korean counterpart and implement an FTA policy so that national firms are not excluded from international markets (NHK 2010).

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, 126-27).

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.

## 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 politics? This study investigated South Korea's embrace of FTAs, which 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. This is a developmental state characteristic. But it also incorporates liberal elements. The economic crisis of 1997-98 contributed to the rise of the 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 to pacify South Korea's vocal protectionist interests, the Roh government chose to provide generous side payments. 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.

If we broaden the geographical horizon to South Korea's giant neighbors, Japan and China, we can find a similar, if not uniform, pattern. The Japanese political economy has undergone a fundamental 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 win-

ners 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, a new policy equilibrium is emerging in Japan's pursuit of FTAs: developmental liberalism rather than embedded mercantilism or neoclassical liberalism (Pempel and Urata 2006; Solis and Katada 2007; Vogel 1999).

As in the case of South Korea and Japan, a top-down approach has characterized China's newfound interest in FTAs. While China has been a vigorous global trader since the 1970s, top political leaders in Beijing have only recently begun pursuing FTAs vigorously, both with China's usual trading partners and with other countries. 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 payments.<sup>20</sup> South Korea's experience shows that the success of China's FTA initiatives may depend on how effectively it can devise side payments 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 be valid and will not serve well in the future. However, for South Korea and other 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, this study shows that developmental liberalism is becoming an increasingly prominent feature of South Korea's trade policy.

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20. For instance, a sticking point in the FTA negotiations between New Zealand and China was 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 (Hoadley and Yang 2007).

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