

Chapter 6

Trade Policy for Development: Paradigm Shift from Mercantilism to Liberalism

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6.1 Introduction

At the end of 2011, the Republic of Korea (hereinafter Korea) became the ninth country to join the “one-trillion-dollar trading club,” departing from the ranks of newly emerging countries to join the ranks of trade giants. After reaching the \$100 million mark in 1964, Korea’s exports grew more than five thousand times in 47 years, making it the seventh-largest exporting country in the world. Its economic development model has been characterized as export-oriented industrialization (EOI). In trade policy terms, Korea has adopted a mercantilist policy centered on export promotion and import protection, which traces back to its developmental period in the early 1960s. For the past two decades, however, Korea’s trade policy has undergone a fundamental transformation as a result of democratization and globalization. The departure from its traditional mercantilist policy can be best illustrated by its active pursuit of free trade agreements (FTAs). This trend took its most pronounced turn when Korea concluded an FTA with the world’s largest economy, the United States (US), in 2007. The global economic crisis in 2008 has not reduced the speed and scope of Korea’s FTA initiative, as demonstrated by the conclusion of agreements with India in 2009 and the European Union (EU) in 2010.

In an era of maturing democracy, the rapidly changing electoral and legislative dynamics have structured Korea’s trade policy options. Underlying the structured choices are the difficult challenges confronting policymakers who now have to

This chapter is adapted from, and draws heavily on, the author’s previous publications as cited in the references section.

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satisfy not only domestic constituents, but also international communities, including foreign governments, multinational firms, and international organizations. Against this backdrop, this chapter aims to answer four basic questions: What factors have contributed to the successful evolution of Korea's trade policy? How have government institutions impacted the way in which Korea has responded to policy opportunities and challenges in trade issue areas? How do electoral and legislative politics interact with Korea's new trade policy strategy, which seeks to strike a right balance between neodevelopmentalism and neoliberalism? And how do 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 Korea's new trade policy initiative is threefold. First, it constitutes a notable shift toward 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 Korea's liberal but state-centric nature, its partisan politics has led its trade policy to be closely embedded in the country's social fabric, both competitive and noncompetitive.

It would be preposterous to argue that Korean policy elites have embraced new trade policy initiatives as a tool to promote purely neoliberal economic goals in a political vacuum. In particular, the country's FTA policy is hardly insulated from societal pressures and electoral politics. Korea's policy elites have made no secret of the fact 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 a new policy equilibrium between liberalization and social protection.

The remainder of this chapter unfolds as follows. [Section 6.2](#) outlines the origins of Korea's mercantilist trade policy from a historical and institutional perspective. [Section 6.3](#) analyzes the transformation of the country's trade policy in an era of democratization and globalization. It also demonstrates that generous compensation measures designed for potential losers of free trade have been an outcome of Korea's unique partisan politics, which has structured the dynamics between trade policy elites and affected interest groups. [Section 6.4](#) summarizes the key arguments and draws policy implications for developing countries, most of which face the twin challenges of democratization and globalization.

6.2 Origins of Korea's Mercantilist Trade Policy

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 Syngman

Rhee's in the previous year. President Park felt a strong urge to improve his country's economic relations with Japan and the US. He realized he could no longer delay negotiations for normalizing Korea's relations with Japan and, in October 1962, sent his right-hand man, Kim Jong-pil—director of the Korean Central Intelligence Agency—to Tokyo as chief negotiator to conclude the prolonged discussions. To be sure, the path to a 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 reparations package.¹

The 1962 Kim-Ohira secret agreement was a breakthrough in the stalemated talks, but left many problems. The diplomatic atmosphere between Korea and Japan became dangerously charged with mutual suspicion when the Kim-Ohira memorandum was released in January 1963. In 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 Korean nationalism, leading to nationwide demonstrations against normalization talks (Koo 2009a, p. 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 draft treaty was imminent drew allegations in Korea that Kim had secretly cut another deal with his Japanese counterpart by conceding Korea's negotiating position in exchange for a vast amount of Japanese funds for his own profit and the ruling party's 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 turmoil resulted in Kim's resignation from the DRP chairmanship in June 1964 and his departure for the US on an extended leave of absence (Lee 1990, pp. 169–170; Lee 1995a, b, pp. 200–201; Cha 1996, p. 135).

Despite the complex domestic power dynamics, geopolitical conditions began to change dramatically toward a Korean-Japanese rapprochement. It is widely held that the US created the necessary momentum for concluding a normalization treaty in 1965. Until 1963, the US maintained a somewhat indifferent position toward the normalization talks. While reconciliation between Seoul and Tokyo would be beneficial to American security interests in the region, the issue did not have a high priority in Washington, except among regional experts. By 1964, however,

¹ The Kim-Ohira memorandum states that Japan would pay \$300 million in grants over the following 10 years; it would loan a further \$200 million—also over a period of 10 years—from its Overseas Economic Cooperation Fund, with a repayment schedule of 20 years at 3.5 % interest, deferred for 7 years; and that it would arrange for private loans of over \$100 million through its Export-Import Bank (Lee 1995a, b, pp. 124–125).

increasingly intense Cold War competition in East Asia prompted a significant change in the US approach.² In face of growing regional uncertainties, a stable relationship between America's two major allies, Korea and Japan, became the highest concern. The US began to push strongly for a conclusion of the prolonged normalization negotiations. America's hegemonic position certainly assured that potential bilateral tensions between Korea and Japan took place within certain confines. It was no coincidence that US President Lyndon Johnson reiterated his unconditional backing for a Korea-Japan settlement and its importance not only for the two countries, but also for the anti-communist front in East Asia. Johnson also confirmed in conversations with Park that American military and economic assistance to Korea would remain intact after normalization (Lee 1995a, b, pp. 249–50, 351–52; Cha 1996, pp. 131–135, 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 Korea and Japan to normalize their bilateral relations. In particular, the Park government faced a near-desperate situation as the first 5-year development plan (1962–1966) failed to overcome the persistent economic troubles of poverty and low levels of development. A steady decline in US economic aid further exacerbated the grim situation, as it reached a 16-year low in 1965. President Park decided to “live or die” with the normalization issue. 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 administration stressed a pragmatic need to overcome historical animosities and normalize ties with Japan (Lee 1990, pp. 170–171; Cha 1996, pp. 128–129).³

² In the early 1960s, the Chinese communist threat loomed large. Beijing's geopolitical divorce from Moscow, its signing of a mutual defense treaty with North Korea (1961), and its support for Southeast Asian communist movements strongly indicated to US 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 exacerbating threat perceptions in the rest of the region. The security outlook in Southeast Asia appeared even less promising. In April 1965, US commitment to a deteriorating situation in Indochina became much more complicated with the decision to send American troops to the conflict (Cha 1996, pp. 131–142).

³ In Japan, political elites were aware of their strengths concerning Korea's desperate economic needs. Prime Minister Eisaku Sato and the elder Liberal Democratic Party politicians, particularly former Prime Minister Nobusuke Kishi, decided to take full advantage of a strong but relatively pro-Japan Korean dictator to accelerate the negotiation process (Lee 1990, pp. 169–170). Voices within the Korean Ministry of Foreign Affairs (MOFA) also pressed strongly for a settlement. As a 1965 MOFA white paper noted, the reestablishment of ties with 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 Korea. The Sato government faced additional pressure from the powerful Japanese business lobby. Korea was becoming an increasingly important export market for Japan. Park's second 5-year plan (1967–1971) would offer Japanese firms a plethora of large-scale projects, all of which could be underwritten by the financial package to be followed by a normalization settlement (Bridges 1993, pp. 32–33; Cha 1996, pp. 129–130).

Foreign Ministers Etsusaburo Shiina and Lee Dong-won finally signed the Treaty on Basic Relations and four other agreements in Tokyo on June 22, 1965. The normalization treaty provided a fledgling 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 US as Korea's foremost trading partner within just a year. As its market grew, Korea became increasingly important to Japan as an importer of greater quantities of Japanese goods (Cha 1996, pp. 124). During the period 1961–1965, Korea's exports to Japan rose from \$19 million to \$44 million, while its imports climbed from \$69 million to \$167 million. As a result, Korea's trade dependence on Japan as a share of its gross domestic product (GDP) jumped from 3.77 to 6.98 %. Although the conclusion of the normalization treaty stood on somewhat shaky ground, it was certainly a big step forward toward the restoration of amicable relations. In addition to the overriding demands of alliance politics at the height of the Cold War, the high priority given to a stable economic relationship motivated both Korea and Japan to make the conscious choice to normalize their diplomatic relations (Koo 2009a, pp. 77–78).

Korea's dramatic economic takeoff resulted from its export-oriented industrialization, together with heavy protectionism under the auspices of America's Cold War strategy. Following in the footsteps of the Japanese developmental model, Korea's active promotion of the export sector allowed this once reclusive country to aggressively participate in the global market. As a trade-dependent nation, Korea's full integration into the world trading system was not a matter of choice but of survival (Koo 2006, pp. 142–143). As shown in Table 6.1, its GDP grew at an average annual rate of 8.8 % during the period 1965–1979, while its international trade increased almost 60-fold for the same period. It is also notable that Korea's total trade as a share of GDP has become more than 50 % since 1973.

In the political vacuum left by the assassination of President Park in October 1979, General Chun Doo-hwan (1980–1988) seized power through a military coup, overthrowing the interim government in December 1979, and getting himself elected president in August 1980. President Chun and his successor, Roh Tae-woo (1988–1993), continued with the EOI strategy. In the 1980s, Korean GDP grew rapidly at an average annual rate of 8.7 %. In particular, the 3-year period from 1986 to 1988 witnessed an unprecedented economic boom, with an average GDP growth rate of 10.8 % because of the so-called “three lows”—a low yen, a low exchange rate, and low oil prices. Korea experienced trade surpluses for the first time with a 3-year total of \$18 billion. Its trade dependence on Japan remained significantly in double digits throughout the 1980s, although its trade deficit with Japan fell from a 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 foreign direct investment, particularly after the 1985 Plaza Accord that pushed the value of the yen to nearly twice its value against the US dollar (Bridges 1993, 102–103).

Table 6.1 Korea's economic outlook, 1961–1997

| Year | Population (million) | GDP (current US\$ billion) | Annual GDP growth rate (percent) | Export (current US\$ million) | Import (current US\$ million) | Total trade (exports plus imports, current US\$ million) | Share of total trade in GDP (%) |
|------|-------------------------|----------------------------------|---|-------------------------------------|-------------------------------------|--|---------------------------------------|
| 1961 | 25.7 | 2.4 | 4.94 | 38 | 297 | 335 | 14.2 |
| 1962 | 26.4 | 2.7 | 2.46 | 55 | 415 | 470 | 17.1 |
| 1963 | 27.1 | 3.9 | 9.53 | 86 | 558 | 644 | 16.7 |
| 1964 | 27.8 | 3.4 | 7.56 | 117 | 403 | 520 | 15.5 |
| 1965 | 28.5 | 3.0 | 5.19 | 171 | 454 | 625 | 20.7 |
| 1966 | 29.2 | 3.8 | 12.70 | 249 | 716 | 965 | 25.4 |
| 1967 | 29.9 | 4.7 | 6.10 | 319 | 996 | 1,315 | 28.0 |
| 1968 | 30.6 | 6.0 | 11.70 | 455 | 1,468 | 1,923 | 32.3 |
| 1969 | 31.2 | 7.5 | 14.10 | 624 | 1,823 | 2,447 | 32.7 |
| 1970 | 31.9 | 8.9 | 8.34 | 844 | 1,984 | 2,828 | 31.8 |
| 1971 | 32.6 | 9.9 | 8.24 | 1,079 | 2,394 | 3,473 | 35.3 |
| 1972 | 33.3 | 10.7 | 4.47 | 1,631 | 2,522 | 4,153 | 38.7 |
| 1973 | 33.9 | 13.7 | 12.03 | 3,254 | 4,240 | 7,494 | 54.7 |
| 1974 | 34.6 | 19.2 | 7.18 | 4,508 | 6,852 | 11,360 | 59.1 |
| 1975 | 35.3 | 21.5 | 5.95 | 5,110 | 7,274 | 12,384 | 57.7 |
| 1976 | 35.8 | 29.6 | 10.57 | 7,715 | 8,694 | 16,409 | 55.5 |
| 1977 | 36.4 | 37.9 | 9.99 | 10,048 | 10,806 | 20,854 | 55.0 |
| 1978 | 37.0 | 51.1 | 9.30 | 12,594 | 14,975 | 27,569 | 53.9 |
| 1979 | 37.5 | 65.6 | 6.78 | 15,036 | 20,176 | 35,212 | 53.7 |
| 1980 | 38.1 | 63.8 | -1.49 | 17,439 | 22,063 | 39,502 | 61.9 |
| 1981 | 38.7 | 71.5 | 6.16 | 21,271 | 26,154 | 47,425 | 66.4 |
| 1982 | 39.3 | 76.2 | 7.33 | 21,827 | 24,250 | 46,077 | 60.5 |
| 1983 | 39.9 | 84.5 | 10.77 | 24,459 | 26,196 | 50,655 | 59.9 |
| 1984 | 40.4 | 93.2 | 8.10 | 29,259 | 30,628 | 59,887 | 64.2 |
| 1985 | 40.8 | 96.6 | 6.80 | 30,289 | 31,058 | 61,347 | 63.5 |
| 1986 | 41.2 | 111.3 | 10.62 | 34,793 | 31,734 | 66,527 | 59.8 |
| 1987 | 41.6 | 140.0 | 11.10 | 47,303 | 41,026 | 88,329 | 63.1 |
| 1988 | 42.0 | 187.4 | 10.64 | 60,683 | 51,812 | 112,495 | 60.0 |
| 1989 | 42.4 | 230.5 | 6.74 | 60,496 | 60,210 | 120,706 | 52.4 |
| 1990 | 42.9 | 263.8 | 9.16 | 65,021 | 69,858 | 134,879 | 51.1 |
| 1991 | 43.3 | 308.2 | 9.39 | 71,875 | 81,508 | 153,383 | 49.8 |
| 1992 | 43.7 | 329.9 | 5.88 | 76,641 | 81,777 | 158,418 | 48.0 |
| 1993 | 44.1 | 362.1 | 6.13 | 81,736 | 83,800 | 165,536 | 45.7 |
| 1994 | 44.5 | 423.4 | 8.54 | 96,040 | 102,348 | 198,388 | 46.9 |
| 1995 | 45.1 | 517.1 | 9.17 | 131,312 | 135,110 | 266,422 | 51.5 |
| 1996 | 45.5 | 557.6 | 7.00 | 137,413 | 150,157 | 287,570 | 51.6 |
| 1997 | 46.0 | 516.3 | 4.65 | 144,023 | 144,634 | 288,657 | 55.9 |

Sources International Monetary Fund; World Bank

The story of Korea's successful EOI, often dubbed the "miracle on the Han River," is a good example of developmental mercantilism.⁴ The institutional marriage of developmentalism and mercantilism quickly spread throughout the country, brokered by the social embeddedness of industrial and trade policies.⁵ The 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 Korea's EOI clearly lacked the comprehensive social security system found in the West (Chang 2007, p. 67). As elsewhere in the world, 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 divide a permanent feature of the country's political economy. Although the 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 toward economic development and covered only a narrow section of the population. Against this background, 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 (Kwon 2005).⁶

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 Korean government made desperate efforts to protect rice and other

⁴ 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 this 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, pp. 5–10).

⁵ 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 being 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 Korea's developmental state, see Amsden (1989) and Woo-Cumings (1999).

⁶ For more details about the evolution of Korea's welfare state, see the chapter by Kwon in this volume.

agricultural and fishery products at the expense of consumers and of Korea's international reputation as a free trading country. The relatively short history of Korea's industrialization since the 1970s means that many Koreans continue to have rural roots, despite large-scale migration to urban areas. Before the UR negotiation, agriculture had been completely excluded from the free trade debate. Although 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.⁷

6.3 Globalization and Institutional Transformation

The political and economic conditions, both external and internal, that underpinned Korea's traditional trade policy paradigm came under heavy pressure at the end of the 1990s. Most importantly, the outbreak of the Asian financial crisis of 1997–1998 shattered the illusion of Korea's unstoppable economic growth, thus having a profound impact on the way in which the country perceived its economic survival in a world of deeper and wider globalization.⁸

As with many other East Asian countries, Korea began to hold the perception of being pushed away by the Washington Consensus, which aggressively promoted the policies of deregulation, privatization, and liberalization as prerequisites for economic development (Dieter 2009, p. 76). Although the International Monetary Fund (IMF) loan package caused a region-wide resentment of the Washington-dominated agency, Korea and other crisis-ridden countries in the region had little choice.⁹ In addition, the 1999 World Trade Organization (WTO) Ministerial Conference in Seattle failed to launch a new round of trade talks, leading Korea's top policymakers to recognize that the mediocre performance of the WTO, and

⁷ Under the UR agreement, Korea received a 10-year exception to tariffication of rice imports in return for establishing a minimum market access (MMA) quota. Under this quota, Korea's rice imports grew over 10 years from 0 to 4 % of domestic consumption during the base period. The Korean government, through state trading enterprises, exercised full control over the purchase, distribution, and end use of imported rice. The original MMA arrangement expired at the end of 2004, but Korea successfully negotiated a 10-year extension. It also established tariff-rate quotas that were intended to provide minimum access to previously closed markets or to maintain pre-UR access (Office of the United States Trade Representative 2006).

⁸ Kim (2011) argues that Korea has pursued a “bandwagoning” strategy, “putting too much emphasis on accepting and adapting to neoliberal globalization,” and that it now “needs to pursue a more flexible national strategy to deal with multiple types of globalization.”

⁹ According to Fred Bergsten (2000, p. 22), “most East Asians feel that they were both let down and put upon by the West in the crisis.” They believe that the West, in particular the US, “let down” Asia because Western financial institutions and other actors caused or exacerbated the crisis by withdrawing their money from the region and then refused, as did the US, to take part in rescue operations to manage it. They believe that East Asia has been “put upon” by the West because of the way in which, through the IMF, the West dictated the international response to the crisis and because of the perceived consequences of the IMF's prescriptions. See also Pempel (1999) and Wade (2000).

increasing competition in its traditional export markets, could hurt export-dependent Korea (Cheong 1999; Sohn 2001).

In the immediate aftermath of the Asian financial crisis, Korea's protectionist veto players, such as labor unions and farmers' organizations, were temporarily disorganized due to the liberal reform of President Kim Dae-jung (1998–2003) and the austerity program imposed by the IMF (Chang 2007, p. 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.¹⁰ 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, dramatically altering Korea's development path. The case of import diversification rules illustrates this point. In trying to correct the worsening trade deficit with Japan, the Korean government restricted or completely excluded certain Japanese products from the Korean market.¹¹ The problem for the Korean government was to balance the needs of its own industries for key components and products from Japan against its fears that the Japanese would dominate certain sectors of the domestic market if allowed complete freedom. The Japanese government protested regularly about these restrictions, which it regarded as a violation of the principles of the General Agreement on Tariffs and Trade prohibiting quantitative restrictions, but did nothing to retaliate, since—in practice—Japanese companies were able to find ways around these restrictions (Bridges 1993, pp. 95–96). This protectionist practice was gradually phased out at the end of the 1990s as a result of the rescue loan package agreement between Korea and the IMF. Apparently, the elimination of the import diversification rules was influenced by Japan, which was one of the principal patrons of the IMF rescue package for Korea (Koo 2009a, p. 81).

As shown in Table 6.2, Korea's trade strength quickly bounced back after the financial crisis and has grown even more rapidly since then. The average share of trade in GDP grew from 52 % (1987–1996) to 68.6 % (1999–2010). Despite brief hiccups due to the 2008 global economic crisis, the rising trend continues, making Korea the seventh-largest exporter as of 2011. Korea owes this remarkable recovery from the Asian financial crisis to the transformation of its trade strategy.

¹⁰ The share of agriculture, forestry, and fisheries in Korea's total employment decreased continuously from 17.9 % in 1990 to 8.1 % in 2004. The share of the three sectors in Korea's GDP was less than 4 % in 2003 (Ministry of Finance and Economy 2005).

¹¹ Under a 1977 government directive to diversify imports, 50 products from Southeast Asian countries were subjected to import approval. Japan was not specifically designated, but was the implied target. In 1980, the list was expanded, and formal restrictions were applied to the country—that is, Japan—which had been the largest exporter to Korea in the previous year. When, in 1982, Saudi Arabia became the largest source of imports, this qualification was changed to include the largest source of imports over the previous 5 years. The list has fluctuated in length, from 162 Japanese products subject to this system in July 1982, to a peak of 344 items in April 1988, before falling to 258 in 1991. This list was regularly amended.

Table 6.2 Korea's economic outlook, 1998–2010

| Year | Population (million) | GDP (current US\$ billion) | Annual GDP growth rate (%) | Export (current US\$ billion) | Import (current US\$ billion) | Total trade (exports plus total trade imports, current US\$ million) | Share of in GDP (%) |
|------|-------------------------|----------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|--|------------------------|
| 1998 | 46.3 | 345.4 | -6.85 | 132.7 | 93.4 | 226.1 | 65.4 |
| 1999 | 46.6 | 445.4 | 9.49 | 143.9 | 119.7 | 263.6 | 59.2 |
| 2000 | 47.0 | 533.4 | 8.49 | 172.3 | 160.5 | 332.8 | 62.4 |
| 2001 | 47.4 | 504.6 | 3.97 | 150.4 | 141.1 | 291.5 | 57.8 |
| 2002 | 47.6 | 575.9 | 7.15 | 162.3 | 152.1 | 314.4 | 54.6 |
| 2003 | 47.9 | 643.8 | 2.80 | 193.8 | 178.8 | 372.6 | 57.9 |
| 2004 | 48.0 | 722.0 | 4.62 | 254.4 | 224.5 | 478.9 | 66.3 |
| 2005 | 48.1 | 844.9 | 3.96 | 285.5 | 261.2 | 546.7 | 64.7 |
| 2006 | 48.4 | 951.8 | 5.18 | 326.3 | 309.4 | 635.7 | 66.8 |
| 2007 | 48.6 | 1,049.2 | 5.11 | 373.7 | 356.8 | 730.5 | 69.6 |
| 2008 | 48.9 | 931.4 | 2.30 | 426.8 | 435.3 | 862.1 | 92.6 |
| 2009 | 49.2 | 834.1 | 0.32 | 373.2 | 323.1 | 696.3 | 83.5 |
| 2010 | 49.4 | 1,014.9 | 6.32 | 471.1 | 425.3 | 896.4 | 88.3 |

Sources International Monetary Fund; World Bank

Some scholars believe that the economic reforms under Kim 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 continuing to play 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 Korea’s policy away from its earlier focus on access to the US market through global multilateralism and the protection of uncompetitive domestic industries (Koo 2009b, pp. 186–188). In November 1998, the government’s Inter-Ministerial Trade Policy Coordination Committee announced that Korea would start FTA negotiations with Chile, while conducting feasibility studies with other prospective FTA partners such as the US, Japan, New Zealand, and Thailand (Sohn 2001).

Although the link between the FTAs and domestic reform was not clearly defined, Kim’s FTA policy was 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, focusing on export industries. The Kim administration wanted to ensure the survival of most of Korea’s major export firms, but at the same time clearly understood that post-crisis external conditions would not allow Korea to free ride on others’ markets any longer. It was indeed the beginning of an irreversible transformation of the country’s trade policy paradigm (Koo 2010).

The policy shift toward FTAs under President Kim did mark a dramatic departure from Korea's developmental mercantilist policy. Yet it was not until President Roh entered office in 2003 that the comprehensive road map for FTAs and detailed action plans for its multitrack FTA strategy was completed (Lee 2006; Ministry of Foreign Affairs and Trade 2006). In contrast to its rather peripheral position 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 reluctantly inherited his predecessor Kim's economic policy agenda because the former's principal power base included those who were negatively affected by trade liberalization. Looked at beneath the surface, however, Roh further expanded it by completing a road map for Korea's multitrack FTAs and adopting comprehensive side payments to adversely affected groups (Koo 2010).

The nature and scope of Korea's shift in trade policy focus under Roh is best illustrated by the Korea-United States (KORUS) FTA negotiations. 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 US was a long-term goal, while deals with lighter 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 Korea's FTA equations. Certainly, Korea expected generous economic gains from an FTA with the US. Its top policy elites believed that an FTA with the US would accelerate Korea's market-oriented reform process and upgrade its economy, thus helping overcome the likely scenario of a Korea "sandwiched" between Japan and China.¹² On this score, Korea's then trade minister, Kim Hyun-chong, was particularly enthusiastic. He made no secret of the fact that the KORUS FTA would be an effective means to transform the structure of the Korean economy, departing from its replication of the Japanese developmental model and adopting an American-style liberal economy.¹³

Ultimately, President Roh made the final decision. He became a champion of the FTA as a diplomatic tool to strengthen strategic ties with the US. President Roh supported Minister Kim's ambitious idea at the expense of his loyal constituents, including progressive civil groups, labor unions, and farmers' associations. He clearly understood the strategic utility of the FTA. Equally important was the fact that Roh became a true believer in free trade and the opening of markets as a key to economic growth.¹⁴ 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

¹² In a speech to the Korean Chamber of Commerce and Industry on March 28, 2006, President Roh asserted: "China is surging. Japan is reviving. Trapped between China and Japan, Korea desperately needs to develop a strategy to cope with current challenges. One of the most effective ways to accomplish this goal is to improve our country's competitive edge against China and Japan in the US market by concluding a KORUS FTA" (quoted in Koo 2009b, p. 190).

¹³ Interview with Minister Kim Hyun-chong, May 2009 (quoted in Sohn and Koo 2011, p. 443).

¹⁴ Interview with Minister Kim Hyun-chong, May 2009 (quoted in Sohn and Koo 2011, p. 450).

of free trade.¹⁵ More notably, he rejected the Japanese “flying geese” model of development,¹⁶ saying that it had already outlived its utility for Korea. His assertion, instead, was that Korea should find its economic future in high-technology and service industries, moving away from the traditional focus on heavy manufacturing. Economic nationalism was critical to the rise of the developmental state approach in 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.¹⁷ As a champion of liberal economic ideas, the OMT was relatively insulated from pressure from special interest groups, which in turn prevents it from obtaining sufficient public support for FTAs.¹⁸ Nevertheless, the top-down nature of 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 long-standing embeddedness of the state (Koo 2010).¹⁹

Under these circumstances, it is not surprising that 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

¹⁵ On February 5, 2008, in a forum arranged on the fifth anniversary of his inauguration, 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” (quoted in Sohn and Koo 2011, p. 450).

¹⁶ The concept of “flying geese” was first used by the Japanese economist Kaname Akamatsu (1937). Akamatsu found that the process of industrialization in the Japanese empire in the 1920s–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 geese migrating between Japan and Siberia. Akamatsu’s product cycle theory was used to justify the hierarchically organized division of labor in the Greater East Asia Co-Prosperity Sphere. Subsequent adherents of the flying geese model—Korea and Taiwan in the 1960s, and 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).

¹⁷ 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, p. 148). However, the OMT was abolished and its trade negotiating power has been delegated to the Ministry of Industry, Trade and Energy as a result of the 2013 government organization reforms.

¹⁸ The OMT’s neoliberal policy orientation was further highlighted by the appointment of its third trade minister, Kim Hyun-chong, in July 2004, as well as the promotion of its first trade minister, Han Duk-soo (1998–2004), to the post of deputy prime minister and minister of finance and economy. For the critics of neoliberal economic policy as well as hard core 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 US and was trained there as a lawyer, which—the critics argued—undermined his nationalist credentials (Koo 2009b, p. 189).

¹⁹ In many respects, the institutional design and operation of the OMT on trade issues resembled the Economic Planning Board (EPB) in broader economic policy areas during 1960s–1980s. For more details about the way in which the EPB managed and coordinated Korea’s economic policy, see Choi’s chapter in this volume.

economy by inviting external pressure—the FTAs—could only worsen the economic polarization in Korea, rather than providing an opportunity to upgrade its economy to a more advanced level (Lee 2006, p. 6). The debate surrounding the KORUS FTA illustrated this 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 the financial crisis and began to work closely with anti-globalization non-governmental organizations 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 findings in the broader literature on post-crisis economic reform in Korea.²⁰

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. Roh pledged many FTA-related side payments. For instance, the ratification of the Korea-Chile FTA in February 2004 was followed by the passage of a special law designed to make up for 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 were earmarked for rescue programs for the farming and fishing sectors over a 10-year period (Ministry of Foreign Affairs and Trade 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 funds amounting to \$400 million as compensation for cutting Korea’s annual screen quota in favor of the US.²¹ The Roh government also committed itself to providing cash allowances for 7 years to offset income losses of up to 85 % for farmers and fishermen once the KORUS FTA went into effect. Aside from this, Korean farmers and fishermen were to receive government subsidies for 5 years if they went out of business due to the KORUS FTA.²²

The conservative Lee Myung-bak administration (2008–2013) made a dramatic break with the progressive policies of the preceding decade, with the FTA strategy being one of the few areas in which it followed in the footsteps of its predecessors.

²⁰ For instance, Lim (2010) found that the relationship among politicians, bureaucrats, and interest groups have been altered, so that the relative power of interest groups has been strengthened vis-à-vis politicians and bureaucrats in the fields of manufacturing, information technology, and finance.

²¹ Korea’s screen quota system was designed to stem a flood of Hollywood blockbusters. Korea originally had a quota of 146 days or 40 % reserved for domestic films; this was cut to 73 days or 20 % starting July 1, 2006 (Chosun Ilbo 2006a, b).

²² To boost investment in agriculture, the Roh government promised to encourage the creation of private agricultural investment funds, with agriculture-related companies being allowed to bring in chief executive officers from outside the industry. The government would offer low-interest loans to businesses that lost more than 25 % of their sales due to the KORUS FTA by making them eligible for subsidies of up to 75 % of their payroll for one year if they switched to another industry or relocated their employees. The government also pledged to provide cash incentives of up to \$600 a month to companies that hired farmers and fishermen who had been dislocated from their work (Chosun Ilbo 2007).

In April 2008, President Lee's government announced 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 US. The administration of George W. Bush claimed it had resolved the mad cow problem and that US beef was safe for consumption. Key US lawmakers signaled that ratification of the KORUS FTA hinged on the lifting of the Korean ban. The announcement that US beef imports would resume, with some restrictions on the types of meat to be allowed, sparked a series of mass demonstrations across Korea. This seriously damaged the legitimacy of the new Lee administration (Hundt 2008, pp. 508–509).

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 of US beef imports. 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, the Korean and US governments confirmed a voluntary private sector arrangement that excluded import of beef from cattle over the age of 30 months, as well as beef products from the brain, eyes, spinal cord, and cranial bones of cattle (Jurenas and Manyin 2010, p. 8).

In 2010, during the additional negotiations held in Columbia (Maryland) from November 30 to December 3, Korea made additional concessions to the US in the automobile sector, while gaining American concessions in the areas of beef, pork, pharmaceuticals, and visas. On December 3, the Korean and US governments reached an agreement to modify the KORUS FTA by resolving bilateral differences over beef and automobile issues. The following year, on October 12, the US Congress passed the KORUS FTA, which was the largest free trade deal for the US since the North American Free Trade Agreement. About a month after the congressional move, the National Assembly of Korea also ratified the bilateral trade deal, finally ending a 4.5-year long legislative battle on both sides of the Pacific. The long overdue, but triumphant, story of the KORUS FTA shows that the Lee administration remained committed to the multitrack FTA strategy originally designed by the administration of President Roh. As summarized in Table 6.3, the conclusion of FTA deals with major economies like India and the EU during Lee's presidency also proves the point.²³

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 urged his people to practice not just passive liberalization but ever more proactive globalization. He increased Korea's foreign assistance, encouraged internationalization among its people, demanded that Seoul become an international hub, and sought a more active participatory role in global governance mechanisms such as the G-20. Since his electoral victory in December 2007, Lee promoted global

²³ At the ceremony concluding the Korea-EU FTA negotiations on July 13, 2009, President Lee expressed his hope and belief that 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 % of global trade in services (Chosun Ilbo 2009).

Table 6.3 Korea's multitrack FTA negotiations

| Signed ^a | Under negotiation ^b | Joint study |
|---|---|----------------------------|
| Chile (0.8 %, 2003, 2004) | Japan (10.3 %, 2003) | Korea-China-Japan (34.4 %) |
| Singapore (2.6 %, 2005, 2006) | Canada (0.9 %, 2005) | South Africa (0.4 %) |
| European Free Trade Association (1.0 %, 2005, 2006) | Mexico (1.2 %, 2006) | Russia (2.0 %) |
| Association of Southeast Asian Nations (ASEAN) ^c (10.9 %, 2006, 2007) | Gulf Cooperation Council (8.8 %, 2008) | Israel (0.2 %) |
| United States (10.1 %, 2007, 2011) | Australia (3.0 %, 2009) | Vietnam (1.4 %) |
| India (1.9 %, 2009, 2010) | New Zealand (0.2 %, 2009) | Mercosur (1.7 %) |
| Peru (0.2 %, 2010, 2011) | China ^d (24.1 %, 2012) | |
| European Union (10.3 %, 2010, 2011) | | |
| Colombia (0.2 %, 2012, N/A) | | |
| Turkey (0.5 %, 2012, N/A) | | |

Percentage scores indicate the value of bilateral trade as a portion of Korea's total trade (exports plus imports) in 2010

Sources International Monetary Fund; World Bank

^aThe figures after the percentage scores indicate the year of signing the agreement and the year of the agreement coming into force (updated as of August 2012)

^bThe figures after the % scores indicate the year of the launch of official negotiations

^cThe Korea-ASEAN framework agreement on comprehensive economic cooperation was signed in December 2005; the Korea-ASEAN agreement on trade in goods was signed in August 2006 and came into force in June 2007; the Korea-ASEAN agreement on trade in services was signed in November 2007 and came into force in May 2009; the Korea-ASEAN agreement on investment was signed in June (Dieter 2009) and came into force in September 2009

^dIncluding Hong Kong

projects and emphasized inward foreign investment. Indeed, Global Korea had become a centerpiece of Lee's foreign policy initiative, both domestically and internationally (Lee and Hewison 2010).

To summarize, Korea's multitrack FTA initiative has 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. Most notably, the Roh and Lee governments envisaged the KORUS FTA as a means for Korean firms to benefit from the economies of scale which access to the US market would allow, and so upgrade their competitive edge. In what has been dubbed a version of new industrial policy, Korean firms could thus compete with their Chinese and Japanese counterparts (Woo 2007, pp. 126–127). This 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 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 had been disadvantaged by the FTAs. Even with these changes, the most important feature of Korea's new trade 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.

6.4 Conclusion and Policy Implications

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 chapter argues that it was a good example of developmental mercantilism. However, the political and economic conditions, both external and internal, that underpinned 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 1997–1998 was a painful wake-up call to seriously consider remodeling Korea's mercantilist policy bias. Its departure from a traditional, top-down trade policy centered on export promotion and import protection can be best illustrated by its active pursuit of FTAs. 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 the country concluded an FTA with the world's largest economy, the US, in 2007. The global economic crisis of 2008–2009 has not reduced the speed or scope of Korea's FTA initiative, as demonstrated by the conclusion of trade agreements with India in 2009 and the EU in 2010. The tale of 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 Korea's FTA initiative is three-fold. First, it constitutes a notable policy shift toward 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. Korea's dramatic embrace of FTA policy thus contains a developmental state characteristic. But it also incorporates liberal elements.

The economic crisis of 1997–1998 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, shifting Korea's trade policy focus from global multilateralism to regional/cross-regional bilateralism and minilateralism. And finally, despite Korea's liberal but state-centric nature, its 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 Korea's vocal protectionist interests, the Roh government chose to provide

generous side payments to pacify them. As a result, the country's FTA initiative combines developmental embeddedness and liberalism—with this paradigm shift being a key feature of the Lee administration.

This chapter shows that developmental liberalism is increasingly becoming a prominent attribute of Korea's trade policy. Although it is not clear whether and to what extent the trajectory of this trade policy can be replicated in developing countries, one clear lesson can be drawn from Korea's EOI, as backed by neomercantilism: it was made successful only under an unusual combination of international and domestic circumstances, including the Korean War, Japanese colonialism, US hegemony during the Cold War, President Park's strong leadership supported by a capable and committed bureaucracy, and a strong sense of nationalism. It is equally important to note that Korea's embrace of liberal trade policy in the aftermath of the Asian financial crisis does not indicate that it has completely abandoned its top-down approach to trade liberalization. The developmental state model, and its embedded mercantilist variant, may not be valid and will not serve well in the future. However, the Korean government's social embeddedness persists in its top-down pursuit of FTAs. To conclude, the right balance between embeddedness and laissez-faire policy may continue to evolve across time and space.

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