LEARNING, INSTITUTIONS AND KOREA'S FDI POLICY COMPARED WITH JAPAN

by

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Abstract

The basic assertion of this thesis is that policy makers' belief systems and economic institutions have to change their structures and contents as the nation's economic developmental stage is upgraded. Put differently, a state's economic performance or achievement of economic objectives will be facilitated if there is no cleavage or conflict among economic policy, economic belief systems, and economic institutions. This means that the utility of the developmental state is valid until a nation's economy is in a take-off position. Persistent developmentalism after this stage will result in developmentalism losing its validity and becoming a main obstacle for further economic development. At this time, more liberalised economic policies which are not only supported by changed belief systems and institutions but also compatible with the neo-liberalising international political economy are needed. In other words, this thesis does not seek to answer the question 'which is the better strategy for economic development between developmentalism and neo-liberalism?' but emphasises the importance of the proper timing of transition from developmentalism to a liberalised and deregulated economy which is compatible with a mature civil society and the neo-liberalising international political economy.

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List of Abbreviations

ACF	ASEAN Co-operation Fund (Korea)
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
AIST	Agency for Industrial Science and Technology (Japan)
AKBC	ASEAN and Korea Private Economic Co-operation Committee
AMCHAM	American Chamber of Commerce
AMF	Asian Monetary Fund
AOTS	Association for Overseas Technical Scholarship
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of South East Asian Nations
ASEM	Asia-Europe Meeting
BIS	Bank for International Settlements
BITs	Bilateral Investment Treaties
CFEOT	Committee on Foreign Exchange and Other Transaction (Japan)
DAC	Development Assistance Committee
DSM	Dispute settlement mechanism
EDCF	Economic Development Co-operation Fund (Korea)
EPA	Economic Planning Agency (Japan)
EPB	Economic Planning Board (Korea), incorporated into MOFE in 1994.
FCCL	Foreign Capital Control Law (Japan)
FCIA	Foreign Capital Inducement Act (Korea)
FCIPA	Foreign Capital Inducement Promotion Act (Korea)
FDI	Foreign direct investment
FE & FTCL	Foreign Exchange and Foreign Trade Control Law (Japan)
FE & FTL	Foreign Exchange and Foreign Trade Law (Japan)
FEO	Federation of Economic Organisation (Keidanren) (Japan)
FI & FCIA	Foreign Investment and Foreign Capital Inducement Act (Korea)
FIC	Foreign Investment Council (Japan), former organisation of CFEOT
FIND	Foreign Investment in Japan Development Corporation
FKI	Federation of Korean Industries (Jeongyungryeon)
GATT	General Agreement on Tariffs and Trade
GSP	Generalised System of Preferences
HCI	Heavy and Chemical industry
IDE	Institute of Developing Economies (Japan)
IMF	International Monetary Fund
JAIC	Japan ASEAN Investment Company
JAIDO	Japan International Development Organisation
JDB	Japan Development Bank
JETRO	Japan External Trade Organisation
JEXIM	Japan Export - Import Bank
JIC	Japan Investment Council
JICA	Japan International Co-operation Agency
JSBC	Japan Small Business Co-operation
KCDTU	Korean Confederation of Democratic Trade Unions
KDI	Korea Development Institute

KEXIM	Korea Export - Import Bank
KIET	Korea Institute for Industrial Economics and Trade
KISC	Korea Investment Service Centre
KIST	Korean Institute for Science and Technology
KOICA	Korea International Co-operation Agency
KOTRA	Korea Trade - Investment Promotion Agency
LDCs	Less Developed Countries
LDP	Liberal Democratic Party (Japan)
MAI	Multilateral Agreement on Investment
M&A	Merger and Acquisition
MCI	Ministry of Commerce and Industry (Korea), former organisation of MOTI
MITI	Ministry of International Trade and Industry (Japan)
MNCs	Multinational corporations
MOCI	Ministry of Commerce and Industry (Korea), former organisation of MOTI
MOCIE	Ministry of Commerce, Industry and Energy (Korea)
MOF	Ministry of Finance (Japan)
MOF	Ministry of Finance (Korea), former organisation of current MOFE
MOFA	Ministry of Foreign Affairs (Japan)
MOFAT	Ministry of Foreign Affairs and Trade (Korea)
MOFE	Ministry of Finance and Economy (Korea)
MOTIE	Ministry of Trade, Industry and Energy (Korea), former organisation of current MOCIE.
NAFTA	North American Free Trade Agreement
NFIPA	New Foreign Investment Promotion Act (Korea)
NIEs	Newly industrialising economies
NTBs	Non tariff barriers
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OECF	Overseas Economic Co-operation Fund (Japan)
OIDC	Overseas Investment Deliberation Committee
OOF	Other Official Flow
OPEC	Organisation of Petroleum Exporting Countries
OTCA	Overseas Technical Co-operation Agency (Japan)
PCPAR	Provisional Council for the Promotion of Administrative Reform (Japan)
R&D	Research and development
SII	Structural impediments initiative
SMEs	Small and medium sized enterprises
TIFO	Trade and Investment Facilitation Office (Korea)
TRIM	Trade related investment measures
TRIP	Trade related intellectual property rights
UNCTAD	United Nations Committee on Trade and Development
VERs	Voluntary export restraints
WTO	World Trade Organisation

Note on Transliteration

This thesis adopts a system of transliteration which produces sound that is closer to the exact pronunciation of Korean spoken language. There are two ways of transliteration of Korean to English. First is the one which is used in this thesis. In this system, the exact pronunciation of Korean is tried to be written in the alphabet. So, if foreigners pronounce words written in this system, the sound will be familiar to and easily recognised by ordinary Korean. But it is difficult for foreigners to pronounce. For example, the second largest city in Korea is not 'Pusan' but 'Busan' in this system. The other system is used for the convenience of foreigners. In other words, in this system, the exact pronunciation of Korean spoken language is sacrificed in order to make foreigners to pronounce easily. Thus, words which are written in this system are easier for foreigners to pronounce. For example, in this system, 'Chaebol' (Korean conglomerates) is used instead of 'Jaebeol'. Other examples of this system are common family names in Korea such as Park, Kim, and Lee. If we adopt the former system, these family names are Bak, Gim, and Yi. Even though this thesis adopts the former transliteration system, widely used or already familiar words which are written in the latter system are also used and cited in this thesis in order to prevent confusion.

Chapter 1.
Introduction: Conceptualising the post developmental state

The post developmental state (PDS)

This thesis starts from the simple observation that in both the Republic of Korea (hereafter Korea) and Japan there was a distinctive period after the mid-1980s which cannot be explained by the theoretical framework of either developmentalism or neo-liberalism. In this period, economic policies oscillated between the free-market system and state intervention. This inconsistency and confusion has been neglected by the literature of both developmentalism and neo-liberalism. Accordingly, a new conceptualisation is necessary. In this thesis, the concept of the 'post developmental state' (PDS) is used to explain these trends. It refers to the situation in which the legacies of the developmental state (DS) or autonomous state were so strongly embedded in socio-economic and political institutions that, despite challenges and pressures from civil society and the neo-liberalising international political economy (e.g. through liberalisation, deregulation, privatisation, free trade and investment, government downsizing), state intervention in the market system persisted.

A key difference between the DS and the PDS lies in the extent of congruence among three pillars of economic development: economic policies, economic institutions, and economic belief systems. More specifically, in the DS period, organic and congruent relationships among the three pillars were prevalent. A strong belief in the efficacy of state intervention in the market system was shared by crucial policy-makers and ordinary people. Thus, economic policies based on developmentalism were faithfully

planned and implemented. Also, institutions such as governmental organisations were rearranged in order to facilitate and consolidate developmental policies and the supporting belief system. By contrast, in the PDS period, there emerged an ever increasing cleavage among the three pillars. Economic policies initially embraced the free market principle and were continuously liberalised and deregulated [1].

However, there was a sharp division of economic beliefs within the bureaucracy between developmentalsim and neo-liberalism and institutions were deeply entrenched in the legacy and inertia of developmentalism-oriented state intervention. Thus, the PDS period was unique in its contradictory configuration of liberalised economic policies, divided belief systems, and developmentalism-oriented institutions. This means that the PDS period cannot be explained or understood through the incompatible approaches of developmentalism or neo-liberalism. It also means that social constructions such as society, state and the international system are not static but dynamic. Thus, the major structures and specific features of the Korean and Japanese states and societies have exhibited continuous change and transformation.

The Korean transitionary state (TS)

[1] Liberalisation in Korea was caused by several factors. First, in the domestic sphere, big conglomerates (Chaebol) grew to the extent that they regarded government guidance and regulations as constraints on their productivity, competitiveness, and managerial freedom. The Chaebol strongly pursued economic liberalisation and tried to induce more liberalised economic policies through intensive lobbying of the policy making process. Second, policy-makers in the government were under great pressure from the multilateral free trade regime (the GATT and the WTO). Third, more high ranking policy-makers accepted the efficacy of a free market economy as they either obtained their academic degrees in America, where neo-classical economics is dominanat, or influenced by neo-classical economists. Finally, the collapse of the Cold War bipolar system in the late 1980s not only weakened Korea's strategic importance to the US but also strengthened the predominance of low politics over high politics in the context of the international political economy. Economic pressure from the US and the neo-liberalising international political economy forced Korea to liberalise its economy.

In Korea there emerged new phase after the East Asian economic crisis of 1997. The massive impact of the crisis forced Korea to request help from the IMF. Following the IMF bailout, Korea faced harsh but unavoidable pressures to adjust its entire economic system including economic practices and institutional structure and modify its attitude towards the efficacy of the developmental state in propelling its economic objectives. In a word, Korea was forced to abandon core parts of developmentalism. The neo-liberal structural adjustment was initiated by the economic crisis, but it is more correct to say that the need for structural adjustment was deeply embedded in developmentalism itself [2].

First, the bureaucrats' divided belief in the efficacy of developmentalism in the PDS period obstructed the effective accomplishment of economic objectives and the government's ability to deal with erupting structural problems. Persistent corruption among politicians, bureaucrats, and businessmen was pervasive throughout the Korean PDS period, leading to a distorted and dependent policy making process. In other words, whereas, in the DS period, an independent and efficient policy making process prevailed, in the PDS system economic policy became a product of coalitional give-and-take relations between politicians, bureaucrats and businessmen. As a result, a dual economic system, under which the Chaebol dominated the Korean economy and small and medium sized companies were suffocated by lack of capital and markets, emerged, with the Korean government pursuing a strategy through which

[2] Stanley Fischer, the deputy managing director of the IMF, clearly detects the structural problems of the Korean developmental state: "the problems of weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among government, banks, and corporations were central to the economic crisis" (Fischer 1998: 105).

Korea's international competitiveness was based solely on the Chaebol's competitiveness.

However, this strategy led to a dangerous situation when some of the Chaebol began to suffer from serious liquidity problems, which were the unavoidable results of overinvestment, overcompetition in the small domestic market, and intensified competition in the world market. The Korean government failed to deal effectively with these ailing Chaebol. This was the inevitable consequence of the bureaucrats' divided belief systems, i.e. the Korean government was confused and fragmented in terms of its economic ideas between the free-market system and state intervention. Thus, the government could neither bankrupt the ailing Chaebol, as neo-liberalism proposed, nor channel massive public funds to the Chaebol, as developmentalism recommended. Eventually, these lagging and confused governmental efforts to deal with the Chaebol led to the start of economic crisis in Korea. This process is discussed in more detail in Chapter 5.

Second, the Korean PDS's efforts to pursue economic structural reform, which were mainly focused on the improvement of the dual economic structure and full-scale economic liberalisation, failed and were continuously delayed. This was due to several factors. To begin with, the Chaebol, which were regarded by the government as the primary means to facilitate economic development, became the main obstacle to further structural reform. Because the Chaebol dominated the Korean economy, extensive structural adjustment of the Chaebol was considered to be too costly. Also, there was strong institutional resistance and inertia which prevented full-scale economic reform. The legacy and inertia of institutions which were deeply embedded

in developmentalism became an obstacle to pursuing economic liberalisation and deregulation. Third, as we have seen above, the belief systems of bureaucrats were divided. This obstructed coherent policy making in the pursuit of economic structural reform and the determination of major targets of reform.

Finally, as the international economic system became more closely interdependent and as the international political economy became highly politicised, developmentalism in one country, entailing domestic market protection and fierce export penetration into other countries, tended to result in economic losses in other countries and intensified trade friction. As a result, East Asian developmentalism became a highly controversial and problematic feature of the international political economy. Moreover, with the outbreak of the East Asian economic crisis, the neo-liberal regime, led by the IMF, the World Bank, and the US forced crisis-struck countries to adopt neo-liberal economic adjustment programmes which aimed to facilitate the eventual dismantling of developmentalism in these countries. Thus, accepting the IMF's adjustment programmes, Korea entered into a new phase, which called the transitionary state (TS) period. In it, foreign economic policies are fully liberalised and bureaucrats have embraced the economic belief of neo-liberalism. Thus, in the present TS period, economic policies and ideas are based on the efficacy of the free market system, but economic institutions are still strongly embedded in developmentalism.

As a result, a concern has grown about whether Korea will transform itself from a developmental state to a neo-liberal economy. The answer to this question must await the results of various ongoing economic reforms in the labour market, finance, and the

Chaebol. However, we can anticipate the answer through the conceptual tools of 'learning' and 'institutions'. In other words, by incorporating the belief systems of the bureaucracy and the phenomenon of institutional resistance and inertia into our analysis, we can offer some reliable speculation regarding the future direction of the Korean political economy. The issue will be discussed in more detail in Chapter 7, with four possible scenarios. The main assertion of this thesis is that even though the original configuration of material interests and political coalitions, which induced a consolidated belief system and institutional settings, has changed or disappeared, that belief system and those institutional settings have persisted. However, they are unlikely to survive as the friction between changed interests and a resilient belief system and institutions becomes intensified. The important point here is that the sooner ideational and institutional transformations occur, the better economic performance becomes and the less economic inefficiency or turmoil.

In other words, the basic assertion of this dissertation is that the policy- makers' belief system and economic institutions have to change their structure and content as the nation's economic developmental stage is upgraded. Put another way, a state's economic performance and achievement of its economic objectives are facilitated if there is no cleavage or conflict among economic policy, economic belief system, and economic institutions. This means that the utility of the developmental state is valid until a nation's economy is in the take-off position. Persistent developmentalism after this stage will result in developmentalism losing its validity and becoming a major obstacle to further economic development. At this time, more liberalised economic policies which are not only supported by changed belief system and institutions, but are also compatible with the neo-liberalising international political economy, are

needed. Thus, this dissertation does not seek to answer the question 'which is the better strategy for economic development: developmentalism or neo-liberalism?' Rather, it emphasises the importance of the proper timing of the transition from developmentalism to a liberalised and deregulated economy which is compatible with the neo-liberalising international political economy.

Developmentalism and neo-liberalism as belief systems

In the literature devoted to explaining the underlying features and background of Korea's and Japan's economic development, the unique characteristics of the PDS and TS periods are ignored by most researchers. There has been no academic effort to build a bridge between developmentalism and neo-liberalism in order to obtain a clear understanding of the Korean and Japanese PDS periods and the Korean TS period. More importantly, as Bishop points out, "the literature may have underestimated the role of the state's developmental ideology" (1997: 3) or "the ideology of developmentalism" (1997: 6). And, as Haggard observes, the debate on state autonomy "does not answer the nagging question where state interests come from" (1990: 46). Thus, the key role of belief systems in determining economic policies and the preferences of policy-makers cannot be ignored any more. As the rational model suggests, material interests are important in influencing the policy-making process and policy outcomes. However, belief systems are just as important. As Higgott points out, the East Asian economic crisis was an ideational conflict between East Asian developmentalism and Anglo-American neo-liberalism (Higgott 1998). Amsden also argues that "neo-classical economics . . . is still only a theory. The policies associated with it do not automatically generate the outcomes they promise . . . Between theory and practice lies a mountain of assumptions" (Amsden 1994: 628).

This means that developmentalism and neo-liberalism are economic ideas or economic grand-theories which have to be chosen by policy-makers in order to implement economic policies and to achieve certain policy outcomes. Thus, the absence of an ideational approach in the literature of Japanese and Korean studies is a major problematic factor. For this research, this thesis seeks to incorporate learning theory, which focuses on the belief systems of policy-makers, into the existing literature through a critical review.

Belief systems and the strong state

The significance of belief systems is also neglected in the debate on the DS or 'strong state'. The emphasis of this debate has been on autonomy, capacity, and a coherent policy-making process (Haggard 1990: 43-44). For example, Wade (1997: 375) argues that state effectiveness depends on both policy coherence and the insulation (autonomy) of the bureaucracy. The statist approach argues that a strong state can emerge only when policy-makers are insulated from societal interest groups (Woo 1991, Johnson 1987: 145, Leftwich 1996) and international systemic pressures (Clapham 1996: 601). Insulation is a prerequisite of state autonomy. A strong state is also regarded as one which possesses extensive policy instruments through which policy-makers can coerce or persuade various economic actors in order to achieve the state's economic objectives. For the statists, a strong state also needs a coherent policy-making process, which is possible only when inter-ministerial conflicts are absent.

However, the critics of these debate on the DS or strong state argue that bureaucrats' insulation and a coherent policy making process do not necessarily lead to effective policy outcomes. As Doner (1992) argues, state preferences are not independent but are reflections of coalitional preferences. Moreover, even in a highly efficient developmental state, a decentralised policy making process and inter-ministerial conflicts can easily be detected. Also, these debates are not dynamic but static because they assume "that once the state initiates and plays a successful role in economic development, its hegemony in the economy will continue indefinitely" (Eun Mee Kim 1988: 515).

What all these arguments ignore is the importance of belief systems or ideas. A coherent policy making process can be realised only when policy-makers share the same economic beliefs or ideas. As Bishop notes: "a key determinant of bureaucratic capacity is the value system which holds the bureaucracy together" (Bishop 1997: 147). Neo-statists like Weiss ignore the significance of belief systems in determining the strength of a state. Weiss and Hobson (1995) argue that the state has three outstanding capacities: penetrative, extractive, and infrastructural. Infrastructural capacity is based on 'governed interdependence' between state and civil society. The penetrative and extractive capacities are closely interlinked because if a state has a high penetrative capacity into civil society, then, it will also have a high extractive capacity, as measured by, for example, the amount of taxation. Weiss and Hobson emphasise the infrastructural or co-ordinating capacity through which state can assume a leadership position while accomplishing a higher form of co-ordination from civil society. For Weiss and Hobson, Japan is a representative state with a high co-ordinating capacity. This perception is similar to Johnson's structural model of East

Asia. For Johnson, in addition to bureaucrats' autonomy from societal forces, "co-operation between public and private sectors under the overall guidance of a pilot planning agency" (1987: 145) is a distinctive characteristic of East Asian economic development. Evans (1989) also argues that a strong state has an 'embedded autonomy' which facilitates continuous negotiations between state and society. Young-Myung Kim (1996: 24) also argues that "the strong state exercises its power not by coercion but by close interactive relationships between the bureaucracy and private companies".

Weiss and Hobson, Johnson, Kim and Evans all fail to appreciate that continuous co-ordination and negotiation between state and society can be realised or strengthened only when there is a shared belief system between state and society. By highlighting the co-ordinating aspects of the developmental state, this literature overcomes the prevalent argument which not only emphasises the state's coercive capacity over society (Woo 1991) but also regards state-society relations as a zero sum game. However, it fails to identify the basis of co-operation between state and society in shared economic beliefs.

In the cases of Japan and Korea, the shared beliefs in economic mercantilism and developmentalism, which are externalised respectively as the 'catch up' policy in Japan and the 'economic growth first policy' in Korea, have enabled the Korean and Japanese developmental states to accomplish rapid and high levels of economic growth. The key role of belief systems in determining the strength of the state is elaborated in more detail in Chapter 5.

Intangible institutions and sociological new institutionalism (SNI)

In the literature on Korean and Japanese studies, institutions are another important but neglected variable. Institutions in this literature tend to be restricted to only tangible institutions such as governmental organisations, legal systems, and standard operating procedures. Even though Haggard calls his approach an institutional approach (Haggard and Moon 1990), his approach is interchangeable with statist approach (Fields 1995: 23). For him, "the institutional perspective on economic policy emphasises the organisational features of the state" (Haggard and Moon 1990: 230). Doner (1992) claims that he adopts an 'institutional approach' in which not only the characteristics of the strong state but also the co-operative aspects between state and influential groups are incorporated. However, he also neglects the importance of economic belief systems. The shortcomings of these narrowly defined institutional perspectives become clear when we endeavour to understand the roles and effects of intangible institutions in the foreign economic policy making processes of Korea and Japan. People's sentiments, externalised as economic nationalism and xenophobia, which can be easily detected in the cases of Korea and Japan, are observable but intangible institutions. Without incorporating these intangible institutions into analysis, Korea's and Japan's highly protected inward FDI (IFDI) environment cannot be clearly understood. Moreover, since institutions are vitally important in the learning process, it is necessary to consider institutional settings. In other words, a country's learning result is heavily influenced by that country's specific institutional settings as exhibited in culture, practices, social norms, and people's sentiments, as well as, governmental organisations and legal systems.

Thus, in order to overcome the limitations of the existing literature and to take account of the role of intangible institutions, this thesis adopts the perspective of sociological new institutionalism (SNI). The concept of 'imbeddedness', which is elaborated in SNI, provides useful tool to explain the institutional inertia which causes institutional resistance to change, even though the original configuration of interests and political coalitions which produced the emergence of particular institutional settings has been modified. The term 'isomorphism' is also useful: through mimetic, normative, and coercive isomorphism, institutions change. Thus, this thesis seeks to incorporate SNI into the existing literature, thereby highlighting the influence of intangible institutions on policy making processes and policy outcomes. The role of ideas and institutions in the foreign policy making process is discussed further in the sub-conclusion of Chapter 5.

A synthetic theoretical framework

Another major limitation of the existing literature lies in the problematic nature of its theoretical frameworks. The literature of Korean and Japanese studies has been dominated by the statist and international system approaches. Because the civil societies in both Korea and Japan are underdeveloped and not mature, a society-centred approach has not appeared to be suitable for explaining Korea's and Japan's foreign economic policy (Chu 1989, Johnson 1995: 67). However, as we have seen, Korea and Japan entered the PDS phase after the mid-1980s. As a result of steady but high economic growth during the two countries' DS period, there emerged a middle class and various societal groups which formed a basis for challenging the Korean and Japanese states. As Thompson points out, the case of Korea "fit[s] with the predictions of modernisation theory" (Thompson 1996: 626). As modernisation

theory argues, Korea's civil society has steadily grown as a result of economic development. This argument can also be adopted to the case of Japan: Japanese civil society has grown and, as a result, a middle class and pluralistic interests groups have increased (Pempel 1993, Jang-Kwon Kim 1996, Higashi and Lauter 1990, Zhao 1995). This means that a society-centred approach cannot be ignored any longer in explicating Korea's and Japan's foreign economic policy.

This thesis elaborates a synthetic approach to Korea's and Japan's foreign economic policy. The aim is to synthesise the statist approach, the societal approach, the international system approach, the learning approach, and the institutional approach. Each of these approaches in isolation produces only a partial analysis. There are several researches which have endeavoured to overcome the limitations of a single approach. Woo (1991) argues that her approach takes account of the statist, societal and international system dimensions of Korea's political economy. However, she does not consider the roles of ideas and institutions. In his efforts to elaborate the background of the Japanese 'reactive state', Calder (1988) considers the Japanese state, the international system, and the domestic political structure with equal emphasis. However, he excludes the institutional and ideational influences on the emergence and consolidation of the Japanese reactive state. Without considering both Japanese bureaucrats' belief in the efficacy of developmentalism, and the institutional resistance emanating from developmentalism-based institutional settings, a clear understanding of the Japanese reactive state is impossible. Criticising the statist approach, Koo (1987) argues that he adopts a 'comprehensive approach' through which the inter-relations among state, society and the international system are closely

examined. However, he also overlooks the institutional and ideational aspects of the political economy of Korea and Japan.

Haggard adopts an approach which incorporates statist, societal, international systemic, and ideational factors in his book *Pathways from the Periphery* (1990). However, for him, societal and international systemic factors are of less importance than statist factors (1990: 42-43). And he also fails to understand the significant role of intangible institutions. Moreover, even though he acknowledges the importance of ideational factors, he also fails to suggest any concrete explanation of the role of belief systems and ideas in his research. Weiss and Hobson (1995: 10) argue that their theory of neo-statism does not exclude societal and international system approaches. However, their approach remains essentially a statist approach. Goldstein (1993) connects ideas and institutions to America's trade policy. Her excellent contribution in developing an ideational approach cannot be doubted. However, for her, institutions are defined narrowly as laws. Even though she argues that her research incorporates intangible institutions such as norms and rules, her research is strongly focused on changes in America's trade laws, which are of course closely interlinked with economic ideas. Although Goldstein explores the ideational approach, for her only economic liberalism and economic protectionism are regarded as economic ideas. In this thesis, developmentalism and neo-liberalism are regarded as economic belief systems or ideas.

The neglect of ideational and institutional factors in research produce a partial understanding. For example, Gill argues that continuous liberalisation policies under Korea's 'Segyehwa (globalisation) policy', initiated by the Young-Sam Kim

government, "poses the possibility of an abandonment of the developmental state model" (1996: 667). Byung-Chun Lee also argues that "developmentalism as a model was continuously adjusted to market economy, and as a result, in the Young-Sam Kim administration, the fundamental structure and features of developmentalism finally collapse" (1998: 1). These assertions are simply wrong. As we will see in Chapter 5, liberalised policies in the PDS period were not accompanied by changes in ideas and institutions. Liberalisation processes were not an outcome of genuine 'learning' (changes in belief systems) but merely a tactical 'adaptation' (in terms of behavioural change) to pressures from both the international system and domestic society. Ideas and institutions were strongly entrenched in developmentalism. As a result, far from making the abandonment or collapse of developmentalism, the Segyehwa policy was an extension of the 'economic growth first policy', which was the core part of Korea's developmentalist belief system.

Four types of learning

The concept of learning has been developed by several disciplines in the social sciences. There are basically four types of learning relevant to this thesis: (1) technical learning, which refers to the transfer of technology and managerial know-how; (2) institutional learning, which refers to the mimetic or coercive isomorphism of institutions; (3) learning in foreign policy analysis, which deals with the belief systems, ideas and ideologies of policy-makers; and (4) learning and the applicability of the East Asian development model (EADM) to other less developed countries. In this thesis, learning in foreign policy analysis is the primary analytic framework, but the other three varieties of learning will not be excluded. The concept of 'technical learning' gives us a tool to explain Korea's technological dependency on Japan and

the US. It is also necessary for understanding Korea's and Japan's FDI flows, because FDI accompanies the transfer of technology and managerial know-how. Mimetic isomorphism, which is developed in the theory of sociological new institutionalism, can provide a persuasive answer to the question: why are there so many similarities in the bureaucratic or semi-governmental structures between Korea and Japan? And the concept of coercive isomorphism provides a sophisticated explanation of Korea's learning from the international neo-liberal regime, represented by the combination of the IMF, the World Bank, and the US. Before the IMF bailout, the view that the timing of Korea's neo-liberal structural adjustment would be slower and more costly than that of Japan was dominant. This view was supported by the fact that Korea had a more dirigiste economy and a more rigidly strong state compared with Japan. However, this prediction proved wrong. After the economic crisis, Korea experienced rapid reform, including labour market flexibility, financial deregulation, Chaebol restructuring, and administrative streamlining. These reforms were the result of coercive isomorphism or coercive learning from the international neo-liberal regime.

Learning in foreign policy analysis deals with policy-makers' belief systems, ideas and ideologies. So far, this approach has focused mainly on strategic studies during the Cold-War period, particularly relations between the US and the Soviet Union. In this thesis, the concept of learning is employed to analyse foreign economic policy. Thus, developmentalism and neo-liberalism are considered not as empirically proven prescriptions but as belief systems for economic development. The literature on learning and the applicability of the East Asian development model seeks to extract core strategies or specific features from East Asian countries' economic development, and then to formulate an economic model to be emulated by other less developed

countries (Amsden 1994, Broad and Cavanagh 1995). This thesis offers an overview of learning theories which are presently scattered in the social sciences, and the application of a belief systems approach to the analysis of Korea's and Japan's foreign economic policies on FDI. We will discuss the four types of learning in more detail in Chapter 3.

FDI and belief systems and institutions

Foreign direct investment (FDI) is taken as a case study in this thesis. Both inward and outward FDI are dealt with as a major focus of this research. The role of FDI has already surpassed that of trade in international political economy. Research toward FDI flows has been centred around two main questions: (1) What are the determining factors of FDI flows?; (2) How are host countries, home countries, and MNCs related in terms of power? In other words, what are the relationships between the state and the market? In the literature of International Business (IB), the main concern has been devoted to explain the determining factors of FDI flow, while in the discipline of International Political Economy (IPE), the second question has been predominant. However, academic communication or mutual understanding between IB and IPE have been very rare. As Gilpin (1975: 5) points out, political scientists believe in power and economists believe in the market. This thesis tries to overcome this sharp division and the basic limitations of research on FDI by incorporating both IB theories on FDI and IPE theories on FDI. FDI theories in both IB and IPE are critically summarised in Chapter 2. This includes both FDI theories of developing countries and FDI theories of developed countries. After the 1980s, developing countries started their outward FDI (OFDI) in order to maximise their comparative advantage in

cheap labour costs or to obtain high technologies through M&As and strategic alliances. Korea is one of the outstanding cases of such OFDI development.

The most important contribution of this thesis lies in its focus on belief systems and institutions to explain the inward and outward FDI flows of both Korea and Japan. The crucial influence of belief systems and institutions in FDI developments can be explained through comparative research. Thus, in this thesis, the historical and comparative study of Japanese and Korean FDI development is pursued. This approach has not previously been employed. Even though some researchers have adopted the comparative or historical research method (Gwang-Chul Lee 1995), they have been heavily dependent on an economic approach in terms of the regional, industrial and country distribution of FDI flows. And even though some research has taken account of state roles in FDI flows, particularly in terms of the supporting organisations and regulating systems of both countries (for Japan, Sakurai 1995, Tokunaga 1992, Dobson 1993, Machado 1996, and for Korea, Neurath 1984, Clark and Chan 1996, Lall 1995, Chung and Branscomb 1996), there has been no research focusing on national institutional and ideational settings.

Characteristic business practices (Keiretsu in Japan, Chaebol in Korea, opposition towards hostile take-overs in both countries) and ordinary people's xenophobia and economic nationalism (e.g. in the civil movements of 'buy Korean or buy Japanese goods') are intangible but significant institutional factors which heavily influence both countries' IFDI flows. The belief in the efficacy of developmentalism has also constrained IFDI flows in both countries. Without considering these ideational and intangible institutional factors, both Korea's and Japan's FDI policies and policy

outcomes cannot be fully understood. For example, in the Korean and Japanese DS period, developmentalism as a belief system prevented IFDI liberalisation and led to detailed state regulations and screenings. In the Korean and Japanese PDS period, institutions, particularly business practices and business culture, hindered the increase of IFDI, although IFDI policies were continuously liberalised and state regulation also gradually perished. These factors are ignored in the existing literature on the FDI development of Korea and Japan.

FDI flows are chosen as a case study because, first, FDI is an important index of economic globalisation. International investments among states have now surpassed international trade among states. However, as we have seen above, there has been little comparative research on Korean and Japanese FDI, and it has tended to adopt an economic approach. The political aspects of Korean and Japanese FDI development have been neglected. Second, as the Korean and Japanese economies have been increasingly internationalised, the content of Korea's and Japan's FDI policies and policy-makers' belief systems regarding FDI have changed. These changes clearly reveal the differences among the DS, PDS and TS periods. The DS was characterised by the state's heavy regulations and case by case screenings. The PDS was characterised by consecutive liberalisation processes of FDI policy which were not accompanied by changes in bureaucrats' belief systems and institutions. The lack of congruence and consistency among these three pillars resulted in the general ineffectiveness of liberalisation policies. Inward FDI flows were continuously regulated and protected in the PDS period. The Korean TS period is characterised by fully fledged and comprehensive liberalisation of the Korean FDI regime, caused by the impact of the economic crisis. Korean bureaucrats' belief system has changed and

became geared to the efficacy of the neo-liberal free market economy in the TS period. In sum, Korean and Japanese FDI policy and the associated belief systems in FDI clearly reveal the distinctive features of the DS, PDS, and TS periods.

The expansionist developmental state (EDS)

As well as using the ideational and institutional approaches, we also need to use the political approach. This is because both the massive Japanese OFDI development and the smaller Korean OFDI development have been facilitated by political calculations and governmental interventions. Thus, this thesis seeks to connect Japanese and Korean OFDI development in Southeast Asia with the domestic characteristics of developmentalism in the two countries. Without considering Korean and Japanese domestic developmentalism's massive influence on OFDI flows, we cannot obtain a clear understanding of East Asian economic integration. In order to connect East Asian economic integration with Japan's and Korea's domestic developmentalism, a new conceptual framework is required, and for this purpose the concept of the 'expansionist developmental state (EDS)' is employed in this thesis.

The EDS refers to the state which propels economic structural adjustment and its ultimate political objectives by expanding and re-locating the peculiar characteristics of the developmental state into other states or regions in order to overcome the challenges from both the domestic and international arenas. The main challenges are rising production costs and increasing trade friction caused by the highly politicised international political economy. Political objectives include the acceleration of economic structural adjustment in the domestic sphere and the improvement of a state's political weight in a certain region in order to accomplish 'omni-directional

diplomacy' (Korea) or regional hegemony (Japan). In this respect, the EDS was a policy outcome of Korea's and Japan's post developmental state. The PDS has an active aspect in its characteristics: it is a dynamic state which pursues not only the internalisation of external pressures coming from the international system but also the externalisation of internal pressures coming from domestic society in order to solidify and extend its autonomous position emanating from historically determined or influenced institutions. The result of this active feature is the emergence of the Japanese and Korean EDS in Southeast Asia.

There are basically two distinctive FDI theories which are used to explain the phenomenon of East Asian FDI development: product cycle theory, developed by Vernon, and the production networks approach. Product cycle theory is interchangeable with the flying geese analogy first introduced by Akamatsu (Bernard and Ravenhill 1995: 174). Product cycle theory argues that as a result of transfers of standardised technologies and products from developed countries to less developed countries, a massive increase of reverse imports to developed countries from the less developed countries, led by those transferred products, will be realised. And, as a result of the successive processes of these transfers, product cycle theory argues that, not only the 'catch up' phenomenon but also the homogenisation of industrial structures among the countries will occur. Product cycle theory is based on the natural changes of comparative advantage among countries. Through the product life cycle, Japan transferred standardised and outdated technologies and products to NIEs and then to ASEAN countries. Thus, by being incorporated into this product life cycle, both NIEs and ASEAN countries achieved a certain level of economic development. And, because of differences in comparative advantages among East

Asian countries, there emerged a vertical division of labour in which a triple structure of regional economic tiers was consolidated: Japan provides expensive and high-technology based capital goods: NIEs countries produce low-level capital goods, while ASEAN countries are positioned to provide cheap labour costs. This is what is representing the flying geese analogy.

The production networks approach (Bernard and Ravenhill 1996, Hatch and Yamamura 1996) refutes the assumptions of product cycle theory. It highlights a hierarchical and unequal division of labour in the region. This is different from the predictions of product cycle theory, for example, the realisation of catch ups by less developed countries, the massive increase of reverse imports, and the homogenisation of industrial structures and strategies among regional countries. Thus, the production networks approach emphasises the slow increase of reverse imports to Japan in the region and more exacerbated technological gaps among regional countries. Moreover, by focusing on each country's specific historical, institutional settings, which are the outcomes of the country's distinctive state-society relations and unique timing and strategy of incorporation into the regional and global structures of the division of labour, the production networks approach strongly criticises the concept of the homogenisation of industrial structure and strategy assumed by product cycle theory. In this thesis, particularly in Chapter 2, it will be argued that the production networks approach is a part of product cycle theory. It will be also argued that both approaches reveal the same weak point, in the sense that they underestimate the dynamic roles and efforts of regional countries in promoting technological capabilities and overcoming the structural problems of 'dependent development' consolidated in the region.

As we will see in Chapter 2, there are several FDI theories in International Business (IB) which seek to explain the determining factors of FDI flows: the OLI paradigm (ownership, locational, and internalisation advantage), strategic management theory, and Investment Development Path (IDP). However, from the early 1990s, a new FDI phenomenon (new integration) emerged, different from the old integration (See Table 2-1). This is alliance or collective capitalism which indicates the importance of strategic alliance-seeking FDI flows (Dunning 1995: 58). Alliance capitalism is carried out through M&As and strategic alliances. This new phenomenon replaced old types of integration (vertical, horizontal integration, and intra-firm, inter-industry and intra-industry trades) with new integrations (alliance capitalism and inter-firm integrations.) Of course, the emergence of new integration has been facilitated as the costs of technological developments has become so expensive that only individual firms cannot undertake the costs of R&D. Also, the life cycle of new technology has become shorter. As competition in technological development has become highly intensified and leading MNCs' capacity for innovating new technology has become increasingly homogenised, the learning curve has become steeper. As a result, the technological gap between developed countries and less developed countries is getting wider. Neither the product cycle theory nor the production networks approach can produce a complete explanation of these new FDI developments. They can explain only the old integrations.

However, it has to be remembered that in East Asia, new integrations (alliance capitalism) are very rare. Japan's and Korea's OFDI development in Southeast Asia is still based on the old integration. New integrations occur between the MNCs of developed countries. This means that in this thesis, the flying geese analogy, product

cycle theory, the production networks approach, the OLI paradigm, strategic management theory, and investment development path theory will be dealt with in Chapter 6 with a variety of data. However, in Chapter 2, new theories which explain new FDI development will be reviewed in order to improve our understanding of FDI theories and developments.

A brief preview of subsequent chapters

As we have seen, Korea has undergone three distinctive developmental stages: the developmental state period; the post developmental state period; and finally the transitionary state period under which IMF-forced neo-liberal reforms have been undertaken. In these stages, we have witnessed two types of learning: voluntary learning from the Japanese developmental state and coercive learning from the international neo-liberal regime. The main characteristics of three developmental stages and the two types of learning are clearly revealed through the case study of FDI. The flows of FDI are determined by both government and private enterprises. Therefore, theories of FDI and theories of the policy making process are both re-examined in this thesis. Theories of FDI elaborated not only in International Political Economy (liberalism, realism or mercantilism, structuralism, the flying geese analogy, product cycle theory) but also in International Business (the OLI paradigm, strategic management theory, investment development path theory) are reviewed in Chapter 2. Theories of the policy making process, which focus on three analytic levels (domestic or societal, statist, systemic) are re-examined in Chapter 3. In Chapter 3, these theories of the policy making process are supplemented by the belief system approach and sociological new institutionalism in order to develop a synthetic approach. Any analysis which focuses on only one analytic level of the policy making process

(international systemic, statist, societal, institutional, or ideational approaches) will fail to grasp the whole picture of the complicated reality of Korea and Japan's foreign economic policy making processes and outcomes. Also, a theory of FDI which is focused on only macro-level analysis, such as mercantilism or structuralism, lacks a coherent understanding of the micro-level motives of private enterprises, which are developed in International Business.

In Chapter 4, the Japanese state's socio-economic and political transformation from the developmental state to the post developmental state are explained, and in Chapter 5, the Korean state's transformation from the developmental state through the post developmental state to the transitionary state are elaborated. Differences between the DS, PDS, and TS period in terms of the relations among civil society, state and the international system are elaborated in Figures 1, 2, and 3 in Chapter 3. In Chapter 6, both Korean and Japanese FDI flows are examined on a comparative and historical basis. In this Chapter, both inward and outward FDI are researched.

Japan as an object of comparative study with Korea

The reason why Japan is chosen here as an object of comparative research is that a comparison of Korean and Japanese FDI provides an academic space in which four types of learning can be dealt with. Because of their geographical closeness and cultural affinity, there has been wide and intensive economic interactions between the two countries. After the mid-1960s, Korea learned from Japan in terms of technical learning and institutional learning. As a result, Korea is sometimes regarded as the next Japan. The proponents of this view believe that for the last 35 years, Korea has developed in the same ways as Japan. As a matter of fact, there are similarities

between the developmental models of Korea and Japan. These similarities can be found in each country's strategic trade and investment policy, industrial policy, and well-organised bureaucracy. Consequently, with regard to the role of the state in planning and achieving economic national goals, both Korea and Japan are categorised as 'plan rational' states for scholars like Johnson (Henderson and Applebaum 1992). Moreover, Korea's belief in the efficacy of developmentalism in achieving economic targets was learned from Japanese developmentalism. Thus, a comparative study of Japan and Korea provides us with the chance to deal directly with three types of learning. Moreover, because Japan is the original prototype of the East Asian developmental model, and also because Korea is another type of EADM, a comparative study of Japan and Korea provides us with the opportunity not only to investigate the common features of the EADM but also to retrieve some implications for the applicability of the EADM to other less developed countries.

Scope, time span, and method

In dealing with Korean and Japanese OFDI in this thesis, the host countries are confined to the ASEAN 5 (Indonesia, Malaysia, Thailand, Philippines, and Singapore) and the time span for FDI development is from 1962 to 1998 for Korea and from 1950 to 1998 for Japan. This thesis is based on a range of sources including an extensive literature review. Secondary sources such as governments' and international organisations' official statements and publications were also analysed to supplement the literature review. The government sources used in this thesis are: 'Economic Bulletin' (published by the Korean MOFE), 'Monthly Review' (Korea Exchange Bank), 'White Paper on International Trade' (JETRO), and 'Monthly Finance Review' (the Japanese MOF). In order to check and confirm information obtained from

government sources, private sector publications and opinions are also introduced. The private sources are: JAPANECHO (English version), 'Japan Economic Almanac' (Nihon Keizai Shimbun), and various Korean newspapers.

Chapter 2.
Theories on FDI

Contents

With the increasing MNCs' horizontal and vertical integration, international production caused by FDI has become the chief vehicle of economic interdependence and globalisation. Thus, the importance of FDI as a symbol of globalised MNCs activities both in the economic and political spheres has been at the centre of the disciplines of IPE and International Business (IB) since US MNCs increased their activities in Europe from the early 1960s. Since then, in the discipline of IPE, the main concerns have been devoted to the relationship between the state and market or the state and MNCs. Thus, discussions have centred around several key questions. First, whether the state has lost its economic sovereignty over MNCs or globalising market forces. Second, whether FDI has negative effects on the home country's domestic economy such as the hollowing out of industry and the increase of unemployment or on the contrary, whether FDI accompanies domestic structural

adjustment by facilitating the shift to a high-technology and high value added industrial structure in the home country. Third, whether FDI flows are trade diminishing or trade promoting. Fourth, which theory among realism, liberalism, and structuralism provides a better interpretation of the relationship between the state and market. In relation to the first question, the discourses of 'the retreat of the state' (Strange 1996), 'sovereignty at bay' (Vernon 1971) and 'the end of nation state' (Ohmae 1995) privileges the predominance of market forces spearheaded by MNCs over the state's regulatory, managerial, coordinative and transformative capacity.

In contrast, the discourse of 'MNCs at bay' and 'bringing the state back in' insist on the resilience of the state as a main determinant actor in international political economy. With respect to the third question, Kojima's FDI theory argues that the type of FDI can be divided in terms of macroeconomic and microeconomic underpinnings. While the former is based on the changes of comparative advantage between home and host countries, the latter is based on the MNCs' search for the host country's local market in order to exploit its oligopolistic advantages such as highly sophisticated technology. Thus, while "Japanese direct investment is complementary to changes in its comparative advantage position" (Kojima 1978:86) and facilitates Japan's industrial adjustment by improving its industrial structure from labour intensive to knowledge intensive, American FDI which is mainly developed by innovative, oligopolistic MNCs cut-off their comparative advantage by setting up foreign subsidiaries. In other words, by transferring labour-intensive industry through FDI to developing countries, which then gain their comparative advantage in labour intensive industry, Japan's FDI plays a significant role in facilitating both Japan's structural adjustment and increases in host country exports in labour-intensive industry. In

contrast, American FDI, which is mainly developed by innovative, oligopolistic MNCs pursues microeconomic or firm-specific interest at the expense of America's comparative and competitive advantage by transferring technology to foreign subsidiaries and giving up the chance to increase the amount of exports (Kojima 1978: 86-9). This specific feature of America's FDI is explained by Vernon's product life cycle theory. In sum, Kojima insists that "the main distinction between Japanese and American FDI is that Japan's FDI is aimed at increasing international trade and is, thus trade-oriented, while American FDI is to serve the recipient country's market: as such, it is anti-trade-oriented" (Okposen and Kanbur 1996: 56).

On the other hand, in the discipline of IB, questions such as why and how MNCs invest overseas and where they invest have been the main area of interest. Thus, eclectic theory (ownership, internalisation, locational advantages) and strategic management theory have been developed in order to explain these questions. It is important to acknowledge that there have been some interactions between IPE and IB. The incorporation of Vernon's works (product life cycle theory, sovereignty at bay, and the obsolescing bargaining model) into IB and the discussion of Dunning's work on eclectic theory (OLI : ownership, locational, internalisation advantage) in IPE provide clear evidence of the interactions between IPE and IB (Eden 1991:203). However, the main focus of each discipline (the state or firms) remains unchanged and resists more intensified interaction between the two disciplines. In other words, "economist do not believe in power" and "political scientists . . . do not really believe in markets. Economists have ignored the political context and the necessary political conditions underlying foreign direct investment . . . Political scientists, on the other hand, have generally neglected economic theories which explain the sufficient

economic condition for foreign direct investment" (Gilpin 1975: 5). Thus, while IPE treats firms and their collectivity as a black box, IB ignores the inherent conflicts between the state and MNCs (Sally 1994). This incompatibility is, without a doubt, the main obstacle to obtaining a clearer understanding through a multidisciplinary approach of the relations between the state and MNCs as main facilitators of the globalising market (Strange 1996: 12).

The main purpose of this chapter is to overcome this deep division and relatively mutual ignorance between IPE and IB in understanding the changed international political economy caused by the increased activities and leverage power of MNCs against the state and the various response of the state to MNCs. In order to fulfil this purpose, first of all it is necessary to review the theories of FDI developed in both IPE and IB and then in the sub-conclusion review the significant debates concerning the state versus/and market.

1. FDI theories

1-1. FDI theories in IB

According to Eden, the major analytical focus of IB has changed three times since the 1960s. At first, a macro approach focusing on the question of the substitutability of FDI and international trade was developed. In the mid 1970s, the focus shifted from FDI's impact on trade to MNCs' institutional structures. Finally, from the mid 1980s, this institutional focus, which produced the OLI paradigm (ownership, locational, internalisation advantage) was supplemented by strategic management theory. The latter was developed using the core concept of 'value chain' in order to explain the

new pattern of international production called alliance, relational, and collective capitalism[1] in the 1990s (Eden 1991:204).

In the study of IB, there have been five main approaches to international production; the cost of capital theory, industrial organisation theory, internalisation theory, eclectic theory and strategic management theory. The cost of capital theory is based on classical trade theory's main assumption of factor immobility between countries (Heckscher-Ohlin model) and this theory argues that interest rate differences are the main reason for international capital investment. However, with the emergence of international production, this traditional portfolio capital flow theory became obsolete "because it contradicts the idea of long-term commitment and managerial control inherent aspects of foreign direct investment" (Huang 1997: 8-9). Industrial organisation theory (ownership advantage) was developed by Hymer and argues that firm specific assets such as economies of scale, superior knowledge competence or property rights (technology innovation capacity, patent rights, royalty, managerial know-how, brand name rights), well established distribution networks, and efficient credit mobilisation capacity are the background of a firm's advantages that overcome the extra costs incurred by operating in foreign countries (Huang 1997: 9).

The internalisation approach (transaction cost approach) was developed by Dunning and internalisation advantages are the "advantages a company gains by using its ownership factors internally instead of trying to sell them on the market to third

[1] Dunning defined this term to describe specific feature of international production in the 1990s, especially M&A. "The critical feature of strategic-asset-seeking FDI is that the acquiring firm in a takeover . . . accepts that its internal, or stand-alone, resources and capabilities are insufficient to sustain its international competitiveness, and that it needs to draw upon resources and capabilities of other firms to achieve this goal". See John H. Dunning (1995: 58).

parties, e.g. foreign production as opposed to licensing . . . and include the ability to cross-subsidise products or operations, the ability to avoid transaction and negotiation costs, buyer uncertainty about the value of technology being sold, and the ability to control supplies of inputs and their conditions of sale" (Taggart and McDermott 1993:28). This oligopolistic feature of MNCs' internalisation advantages cannot be explained by the neo-classical assumption of perfect markets and its ignorance of the concept of transaction costs, because under neo-classical "perfect competition, atomistic firms all enjoy equal access to technology and markets, with none large enough to influence prices of inputs or output" (Froot 1993:39-40).

The eclectic theory (OLI paradigm) was developed by Dunning and is the result of a combination of internalisation and ownership advantages with host country locational factors which include "trade barriers which restrict imports, most types of labour, natural resources, proximity to final markets, condition of transportation and communication, degree of government intervention, and cultural distance" (Taggart and McDermott 1993:25-6). Thus, it can be argued that Dunning's eclectic theory provides a comprehensive answer to the question of why firms invest abroad and where they go. Strategic management theory insists that MNCs engage in a set of activities called 'value chain' and it:

> consists of primary activities (functions involved in the physical creation of the product such as extraction, processing, assembly, distribution, sale and service) and support activities (functions that provide the infrastructure necessary to support the primary activities such as research and development, finance, marketing). Each firm must decide the shape and length of its value chain (Eden 1991: 208).

It is the combination of the OLI paradigm and the value chain of MNC strategy which provides the key understanding of today's ever increased horizontal and vertical integration of MNC activities. As we have seen from the above, the study of IB has transformed its main focus three times. The last change in focus from the institutional characteristics of MNCs (OLI paradigm) to the production activities and international value chains of MNCs reflects the rapidly changing structures of today's international production. The outstanding features of today's international production are "an enormous increase . . . both in crossborder alliance between firms in the same industry within the Triad economies . . . [and] . . . the increasing use by states of aggressive industrial policies in high-technology sectors designed to increase national competitiveness" (Eden 1991: 204). In other words, the new style of MNCs in the 1990s was a constellation of several motives: the pursuit of knowledge intensive production rather than low cost labour production and the search for new Schumpeterian innovations in production and processes from other triad economies' MNCs. This new style of MNCs of the 1990s, which can be called alliance capitalism, became much more complicated as nation states intervened in this game in order to upgrade national competitive advantage and created assets (technological and informational capacity, managerial and organisational competence) (Dunning 1993:6). This combination of the market force of MNCs and the state's increased role in promoting economic growth needs a combination of both IPE and IB theories on FDI which have been focused on politics and economics respectively.

1-2. FDI theories in IPE

FDI theories in IPE can be divided into two distinct groups: the first group is based on IR theories of realism, liberalism, and structuralism (Gilpin 1975, Clark and Chan

1996) while the second group encompasses more economically oriented approaches such as the product life cycle theory, the law of uneven development, the obsolescing bargaining model, and finally, the changing international division of labour approach (Eden 1991:198).

The first group was developed by Gilpin's pioneering work on the relations between the impact of US hegemony decline and FDI flows. For him, there are three models in interpreting FDI flows, that is, the sovereignty at bay model (liberal view), the dependencia model (structuralist view) and the mercantilist view (realist view). Meanwhile, Clark and Chan suggest a different version of naming each theory, that is, modernisation theory (liberalism), dependency theory (structuralism), and statist theory (realism) (Clark and Chan 1996: 84). The sovereignty at bay model and modernisation theory argue that because of the magnificent advances in technology, communication, and transportation and MNCs' indifference to national territories in making decisions on investment, trade, production, and distribution, the nation state has lost its control over the domestic economic sphere and it is unable to preserve its independence and sovereignty in setting macro-economic objectives and policies. Proponents of this view insist that MNCs can promote economic growth and contribute to improving economic efficacy through both stimulating competition in the host country and transferring high technology. In doing so, MNCs also lessen income inequality between developed and developing countries. In summary, MNCs are "seen by liberals as generally beneficial in their role as promoters of a more integrated world order, offsetting the mercantilist tendencies of nation-state" (Eden 1991:198).

The dependencia model which is Marxist inspired argues that MNCs are aggravating the already problematic asymmetrical development between core and periphery countries and preventing the realisation of a balanced distribution of wealth. Proponents of this view believe that MNCs are frustrating developing countries' aspiration to attain indigenous technological capability by providing out-dated or obsolete technology and solidifying dependence and exploitation by concentrating high-tech, value-added industry and R&D facilities in their home countries while confining third world countries' economies to labour-intensive or resource-extraction industry. Moreover, by incorporating the third world elite into their transnational capitalist class, MNCs also generated the potential for domestic conflicts and social division or hostility in developing countries. Structuralists also contend that the predominance of MNCs in the host country will result in a further spiral circle by undermining indigenous national capital accumulation, indigenous technological capability, and native entrepreneurship, which are the underlying foundations of autonomous economic development. In summary, structuralists consider MNCs as "oligopolistic transnational capitalists that systematically exploit and promote underdevelopment in the periphery and semiperiphery creating global income inequalities" (Eden 1991:198) and argue that developing countries' high dependence on MNC finance, technology and production systems will ultimately result in unavoidable, permanent deeper dependence caused by a distorted domestic economic structure.

The basic proposition of the mercantilist model or statist view is that "strong and autonomous states can regulate MNCs and thereby make them contribute to national economic performance" (Clark and Chan 1996: 84). This view can be related to the

state's managerial capability' of making efficient industrial policy, strategic trade policy, and competition policy which are suitable for each state's industrial structure, developmental stage and ultimate economic objectives. Moreover, this statist view can also be related to the state's transformative capability' which means the ability of the state to adjust its economic ideology, institutions and policies in order to overcome challenges from the rapidly changing international political economy such as economic globalisation and the convergence process towards neo-liberalism and multilateral liberalisation of trade, investment and finance. This version of the state's transformative capacity is similar to Weiss's definition. For Weiss, the state's transformative capacity "refers to the ability of policy-making authorities to pursue domestic adjustment strategies that, in cooperation with organised economic groups, upgrade or transform the industrial economy. Such strategies encompass both structural shifts; from declining to expanding sectors, as well as technological diffusion and innovation; and the creation of new industries, products and processes" (Weiss 1998: 5). For Weiss, a state's competitiveness is derived form its transformative capacity.

Gilpin's mercantilist model has a slightly different view compared with the statist view. The proponents of the mercantilist model believe that "the erosion of national self-sufficiency has gone too far and the world has surpassed the limits of beneficial interdependence" because "[i]nterdependence accentuates domestic economic problems as economic instabilities in one economy spill over into other" and "[i]t causes labour dislocations, accentuates inequalities of income distribution, makes national planning more difficult, and increases the society's vulnerability to external political pressures" (Gilpin 1975: 236). In this mercantilist model, the state

participates in a regional economic bloc in order to enter into alliance with like-minded countries to deal with trade, investment, and finance related problems in a mini-multilateral setting rather than stands alone (Gilpin 1975: 234, Oman 1994: 15). This is because regionalism allows the state to obtain the benefits of interdependence without losing its autonomy and without causing excessive adjustment costs. In summary, the mercantilist model and the statist view believe that MNCs are challenging the power of nation states and MNCs "need to be regulated . . . to ensure that state autonomy and sovereignty are maintained" (Eden 1991: 198).

These three approaches have their weaknesses and although these shortcomings are the result of the pursuit of theoretical parsimony, they also raise serious criticisms from opponents. The foremost critique of the sovereignty at bay model can be found in its negligence of the political context within a country or between the home and host countries. It is clear that the liberalist view asserts MNCs' preponderance and leverage advantage over the host state. However, the host country can set a protective barrier to IFDI from foreign MNCs in order to provide a stable market for domestic corporations or to promote domestic competitive advantage by fostering a domestic oligopolistic market structure which will provide economies of scale for domestic corporations. Moreover, the host country can alter FDI flows by establishing laws which prefer licensing and joint ventures rather than wholly owned subsidiaries. This state's managerial capability of "breaking the package of capital, technology, and entrepreneurship which foreign direct investment has most frequently entailed" (Gilpin 1975: 239) has been the main feature of both Korea and Japan's foreign economic policy on FDI. Moreover, in contrast to the liberalist view, the statist view contends that the state is not losing its regulatory, managerial, and bargaining power

but the state is flexible enough to transform its institutions, policies and economic beliefs in order to overcome pressures from both domestic society and the international system.

The structuralist view has lost its persuasive and interpretative power as a theory especially with the emergence of East Asian NIEs from the periphery to semi-periphery status. Its main assumption is that FDI is basically exploitative. However, there are exception such as Singapore, Hong Kong, Malaysia and Thailand which have pursued an open door policy to IFDI but managed tremendous economic growth. Moreover, the dependencia model regards Third Wworld countries as passive objects in the context of the international political economy (Gilpin 1975:247). However, considering the bargaining power of the Organisation of Petroleum Exporting Countries (OPEC) and the active regional arrangement of the ASEAN member countries, it is obvious that peripheral countries or semi-peripheral countries are not necessarily reactive or passive to external pressures and impacts.

According to Gilpin, there are more controversial debates about the causal relationship between MNCs and host countries' subordinated, dependent, and underdeveloped economic structure. The first controversy is whether MNCs' presence causes a collapse in the domestic industrial base and local entrepreneurship or vice versa. The second controversy is whether technology transfer from MNCs is good for only the short-term but bad in the long run for economic development. The third controversy is whether IFDI will eventually lead to a distorted economic structure and increased over-consumption which will dry up domestic financial resources and in turn, will inhibit further investment. Gilpin argues that it is difficult

to distinguish between "what is cause and what is effect" (Gilpin 1975: 250). In a word, the direction of causality is not clear. For example, we can not decide which is cause and which is effect between MNCs predominance and absence of native technological capacity and indigenous entrepreneurship. In relation to the second controversy, Gilpin insists that if a state has an aversion to MNCs and worries about the disadvantages of technological dependence, the significant questions are whether that state has an autonomous capability in technology innovation and whether that state can support the enormous costs needed to develop indigenous technology (Gilpin 1975: 249-52). The third contention of structuralists that increased IFDI will result in over-consumption and that this will lead to a shortage of finance for investment can be easily rejected by pointing to the cases of Singapore, Hong Kong, Malaysia, Thailand where high rates of domestic saving and inward FDI flows have co-existed with each other.

Gilpin's mercantilist model indicates that with the decline of US hegemony and the disappearing of the technological gap between the US, Japan and Germany, regionalisation based on each of the three state's mercantilist strategy will replace the US hegemony-led multilateral liberalisation regime. Moreover, there are three factors which would propell the emergence of regionalism. First, the difficulty of pluralist leadership among the three core countries. Second, the state's preference for domestic economic autonomy to excessive interdependence, and third, the state's resistance to economic structural adjustment (e.g. protection of declining industry in order to prevent unemployment) caused by other states' arbitrary comparative advantage and strategic intervention into the market (Gilpin 1987: 397-400). In this mercantilist model, the market as an efficient allocator of production factors is losing

its value as states pursue more interventions into the market by forging 'creative assets', 'arbitrary comparative or competitive advantage' through industrial policy, strategic trade policy, competition policy, protectionism and various incentive systems. Thus, FDI policy in this model is based on a distorted market and this market distortion appears as a set of forms: the selective opening to IFDI by implementing a negative list or approval system; protection of certain industries; screening; red tape; window guidance; and induction of joint venture or licensing rather than FDI. These policies have been practised by Korea and Japan in their developmental state period and the post developmental state period.

The mercantilist model and statist model face ever-intensified pressures from globalising market forces and interdependence. Globalists argue that "states were once the master of markets, now it is the markets, which, on many crucial issues, are the masters over the governments of states" (Strange 1996 : 4). The main facilitators of this retreat of the state and sovereignty at bay are MNCs and global finance and MNCs' "attraction to host states is its ability to raise finance both for the investment itself and . . . for the development of new technology" (Strange 1996: 9) Thus, because of the dramatic growth of MNC activities, "the latitude for autonomous and purely domestic oriented actions on the part of the governments of nation states . . . is being severely curtailed" (Dunning 1993:2). In summary, while statists argue that the state can regulate MNCs and FDI flows and control them by intrusive policy in order to realise its economic objectives, globalists criticise the statists' assertion by arguing that MNCs are "no longer shaped and conditioned by reasons of the state" and "[g]overnment funded subsidies-old fashioned tax breaks for investing in this or that location-are becoming irrelevant as a decision criterion" (Ohmae 1995: 3). The

relationship between the state and market (MNCs) or the state and economic globalisation will be elaborated in the sub-conclusion.

The second group of FDI theories in IPE is more economics-oriented developed by Vernon and Hymer and these are the product life cycle theory, the obsolescing bargaining model, the law of uneven development and the international division of labour. The product life cycle theory, which was developed by Raymond Vernon, has two versions. The first version maintains that "every technology or [manufactured] product evolves through three phases in its life history: (a) the introductory of innovative phase, (b) the maturing or process-development phase, and (c) the standardised or mature phase . . . [and] . . . The evolution of technology, its diffusion from economy to economy, and the corresponding shift in comparative advantage among national economies explain both the patterns of trade and the location of international production" (Gilpin 1987:235). The second version was modified by Vernon himself and this revised model regarded MNCs as oligopolistic firms. Thus, FDI is the result of the oligopolistic MNCs' strategic behaviour "to erect barriers to entry in foreign markets in order to maintain market share" and "[o]nce the oligopoly becomes mature, the members use economies of scale in production, marketing, and research and development as entry barriers to new firms" (Eden 1991:199).

This product life cycle theory faces several critiques. First, the MNC, that is the investing firm, "is not necessarily the innovator", and "[s]uch examples are the Korean and Japanese conglomerates" (Huang 1997: 13). In other words, this model "disregards the increasing proportion of foreign investment that is not trade replacing"

(Tolentino 1993: 72). Second, because this theory is focused on manufactured goods, service industry and raw material related FDI cannot be explained. Third, this theory is limited as it is unable to explain the rapidly changing reality of the 1990s. In other words, "with the elimination of the technological gap . . . among the triad economies, global MNEs now have leading plants and outposts in the major Triad markets . . .Thus the parent firm is importing products and technology from its foreign affiliate abroad in a reversal of the model's prediction. In addition, the product cycle model cannot explain where or when particular products are developed in the Triad, or why there are mutual cross investments by MNEs in each other's market" (Eden 1991:214).

Put differently, MNCs "have increasingly pursued global strategies that are inconsistent with the model. The combined effects of the high costs of R&D, the convergence in technological capabilities between firms in the developed countries and the rapid rate of technological diffusion in these countries has meant that the firms' networks must introduce newly developed products in all sales territories simultaneously" (Tolentino1993: 71-2). Fourth, "the model does not address properly the question of why MNCs do not license or export, but instead prefer to invest in their own foreign production facilities" and "the model does not examine what systematic advantages foreign firms have that enable them to overcome their inherent disadvantages vis-à-vis local firms" (Taggart and McDermott 1993: 26). In other words, while this theory can explain locational factors, it does not analyse internalisation factors. Finally and most importantly, recent pattern of FDI in developing countries does not conform to the Schumpeterian approach adopted in this model. MNCs from developing countries can "engage in foreign direct investment or

licensing activities as a form of backward technology transfer in order to gain access to complementary foreign technology which . . . these firms can combine with their indigenous technological innovation" (Tolentino 1993: 73). The product life cycle theory will be articulated further in section 3 which deals with theories of FDI in developing countries.

The obsolescing bargaining model was also developed by Vernon and the main assumption of this model is that relations between the host country and MNCs are not static or fixed but dynamic and changeable over time:

> Prior to the entry of the MNE, the host government is assumed to be in a weak bargaining position. Given the uncertainty of investing in a new country, and the number of options open to the MNE, the state must offer concessions in order to attract entry. However, once the investment has been made, bargaining power shifts towards the host state. Over time, the uncertainty dissipates; the MNE commits more and more immobile resources that can be used as hostages; and the host country becomes less dependent on the MNE for capital, technology, and access to markets (Eden 1991:201).

This obsolescing bargaining model shows the active interaction and continuous tug-of-war between the host country and MNCs and implies that any assertion of single dominance by one over the other between the host country and MNCs is flawed. However, it has to be added into the calculation that "with more MNEs following global strategies focused on knowledge-intensive production, the country-specific advantages of many developing countries are not high enough to attract global MNEs" (Eden 1991:216). Moreover, as more developing countries adopt open market policies to IFDI flows, the competition among them has increased and this position can lead to the weakening bargaining power of host countries.

The law of uneven development is explored by Hymer and this model shares a common understanding with the dependencia model in seeing MNCs as leading agents of exploitation and underdevelopment of periphery and semiperiphery countries (Eden 1991:201). In the view of Hymer, MNCs create a hierarchical division of labour by international FDI deployment and in this hierarchical integration, high-technology and high-value added activities are positioned in the home country while labour-intensive, resource-extractive, and low value added activities are located in host countries. This uneven development caused by the hierarchical MNC structure is further exacerbated by the host country's concessionary incentives such as tax breaks, minimal regulations, free land supply and direct subsidies from the central or local government. Moreover, "the new-style MNEs of the 1990s . . . may play out the law of uneven development by widening the income gap between the richest and poorest countries. With FDI almost totally occurring within the Triadic economies and strategic alliances among Triad MNEs producing most of the new technology, the technology gap between the North and the poorest countries of the south . . . is to widen" (Eden 1991: 217).

The changing international division of labour model was also developed by Hymer based on historical changes in the nature of the division of labour. The nature of the international division of labour sought by MNCs activities has been transformed from the pursuit of raw material extraction (old division of labour) through the search for cheap labour cost (new division of labour) to the seeking of knowledge and technology improvement in order to attain strengthened innovative capability (new new division of labour) (Eden 1991:202). In this model, if MNCs search for low labour cost was the main reason for the increased FDI from the US and Japan to East

Asian and Latin American developing countries in the 1970s and 1980s, then MNCs pursuit of more knowledge and technology intensive production methods is the factor underpinning the increased inter-firm and intra-industry trade and investment among the triad (the US, Japan and the EU). This appears to have been the outstanding feature of FDI trends in the 1990s. This changing international division of labour model has its benefits in explaining the historically changing trends and main characteristics of FDI development.

However, this model's disadvantage lies in its theoretical inability to explain certain FDI flows created by developing countries' MNCs whose main motivation is the search for cheap labour cost. In other words, this model's inherent theoretical flaw which arises from its insistence on the linear or sequential advancement of FDI trends obfuscates the reality of the 1990s where not only developing states' outward FDI (both cheap labour and technology acquisition pursuit) but also triad countries' mutually penetrating FDI (both cheap labour and strategic assets searching) co-exist. Moreover, this reality of the 1990s is getting more complicated by the existence of substantial FDI growth which was formed in order to avoid protectionist behaviour such as local content requirement in host countries. However, this model's contribution is its provision of a theoretical tool which enables us to understand the new style FDI development in the 1990s such as alliance capitalism (M&A, strategic alliance, and international subcontract) by including the 'new new' division of labour into IPE perspectives. The specific features of this 'new new' division labour have been detailed in the section on FDI theories in IB.

1-3. FDI theories for developing countries

In IPE and IB, there are three main FDI theories which have direct or indirect implication for the explications of developing countries' FDI development: the product life cycle theory developed by Vernon; the theory of localised technological change by Lall; and the investment development path by Dunning. As we have seen in the section on FDI theories in IPE, the product life cycle theory has a serious flaw in explaining increased inter-firm integration among triad MNCs through the formation of strategic alliances and M&As. This new form of international production, which is called alliance capitalism, is a result of a convergence among triad countries in terms of technological capability, income per capita, and homogenous consumer taste. However, although this model "is losing its relevance in explaining trade and investment among advanced industrial countries, the model maintains some relevance with regard to developing countries since some form of divergence still exists in their national markets" (Tolentino 1993: 74).

The ownership advantage of developing countries' MNCs is based on not only their capacity for imitation but also their capacity for adaptation of transferred technology. This ownership advantage is the result of a response to the unique condition of the home market and the creation of new products and production processes. In other words, the competitive advantage of developing countries' MNCs "need not be based on technological innovation or other oligopolistic advantages but on the development of special skills in the maintenance, repair and supply of spare parts for second-hand machinery, the use of lower-cost labour intensive production processes and low salary payments to managers who are nonetheless adept at organising in developing country conditions" (Tolentino 1993: 74).

There are two reasons for the strategy of internationalisation through internalisation by these firms in FDI development. First, because of advanced countries' protectionism and increased transaction costs, these firms go abroad. Second, because most of the skills, technology, and their accumulated experience which are the result of learning by doing or learning by using are "not codifiable and therefore cannot be easily transferred to other firms" (Tolentino 1993: 85), these firms choose to internalise their competitive assets by FDI rather than licensing. In summary, the competitive advantages of developing countries' firms "is predicated to derive from their ability to imitate and adapt foreign technology in accordance with Third World markets and production conditions" (Tolentino 1993: 84).

In the theory of localised technological change developed by Lall, Third World MNCs' firm specific advantages, which are the main reason for Third World MNCs' FDI development, are derived from three sources:

> First is the localisation of technical knowledge . . . Innovation may take form of adaptation of imported technology or specialisation in some foreign outdated technology. Second . . . Innovation in this case may result indigenously through the improvement of local products or the adaptation of imported products. Third is innovation that results in smaller-scale techniques as opposed to the large-scale techniques of developed countries (Tolentino 1993: 78).

Thus, it can be argued that in understanding Third World MNCs' ownership advantages, both the product life cycle theory and the theory of localised technological change share common features. However, the difference between these two theories lies in Lall's acknowledgement of Third World MNCs' capacity to develop genuine, indigenous and independent technological accumulation and his emphasis on irreversible, path dependent technological development of each country and the great

differences in competitive advantages among developing country MNCs. Thus, it can be argued that the product life cycle model is based on a simple generalisation about the nature of Third World MNCs and because of this, it "fails to explain marked variations in the characteristics of MNEs between developing countries . . .[and] . . . The model excludes other important sources of competitive advantages for developing country firms and, specifically, the genuine indigenous technological capability for competitive innovation" (Tolentino 1993: 79). In summary, the major shortcomings of the product life cycle theory is "in failing to consider the case when firms from the more advanced developing countries increasingly generate the capacity for localised technological change. The theory of localised technological change formulated by Lall shows the capability of indigenous firms in developing countries to generate genuinely unique innovations" (Tolentino 1993: 85).

Dunning's investment development path (IDP) is based on the relationship between the state's GNP growth and the state's Net Outward Investment (NOI) and this path has five stages. In the first stage, IFDI is very low because the country's locational advantage is insufficient to attract foreign investment. The low level locational advantages are derived from the undeveloped infrastructure, the small domestic market, inappropriate government policy on IFDI, and low quality human resources caused by a poor education system in the host country. The government can intervene at this stage by improving the quality of education and infrastructure and implementing favourable FDI policy. In the second stage, IFDI is rising because the country's consumption or purchasing power has increased and the country's OFDI has entered into the nascent period. However, the gap between inward and outward FDI is widened because the increase of OFDI cannot offset the increase of IFDI. In this

stage, the state can provide subsidies for export promotion and technological improvement in order to strengthen competitiveness. The state in the third stage will experience not only a gradual decrease in the growth rate of IFDI but also a rapid growth of outward FDI. "Comparative advantages in labour-intensive activities will deteriorate, domestic wages will rise, and outward direct investment will be directed more to countries at lower stages in their IDP. . . [and] . . . The original [ownership] advantage of foreign firm also begin to be eroded, as domestic firms acquire their own competitive advantages and compete with them in the same sector" (Dunning 1996: 4). As a result of this enhanced domestic firms' competitive advantage, there will be increased OFDI to countries at stages 1 and 2. The important point in this stage is that in order to realise steady economic development and move up to the next stage of the investment development path, industrial structural adjustment has to be implemented.

In the fourth stage, the state will accomplish net outward FDI. Firms in this stage will have competitive advantage both in the domestic and foreign market. "Production processes and products will be state of the art, using capital-intensive production technique as the cost of capital will be lower than that of labour. In other words, the L[ocational] advantage will be based almost completely on created assets" (Dunning 1996: 6). And because of this, IFDI in the fourth stage will be focused on seeking strategic assets from other states located in the same fourth stage or the fifth stage. At the same time, in this stage, there will be some IFDI from lower stage countries in order to gain access to markets or technological acquisition. At this stage, because of the increased competition between countries with similar capabilities in created assets and national competitiveness, the role of the state will be strengthened. Thus, "[w]hile continuing its supervisory and regulatory function to reduce market

imperfections and maintain competition, [the government] will give more attention to the structural adjustment of its location-bound assets and technological capabilities" (Dunning 1996: 7). The fifth stage is "the scenario towards which advanced industrial nations are now approaching" (Dunning 1996: 7). This scenario is similar to the globalists' view of a convergence among triad countries. In this stage, "as income levels, economic structures and patterns of international production among the Triad countries converge, the relative attractions of a particular location will depend less on the availability, quality and price of their natural assets and more on those of their created assets" (Dunning 1996: 7). Thus, at this stage, there will be true transnational corporations and strategic assets seeking investment through strategic alliances and M&As will increase and such strategic assets seeking behaviour of firms will precipitate the process of convergence among Triad countries.

It is important to note that Dunning's convergence thesis in the stage 5 scenario is different from the argument of 'the end of the nation state', 'sovereignty at bay' and 'the retreat of the state' perspectives, because for Dunning, even in the fifth stage, not to mention all the previous four stages, the role of government remains significant. Dunning argues that even in the fifth stage, "governments will increasingly assume the role of strategic oligopolists, taking into account the behaviour of other governments in the formation and execution of their own macro-organisational strategies" (Dunning 1996:11). The investment development path suggests a useful tool to trace the changes in each state's FDI flows in conjunction with each state's developmental stage.

1-4. FDI theories for East Asia

The literature which seeks to explain the major features and environment of FDI development in East Asia has focused on either product cycle theory (the flying geese analogy) or production networks. Akamatsu's flying geese analogy and Vernon's product cycle theory are used interchangeably in the literature (Bernard and Ravenhill 1995: 174). They are basically neo-classical approaches (Chowdhury and Islam 1993: 101) and consist of two stages. In the first stage, Japan as a leading goose transfers its matured or outdated technologies or manufacturing products to less developed countries in the region as Japan's industry moves up in the developmental ladder through innovative technological developments. Through these continuous transfers of matured technologies and products, less developed countries are sequentially incorporated into regional economic integration. In the second and final stage of product cycle theory, 'catch ups' are realised as reverse imports from less developed countries' manufactured goods to Japan greatly increase.

More specifically, in the first stage, East Asian countries are integrated into a vertical division of labour (inter-industry trade) according to changes in comparative advantage among countries. As a result, a vertical division of labour among Japan, NIEs and ASEAN countries emerges. The second and final stage of product cycle theory further argues that through continuous transfers of products and technologies, a horizontal division of labour, which leads to increase of intra-industry trades, emerges in the region. As a result of the emergence of horizontal integration, reverse imports to Japan, catch-up processes, and the regional homogenisation of industrial structures and development trajectories are realised in the region.

The production networks approach elaborated by Bernard and Ravenhill (1996) and later Hatch and Yamamura (1996) argues that in East Asia, through Japanese-formulated production networks, highly unequal and hierarchical integration is realised. The production networks have increased intra-firm trade, with scattered subsidiaries of Japanese MNCs in the region producing standardised and more price-competitive intermediary goods in order to improve parent firms' international competitiveness. However, deepening technological dependence and the consolidating trade deficits of regional countries show that there is a vertical division of labour in the region. And, instead of an increase of reverse imports to Japan, as predicted by the final stage of product cycle theory, less developed countries' exports are greatly dependent on the domestic markets of the US and the EU countries. Thus, a triangular relation among Japan as a capital goods provider, East Asian countries as both importers of Japanese capital goods and exporters of final goods, and Western countries as market providers has emerged.

Proponents of the production networks approach criticise product cycle theory by refuting the assumptions of the final stage. The final stage argues that, first, technological catch up, second, massive reverse imports, and finally, the homogenisation of industrial structures and developmental trajectories (through continuous transfers of products and technologies among the leading country and following countries) will be realised in East Asia. However, the current reality of production networks in East Asia shows that these three predictions cannot be vindicated due to three main reasons (Bernard and Ravenhill 1995: 175-178). First, the heavy technological dependence of East Asian countries on Japan shows that in the region, the phenomenon of dependent development is being consolidated and this

dependency is getting deeper. The rapid changes of innovative technologies by Japanese MNCs and Japan's extremely careful protection of its high and core technologies can be seen as major reasons for the obstruction of the technological development of East Asian countries. Moreover, instead of the process of standardisation and the transfer of technologies, as argued by the first stage of product cycle theory, continuous innovations in Japan actually frustrate the transfers of standardised technologies.

Second, reverse imports from East Asian countries to Japan are not satisfactorily realised. As we will see in Chapter 6, the amount of reverse imports has steadily increased (Hook 1996: 182). However, a triangular relationship among Japan, East Asian countries, and the US remains. This indicates that the Japanese market is not fully open to East Asian countries' exports. As a result of technological dependence and the small amounts of reverse imports, East Asian countries have experienced chronic trade deficits with Japan. Third, instead of the homogenisation of industrial structure and development trajectory, there exist diversified forms of industrial structure and different development trajectories in East Asia. Even though, as Cumings argues, we cannot neglect the similarities among East Asian countries, (the most outstanding similarity is the existence of a shared economic belief system which is strongly anchored in the efficacy of developmentalism in East Asia), Japan, the NIEs, and ASEAN countries have different economic structures and strategies of incorporating into regional and global economic integration. The reasons for these variations are, as Bernard and Ravenhill (1995) and Bernard (1996) point out, the result of differences between each country's historical and institutional settings, which are deeply influenced by each country's society-state relations and the timing and

strategy of incorporation into regional economic integration and the international division of labour.

However, the literature on East Asian FDI development overlooks the fact that the product cycle theory and production networks approach are not mutually exclusive. More correctly speaking, the reality of regional economic integration in East Asia contains a complicated structure which can be explained only when we adopt both approaches. In other words, a sharp dichotomy between the two approaches cannot produce a clear analysis of East Asian FDI development. This means that the two approaches are not incompatible in explaining historical FDI development in the region.

First, as we have seen above, product cycle theory has two distinctive stages. In the first stage, the differences of technological capability and the changing comparative advantage among regional countries lead to successive transfers of standardised and matured products and technologies from advanced countries to less developed countries. Thus, in this stage, there exists a hierarchical industrial structure among countries. It is these uneven relations among countries in terms of technological capability that are more clearly and specifically highlighted and emphasised in the production networks approach. As we have seen above, the production networks approach's great contributions to the understanding of East Asian FDI developments can be found in its emphasis on exploitive, unequal, and highly politicised economic integration processes in the region. Thus, the approach reveals the problematic division of labour in the region by highlighting the small amount of reverse imports to Japan from regional countries and the exacerbated technological dependence of

regional countries on Japan. A more problematic structure, which is strongly consolidated, is the triangular relationship among Japan, the US and regional countries. In this triangular form, Japan enjoys massive trade surplus while the US undertakes the costs of industrial adjustments in East Asian by absorbing enormous exports from regional countries. East Asian countries act as Japan's export platform, and suffer from heavy trade deficits and technological dependence with Japan as well as political pressure from the US in terms of market opening and liberalisation.

In summary, production networks theory has an advantage in explaining the worsening and intensifying 'unequal and dependent integration processes' in the region by highlighting such phenomena as technological gaps, the small amount of reverse imports, the consolidated trade deficits structure, and the highly politicised triangular trade relations in the region. What the literature on production networks approach fails to understand is that production networks are a part of product cycle theory. The first stage of product cycle theory is basically unequal and dependent process in terms of technological capability and economic strength of each country in the region. The exacerbated unequal and dependent economic relationships among countries can be explained more clearly by the production networks approach. However, this does not mean that the first stage of product cycle theory fails to explain these problematic features of the regional division of labour. Thus, it can be argued that Japanese production networks in Southeast Asia are basically a negatively consolidated or extended first stage of product cycle theory.

Second, having pointed out that production networks are a part of the first stage of product cycle theory, it can be argued that the most crucial question is how to

accomplish an equal and genuine horizontal division of labour in the region, rather than trying to determine which theory is better in explaining East Asian FDI development. Put differently, the major concern is the significance of political factors for regional economic integration. The final stage of product cycle theory assumes that catch ups and massive reverse imports will be realised. However, as the proponents of the production networks approach point out, technological gaps are increasing and, as a result, "Japan is actually flying further and further ahead of the regional flock" (Hatch and Yamamura 1996: 28). The pace of reverse imports to Japan is very slow. Moreover, triangular relations among Japan, the US, and East Asian countries produce higher economic tension among them. These structural problems cannot be overcome through purely economic efforts. Here, the importance of political factors in regional economic integration is clear. The crucial weak point of product cycle theory is that it cannot explain created or artificial comparative advantage, which is an intentional outcome of governmental efforts through industrial policy.

As we have seen above, the flying geese analogy and product cycle theory are based on the natural changes in comparative advantages among countries. This means that product cycle theory cannot provide a theoretical foundation capable of explaining the role of regional states and their industrial policies in purposefully creating artificial comparative advantage. With the help of this concept of created comparative advantage, we can lay a firm theoretical foundation which can explain Japan's effort to protect its core and innovative technologies, and Korea's efforts to raise its technological capability through various regulations and supportive systems. As a result of each country's industrial policy, there has emerged a complex economic

integration process in which not only technological dependence but also competitions and complementation among regional economies are formulated.

Hook argues that "the general increase in technologically sophisticated industries being located in other parts of East Asia suggests these economies are not so much following Japan as the lead goose in the flying geese model of economic development as much as leap frogging into advanced industries, at least in the electronics fields" (Hook 1996: 181-182). Awanohara (1989) also argues that we cannot underestimate the emergence of a multi-layered competition and chase process in East Asia. In this respect, it can be argued that the production networks approach also reveals its weak point by underestimating the dynamic roles of regional states and their industrial and technological policies. As we have seen, the production networks approach over-emphasises deepening technological gaps and unequal economic integration processes in the region. To be sure, these structural problems have to be resolved by political interactions among regional countries. Because the production networks approach underestimates the role of politics and regards NIEs and ASEAN countries as simply passive and inactive actors in raising their technological capabilities and overcoming structural dependence on Japan, the approach cannot yield a rigorous theory. As we will see in Chapter 6, this thesis emphasises these political dimensions of regional economic integration.

Third, from the macro point of view, the flying geese analogy and product cycle theory can produce a holistic approach to East Asian economic development and integration. By comparing three Northeast Asian countries' (Japan's, Korea's, and Taiwan's) historical patterns of industrialisation, Cumings (1987: 46) points out that

"it is misleading to assess the industrialisation pattern in any one of these countries: such an approach misses . . . the fundamental unity and integrity of the regional effort". In other words, for Cumings, "industrial development . . . cannot be considered as an individual country phenomenon; instead, it is a regional phenomenon" (Cumings 1987: 81). This means that we cannot exclude an approach which promotes a holistic understanding of the regional economic developmental trajectory. Product cycle theory and the flying geese analogy provide us with a holistic insight into the regional characteristics of East Asian countries' economic developments. It cannot be denied that in East Asia, Japan has been an explorer and transferor of economic development. NIEs and ASEAN countries have achieved their economic developments and growth with great help from Japan in terms of technology, investment capital, and as a model to emulate. Thus, the analogy of flying geese and a generalised theory of product cycle cannot be ignored or underestimated, even though they cannot alone produce an adequate explanation of the complicated economic integration processes in East Asia. On the other hand, from the micro point of view, production networks theory, as we have seen above, can provide a detailed and specific tool to promote an understanding of the complex economic integration processes and interactions among regional states and MNCs.

Fourth, product cycle theory was better equipped to illustrate FDI development and economic integration processes in East Asia before the mid-1980s. Japanese OFDI flows to East Asian countries before the mid-1980s were led by the movements of changing comparative advantage in the region. This means that we cannot exclude product cycle theory when seeking to explain the historical transformations of Japanese FDI development before the mid-1980s. In that period, Japan transferred

industries in which it has lost international competitiveness to less developed countries in the region. As a result, light industries such as textiles, garments, and footwear were transferred to less developed countries. Then, heavy and chemical industry followed the same process. Thus, less developed countries started to develop their economies by hosting these transferred industries. This means that as product cycle theory argues, regional countries' economic development was the result of transferred industries from Japan [2].

However, after 1985, when the Plaza Accord was agreed between Japan and the US, Japanese OFDI development changed its structure and specific features. The OFDI flows which were basically facilitated by changes in comparative advantage before the mid-1980s changed dramatically in their structures and modes. With the massive flow of OFDI from Japan to ASEAN countries in the electronics industry, there emerged production networks in which intra-firm trade massively increased, not according to changing comparative advantage in the region but due to Japan's strategy. More specifically, the production networks were the results of both Japanese private companies' 'global strategy', based on strategic management theory, and the Japanese PDS's 'political strategy', based on a mercantilistic developmental belief system and institutions. From the point of view of Japanese parent companies, their subsidiaries in the region play an important role in reducing production costs by producing standardised intermediary parts with cheap labour costs. Thus, parent

[2] On the point, Bernard and Ravenhill (1995: 187) criticise product cycle theory by correctly revealing that it is basically a state-centric approach which neglects the specific institutional, historical, societal, regional, and global contexts of each country's economic trajectory. In other words, by adopting a statist approach, product cycle theory not only homogenises a country's economic development with a transferred specific product or technology but also fails to consider the important factors such as each state's distinctive timing and strategy of the industrialisation process, regional and global environments, and the unique feature of state-society relations.

companies as assemblers can sustain their international competitiveness. As a result, there emerged an argument that a horizontal division of labour is realised in East Asia. However, this view is exaggerated when we consider the technological inequality in the region. Between Japan and other East Asian countries, deepening technological dependence and the widening gap on technological capacity are major barriers which prevent an equal and genuine horizontal division of labour in the region. This reality shows that the final stage of product cycle theory is not realised, and the production networks approach can produce a more persuasive and specific explanation of Japanese OFDI development after the mid-1980s.

However, in contrast to Japan, OFDI developments from NIEs after the mid-1980s still conform to the theory of the product life cycle. Unlike Japanese production networks-based OFDI development, NIEs' OFDI developments are based on changes in comparative advantage. Thus, Korea transferred labour intensive industries to Southeast Asian countries as Japan did before the mid-1980s. In this regard, it can be argued that the crucial difference between current Japanese and Korean OFDI developments lies in their major motives. In other words, Japan exploits its competitive advantage in technology and surplus capital by implementing strategic management, while Korea exploits the comparative advantage of Southeast Asian countries in cheap labour costs. Korean OFDI develops according to changes in comparative advantage, while Japan OFDI develops not according to the division of labour, which is determined by changing comparative advantage among regional countries, but by strengthening and expanding the production networks in which a technologically vertical division of labour is consolidated. In sum, after the mid-

1980s, there emerged a complicated and multi-layered economic integration process in East Asia led by not only Japanese production networks-based OFDI development but also by NIEs' OFDI developments driven by comparative advantage. This means that we need both product cycle theory and the production networks approach to understanding East Asian FDI development.

Fifth, the existence of technological gaps among East Asian countries supports the argument that as far as technological divergence can be found in the region, the product life cycle theory explains the region's OFDI developments. As we have seen in section 1-2, OFDI developments among triad countries (Japan, the US, and EU) cannot be understood by product cycle theory alone, because there are no significant technological gaps among these countries. By contrast, in East Asia, significant differences in technological capabilities can be easily found. This is another reason why product cycle theory cannot be excluded from this thesis.

2. The State and MNCs

The relationship between the state and MNCs is basically ambivalent. Two questions are critical: which has more bargaining power and whether an increased FDI presence and a neo-liberal open policy to FDI are ultimately beneficial or harmful to the state. Before we start the debate about the state and MNCs relationship, it is necessary to distinguish between the state in the home and host countries, because MNC activities always affect both host and home country's economic and political setting at the same time. The host country's purpose is to maximise national wealth without losing economic and political independence. In contrast, the MNC's purpose is to maximise the firm's interest without sacrificing managerial autonomy and weakening its

competitive (ownership) advantages. On the other hand, the home country's purpose lies in the dual pursuit of the maximisation of national wealth and the realisation of political, and diplomatic objectives through MNC activities in the host country. Thus, Japan's OFDI into Southeast Asian countries has to be understood in terms of the home country's (Japan) economic and political purposes and not only in terms of the economic purpose of firms. It is not only MNC's economic interest but also both host and home country's political objectives that have to be incorporated into any understanding of FDI development. This proposition leads to the second proposition that the study of IB, which shares similar views with the liberalists in IPE has to be supplemented by the other two IPE views, namely structuralism and the statist approach in order to comprehend the economic and political nature of FDI (See Table 3-1).

The strengths and weaknesses of the host country's bargaining power over MNCs are based on its locational features such as market size, production factor costs (Labour, Land, interest rate, technology, natural resources), infrastructure, incentive system, and the cultural and geographical distance (Safarian 1993: 53). Although these factors (except the cultural and geographical distance) may be improved by the host country, there are two external factors which are likely to reduce the host country's bargaining power. First, with the spread of liberalisation and deregulation processes to IFDI, the increased competition to induce FDI into their territory among the developed countries, not to mention, among the developing countries, has intensified. This high demand for IFDI has raised MNCs' bargaining power against the host state. Second, as mentioned above, the pressure from the multilateral liberalisation regime also facilitates the weakening of the host state's leverage. By implementing liberalisation

and deregulation policies, the host country has also weakened the state's regulatory capacity as well as reduced the space for strategic intervention into FDI flows that stressed joint ventures and licensing over FDI. In addition, once FDI is established, the host government's bargaining power and policy autonomy are further diminished because of the strengthened MNC's lobby and home country's intervention through the application of home country's law and policy to host country (Safarian 1993: 17).

However, the host country has a set of policy options to regulate or restrict IFDI flows. First, the host government can close certain sectors to FDI either wholly or partially. Second, the host country can also ban certain types of FDI such as M&As and induce certain types of FDI such as joint venture or licensing. Third, the host country can discriminate against MNCs in favour of domestic firms through various incentives. The host country can also exclude MNCs in certain sectors such as government purchasing. Fourth, the host country can provide or abolish various incentives such as tax breaks, direct subsidies, and special zones for FDI. Fifth, by using strategic trade policy, the host state can request foreign subsidiaries for a certain compulsory amount of exports and to restrict imports from parent firms to subsidiaries.

Moreover, through industrial policy, the host country can support domestic firms' R&D in order to decrease MNCs competitive advantage against domestic firms. By the harsh application of competition policy, the host government can regulate or restrict foreign MNC access to domestic markets (Safarian 1993: 6).

		MNC	
		Old integration (vertical, horizontal integration. Intra-firm trade. Inter-industry trade Intra-industry trade).	New integration (Alliance, relational, collective capitalism. Inter-firm integration).
Home country	Collision site	Hollowing out. Job export. Conflicts between state's economic objectives and MNC's interest.	Transnationalisation of MNC. Denationalised TNC. (The end of the state).
	Co-ordination site	MNC as a tool for foreign economic policy. Promotion of structural adjustment. Market protection against foreign MNCs to promote home MNC's competitiveness. Various state supports to home MNC to improve its ownership advantages.	Co-operation between home state and MNC to improve creative assets of state and MNC's ownership advantages through industrial, trade, and competition policy. (State as a creative assets promoter).
Host country	Collision site	Technological dependence. Exploitation of low cost labour and natural resources. Loss of national independence (Structuralism). Increase of the state' role in regulating FDI flows to accomplish national economic objectives (Statist view).	MNC's oligopolistic behaviour conflicts with host state's economic wealth. The decrease of FDI into developing states. The increase of inter-Triad FDI. Further technological dependence of developing countries. Increased inequality between advanced and developing countries. Increased role of the Third Word host states based on the belief that open policy does not necessarily mean direct national development and does not solve inequality problem. (Resurrection of the state).
	Co-ordination site	FDI as a facilitator of national development (Liberalism). Increased state role in improving Locational advantage (Statist view)	Fully open market to FDI. Liberalisation. Deregulation. Global, regional, bilateral agreement on investment (Hyper liberalism or Globalisation).

Table 2-1. Trilateral relationships among home country, host country and MNCs.

The MNC's leverage is based on its ownership advantages in marketing, organising, financing, producing, and technology. However, the MNC's bargaining power can be

weakened by two reasons. The first arises from the intensified competition among MNCs themselves to obtain a certain investment project. An increased number of bidders for one investment project decreases the leverage of MNCs against the host country. Moreover, a threat of retreat from an MNC cannot be seriously regarded as a real threat, because alternative MNCs are abundant. In short, the MNC's bargaining power can be decreased "with the number of effective competitors, whether local firms or other foreign-owned firms" (Safarian 1993: 56). And, as we have seen from the obsolescing bargaining model, the MNC's leverage is likely to be weakened because of the MNC's increased immobile assets in the host country. In other words, the MNC's freedom of market exit is so limited that the host government long-term bargaining power is improved.

It is important to remember that these debates on the bargaining power of states and MNCs have not been sufficiently incorporated into the debate on the relationship between the state and globalising market forces. Globalists and neo-liberal views are based on two major concepts, that is, on the convergence of national diversities and market efficiency. Apart from a strong belief in the efficiency of the market, another major argument of the neo-liberalists and globalists is that as Triad countries converge to the same technological capacity and living standards, there will be a convergence of national diversities in economic policy, institutions, and production systems. There are three notions of convergence: "convergence as the triumph of market forces, abetted by passive governments; convergence as the result of diffusion of best practice and competition among institutional forms; and convergence as the internationally negotiated or coerced choice of one set of rules and institutions" (Berger and Dore

1996:16). However, this convergence theory's weakness lies in its neglect of the state's distinctive historical, cultural and institutional solidity. Critics who advocate the persistence and resilience of national diversities "see national production systems as rather tightly bundled packages of specific national resources, institutions, and legacies. The 'tightness of fit' makes it extremely unlikely that any one practice or institution, even if dysfunctional, can be easily changed without requiring changes in other pieces of the system" (Berger and Dore 1996:22). "The tightness of fit in this perspective reflects the mesh between politics, the polity, and economic institutions and the coherence of a system that responds only slowly and unevenly to changing markets" (Berger and Dore 1996: 23). This understanding of 'tightness of fit' of a state's institution, culture, and policy shares the view of 'the myth of the global corporation' (Doremus et al. 1998). After comparing different and specific behaviours among the US, Japanese, and German MNCs in their financing, R&D, and investment patterns, Doremus et at. argue that "[d]istinctive national institutions and ideologies shape corporate structure and vitally important policy environments in home markets. Their external behaviour of firms continues to be marked by their idiosyncratic foundations" (Doremus et at 1998:139). Thus, it can be argued that speculation on the convergence of national diversities does not reflect the reality of the persistence of national diversities.

As we have seen from FDI theory, globalists and neo-liberalists argue that the state is not a major actor any more in the globalising economic system and they also believe that the efforts of state intervention into the market system will deteriorate market efficiency and will finally result in the loss of national wealth by causing costly isolation from globalising economic integration. Neo-liberal economists maintain that

> [t]he ultimate objectives of FDI liberalisation is to enhance economic growth and welfare in countries . . . the efficient functioning of markets depends on the contestability of market . . . Foreign direct investment liberalisation, by removing formal barriers to the entry of FDI, can increase the contestability of national markets and inject greater competition into them (World Investment Review 1997: 25).

Thus the wide-spread views of globalists and neo-liberalists coupled with pressures from the multilateral liberalisation regime have led to "a formidable case for wholesale and rapid liberalisation in all developing countries regardless of the level of development: not the improvement of government interventions, not the improvement of markets and the setting up of new institutions, but the wholesale rejection of the state" (Lall 1995: 2). It has to be acknowledged that the globalists view is correct until they insist that the state's role has been diminished with increased international production and increased bargaining power of MNCs. The globalists view is also correct until they criticise the hyper-liberalist view of 'a borderless world' (Stopford et al. 1991: 7). However, they are incorrect to argue that the state's role is now obsolete and their view that any reaction by the state to regulate and restrict the globally integrated economic system will result in the unavoidable deterioration of national wealth is flawed. For globalists as well as statists, it is important to remember that "what is good for firms need not be good for national economies" (Wright 1995: 164), and, "if the combination of weak states and strong TNCs is unlikely to sustain economic growth under a more integrated international production system, then sooner or later measures must be found to strengthen the role of national states" (Wright 1995: 166).

As we have seen from the section on FDI theory, economic development today does not not depend on the prices of production factors but increasingly on created assets (e.g., capacity of high technological, managerial, and organisational innovations). The need for state intervention in FDI flows lies in this context. "[A] passive reliance on TNCs to upgrade and deepen technological capabilities may take a very long time to bear results . . .[and]. . . a strong TNC presence in an industry, while stimulating local competitors to be more efficient in their production, can inhibit them from deepening their technological capabilities" (Lall 1995: 6). Moreover, in contrast to the assertion by neo-liberal economists of market efficiency, the market cannot provide public goods which include education, security, law enforcement and defence (Boyer 1996: 104). Minimal state intervention will lead to the sharp decrease in public investment and will, in turn, lead to low level locational advantage or low level productivity caused by poor educational infrastructure.

Neo-liberal economists also exclude the state's coordinative capacity. This capacity includes the ability of the state in "co-ordinating complementary investment decisions, organising the specialisation of smaller firms . . . promoting the sharing of information as well as technological acquisition, learning, and diffusion" (Weiss 1998: 6). The state's coordinative capacity in this thesis is expanded to include the state's ability to "mobilise consent or to institutionalise co-operation" (Weiss 1998: 4). Through this capacity, the state can organise consent from its society (the middle class and big conglomerates) and participate in regional or global arrangements in order to institutionalise co-operation with other countries. The roles of the state are many. Through its coordinative, transformative, regulatory and managerial capacity, the state can still find much spaces to exert its autonomy. This proposition leads to an

important point that the state's isolation from society (policy autonomy and the base of policy efficiency) is neither a sufficient nor a necessary condition for economic development. The state's autonomy has to be supplemented by the state's coordinative capacity. "Isolation by itself is no guarantee of effectiveness; it needs to be matched by embeddedness, by institutionalised bureaucracy-business collaboration" (Weiss 1995: 240). Thus, it can be argued that "the message that increasingly what governments do and how they do it is much more important than how much government involvement should there be!" (Dunning 1993: 28). In other words, the "market and the state are not opposed forms of social organisation, but symbiotically linked. The point is . . . that markets require some form of central co-ordinating intelligence in order to effect change and adjustment to the continuously changing conditions of competition" (Weiss 1995: 8).

As we will see in Chapter 6, both Korean and Japanese FDI policy have changed their major characteristics as Korea and Japan underwent socio-economic and political transformations. In the DS period, both countries' FDI policies were highly interventionist. Case by case screenings and detailed regulations were easily detected in the period. Thus, in the DS period, the statist view provides the most persuasive explanation of the characteristics of and changes in both Korea's and Japan's FDI policies. However, in the PDS period, we can witness an extended conflict between the liberal view (neo-liberalism) and the statist view (developmentalism). Although consecutive processes of liberalisation and deregulation were pursued in relation to FDI, state intervention did not disappear due to the unchanged belief systems of working level bureaucrats and institutional resistance and inertia which were derived from embedded developmentalism in both Korea and Japan's institutional setting.

This brief summary of Korean and Japanese FDI policy changes in the DS and the PDS period reveals that the grand theories in IPE (such as dependencia, sovereignty at bay, and mercantilism) could be regarded not as empirically proven prescriptions but as theories or ideas of international political economy. The most serious theoretical problem of the structural approach (or dependencia model or the law of uneven development) lies in its failure to explain Korea's development from a periphery country to a semi-periphery country. So long as this theory cannot provide a proper explanation of the economic success of the NICs and ASEAN, this theory's applicability to East Asia is greatly limited.

It has to be acknowledged that the relations between the host country and MNCs are so complicated that it could be very reckless to decide the validity of the obsolescing bargaining model. Which has more structural power or bargaining power -the host country or MNCs? As we have seen throughout this chapter, these relations are complicated and still ongoing. This is the reason why we need more time to observe before we can provide an answer. The validity of the theory of localised technological change can be tested by observing Korea and Japan's processes of technological improvement through licensing agreements, joint ventures, and reverse engineering. Korea's achievement of a certain level of technology can be submitted as proof for the validity of the theory of localised technological change. In this thesis, particularly in Chapter 6, we will adopt the theory of product life cycle (and the flying geese model), production networks approach, eclectic theory (OLI advantages), and the investment development path approach , in order to supplement a political approach to analysing Korea and Japan's FDI policy.

Chapter 3.
Approaches to learning and the theoretical framework

Contents

1. Various conceptions of learning in IPE, DS, IB, and CP

The concept of learning has been differently defined and interpreted in various academic disciplines. Thus, from the literature of International Political Economy (IPE), Development Studies (DS), International Business (IB), and Comparative Politics (CP), various discussions and theoretical developments towards the concept of learning have emerged. However, there have been no co-ordinated efforts to

overcome the conceptual diversity in adopting learning theory and applying it towards the objects of analysis. In the above disciplines, learning theory tends to be seen in terms of either 'technical learning', 'learning and the applicability of the East Asian development model (EADM)', or 'institutional learning'. Technical learning means that the learning process is related to the transfer of advanced countries' technological or managerial know-how which is then adapted to suit the needs of developing countries, taking into account their developmental stage, domestic market scale, the level of consumer demand, and domestic capacity for absorbing and modifying transferred technology or managerial know-how.

Thus, for Amsden technical learning involves "borrowing, adapting, and improving foreign designs" (Amsden 1989: 141). In technical learning, the learning period or infant industry period is defined as the "period from the point of entry to the point where the firm (or industry) is competitive in the international arena" (Jacobson 1993: 407). Meanwhile, the measures for technical learning are FDI, joint ventures, Original Equipment Manufacture (OEM), strategic alliances, licensing, and informal means (such as sending trainees to advanced firms or countries and hiring foreign engineers) (Hobday 1995). Technical learning is an important concept in dealing with FDI flows among countries. FDI accompanies transfer of technological or managerial know-how. Technical learning is also an important index which can be used in measuring a country's level of economic development or extent of economic dependency. Recipient countries tend to be at a low level of economic development and have a high extent of economic dependency. The highly contested issue here is the role of the state or market in the process of technical learning. Which measures can produce economic development through technical learning? The free market or state

intervention? In this thesis, Korea and Japan's technical learning will be dealt with in Chapter 6 by adopting FDI as a case study.

The literature about 'learning and the East Asia development model (EADM)' tried to elaborate the similar conditions and underpinning features between the Japanese model[1], the NIEs model, and the ASEAN model and then cautiously sought to apply it to less developed countries in order to promote economic development (Amsden 1994, Broad and Cavanagh 1995, Nafziger 1995). However, after long discussion, a consensus was made in the literature that there is no single EADM (Ito 1997: 198, Lall 1996: 14, Hirono 1988: 258, Ungsuh K. Park 1988: 176, Krugman 1994: 78, Lim 1998: 477, Breslin 1996: 704). Japan, the NIEs, and the ASEAN countries have adopted different economic strategies in pursuing their respective economic objectives. More specifically, Korea, Japan, and Taiwan adopted the interventionist model, Singapore and Hong Kong adopted a laissez faire model, while the other Southeast Asian countries adopted the FDI dependency model (Perkins 1994: 655). Among these East Asian countries, there were distinctive differences in terms of culture, history, institutions, market liberalisation, role of the state, attitude towards foreign capital, domestic political configuration, and international systemic influences. However, despite these differences, the literature found out some similarities among the countries in East Asia and formulated the EADM, which is characterised by state interference into the market system with the help of industrial policy, strategic trade policy, an export oriented economic structure, state regulations and screening towards

[1] Chalmers Johnson provides four elements of the Japanese model: the existence of small but elite bureaucracy; a political system in which bureaucracy can enjoy autonomy and initiative; market conforming state intervention; and finally an existence of pilot governmental organisation like the MITI. See Chalmers Johnson (1982: 315-319).

foreign capital and technical learning, domestic market protectionism, and a domestic political configuration centred around an authoritarian regime. The problem is that even these criteria are not shared among the countries. The most exceptional case is Hong Kong which adopted the free market system. Thus, it can be argued that the characteristics of the EADM are neither necessary nor sufficient conditions to be imitated or learned by other developing countries in other regions.

What is important is that as Lall says, even though these distinctive features of the EADM are not directly applicable to other developing countries, it does not necessarily mean that the strategic planning and regulation of these East Asian countries cannot be learned by other developing countries (Lall 1996: 24). In this thesis, the applicability of the EADM is dealt with in the theory of developmental stage. This theory argues that as one country's economy matures, the policy, belief systems, and institutions in the country have also to be changed in order to adjust to changing internal and external environments. Without adequate changes in policy, belief systems, and institutions, pressures from domestic society or the international system will increase and as a result, efficient and effective realisation of the state's economic objectives will be damaged or delayed. Japan's great transformation from the developmental state to the post developmental state and Korea's great transformation from the developmental state to the transitionary state reveal the significance of changes in policy, belief systems, and institutions which are commensurate with both countries' economic position in the international political economy.

Institutional learning results in changes in a country's tangible institutions (particularly governmental or semi-governmental organisations) as a result of learning or imitation from other countries' counterparts. This institutional learning is called institutional isomorphism in this thesis. In the theory of sociological new institutionalism, institutions change as a result of mimetic, coercive, and normative isomorphism. There are two conspicuous examples of institutional isomorphism in Korea: mimetic and coercive. Korea's mimetic isomorphism derived from learning form Japan[2]. As we will see in Chapters 5 and 6, Korea's governmental and semi-governmental organisations are very similar to Japan's with regard to their official names, objectives, and operational systems. On the other hand, Korea's coercive isomorphism happened in the aftermath of the East Asian economic crisis. The neo-liberal global regime led by the IMF, the World Bank, and leading countries in these international organisation such as America strongly pushed Korea to adopt neo-liberal reforms in the financial, labour, corporate, and administrative sectors in return for financial aid to Korea. As a result, Korea implemented a wide range of neo-liberal oriented reforms and Korea experienced coercive institutional isomorphism which was more or less acceptable to the neo-liberal global regime.

2. Learning in foreign policy analysis (FPA)

The previous section provides a brief summary of the three conceptions of learning that have been developed in the disciplines of IPE, IB, CP, and Development Studies. However, there is another perspective towards learning theory which has been

[2] Taylor argues that China also learned from Japan in terms of mimetic isomorphism: "institutions . . . like MITI and the Economic Planning Agency, now find their parallels in the Trade and Economic Office . . . and the State Planning Commission, while China's newly unveiled industrial plan bears resemblance to equivalent Japanese documents in its targeting of specific economic sectors" (Taylor 1996: 54).

developed in the literature of Foreign Policy Analysis (FPA), a sub-field of International Relations (IR). It is this concept of learning that this thesis is essentially based on in analysing both Korea and Japan's FDI policy. In this literature, the learning process is dealt with in terms of the psychological aspects of policy makers. Thus, scholars in this discipline have focused on policy makers' belief systems, ideas and ideology. This approach emerged as a counter-attack to the strong tendency of realists to treat domestic and individual environments in the policy making or decision making process as a black box (Kegley 1995: 47). The realist approach is based on the assumption that the state is a rational and unitary actor and considers the international system in terms of the interaction among rational and unitary states. Thus, the international system is conceived as a billiard table on which states act like billiard balls. Foreign policy analysis or decision making analysis emerged in order to overcome the shortcomings of the realist approach by the pioneering work of Snyder in 1954 which focused on the human decision making process (Herman and Peacock 1987: 22, Powell, et al 1987: 205). With the emergence of foreign policy analysis, several approaches were elaborated in order to investigate significant variables in the decision or policy making process. The bureaucratic politics approach, the cybernetic approach, and the cognitive approach were developed in order to reveal and analyse the areas inside the black box neglected by realism.

In the bureaucratic and cybernetic approaches, the decision or policy making process is not the result of utility maximisation led by rational calculations as the realist approach argues. Rather, the decision or policy making process is a process of reaction from the segmented roles and responsibilities among policy or decision makers who possess already prepared standard operating procedures (SOPs) by which

they produce routine and simple reactions towards domestic or international inputs or stimuli. The most significant weak point of these approaches is that in a crisis situation, these approaches cannot explain the actual decision or policy making process. These approaches have analytic advantages in investigating stable or normal situations. The difference between the cybernetic approach and bureaucratic politics approach is that the latter emphasises the conflicting aspects of policy or decision making processes among different ministries. Each governmental organisation has different supporting groups and interests. And, as these interests are incorporated into organisations and become institutionalised, each governmental organisation develops different belief systems or institutional features. The bureaucratic politics approach has its analytic advantage in the sense that it can explain contending and conflicting policy issues among ministries. However, it has its limit in explaining the coherent, efficient, and strong government or state in the Korean and Japanese developmental state period. Moreover, the bureaucratic politics approach neglects the strong leadership role by a supreme decision maker like the Korean president who can arbitrate among ministerial conflicts or dictate a certain policy without significant resistance from frustrated ministries.

In contrast to these two approaches, the cognitive or psychological approach focuses on an individual policy or decision maker's perception towards the external environment. Thus, in this approach, a policy or decision maker's personal experience, lessons from history, and analogies from similar issues are major research topics in analysing decision or policy making processes (Jong-Wook Jeong and Tae-Hyun Kim 1992: 436). This approach also emphasises the cognitive limits of a person in processing information. Excessive information cannot be efficiently processed in a

person's cognition process and, as a result, rational choice or utility maximisation cannot be obtained. Rather, utility satisfaction or psychological choice can be produced. In other words, as Peter M. Haas points out, the individual's cognitive content and structure can restrain rationality (Haas 1992: 29).

The shortcomings of this approach are that it is based on description and cannot predict future policy direction. Furthermore, in order to testify the assertion of this approach, an enormous volume of quantitative research has to be done in order to analyse decision or policy maker's cognitive or psychological structure towards a selected policy issue (Kegley 1995: 55). For example, Ole R. Holsti analysed 3,584 statements made by the US secretary of State, John F. Dulles in order to investigate Dulles' belief system towards the Soviet Union (Smith 1998: 15).

The psychological and cognitive approach has its historical background. As Smith points out, there was an academic fashion towards behaviouralism which emphasised observable and measurable components of behaviour rather than unobservable assumptions (Smith 1988: 14). Using behavioural methodology, the following six approaches were developed to link the sets of belief systems held by individuals and the behaviours of states (Smith 1988: 15) : (1) The 'image approach' suggested by Kenneth Boulding in 1956. Boulding argued that each individual holds images of the world. Thus, events which support the individuals' images of the world can be easily accepted, whereas events which contradict the images will be rejected; (2) The 'belief systems approach' by Ole R. Holsti in 1960. Holsti focused on the empirical investigation of the content of a leader's belief systems. His case study was the belief system of US Secretary of State John Foster Dulles. Thus, he analysed 3,584

statements made by Dulles. He distinguished open belief systems from closed ones; (3) The 'operational code approach' by Alexander George in 1969. George divided the operational code into instrumental beliefs and philosophical beliefs. The former are beliefs about the best means to achieve an actor's goals. The latter are beliefs which are related to the basic assumptions of an actor's norms and behaviour; (4) The 'cognitive map approach' by Axelrod in 1976. A cognitive map consists of concepts and causal beliefs. To make a cognitive map, Axelrod regarded the concepts as variables and causal beliefs as relationships between the variables. Thus, on the cognitive map, points replaced concepts and arrows between points replaced causal beliefs. The result of this pictorial representation was a cognitive map; (5) The 'lessons of the past approach' by Ernest May in 1973. May argued that first, decision-makers were apt to be influenced by beliefs about the lessons of history, and second, policy-makers misused historical lessons to strengthen their political positions or to avoid political crises; and (6) 'Brecher's research design' approach by Michael Brecher in 1969. Brecher argued that policy makers' psychological systems or environments determine the individual's ideology.

Thus it can be argued that, the significant achievement of FPA was to turn the attention of scholars away from the unobservable generalisation of realism and explore neglected areas such as governmental, organisational, and psychological domains in the policy or decision making process. However, due to its methodological and theoretical limits (such as lack of theoretical prediction and complicated, time consuming research based on behaviouralism), the psychological approach failed to become an independent model. Moreover, as the Cold War bi-polar system became consolidated, the systemic approach which was elaborated by

neo-realism became the dominant theory in the discipline of International Relations and the psychological approach lost scholars' attention.

However, as the Cold War order suddenly collapsed and the dominant neo-realism failed to explain or predict this historical phenomenon, the psychological approach re-emerged as one of the alternatives to the systemic approach (Levy 1994: 280). The structural approach adopted by neorealism deduces expectations and preferences only from structure and defines structure in terms of the material distribution of power (Alder and Haas 1992: 386-89). Thus, neorealism could not detect significant changes in a supreme decision maker's belief system. It cannot be denied that the sudden change in Gorvachev's belief system towards the survival strategy of the Soviet Union against America facilitated or ignited the collapse of the Cold War order. Learning theory as a sub-field of the psychological approach was elaborated before the end of the Cold War order to deal with images, belief systems, cognition, perception, and ideas of decision makers or groups who were in charge of security issues in America and the Soviet Union. At this time, learning theory was applied to foreign security policy analysis. Accordingly, Breslauer and Tetlock attempted to explain the revolutionary changes in Soviet foreign policy under Gorbachev by applying learning theory.

In this thesis, learning theory is applied to foreign economic policy analysis, particularly for both Korea and Japan's FDI development. Different from the cognitive or psychological approach, learning theory is not confined to the individual's cognitive or psychological structure. It also deals with behavioural changes. Moreover, as we will see below, learning theory deals with not only the

individual's belief system but also with organisational or governmental belief systems. In other words, individuals, groups, and governments can learn and change their belief systems or behaviour. Then, what are belief systems and what are ideas?

Before we start to review contending concepts of learning in FPA, we need to define belief systems and ideas. Belief systems and ideas are formulated, maintained, consolidated or changed by studies, experiences, and interactions at the level of individuals, groups, governmental organisations, and states. Studies, experiences, and interactions produce personal, organisational, historical, societal, cultural, economic, and political knowledge (perceptions, images, analogies, concepts) or practices. These knowledge, practices, and interactions in turn, re-formulate, retain, and consolidate or change previous belief systems and ideas. The individual's knowledge (cognitive) structure and governmental organisations' cultural or institutional features (practices, SOPs) are heavily influenced by these belief systems and ideas. The process of studies, experiences, and interactions is the process of learning. The learning process can lead to either changes in belief systems and ideas or changes in behaviour. The most important assumption of the belief systems approach is that "prior beliefs and expectations play a key role in structuring perceptions during the stages of the foreign policy decision-making process" (Powell et al. 1987: 206). Thus, it can be argued that learning theory brought back the neglected psychological or cognitive environment (belief systems, ideas) to the discipline of International Relations and connected these with the external environment (realities in domestic, state, and international levels).

Goldstein defines ideas as shared beliefs (Goldstein 1993: 11). This means that ideas and belief systems are interchangeable. Goldstein and Keohane argue that "ideas influence policy when the principled or causal beliefs they embody provide road maps that increase actors' clarity about goals or ends-means relationships (Goldstein and Keohane 1993: 3). They also elaborate two conspicuous pathways through which ideas play important roles in influencing policy outcomes by ordering the world and shaping agendas. The two pathways are ideas as road map, and the institutionalisation of ideas. First, ideas as road maps derive from "the need of individuals to determine their own preferences or to understand the causal relationship between their goals and alternative political strategies by which to reach those goals" (Goldstein and Keohane 1993: 12). Second, once ideas have influenced the organisational set-up, their influence will persist in the organisation through those working in the organisation and whose interests are served by it. Thus, although the initial interests which promoted institutionalisation fade away, if ideas are institutionalised, the impact of ideas may be prolonged (Goldstein and Keohane 1993: 23).

Bearing these in mind, in the first section various distinctive arguments about learning theory in FPA will be reviewed in greater detail, and in the second section, a theoretical framework will be developed. In developing the theoretical framework, a synthetic approach will be elaborated. The synthetic approach includes societal, statist, international systemic, ideational, and institutional approaches. The reason why the synthetic approach is necessary in analysing Korea's and Japan's socio-economic and political changes and transformation will be explained in the second section.

2-1. Contending concepts of learning in FPA

So far, the concept of learning has not been clearly defined in the literature on foreign policy analysis. Several scholars offer different definitions and interpretations. As we have seen above, learning can happen in individuals, groups, governmental organisations, and states and the result of learning can be either changes in belief systems or changes in behaviour. Hence, there are significant disagreements. First, there is the problem of the 'analytic unit'. As we will see later in this section, Levy suggests that learning is researched at the individual level only. For him, organisational or collective learning is difficult to measure. On the other hand, Ernst B. Haas emphasises collective learning and insists that learning should be dealt with within organisational frames. For him, individual learning cannot be easily translated into policy changes or outcomes.

Secondly, there is the problem of 'analytic scope'. As we will see later in this section, Nye contends that significant learning must result in changes in actors' 'behaviour'. For him, measuring changes in actors' belief systems is extremely difficult and it is the behavioural changes of actors which are, in the end, the most important research objective in foreign policy analysis. By contrast, Ernst B. Haas and Levy emphasise that learning leads to vital changes in actors' belief systems. They claim that if we focus only on actors' behavioural changes, the actual process of learning which occurs in the psychological and cognitive processes of individuals cannot be understood. Moreover, they point out that learning processes do not necessarily result in behavioural changes in actors. Thirdly, there is the eclectic approach to 'analytic scope'. Ziegler insists that changes in both belief systems and behaviour can be regarded as learning (Ziegler 1993: 10-11).

After reviewing these theoretical disagreements, firstly, the 'analytic unit' will include both collective learning and individual learning in this thesis. Collective learning is necessary because the main actors in this thesis are governmental organisations and bureaucrats. On the other hand, considering that Korea's presidential system has produced a hierarchical and centralised decision making process, the importance of individual learning cannot be ignored. Secondly, the concept of learning developed by Ernst B. Haas and Levy will be adopted. They conceptualise learning as the process which leads to a change in actors' beliefs, not behaviour. Thus, the 'analytic scope' of learning is not focused on behavioural changes but on belief system changes. As we will see throughout the thesis, policy changes (behavioural changes) have to be distinguished from belief system changes and institutional changes. Policy changes which are not accompanied by changes in the belief systems of state bureaucrats represent only a strategic effort to evade pressures from domestic society or the international system. For example, liberalisation policy towards IFDI in both Korea and Japan could not bring real changes to the protected and highly regulated IFDI environment. Unchanged belief systems which were deeply embedded in the efficacy of state strategic regulation of IFDI and developmentalism oriented institutions actually prevented substantive IFDI liberalisation in both Korea and Japan. Thirdly, learning will be distinguished from 'adaptation'. As Ernst B. Haas points out, adaptation means the emergence of new means by which to achieve fixed ends. In the process of adaptation, there are no changes in original belief systems or goals. In contrast, learning leads to changes in original belief systems or goals. Thus, under learning processes, the causal relations between means and ends will be changed as a result of changes in belief systems. Learning brings changes in cognitive

environments and adaptation brings behavioural changes in order to adjust to the reality of changing external environments.

In developing learning theory and in seeking to identify the effects of learning on the economic policy making process, the systemic approaches based on actors' rationalism will be criticised. As we have seen, the recent resurgence of interest in learning arguably reflects the widespread disappointment with the neo-realist systemic approach. Meanwhile, the epistemic community approach and social constructivism will be reviewed to supplement learning theory. The role of an epistemic community is important, given that ideas or belief systems need supporting groups. Goldstein argues that "for ideas to became politically salient they need to have sponsors, and those sponsors must either have political power or influence those who do" (Goldstein 1993: 15). Without supporting or advocating groups, ideas and belief systems can neither be sustained for long or occupy a dominant position in policy or decision making processes. As constructivists argue, interests are not exogenously given, but are constructed by intersubjective processes among actors.

In this thesis, not only the role of belief systems but also material interests will be given equal emphasis. Foreign economic policy is not only the result of a state's efforts to promote its economic interests but also a reaction towards other states' pursuit of economic interests through their foreign economic policies. Thus, a state's foreign policy making process is a simultaneous combination of pursuit of its economic interest and intersubjective relations with other relevant states' economic interests. This means that both belief systems and economic interests are not fixed but subject to change, as continuous interaction brings both learning processes and

different domestic and international environments. For example, Korea's economic interests were accomplished by highly regulating and screening IFDI flows in the developmental state period and bureaucrats' primary belief systems were based on the efficacy of state strategic intervention into the market to realise economic objectives. But, in the Korean transitionary state period, economic interests could be realised through the massive support and promotion of IFDI and the bureaucrats' belief system also changed from a developmentalism oriented one to a free market oriented one. These changes in economic interests and belief systems reflected the changed international economic system in terms of politicisation among states. We will see this in greater detail in Chapters 4, 5, and 6.

In the following sub-sections, contending concepts of learning and the shortcomings of using learning theory will be investigated.

(1) Philip E. Tetlock: A comprehensive approach

Tetlock summarises three approaches to learning: the neorealist approach; the belief systems approach; and the organisational and political cultural approach. In the neorealist approach which emphasises the systemic constraints and opportunities caused by the international environment, there is no need to be concerned about a particular policy-maker's cognitive content or structure. Learning in the neorealist approach involves the rational adjustment of policy in response to the shifting rewards and punishments of the international environment. "The choice is between learning and being selected out of the game in ruthless Darwinian fashion. . . . A national government that displays little capacity to learn has little chance to survive" (Tetlock 1991: 24). However, this straightforward reward-punishment model of learning is apt

to fail because it does not recognise the ambiguity and uncertainty inherent in the policy-making process. Moreover, the feedback flows from international events to the policy-making process may be delayed or blocked by domestic or individual variables.

The belief systems approach understands that the international system is extraordinarily complicated and in this context, policy-makers are inclined to depend on simplified assumptions or views to cope with the complex, uncertain, and difficult trade-offs inherent in the foreign policy-making process. Thus, identifying policy-makers' simplified images of reality is an essential duty in explaining or predicting policy outcomes. The main benefits of the belief systems approach is that by providing already prepared answers to basic questions about situations with which policy-makers have to deal and guidelines for choosing among several options, they facilitate decision-making. However, a main shortcoming is that in "their efforts to maintain stable, internally consistent belief systems, policy makers may fashion images of the world that are more orderly and regular than reality itself. Belief systems may facilitate the learning of lessons consistent with the underlying assumptions but impede the learning of anything else" (Tetlock 1991: 28).

The two concepts of learning which have been considered so far are confined to the individual's intra-psychic aspects. However, learning can take place at the organisational or politico-cultural levels. In other words, institutions and political systems are capable of change in response to events. There are two categories of collective learning: (1) institutions can be dismantled or created by policy-makers to avoid or repeat past experiences; (2) policy-makers can depend on the specific knowledge of an epistemic community in uncertain situations which require

professional knowledge about certain policy issues and attempt to institutionalise the access of that community to the decision-making process (Tetlock 1991: 41).

(2) Ernst B. Haas: A collective learning approach

As we have seen, Tetlock's conception of learning is broad and comprehensive. By contrast, Ernst B. Haas develops a unique conception of 'collective learning' connected with the idea of an epistemic community. The distinctive contribution of Ernst B. Haas to the theoretical development of learning lies in his distinction between 'learning' and 'adaptation'. For Haas, "learning in and by bureaucracies implies that the organisation's members are induced to question earlier beliefs about the appropriateness of ends of action, and to think about the selection of new ones, to revalue themselves" (Haas 1991: 72-73). By adaptation, he means the process of changing the way one solves problems without re-evaluating one's beliefs about basic causation. Adaptation involves recognising the failure of technical rationality and involves the selection of a new set of means (Haas 1991: 73).

Then, which one is better - adaptation or learning? Ernst B. Haas argues that adaptation and learning both coexist and interact (Haas 1991: 95). In summary, for Ernst B. Haas, adaptation brings changes in behaviour and means while learning brings changes in belief systems and ends. In the adaptation process, both epistemic communities[3] and consensual knowledge[4] remain weak and the degree of

[3] Ernst B. Haas defines an epistemic community as "a group of professors who share a commitment to a common causal set of policy values. They are united by a belief in the truth of their model and by a commitment to translate this truth into public policy, in the conviction that human welfare will be enhanced as a result" (Haas 1991: 67).

[4] Ernst B. Haas defines consensual knowledge as "generally accepted understandings about cause-and effect linkages about any set of phenomena considered important by society" (Haas 1991: 65).

institutionalisation of innovation is gradual and unsystematic. On the other hand, in the learning process, epistemic communities and consensual knowledge remain strong and the degree of institutionalisation of innovations is sudden and systemic triggered by crisis (Haas 1991: 91).

(3) Jack S. Levy: A minimalist approach

Levy defines learning as "a change of beliefs at the individual cognitive level" (Levy 1994: 287). In contrast to Haas's opinion about collective learning, Levy argues that collective (organisational or governmental) learning is not analytically viable. For him, organisations learn only through individuals who work in those organisations and he insists further that individual learning is not a sufficient but a necessary condition for collective learning (Levy 1994: 288-289). Thus, Levy argues that individual learning, defined as "a change of beliefs, the degree of confidence in one's beliefs, or skills as a result of the observation and interpretation of experience" (Levy 1994: 311), has little impact unless those who learn are able to implement their preferred policies or to influence others to do so (Levy 1994: 300). Governmental learning "involves more than the aggregation of individual learning or the development of new consensual knowledge. Unless new knowledge is institutionalised, it will not endure" (Levy 1994: 289). As a result, for Levy, organisational learning is "the institutionalisation of individually learned lessons into organisational routines and procedures" (Levy 1994: 311).

Levy has a different view about the neorealist interpretation of learning. Neorealism is a structural theory which sees a given structure as having a fairly well defined set of consequences. In the neorealist perspective, structure determines or constrains

outcomes and intervening perceptual variables are simply ignored. Levy points out that in the theory of neorealism, learning is socialisation[5]. Socialisation means the adjustment or assimilation process of states to the norms of the system. The system functions as a selector by rewarding some behaviours and punishing others. States that fail to learn the causal laws or to socialise to the norms of the international system cannot compete and so drop out of the system (Levy 1994: 298).

Hence, in contrast to Tetlock who regards the neorealist theory of selection by the system as one of his three definitions of learning, Levy contends that learning and neorealism present different explanations of foreign policy change: "Neorealists emphasise the rational and efficient adjustment to changing structural incentives, whereas learning theorists emphasise significant variations in cognitive structures, beliefs, and processes" (Levy 1994: 298). Levy also argues against Nye's view of learning. According to Levy, Nye views learning as a process of obtaining new knowledge or information which results in behavioural change. In other words, Nye focuses not on cognition but on behaviour. Thus, Nye contends that if there is no change in behaviour after learning, then learning is not useful for elaborating a more general theory of foreign policy (Levy 1994: 290). Levy rejects this view by arguing that if we focus on learning only when it is followed by policy change, then we cannot

[5]Ikenberry and Kupchan conceptualise socialisation as a "process of learning in which norms and ideas are transmitted from one party to another" (Ikenberry and Kupchan 1990: 289) or "a process through which the value orientations of leading states are transmitted to elites in other nations, regardless of the structural setting" (Ikenberry and Kupchan 1990: 290). This notion is different from that of a neorealist like Waltz. For Waltz, socialisation is a "process through which actors come to conform to the structural norms of the international system. It is a process that limits and molds the behaviour of states in ways that accord with the imperatives and constraints of international structure" (Ikenberry and Kupchan 1990: 290).

understand when individual learning is translated into policy and when learning is blocked by institutional or political constraints (Levy 1994: 290).

(4) Charles E. Ziegler: An eclectic approach

Ziegler employs an eclectic approach to learning, compared with Tetlock, Haas, and Levy who emphasise changes in 'belief systems', and Nye who emphasises changes in 'behaviour'. Ziegler argues that "learning takes place as the subject reassesses the appropriateness of earlier beliefs or behaviour, and consequently adjusts toward a better fit of means and ends" (Ziegler 1993: 10-11). Ziegler, like Ernst B. Haas, distinguishes adaptation from genuine learning. For him, adaptation involves utilising new knowledge for adjustments within existing structures to more closely achieve regime goals. Adaptation does not challenge the organisations' motivating ideology, basic system values, decision-making structures, or central goals. Adaptive behaviour seeks to preserve the existing order (Ziegler 1993: 12-13). In contrast, learning accompanies changes in ideology, government structure, and basic goals, and it can take place only when conditions reach a crisis. Thus, learning in institutions involves "a process of building consensus through new knowledge on the seriousness of existing problems, on the inadequacy of current problem solving strategies, and on the need for fundamental changes to realign methods with goals" (Ziegler 1993: 13).

According to Ziegler, Rosenau also defines adaptation "as a process of coping with or stimulating changes that contribute to keeping the essential structures of a system within acceptable limits" (Ziegler 1993: 16). Thus, Ernst B. Haas, Ziegler and Rosenau all distinguish adaptation form learning, and all of them share the understanding that adaptation does not lead to a fundamental change in the belief

systems of an individual or the essential structure of an organisation or in ultimate goals of both individuals and organisations. Ziegler insists that the learning process tends to be influenced by organisational structure and ideological flexibility. Thus, "in closed systems, central decision makers are relatively isolated from lower level foreign policy organisations, and from factors in the domestic environment that might constrain their behaviour" (Ziegler 1993: 13). By contrast, open systems are highly perceptive internally and internationally, and are more receptive to new ideas, knowledge and information. In summary, Ziegler develops an eclectic approach to learning by suggesting that both beliefs and behaviour are determining variables in defining the conception of learning. Ziegler shares the view of Ernst B. Haas and Rosenau that distinguishes adaptation from learning.

(5) Peter M. Haas: An epistemic community approach

In his development of the epistemic community's role in affecting the foreign policy-making process, Peter M. Haas provides a very loose definition of learning. An epistemic community is "a network of professionals with recognised expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area" (Haas 1992: 2). The roles of epistemic communities are in "articulating the cause-and-effect relationships of complex problems, helping states identify their interests, framing the issues for collective debate, proposing specific policies, and identifying salient points for negotiating" (Haas 1992: 2). It is important to know how epistemic communities can be distinguished from other groups. An epistemic community is "the combination of having a shared set of causal and principled beliefs, a consensual knowledge base and

shared (common) interests that the distinguishes epistemic community from various groups" (Haas 1992: 18).

For Peter M. Haas, learning is not only about acquiring new information about the environment but also accepting innovative ways of linking causes and effects and aligning means and ends (Alder and Haas 1992: 385). Haas suggests two types of learning processes: one is the adoption of new instrumental ends (new practices) and the other is the adoption of new principled ends (new goals). Thus, it can be inferred that he neither distinguishes adaptation from learning nor behaviour from beliefs. As a result, even the emergence of a new policy, which is not accompanied by changes in policy maker's belief systems, can be accepted as learning.

Haas further explores the relationship between the epistemic community and ideas and beliefs. For him, the usually accepted notion that ideas facilitate policy innovation and that prevailing ideas can determine or regulate policy choices leaves a number of questions unanswered: How do ideas emerge? How are they disseminated? How do they change and evolve? The answers to these questions produce the contention that ideas without carriers are useless and sterile. Thus, for Peter M. Haas, one of the most significant roles of epistemic communities is that they act as "channels through which new ideas circulate from societies to governments as well as from country to country" (Haas 1992: 27).

In summary, Peter M. Haas, compared with other theorists reviewed in this chapter, has developed a loose definition of learning. For him, any new policy practices, let alone new policy goals, are considered to be the results of learning. For him the most

significant questions concerning learning processes are "who learns what; whose learning gets translated into policy and why; and whose learning gets a chance to affect other countries" (Alder and Haas 1992: 386). These questions need input from the theory of the epistemic community. Peter M. Haas's distinctive contribution lies in the connection he makes between the epistemic community and learning theory.

(6) Alexander Wendt: Constructivism and learning

Wendt argues that both neorealism and neoliberalism have a shared commitment to rationalism. Rational choice treats the identities and interests of agents as exogenously given and focuses on how the behaviour of agents generates outcomes. In contrast, constructivism sees identities and interests as not exogenously given by structure but endogenous to 'process'. In other words, constructivists pursue a cognitive and intersubjective conception of process in which identities and interests are endogenously generated by interaction. The fundamental principle of constructivism is that 'collective meanings', referring to 'intersubjective understanding and expectation' of self and others, constitute the structure by which human actions are regulated or restrained:

> The distribution of power may always affect states' calculation, but how it does so depends on the intersubjective understanding and expectations, on the distribution of knowledge that constitute their conception of self and other . . . It is collective meanings that constitute the structures which organise our actions. Actors acquire identities -relatively stable, role specific understandings and expectations about self- by participating in such collective meanings. Identities are inherently relational . . . Identities are the basis of interests (Wendt 1992: 397-398).

For Wendt, institutions are a "relatively stable set or structure of identities and interests" (Wendt 1992: 399) and are "fundamentally cognitive entities that do not

exist apart from actors' ideas" (Wendt 1992: 399). But this does not mean that institutions are not objective and are only beliefs (Wendt 1992: 399). Thus, institutionalisation is "a process of internalising new identities and interests" (Wendt 1992: 399). In brief, whereas rationalism posits that structure determines identities and interests, social constructivist theory assumes that identities and interests and even structure are endogenous to process.

From the above, it can be inferred that from the social constructivist view, learning in neorealism, which refers to a behavioural change conforming to the international system's constraints or opportunities, is not genuine learning. Real learning has to be accompanied by changes of individuals' or institutions' identities or interests in interactive and intersubjective processes.

2-2. Shortcomings and pitfalls of using Learning theory

First of all, as we have seen so far, the very definition of learning has been disputed in the scholarly literature (Breslauer 1991: 825). Moreover, to demonstrate the structures and processes of the psychological environment is an inherently difficult task as is the empirical measurement of the psychological environment (Levy 1994: 280, Vogler 1989: 153). Thus, while Tetlock defines learning very broadly and treats it as a generic concept, Levy adopts a very narrow concept of learning and confines it to individuals' belief systems. Ernst B. Haas develops a distinctive concept of 'adaptation' according to which many of Tetlock's learning processes are reduced to adaptation. Ziegler is right to point out that the notion of learning "cannot easily be developed into an elegantly systemic, rigorous explanatory framework, because learning is itself a disjointed, largely trial-and-error process" (Ziegler 1993: 11).

In addition, we can identify eight major theoretical or methodological traps in adopting learning theory. First, learning theory does not consider policy-makers' arbitrary and purposive use of history to justify their ongoing policy implementations. This is a serious theoretical flaw. Levy clearly points out this problem: "instead of genuinely learning from historical experience, individuals might use history instrumentally. They often select from historical experience those cases that provide the greater support for their pre-existing policy preferences or they reinterpret a given case in a way that reinforces their views" (Levy 1994: 306).

Second, researchers could use the definition of learning "so loosely that it becomes synonymous with any new policy initiative by a government. Learning- at a psychological or institutional level of analysis- is by no means the only possible explanation for policy change . . . for instance, governments often change course in a mechanistic or cybernetic fashion, with little or no reassessment of basic beliefs and goals" (Tetlock 1991: 23). Third, researchers could take "foreign policy rhetoric too seriously as evidence of how policy makers actually think" (Tetlock 1991: 23). However, decision makers' rhetoric and belief systems could be different. In interpreting rhetoric, we cannot exclude the possibility of decision makers' intentional exaggeration, abridgement, or concealment of their original belief systems.

Fourth, researchers could confuse 'learning' with 'adaptation'. They could conclude that a government learned when it merely adapted to changing stimulus conditions without changing its belief systems (Tetlock 1991: 41). Fifth, observers could confuse learning with political competition or the random ebb and flow of event streams

within groups or organisations. Political competition and event streams can also results in policy shifts (Tetlock 1991: 41). Sixth, we have seen above that observers have to be careful in interpreting decision makers' rhetoric. But, how can we distinguish the decision-maker's rhetoric from real beliefs? Belief systems cannot be directly observed. And, because simple observation fails to measure or identify belief systems, researchers have to depend on decision makers' rhetoric or statements. This means that researchers are heavily dependent on inference in identifying decision makers' belief systems (Smith 1988: 32). Goldstein and Keohane clearly summarise this problem: "we observe only claims about beliefs and actions presumably based on beliefs. Thus our descriptions of beliefs require inferences which need to be tested" (Goldstein and Keohane 1993: 27).

Seventh, the causal relationships between belief systems and foreign policy changes are not direct. In other words, changes in belief systems or ideas do not immediately lead to changes in foreign policy. Such changes may take place when an existing set of belief systems or ideas are discredited by events or "when a new idea is simply so compelling that it captures the attention of a wide array of actors" (Goldstein and Keohane 1993: 16). Eighth and finally, because ideas and interests cannot be clearly distinguished and because purely ideational-based or purely interest-based approaches are apt to miss significant aspects of policy changes, it is important for researchers not to underestimate the interrelations between ideas and interests. Ideas and interests are "not phenomenologically separate and all interests involve beliefs" (Goldstein and Keohane 1993: 26).

Despite all these limits, Holsti points out that the belief systems approach may be useful in certain situations; namely (1) in non-routine situations[6] that require more than the mere application of standard operating procedures; (2) in decision-making at the pinnacle of the government hierarchy by leaders who are relatively free from organisational constraints; (3) in long-range planning that involves uncertainty and in which normative conceptions are central; (4) in highly ambiguous situations that are open to a variety of interpretations; and (5) in situations of information overload (Smith 1988: 35).

3. The theoretical framework

The main purpose of this section is to develop a synthetic approach to analysing both Korea and Japan's foreign economic policy, particularly FDI policy. In order to promote a clear understanding of both countries' FDI policy, the role of the state, domestic society and the international system will be compared. Thus, this section begins with a review of the three contending approaches to foreign economic policy analysis (state centred, system centred, society centred). Having done this, the literature on sociological new institutionalism will be reviewed in order to supplement the three dominant approaches (statist, societal, international systemic) and to overcome their limitations. A literature review of sociological new institutionalism and its key conceptual terms, including 'bounded rationality', 'mimetic isomorphism', and 'embeddedness', suggest a sound explanatory framework for comprehending the legacies and irrational existence of core characteristics of Korea and Japan's post

[6] A crisis situation is the most urgent non-routine situation. Vogler provides the characteristics and conditions of crisis: "A crisis is said to exist when there is a serious threat to high priority goals, when the amount of time allowed for decision is sharply limited, and where precipitating events have been unanticipated. A range of conditions have been observed in crises. They include a sudden rise in the

developmental state. And finally, the theoretical framework of this thesis will be elaborated. As we will see, a synthetic approach consists of statist, societal, international systemic, institutional, and ideational approaches.

3-1. Analysing foreign economic policy

There are three approaches to foreign economic policy analysis: the system centred approach; the society centred approach; and the state centred approach. The state centred approach can be divided into two groups. One approach sees the state as an efficient and autonomous actor and the other approach emphasises the institutional settings in a state which is the result of a specific historical context. The system centred approach focuses on the international political economy, and it regards opportunities or constraints from the system as a necessary first step in any analysis of a state's foreign economic policy. In particular, world system theory, international regime theory, hegemonic stability theory, transnational relations and economic interdependence are approaches based on systemic theories that have pursued a system centred approach to foreign economic policy analysis (Ikenberry, Lake, and Mastanduno 1988: 4-5). For the proponents of system centred explanations, such as the neorealists, a state's domestic politics is not a proper subject of analysis. Thus, although a system-centred view can lead to more parsimonious theory by excluding the concept of the state, domestic political variables such as the influence of social groups in policy making processes and changing coalitions at governmental level are simply ignored. This shortcoming regarding domestic politics as a black box causes serious theoretical flaws, particularly in explaining both the 'post developmental state'

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volume of information . . . ; resort to informal channels of communication; and the location of responsibility for decision at the highest levels of the governmental hierarchy" (Vogler 1989: 151).

and the 'expansionist developmental state'. Explanations about Korean and Japanese PDS and EDS' foreign economic policy require a greater appreciation of the legacies of the 'developmental state' such as the efficacy of the state and autonomous bureaucrats insulated from social group influences and political coalitions. Thus, without theories about domestic politics and the state's relative autonomy, neither Korean nor Japanese foreign economic policy in the PDS period can be fully understood. To be sure, the strength of state autonomy and the extent of its insulation from civil society are presently being eroded by strengthened domestic society in the form of a growing middle class, a consolidating labour force, and big business (Chaebol in Korea and Keiretsu in Japan) as well as by the neo-liberalising international political economy.

Being aware of both the shortcomings and advantages of the system centred approach, Milner and Keohane have developed a more elaborate 'second image reversed' approach by analysing the impact of the globalising economy on domestic politics:

> The clearest effect of internationalisation has been to undermine governments' autonomy in the domain of macroeconomic policy, and this has resulted largely from rising capital mobility, rather than trade . . . Internationalisation has also created new policy preferences and coalitions . . . Hence, there is an ongoing interaction between pressures from internationalisation and resistance by entrenched interests and institutions. The blocking and freezing effects of domestic institutions are most powerful in the short run. However, in the long run they seem unable to persist (Keohane and Milner 1996: 256-257).

Keohane and Milner define internationalisation as "the processes generated by underlying shifts in transaction costs that produce observable flows of goods, services, and capital" (Keohane and Milner 1996: 4). As can be inferred from above, their main arguments are twofold: first, as internationalisation is intensified, it can cause

changes in domestic politics by creating new policy preferences and coalitions, by triggering domestic economic and political crises, and by weakening government control over macroeconomic policy (Keohane and Milner 1996: 243). Secondly, the unprecedented increase in international transactions in trade and capital are raising the extent to which each economy is exposed to world market pressures and therefore the degree of sensitivity of the domestic economy to international price trends and shocks. Internationalisation therefore implies that economic shocks from abroad will more fully and quickly impact upon the domestic economy (Keohane and Milner 1996: 16).

The East Asian economic crisis that started in early 1997 confirms the validity of these assertions. The chain-reacting financial crisis in the region showed how closely each economy is intertwined, how each economy is vulnerably exposed to the globalising world economy and how government policies are restrained by the international economy and international organisations. The aid and stabilisation funds from the IMF meant that the recipient country conceded its economic sovereignty particularly in controlling fiscal and monetary policy to the IMF, which insists on neo-liberal style economic adjustments in return for assistance. Thus, "pressures from the international economy are not the only source of external pressure that matter for domestic politics. Political pressures emanating from the international system may also play a significant role . . . Powerful actors within the international system - whether states like the US or institutions like the IMF - can also affect domestic politics, and can probably do so even more as internationalisation processes" (Keohane and Milner 1996: 255-256). In sum, under the neo-liberalising international political economy system, the state's capacity to exercise control over both public and foreign economic policies (fiscal policy, monetary policy, strategic trade policy,

industrial policy, competition policy) is seriously restrained. This is the reason why the systemic view cannot be ruled out in explaining the foreign economic policies of both Korea and Japan despite its theoretical flaw in ignoring domestic politics and institutions (see Figures 1, 2, 3, and Tables 1,2).

The society centred approach views foreign economic policy "as either reflecting the preferences of the dominant group or class in society, or as resulting from the struggle for influence that takes place among various interest groups or political parties. In either case, this approach explains foreign economic policy essentially as a function of domestic politics" (Ikenberry, Lake, and Mastanduno 1988: 1-2). Opposing the statist approach, Gourevitch insists that "there seem to be no characteristics of associations or state structure that can stand independently of social factors in explaining policy outputs" (Gourevitch 1986: 28, requoted from Kesselman 1992: 651). Moreover, he defends his society centred approach against the emphasis on state autonomy by arguing that the latter "has a social base: for state autonomy to exist for specific purposes, the state must be able to obtain the support of differing kinds from societal actors" (Gourevitch 1986: 238, requoted from Kesselman 1992: 651). Halliday also argues that "the state is no longer an embodiment of national interest or of judicial neutrality, but rather of the interests of a specific society or social formation, defined by its socio-economic structure . . . Sovereignty equally becomes not a generic legal concept but the sovereignty of specific social forces" (Halliday 1994: 60-61, requoted from Jacobson 1996: 101-102).

Thus, in this view, state bureaucrats and institutions are neither autonomous nor significant variables in planning or performing foreign economic policy. Moreover,

policy constraints or opportunities from the international systemic level cannot be explained. And, "the approach tends to lack theoretical rigor and predictive value, largely because it lacks an independent measure of group power . . . If the outcome of group struggle can only be explained after the fact, the predictive value of the approach is severely limited" (Ikenberry, Lake, and Mastanduno 1988: 8). There are more intensive criticisms of the society centred view offered by proponents of state centred approaches:

> Lake argues . . . that state officials can have an important impact by shaping the array of interest groups that contend over policy . . . Goldstein contends that state institutions can shape an interest group's ability to gain access to the policy arena . . . Ikenberry . . . demonstrates that the existing state institutions may influence the interests societal actors possess (Ikenberry, Lake, and Mastanduno 1988: 8-9).

Most importantly, the society centred approach to foreign economic policy is not suitable to illustrate the peculiar relations between the 'developmental state' and its weak society. Under the developmental state, social groups and classes were not active enough to participate in and influence the policy making process. These weak societal forces were the actual output of the purposive state's oppressions, ideological manipulation (such as catch up slogan in Japan, national modernisation and growth first policy in Korea), and were derived from the under-developed political systems and the low level of democratisation. Thus, in explaining the developmental state's relations with society and the international system, the persuasive power of the society centred view is seriously limited. However, as the 'developmental state' transformed into the 'post developmental state', and as societal forces in the 'post developmental state' became stronger, an exclusion of society can result in an imperfect explanation

of Korea and Japan's foreign economic policy (see Figure 2-1, 2-2, 2-3 and Table 2-1, 2-2).

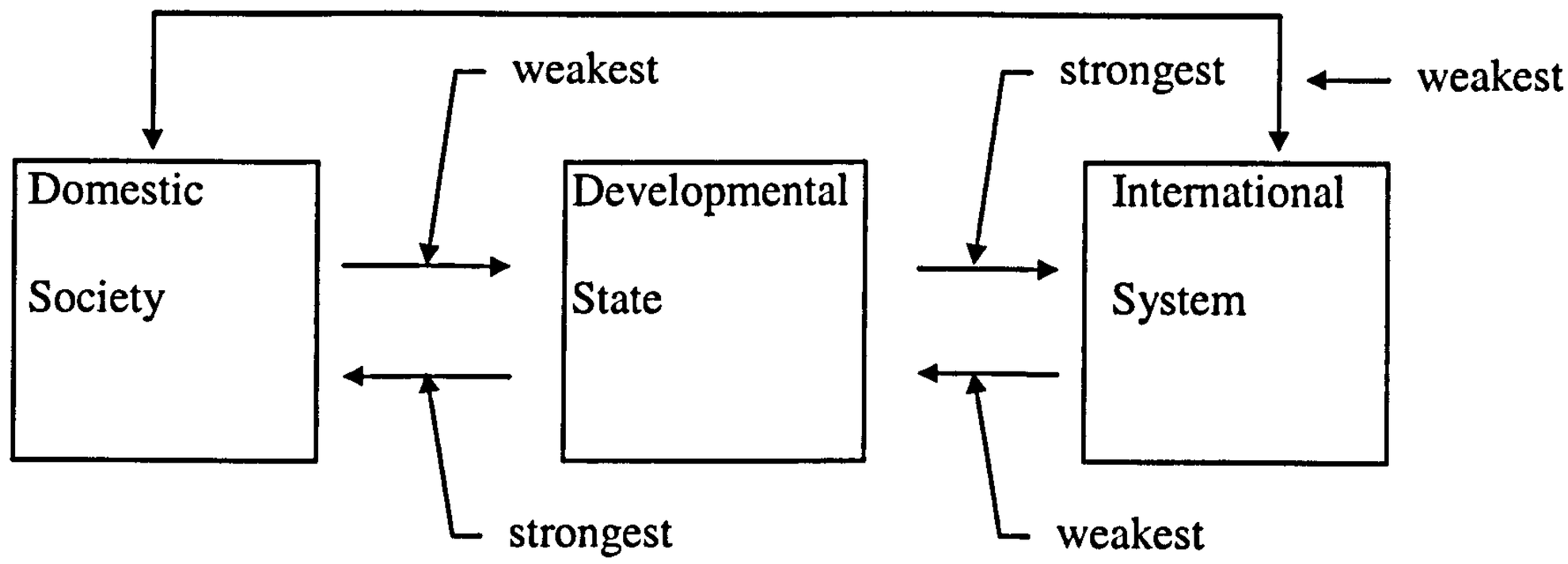

Figure 3-1. Inter-relationships and influential flows among society, the international system and the DS regarding foreign economic policy.

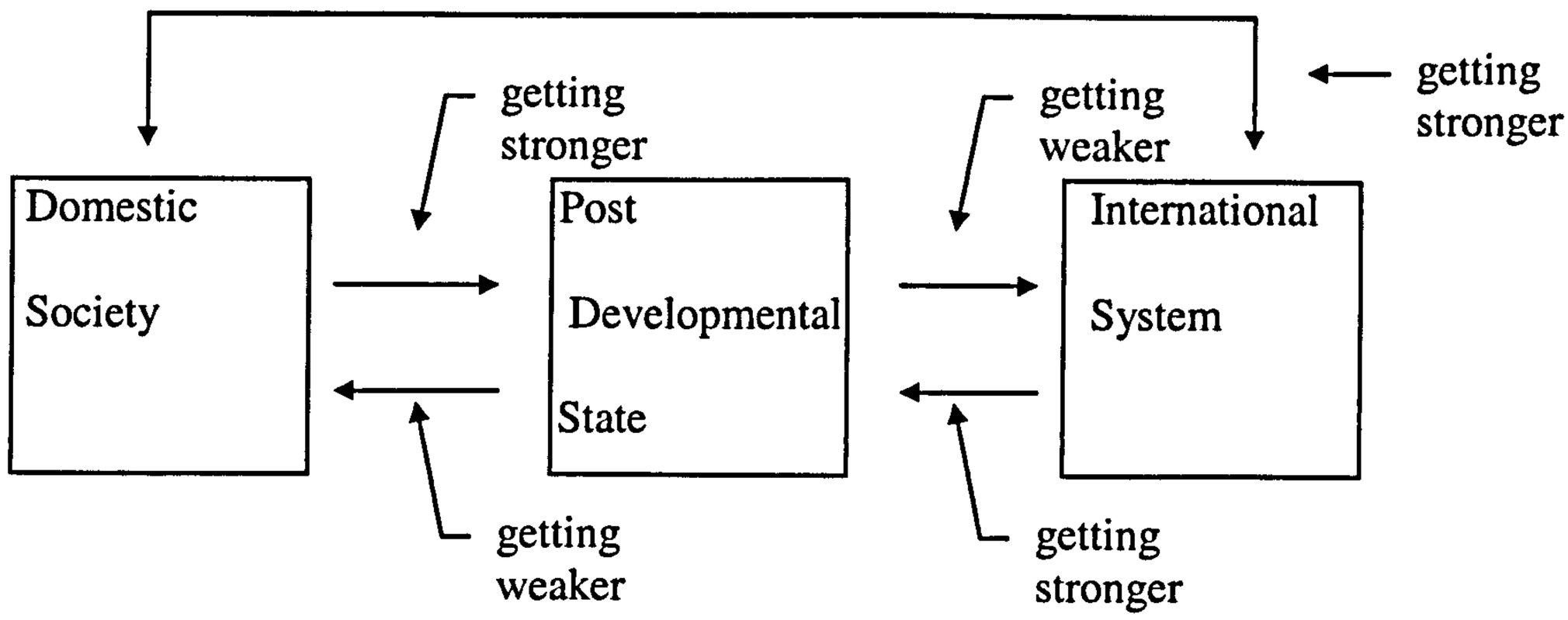

Figure 3-2. Inter-relationships and influential flows among society, the international system and the PDS regarding foreign economic policy.

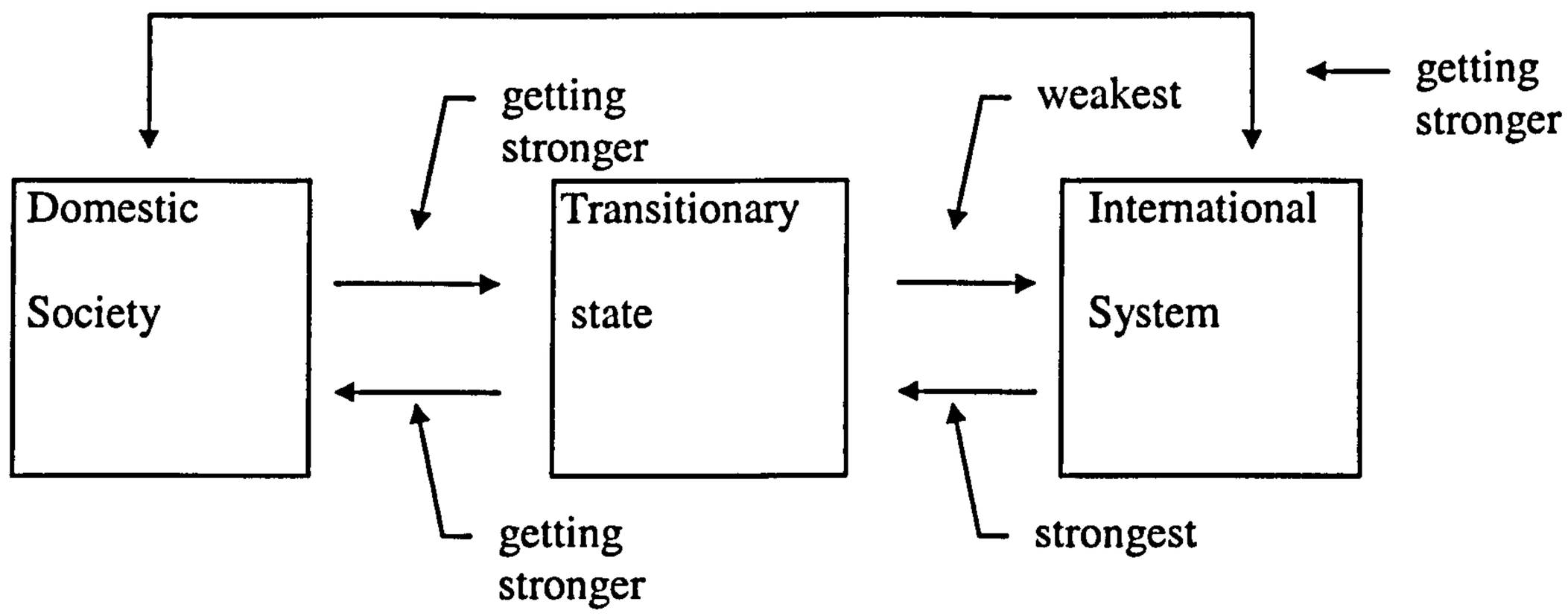

Figure 3-3. Inter-relationships and influential flows among society, the international system, and the TS regarding foreign economic policy.

1960s-the mid 1980s	The mid 1980s-1997	1997-to present
-Neo-mercantilistic capitalism -Communitarian capitalism[7] -Developmental state	-Post developmental state -Voluntary learning from Japan's EDS in East Asia -Nascent development of the EDS in East Asia	-Transitionary state -Coercive learning from neo-liberal regime

Table 3-1. Korea's transformations from the DS, through the PDS, to the TS and distinctive features in each period.[8]

[7] The term 'communitarian capitalism' was developed by Lester Thurow (1992) in his book *Head to Head: The Coming Economic Battle among Japan, Europe and America*, (New York: William Morrow and Company Inc.). According to Young-Myung Kim (1996: 20-21), Japanese and Korean communitarian capitalism has three conspicuous features different from Anglo-American capitalism which is based on individualistic and liberal capitalism. First, the primary objective of communitarian capitalism lies in the improvement of national wealth. Second, because communitarian capitalism's basic unit is the nation-state and because it searches for mercantilistic economic policy, communitarian capitalism is likely to be exclusive to other countries. Third and finally, communitarian capitalism stresses the interests of the group or nation-state. So it prefers to improve national competitiveness rather than to increase individual consumers' quality of life.

[8] Korea's economic development plan started from the early 1960s, and after the late 1980s Korea's OFDI increased in the wake of currency appreciation and the first realisation of a trade surplus. Thus,

1945-the mid 1980s	The mid 1980s-to present
-Neo-mercantilistic capitalism -Communitarian capitalism -Developmental state	-Post developmental state -EDS in East Asia

Table 3-2. Japan's transformation from the DS to the PDS and EDS and distinctive features in each period.[9]

The state centred approach, as we have seen, is divided into two approaches (the institutional approach and the state as rational actor approach). Ikenberry et al. clearly explain these two state centred approaches:

> First, what can be termed the institutional approach conceives of the state primarily as an organisational structure, or set of laws and institutional arrangements shaped by previous events. In this view, institutions, once formed, tend to endure. Institutional change . . . occurs primarily at moments of significant crisis . . . The persistence of institutions enables them to influence policy even after the ideas and coalitions that initially gave rise to them no longer dominate. The second approach conceives of the state as an actor . . . Its primary emphasis is on the goal-oriented behaviour of politicians and civil servants as they respond to internal and external constraints in an effort to manipulate policy outcomes in accordance with their preferences. An underlying presumption is that these preferences are partially, if not wholly, distinct from the parochial concerns of either societal groups or particular governmental institutions (Ikenberry, Lake, and Mastanduno 1988: 10).

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it can be argued that Korea's 'developmental state' started from the early 1960s and after the late 1980s, Korea entered into the post developmental state. After the economic crisis, Korea transformed into a transitionary state. We will discuss these transformational processes and conspicuous features in each period in greater detail in Chapter 5.

[9] Japan's peculiar economic development led by the developmental state started after the end of the Second World War and after 1985, as the result of currency appreciation caused by the Plaza Accord, Japan's OFDI increased rapidly. Thus, it is reasonable to insist that Japan's 'expansionist developmental state (EDS)' started from 1985. We will discuss Japan's transformation from the DS to the PDS and conspicuous features in each period in greater detail in Chapter 4.

The second approach considers the state as an efficient and autonomous actor which is insulated from pressures emanating from both domestic society and the international system. Thus, in this view, states "operate simultaneously at domestic and international levels and want to maximise benefits in one domain to enhance their positions in the other" (Jacobson 1996: 101). This view clearly explains the characteristics of the 'developmental state'. In the developmental state period, particularly in Korea and Japan, bureaucrats and supreme decision makers exercised a great deal of autonomy and pursued policy objectives which were not influenced by parochial interests but were compatible with national interests. Korea's 'national modernisation' slogan and 'economic growth first' ideology and Japan's 'catch up' slogan were undeniably manipulated and became pervasive in domestic society by the initiative of autonomous and efficient government officials or supreme decision makers in order to improve economic wealth and enhance national pride for the whole country, and not just to satisfy parochial interests.

For instance, ideology manipulation by the state about the necessity and efficacy of state autonomy in pursuing economic development was artificially reproduced in the form of a social pact or agreement in Korea in the period of the 'developmental state'.[10] This confirms the fact that in the developmental period, the strength and

[10] Through the 1960s, 1970s, and until the middle of the 1980s, the belief in the efficacy of state autonomy and the strong state in pursuing economic development was pervasive in Korea's domestic society. There were several underlying factors explaining this socially agreed belief in the autonomous state as an efficient way to achieve rapid economic growth. The most important factor was the simple fact that the Korean DS achieved unprecedented economic growth in the 1960s and 1970s. Economic growth in those periods further legitimised and consolidated previous state autonomy. However, of great significance was the government's intentional effort to introduce Western academic literature on the 'East Asian development model', which emphasised the successful role of autonomous and intrusive government intervention in the market system, to

autonomy of the state over society were strong enough to manipulate and mobilise societal forces. Thus, the second view of considering the state as an efficient actor emphasises state officials' ability to build and reshape new institutions and mobilise inactive societal groups in order to achieve national objectives such as economic growth. In sum, in this view, "the state is situated at the intersection of the domestic and international economies and is the principal national actor charged with the overall conduct of defence and foreign affairs. This unique position of the state gives executive officials a special legitimacy in the formation and implementation of foreign economic policy" (Jacobson 1996: 13). This view also suggests a valuable explanation for the active and autonomous state's position in the internalisation of external pressures from the international system and the externalisation of domestic society's pressures to the international system. The Japanese and Korean EDS can be explained with the help of this approach. Both the Korean and Japanese PDS pursued OFDI in Southeast Asia as a result of the simultaneous process of internalisation of external pressures and externalisation of internal pressures. More specifically, from the internal side, both the Korean and Japanese PDS suffered from shortage of labour, high labour costs and competition from other East Asian countries in labour-intensive industry. Moreover, from the external side, both countries were under harsh pressures to open the domestic market and to evade protectionist measures in foreign markets particularly in America and the EU. As a result, OFDI was massively developed in Southeast Asia in order to overcome both internal and external pressures at the same time. The role of the Korean and Japanese PDS in developing and supporting the EDS system in Southeast Asia will be further investigated in Chapters 4, 5, and 6.

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ordinary Korean people in order to legitimise and consolidate the autonomous and strong state by ideologically manipulating and persuading ordinary people.

However, the serious shortcoming of this approach is that it cannot explain the weakening position of the state in the Korean and Japanese PDS period caused by strengthened societal forces and globalising forces centred on the neo-classical economic paradigm and neo-liberal political paradigm.

The institutional approach emphasises the tendency of state institutions to persist well after social coalitions or international conditions that initially led to their creation decline (Ikenberry, Lake, and Mastanduno 1988: 11, Ikenberry 1988: 223-224). It focuses on "the shaping and constraining role of institutional structures of the state and society, and on the historical dynamics of continuity and change that underlie these structures" (Ikenberry 1988: 11). Keohane and Milner identify three types of domestic institutional resistance to the globalising world economy. First, "domestic institutions can block signals from the international environment . . . South Korea's policies of industrial intervention and capital controls, were also attempts to block, or at least reshape, international price signals" (Keohane and Milner 1996: 251). Secondly, pre-existing institutions may negate or modify influences from the world economy by freezing coalitions and policies in place. "International price signals may enter the domestic economy, but politics will remain frozen in time-worn patterns" (Keohane and Milner 1996: 253). Thirdly, "pre-existing institutions filter the international pressures, and countries make different choice about their responses to the world economy" (Keohane and Milner 1996: 255).

In order to review the institutional approach, it is necessary to define what institutions are. Ikenberry suggests three definitions. First, as the narrowest explanation,

institutions refer to "the administrative, legislative and regulatory rules that guide the adjudication of conflict. Rules and procedures at this level are extensive, and they undergird the making of foreign economic policy" (Ikenberry 1988: 226). Secondly, institutions refer to "the centralisation and diffusion of power within the state. The capacities and resources of the various organisations that comprise the state are of concern here . . . In relating these institutional structures to foreign economic policy, scholars have given special attention to the role and efficacy of executive officials within the state" (Ikenberry 1988: 227). Finally, as the broadest conception, institutions refer to "the norms that govern the relations between state and society . . . Nations differ in terms of the reigning political beliefs that render legitimate particular types of state involvement in the economy and society" (Ikenberry 1988: 228).

The first and second definitions indicate tangible institutions while the third definition indicates intangible institutions. In the third definition, as we can see, political belief systems are regarded as institutions. This definition is close to the definition developed in sociological new institutionalism. We will discuss sociological new institutionalism in the next section. The reason why the new institutionalism is incorporated into the theoretical framework of this thesis is also explained in the following section.

3-2. Sociological new institutionalism

As we have seen, in foreign policy analysis, system, structure, process, agent (individual, group, organisation), culture, institutions, and belief systems are contending analytical units or levels. Thus, there are the international systemic approach, structuralism, constructivism, the cultural approach, rational choice theory

and the ideational or belief systems approach in foreign policy analysis. All of these have their advantages and shortcomings in analysing and predicting changes in a state's foreign policy. The reason why sociological new institutionalism is incorporated in this thesis is that it can complement the institutional approach. As we have seen, in foreign policy analysis, the definition of institutions is confined to observable and tangible institutions such as the administrative and legal system, and standard operating procedures. However, it is important to remember that there are intangible but very significant institutions such as culture, practice, social norms, and people's sentiments (e.g. economic nationalism and xenophobia) that can play a greater role in determining or influencing foreign policy making processes or outcomes. For example, without considering Korean and Japanese xenophobia and economic nationalism which are expressed through the 'buy Korean or Japanese goods' and 'national wealth first' mentality rather than the individuals' quality of life, Korea and Japan's institutionally protected domestic market structure cannot be understood. Moreover, without considering the effects of intangible institutions' role and influence, the low level of IFDI in both Korea and Japan cannot also be explained properly.

Thus, in this section, first, the background of the emergence of the new institutionalism and second, the origins, changes, and definitions of institutions will be investigated. In this thesis, the institutional approach is used as a combination of the institutional approach developed in foreign policy analysis and sociological new institutionalism. In other words, not only tangible but also intangible institutions will be analysed with equal emphasis.

The old institutionalism flourished between the 1880s and 1920. The old institutionalists were "strongly committed to the study of formal state institutions, viewing them as tangible entities that evolve in coherent ways" (Ethington and McDonagh 1995: 88). The old institutionalism was criticised because it "was excessively formalistic in its approach to political institutions; did not have a sophisticated awareness of the informal arrangements of society . . .; was descriptive rather than problem-solving, or analytic in its method" (Rhodes 1995: 48). Academic interest in institutions was re-ignited by March and Olsen in the late 1980s after the long dominance of behaviouralism and rational choice theory in social science. In their co-authored book *Rediscovering Institutions* published in 1989, March and Olsen criticised that "both the behavioural approach of the 1960s and the rational choice school eliminated any role for institutions in explaining political outcomes" (Koelble 1995: 233). For March and Olsen, "human rationality is limited or bounded. Human action is an attempt to satisfy and fulfil expectations which are context specific and deeply embedded in cultural, socio-economic, and political fields or structures" (Koelble 1995: 233). Thus, the new institutionalism "seeks to retrieve the significance of both formal state institutions and informal societal pressures, while avoiding the extremes of old institutionalism or behaviouralism" (Ethington and McDonagh 1995: 90).

With the help of March and Olsen's stimulating work, there emerged three new institutionalisms: sociological, historical, and rational choice. For sociological new institutionalists, institutions "are not merely rules, procedures, organisational standards, and governance structures, but also conventions and customs" (Koelble 1995: 234). In other words, institutions are "not just formal rules, procedures, or

norms, but the symbol systems, cognitive scripts, and moral templates that provide the frames of meaning guiding human action. Such a definition breaks down the conceptual divide between institutions and culture" (Hall and Taylor 1996: 947). In explaining the origins, persistence, and changes of institutions, sociological new institutionalists depend on the concepts of 'social legitimacy', 'embeddedness', and 'institutional isomorphism'. Sociological new institutionalists insist that "organisations often adopt a new institutional practice, not because it advances the means-ends efficiency of the organisation but because it enhances the social legitimacy of the organisation or its participants. In other words, organisations embrace specific institutional forms or practices because the latter are widely valued within a broader cultural environment" (Hall and Taylor 1996: 947). Thus, sociological new institutionalists "focus attention on the processes whereby those developing new institutions borrow from the existing world of institutional templates. This approach usefully emphasises the way in which the existing institutional world circumscribes the range of institutional creation" (Hall and Taylor 1996: 953). Meanwhile, the term 'embeddedness' suggests the reason why old institutions persist:

> Most people are inherently conservative: once they establish a routine, they tend to stick with it. Cognitive and cultural embeddedness explains why most individuals cannot even conceive of alternative institutional arrangements or ways of doing things . . . Even more important are . . . structural and political embeddedness . . . Individuals are viewed as embedded in so many social, economic, and political relations beyond their control and even cognition that it is almost absurd to speak of utility-maximising and rational behaviour in a strictly economic sense (Koelble 1995: 234-235).

Thus, it can be inferred that sociological new institutionalists have some advantages in explaining institutional persistence and inertia, but they cannot clearly explain why institutions change despite human actors being strongly embedded in present social

and structural institutions. However, Powell and DiMaggio contend that "institutional isomorphism explains institutional change. Change occurs as a result of coercive, mimetic, or normative isomorphism which lead organisations and institutions to adopt surprisingly homogeneous forms" (Powell and DiMaggio 1991: 64-74, requoted from Koelble 1995: 235).

This concept of institutional isomorphism suggests a good explanatory tool for comprehending the Korean state's mimetic and coercive isomorphism with the Japanese state and international organisations such as the IMF or the international neo-liberal regime led by America. In both the DS and the PDS periods, the Korean government ministries and government-supported organisations (semi-governmental organisations) for trade and investment promotion were similar to those of Japan's. More correctly, Korea consciously followed or imitated the Japanese model (Singh 1994: 1821). The Korean government's mimetic isomorphism is well described by Vogel:

> The Korean Finance Ministry and Ministry of Trade and Industry looked very much like Japan's Ministry of Finance and MITI. To promote foreign trade, MITI had established JETRO (the Japan External Trade Organisation), and South Korea established KOTRA (Vogel 1991: 53).

The Korean state also accepted Japan as a model in science and technology policy: "indeed, Japan has been a reasonably explicit model for Korean science and technology policy during the past three decades" (Branscomb 1996: 161). However, it has to be remembered that although Korea learned and imitated from Japan, Korea did not absolutely duplicate the Japanese state due to cultural, historical, institutional, and political differences between the two countries. Although there are great similarities

in governmental organisations, economic planning, and the export oriented economic system between the two countries, the most conspicuous difference is the extent of bureaucrats' autonomy or freedom from politics. Japanese bureaucrats have autonomy from politics, while Korean bureaucrats are subordinate to politics (Kang 1989: 27-36). Moreover, in relation to the corporate system, ownership and management is divided in Japan. Thus, "management acts as a mediator between shareholders and employees" (Keun Lee 1993: 47). In contrast, management is synonymous with ownership in Korea. Thus, there are confrontational relations between management and workers. These institutional differences between Japan and Korea show that institutions matter in learning processes. Although Korea has learned from Japan, there are significant differences between the two countries' institutional setting.

In the TS period after the economic crisis, Korea followed the economic prescriptions from the IMF in order to obtain aid for economic stabilisation. This facilitated coercive isomorphism in Korea's economic related ministries, which had been the symbol of successful government intrusion into the market system, with the IMF as the symbolistic keeper of the neo-liberal, free market economy. Thus, the characteristics of the Korean PDS, in which the belief system regarding the efficacy of the intrusive and developmental state co-existed with the neo-liberal belief system regarding the efficacy of the market system, were transferred to the TS which is more compatible with the neo-liberalising international political economy.

However, sociological new institutionalism has two main theoretical flaws. First, it seems "so focused on macro-level processes that the actors involved in these

processes seem to drop from sight and the result begins to look like action without agents" (Hall and Taylor 1996: 954). Secondly, "it can miss the extent to which processes of institutional creation or reform entail a clash of power among actors[11] with competing interests" (Hall and Taylor 1996: 954).

Despite these theoretical problems, the reason why sociological new institutionalism is incorporated in this theoretical framework is to supplement the institutional approach. As we have seen, in the institutional approach, which is a part of the state centred approach, the definition of institutions is confined to tangible institutions. However, we need to understand the role and influence of intangible institutions in order to fully understand Korea and Japan's foreign policy making processes and policy changes. In the Korean and Japanese PDS period, the legacies of the

[11] The rational choice institutionalists criticise these theoretical flaws of sociological institutionalism and emphasise that the emergence and changes of institutions are closely related to human rationality. They argue that cultural norms and social institutions are the product of repeated rational, calculative and utility-maximising human actions. In other words, institutions are "designed to stabilise exchange relationships, to induce co-operative behaviour among self-interested individuals, and to minimise transaction costs between the parties" (Koelble 1995: 239). Thus, "institutions are another kind of market and the shape of institutions and their behaviour are the aggregate product of individual calculations of instrumental interests" (Ross 1995: 120). They also argue that actors' habitual behaviours in institutions are not due to irrationality but due to limited information "since those forming institutions had the intention of bringing about a habitual (that is certain and consistent) exchange" (Koelble 1995: 240). It can be inferred from the above that for the rational choice institutionalists, an institution is intentionally created by relevant and voluntary human actors in order to obtain co-operation and to reduce transaction costs. For rational choice institutionalists, the institution persists and "survives primarily because it provides more benefits to the relevant actors than alternative institutional forms" (Hall and Taylor 1996: 945). And, institutional change takes place "as a result of changing prices, which provide an incentive for those within institutions, and sometimes those outside of them, to renegotiate terms of participation and to change institutional rules and enforcement procedures" (Koelble 1995: 240).

However, the most significant theoretical flaw is that rational choice institutionalists postulate that "the relevant actors have a fixed set of preferences or taste" (Hall and Taylor 1996: 944). Thus, it cannot be denied that they fail to explain how preferences are formulated. In other words, "[n]o abstract rational actor, whose preferences are simply given, and who acts simply according to interest, has ever existed. The concept of rationality is itself a social and historical construct. Preferences are always culturally shaped and vary enormously" (Kloppenberg 1995: 126). Moreover, this approach often leaves us without an explanation for the many inefficiencies that institutions display" (Hall and Taylor 1996: 952).

developmental state[12] were strongly embedded in the socio-economic and political contexts although domestic society and the international systems changed and became unfavourable or conflicting to developmentalism. And, in the Korean TS period, although both Korea and Japan needed a new economic paradigm to adjust to a highly politicised and neo-liberalising international political economy, intangible institutions such as economic nationalism and xenophobia remain intact and persistent.

Because of these institutional legacies and the inertia of the developmental state in Korea and Japan, both countries failed to quickly adjust to the changing international environment. It cannot be denied that as a result of the 'economic growth first policy' in Korea which has lasted for more than 30 years and the 'catch up phase' which has lasted for almost a century since the Meiji restoration in Japan, the developmental state and mercantilist capitalism were strongly institutionalised not only in intangible institutions (culture, practice, social norms, rules and people's sentiment, implicit consensus between the and state and society) but also in visible institutions (governmental organisations, legal systems, standard operational procedures) in Korea and Japan. Moreover, the self-interests of bureaucrats were also strongly engrained in both countries' bureaucratic organisations. Sociological new institutionalism provides

[12] The outstanding characteristics of the 'developmental state' can be summarised as follows: autonomous government insulated from the constraints emanating from both domestic society and the international system; government intervention in the market system; strategic trade and investment policy; co-operation between government and big business; long-term industrial policy; protectionism in the period of import substitution industry; targeting future industry; promoting artificial comparative advantage; governmental support for indigenous technology; government subsidies and beneficial finances toward targeted industry and technology development; a government-led financial sector; high rate of domestic savings; oppression towards labour movement; uni-polar political system (authoritarian regime in Korean and long-term Liberal Democratic Party dominance in Japan). The legacies of these policies and institutions still remain in Korea and Japan as a form of the post developmental state and the transitionary state, although they are contradictory and conflicting to the globalising world economy and the neo-liberalising international political economy.

useful theoretical tools to explain these rigid institutional legacies and inertia in both countries. As a result, the theory of sociological new institutionalism provides a good explanatory framework in comprehending the characteristics of the post developmental state and the transitionary state.

3-3. The theoretical framework: Towards a synthetic approach

So far, we have reviewed five approaches to foreign policy analysis: the ideational approach, the statist approach, the societal approach, the international systemic approach, and the institutional approach. As we have seen, each approach has its advantages and disadvantages in explaining a state's foreign policy making process and policy changes. The state as rational actor approach provides the most persuasive explanation of the Korean and Japanese DS. In the DS period, the respective Korean and Japanese state were efficient and effective in planning and accomplishing their economic objectives due to a combination of a set of environments. In the DS period, underdeveloped civil society, an unpoliticised international political economy, developmentalism oriented governmental organisations and bureaucracy, and the autonomous state facilitated the rapid realisation of economic growth. As a result of these environments, there were congruent and consistent relations among economic policy, economic institutions, and economic belief systems in the DS period and this was the underlying background of rapid economic development in both countries.

However, in the Korean and Japanese PDS period, there emerged cleavages among policy, institutions, and belief systems. As the international political economy became highly politicised and economic interests became more significant than security concerns after the collapse of the Cold War order, both the Korean and Japanese

mercantilistic economic behaviour and structure were subject to harsh pressures from the international system. Both countries' economic structures which were characterised by protected domestic markets and fierce penetration of open foreign markets in America and Europe were highly controversial and harshly criticised. As a result, both countries started economic liberalisation and deregulation in order to evade foreign pressures. However, this change in policy was not accompanied by ideational or institutional changes. Changes in belief systems do not directly lead to changes in policy. However, the more important point here is that changes in belief systems do not easily occur. There is a gap between the external environment and the psychological or cognitive environment. Policy makers' or decision makers' belief systems persist because of this gap caused by 'cognitive consistency'. People have a strong tendency to more easily accept events which are close to their present belief systems and to more easily reject events which are different from present belief systems (Kegley 1995: 53, Vogler 1989: 146). This shows that belief systems are not inclined to easily change, despite external environments constantly changing.

The belief systems of the bureaucrats in the Korean and Japanese PDS were strongly embedded in the efficacy of developmentalism. In other words, the bureaucrats believed that state intervention in the market through planning, screening, regulations, and other supporting measures were still effective in achieving economic development, although the international system had become much more politicised and unfavourable to this belief system. Thus, right before the economic crisis, Korean bureaucrats, particularly medium and low level (working level) bureaucrats were strongly rooted to core aspects of developmentalism such as red tape, internal guidelines, and administrative guidance. Although the maturing civil society strongly

requested the diminution of bureaucratic intervention into the market, and although, the side effects of developmentalism such as collusive relations among politicians, bureaucrats, and business had been revealed several times through constant corruption and bribery scandals in the PDS period, bureaucrats refused to adjust to the changed environment in a pluralised domestic society.

The Korean TS began in the aftermath of the economic crisis. With the intervention of the IMF, the Korean TS changed its developmentalism oriented belief systems to neo-liberal, free market oriented belief systems. The massive shock and severe experience from the economic crisis finally led to a change in belief systems of Korean bureaucrats. However, institutions, particularly people's sentiment of economic nationalism and xenophobia continue to resist change in the TS period. Changes in institutions are more difficult and time consuming than changes in belief system. Institutionalised belief systems last far longer, even after the initial configuration of material interests and belief systems that had led to the emergence of particular institutions change or disappear. Thus, in the Korean and Japanese PDS period and in the Korean TS period, we can witness cleavages and contradictory relations among policy, institutions, and belief systems. More specifically, in the PDS period, institutions and belief systems were strongly engrained in developmentalism, which is characterised by state intervention in the market and market protection, while foreign economic policy only was liberalised. In the Korean TS period, the resistance and inertia of institutions still embedded in developmentalism can be observed, although both policy and belief systems were changed and geared to the neo-liberal, free market system.

These transformations in both Korea and Japan from the DS to the PDS and TS shows that we need an approach comprising societal, statist, international systemic, ideational and institutional approaches. In other words, understanding both the Korean and Japanese states' historical transformation needs these five approaches. Neglecting any one approach will result in partial or incomplete analysis. However, we can identify a determining approach in each period. For example, the DS can be clearly explained by the approach that sees the state as an efficient and autonomous actor while the PDS can be explained by the institutional approach. And, the TS can be explained by the international systemic approach. However, it is important to remember that this does not mean that we can explain the characteristics of the DS period only by the approach that sees the state as an efficient and autonomous actor.

A determining approach can be identified only when we investigate the underlying environments which contributed to the establishment of the efficient and autonomous state in the DS period. In other words, the autonomous state in the DS was the historical result of a combination of weak civil society, an unpoliticised international political economy, and the lack of cleavage among policy, institutions, and belief systems. This argument shows why we need to investigate the five analytic levels (state, society, international system, institutions, and ideas) by adopting a synthetic approach. Also, even though the institutional approach can explain the PDS period in which the legacies and inertia of developmentalism were pervasive and rigid, we need to understand why the institutional legacies and inertia persisted for so long. The extended and prolonged institutional legacies of the developmentalism in the PDS period can only be fully understood when we adopt the theory of sociological new institutionalism and the ideational approach. Sociological new institutionalism

provides us with an effective theoretical tool in explicating institutional legacies and resistance. The divided belief systems within the bureaucracy in the Korean and Japanese PDS period also promoted the institutional resistance of developmentalism. Shared belief systems within bureaucrats and between the state and civil society can facilitate rapid economic development. Furthermore, shared belief systems can shorten the time interval for institutional change, because with these shared belief systems, societal and state actors can pursue institutional change and shorten the time interval for institutional changes.

The Korean TS period can be explained by the international systemic approach, particularly economic interdependence theory because the Korean TS emerged in the aftermath of East Asian economic crisis. The crisis in Southeast Asia spilled over to Korea and the contagion effect revealed the fact that in the context of globalising world economy and financial globalisation, every economy is closely inter-related and interdependent. Thus, the origins of the Korean TS can be explained by the systemic approach. However, we need to understand the background of the economic crisis in Korea. Thus, we need to investigate other analytic levels such as state, society, ideas, and institutions. The crisis was a result of a complex situation. The Korean PDS was ideationally divided between high ranking bureaucrats and working level bureaucrats. The free market economic idea was supported by high ranking policy makers while developmentalism oriented economic ideas were advocated by working level bureaucrats. This ideational division resulted in lack of supervision in the newly liberalised financial sector. The lack of state supervision led to a massive increase in foreign debt by the private sector. The enormous increase in foreign loans was one of the important factors which caused the overall economic crisis in Korea. Thus, it can

be argued that even though the systemic approach can provide a first step in the explanation of the Korean TS, we need to analyse the state level, the ideational level, and the societal level as well.

This shows that we need a synthetic approach which consists of a state centred approach, a society centred approach, an international systemic approach, an ideational approach, and an institutional approach. This multi theoretical research is supported by Rhodes: "You can learn from the critical assessment of one theory; you can learn more from a comparative critical assessment of several theories when they are brought to bear on a single topic" (Rhodes 1995: 56).

Chapter 4.
From the DS to the PDS:
Socio-economic and political transformation in Japan

Contents

The specific nature and characteristics of the Japanese state, society and its economic system have been highly contested both in academic and practical fields. Sometimes, the differences between the views are so enormous that for some observers, Japan could be considered as a multifaceted country. Along the spectrum of interpretation and analysis of the Japanese state, society and its economic system, there have been four distinctive approaches: (1) a statist approach that focuses on the role of the bureaucracy; (2) a market-centred approach that emphasises Japan's market conforming state intervention in the economy; (3) an institutional approach that investigates specific features of the relationships between political party, bureaucracy and business; and finally, (4) a societal state approach.

The statist approach mainly developed by Johnson (1995) and Wade (1990) argues that Japanese economic success is a result of highly planned and effective interventions by the bureaucracy and this approach has been termed as 'capitalistic developmentalism' or 'the governed market theory' in the IPE literature and in Development studies. In this approach, "[t]he state is not simply an instrument of elite control, responsible for maintaining the status quo. Nor is it merely a neutral aggregator of pluralist competition between interest groups. The state has its own set of interests and goals, its own repertoire of power resources, including administrative authority and an established legal order, and legitimate control over the instruments of coercion" (Okimoto 1988: 309). The advantage of this approach is that it provides a comprehensive conceptual tool in explicating Japan's high growth period or the catch up period. In this period, the state was a powerful locomotive in planning and pursuing national economic objectives.

The major weakness of this approach is that first, it cannot illustrate the close, co-operative relationships of the state with business and the co-ordinated trade and investment policies emanating from such relations. Second, this approach cannot explain inter-ministerial struggles and differences over policy objectives and representations of various social groups, which have clearly appeared in the conflicts between the MITI and the MOF (Jin 1996:445).

The market centred tradition has produced two groups: neo-classical interpretations and a concept of 'corporate led strategic capitalism' formulated by Calder (1993). The neo-classical approach is further divided into two groups: the first group faithfully follows the assertion of predominance of the market system over the state

and tries to highlight the side-effects of state intervention into markets. This approach is an economic expression of the neo-liberal international political economic order and lies in sharp contrast to developmentalism. For the proponents of this approach, Japan's remarkable economic performance is the result of non-interference of the state into the market. Thus, it can be argued that this free market approach has no advantages in enhancing a comprehensive picture of Japanese economic development. Any approach which ignores the roles of the Japanese state and relies on the free market system cannot privide a sufficient explanation in Japanese studies. Meanwhile, the second group recognises some state interventions as long as this interference is market conforming and not distorting.

Wade calls these two approaches the free market (FM) theory and the simulated free market (SM) theory (Wade 1990: 22-23). In a nutshell, the difference between the two versions of the neo-classical approach lies in the acceptance of state intervention. Thus, the former highlights the failures of the MITI's planning and interventions in the early car industry and the latest bio-technology industry and doubts the efficacy of industrial policy, arguing that the role of industrial policy has been, at best, a supplement to the market system. Also, this group emphasises the price differences between domestic and international markets. Japan's high costs in product factors, high prices in goods and services, and poor housing and quality of life are recurring items on the menu of this group in criticising Japan's market distortions and their side effects. This group can be thought of as a pure neo-classical approach. Meanwhile, the second group starts from a recognition that Japan's economic performance cannot be understood only by a single logic of the free market system. This group accepts the efficacy and usefulness of industrial policies, government-led financial system, and

strategic trade and investment policies which led to domestic market protection and exports promotion as long as these state policies do not totally violate a market system of demand and supply. Thus, this approach is particularly focused on the systematic efforts of the Japanese government in developing such areas as human resources and social infrastructure which facilitate and support the smooth operations of the market system.

Calder's corporate-led strategic capitalism argues that it is not the state but the configuration of private sector actors found in the Keiretsu system and the long-term credit bank which have been efficiently allocated financial and material resources. Calder's assertion, which argues that the private sector dominates the public sector in Japanese capitalism, is different from Johnson's developmentalism. For Calder, Japanese capitalism includes such patterns as "(1) fragmented state administrative controls over industries and finance, with no strong central executive to integrate policy . . . (2) powerful and largely self-contained private industrial groups [which are] more cohesive, market-oriented, and often more strategic than the public sector" (Calder 1993:263). This contrasting interpretation and understanding of the Japanese state, society and economic system are the reason why Japanese studies in IPE and Development Studies are unable to reach an agreement on understanding Japan's enigmatic state-society relations and economic accomplishment and why Japan is regarded as a multifaceted country by some observers.

Market centred approaches have received fierce criticism from the proponents of the statist approach, mainly because of their neglect of state interventions, planning and price distortions through industrial policies and strategic trade and investment policies

which have been very prevalent throughout Japan's economic trajectory. Criticising Johnson's concept of the 'capitalist developmental state', Calder argues that Japan's economic success does not come from state interventions but from corporate led strategic resource allocations. In other words, it is not state intervention and planning but the private sector of the Keiretsu system and long-term credit bank nexus that plays the most determining role in achieving efficient resources allocation which is a prerequisite of economic growth. Calder's approach is peculiar and to some extent, has persuasive power in explaining Japan's economic system, considering that Japan's specific industrial organisation such as the Keiretsu system has underpinned Japan's economic strength in manufacturing sector.

The Keiretsu system is an informal configuration of corporations and a main bank which are closely connected with each other by intercorporate shareholdings and personnel exchanges at company' directorate level. The main bank functions as a control tower in terms of long-term and excessive lending to the member corporations of same Keiretsu system. This Keiretsu system is also widely extended to SMEs by close, long-term sub-contracting relationships. Thus, the presence and role of the Keiretsu system in Japan has been a focus of scholars studying Japan's remarkable economic performance. However, Calder's approach shares a common feature with the neo-classical approach by underestimating the persistent roles of the Japanese state in achieving economic objectives.

The third approach which focuses on Japan's institutional characteristics is best elaborated by Hatch and Yamamura (1996). In their view, "Japan has neither a bureaucratic authoritarian nor a centerless state. It is ruled instead by a government-

business network" (1996: 116). Thus, for them, the triad network among the bureaucracy, party and business is the key to understanding Japan's remarkable economic success. In other words, these well-organised private-public connections are the key reason for Japan's effective accomplishment of its economic objectives. This network theory has its strength in highlighting the positive results of Japan's economic structures and systems, particularly, the active, high growing economic period, but it is limited in suggesting an answer to the question of why Japan is in a decade-long, deep recession despite the strong presence of this efficient network between state and business. Second, it fails "to account for the deep-seated discord, clash of interests, and sectoral variations in government-business relations in Japan" (Okimoto 1988: 306). Third, this approach cannot coherently explain the dark side of this network, that is, chronic, recurrent corruption, bribery and reciprocal special treatments.

The fourth approach is the societal state approach. Okimoto contends that Japan is "a societal state in the sense that government power rests on its capacity to work effectively with the private sector . . . Political power in Japan is thus exercised through a complex process of public-private sector interaction, involving subtle give and take, not frontal confrontation that results in the forceful imposition of one side's will on the other" (Okimoto 1988: 314). This approach provides the most useful analytical tool in explicating the current relationships between state and civil society in the late 1990s. The emergence of the middle class and various pluralistic interest groups in current Japanese civil society (Pempel 1993: 125-127) signalled the end of the dominant state over society as we will see in section 2. In this regard, Okimoto's societal state theory explains in detail processes of policy making and

implementations by highlighting the complex political interactions between state bureaucrats, politicians, and civil society members.

What all these approaches lack is a theory of change and transformation. The Japanese state, society and economic system are not fixed and not static. They are changing continuously and dynamically transforming. Thus, this thesis' main argument is that all these four approaches have a similarity in ignoring or neglecting the simple aspects of human history and social constructions, that is, continuous, structural change and transformation of state, society and economic system. In other words, the Japanese state, society and its economic system have to be understood with the concepts of micro changes and great transformations. And, this concept leads to the 'theory of stage' which is arguing that "countries at different stages of development may require different degrees of state intervention" (Friedman 1988: 208).

In summary, for Johnson, Japan is a bureaucracy-led capitalist state and for Calder, Japan is a corporate-led strategic capitalist state. For Hatch & Yamamura, Japan is a network state which is characterised by a close, co-operative relationships among business, political parties and the bureaucracy. And for Okimoto, Japan is a societal state in which public or foreign policy making and implementing processes are greatly influenced by political interactions between civil society members and the state. These understandings are perplexing and compete with each other for theoretical predominance and so far, the competition among them is still on-going. However, these sharply contrasting interpretations are not necessarily contradictory if we adopt the view of transformations and changes in socio-economic and political orders. In

other words, Japan has been continuously changing the structures and characteristics of state, society and economic system as its developmental stage moves up the ladder. In this view, both Johnson's developmentalism and Hatch and Yamamura's network theories have their advantage in explaining Japan's developmental state period, and Calder's corporate-led strategic capitalism and Okimoto's societal state theory have their advantage in explaining Japan's post developmental state period.

It is not difficult to say that everything is subject to changes and transformations but it is quite difficult to divide the exact timing and to explain the extent and intensity of changes, let alone anticipate future results and direction of these changes and transformations. This chapter will investigate the timing and extent and intensity of changes and transformations in order to provide a firm base to understand Japan's changing foreign economic policies over FDI. Finding a dividing point between the DS and the PDS is a more difficult task. In this chapter, the end of the Japanese DS period will be the middle of the 1980s. The reasons are several. First, Japanese OFDI exploded after the Plaza Accord in 1985 and the high Yen caused by the Plaza Accord propelled outstanding changes in Japan's economic system and corporate organisational structures. Second, Japanese IFDI policies were nominally liberalised in terms of changes to relevant laws, but these have not been accompanied by substantial changes in FDI inflows nor in institutions such as the complex domestic distribution system that is essentially closed to foreign companies, the populace's economic nationalism and the still pervasive government regulations. However, as we will see, legal changes are an important indicator of the Japanese state's turning point from the DS period into the PDS period.

Third, Japan's economic heyday was in the 1980s. This economic boom and prosperity in that period also caused changes in Japan's state-society relations. The maturing of Japanese civil society, which is an inevitable offspring of economic growth, has increased pressures for social and political pluralism against the DS period's elite coalition among the bureaucracy, the LDP and business. It has also led to fundamental changes in the political terrain by changing the nature of supporting groups of the LDP. As we will see in the following sections, the LDP's supporting groups in the DS period were the farmers, small and medium size self enterprises and big corporations. Meanwhile, the LDP's supporting groups in the PDS period are the middle class, financial industries and big corporations. These changes in LDP support ultimately resulted in the end of the long period of LDP rule in 1993. Thus, it can be argued that the 1980s was a watershed period for the emergence of a strengthened Japanese civil society and the starting point for political reconfiguration. And finally, as Japan reached its ultimate national goal of 'catch up' in the 1980s, the domestic and international economic environment also dramatically changed. Among the changes, the shift in the role of industrial policy in Japan's economic development were remarkable. The bureaucrats role as strategic planners gave way to private companies, and strategic trade measures such as protectionism and non tariff barriers ceased to be effective measures as internal and international criticism and pressures increased.

In the next sections, the nature and characteristics of the Japanese DS and PDS will be explained and compared. Japanese post developmentalism is competing with the neo-liberal global political economic order in order to be not only an economic superpower but also to secure a dominant economic paradigm. Thus, Japanese evolution is an interesting and important issue both in scholarly and policy (public and

private) domains. In the sub-conclusion, Japans' future direction and evolution of the PDS period will be discussed with possible scenarios. In this respect, an analysis of the impact of the long-term domestic recession and the East Asian crisis is also necessary.

1. The Japanese DS

1-1. The major characteristics of the Japanese DS period

The Japanese DS was a mercantilistic state in which policies, institutions, and belief systems shared the same principles, norms, and objectives. The bureaucracy's persistent belief systems regarding the efficacy of the intrusive state into the market system were supplemented by industrial policies which were organised into domestic market protection for both imports and IFDI and promotion of both exports and OFDI in the DS period. Institutions such as governmental ministries, the collective national culture which produced a 'rich country mentality', Japanese style corporate organisational structures, and trade and investment related laws were adjusted to and unified with the persistent belief systems regarding the efficacy of developmentalism. In sum, belief systems, institutions and policies were combined into a unified mercantilistic developmentalism and there were no contradictions or conflicts among these three pillars of economic development. These close, organic relations among institutions, belief systems, and policies were the crucial background of Japan's rapid, remarkable economic growth in the DS period.

Japan enjoyed the benefits of an industrial policy in the DS period. Industrial policy is the "application of government resources and influence to industrial affairs"

(Magaziner and Hout 1980: 1) and is "geared toward the redistribution of capital, labour, and production resources among different industries to tailor the entire national industry into a desired form" (JETRO (a)1985:1). In Japan, industrial policy has also "served as the main instrument for consensus building, the vehicle for information exchange and public-private communication" (Okimoto 1989: 231). In the DS period, industrial policy was sustained by the two most influential ministries, that is, the MITI and the MOF (Okimoto 1988: 319). MITI's objectives were:

> (1) shaping the structure of industry and adjusting dislocations that arise in transition;
> (2) guiding the healthy development of industries and their production and distribution activities;
> (3) managing Japan's foreign trade and its commercial relations;
> (4) ensuring adequate raw materials and energy flows to industries (Magaziner and Hout 1980: 33).

As we can see from the above, the MITI's roles and responsibilities in domestic industries and international trade and investments were astonishingly comprehensive. The relations between state and private sector, particularly between the MITI, the Keiretsu system, and industrial associations show how effectively industrial policy was organised and worked in the DS period. The MITI could improve the efficiency of industrial policy by forging close relations with Keiretsu member enterprises and industrial associations. The private sector also enjoyed benefits by closely working together with the MITI, as cheap policy loans, direct subsidies and various incentives were, in return, provided by the MOF. The MITI orchestrated the strategic industrial coalition by incorporating both industrial associations and Keiretsu member companies in order to expedite co-ordination and co-operation within a single industry and among different industries (Huber 1994: 12).

On the other hand, the MOF promoted the efficiency of industrial policy by regulating monetary and fiscal policies which were favourable to developmental objectives. The Bank of Japan lends money to commercial and regional banks which in turn lend to major industries (Huber 1994:52). Thus, the MOF as a supervisor of the BOJ can "exert considerable leverage over the banks, and on occasion will suggest which projects to support" (Magaziner and Hout: 1980: 37). To be sure, as we have seen above, the close interrelationship between the public and private sectors, and shared industrial objectives among them were the major foundation of the efficient implementation of industrial policies and remarkable economic growth in the DS period. The background of the powerful and influential MITI and the MOF was derived from their relative insulation both from social interest groups and politicians. For Okimoto, the MITI is a comparatively non-politicised ministry and the MOF is somewhat politicised. Heavily politicised ministries are the Ministry of Construction and the Ministry of Agriculture, Forestry and Fisheries (Okimoto 1988: 324).

As a successful late developer, Japan became a model for late-late developers in East Asia and later became a prototype of the East Asian developmental model (Wade 1990: 326). The Japanese model consists of a set of features:

> an one-party political structure; the ability of technocrats to pursue economic policies free from political interference; the use of markets as a tool for industrial development while avoiding excessive competition; the mobilisation of nationalism on behalf of economic development; the emphasis on the collective good rather than individual rights; a social bargain that favours producers (Mochizuki 1994: 132).

The East Asian developmental model is a combination of a number of specific features of industrial policy. More specifically, policy measures of the developmental model are a composition of strategic trade and investment policies, a government led

financial sector, administrative guidance, policy loans to selected industries, infant industry protection, future industry targeting, exchange rate controls, domestic market protection for both imports and IFDI, fiscal and monetary subsidies for the promotion of exports, export requirements and local content requirements when admitting and screening IFDI, and finally, a preference for licensing and joint ventures over IFDI and full foreign ownership in order to promote indigenous technology. As a late-developer, Japan was dependent on advanced foreign technologies and the Japanese government tried to improve indigenous technological capacity by implementing policies which preferred licensing and joint ventures over IFDI. With the help of licensing and joint ventures, Japan could upgrade its technological level through technical learning. Thus, in the DS period, Japan was not only a pioneer of the East Asian developmental model, it was also a technology learner from more advanced countries. In practising technical learning, Japan adopted the strategy of reverse engineering and wide commercialisation of imported technologies ahead of competing countries.

After a short period of technical learning, Japan's technological capacity became equivalent to other advanced countries particularly in manufacturing industries. In addition, Japan's exports dramatically increased due to the massive growth of the manufacturing sector. The chronic trade surplus coming form this sector caused both pressures and protectionist backlash from Japan's major trading partners. In response to these pressures and protectionist measures, Japan changed its trade and investment related policies although these were not accompanied by changes in belief systems and institutions. Thus, the policy changes were superficial and merely for show-window display in order to cope with foreign pressures. In other words, liberalised

and deregulated trade and investment policies without institutional and belief system changes did not result in a substantial increase in imports and IFDI. Such behavioural and superficial changes in policies can be termed as 'adaptation' rather than 'learning', which brings changes to belief systems. Unchanged belief systems regarding the efficacy of developmentalism was the most crucial factor underpinning the preparation of the Expansionist Developmental State (EDS) in the early 1980s. These superficial policy changes are the major characteristics of the PDS and this will be further elaborated in Section 2. The characteristics of the Japanese DS can be summarised in the following Table 5-1.

	The Japanese Developmental State period
IFDI OFDI	1962-1980 1951-1985
	-belief systems = policies = institutions -Pioneer of East Asian developmental model and Expansionist Developmental State -Neo-mercantilistic capitalism -State intrusive but efficient industrial policy -Before catch up: **technical learning** from more advanced countries -After catch up: **adaptation** to the neo-liberal regime and globalising economy -Joint venture, licensing preference over inward FDI -Raw material security oriented outward FDI in the 1960s -Industrial structural adjustment related outward FDI from the 1960s to the early 1980s -Kojima's trade promoting FDI by Japan in Southeast Asia in the 1960s and 1970s

	-Preparation of the **Expansionist Developmental State (EDS)** to Southeast Asia in the early 1980s

Table 4-1. The major characteristics of the Japanese DS period

1-2. Society, state and international system in the Japanese DS

The Japanese DS period was sustained by a combination of several pivotal features. In the political sphere, co-operative triad relations among the Liberal Democratic Party, the bureaucracy, and business formed the core of an elite coalition that excluded civil society members, particularly trade unions, blue and white colour workers, and the urban middle class. The LDP's lengthy single party rule from 1955 to 1993 was the sustaining foundation of this triangular relationship and the 'catch up' slogan was an expression of social consensus which resulted in the tolerance by civil society members for state policies which exclusively pursued national wealth at the expense of the populace's quality of life and social welfare.

The background of the sustained triangular elite coalition and inactive civil society in the DS period were as follows. First, civil society was not sufficiently mature to the point that it could influence policy making processes. Trade unions could not be organised into an unified nation-wide organisation as a significant political actor because of business' conciliatory measures such as life-long employment, and as a result, trade unions turned into company unions. This was the major reason for the absence of economic struggle between business and labour, and the stabilisation of the labour market in Japan (Okimoto 1989: 233).

Second, the social consensus of catch up was exploited by the triad elite coalition in order to prevent civil society members from perceiving their rights to fair and equal distribution of national wealth and to mobilise the entire nation to realise the goal of a rich and strong country. Thus, Wolferen argues that "Japanese civil society is extremely weak and politically ineffectual . . . Genuine labour unions were crushed long ago and have a tradition of serving management. Japan's famous company loyalty precludes political activism . . . and has prevented the emergence of a politically significant middle class" (Van Wolferen 1993: 62-3).

Third, the LDP's long-term rule was a product of long-term patronage relationships and clientelistic voting systems associated with electoral constituencies (Okimoto 1988: 323-330). The LDP's social support groups were in the farmers, SMEs, the construction industry, and big conglomerates. Thus, under the clientelistic system, the LDP developed and implemented public and foreign economic policies which were favourable to these supporting constituencies and in return the LDP was able to secure sufficiently safe Diet seats to perpetuate its rule. Thus, among the members of civil society, only these LDP supporting groups enjoyed favourable policies while other remaining members were excluded and marginalised. This division among civil society members prevented the emergence of an organised and unified civil society movement in the DS period. On the other hand, under the patronage system, Diet members of the LDP influenced the distribution of the government's public spending such as public procurements, subsidies, public works, and local infrastructure construction by influencing policy making processes in the bureaucracy. Japanese fiscal management is centralised. The central bureaucracy administers fiscal management in detail, while local government is heavily dependent on central support

in fiscal management. This fiscal structure is the reason for the close relationship between politicians and the central bureaucracy. Diet members whose electoral districts are local or rural have to maintain close relations with the bureaucracy in order to attract public spending into their districts. In Japan, bureaucrats are substantial law makers. Diet members suffer from a shortage of assistants in the law making processes (Zhao 1993:189) and this shortage of human resources was the major reason for the monopoly of law making processes by the bureaucracy. In order to have their proposed drafts passed in the Diet without any delay, bureaucrats also have to maintain close relations with Diet members. In sum, LDP politicians and bureaucrats were closely linked through distribution of public spending and legislation of proposed law drafts.

Fourth, the role of traditional, cultural and historical factors contributed to the predominance of the bureaucracy over civil society. Under the influence of Confucianism, the state and the bureaucracy were superior to the populace. The bureaucracy was revered by the common people and the state was identified with the will of heaven. Thus, state legitimacy and bureaucracy's authority could not be doubted or challenged. This cultural tradition was supplemented and consolidated by the highly competitive bureaucratic examination and the intentional nurturing of the bureaucracy by the US Occupational Army after the Second World War. The Occupational Army strengthened Japanese bureaucracy in order to fill the political vacuum caused by the destruction of the Japanese military regime which had gained supreme power during the War. Moreover, it was the bureaucracy that could be re-organised into a major base of Japanese economic restoration, which was the most important objective of the US Occupational Army, now that Japan was at the front-

line of East-West confrontation in terms of the battle of ideology between communism and liberal democracy.

Finally, business became an inevitable coalition partner of the bureaucracy and politicians. Politicians needed financial support from business in order to be re-elected. Japan adopted a medium size electoral district system before 1994[1]. This meant that in an election district, even the same party members had to compete with each other to be elected. This electoral system produced a high cost election structure in Japan (Calder 1988: 530). Politicians needed funds and the primary source was business. Business donated political funds to politicians and in turn, politicians exerted influence in the policy making processes of bureaucracy. On the other hand, economic ministries developed close relations with business in order to improve the efficacy of economic policy implementation. For example, the MITI has maintained close relations with manufacturing industries in order to attain more efficient and effective policy results in conjunction with export promotion and facilitation of industrial structural adjustment. Thus, the MITI advocated manufacturing industries' request and resolved predicaments in return for manufacturers' co-operations in policy implementation. All these inter-connections mentioned above among business, the LDP and the bureaucracy charactered the triangular coalition in the DS period.

In the economic sphere, the Japanese DS formed a dual economic system: a highly productive Keiretsu system and an underdeveloped SMEs sector (Huber 1994: 14-15,

[1] In Japan, a political reform was accomplished in 1994 as a means to overcome consecutive political corruption which started from the 'recruit scandal' in 1988. As a result, the medium size electoral system was replaced with a small size electoral sytem supplemented by a proportional representative system.

Hatch and Yamamura 1996: 194). As we have seen above, the Keiretsu system's distinctive feature was its inter-firm shareholdings among member companies. Member companies do not sell other members' stock even though the stock price may be sharply falling or dramatically rising. This persistent and stabilising feature was the major driving force of Japanese companies' preference for long-term and market share oriented investments over short-term profit-oriented investments, because, managers of member companies did not need to worry about hostile take-overs through the stock market. Thus, " Japanese managers were able to plan investments for long-term profits, relatively free from dividend payment requirements because of weaker control exerted by the shareholders" (JETRO 1985: 2). The Japanese bank based-financial system is different from the Western capital market-based system. This means that Japanese companies can rely heavily on bank loans instead of the stock market. Thus, a main bank in a Keiretsu system played an important role in supplying stable, long-term credit to member corporations. The Keiretsu's financial stability was supplemented by governmental financial aid through industrial policies in general and policy loans in particular. These structures of the Keiretsu system produced both the life-long employment system and the seniority based promotion and wage system which contributed to labour market stabilisation in the Japanese DS and PDS period.

The Keiretsu system is also extended to include the SMEs that are sub-contracted to produce parts for their parent companies. What we need to note about these sub-contracting relations is that parent companies and sub-contractors are tightly tied to each other by long-term, durable commitments. This long-term commitment from big parent companies built up the environment in which the sub-contacting companies

could devote themselves to developing technologies. One of the reasons for Japanese competitiveness in manufacturing industries is the competitive sub-contractors. Also, these inseparable relations are one of the reasons why foreign companies could not penetrate into the Japanese domestic market (Hatch and Yamamura 1996: 194). A structural feature of the Keiretsu system which distinguishes it from the underdeveloped economic sectors is the destination of products. Keiretsu member companies are geared to export oriented industries while underdeveloped sectors are geared to the domestic market. The Japanese DS was a neo-mercantilistic state which pursued national wealth by the promotion of exports. Thus, it is not difficult to understand why the Japanese government supported and helped high-performing export oriented Keiretsu member companies at the expense of domestic market-oriented companies. This structural feature of the DS' economic system amplified the gap between the Keiretsu system and under-developed SMEs and ultimately consolidated the dual economic system in Japan.

The international system was favourable to the earlier period of the Japanese DS. In other words, it cannot be denied that Japan's high growth period of the 1960s and 1970s was a by-product of the international free trade environment and Cold War bipolar confrontation. In this period, there was "relatively favourable access to industrial country markets, dramatically increased access to international finance, and increasing relocation of production by multinational corporations to low-wage sites" (Wade 1990: 346). Thus, the international free trade regime in the 1960s and 1970s also provided full benefits to the Japanese DS and its export-oriented economy. JETRO points out the major factors of the beneficial international environment: "Free trade was strongly maintained under the IMF-GATT regime . . . Advanced

technological innovations were obtained from around the world. The period of Japan's economic expansion coincided with a period of world economic growth" (JETRO 1985: 1). The US-Japan Security Pact signed in 1951 and renewed in 1960 provided security for the Japanese DS and produced the environment in which the Japanese DS could fully dedicate itself to economic development (Calder 1988: 527). However, the Japanese DS period in the later 1980s witnessed the emergence of a politicised international economic system which is characterised by increased trade disputes, Non Tariff Barriers (NTBs), Voluntary Export Restraints (VERs), anti-dumping actions, and American Trade Law, particularly the Super 301 provision and unilateral or bilateral trade retaliations.

The sharp difference between the 1970s and the 1980s in terms of the international free trade regime derived from several factors. First, the US economy in the 1980s experienced a dramatic deterioration. Not only the trade deficit but the fiscal deficit also grew like a snowball. The US could not tolerate the ever-increasing twin deficits. Thus, trade regulating measures such as the fair trade concept, Super 301 provision, local contents requirements, and VERs were introduced. The reason why the US could not pursue a policy to reduce the fiscal deficit was that the 1980s was a period of intense military competition between the US and the former Soviet Union. America's shift to a closed, regulated market was the main reason for the weakening of the world free market environment in the 1980s. Second, Japan's economy had accomplished its objective of catch up in the 1970s and after that enjoyed unprecedentedly high trade surpluses. Without a doubt, the Japanese government's industrial policies and the subsequently created comparative advantage of Japanese manufacturing goods with the help of policy loans led to a sense of unfairness from

the point of view of Western free market-based economies. Moreover, Japan's protected domestic market in terms of investment and trade also drew criticism from its trading and investment counterparts. Thus, it can be argued that the origin of the ideational conflict between developmentalism and neo-liberalism can be found in this period. It was in this period of trade disputes that Japan became a reactive state in dealing with foreign pressures and criticism. Calder points out two characteristics of the reactive state. "(1) the state fails to undertake major independent foreign economic policy initiatives when it has the power and national incentives to do so; and (2) it responds to outside pressures for change, albeit erratically, unsystematically, and often incompletely" (Calder 1988: 516). This reactive Japanese state to foreign pressures is in sharp contrast with the autonomous and efficient Japanese state in pursuing economic objectives by industrial and strategic trade policies.

So far, we have examined the structural and institutional characteristics of the Japanese DS period. As we have seen, the Japanese DS period is a mixed period in which Johnson's developmental state and Hatch & Yamamura's network state co-existed. This means that answering the question of which theory is better in explaining the characteristics of the Japanese DS is very unproductive. As Johnson points out, the strength and legitimacy of the Japanese bureaucracy originated from the US occupational Army's strategic planning of Japan's economic restoration (Johnson 1995: 127-133). Thus, it was the bureaucracy that initially strengthened its pre-eminent position of rule at that time compared with business and political parties. However, because of their positional limitations in the political and economic spheres, they had to promote a co-operative relationship with the LDP and business. In this respect, it can be pointed out that Johnson's view which argues that 'politicians reign

but bureaucrats rule' (Johnson 1995: 68, Fingleton 1995: 85) is suitable for the earlier period of the Japanese DS while network state theory is better in understanding the later part of the DS period in which the LDP, business and the bureaucracy are closely inter-related in a patronage based clientelistic system. Johnson anticipated the potential deconstruction of the unique DS system which is embedded or dormant in the DS system itself:

> in the long run, greater political instability may result from trying to maintain the current political status quo . . . The capitalist developmental states may soon face . . . internal challenges to their political and social norms (Johnson 1995: 50).

In summary, the Japanese DS is strong, efficient, and centralised in terms of implementation of industrial policies which give preference to producers. The Japanese DS is also strong and efficient in terms of its capacity for regulating and controlling civil society. On the other hand, the Japanese DS is weak and reactive in terms of managing and coping with foreign pressures and in terms of taking on a leadership role in international affairs.

Domestic Society	Developmental State	International System
-Low level configuration of social groups -No room for social groups in policy making process	-Efficient and autonomous state in implementation of industrial policy -Intrusive state into market	-The US beneficent hegemony until the collapse of the Bretton Wood system -The Cold War bipolar

[2] Calder's term of the reactive state can be applied to both the Japanese DS and PDS. However, the term can be modified and divided into two new concepts: 'a domestically institutionalised reactive state' and 'an internationally structured reactive state'. The former provides a better analytical tool to illustrate the domestic impediments preventing active policy initiatives. Time consuming consensus building processes, inter-ministries rivalry, overlapping judiciaries among ministries, lack of political responsibility and leadership are the distinctive features of 'the domestically institutionalised reactive state'. On the other hand, as the case of the Asian Monetary Fund (AMF) indicates, even though Japan initiated and showed dynamic policy action in dealing with the East Asian economic crisis, this effort can be frustrated by international systemic power, particularly America's power. In this case, Japan is a prototype of 'the internationally structured reactive state'.

-Docile social groups in relation to the state: pacified trade unions (Pempel 1993: 125-126) -Conservative LDP supporting groups: farmers, SMEs, big corporations (protectionism and export supporting groups)	-Elite coalition among bureaucracy, business, and LDP -State's manipulation of catch up mentality in society -Growth oriented socio-economic system -Effective industrial policy -Mixture of Johnson's DS and Hatch & Yamamura's network state -'Domestically oriented reactive state' to foreign pressures[2]	system favourable to Japan by the US-Japan strategic alliance -Free trade regime until 1970s -America's recognition of Japanese style capitalism[3] -The emergence of politicised international economic system in the 1980s

Table 4-2. The inter-relationships among society, state and international system in the Japanese DS period.

2. The Japanese PDS

2-1. The major characteristics of the Japanese PDS

The Japanese PDS period has to be divided into two sub-periods: before and after the burst of the speculative bubble economy. However, despite differences in the extent and intensity of conflicts among changed policies and persistent institutional settings and belief systems, the Japanese PDS period is distinctive compared with the DS period in terms of the cleavage among policies, institutions, and belief systems. In other words, departure of policies or their separation from belief systems and institutions signals the emergence of the PDS period. The Japanese PDS period is a

[3] Reich argues that "Americans have oscillated in the second half of the Twentieth Century between two conflicting positions. The first is an acceptance of the fact that Japan operates a distinctive form of capitalist democracy; the second is an insistence that the forms of capitalist democracy practised in

period in which bureaucrats' belief systems regarding the efficacy of developmentalism remain firmly entrenched, despite the external pressures caused by the protected Japanese domestic market and intensified trade disputes as well as the internal criticism against the corrupt bureaucracy and its inability in managing the economic recession. For Hatch and Yamamura, the reason for the persistent characteristics of developmentalism in the PDS period is that "because it is a system of policies and practices now deeply ingrained in the Japanese political economy. It has become a solid structure of incentives that resists changes, even though it has outlived its usefulness" (Hatch and Yamamura 1996: 194). This co-existence of bureaucrats' institutional resistance and increasing criticism towards it is clearly revealed in this argument:

> The system of bureaucratic leadership actually completed its mission at the point when Japan reached the general economic and technological level of its Western models . . . But a huge institution that has lost its raison detre does not automatically disappear. On the contrary, it clings all the more tightly to its authority and goes on the defensive to maintain its own existence (Taichi 1997: 11).

The Japanese PDS period is also a period in which zigzag and confused policies between developmentalism and the neo-liberal free market system were prevalent and structural adjustment was continuously delayed by the rigid belief system of the bureaucracy and the populace's hesitation towards abrupt changes. Uriu clearly shows the populace's hesitation between its aspiration for domestic economic and political reforms and the uncertainty which results as a result of the reforms.

> Certainly, the voters were expressing their frustration at the lack of progress in getting the domestic economy growing again . . . [however] voters did not seem to be willing to accept the chaos that drastic reform such as deregulating the economy would bring (Uriu 1988: 119).

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the two countries converge . . . We are, I contend, currently witnessing a period of American evangelical push towards a convergence hypothesis". Simon Reich (1998: 4).

This retarded structural reform can also be explained by a cultural factor. Japanese society is based on collectivity and communication among the collectivity is based on consensus termed 'nemawashi'. Delayed reform can be interpreted as the result of the need for a long period of consensus building in which the Japanese style economic system competes or compromises with global standards and global convergence. However, the important thing is that the longer the consensus building period the worse Japan's economic performance. Japan's economic recession after 1990 testifies to this argument. Under economic recession, the conflicts between changed polices and unchanged institutions and belief system were intensified and as a result, the Japanese economy suffered from an unprecedented economic contraction. Thus, it can be argued that the genesis of the economic recession was the divergence of policies from institutions and belief systems and the subsequent ineffectiveness of policy implementation caused by the intensified conflicts and contradictions derived from the ever increasing cleavage among the three pillars of economic development. This also illustrates that the internally contradictory PDS period encompasses 'adaptation' to pressures from the global neo-liberal order by changing policies only.

Before the bursting of the speculative bubble, Japan enjoyed its economic heyday in the latter part of the 1980s. An astronomical trade surplus was supplemented by increasing OFDI. Euphoria over the Japanese style economic system and developmentalism was high. This was the period in which the bureaucracy implemented expansionist developmentalism (ED) to Southeast Asia. The ED was a dynamic policy initiative by which the bureaucracy tried to overcome both internal and external pressures through the logic of internalisation of external pressure and

externalisation of internal pressure. In other words, Japan was suffering from high product costs in the domestic market and market opening pressures from foreign countries in the 1980s. In order to improve the international competitiveness of Japanese industries, Japan had to transfer its production sites offshore, pursuing cheap production costs. Rising land and labour costs were the major obstacles for Japanese firms. On the other hand, Japan's astronomical trade surplus and strictly protected domestic market in terms of imports and IFDI accessibility were the major reasons for trade disputes with other countries, particularly the US. Thus, the Japanese bureaucracy carefully planned the Expansionist Developmental State (EDS) system in order to solve the problems of trade disputes and rising domestic product costs. By implementing and developing the EDS system in Southeast Asia, Japan used both internal and external challenges as opportunities to develop further. Establishing production networks in Southeast Asia suggested a chance to avoid trade disputes with the US and made the domestic industrial structure more advanced by focusing on higher technology research and development and higher value added products. Moreover, Japan transferred the costs of industrial adjustment to Southeast Asian countries by avoiding domestic structural reforms and refusing to change the rigid institutional settings and belief systems which were geared towards protectionism and mercantilism. Thus, it can be argued that the Japanese EDS system in Southeast Asia was an intentional policy of the bureaucracy which not only strongly held to its developmental belief systems but also tried to extend its self interest by securing the authority and initiative in the implementation of the EDS system in the region. In this respect, the EDS system in the region is a result of transplanted Japanese developmentalism and an offspring of a combination of bureaucratic institutional resistance and adaptation towards the changing environment.

As a result, the delayed structural adjustment particularly in the financial sector in this period was the most important factor which caused the Japanese financial crisis in the late 1990s. Moreover, the Japanese production network in Southeast Asia also caused problems for Japan. Japan's development of production sites in the region was not in accordance with each nation's comparative advantage. In other words, Japan's enormous FDI deployment deteriorated the order of the division of labour in the region. This was the reason for increased competition among the Southeast Asian states. They have been competing with each other in the same manufacturing industries such as electronics and semi-conductors which had been mainly developed by Japanese FDI. Overcapacity and overcompetition inevitably resulted in price competition. And this was one of the crucial factors which caused the competitive currency devaluation in the region which finally resulted in the sudden depreciation of the Chinese Yuan in 1994 (Hughes 1999:35). The devaluation of the Chinese Yuan was the prelude to the East Asian crisis. Moreover, the massive Japanese FDI in the region also "indirectly promoted an investment environment conducive to speculative bubbles" (Hughes 1999: 20). Thus, to some extent, the East Asian crisis was caused by Japan's enormous FDI development which ignored the regional order in the division of labour and indirectly induced speculative capital by introducing artificially created comparative advantage[4].

[4] Yong-Bok Kim (1998: 109) argues that "a combination of Japan's export of the bubble economy to Southeast Asian countries and these countries' collusive relationships between politicians and business was a major reason for the burst of the East Asian economic crisis. In other words, the exports of Japanese illness to other East Asian countries was a process of internationalisation of

	The Japanese Post Developmental State
IFDI OFDI	1981-To current 1986-To current
	-belief systems=institutions but only policy changes -Intensified friction between developmentalism and neo-liberal regime and globalising domestic and world economy -Delayed structural reforms because of bureaucrats' rigid belief systems regarding the efficacy of developmentalism -**Adaptation** to the neo-liberal regime -Competition with the US to be an economic hegemon -Zigzag and confused policies between state intervention and free market system[5] -**Embeddedness** of the DS in institutions and belief systems -Undergoing financial and administrative reform in the second half of the 1990s -Continuous policy liberalisation and deregulation towards IFDI which were not accompanied by institutional and belief systems changes -Implementation and deepening of the **EDS** system to Southeast Asia by the combination of FDI and ODA -Establishment of production network as an export platform in Southeast Asia

Table 4-3. The Major characteristics of the Japanese PDS period

2-2. Society, state and international system in the Japanese PDS

Japan's domestic economic problem, and finally the East Asian economic crisis was caused due to this Japan's strategy".

[5] The zigzag and confused policies between the state intervention and free market system was clearly revealed in the process of financial reform: "The government has left people in doubt about the direction of its liberalisation of financial markets. Even as it talks about its Big Bang program, it has intervened in the stock market to prop up prices" (JAPANECHO August 1998), "While implementing stopgap measures involving greater government intervention to deal with the crisis at hand, they continue to claim they are pursuing the Big Bang goal of free and open competition" (JAPANECHO June 1998).

During PDS period, Japan experienced a set of challenges from the economic, social and political spheres. In the economic sphere, the bargaining power and influence of big business on policy making processes was strengthened in several areas. First, for business, a closed domestic market was a primary source of friction with major trading and investment partners. From the view point of business, opening the domestic market was necessary to promote Japan's trade and investments further. This understanding was based on the concept of reciprocity. A closed domestic market to foreign firms meant intensification of foreign protectionist measures against Japanese firms in the politicised international economic system. Moreover, opening the domestic market was seen as a means to improve underdeveloped domestic market-oriented industries by introducing harsh competition from the outside through inward investment. As we have seen in section 1, Japan had a dual economic system which had been a major obstacle in achieving balanced and equal development of the entire national economy. Thus, business was a powerful advocate of deregulation and domestic market opening (Higashi and Lauter 1990: 124). Yoshimatsu points outs four crucial reasons for demands by business for deregulation.

> First, Keidanren advocated deregulation in order to promote a change in the Japanese economic system away from a bureaucratic, centralised system toward a private sector-led, decentralised system . . . Second, Keidanren sees deregulation as important in raising international competitiveness in the nonmanufacturing sector . . . Third, Keidanren regards deregulation as indispensable for resolving trade friction . . . Furthermore, deregulation would make Japan's economic system more compatible with international norms (Yoshimatsu 1998: 337-8).

Second, business also pursued liberalisation of the financial market. Deregulating the financial market could reduce the transaction costs of export-oriented business by avoiding commission on foreign currency exchange. The underdeveloped Japanese financial sector, which has been incompatible with international financial standards

and suffered from the bursting of the bubble economy, has been a crucial factor causing the decade long economic recession. Under this financial sector initiated economic recession, domestic aggregate demand contracted and did not sensitively respond to the government's economic stimulus packages. Contracted domestic demand and a struggling financial sector have shackled business for more than a decade. Thus, business has been a strong advocate of financial reform.

In summary, business has matured to the point that the developmental state's strategies which were crucial to business growth became a shackle, preventing further development of business in terms of international competitiveness and global strategy. State protectionism took care of infant or less competitive industries in the early DS period. Adolescent business became an important triad coalition partner in the later DS period. In the PDS period, business had matured to the point that it regarded the state's nurturing strategies as restraints. As a result, the DS period's protected and regulated domestic and financial markets came under extreme pressure from Japanese big business that competed with other foreign MNCs.

The so-called Japanese economic system is also under pressure and gaining the momentum for change at present. Basically, the conflicts between the DS and the PDS in terms of economic system are derived from the dichotomy between catch-up, rapid growth, and industrialisation process versus pioneer, slow growth, and informationalisation process (Yong-Yeol Kim 1996: 104). It is widely recognised that Japan has failed to prepare and identify new industrial growth sectors related to information, telecommunications and software. In other words, Japan's industrial

structure is highly dependent on a limited set of industries such as cars and electronics, while failing to explore new areas of competitiveness in the telecommunications and information industries. Drucker points out this problematic situation. "Even though quantitatively Japan's export surplus with the United States rose . . . qualitatively it is deteriorating. Almost three quarters of it is now being earned by the products of old industry" (Drucker 1993: 11). As we have seen in section 1, the peculiar Japanese economic system was a complex set of distinctive features that included a life long employment system, a seniority based promotion system, long-term investment rather than pursuit of short-term profits, close and long-term relationships between parent and subcontracting companies, a banking based financial industry, and absence of hostile take-overs. However, these characteristics of the DS period faced challenges as Japanese firms experienced growing internationalisation and globalisation.

The major challenges were, firstly derived from the economic recession. The economic recession aggravated the corporate financial structure and this caused the reconsideration of the life long employment and seniority based promotion systems. Companies in bad financial condition could not sustain the system of labour market stabilisation by their commitment to the life long employment system (Gyohten 1994: 32, Japan Economic Almanac 1996: 50). Labour flexibility is important to overcome the period of economic hardship. Japanese labour costs have continuously risen and Japanese firms have managed to cope with increasing labour costs by improving market shares and profits. However, more than a decade of economic recession meant deteriorating financial conditions for firms and the increased possibility of the adoption of labour flexibility by Japanese firms. Under economic recession, firms

could not pursue long-term investment because economic hardship requires more short term profits in order to prevent potential liquidity problems. The long-term investment and market share approach rather than short-term profit seeking cannot be sustained in a prolonged economic recession.

Another factor which facilitates changes in the Japanese economic system is the rising Yen. The high Yen, particularly in 1994, was the result of a prolonged trade surplus and the emergence of the Clinton administration. This high Yen propelled OFDI, global outsourcing, competitive bidding, and strategic alliances with foreign companies particularly in high cost areas such as R&D (Jong-Yoon Lee 1994). Without a doubt, the DS style Japanese economic system such as the long-term, close commitment between big conglomerates and sub-contracting companies is being challenged by these changes. Moreover, foreign pressure, particularly from the US, also propelled the collapse of the protective aspect of Japanese economic institutions with the conclusion of the agreement on the SII between the US and Japan in 1990. The major target of the US in the agreement was to resolve the problem of institutionalised protection engrained in specific Keiretsu systems.

Increased OFDI by export-oriented industries also induced changes in the Japanese economic system. Close, long-term relations between parent and subcontracting companies faced challenges as parent companies moved out to foreign countries in order to develop OFDI. Although some parent companies moved out with their subcontracting companies, the numbers were insufficient to maintain the traditionally close, long-term relations between them. Moreover, host countries impose contracts between their local companies and Japanese investors. In order to reduce production

factor costs, Japanese parent companies increased the use of outsourcing and bidding from other subcontractors, whether Japanese or foreign, rather than depending on long-term subcontracting relationships. Thus, long-term, close, vertical relations were replaced by short-term, open, horizontal bidding and outsourcing. These changes were related to the shift from long-term investment to the pursuit of shot-term profits. The banking based financial system also faced challenges and as a result, financial reform is now being undertaken. The relationship between the Japanese financial system and the financial crisis in the late 1990s is summarised in Figure 4-1.

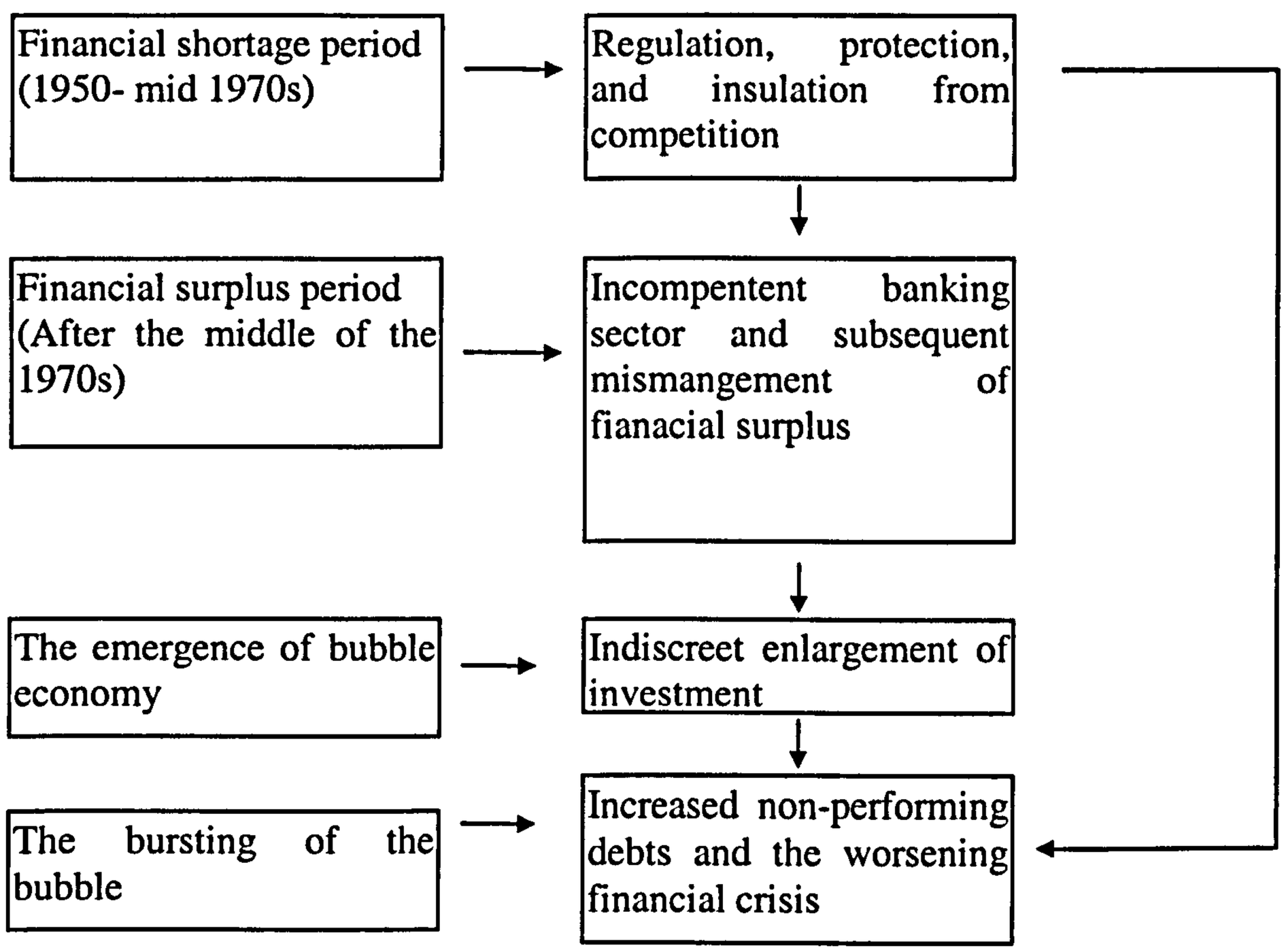

Figure 4-1. The relationship between the Japanese style financial system and the financial crisis in the 1990s. Modified from Gang (1996: 94).

Financial reform combines a stabilisation programme and a structural reform programme. Stabilisation targets the resolution of non-performing loans and structural reform targets the realisation of a competitive financial system through

deregulation and liberalisation. Structural adjustment together with M & As among banks and the abolition of the barriers between the banking, security, and insurance industries will result in a system which will be competitive and compatible with the neo-liberal standard. This means that the Japanese financial system will be similar to the Western system and hostile take-overs among competing firms will be easier as foreign firms get easier access to the domestic financial market with the help of deregulation. These changes in the Japanese style economic system can be summarised in the Table 4-4.

	DS period	PDS period
1. Government and Corporations	-bureaucratic leadership -Targeted industry promotion -Preference for producer interests	-Deregulation -Reduced government intervention -Domestic market opening -Possible change of preference towards consumer interests
2. Corporations and banking	-Main banking system -Intercorporate share holding -Long-term, market share oriented investment and management	-Emergence of shareholders' interests -Short-term profit pursuing investment and management -Diminished benefits of intercorporate shareholding because of the collapse of stock prices in the 1990s
3. Parent and sub-contracting companies	-Long-term commitment -Protective institutional barrier to foreign companies	-Possible collapse of long-term commitment because of the introduction of competitive bidding and global outsourcing and increased OFDI
4. Corporations and workers	-Life-long employment	-Increased difficulties and costs in maintaining DS style labour

	-Seniority based wage and promotion system	system -Introduction of team system and performance based wage and promotion system

Table 4-4. The changing characteristics of Japanese style economic system. Modified from Yong-Yeol Kim (1996: 124).

In domestic society, the populace's dissatisfaction had risen because of the poor quality of life and weak social welfare system compared with the enormously improved national wealth. Increasing economic disparity among the rich and poor and poor housing, heavy taxes, and high consumer prices were the major reasons for the increasing dissatisfaction. This means that the Japanese populace experienced a sense of deprivation and relative poverty, because of the sharp contrast between the rich nation and the poor populace. Thus, the DS period's social consensus of 'rich country first mentality' is being damaged in the PDS period. And, the damaged social consensus encroaches on the capacity of the state to pursue developmental policies further. The young generation's individualistic tendency is another factor which has diluted the Japanese collectivist cultural peculiarity. These changes in the Japanese life style from social humans to individualistic humans further amplifies the growing indifference towards Japanese politics which has already suffered from the lack of political leadership and responsibility (Gang 1996: 101). The DS period was characterised by equal distribution of national wealth and economic growth. However, in the PDS period, Japan is witnessing a dividing stratification of social classes. The gap between the rich and the poor is increasing, further contributing to the dissatisfaction of the populace in civil society. Higashi and Lauter clearly point out this domestic division:

> Traditionally, the Japanese have subscribed to the belief that they were overwhelmingly (90 percent) middle class. However, this is changing as wealth and lifestyle differences are leading to a socio-economic stratification that departs from the homogeneous, self-described, middle-class society (Higashi and Lauter 1990: 186).

In the political sphere, the LDP departed from its traditional support groups of the farmers and SMEs and tried to incorporate the middle class, financial industry and big companies into its support base. Continuous fiscal support towards farmers and small enterprises could not be sustained as the costs of the conservative coalition reached crisis point. Prime Minister Hashimoto's introduction of the consumption tax in order to improve the fiscal balance further deteriorated the already contracted economy. Moreover, domestic market openings caused by US pressure symbolised by the opening of the rice market and the acceptance of the SII agreement, resulted in harsh criticism from the LDP's traditional support groups of the farmers and small enterprises in the wholesale and retail distribution industry. Meanwhile, potential new coalition partners such as the urban middle class and financial and manufacturing industries that had suffered from high prices and heavy taxes also expressed dissatisfaction as market liberalisation and administrative deregulation were delayed by institutional barriers and bureaucratic resistance. Thus, it can be argued that the LDP lost its traditional support groups and failed to include newly emerging social groups as coalition partners. This meant a state apparatus dissociated from civil society (Jang-Kwon Kim 1996:350). This also meant that in the PDS period, conflicts between these two support groups intensified and the objectives of public and foreign policies became confused. This is the reason for the zigzag and confused policy implementation in the PDS period. In other words, the support groups of the LDP in the DS period pursued protectionist policies, while the support groups of the LDP in

the PDS period pursued liberalisation and deregulation. This conflicting and contrasting interests and economic ideas are an obvious background to the inefficient policy implementation and ineffective policy results in the PDS period. Put differently, the co-existence of open market oriented interests and ideas with protectionist interests and ideas caused contradictions in the PDS period and this is the reason for the decade long recession. Pempel's assertion clearly illustrates the relationship between the LDP's changing terrain of support groups and the zigzag economic policies in the PDS period:

> The power of many protectionist members of the conservative coalition remains strong, although that of organised agriculture is undoubtedly on the wane. That of small business seems destined for a similar reduction in power. Conversely, forces that have more to gain from increased openness and internationalisation, such as big business, and finance . . . and urban consumers, have been gaining their relative power . . . But on the specific subissues that make up the nation's overall foreign economic policy, many internecine battles remain to be fought within the conservative coalition (Pempel 1993: 130).

In the statist sphere, the role of political parties strengthened against the bureaucracy in the later PDS period (Calder 1988: 532). In other words, the bureaucracy's legitimacy and its leadership role in the DS period confronted serious challenges from the increased influence from political parties. The reasons are mainly four-fold. First, bureaucracy lost its legitimacy and leadership position by the continuous revelation of corruption and scandals. Second, the consolidation of specialised Diet members in a certain subject, called 'Zoku', weakened the bureaucracy's autonomous position. These Diet members have served on the same Diet committee and as they have been continuously re-elected, their knowledge of a certain subject has accumulated and as a result, they have beoame specialists in that policy area. Moreover, the opportunities for becoming ministers from the Zoku has increased. Thus, the autonomous position

of the bureaucracy in policy making has decreased in the PDS period (Zhao 1993: 189, 194). Third, during the later period of the Japanese PDS, administrative reform was undertaken which led to the weakening of the bureaucracy by reducing the number of ministries and by strengthening the prime minister's political power and responsibility (Fukui and Fukai 1998, Nakano 1998). Fourth, with the further development of globalisation, overlapping jurisdictions among ministries emerged and became more complicated (Calder 1988: 529). This undoubtedly led to the weakening of bureaucratic leadership as inter-ministerial conflicts over jurisdiction intensified, and by constraining rapid, efficient and unified administrative responses because more time was needed to build consensus among ministries. It means that "[p]olitical pluralism in Japan began to blossom as bureaucratic dominance on policymaking began to weaken. Both the ruling party and interest groups have gradually increased their influence in the policymaking process" (Zhao 1993: 193). This also means that Johnson's concept of bureaucracy-led Japanese capitalism is no longer suitable for the PDS period. The reduced legitimacy of the bureaucracy led to reduced effectiveness in implementing industrial policy in the PDS period (Jones 1997: 68).

The international sphere also dramatically changed in the PDS period. The international system has become multilayered by both horizontal and vertical integration of globalisation, regionalisation and localisation. This means that the interdependence and politicisation of the international system has been extended and deepened to an unprecedented degree. Thus, the free trade regime which was pervasive during the Japanese DS period can hardly be found in the PDS period. In other words, the benign American hegemon towards Japanese developmentalism

suddenly changed into a self-interest seeking malign hegemon after the collapse of the Cold War bipolar order. Multilateral institutions and agreements such as the WTO and the MAI now co-exist with bilateral and unilateral trade and investment measures. A free trade neo-liberal regime co-exists with unilateral retaliation. As a result, the international system in the Japanese PDS period became so complicated and politicised that the issue areas were too diversified to be dealt with within the structure of the bureaucracy. This is the major reason why the Japanese bureaucracy in the PDS could not efficiently cope with foreign economic and political issues.

All these changes in the PDS period meant the diminished efficiency of Japanese industrial policy. In the period of the PDS, industrial policy was resistant to the changing environment even though the extent of co-ordination and efficiency in policy making processes and implementation weakened because of both internal and external pressures. Okimoto clearly reveals this situation in which industrial policy and bureaucratic institutions refuse to adjust to the changing environment.

> industrial policy is not something that can be easily abandoned, even though the era of latecomer catch-up is past . . . If industrial policy once functioned to compensate for market imperfections, the need to rely on it as a compensating mechanism is now significantly reduced; and if the government once derived its capacity to implement industrial policy from the allocation of substantial financial resources, that capacity has been significantly diminished. Foreign pressures to drop what are perceived abroad as unfair industrial policy practices . . .have also been stepped up. Yet even in the face of such developments, MITI is unlikely to relinquish industrial policy (Okimoto 1989: 232).

More importantly, it is the economic structure formed by the effects of industrial policy that undermines the very existence of Japan's economic system. As a result of long-term industrial policy, Japan's economic system has been sustained by the two

pillars of domestic protectionism and export penetration of open foreign markets. Institutional barriers such as the complicated distribution networks, close and long-term commitments between big conglomerates and sub-contracting companies, and government regulations were the major features of the protected domestic market. This economic structure led to the astronomical trade surplus which, in turn, resulted in the high Yen which finally caused a serious blow to Japanese industries through price differences and weakened their international competitiveness (Gang 1996: 95-6). In sum, in the DS period, Japanese industrial policy was a combination of both theory and the effective practice of 'one country's prosperity' at the expense of other countries and it became a theory and practice of self destruction as Japan could not dynamically adjust to domestic and international environmental changes in the PDS period.

Domestic Society	Post Developmental State	International System
-Increased leverage power and managerial autonomy of business -Increased dissatisfaction of populace towards poor life quality and stratification of social class (Higashi and Lauter 1990: 187). -Conservative LDP supporting groups (Middle class, financial industry, and big business) which are supporting liberalisation and market opening -Potential deconstruction of life long employment	-The end of triad elite coalition (Japan Economic Almanac 1995: 42) by the collapse of LDP long-term rule, financial and administrative reform, and increased OFDI -Diminished efficiency of industrial and strategic trade policy -Increased influence of political party against bureaucracy -Disjointed state from civil society -Increased contradiction between neo-mercantilism	-No economic hegemon -Strengthened neo-liberal regime -Weakened security alliance between the US and Japan (Drucker 1993: 10). -America's pushing of Japan towards global convergence -Highly politicised and competitive international economic system -Highly interdependent, regionalising and

and seniority based promotion system -Increased new middle mass and emergence of pluralistic interests groups (Pempel 1993: 125-127).	and globalised Japanese economy -Decreased efficacy of the bureaucracy led-industrial policy -'Internationally structured reactive state' -Calder's corporate-led strategic capitalism and Okimoto's societal state (Jones 1997: 67).	globalising international political economic system -Controversial position between multipolar system and unipolar system dominated by the US -Coexistence and conflicts between global free trade regime strengthened by the WTO and regionalism strengthened by regional economic integration

Table 4-5. The inter-relationships among society, state and international system in Japanese PDS period.

3. Sub-conclusion:
Japan's convergence towards the neo-liberal regime?

As we have seen in sections 1 and 2, Japan experienced a great transformation from the DS to the PDS system. Accumulated socio-economic and political changes in the DS period suddenly led to the great transformation. The efficient and remarkable accomplishment of economic objectives in the DS period was an inevitable outcome of the organic relationships among the belief system, institutions, and policies. All these three pillars of economic development in the DS period shared the same principle, norms, and objectives and were uniquely organised into a social consensus based on the 'catch up' slogan and 'rich country first' mentality. Thus, it can be argued that the absence of contradictions and cleavages among the three pillars of economic development was undoubtedly the major factor sustaining the efficient and high-performing Japanese DS system. In contrast, the PDS system showed an ever-increasing inconsistency between changed policies and resilient institutions and belief system resistance. Policies were changed as a strategy of adjustment towards internal

and external pressures. The outward appearance of protectionist policies changed and became a show window display of deregulation and liberalisation for complaining foreign trading and investment partners. However, these changes were not accompanied by institutional and belief system changes. The bureaucracy's durable and privileged developmental belief systems of the DS period refused to give away to adjustment in response to the changed internal and external environment of the PDS period. On the contrary, the MITI bureaucracy initiated the EDS system in Southeast Asia in order to extend and protect its vested rights and authority. Thus, it can be argued that even though bureaucratic self-interest played an important role, the most crucial background of the bureaucratic institutional resistance was the ingrained, unimpaired developmental belief systems of the bureaucracy.

The Japanese EDS system has developed a high level of economic integration in the region. The economic prosperity of Southeast Asian countries from the second half of the 1980s to right before the East Asian crisis was based on the transplanted Japanese DS system in the region. Without a doubt, massive Japanese FDI and increased exports of these countries were the locomotive of the economic boom. However, with the emergence of the crisis, the hidden structural problems of the EDS system have emerged, as the impact of the crisis settles and subsequent economic structural adjustments are implemented in the affected countries. The structural problems of the EDS system in the region are a configuration of an economic system highly dependent on exports towards open Western markets, excessive domestic market regulation and protection, and underdeveloped financial institutions and the absence of efficient financial supervision. The IMF led structural adjustment in the crisis countries are geared to neo-liberal prescriptions, and its major target is to dissolve these structural

features of the EDS system in the region. This shows that the East Asian crisis has been a battle field of not only material interests but also economic belief systems (ideas) between the globalising neo-liberal order led by the US and East Asian developmentalism championed by Japan (Higgott 1998). Thus, the US and Japan have been sharply divided in both understanding and interpreting the origins of and reasons for the crisis and recommending policy prescriptions. Japan basically contended that the East Asian crisis was not structurally initiated but just a cyclical and transitory liquidity problem and advocated the persistent validity and effectiveness of developmentalism in the region. Hughes clearly summarises this view: "Japanese policy-makers have viewed the developmentalism model as fundamentally sound and capable of continuing to deliver solvency and growth" (Hughes 1999: 39). On the contrary, the neo-liberal regime asserted that the East Asian crisis was the result of structural flaws and contradictions of the developmental model, as well as insolvency problems and propelled the dismantling of the model through the neo-liberal IMF conditionality (Hughes 1999: 38).

Considering that Southeast Asia is heavily dependent on present Japanese FDI, capital investment and ODA deployment, it can be argued that the future direction and development of the EDS system will also heavily rely on whether the developmental belief systems of Japanese bureaucracy and businessmen will change or will persist. Thus, analysing the domestic debates in Japan on Japan's own economic recession has direct and valuable implications for the future development of the EDS system in the region. We need to recognise that Japan is not a unitary state but a pluralist state particularly in the later PDS period as we have seen in section 2. Japanese views in relation to Japan's own economic problems are sharply divided and contend with each

other. Reich clearly illuminates these divided Japanese views. First, the optimistic view which is pervasive in bureaucrats and politicians sees the recession as a cyclical downturn, and not a crisis. Second, the pessimistic view which is prevalent in the reformist groups assumes that free market based economic reform is impossible because of the absence of strong political leadership. Third, the rejectionist view which is easily found in nationalistic groups argues against the need to reform the Japanese developmental system (Reich 1998: 43-9). This analysis shows that the bureaucracy's developmental belief system is still intact despite the harsh challenges of the East Asian crisis and a decade-long domestic economic recession. This means that Japan is deeply stuck in the PDS system and will continue to be stuck in the PDS system. This also implies that the inefficient and ineffective economic performance that derived from the inconsistency among the belief system, institutions, and policies will be pervasive in the future economic trajectory of Japan for a long-time unless political leadership is strengthened or a real and unbearable economic crisis which will lead to a change in the belief system regarding developmentalism takes place. Heizo's assertion shows the importance of belief system changes which come after sudden, large, and serious crises in reforming Japanese economic problems: "Unless they are confronted with an obvious crisis, I fear, the Japanese are not going to really move" (Heizo 1997:25).

Chapter 5
From the DS through the PDS to the TS: Socio-economic and political transformation in Korea

Contents

Korea's rapid economic growth and turbulent socio-political changes have been fascinating topics for the disciplines of comparative politics and international political economy. The literature in conjunction with this topic can be divided into two major streams: research based on neo-classical economics and research which emphasises the specific structure and role of the Korean state (statism) (Burkett and Landsberg 1998: 435). This shows the conflictual and contending co-existence of the market approach and the statist approach. For the proponents of neo-classical economics, Korea's market conforming policies, export-oriented economic structure, limited

government interventions only in areas such as infrastructure, education, and macroeconomic stability and the open economic system towards foreign capital and technologies are the primary reasons for Korea's rapid economic growth (Chu 1989: 655, Hoogvelt 1997: 203, Westphal 1995: 444, Wade 1992: 271). However, what this theory neglects is that each country's specific historical and institutional backgrounds have more divergent effects on the developmental path of each country. In relation to this problem, a set of serious theoretical flaws in this approach can be easily detected. First, in this understanding, the Korean state's specific historical and institutional settings are simply neglected and became unimportant variables (Mardon 1990:112). Korea's historically and institutionally strong state which is deeply embedded in its society needs further explanation. In the discussion about the statist approach, we will investigate the historical and institutional background of the strong Korean state in more detail.

Second, the historical development of the Korean market system is also simply neglected. The Korean market system under Japanese colonial rule and after the Korean War was underdeveloped. It can be argued that before colonial rule in Korea, there was no market system equivalent to the Western markets of the 19th century and early 20th centuries. The sluggish and underdeveloped market system in the early 1960s needed the active role of the Korean state. Moreover, Korea's open and export-oriented economic system from 1962 was possible because of more than a decade-long economic preparation through Import Substituting Industries (ISI) and market protections in the 1950s. Third, the neo-liberal approach also does not consider the socio-political aspects of economic policies. As Higgott and Phillips correctly point out, markets are socio-political constructions and "their domestic functioning depends

on their legitimacy and support within civil society" (Higgott and Phillips 1998: 26). The neo-liberal approach to Korea's economic success only focuses on the economic system of Korea. However, we need to explicate the power relationships and changing bargaining positions among the market, the state, and civil society in order to produce a more persuasive and comprehensive explanation. This is the reason why this thesis adopts a synthetic approach which comprises societal, statist, international systemic, institutional and ideational approaches. Finally, advantages or pressures from the international system towards Korea's economic developmental trajectory have been simply discarded in the neo-classical approach. As we will review in the following sections, international factors are indispensable variables in understanding the Korean state's economic and socio-political changes and transformations.

In contrast, proponents of the statist approach try to illuminate the Korean state's specific characteristics emanating from its unique historical and institutional configuration which gives rise to the emergence and persistence of the strong Korean state (Haggard and Moon 1995). This approach insists that Korea's social forces have been relatively weak in terms of their influence and incorporation into policy making processes and argues that it is the state itself that plays the most significant role in economic development as a strategist, planner, entrepreneur, market establisher and regulator, and material and financial resource allocator and so on. In a word, from the point of view of the statists, it is the presence and efforts of the strong state that caused rapid and amazing economic growth. Because of the underdeveloped civil society of Korea, the societal approach is unsuitable for analysing Korea's foreign economic policy (Suk-Joon Kim 1992: 46, Young-Myung Kim 1996: 63, Chu 1989: 654). In the statist approach, we have a theoretical anomaly developed by Haggard.

Haggard identifies statism with the institutional perspective and in his institutional approach, only tangible state organisations are regarded as institutions (Haggard and Chen 1987, Haggard 1990). In other words, "Haggard frequently uses the terms statism and institutionalism interchangeably" (Fields 1995: 23) and as a result, for him, the institutional approach focuses on "the organisational features of the state that affect the ability of social groups and political elites to realise their objectives" (Haggard and Moon 1990: 230).

However, as we have seen in Chapter 3, institutions in this thesis have a much wider variety of meanings than Haggard employs. Even though the term 'institutions' is highly ambiguous and difficult to define, we need a refined definition of institutions in order to illuminate Korea's foreign economic policies more comprehensively. Tangible and intangible institutions are equally emphasised in this thesis. Tangible institutions include governmental organisations, legal systems, the dominant Chaebol structure and specific economic structures like the persistent collusive relationships among the state, business and banking sectors. Meanwhile, intangible institutions include, among others, the populace's economic nationalism, window-guidance or internal administrative guidelines with no written regulations, the historical or cultural background of the strong state and bureaucratic autonomy. Thus, in this thesis, institutions "are social constructs ordering human interactions. They may be formal or informal, temporary or regularised. Once constructed, they persist in time and constrain or otherwise modify the behaviour and actions of groups and the individuals associated with those groups" (Fields 1995: 9). Thus, the institutional approach is much broader than the statist approach and "statism is not analogous to, but rather a component of, an institutionalist approach" (Doner 1992: 401).

In the literature on the state-centred approach, the strong state implies three conditions (Haggard 1990: 43, Doner 1992: 399, Martinussen 1997: 238). First, bureaucrats must be insulated from social forces such as interest groups, trade unions, and the middle class in policy making processes. Insulation is a firm base of bureaucrats' autonomy. Second, bureaucrats have to possess enough and efficient policy instruments in order to systematically pursue their policy objectives. Policy instruments basically include incentives and punishment which will eventually bring support, as well as persuasion or co-ordination of civil society members. The extent of available policy instruments is an index of state capacity. Third, a coherent policy making process must exist which can be realised by inter-ministrial co-ordinations. If there are conflicts among governmental organisations, policy implementation will lose its efficiency.

However, this definition of a strong state becomes theoretically vague if we consider the importance of international systemic factors and ideational factors in analysing Korea's foreign economic policy. First, in the theory of dependency and world systems, the peripheral or semi-peripheral state is regarded as a weak state compared with the strong state of core advanced countries. In this regard, Korea is definitely a weak state. However, this argument is controversial and contradictory, given that in the literature on developmentalism, Korea is a prototype of a strong state. Moreover, in terms of security, Korea is unarguably a weak state which has been vulnerable to communist expansion and benefited from the US security umbrella. Without considering Korea's strategic position in Northeast Asia, any debate on the strong state is in vain. Thus, it cannot be denied that Korea's comfortable relationship with

the international economic system in the 1960s and 1970s was possible because of American's strategic calculations and because the Cold War order provided open, tolerant markets for Korea's penetrative and mercantilistic developmentalism. In short, the concept of Korea's strong state becomes blurred and confused if we consider international systemic factors (Potter 1992: 222).

Second, in the ideational approach to economic policy, a strong state means a state where shared economic belief systems among politicians, bureaucrats and civil society members are persistent and coherent. For example, in the DS period, the Korean state was strong in terms of shared beliefs on the efficacy of developmentalism in the pursuit of economic objectives among bureaucrats, big business, and the populace. On the other hand, the Korean PDS was unarguably a weak state considering that bureaucrats' belief system was sharply divided into two opposite ideas: the free market initiated beliefs and persistent beliefs regarding developmentalism. What is missing and neglected in the strong state debates is this ideational factor. So far, in the literature on strong states, only autonomy, capacity, and cohesive policy making processes (or internalised co-ordination structure among government organisations) have been considered as determining indices of state strength.

Thus, it can be argued that the concept of the strong state needs to be redefined and refined. This means that the discussion of the strong state has to be based on three dimensions: first, state autonomy and insulation from not only domestic society but also the international system; second, state capacity emanating from sufficient and efficient policy instruments; and most importantly, ideational coherence among bureaucrats and civil society members. This ideational coherence is the foundation

underpinning cohesive policy making processes and the internalisation of inter-ministrial coordinations. Shared economic belief systems and economic objectives among governmental economic organisations and bureaucrats is the most important determining factor of the strong state. Haggard clearly points out the need for the ideational approach in the literature on the strong state: "State autonomy may explain the capacity to formulate and execute an economic program, but it does not answer the nagging question of where state interests come from" (Haggard 1990: 46).

In this thesis, Korea's developmental stages are divided into three periods: the developmental state period; the post developmental state period; and finally the transitionary state period. The main argument of this chapter is that the intensity and the strength of the Korean state varies according to different policy issues and the progress of the developmental stage. The Korean DS is a strong state in terms of bureaucrats' autonomy from domestic society and the international system, efficient policy instruments, and ideational coherence between the state and civil society members. Meanwhile, the Korean PDS is a relatively weak state compared with the DS, given that the Korean PDS confronted intensified pressures from not only domestic interest groups, particularly big conglomerates, trade unions, student movements and the middle class but also from the international trade and investment system. More importantly, the Korean PDS revealed ideational conflicts and cleavage among the bureaucrats themselves. Thus, it can be argued that diminished bureaucratic autonomy and the emergence of ideational conflicts in the PDS period resulted in a weak state. In the Korean TS period, we can witness a return of a relatively strong state compared with the PDS. The Korean TS faces unprecedentedly high pressures from the international neo-liberal regime under the economic crisis.

Thus, bureaucratic autonomy relatively lessened as a result of IMF conditionality. However, it is important to remember that the externally driven reforms are intentionally and purposefully exploited or manipulated by the state itself to drive the momentum of domestic reforms including labour reform, financial reform, corporate (Chaebol) reform, and public sector reform which can be divided into the privatisation of public corporations and the streamlining of administrative systems. Moreover, pressures from civil society, particularly from trade unions and the middle class are dramatically decreased despite worsened family incomes and poor social safety nets caused by the economic crisis and subsequent reforms which led to the unprecedentedly high unemployment rate. Thus, it can be argued that the Korean TS is a relatively strong state compared with the PDS and a relatively weak state compared with the DS.

In other words, in Korea's socio-economic and political transformations, the DS was the strongest state in which autonomy, capacity, and ideas (belief systems) were coherently integrated. The PDS was the weakest state in which bureaucratic autonomy was reduced and conflicting belief systems emerged among the bureaucrats themselves. The TS is a strong state in which ideational conflicts among the bureaucrats have disappeared and autonomy is regained with the weakening of civil society. These changes in the extent and intensity of the strength of the Korean state will be more specifically reviewed in the following sections.

Before we begin the main sections of this chapter, three things have to be clarified. First, a strong state or a weak state does not come into existence in a vacuum. In other words, the presence of a strong or a weak state has its own historical, and institutional

background. It means that we also need to examine the underlying background of Korea's strong or weak state historically and institutionally. Second, the concept of the strong state is not an absolute term but a relative term against civil society and the international system. As Kim points out "[s]tate power is not constant over time . . . we need to look into the domestic and international contextual variables" (Eun Mee Kim 1995: 515). Thus, an explanation which overemphasises the statist approach and entirely ignores both the societal and international systemic approaches represents only a partial analysis of Korea's economic and socio-political changes and transformations (Woo 1991: 6). In other words, even though the statist approach "reveals important dimensions of the East Asian development pattern, it tends to overstress the independent role of the developmental state, paying insufficient attention to other, equally important socio-political forces such as social classes and core-periphery relations in the world economic system" (Koo 1987: 165). As we have seen in the theoretical framework of Chapter 3, we need a synthetic approach which covers societal, statist, international systemic, institutional, and ideational approaches. Third, the term 'the strong or weak Korean state' is also not an absolute term but a relative term. Put differently, it has to be emphasised that even the weak Korean state in the PDS period is stronger than the state in other developing countries in East Asia. This means that the Korean state is basically a strong state compared with other states in terms of its autonomy, capacity, and ideational coherence. However, we need to elaborate and specify the weak and strong periods of the Korean state in order to clearly understand Korea's socio-economic and political changes and transformations.

In this chapter, Korea's transformation from the DS through the PDS to the TS will be explicated respectively in each section and in the sub-conclusion, the theory of

developmental stage will be maintained as an eclectic approach in order to overcome the shortcomings of the two extreme approaches which have been dominant in the literature on Korea's political economy, that is, the neo-classical and the statist view.

1. The Korean DS

1-1. The major characteristics of the Korean DS

The most significant feature of the Korean DS was the absence of any cleavage and discrepancy among belief systems, institutions and policies. Without a doubt, this coherence among the three pillars of economic development was the major reason for the rapid and magnificent economic development of Korea from the 1960s to the middle of the 1980s. Belief systems on the efficacy of developmentalism was pervasive inside civil society as well as among bureaucrats. 'National growth first mentality' and 'national modernisation slogan' were manipulated by the second president Chung-Hee Park's government after 1962 when the first five year economic development plan was started. Moreover, government manipulation easily penetrated into and was accepted by civil society.

Japanese colonialism and the Korean War devastated the entire economic foundations of Korea. First President Singman Rhee's government was corrupt and the entire national economy was geared towards to import substituting industry (ISI) and heavily dependent on aid from the US. Under the ISI and foreign aid-based economic structure, the government lost its autonomy through corruption by being involved in the processes of dispensing licenses to importers of capital goods essential to pursue ISI and in distributing foreign aid and cheap loans to selected or privileged groups (Haggard and Moon 1987: 110-11, Kyong-Dong Kim 1995: 373). Thus, the poverty-

ridden populace welcomed the second president Park's initiative to develop the national economy by breaking the corruption networks and developing an economic structure based on export oriented industry (EOI) (Haggard, Kim and Moon 1995: 449, 456-57). This period was the start of the Korean DS. The Korean DS thus began with the onset of EOI. The pursuit of EOI established new entrepreneurial groups totally different from the old corporations which had prospered under the ISI based economy. Thus, in the DS period, Korea enjoyed an ideational coherence in the pursuit of EOI among politicians, bureaucrats, the populace, and newly emerged entrepreneurial groups which later became the Chaebol.

Korea voluntarily learned from Japanese developmental strategies (Johnson 1987: 138) and as a result, we can find mimetic isomorphism in the administrative structure and semi-government institutions between Japan and Korea. As a late-late developer, Korea benefited from late developer Japan with the help of mimetic isomorphism by reducing the costs of trial and error in relation to establishing efficient governmental economic organisations and implementing economic strategies. Under Park's regime, Korea established the Economic Planning Board (EPB), the Ministry of Commerce and Industry (MCI), and the Ministry of Finance (MOF) as imitations of the Japanese Economic Planning Agency (EPA), the Ministry of International Trade and Industry (MITI), and the Ministry of Finance (MOF). These government organisations are also common to other countries whether they are developmental states or free market oriented states. What is important in this process of mimetic isomorphism is that Korea learned from Japan not only formal and procedural factors but also the core aspects of developmentalism.

Japanese developmentalism thus transferred into Korea and turned into a more dirigiste and nationalist form of developmentalism (Chu 1989: 652, 655, 662). The result of the voluntary learning and mimetic isomorphism from Japan resulted in a Korean version of neo-mercantilistic capitalism which in turn, produced intrusive industrial and trade policy and a government controlled financial sector. Thus, it can be argued that in the DS period, institutions such as government economic organisations (the EPB, the MCI, and the MOF), economy related laws, close government-business relations, the populace's economic nationalism, and bureaucrats' window guidance (or internal guidelines) were systematically geared to developmentalism.

In relation to FDI, government policy preferred joint ventures and licensing instead of majority foreign ownership and in conjunction with foreign capital inducement, government policy preferred loans rather than inward FDI. These government policies revealed the neo-mercantilistic nature of the Korean DS. Put differently, the preference for loans, joint ventures, and technology licensing was an expression of government intentions to accumulate national wealth by indigenous entrepreneurs. Thus, the state was not only a protector of national entrepreneurs from foreign capital and MNCs but also a promoter of indigenous entrepreneurs and capitals. These policies were complemented by strategic trade policies which protected the domestic market while enabling Korean firms to penetrate other open foreign markets by providing various incentives for export promotion. Moreover, by nationalising banks, the state controlled the financial sector and as a result, the state possessed efficient policy instruments, particularly 'policy loans' at cheap interest rates. Thus, by

controlling the banking sector, the state could directly manage the corporate sector. The major characteristics of the Korean DS can be summarised in Table 5-1.

	The Korean developmental state period
IFDI OFDI	1962-1983 1968-1985
	-Belief systems = policies = institutions -**Voluntary learning** from the Japanese developmental model[1] -**Mimetic isomorphism** from Japanese governmental and semi-governmental institutions -Neo-mercantilistic capitalism -State intrusive but efficient industrial policy -Strategic trade policy -State controlled banking sector -Joint venture and licensing preference in managing inward FDI (Mardon 1990: 127). -Foreign loans preference over inward FDI (Haggard and Cheng 1989: 94, Hyug Baeg Im 1987: 247). -High regulations on outward FDI because of foreign currency scarcity

Table 5-1. The major characteristics of the Korean DS period

1-2. Society, state, and international system in the Korean DS

As we have seen from the above, the Korean developmental state was strong in terms of its autonomy, capacity, and ideational coherence. Korean state autonomy was

[1] Wade suggests the reason for the smooth learning process between Korea and Japan: "Proximity, cultural affinity, and historical familiarity all helped to create important neighborhood growth effects, not just in terms of trade but also in terms of the plausibility of Japan as a model for emulation" (Wade 1992: 312).

accomplished because of two remarkable factors before the first five year economic plan was implemented in 1962. First, civil society had not developed to the point that it could check and balance the state. Land reform which was undertaken under the US military government encroached on traditional land owners and produced small and medium sized peasantry (Haggard and Cheng 1987: 110, Koo 1987: 170). The absence of traditional land owners and the presence of equally distributed landownership under more satisfied small and medium sized peasantry who became "politically disarticulated" (Moore 1995: 279) ultimately led to a political vacuum in rural society. Commercial or industrial capitalists were also underdeveloped under Japanese colonial ruling (Koo 1987: 171). Japanese Zaibatsu controlled the entire Korean commercial and industrial economy (Cheng 1995: 128) and as a result, it was difficult for indigenous capitalists to grow. Thus, after the Korean war, there were no dominant civil society members who could challenge the state. Put differently, societal actors were "little more than passive, powerless pawns: they existed to serve the interests and purpose of a highly repressive developmental state" (Lim 1998: 457).

Second, if we borrow a term from Alavi (Martinussen 1997: 183), the Korean state was basically an 'overdeveloped state' from the end of colonial rule. Under Japanese colonial rule, Japan needed an efficiently organised bureaucracy in order to facilitate colonial exploitation and to manage the colony more systematically (Koo 1987: 170). Japan also strengthened the surveillance structure such as the police system in order to suppress Korea's independence movements. Moreover, the Korean War contributed to a strengthened military force in the newly born South Korean state. Thus, the legacies of colonialism and the Korean War eventually resulted in a combination of strengthened bureaucracy, police, and military force in Korea.

The reason why the bureaucracy and the police who served Japanese imperialism survived even after the end of colonial rule needs to be explained. The American military government was worried about the expansion of communism into South Korea. 'The special committee for anti-national behaviour' established by a popular central-leftist politician, Woon-Hyung Yeo, could not undertake its primary duties of placing them on trial because of implicit objection and hindrance from the US military government. The US authority, instead, supported Singman Lee as the first president because his political background was anti-communist. After he became president, Lee recruited old bureaucrats and policemen who had served during Japanese colonial rule in order to stabilise and strengthen his own political position. All these meant that the overgrown state was the result of an extraordinarily overdeveloped state apparatus compared with its lagged economic developmental stage and the immaturity of civil society. These are the historical origins of the overdeveloped and strong Korean state and weak civil society at the outset of the DS in 1962.

After 1962, the Korean state enjoyed an uninterrupted position as a strong state. The international system was favourable to Korea's export oriented economy by providing open markets. The international system in the 1960s and 1970s was a period of economic expansion, helped by the stable Bretton Woods system (Koo 1987: 169). Even though, in the 1970s, the fixed exchange rate system collapsed and a double oil crisis occurred, the free trade regime undergirded by the GATT system was unimpaired (Cheng 1995: 145). Moreover, Korea continuously enjoyed access to an open US market and as a result, Korea was able to overcome exchange rate instability and the oil crises. Needless to say, this benign international economic system was an

offspring of Korea's strategic position in Northeast Asia (Koo 1987: 169, Mardon 1990: 114). Thus, Korea could avoid the harsh pressures from the international economic system and this was the most important background for the Korean state's autonomy and insulation from international systemic pressures. The absence of dominant foreign investors or foreign capital in Korea also facilitated the autonomy of the Korean DS. As we have seen earlier in Table 5-1, the Korean state preferred foreign loans over IFDI. Thus, it was hardly possible for foreign investors to have a dominant position in the Korean economy in the DS period (Mardon 1990: 114).

Korea also enjoyed autonomy from domestic society. As we have seen above, Korea in the 1950s was a state with no dominant societal groups. However, in the domain of civil society, three distinctive groups emerged as potential challengers to the strong state from the 1960s to the early 1980s: big business, the labour class, and students. First, big business which was geared to export industry steadily grew with the help of the government's fiscal and direct incentives (Song 1990: 71). The government used various policy instruments to promote exports. After President Park nationalised commercial banks in 1961 (Koo 1992: 29) and established special banks such as the Korea Development Bank, the Small and Medium Industry Bank, and the Export-Import bank, the government could control domestic capital flows (Neurath 1988: 75). Moreover, after the Bank of Korea came under the control of the MOF in 1962 (Koo 1992: 29), government capacity to manage the entire economic system was remarkably improved. In other words, by consolidating the state's management of the banking sector, "the role of banks, both commercial and specialised, became that of credit-rationing outlets for the government as the allocation of credit was tightly controlled by the Ministry of Finance" (Lee 1992: 190). One policy instrument which

was absolutely useful was policy loans to industrial sectors. By dispensing policy loans, the government could handle the industrial sector more easily and as a result, the government could drive the economic system as it planned (Johnson 1987: 149, 159). And in this process of credit rationing, "[b]anks were allowed no voice over allocative decisions, and had to passively accommodate the loans irrespective of their portfolio strategies" (Woo 1991: 12).

Differing from the Japanese financial and corporate system characterised by a main banking system inside each Keiretsu group, big Korean companies could not become involved in the banking sector (Hamilton and Biggart 1995: 195-96). Korea's banking industry was basically a state controlled or managed sector. Thus, big business was heavily dependent on the government in order to fund their running and investment capital (Wade 1995: 304, Mardon 1990: 115). Moreover, the government also controlled import licenses in order to promote exports (Neurath 1988: 77). Only exporters who satisfied the government's export target could be permitted to import. This whole story means that even though big business steadily grew, its relationship with government was still highly dependent and subordinate (Koo 1987: 173). Thus, it can be argued that, in the period of the DS, the relationship among the bureaucracy, business, and the banking sector was basically hierarchical. At the top was the bureaucracy, the banking sector was in the middle and at the bottom was business (Woo 1991: 15, Chung H. Lee 1992: 189).

Second, the labour class also steadily grew under the export-oriented economic structure. Cheap labour was the basis of Korea's comparative advantage and international competitiveness from the 1960s to the early 1980s. The labour

environment was seriously unfavourable to workers. In order to sustain cheap labour conditions, the government was intolerant and extraordinarily strict with regard to strikes and labour movements (Koo 1987: 174, Mardon 1990: 115). Park's authoritarian regime was oppressive towards even any fair requests from the labour class (Johnson 1987: 150). President Chun also heavily suppressed labour movements. However, it is important to remember that different from Japan's docile labour class, Korea's labour has been continuously organised and has challenged the authoritarian government. Thus, it can be argued that the militant labour movements in the late 1980s were unavoidable results of the continuous preparation and the growth of labour consciousness in the 1960s and the 1970s even under authoritarian and military regimes.

Third, students have been a crucial actor in determining Korea's socio-political transformations. President Lee was expelled from his position because of nation-wide protests which had been initially ignited by student protests. The labour movement was also organised with the help of students who suspended their study and became workers in order to educate workers and to organise labour movements for the purpose of ultimately improving the labour environment. Student movements also facilitated Korea's democratisation in 1987 by protesting against president Chun's regime. As a result, in 1987, civil society members attained a shift to direct presidential election in Korea. This period was the PDS period. We will discuss this much further in section 2. The specific features of society, state, and international system in the Korean DS period can be summarised in Table 5-2.

Domestic society	The developmental state	International system
-Low level configuration of social groups (Randall and Theobald 1998: 211). -No room for social groups in policy making process -Subordinate enterprises' position in relation to the state -State controlled and governed banking sector -No organised labour force -No politically awakened middle class	-Overdeveloped state (Bureaucracy, police, army) -Low level of democratisation -Authoritarian regimes (Park and Chun regimes) -Intrusive state into market system -Strong state in terms of autonomy, capacity, and ideational coherence -Nationalistic economic patriotism[2] -State controlled banking sector as a means of industrial policy	-The Cold War bipolar system -Unpoliticised international economic system and a period of intensive growth of world trade and economy (Haggard 1986: 363). -The Bretton Woods system until the early 1970s (Stable exchange system and free trade regime) -Beneficent American hegemony (Hoogvelt 1997: 211). -Constantly open US markets to Korea in the 1960s and 1970s[3] -The emergence of market protection in the US and Europe in the early 1980s[4]

[2] Johnson explains the effects of economic nationalism in Korea's economic development: "the existence of mass nationalism in Korea and a widespread public-private agreement on economic goals . . . (eclipse) the class or pluralist pressures on governments that are commonly encountered in less mobilised societies" (Johnson 1987: 138).

[3] See Ho-Geun Song (1995: 150-51). Song argues that until the mid 1980s, the international trade system was favourable towards developing countries. The GATT system provided developing countries with special treatments such as Generalised System of Preference (GSP) and Most Favoured Nation (MFN) while the US also provided an open market for developing countries, because America needed political and strategic partners or suporters in competing with the Communist bloc led by the Soviet Union. Johnson also explains the background of the open US market in this period: "The Cold War deal the Americans offered to keep these satellites in line was unrestricted access to the American market, toleration of their mercantilism and protectionism, and technology transfers at often concessionary prices in return for public anti-communism" (Johnson 1998: 660).

[4] Park explains the backgroud of the emergence of protectionism in the period as follows: "as U.S. hegemony over the world economy has declined over the years, its leadership role in maintaining the liberal economic order in the world economy has diminished. At the same time U.S. foreign policies have become increasingly dependent on domestic economic concerns. For example, protectionist trade measures proposed and supported by U.S. major industries, labour unions, and members of the Congress have increased substantially" (Eul Yong Park 1985: 107).

Table 5-2. The inter-relationship among society, state, and international system in the Korean DS period.

2. The Korean PDS

2-1. The major characteristics of the Korean PDS

Korea's transformation into the PDS period started from the middle of the 1980s. First of all, the developmentalism oriented combination of belief systems, institutions, and policies began to break down and policies towards trade and FDI were incrementally liberalised as a result of pressures from the international economic system. These policy changes from heavy protection to deregulation and liberalisation could be regarded as an adaptation, that is, just behavioural change and not ideational change. The liberalised policies were just the window display in order to cope with external pressures to open the domestic market. Sohn et al. illustrate this limited and slow liberalisation process:

> It should be noted that while there was substantial deregulation, the process was left incomplete. The government still maintained much of its informal control over the financial sector . . . Also, while the government partially deregulated foreign investment, direct foreign investment was still subject to a substantial array of limits . . . While most government officials and economists recognised the need for import liberalisation, they felt that a gradual liberalisation was preferable (Sohn et al. 1998: 42-43).

Belief systems were sharply divided inside the bureaucracy. Firm beliefs regarding the efficiency of the intrusive state and developmentalism which was prevalent in the DS period began to be challenged by top ranking policy makers who obtained their degree in the US where neo-classical policy thinking is prevalent. In contrast, low or medium level bureaucrats had a tendency to cling to the status quo and to stick to already existing, internally prevailing standard operational procedures which had been adjusted to the developmental spirit and objectives. Moreover, there were internal

conflicts among economy-related ministries towards policy options. The EPB pursued economic liberalisation while the MOF and the MCI tried to hold to developmental policies. Thus, in the PDS period, there was a sharp ideational cleavage inside the bureaucracy. Jones clearly points out this ideational conflict in the PDS period:

> Chun's reforms . . . engendered conflict within the bureaucracy between economic liberals and conservatives . . . after 1985, within the government, the EPB encountered growing strategic resistance from the MOF and MCI. These tensions continue into the regimes of Roh Tae Woo (1987-92) and have been further exacerbated during Kim Young Sam's (1992-1997) presidency (Jones 1997:76)

This is the very reason for the zigzag and confused policies in the Korean PDS period. And this ideational divergence inside the bureaucracy undoubtedly led to intensified friction between developmentalism and the neo-liberal free market. In a word, "Korea's state became lost between state and market in the process of political and economic liberalisation" (Rhee 1994: 232, 239). As a result, continuous efforts to overcome or dismantle the side effects of developmentalism such as the overgrown Chaebol, the collusive government-business relationship, and an underdeveloped financial system were frustrated in the PDS period (Sohn 1998:22-23). More specifically, Chun tried to reform the high business concentration of the Chaebol by pursuing liberal economic reform and fair market competition after he became president. Chun's real intention of pursuing reform was to legitimise his military or authoritarian regime by achieving economic justice and equality and showing it to the Korean populace. However, this effort failed and collusive government-business relation re-emerged as Chun's regime later accepted political funds from the Chaebol because Chun "tried to pay the increasing political cost for regime security by

exploiting the state-controlled industrial adjustment" (Rhee 1994: 233). Chun's successor, Roh also attempted to achieve economic liberalisation and Chaebol reform in 1988-1989. However, his efforts were also frustrated because the core part of the reform such as 'real-name financial transaction' and 'public land ownership' were suspended. The main target of these two measures had been the Chaebol, because the legalisation of the former could lead to the complete prevention of illicit political funds and the latter could constrain the Chaebol's rent-seeking behaviour by investing in real estate (Rhee 1994: 234-35). Young-Sam Kim also tried to sever the collusive alliance between the government and the Chaebol by announcing that he would not accept political funds from the Chaebol. Moreover, he legalised 'real name financial transaction', 'real-name ownership of real estate', and 'declaration of property of high ranking bureaucrats'. However, his reform efforts soon went adrift and became obsolete because of the unexpected impact of his 'Segyehwa policy' such as rapid liberalisation of finance without proper supervision and his son's corrupt links with the Chaebol. After the emergence of ailing Chaebol such as Hanbo and Kia, Kim's efforts to achieve economic reforms were in vain. As a result, the collusive alliance among politicians, bureaucrats, and business remained despite Kim's intensive and wide ranging reform efforts (Jaymin Lee 1999: 150-51). We will discuss this further in the following section.

Meanwhile, it has to be emphasised that tangible or intangible economic institutions such as government economic organisations, window guidance[5], administrative

[5] Yeon-ho Lee illuminates the powerful practices of window guidance: "Unofficial regulation through so-called window guidance also continues to function. Government officials arbitralily apply economic, industrial acts with window guidance. Business people even complain that window guidance is superior to written laws. Even if a law is aimed at deregulation, officials often render the act ineffective" (Yeon-ho Lee 1997: 382).

guideline[6], unequal and hierarchical state-banks-business relationship and persistent economic nationalism remained relatively undamaged compared with the ideational divergence. The embeddedness of developmentalism in the Korean state and society was persistent and rigid and denied any adjustment despite changed policy and divided belief systems in the PDS period. Institutional factors do last longer than ideational factors. Institutional changes need more time than policy changes and belief system changes and the direction of the changes is difficult to anticipate. The MOF and the MCI maintained their developmentalism-oriented organisational structure and contents. The EPB never gave up its role of the grand economic strategist and planner. The MOF continuously controlled the Bank of Korea and the MCI never stopped its role of an industrial policy initiator and an advocator of industrial sectors (Yeon-Ho Lee 1996: 158-59). The banking sector was incrementally liberalised but only in limited scope and at very slow tempo. Lee shows the reason for this limited liberalisation: the public officers, "while officially willing to admit the need for liberalisation, did not give up regulations of financial institutions that were the real source of their perks and privilege. As a result, almost the same deregulation issues were being continuously raised for more than a decade without being solved in any real sense" (Jaymin Lee 1999: 150). Thus, the state uninterruptedly controlled the banking sector in the PDS. This is the obvious reason for the underdeveloped banking sector in Korea. Overprotected and guaranteed by the government, the banking sector was subject to moral hazard and failed to improve its administrative and investment skills.

[6] Administrative guideline is "a combination of command and incentive to influence private behaviour that requires continuous consultation between Chaebol and public officers". See Paul W. Kuznets

As we have seen above, the liberalisation of the domestic market and administrative deregulation were a means of avoiding foreign pressures. However, there was another reason for liberalisation. The state purposefully pursued liberalisation measures in order to improve the international competitiveness of indigenous industrial sectors by introducing foreign competition. The primary objective of market protection based on the principle of strategic trade policy was to protect domestic companies and industries from well developed foreign competitors, especially from the MNCs. Under the overarching framework of market protection, infant industry protection was practised and oligopolistic competition among indigenous companies in the same industry was allowed in order to improve international competitiveness. However, from the early 1980s, Korean firms obtained a certain degree of international competitiveness as a result of decades long government efforts at artificial oligopoly formation and infantry industry protection. Thus, in the 1980s, the government forced domestically over-protected industries to compete with foreign competitors by incrementally opening the domestic market. This is the other reason for liberalisation and deregulation in the 1980s.

In the PDS period, Korea voluntarily learned from the Japanese Expansionist Developmentalism in Southeast Asia. As we have seen in Chapter 4, Japan intentionally transplanted its developmental system into Southeast Asia and as a result, Japan established a production network in the region. In the latter part of the 1980s, Korea suffered from rising labour costs and an unstable labour market caused by militant labour movements. Thus, Korea's cheap production costs-seeking OFDI started to rise in Southeast Asia, particularly in Indonesia, Thailand, and Malaysia.

(1994: 149).

Korea's learning from the Japanese EDS and mimetic isomorphism in the FDI related institutional structure and arrangements will be further elaborated in Chapter 6. However, it has to be emphasised that the Korean EDS in the region was very nascent and only in the process of preparation. Two major reasons for this nascent stage can be suggested. First, Korea's OFDI started after the mid 1980s when Korea achieved its first trade surplus. Before the period, OFDI was heavily regulated in order to manage scarce foreign currency. Second, until the middle of the 1980s, the region of Southeast Asia was not crucial for Korea in terms of both strategy and economy. Korea's foreign policy was traditionally focused on 'oceanic diplomacy' with America and Japan. And, from the late 1980s, Korea actively tried to achieve diplomatic normalisation with China and the former Soviet Union by pursuing 'northern diplomacy'. Thus, different from Japan's long-term preparation and aspiration towards Southeast Asia, Korea neglected the presence and value of the region in its foreign policy in relative term (Jeon 1996: 397).

However, despite these obstacles and the short-term history of Korean FDI in the region, Korea's economic policy towards the region has been steadily strengthened. First, as regionalism or regionalisation mushroomed under the globalisation process, East Asia and Southeast Asia became an important region for Korea in terms of economic integration and as a sort of insurance policy against NAFTA and the EU. Second, as internal trade and investment flows in the region continuously grew, for Korea, it became inevitable to actively incorporate into the region by maximising its comparative or competitive advantages in the regional division of labour. Third, Korea's labour costs escalated during the late 1980s because of the intensified labour movements. Thus, increased labour costs and labour market unrest led to the rise of

low cost-seeking FDI towards the region. Fourth, as Japan established a production network in the region, the Korean Chaebols had to explore the region in order to procure price-competitiveness against the Japanese production network (Jeon 1996: 399). As economic integration was facilitated, Korea rearranged its Official Development Assistance (ODA) and established the new ASEAN Co-operation Fund (ACF) in order to actively participate in and take advantage of the process of regional economic integration. Korea also established the Economic Development Co-operation Fund (EDCF) in 1987 which supplies cheap loans to developing countries and the Korea International Co-operation Agency (KOICA) in order to efficiently deal with grants and technological assistance towards developing countries (Jeon 1996: 402-404).

Furthermore, a para-governmental research institute such as 'Korea Institute for Industrial Economic and Trade (KIET)' prepared the policy-report which recommended permission for business's financial outsourcing in the region for its investment capital and the increase and expansion of 'reverse imports' from Southeast Asia in order to propel Korean FDI in the region (Jang 1994: 140). KIET also recommended the diversification and strengthening of economic diplomacy with the ASEAN countries and maintained the organic connection between ODA allocation and ASEAN's development projects such as construction of infrastructure (Chun et al. 1996: 188, 193-194). The major characteristics of the Korean PDS can be summarised in Table 5-3.

	The Korean post developmental state period
IFDI	1984-1997

OFDI	1986-1997
	-**Institutions** deeply rooted in developmentalism[7] -**Divided belief system** inside the bureaucracy -Liberalised and free market oriented economic **policies** -Emergence of Korea as a development model in developing countries[8] -Intensified friction between developmentalism and the neo-liberal free market in the policy making process -Delayed structural reform and limited liberalisation and deregulation[9] -**Adaptation** to foreign and domestic pressures not by changing belief systems and institutions deeply ingrained to developmentalism but by superficially changing policies -Opening of domestic market to improve enterprises' international competitiveness -Incremental and continuous liberalisation and deregulation in the 1990s before the economic crisis -**Embeddedness** of the DS system in the PDS period -Preparation and nascent implementation of the EDS -**Voluntary learning and mimetic isomorphism** from Japan in implementing the EDS -The emergence of the side effects of developmentalism such as collusive government-business relationship, bureaucrats' authoritarianism, unequal regional development, and the overgrown Chaebol (O 1995: 356). -Business' needs to access advanced technology and to extend and diversify export market led to the rise of OFDI

[7] Neurath reveals the institutional resistance inside the bureaucracy by the persistent administrative guideline in foreign investment screening in the PDS period: "Most investment applications, though officially handled by the Ministry of Finance as the one stop clearing agency, require the approval of various ministries. These in turn base their decisions not merely on the Foreign Capital Investment Inducement Law, but also on a number of unpublished internal regulations and guidelines. The latter are often more important and more restrictive than the law itself. Moreover, Korean bureaucrats at the working level enjoy a considrable degree of administrative freedom with respect to how they interprete a given law" (Neurath 1988: 85).

[8] O argues that Korea became a model: "the Korean economy of the 1960s and 1970s is now the object of study to many economists in the world. It is often said that many former socialist countries and developing countries are studying the Korea" (Won-Chol O 1995: 356). By defining the East Asia

Table 5-3. The major characteristics of the Korean PDS

2-2. Society, state, and international system in the Korean PDS

In the domain of civil society, a set of groups steadily improved their leverage against the state. The labour class became a dominant social group (Koo 1987: 177-78, Cheng 1995: 147, Pak 1998: 59), particularly after 'the declaration of 6.29' from president Chun. The day 29th of July in 1987 was a watershed in the process of Korea's democratisation (Celoza and Sours 1993: 105). Students' aspiration for democratisation widely spread throughout the middle class as well as the labour class. The student movements' slogan of 'overthrow the military dictatorship and establish a democratic government' was widely welcome by civil society members. Korea's middle class was politically awakened by supporting the student movement and by being involved in the democratisation movement in June 1987 and emerged as a crucial political actor for the first time in Korea's history (Koo 1987: 178, Cheng 1995: 147, Pak 1998: 60). President Chun was endangered because of the intensified and nation-wide protests and finally he announced the declaration of 6. 29 which contained the promise of direct presidential elections in December 1987. After the 6. 29 declaration, in July and August of 1987, the labour movements spread throughout the entire nation (Sunhyuk Kim 1997: 1136). In the open space of promised

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development Model (EADM) as a combination of the Confucian culture, developmental authoritarianism, state-led export-oriented economic system, and democratisation after accomplishing a certain level of economic development, Goo insists that Korea is a prototype country of the EADM, because Korea has experienced the sequence of the emergence of authoritarian regimes, concentration on economic development, and then democratisation process and economic liberalisation and deregulation process. See Jong-seo Goo (1996: 209).

[9] Sohn et al. shows the backgound of this delayed and slow process of liberalisation like this. "Korean had realised from the early 1980s that Korea must ultimately liberalise in order to maintain an efficient, productive economy. However, there were substantial differences of opinion concerning the speed of liberalisation. Also . . . there were some differences in opinion on how quickly and how much the government must withdraw from its involvement in the marketplace. These argument began in the 1980s and continue to this day" (Sohn et al. 1998: 53).

democracy, the labour class requested their fair share of economic growth. As a result, labour costs dramatically increased from late 1987 throughout the 1990s. The number of trade unions grew while their membership also expanded. After Young-Sam Kim was inaugurated as the sixth president of Korea, they became a politically crucial actor by establishing an independent trade union of 'the Korean Confederation of Democratic Trade Unions (KCDTU)'.

On the other hand, the Chaebol's position in relation to the state also changed its nature (Koo 1987: 176, Pak 1998: 58). Kim clearly illustrates the growing leverage position of the Chaebol against the state by revealing the changes in the relationship between the state and the Chaebol. The relationship was transformed from 'the state-coopting or protecting and Chaebol following' to a 'symbiotic or bilateral bargaining or coexistence of confrontation and collaboration' (Eun Mee Kim 1995: 516). The Chaebol became too big to be made bankrupt as their contribution towards the Korean economy had dramatically risen. The origins of the Chaebol challenge towards state authority could be found in the government's ambitious drive in the heavy and chemical industry (HCI) in the early 1970s. At this time, the Korean state faced a strategic threat as the US incrementally reduced its military presence and capability in Korea as a result of the Nixon doctrine. Korea faced the need to improve its HCI sector rapidly in order to fill the vacuum caused by the US military reduction. Another reason for the government driven HCI development was the need to improve Korea's economic capacity and 'the terms of trade' by transferring its labour intensive economic system to capital intensity one. Thus, Korean government interfered in the market system more intensively than the earlier period of the EOI (Sohn et al. 1998: 29). Enormous policy loans and preferential loans were built up in order to channel

them into the targeted HCI sector. In this process, Chaebol which did not follow the government decision were punished and those that rapidly adopted the government policy benefited from cheap loans and other incentives such as fiscal or direct subsidies. However, the market distortions caused by unequal resource allocation in other industrial sectors and overinvestment and overcapacity in the HCI sector ultimately resulted in economic instability. Chronic high inflation was persistent in the late 1970s. In 1979, after the assassination of president Park, Korea's economy revealed clear signs of the side effects of the HCI and stopped developing by showing almost minus GDP growth (Sohn et al. 1998: 36-37).

The important thing to rememeber here is that the Chaebols have been exploiting these side effects of the government-led HCI promotion policies as a symbol of 'government failure' through over-intervention by the state, whenever they try to obtain more managerial autonomy from government intervention throughout the 1980s and 1990s. As the Chaebol grew further in the PDS period, they felt that government interventions and guidelines were a shackle preventing their autonomy. Thus, the Chaebol pursued more comprehensive administrative deregulation and capital market liberalisation. Too many government regulations and rigid capital market protection became major constraints in doing business from the view point of the Chaebol. Domestic market protection and various incentives provided by the government were indispensable factors for the development of the Chaebol in the DS period. Thus, the Chaebol steadily grew with the help of government protection, support, and guidances. In the PDS period, the mature Chaebol felt the persistent government intervention to be an uncomfortable shackle which was preventing them from being global MNCs and promoting OFDI. Moreover, the Chaebol continuously

exploited the arguments of some economists who insist that the Chaebol's internal system or structure had its own advantages[10]. Fields briefly summarises the justification for the Chaebol: "Korean Chaebol chose an integrated and relational structure in a successful effort to reduce transaction costs and achieve superior economic performance under imperfect market conditions" (Field 1995:14). In summary, government-driven market protection and various incentives gave the Chaebol precious chances by which they could exploit their permitted oligopolistic position and ultimately dominate the entire domestic market (Suk-Joon Kim 1996: 64). As a result, the Chaebol attained a certain level of international competitiveness in their targeted industries and in order to grow further, they needed more cheap capital from the liberalised financial market and more administrative autonomy from the government. Thus, capital market liberalisation and deregulation were pursued by Chaebol in the PDS period.

After the military coup, General Chun was inaugurated as the fourth president of Korea in 1980. His urgent task was to stabilise the economy and consolidate his weak political foundations. In order to overcome the economic contraction caused by the side effects of the HCI promotion policies, financial liberalisation was adopted to overcome the excessive government intervention and management of the banking sector in the period of the HCI promotion (1974-1979). In other words, the underlying foundation of financial liberalisation was the bureaucrats' recognition that the underlying cause of the economic hardship was the excessive government interference in the financial market and the subsequently distorted capital prices and trade (Koo 1992: 31-32). However, it has to be emphasised that the pace and degree

[10] See Chalmers Johnson (1987: 161). And also see Chung H. Lee (1992: 187).

of financial liberalisation in the 1980s was limited and slow because of institutional resistance and the rigidly entrenched developmentalism-oriented belief systems inside the bureaucracy (Sohn et al. 1998: 49). Even though the HCI promotion in the late 1970s and the financial liberalisation in the 1980s shows the changed degree and intensity of state intervention or developmentalism in the market system, the financial liberalisation was not market-driven but state-initiated. The limits of financial liberalisation is clearly explained by Amsden and Euh:

> The Korean financial system has changed in the 1980s . . . Yet it would be misleading to characterise such change simply as a move towards freer markets . . . the financial system continues to operate within the context of industrial policy (Amsden and Euh 1993: 379)

The MOF tenaciously controlled not only the banking sector but also the Bank of Korea even under the process of liberalisation. Thus, it can be argued that financial liberalisation in the 1980s was not the result of ideational change from learning but just an adaptation which accompanies only behavioural changes in policy options and implementation. Economic institutions were still deeply entrenched in developmentalism and the belief systems of the majority of the bureaucrats were also anchored in developmentalism even though there was an ideational divergence inside the bureaucracy with the emergence of a minority group of bureaucrats that was the advocator of the principles and benefits of a free market economy. In this regard, financial liberalisation in the Korean PDS period was the result of adaptation to internally or externally driven environmental changes in the Korean economy. Developmentalism was undamaged due to its strong embeddedness in economic institutions and bureaucrats' belief systems. Thus, as Jones correctly points out, "[a]lthough official rhetoric currently adopts a neo-liberal tone, government continues to offer big leadership" in the economy (Jones 1997: 77).

Korea's sixth president Young-Sam Kim's 'Segyehwa' strategy showed the persistence of developmentalism in the PDS period. Segyehwa, which means globalisation in Korean, became popular in Korea after president Kim implemented the Segyehwa policy (Koo 1992: 36-37). The original intention of the policy was to improve the Korean economy's international competitiveness by liberalisation and deregulation and by actively participating in multilateral and regional economic arrangements such as the WTO, APEC, ASEM, and the OECD (Yeon-Ho Lee 1997: 369). The difference between the liberalisation and deregulation undertaken under presidents Chun and Roh and liberalisation and deregulation under president Kim lies in the passive versus dynamic nature of the Korean government. The former process was slow and involved piecemeal responses towards foreign pressure, especially from the US. On the contrary, the latter process was driven by the Kim government as a dynamic and positive initiative in order to benefit from or exploit the process of economic globalisation. Thus, the Korean government actively tried to be a member of the OECD and in order to be a member country, it pursued trade and investment liberalisation. As a result, Korea's financial market was rapidly liberalised without the commensurate development of financial regulations and supervision. The biggest beneficiary of the liberalisation and deregulation process was the Chaebol. In the freer and open environment, the Chaebol borrowed increasing amounts of foreign capital beyond their capacity because the price of foreign capital was much cheaper than domestic capital.

On the other hand, newly established merchant banks under the capital market liberalisation process also borrowed enormous foreign short-term capital in order to

exploit the interest rate gap between Korea and foreign countries. Increased foreign capital inflows without proper supervision finally led to a currency crisis in 1997. This will be further explained in section 3. Besides the financial instability, the Segyehwa policy unexpectedly resulted in the further strengthening of the Chaebol's leverage against the state. The Chaebol was the only economic sector which had enough capacity and international competitiveness to cope with the effects of rapid liberalisation and deregulation. Small and medium sized enterprises and service industries, particularly financial and distributive industries, were under-developed and were not prepared for rapid liberalisation and deregulation. The Chaebol, which is based on manufacturing industry, was sufficiently prepared to take advantage of economic globalisation. Thus, the Segyehwa policy ultimately became a policy not only for the strengthening of the Chaebol's competitiveness but also for an extended 'growth first policy' of the DS period because the policy lacked an additional package for improving social safety nets to cope with the potential dislocations caused by the neo-liberalism-oriented liberalisation and deregulation process (Im 1995: 256, 261). Thus, it can be argued that, the Segyehwa policy as 'a Korean version of globalisation' was another version of industrial policy and its implementation revealed the developmentalism-oriented economic belief systems in the PDS period (Yeon-Ho Lee 1997: 369).

Economic policies under the Segyehwa strategy became rapidly and widely liberalised and deregulated. However, the process of liberalisation and deregulation was driven by state strategy rather than by the market. The intention of the policy was to improve Korea's international competitiveness by strengthening the Chaebol while sacrificing other underdeveloped industrial sectors, particularly the agricultural sector. State

intervention and the artificial comparative advantage of the DS system persisted and did not disappear in the PDS period as the Korean PDS tried to manage, exploit, and intervene in the process of globalisation which is widely identified with the process of free marketisation and non-governmental intervention. Moreover, the abolition of the EPB under the Young Sam Kim regime and the establishment of the Ministry of Finance and Economy (MOFE) led to an unexpected and contrary result. The original intention was to streamline government organisation, but the merger of the MOF and EPB led to a strengthening of government intervention, because the abolition of the EPB meant the total disappearance of a liberal-minded and free market-oriented government organisation (Yeon-Ho Lee 1997: 381). Thus, it can be argued that even though president Kim tried hard to achieve economic liberalisation and Chaebol reform, the efforts only resulted in confirmation of the persistent legacy and influence of developmentalism which is deeply ingrained in bureaucrats' belief systems and in economic institutions.

In the international system, crucial changes in the security arena led to fundamental changes in the international economic system (Koo 1987: 178). The collapse of the Cold War order resulted in a decline in the importance of high politics. The US, which suffered from chronic fiscal and trade deficits throughout the 1980s, initiated the creation of an environment in which unilateral, bilateral, regional or multilateral trade and investment arrangements mushroomed (Moon 1995: 67, Hoogvelt 1997: 213, Jones 1997: 79, Chowdhury and Islam 1993: 249-250). Trade and investment became much more politicised and as a result, trade retaliations and market openings in the name of fair trade and liberalisation became prevalent phenomena in the 1980s and 1990s. The US has been a strong advocate of the free market economy and

strongly propelled market liberalisation and governmental deregulation in other countries by facilitating multilateral agreements in the Uruguay Round such as the TRIMs, TRIPs, and agricultural talks. Also, by initiating the establishment of the WTO, the US is pursuing liberalisation in service industries, particularly financial industries in which it is the most competitive globally. Thus, it can be inferred from the above that the US is promoting world-wide liberalisation and deregulation particularly in the industries in which it has comparative or competitive advantage compared with other countries.

On the other hand, the US has also adopted unilateral, bilateral and regional arrangements in order to complement the multilateral arrangements mentioned above. These unilateral or bilateral trade retaliations and initiatives were revealed by the strengthened Super 301 provision in US trade law, the structural impediments initiative (SII) and the voluntary exports restraints (VERs) talks with Japan, local content requirements towards IFDI flows, and trade disputes over the opening of the rice market in Japan and Korea. Regional arrangements such as the EU, NAFTA, APEC, and ASEAN have been extended and deepened throughout the 1980s and 1990s. The debates on the nature of regional arrangements have been controversial but basically centred on a set of conflicting views: whether regionalism is a bridge towards economic globalisation or not (Machado 1996: 40); whether regionalism promotes free trade or prevents free trade among regional arrangements; whether regional arrangements are economically driven (regionalisation) or politically driven (regionalism). The answers towards these questions need more empirical research and a longer period of observation. However, what is clear at this juncture is that regional economic arrangements are continuously expanding and deepening and this implies

increasing politicisation of economic issues in terms of equal market accessibility between member and non-member countries of each regional arrangement.

In this regard, what is significant for Korea and Japan is the US strategy of participating in APEC and NAFTA at the same time. America's intention lies in consolidating its traditionally strong control of East Asian countries and in strengthening its bargaining position against the EU by participating both in NAFTA and APEC. The US involvement in APEC shows the complex relationships between the US and the nations in the region. From the view point of the East Asian countries, an open US market is indispensable in order to sustain their developmentalism-oriented economic system which is a combination of export penetration and domestic market protection. From the point of view of the US, East Asia, as a fast growing economic area, is strategically important in terms of American's economic participation in the region and East Asia's value as a potential supporter against the EU. We will further discuss the US involvement in the region in section 3. The economic crisis and Japan's frustrated plan for the establishment of the Asian monetary Fund (AMF) showed the degree and intensity of US control of the East Asian political economy system.

We saw from the above discussion the effects of the collapse of the Cold War on the current international economic system. However, it has to be emphasised that in Northeast Asia, these effects have their limitations, considering that Korea is still divided by the political ideology of communism versus capitalism. In the Korean peninsula, the legacy of the Cold War has not totally disappeared. The US army still has its military base in Korea and Japan. Strategic calculation are still important for

the countries involved in the region. Korea and Japan need the US military presence in order to strengthen their military capability and stabilise an uncertain regional security situation. Thus, Korea became a leading weapons importer. This strategic dependence towards the US definitely limits Korea's leverage against the US in economic issues, particularly in processes of market opening and deregulation. Korea's dependency and vulnerability towards America in terms of security have been amplified by economic vulnerability and dependency caused by high export market dependency on the US market. Thus, it can be pointed out that Korea's strategic and economic dependence and vulnerability towards the US have been an important background of Korea's steady and continuous but slow liberalisation and deregulation processes in the 1980s and the 1990s before the economic crisis. The characteristics of society, state, and international system in the PDS can be summarised in the following Table 5-4.

Domestic society	Post developmental state	International system
-Strengthened civil society[11] -Increased influence and politicisation of middle	-Weak state in terms of ideational division inside the bureaucracy -Democratisation after	-Controversial position between multipolar economic system and unipolar system dominated by the US

[11] Cumings argues that Korea has a much more developed civil society than Japan. See Bruce Cumings (1998: 12).

[12] Different from the government-led intrusive industrial policy of the 1960s and 1970s, the industrial policy in the 1980s changed as foreign pressures and domestic dissatisfaction grew fast. Foreign pressure was the result of foreigners' conception that Korea's industrial policy is responsible for unfair trade practices. For foreigners, incentives and direct subsidies from the government were the major reason for unfair competition. Second, in domestic society, the Korean people who were in the process of political democratisation started to feel that the 'growth first policy' which underpinned industrial policies of the 1960s and 1970s brought about unequal regional development and environmental degradation. As a result, from the 1980s, the Korean government changed the nature of industrial policy from direct intervention to a market-supporting system. Thus, industrial policy from the 1980s (Chun and Roh regimes) became a tool for the promotion of science and technology and human resource development. See, Kyung-Tae Lee (1991: 240-42). Under president Young-Sam Kim, industrial policy and financial regulations were abolished and Chang et al. argue that the sudden abolition of these two government regulation were the most crucial reason for the economic crisis, because the absence of sectoral industrial adjustment under industrial policy directly caused

class after 1987 (Randall and Theobald 1998: 213) -More chances for social groups to criticise or influence policy making process by organising active civil movements -Increased leverage and managerial autonomy of Chaebol (Too big to be made bankrupt) (Hoogvelt 1997: 215, Woo 1991: 13) -Increased leverage of organised labour force (militant labour movements in the late 1980s and the establishment of independent 'Korean Confederation of Democratic Trade Unions' in the middle of the 1990s and the participation in 'the Tripartite Committee' after the economic crisis) -Persistent student movements (Sunhyuk Kim 1997: 1142)	1987 (Haggard and Moon 1990: 236) -Coexistence of the legacy of the DS and increasing beliefs regarding the efficacy of the free market system -Intensified friction between developmentalism and neo-liberal free market regime -Zigzag policies between intrusive state and free market -Decreasing state autonomy caused by increasing constraints both from domestic society and international system -Slow and limited liberalisation and deregulation processes -Delayed structural adjustment Under Chun, Roh and Kim because of persistent collusive relations between business and government (Rhee 1994, Sohn et al. 1998) -Weak state in terms of ideational cleavage, diminished autonomy, and reduced number of policy instruments caused by the weakening of industrial policy	-Highly politicised international economic system (New protectionism and reciprocity) (Haggard 1986: 361) -Globalising economy by MNCs, FDI and financial globalisation (Wade 1992: 319) -Coexistence of free trade regime strengthened by the WTO and regional economic integrations and bilateral or unilateral measures -Strengthened neo-liberal regime by the nexus of the US Treasury, the IMF, and Wall Street (Wade 1992: 318) -Persistent Cold War legacy in Northeast Asia

overinvestment and overcapacity in key industrial sectors and capital market liberalisation without supervisory institutes or skills resulted in the currency crisis. In addition, under the Kim regime, the symbols of industrial policy such as the EPB and five year economic planning were also abolished. Furthermore, under the implementation of the five year financial liberalisation policy, policy loans were abandoned. See, Ha-Joon Chang et al. (1998).

	-Changes in industrial policy[12]	

Table 5-4. The inter-relationship among society, state, and international system in the Korean PDS period.

3. The Korean TS: An intensive challenge to the Korean PDS

3-1. The major characteristics of the Korean TS

The Korean TS began with the East Asian crisis. The crisis which started from Thailand finally spread to Korea, which suffered from the side effects of rapid liberalisation in the financial sector[13] in order to be a member of the OECD. As we have seen in section 2, Young-Sam Kim's government initiated the Segyehwa policy in order to dynamically respond to and benefit from the globalising world economy. Liberalisation and deregulation were implemented in order to make the Chaebol more competitive by introducing foreign competition into the domestic market, which although steadily liberalised in terms of policy remained heavily protected by institutional barriers such as the populace's economic nationalism and the 'buy Korean goods campaign'. However, the effects of the Segyehwa policy resulted in enormous inflows of foreign capital borrowed by newly authorised merchant banks and the Chaebol (Sohn 1998: 24). Moreover, as Young-Sam Kim's government pursued liberalisation and deregulation, industrial policy which had been a locus of government planning and co-ordination between the government and private economic sectors lost its raison detre. The sudden absence of economic planning and co-ordinating mechanisms such as industrial policy directly resulted in economic

[13] An official statement from the MOCIE acknowledged the lack of supervision in the financial liberalisation under Segyehwa policy: "Korea's financial liberalisation drive . . . had not been accompanied by a more transparent financial supervisory system" (Mocie 1998: 8).

chaos (Chang et al. 1998: 739-41). As a result, overinvestment in car and steel industries re-emerged under the Kim regime and in the period of the Korean PDS. Samsung, a Chaebol, became a new participant in the car industry despite criticisms and warnings from economists and civil movements. Sambo, also a Chaebol, expanded its steel production capacity and later confronted administrative adversity and potential bankruptcy. At the same time, Kia, a car manufacturing Chaebol, suffered from the side effects of overcapacity in the car industry and also showed possible signs of bankruptcy. Sambo and Kia asked the government to provide special treatment because they were too big to be bankrupt. They argued that their bankruptcies would lead to the total chaos of the Korean banking industry because of a massive increase in non-performing loans.

Korean politicians and businessmen had been enjoying a close relationship by the network of informal politics and corruption or crony capitalism. By influencing the flow of capital from the banking sector to certain favoured Chaebol, politicians received bribes in return. The chairman of the Sambo group built up huge money reserves in order to bribe politicians to induce funds from banks. The important thing that has to be emphasised here is that at this juncture, the Korean government showed the confused and zigzag policy in dealing with the substantially bankrupt Sambo and Kia Chaebol. In other words, the government revealed the very characteristics of the PDS period, that is, zigzag policies between free market and developmentalism-oriented government intervention in the market. The government could neither let the Chaebol become bankrupt nor intervene with further preferential or aid funds for the suffering Sambo and Kia Chaebol. Foreign investors started to worry about Korea's economic situation, observing the government's disorientation and inability in dealing

with the ailing Chaebol. At this time, the government also suffered from the lame duck president Kim. The Minister of Finance and Economy tried to cover the impending economic crisis caused by the ailing Chaebol and excessive foreign capital inflows worrying about the bad effects of the economic hardship on the coming presidential election (Sohn 1998: 26). The currency crisis in Thailand occurred at this time and foreign investors started to worry about the potential insolvency in Korea. And finally they started to withdraw their capital from the Korean market. In order to defend the Korean currency, the BOK entered into the foreign exchange market and just spent foreign exchange reserves without any defensive effects. The Korean government inevitably asked for help from the IMF and Korea lost its economic sovereignty by letting the IMF make all macroeconomic decisions and by accepting the neo-liberalism-based IMF reform package[14] for economic stabilisation and structural adjustment. More specifically, the Korean government made an agreement with the IMF to carry out the following reforms: elimination of trade-related subsidies; phasing out the Import Source Diversification Program; elimination or change of Special law limiting imports; elimination of ceiling on foreign investment and restrictions on mergers and acquisitions (M&A); allowing foreign banks and brokerage' subsidiaries; and full liberalisation of the money market. (Sohn et al. 1998: 56-57).

[14] Randall and Theobald briefly summarise the nature, major contents, and criticism of the IMF structural adjustment programmes: "Structural Adjustment Programmes . . . were strongly influenced by neo-liberal thinking. Beyond statbilisation they have favoured a reduction in the direct role of the state, removal of trade barriers and an emphasis on export-led growth. Thier requirements have tended to include (sometimes drastic) devaluation of the currency, reduction of government expenditure especially on welfare, removal of price controls, and imposition of wage ceilings . . . (and) privatisation of government-run enterprise . . . But the prescriptions have been doctrinaire and insufficiently responsive to the particular circumstances of individual countires" (Randall and Theobald 1998: 160).

Thus, in the period of Korean TS, we find coercive learning and coercive isomorphism from the international neo-liberal regime. Bureaucrats' belief systems were changed. The divided belief systems of the bureaucracy between the free market and government intervention finally disappeared as Dae-Joong Kim, inaugurated as the seventh Korean president, strongly pursued neo-liberal economic reforms. The belief systems of the bureaucracy became based on neo-liberal economics and the free market system. The economic crisis was not only a material but also an ideational battlefield between Anglo-American capitalism and East Asia's developmental capitalism (Higgott 1998: 9). Lee suggests the ideational changes of the Korean state: "The Korean reform package apparently aims at moving to an Anglo-American type of capitalism . . . This means of course a complete break-away from the developmental state" (Jaymin Lee 1999: 154).

Thus, it can be argued that learning and ideational changes took place in the TS period. On the other hand, financial institutions were forced to adjust towards neo-liberal reforms. Thus, operational transparency in deciding investment capital distribution and administrative autonomy from the government were pursued and the BOK finally became independent after a long struggle to be independent from the MOFE. Moreover, under the corporate reforms, the Chaebol were also forced to abandon their developmental characteristics such as high debt-equity ratios, inter-firm loan guarantees, excessive diversification of businesses and unclear financial statements. In sum, in the period of the Korean TS, we can witness coercive learning and the coercive isomorphism from the international neo-liberal regime.

The nature of economic policies also dramatically changed in this period. As we have seen in sections 1 and 2, the earlier liberalisation and deregulation processes were either for show-window display in order to evade foreign pressures against the heavily protected Korean market or slow, limited changes in which the nature of developmentalism, such as the government initiated liberalisation policy, was untouched or unimpaired. However, in the TS period, the policy changes towards liberalisation and deregulation have been not only rapid and fundamental but also comprehensive and massive. Changed belief systems geared to neo-liberalism propelled full liberalisation and deregulation. The extent and degree of market opening and government deregulation almost reached the level of the OECD countries. In particular, regulations towards IFDI have been totally abandoned. We will more specifically investigate the liberalisation process of FDI policy in this period in Chapter 6.

In the period of the TS, some scholars anticipate the absolute demise of the legacy of developmentalism in Korea's foreign economic policy. However, it can be argued that such speculation may have gone too far. We need more time to draw any firm conclusion because, even though belief systems have changed, the institutional setting which is deeply ingrained in developmentalism cannot disappear in the short term. Because of institutional resistance and inertia, institutions last longer than belief systems. In the Korean TS, we can detect institutional resistance and inertia by observing a set of circumstances: the Korean populace's strong and persistent economic nationalism (Neurath 1988: 100-101, Jones 1997: 78); the Chaebol's reactive response towards the government and the IMF led structural reform process; the persistent and unimpaired 'export-driven growth first policy' which is a core part

of Korean developmentalism; the possible re-emergence of the selfish egoism of bureaucracy which is now dormant under the strong presidency of Dae-Joong Kim.

First, the Korean populace is deeply worried about economic dependency by observing indigenous corporations being cheaply sold to foreign owners because of the devalued Korean currency and the corporations' liquidity problems under the IMF-led contractionary macro-economic policy. As Randall and Theobald point out, "[g]lobalisation may even foster nationalism. This is especially so where national economic difficulties can successfully be attributed to the machinations of other states" (Randall and Theobald 1998: 262). Second, the Chaebol have tried to buy time in order to evade government-led corporate reform. The Chaebol are basically following the prescription suggested by the government reform plan. Thus, they have reduced their debt to equity ratio and provided consolidated financial statements including for all subsidiaries of the group. Moreover, the Chaebol abolished inter-firm debt guarantee as instructed by the government and reduced the number of their subsidiaries by focusing on specific industries in which they have comparative and competitive advantage over foreign competitors. However, they are resisting the so-called 'big deal' which means inter-Chaebol swaps of industries in which they do not have international competitiveness. More specifically, Daewoo was supposed to have its electronics industry handed over to Samsung and in return, Samsung was supposed to have its car industry handed over to Daewoo. However, the deal fell through as Daewoo began suffering from liquidity problems and as a result, Samsung restarted its car manufacturing later in 1999. The Chaebol's main argument is that it is absurd for the Korean government to intervene in the market system again, because the Korean government is pursuing neo-liberal, free market based economic reforms under IMF

auspices. Put differently, the Chaebol are arguing that the 'big deal' is basically a policy which contravenes the free market principle which is pursued by the government itself.

Third, the 'growth first slogan' has not perished even though the developmental economic system is being dismantled by neo-liberal reform. Even in the seriously contracted economy with an unprecedentedly high unemployment rate caused by the economic crisis, social welfare or 'quality of life' issues have never been a priority of government public policy. Only economic development or growth has been the primary objective of the Korean government throughout Korean history. The persistence of 'the growth first mentality' could mean that the core part of developmentalism is still rooted in economic institutions and bureaucrats' belief systems. Fourth, before the economic crisis, Korean bureaucrats enjoyed autonomy and privilege. The use of various discretionary policy instruments and relatively the insulated policy making process provided them with a comfortable space where they could enjoy privilege and engage in corrupt activities. However, as the economic crisis struck and as bureaucrats' inability and negligence in managing and coping with the crisis were revelaed, the Korean bureaucracy became dormant and submerged in order to evade the harsh criticism directed against them. However, as the economy recovers quickly and as Dae-Joong Kim's government enters into its second half period, we cannot simply deny the possible re-emergence of the old selfish, corrupt, and privilege-seeking bureaucracy.

Moreover, besides institutional resistance, there are other circumstances that suggest that speculation of the demise of Korean developmentalism in the TS period is not

persuasive and not feasible. First, foreign belief systems are unchanged and accordingly, foreigners still see Korea as a prototype of the developmental state even though Korea intensively undertook IMF-led, neo-liberal reforms. In order to attain a successful momentum of reform, foreign support of Korean reform efforts are necessary. And, of course, the support and recognition of America and neo-liberal regime are especially indispensable factors which will ultimately determine the performance of Korean reforms. Although Korean bureaucrats' belief systems are changed, without ideational changes of foreigners, Korea's transformation from the TS to the neo-liberal state (NLS) will be an uneasy process.

Second, there could be a squeezed and drifting Korean state between civil society requesting Keynesian welfare policies and continuous external pressure for more market opening and deregulation from the international system. As we have seen, the core part of developmentalism, that is, the 'growth first policy' has not been removed even after neo-liberal reform. And as a result, Korea's social welfare system and a national consensus for fair and equal distribution are shamefully underdeveloped. High rates of unemployment and underdeveloped social welfare could lead to social unrest. Furthermore, an increasingly unequal distribution of wealth under neo-liberal reform could also exacerbate the already unstable socio-political foundation of the Korean state. Social dissatisfaction and possible social unrest could prevent the IMF and state-led neo-liberal reforms in Korea. On the other hand, the neo-liberal regime constantly claims more concessions from Korea in terms of market opening and deregulation. Thus, Korea is in " a complex game in which the internal and external consequences of governments' policies are tightly intermeshed" (Andrews and Willett 1997: 505) and we cannot exclude the possibility of a squeezed and disoriented

Korean state, because the Korean government is located in the middle between welfare requesting-domestic social groups and the insatiable neo-liberal regime towards Korea's liberalisation and deregulation process.

Third, as we will see in the following section, the Korean strong state has been reinstated after the reform process. The government's strengthened supervisory instruments in the financial sector and the populace's wide support for the government in pushing Chaebol and financial sector reform led to a paradoxical situation of a reinstated strong Korean state. Finally, as Lee points out, we can ask the following question: in conjunction with its developmental stage, is it not too early for Korea to abolish developmentalism? "Korea in 1995 is approximately at the place of Japan in the mid-1960s. Japan was still a strong developmental state in the mid-1960s" (Jaymin Lee 1999: 155-56). Having seen the institutional resistance and other complicated circumstances, it can be insisted that the assertion of the end of Korean developmentalism after the economic crisis is not reasonable. This is the reason why the future direction of the Korean TS cannot be simply anticipated. As emphasised several times in this Chapter, institutional changes need more time than ideational changes and we have no choice but to wait and see whether the Korean TS will return to the PDS or transform into the neo-liberal state (NLS). The major characteristics of the Korean TS period can be summarised in the following Table 5-5.

	The Korean TS period
IFDI OFDI	1998-To present 1998-To present
	-**Coercive learning** and **coercive isomorphism** from the neo-liberal regime

	-Change of bureaucrats' belief systems from developmentalism to neo-liberalism -**Reconvergence of belief systems** inside the bureaucracy -Contradictory institutional coexistence between facilitated institutional changes by changed belief systems and institutional resistance and inertia -**Rapid, fundamental and comprehensive policy changes** which are commensurate with changed belief systems -Full liberalisation and deregulation process (financial, corporate, labour, and public sector reforms) -Possible survival of embedded developmentalism (Higgott 1998: 28) -Need for new concept of industrial policy[15] -Korean economy's bifurcation from the Japanese model of developmentalism

Table 5-5. The major characteristics of the Korean TS period.

3-2. Society, state, and international system in the Korean TS

The aftermath of the economic crisis resulted in a diminished middle class. Before the crisis, almost 85 percent of Korean people regarded themselves as middle class, but, a survey conducted by Hyundae Institute of Economy in 1998 showed that only about 35 percent now saw themselves as middle class (The Korea University Weekly

[15] Linda Weiss argues that "[i]n so far industry itself is constantly changing, industrial policy must of necessity be creative. Hence it cannot be defined once and for all in static, snap-shot terms. So many commentators have looked 1960s-style Japanese industrial policy in the 1990s . . . It must be stressed however that the very capacity for industrial policy is one that requires the state to constatntly adapt its tools and tasks" (Weiss 1997: 19). In respect to Weiss's argument, it can be argued that new concept of Korean industrial policy has to be focused on efficient financial supervision and effective management of the exchange system in order to cope with the ever unstable international financial system caused by floating exchange rate system and astonomically increased speculative capital. Moreover, rather than direct sectoral interventions and price distortions in goods and financial markets, the Korean state has to try to achieve advanced human resource development particularly for the development of information and telecommunisation industries which will determine the winners and losers in the first century of the new millenium. See MOFE (1999d: 26,28).

10. 5. 1999: 5). Labour reform which laid the foundation for legal lay-offs in the name of labour flexibility produced an unprecedentedly high rate of unemployment. Corporate reforms also led to a sharp reduction of labour costs by simply reducing the number of employees. In addition, the IMF-led contractionary fiscal and monetary policy brought about massive bankruptcies of the SMEs (Park 1999: 135). Financial reform, which is mainly focused on the improvement of the capital adequacy ratio, also led to a credit crunch in the real economy. As a result of the serious credit crunch, the SMEs could not obtain even company running costs, needless to say, investment capital from the banks, and the bankruptcy ratio in this sector rose dramatically. The close to 10 percent unemployment rate coupled with reduced wages of remaining employees finally led to a sharp reduction in the size of the middle class in the Korean TS period.

A diminished middle class means a contraction of civil society and the weakening of its leverage against the state. The trade unions could not avoid the impact of the economic crisis. The Korean Confederation of Democratic Trade Unions (KCDTU) which was established under the Young-Sam Kim government steadily improved its organisational foundation and it could produce a candidate in the presidential election in December 1997. However, the KCDTU failed to attain the expected support from the constituency. The newly elected president Dae-Joong Kim revised the labour laws and formed the so-called 'Tripartite Committee' which consists of representatives from the state (politicians), business, and labour in order to overcome the dark and heavy shadow of the economic crisis by harmonising the different interests from these three major economic actors. However, it was labour that lost more than the state and business, because the agreements of the Tripartite Committee allowed the legalisation

of lay-offs, while the Committee failed to provide enough social safety nets for those just laid-off. Labour requested the reduction of working hours instead of lay-offs. However, their request was not accepted by the Committee. Thus, the representatives from labour were harshly criticised and an organisational division emerged between top leaders and ordinary union members. By initiating the formation of the Committee, on the one hand the state was able to control labour and prevent nation-wide or militant labour strikes, and on the other hand the state was capable of managing business by providing labour market flexibility as a carrot and strongly pushing the Chaebol to facilitate corporate reform as a stick in return.

Meanwhile, student movements under the Dae-Joong Kim regime almost disappeared. The sudden tranquilisation of student movements derived mainly from three reasons. First, as Dae-Joong Kim who was a symbol of Korea's progress towards democratisation and the Korean people's struggle against authoritarianism became president, student movements lost their primary objective of pressing for democratisation. Second, as Korea's civil movements greatly developed both qualitatively and quantitatively, student movements lost their identity and raison detre as leader and firm base for social movements. Third, as job opportunities for students became seriously reduced due to the economic crisis, students had to focus on preparing for employment. Moreover, this sense of danger facilitated the weakening of student movements as the core and active members of the movements became more distant from ordinary students.

The Korean TS which began with the inauguration of president Dae-Joong Kim showed the return of the strong state as we have seen in section 3-1. The ideational

cleavage inside the bureaucracy had been removed by the neo-liberalism-oriented structural adjustment driven by the IMF and the Korean TS. The transformation into the TS was definitely initiated by the IMF package and its neo-liberalism based prescription. Thus, pressure from the international system was a major background for the transformation of the Korean PDS into the TS. However, it has to be emphasised that the Korean state was not passive in undertaking structural adjustment. The Korean state dynamically exploited foreign or external pressures in pursuing delayed domestic reforms (Mathews 1998: 748, 752) of the PDS period such as labour reform. The IMF did not request for labour reform (Park 1998: 3). However, the Korean state internalised the external pressure caused by the currency crisis in order to propel delayed domestic reforms. An official paper from the MOFE clearly shows this situation:

> Some observers argued that the Korean economy was unfortunately engulfed by the foreign exchange crisis . . . However . . . President Kim Dae-jung identified long-standing structural problems in the financial, corporate, labour and public sectors as the causes of the economic crisis rather than a temporary shortage of foreign reserves (MOFE 1999d: 8).

Thus, it can be argued that the state was not reactive and not passive in dealing with the aftermath of the currency crisis. On the contrary, the state was active and dynamic and manipulated the impact of the currency crisis in order to reinstate its weakened position against civil society and the Chaebol and to consolidate its ideational coherence inside the bureaucracy. In a word, the Korean TS period is a phenomenal space in which the return of the strong state took place. As Randall and Theobald insist, "an effective rolling back of the state in itself requires a high level of state capacity" (Randall and Theobald 1998: 160). From the same understanding, Hoogvelt

clearly illuminates the paradox of globalisation and the background of the return of the strong Korean state:

> [N]ational governments adjust their economies to globalisation by regulating for deregulation. It is this confusion over regulation and deregulation that explains why there is so much controversy . . . between those who hold so called declinist views of the nation-state, and those who claim to observe a strengthening of national authority (Hoogvelt 1997: 139).

Scholte also suggests the same argument more specifically:

> [G]overnments have facilitated global firms' operations and profits with suitably constructed property guarantees, investment codes, currency regulations, tax regimes, labour laws and police protection. States have also provided much of the regulatory architecture for global finance . . . In short, a great deal of globalisation would not unfold . . . if states did not sponsor the process (Scholte 1997: 441).

It has to be emphasised that these roles of the state are what the Korean state is trying perform and exercise under neo-liberal reform and it is these new roles that are strengthening the Korean TS' autonomy, capacity, and ideational coherence by providing the bureaucracy with neo-liberal economic ideas, various policy instruments, and new specialities in managing global corporations and finance.

The Dae-Joong Kim regime has its internal political weakness caused by its uncomfortable coalitional partner or the so-called 'shared government' with prime minister Jong-Pil Kim. Before the presidential election, both Kims agreed to make a political pact containing the promise of a coalition between the two political parties led by both Kims. Their parties were based on the regional division of South Korea. In order to win the election, the coalition was absolutely necessary. And after the election, both Kims participated in the regime by assuming the roles of president and prime minister. However, the coalition was basically unstable because of the differences in each party's political ideology and party members' political

background. The National Congress for the New Politics (NCNP) led by president Kim is basically a reform-oriented party consisting of former opposition party members who worked for the democratisation of Korea. The United Liberal Democrats (ULD) led by prime minister Kim, on the other hand is a conservative party which is constituted by former ruling party members. Thus, the coalitional limitation of Dae-Joong Kim's government have been a major obstacle to quick and efficient policy responses towards internal and external pressures, because the shared government needs more time to reach an agreement or to compromise over differences in policy primacy and interests.

However, it has to be recognised that this coalitional limitation of the regime did not constrain the factors underpinning the strong state, that is, autonomy, capacity, and ideational coherence. State autonomy was strengthened by a set of factors: first, the retreat and decreased leverage of the middle class driven by massive lay-offs and reduced wages; second, the weakened trade unions as they were voluntarily incorporated into the Tripartite Committee which is initiated and managed by the government; third, the Korean government could be isolated from societal groups by manipulating the presence of IMF. The government succeeded in the strategic internalisation of external pressures in order to reinstate its autonomy from domestic society; fourth, it was the state apparatus that has the capability to deal with the unprecedented scale and impacts of the economic crisis. Thus, the state's bureaucratic organisations and their members became rejuvenated in the TS period by not only initiating the entire economic structural adjustment program but also by showing capability in the recovery of the ailing economy.

State capacity, which varies according to the degree of availability of policy instruments, also strengthened in the TS period. The economic crisis was a blessing in disguise (Park 1998: 2-3). The Korean TS actively relied on the presence of the IMF and maximised the benefits of the populace's support towards Chaebol and financial sector reforms. The massive mental shock and economic pain borne by the populace under the contractionary macroeconomic policy and the highest unemployment rate thus far played a crucial role in consolidating the leverage of the state against the Chaebol and unhealthy financial institutions. Put differently, the Korean TS re-gained its economic legitimacy and leadership role in reforming the Chaebol and the financial sector by obtaining a national consensus for the reforms and the support from trade unions, the middle class, and civil movement groups (Park 1999: 133). The establishment of 'the Financial Supervisory Commission' finally gave the state efficient and strong policy instruments such as the order for closures or mergers of ailing financial institutions. The Chaebol also received massive pressure to undertake intensive and wide ranging reforms. Reduction of the number of their subsidiaries, specialisation to a limited number of competitive industries, consolidated financial statement which shows the whole group's financial condition, improvement of minor stock holders' rights, reduction of its debt ratio to within 200 percent, and prohibition of illegal internal trades among the subsidiaries were strongly recommended. The Chaebol which fail to follow the government recommendations will suffer from liquidity problems as the government will regulate or even constrain capital flows from the banking sector to resistant Chaebol.

The international system in the Korean TS became much more unstable. The reasons behind the instability of the global economic system were twofold: an unstable global

exchange rate regime (Dieter 1998: 22); and financial globalisation or the enormous increase of short-term speculative capital. After the end of the fixed exchange rate system sustained by the Bretton Woods system in the early 1970s, a floating exchange rate system was adopted and as short-term capital dramatically increased, developing countries which lacked the protective skills and foreign reserves such as in Latin America and Eastern and Central Europe constantly suffered from recurrent currency crises (Michie 1998: 1, 6). And in 1997, the countries in East Asia finally became the victims of globalised speculative financial industries. In 1994, the scale of the hedge funds reached 20-35 trillion dollars. Considering that America's annual GDP is six trillion dollars and the total sum of all the nations' foreign reserves in the world is just one trillion dollars, the over-accumulation of speculative capital and its destructive impact on the foreign exchange markets can be easily understood (Sohn 1998: 19). Despite this destructive effect on the world economy, collective efforts to regulate globalised finance or speculative capital have been limited. Cohen suggests two major reasons preventing collective control of global finance among countries: first, domestic economic groups which benefited from the globalised finance will further influence the state's policy making process in dealing with global finance. Second, because of the calculation of relative gains from global finance, states are unable to easily make a collective decision to manage or controll global finance (Cohen 1996: 290). All the developing countries which experienced the currency crisis adopted IMF led economic structural adjustment programmes which are firmly based on the principles of neo-classical economics and neo-liberalism. Moreover, it has to be reminded that "[t]he IMF, the World Bank, and the WTO are administrative structures, they are regulatory bodies operating within a capitalist system and responding to dominant economic and financial interests" (Chossudovsky 1997: 16).

Thus, it can be argued that the international system in the Korean TS period is witnessing intensified and inexorable pressures from the neo-liberal regime and globalised speculative capitals.

The international economic system became highly politicised even though the WTO promoted its dispute settlement mechanism (DSM). Under the DSM, small and medium sized countries can take disputed issues to the DSM of the WTO and in this structure, the possibility of unilateral retaliation and unfair treatment from the big countries is diminished. However, it is the unequal economic size and uneven structural economic vulnerabilities that make small and medium sized countries subordinate to big countries. Haggard and Moon suggest three criteria which make a state vulnerable and subordinate: dependency on foreign markets; sensitivity to external changes such as oil prices; and reliance on foreign capital and technology (Haggard and Moon 1997: 55-56). For example, Korea's dependency ratio towards export is more than 70 percent and this economic structure makes Korea vulnerable and sensitive to changes in foreign markets and the international economic system. Korea is highly sensitive towards changes in production factors in world markets and still relies on foreign technology and capital. Thus, in terms of Korea's economic structure, the term of economic interdependence is irrelevant. The Korean political economy is not only heavily dependent on foreign markets and technologies but also sensitive to changes in the price of capital and crucial natural resources.

The frustrated plan to establish the AMF shows the politicisation of the international economic system. The neo-liberal regime led by the US and the IMF rejected the Japanese government's proposal for the AMF (Dieter 1998: 16). The US could not let

Japan and other East Asian countries have their own monetary fund which will ultimately strengthen Japan's economic position in the region by making the Japanese currency the regional currency and will further exclude America's economic involvement in the region. In summary, America's political calculation was a major barrier in forming the AMF and the reason why East Asian countries conformed to the US objection to the AMF lies in their structural economic vulnerability caused by heavy dependence on America's domestic market. Thus, it can be argued that the international economic system in the Korean TS period can be characterised by an unique mixture of the free market oriented trade and investment system led by the WTO and the neo-liberal regime and highly mercantilistic unilateralism or regional integrations. The inter-relationships among society, state, and international system in the Korean TS period can be summarised in the following Table 5-6.

Domestic society	Transitionary state	International system
-Weakened bargaining position of labour and Chaebol under the severe economic contraction and unprecedented national crisis caused by the currency crisis -Establishment of the Tripartite Committee resulted in the weakening of labour -Diminished middle class -Increase in unequal income distribution -Tranquillised student movements	-Reinstated strong state in order to manage the economic crisis (Randall and Theobald 1998: 264) -The state is the only and last resort which has capability to manage the crisis -Ironically, globalisation and the neo-liberal regime did not reduce but brought back the strong state by providing autonomy, capacity, and ideational coherence (paradox of globalisation) -The state regained economic legitimacy by	-Intensified pressures from the neo-liberal regime and globalising world economy -Unstable and shaky international exchange regime caused by dramatically increased speculative, short-term capital -Financial globalisation threatens developing countries which lack defensive skills and foreign reserves -The mixture of free trade and investment system championed by the WTO and mercantilistic

	undertaking Chaebol and financial sector reforms	unilateralism or regional economic integration

Table 5-6. The inter-relationships among society, state, and international system in the Korean TS period.

4. Sub-conclusion: A theory of developmental stage?

Korea's economic and socio-political trajectory from 1962 to 1998 is a dynamic and precious history in which various theoretical interpretations and practical prescriptions for economic growth and socio-political development have harshly competed with each other in order to occupy the dominant position. The entire debate eventually divided into two opposite groups: 'neo-liberalism and developmentalism. The conflicts between the two have produced continuously alternating winners and losers in exact accordance with the economic fortunes of Anglo-American free market capitalism and East Asian developmental capitalism. The theory of the economic cycle shows that every economy has its economic cycle of ups and downs. Thus, from the viewpoint of this economic cycle theory, there is no real winner or loser between the two contending approaches. More specifically, in the 1980s, when East Asian countries, particularly, Japan and the NIEs enjoyed their economic heyday, the theory of developmentalism seemed to be a winner. However, as the Anglo-American model based economies of the US and UK recovered and showed their strength and prosperity in the 1990s, neo-liberalism seems to be a winner now. Moreover, there is an approach which focuses on the ideological pendulum:

> in Dani Rodrik's words, "excessive optimism about what the state would be able to accomplish was replaced by excessive pessimism." Rodrik suggests further that, having now surmounted 'excessive pessimism," we are "on the threshold of a serious reconsideration of the role of the state in development." (Evans 1997: 83).

However, a crucial disadvantage of this approach is that it cannot suggest a micro explanation. Thus, questions like how Korea achieved rapid economic development, how the Korean economy suddenly turned into crisis and how it recovered from the crisis have to be answered by more detailed and rigorous research. Thus, any research on Korea has to incorporate international systemic influences, dialectic interactions between civil society and the state, and the institutional and ideational effects on the Korean economy. In the international system, the Cold War order was a determining factor of Korean DS's economic policy. After the collapse of the Cold War structure, economic globalisation or free marketisation became a determining systemic influence. Without regarding the influence of the bipolar Cold War order and economic globalisation, any research on Korea's economic and socio-political transformations would be imperfect. Also, without considering the constant changes in power relations between the Korean state and civil society, any research will lack persuasive power. So far, much research has adopted these three approaches. However, it is difficult to find research that has adopted ideational or institutional approaches. Even though some researchers like Haggard use the term, 'institutional' in their approach, they identified it in purely statist terms. Even though some researchers have argued that both neo-liberalism and developmentalism are economic ideas or belief systems, they did not pursue an approach in their research that focuses on the close relationship between ideational cleavages or changes within the bureaucracy and Korea's economic changes and transformations. The contribution of this thesis, thus, lies in its exploration of ideational and institutional approaches to studies of comparative politics and IPE.

The unique argument of this chapter is that we need to recognise a theory of developmental stage. Developmentalism and the great role of the state have to change their contents and adjust to constantly changing environments in society, the state, and the international system. Developmentalism played a great part in Korea's economic development process, particularly in the DS period, and now, in the TS period, it has been forced to be readjusted by the challenges from a globalising economy and the neo-liberal regime. As we have seen in section 3, in the PDS period, delayed structural reforms and inflexible industrial policies which were deeply rooted in the belief systems of developmentalism and failed to adjust to the changing environment finally resulted in the economic crisis in 1997. Thus, it can be argued that even though the economic crisis was basically exogenously ignited by an unstable international financial system comprising an unstable exchange rate system and vastly increased speculative capital, such external factors could only have affected the entire Korean economy because of endogenously embedded discrepancies within the Korean economy. In other words, delayed economic structural adjustments in relation to the Chaebol and the financial sector in the PDS period ultimately produced an underdeveloped financial sector and the Chaebol' excessive dependency on domestic and foreign loans. Overinvestment and overcapacity, funded by the Chaebol's enormous borrowings from domestic and foreign financial institutions, finally resulted in successive bankruptcies of several Chaebol, and the Chaebol's bankruptcies, in turn, exacerbated an already unstable domestic financial market and Korea's credibility in the global financial market. As the currency crisis emerged in Thailand and Indonesia, foreign investors suddenly and massively withdrew from the Korean financial market. This is a brief summary of Korea's path to economic crisis. Thus, it can be argued that the economic crisis was an inevitable outcome of a combination of

the Korean economy's structural problems which defied adjustment or reform during the PDS period and unstable global financial markets.

Thus, the lesson of the economic crisis for Korea is that the state and economic globalisation are equally important. They are not in zero-sum game but have a symbiotic relationship. As the country's developmental stage is upgraded, its economic policy has to constantly change and readjust in order to overcome pressures from both the domestic and international system. Flexible and unified economic policy can be obtained only when bureaucrats and politicians are flexible and unified in economic objectives. Here, the importance of institutions and belief systems emerges. Belief systems' changes and adjustments towards a continuously changing environment need more time than policy changes. Institutional changes and adjustments towards a changing environment need far more time than ideational changes. As we have seen, in the PDS period, belief systems which were deeply geared towards developmentalism persisted, despite pressures and criticism of the side-effects of developmentalism such as unfair protectionism, bureaucrats' authoritarianism, the overgrown Chaebol, the underdeveloped financial sector and SMEs. Thus, the ideational resistance of developmentalism in the PDS period produced delayed, slow, and limited reforms in the Chaebol and the banking sector. More importantly, the ideational persistence of developmentalism in the PDS period continuously preserved collusive relations among bureaucrats, politicians and big business.

The rigid economic idea of developmentalism also failed to adjust to changes in the international system. As the Cold War order disappeared and economic globalisation

and unlimited economic competition among nations intensified, developmentalism which heavily protects domestic markets and aggressively penetrates foreign open markets cannot be sustained. However, the Korean PDS constantly protected domestic markets and preserved a high dependency ratio on exports. Foreign pressures and criticisms enormously increased, but Korea dealt with these pressures only through superficial and formal liberalisation policies with no substantive effects. In a word, Korea unpolitically dealt with a politicised international economic system. Thus, in some sense, the inexorable neo-liberal reform processes led by the neo-liberal regime after the onset of economic crisis represents an inevitable punishment from the US, which mostly suffered from Korea's unfair, developmentalism-oriented trade and investment strategy. This shows the importance of flexible changes of policy and belief systems in accordance with a state's economic developmental stage.

The theory of developmental stage shows that a state has to constantly adjust its economic policies and ideas as its economy grows. However, this does not mean that the role of the state has to be diminished as the economy grows further. So far, several scholars argue a theory of developmental stage different from the theory which is maintained by this Chapter. The two theories share the understanding that the state's role has to be decreased as the economy grows further. However, the crucial difference between the two is that the former theory argues for the absolute retreat of the state, as its economy passes the take-off period and grows further, while the latter theory argues that the excessive role of the state needs to be diminished but the state has to be flexible and effective enough to efficiently cope with domestic and international challenges and pressures.

Johnson argues the former theory: "One of the things a state . . . must do is develop a market system, and it does this to the extent that its policies reduce the uncertainties or risks faced by entrepreneurs, generate and disseminate information about investment and sales opportunities . . . Once a market system has begun to function, the state must then be prepared to be surprised by the opportunities that open up to it, ones that it never imagined but that entrepreneurs have discovered" (Johnson 1987: 141). Also, O argues that "the role of government was to help until the corporation became an international unit and was able to compete internationally. Afterwards, it shifted from a government-oriented approach to a private-oriented approach" (O 1995: 350-51). However, it has to be emphasised that these arguments are unsuitable in an era of accelerated and intensified economic globalisation and the neo-liberal regime. Song suggests three contradictions of neo-liberalism oriented economic globalisation: contradiction between economic interdependence and harsh economic competition among states; contradiction between the government's deregulation process and unchecked challenges from free marketisation and global financial integration; and finally the contradiction between economic growth and social welfare (Song 1995: 150-156). In other words, as Rodrik clearly points out, "[t]he question, therefore, is how the tension between globalisation and the pressure to mitigate risks can be eased" (Rodrik 1997: 27).

These discrepancies which accompany economic globalisation and globalising neo-liberalism uncover the need for a state role in the globalisation period. Thus, it can be argued that the old developmental stage theory which insists on the retreat of the state after the domestic market system is developed is irrelevant in the globalisation period. The globalisation process needs the state to paly a role. As we have seen in section 3-

2, the Korean TS regained its autonomy, capacity, and ideational coherence by managing the stabilisation of the currency market and the financial market. Moreover, by actively exploiting external pressures, the Korean TS ambitiously undertook significant domestic reforms in the corporate, labour, and public sectors. The Korean TS's roles during the economic crisis were the pursuit of neo-liberal, global standards in the financial and corporate sectors. However, as the underdeveloped social welfare system and the possible dependency of the Korean economy on foreign capital emerged in the TS period, the Korean state could be squeezed and disoriented between domestic requests for the improvement of social welfare and external pressure to rapidly open domestic markets much further. As Hirst points out, "[t]he danger of recklessly pursued internationalisation without sufficient regard to its social effects is that there will be revolts against an open international economy" (Hirst 1997: 425). This circumstance shows that "[t]he real choice for government is not how best to fight globalisation but how to manage it, which will require creative policies both at home and abroad. It is ironic: the age of globalisation may well be defined in part by challenges to the nation-state, but it is still states and governments . . . that will determine whether we exploit or squander the potential of this era" (Haass and Litan 1998: 6).

Thus, the new theory of developmental stage argues that the state's role is not to be excessive but to be flexible and in order to be flexible, bureaucrats and politicians' pivotal roles in economic governance, financial supervision, and policy making and decision making have to be preserved, because it is only the state which can effectively cope with various challenges and side-effects of economic globalisation towards domestic society and the state itself. This means that the economic

globalisation process and the role of the state is compatible. At the moment, it is hardly possible to anticipate whether the Korean TS will ultimately lead to the neo-liberal state (NLS) or go back to the PDS. However, one thing that is clear is that Korea's liberalisation and deregulation processes will continue in order to make the Korean economy more compatible with neo-liberal standards and also, the Korean state's role will persist in order to flexibly cope with or dynamically take advantage of the challenges and benefits of economic globalisation.

In summary, state and market relations in the globalisation period do not have to be incompatible (Martinussen 1997: 265-66). On the contrary, their relations have to be symbiotic. The lesson of the Korean TS period shows that on the one hand, strong and turbulent pressures from the neo-liberal regime and economic globalisation have to be buffered and checked by the strong state, and, on the other hand, excessive and discretionary government intervention into the market system and the prolonged legacy of bureaucratic authoritarianism have to be balanced by the free marketisation and the neo-liberal regime. Stiglitz clearly points out this complementary relationship: "[t]he pragmatic framework . . . entails a balancing of the strengths and limitations of markets and government, and the determination of how they can best complement each other" (Stiglitz 1996: 17).

Chapter 6.
Korea and Japan's foreign economic policy on FDI compared

Contents

In this chapter, Korea and Japan's historical changes and transformations of FDI policies will be elaborated. So far, the literature on Korea and Japan's FDI policies reveals an inconsistency arising from two distinctive and contrasting observations, that is, developmental characteristics of FDI policies versus continuous deregulation or liberalisation processes of FDI policies. This chapter aims to explain why these contrasting interpretations and observations exist and to show why we need the concept of 'the post developmental state period' in order to get a clear picture of historical changes and transformations in Korea and Japan's FDI policies. As we have seen in Chapter 4 and 5, both Japan and Korea have experienced socio-economic and political transformations from the DS to the PDS (Japan) or to the TS (Korea). In this chapter, Korea and Japan's FDI policies are used as a case study to explain why the concept of 'developmentalism' gives only a partial understanding of Japan and Korea's historical, socio-economic, and political trajectories and to suggest why the conceptual tool of 'post developmentalism' is needed to understand both countries' outstanding transformations in FDI policies. Thus, this chapter will be divided into the developmental state period, the post developmental period, and the transitionary state period.

In the DS period section, the distinctive characteristics of developmentalism-oriented FDI policies such as the preference for licensing over inward FDI (IFDI) in the process of technology transfer, the preference for joint ventures over wholly owned IFDI in the ownership structure, and strategic or prohibitive outward FDI (OFDI) development will first be explained. This will followed by a discussion of the role of the state in controlling, regulating and planning FDI deployment. In contrast with this mercantilistic DS period, the IFDI policies in the PDS are basically in line with

continuous liberalisation and deregulation processes. As we have seen in Chapter 4 and 5, in the 1980s, both the Korean and Japanese state tried to cope with the increasing pressures from not only domestic society but also the international system. In response to these pressures, liberalisation and deregulation policies were adopted and pursued in relation to IFDI. However, the pace and extent of the liberalisation processes were so piecemeal and incremental that the real effects of liberalisation policies were greatly limited. As emphasised several times in this thesis, the PDS period is characterised by the contradictory co-existence of liberalised IFDI policies and unchanged belief systems and institutions which are strongly embedded in mercantilistic developmentalism. Thus, in the section which deals with the post developmental state period, the research will be centred on the ever-increasing conflicts between consecutive liberalisation processes on the one hand and persistent belief systems and institutions that are deeply entrenched in developmentalism on the other. In other words, in the PDS period, we will concentrate on the persistent and recurrent clashes between state intervention (developmentalism) and the free market system (neo-liberalism) by investigating the increased rupture between deregulated FDI policies and rigid belief systems and institutions. This historical period can be regarded as a continuously frustrated domestic structural adjustment period. This extended and postponed structural adjustment finally led to a crisis stage in which previously incremental and piecemeal liberalisation and deregulation processes suddenly turned into rapid and fundamental ones caused by economic recession in the Japanese later PDS period and economic crisis before Korea's TS period. Even though, Japan is still in the PDS period, as we will see in this chapter, prolonged economic recession after the burst of the bubble economy also caused

unprecedentedly comprehensive liberalisation and deregulation policies with regard to IFDI.

In the PDS period, the conceptual tool of the expansionist developmental state (EDS) will be adopted in order to explain the specific features of the Japanese OFDI development in Southeast Asia. The Japanese EDS in the region is not a recent phenomenon. There have been three waves of Japanese OFDI increases from the 1960s to the 1990s towards the region. However, the Japanese EDS refers to the upsurge of OFDI after the Plaza Accord which was agreed in 1985. Only with the development of the EDS, the Japanese state and private companies started to implement regional production networks in Southeast Asia as not only an export platform towards third countries but also a strategic production site of Japanese manufacturing goods. Moreover, the Japanese EDS was accompanied by increased Official Development Assistance (ODA) from Japan to the countries in the region. Thus, in order to investigate the development of the Japanese EDS in Southeast Asia, we also need to illustrate Japanese ODA development in the region. Various governmental and quasi-governmental organisations that were established in order to facilitate Japanese OFDI in the region will be also illustrated.

The Korean state learned from its Japanese counterpart in developing OFDI development in Southeast Asia. Even though the Korean government's support of and co-operation with private corporations in conjunction with OFDI development is relatively insignificant compared with that of Japan, the Korean state's efforts in developing economic co-operation with the countries in the region were undeniably influenced by the Japanese system. Mimetic isormophism in institutional settings can

be easily found in Korea's ODA related government organisations. Thus, in the Korean EDS period, learning from Japan will be discussed in more detail. After Japanese and Korean FDI policies and FDI development are respectively discussed, a comparative analysis will be undertaken in order to identify differences and similarities in the two countries' FDI policies and development.

In the transitionary state period, Korea's full-scale liberalisation processes after the economic crisis will be investigated. The Korean state's desperate efforts to induce more IFDI led to a neo-liberal system of IFDI policies. This sudden change from incremental deregulation to rapid, full-fledged liberalisation shows the importance of the crisis impact in learning theory. As we have seen in Chapter 2, changes in belief systems do not easily occur in normal periods. Changes of belief systems are followed by the emergence of huge ruptures or divisions between previously believed cause and effect or ends and means relations. When Korea was in the DS period, in the structure of Korean bureaucrats' belief system, developmentalism and state intervention in the market were treated equally as a precondition of economic growth and development. When Korea was in the PDS period, as we have seen in Chapter 5, the Korean state's belief systems were divided between the top-level bureaucrats whose belief systems were in accordance with the neo-liberal free market system and medium and low-level bureaucrats whose belief systems were still in line with developmentalism. Thus, although the IFDI policies were consecutively liberalised by the initiatives of the top ranking policy makers including the president, in the actual processes of approval or notification, various bureaucratic practices of red tape exercised by the medium and low level bureaucrats effectively prevented liberalisation of FDI flows. This continuous screening and filtering effects of the medium and low

level bureaucrats finally caused foreign investors' complaints and dissatisfaction and after the economic crisis, the belief systems of the medium and low level bureaucrats also changed towards full liberalisation of IFDI policies. The massive criticism against the bureaucrats and the intensity and extent of the shock from the unprecedented economic hardship finally led to a full and comprehensive change in the belief system of the medium and low level bureaucrats. We will discuss this in greater detail in later section. In terms of OFDI flows, Korea OFDI was not reduced even after the economic crisis. Because of the credit crunch in the home country (Korea) and deteriorating credit ratings of Korean subsidiaries in host countries, it was widely inferred that Korean OFDI might be greatly reduced. However, surprisingly, OFDI flows from Korea increased. Even though the number of investment withdrawals from host countries increased after the economic crisis, Korean parent companies had to finance their subsidiaries that were strategically important.

Before we start the first section, several things have to be mentioned. In investigating Korea and Japan's historical FDI development, a political approach will be emphasised. In other words, economic analysis of the FDI will be supplementary to political interpretations. Even though, economic theories about FDI which are elaborated in Chapter 3 are adopted to explain the historical, industrial, and regional changes of the FDI flows, the major task of this chapter will lie in the political approach towards FDI. A political approach includes analysing the state's roles in regulating, prohibiting, planning, promoting and supporting FDI flows. More specifically, the historical changes of FDI and technology policies will be discussed first, before going on to examine the government's screening mechanism and supporting organisations for FDI. In the third part of this chapter, the deployment of

ODA towards Southeast Asia will be analysed while the fourth section will review the ideational changes towards FDI in each period of the DS, PDS and TS. The final part of the chapter will discuss the domestic and international political pulling and pushing effects of FDI. Economic theories of FDI will also be adopted in analysing FDI data in order to explicate regional, industrial distribution of FDI flows.

1. Inward FDI

1-1. The developmental state period

The most distinctive feature of the Korean and Japanese DS' IFDI regime is their highly calculated regulative aspects of policies. IFDI flows were screened case by case and approved on the basis of a long-term evaluation. Although liberalisation was implemented, it was very slow and in a piecemeal fashion. Thus, liberalisation and deregulation were implemented only in the industrial sectors in which domestic companies had already accomplished international comparative or competitive advantage. The firm belief held by bureaucrats that they can control, manage, and regulate IFDI flows in order to improve national wealth and to achieve national economic targets were legitimised to the extent that both Korea and Japan succeeded in effectively dealing with IFDI flows in the DS period. Both countries not only strictly restricted IFDI flows in such sectors as labour intensive ones but also were eager to attract more IFDI flows in high technology industrial sectors in order to improve their technological level. This dual standard policy towards IFDI will be elaborated in the following sections. The time span of Korean and Japanese DS is based on the changes in FDI laws. The fundamentally different IFDI principle was adopted in 1984 in Korea and 1980 in Japan. The years 1984 and 1980 represented the turning point in Korea and Japan respectively in dealing with IFDI flows in both

countries. 'Prohibition in principle, approval in exception policy' changed into 'approval in principle, prohibition in exception policy' after 1984 and 1980 in Korea and Japan. Thus, time span for the Korean DS in dealing with IFDI is from 1962 to 1983 and that for the Japanese DS is from 1950 to 1980.

1-1-1. The Korean DS period (1962-1983)

($US million)

Calendar year	Total acceptance	Arrival	Calendar Year	Total Acceptance	Arrival
1962-66	47.4	24.3	1979	191.3	195.3
1967-71	218.6	117.2	1980	143.1	130.9
1972-1976	878.5	535.8	1981	153.2	150.2
1977	83.6	142.9	1982	189.0	128.6
1978	149.4	181.0	1983	269.4	122.5

Table 6-1. Total IFDI flows into Korea in the Korean DS period.
Source. Based on the MOF data. Quoted from Won-Young Lee (1987).

The Korean DS period was characterised by its preference for foreign loans and technological licensing over IFDI and comprehensive and detailed regulations on IFDI flows. Thus, as Lall clearly points out, the Korean DS' IFDI regime was based on the strategy of 'restriction and exploitation' (Lall 1995: 23). Korea's efforts to induce foreign direct investment started with the introduction of the Foreign Capital Inducement Promotion Act (FCIPA). In the Act, there were two contrasting contents. One was for the promotion of IFDI and the other was for the tough regulations on IFDI. The promotive aspect of the Act reflected Korea's need for foreign capital in order to supplement the shortage of domestic savings and investment capital and the regulatory aspects of the Act revealed the Korean state's concern about the possible dependency of the whole economic system by more competitive foreign investors or MNCs. More specifically, the promotive aspects included allowing the remittance of principal and earnings, strict protection of intellectual property rights, widening bilateral negotiations such as the Investment Guarantee Agreement and the Double

Taxation Avoidance Agreement, tax reduction and exemption, and provision of the Export Free Zones. On the other hand, the regulatory aspects contained red tapes, performance requirements, entry regulations, ownership regulations, and remittance regulations. Thus, these conflicting ideas and practices on IFDI determined the historical development path of Korean IFDI flows as policy-makers' ideas and practices pendulated between regulations and promotions of IFDI. In this context, as we will see from the following sections, the Korean DS period is characterised by case by case regulations and screening processes towards IFDI and the Korean PDS is characterised by the consecutive, piecemeal but limited deregulation processes.

Tables 3, 4, and 5 show the comprehensive regulative aspects of the Korean DS towards IFDI flows. The Korean state preferred foreign loans over IFDI and even the small amount of the IFDI was strongly regulated in order to prevent foreign domination in the domestic economy. Foreign ownership was managed by detailed screening and strict approval processes and the result was that the majority and wholly owned IFDI were minimal in the Korean DS period. Compared with Singapore and Hong Kong, the share of wholly foreign owned investment in Korea was far lower. According to Chowdhury and Islam, in 1981, the share of wholly owned investment in Korea and Singapore was 14.6 and 42.0 percent respectively and the share of Hong Kong in 1984 was 52. 0 percent (Chowdhury and Islam 1993: 112). This figure reveals the Korean DS' nationalistic regulations on IFDI flows. Accordingly, as Clark and Chan argued, the Korean DS " stands out in its practice of 'sovereign en garde' in that it has imposed the most stringent conditions on MNC access" among Asian countries (Clark and Chan 1996: 94). The small amount of IFDI can also be attributed to the high ratio of technological licensing. The major rationale of screening in

technology transfer was that only high-tech industries and investments towards the free export zones could have majority or wholly owned IFDI. This dual policy in the ownership regulation of IFDI was stipulated in 'the 1981 adoption of dual policy'. More specifically, in the labour intensive and domestic market seeking industries, only less than 50 percent of foreign ownership was allowed and in the industries which are devoted to import substitution or export promotion, foreign ownership over 50 percent was allowed. Only in high-tech industries and in the export free zones, was wholly owned foreign investment permitted (Seung-Jin Kim 1996: 14).

The preference for technological licensing over IFDI was the result of cautious planning of 'the science and technology policy' which contained the Korean state's eagerness to raise its technological level[1]. In order to improve Korea's capacity and competitive advantage in technology, the Korean government manipulated IFDI flows into minority or co-owned investments and preferred technological licensing rather than IFDI, because the technological spill-over effects from these measures were much better than wholly owned IFDI or IFDI itself. However, in the high-tech industries, IFDI was recommended and the industries enjoyed a relatively unregulated environment. The reason for this was that foreign investors prefer not to transfer their high technologies through licensing agreements in order to preserve their ownership advantages in technological capacity. Thus, by adopting a dual policy in technological transfer, the Korean DS forced licensing arrangements in medium-level technology

[1] Chung and Branscomb (1996: 215) argued that "acquisition of advanced technology from foreign sources has been one of the main concern of Korea's science and technology policy . . . The industrialisation of Korea has been a process of learning how to absorb and improve upon borrowed foreign technologies for industrial development".

industries while heavily relied on IFDI in high-technology industries as an effective way to acquire advanced foreign technologies.

Detailed criteria in the technology licensing process imposed by the Korean DS also uncovered the interventionist and mercantilistic essence of the Korean DS. After 1978, the automatic approval system was adopted in technology licensing agreements. However, sophisticated criteria were introduced in order to maximise the spill-over effects of technology transfer and to tightly control foreign currency. Three criteria were adopted. "First, the life span of the project must be less than 10 years; second, the running royalty payments must be less than 10 percent of the total sales value: and third, the front-end payment must be less than one million US dollar" (Won-Young Lee 1988: 192).

Year	Changes in FDI related laws
1960	Introduction of the Foreign Capital Inducement Promotion Act (FCIPA)
1965	Korea's diplomatic normalisation with Japan
1966	Change of the FCIPA into the Foreign Capital Inducement Act (FCIA)
1969	Introduction of 'the Policies for the promotion of foreign investment and foreign companies'
1970	Introduction of the Export Free Zone Establishment Law
1973	Introduction of 'the Principle for the proper share of foreign investment' and 'the General guideline for foreign investment'
1981	Adoption of dual policy in ownership regulation
1984	Amendment of the FCIA (Introduction of the negative system, introduction of the automatic approval system, abolition of the ownership regulation)
1989	Abolition of the performance requirements (such as export requirement and local contents use)
1991	Introduction of the prior notification by replacing automatic approval system
1993	Introduction of the Foreign Investment 5 year Liberalisation Plan Introduction of 'the system of notification in principle and approval in exception'
1994	Introduction of the substantial notification system by changing recipient organisations from the MOFE and BOK to foreign exchange banks.
1996	Korea became a member of the OECD Introduction of the Foreign Investment and Foreign Capital Inducement Act (FI & FCIA) by replacing the FCIA
1998	Introduction of the New Foreign Investment Promotion Act (NFIPA) by replacing the FI & FCIA

Table 6-2. Changes of IFDI related laws in Korea.

These regulative aspects of the IFDI policies could be also found in the internal guidelines circulated inside the FDI related ministries. 'The Principle for the proper share of foreign investment' and 'the General guideline for foreign investment' contained the joint venture recommendation and detailed regulations on the amount of investment according to industrial sectors (Hong-Goo Lee 1994: 188). In 'the General Guideline for Foreign Direct Investment', restricted businesses and exceptional businesses from 50 percent foreign ownership regulation were stipulated. The restricted businesses were the investments that could compete with domestic firms in foreign markets and the projects that aim to pursue rent seeking through land acquisition. The exceptional businesses which were not obliged to have 50 percent ownership regulation were categorised into four areas. First, the projects that were purely export-oriented investments which would not compete with domestic firms.

(Amount percentage)

	Total loans	FDI	Total foreign capital
1962-65	86.0	14.0	100.0
1966-70	96.0	4.0	100.0
1971-75	90.0	10.0	100.0
1976-1980	96.0	4.0	100.0

Table 6-3. Ratio of IFDI and loan flows in the total foreign capital inflows into the Korean DS.
Source. The EPB data and based on the arrival. Quoted from Castley (1996).

(Number of cases percentage)

Year	Minority owned	Co-owned	Majority owned	Wholly owned	Total
1962-66	35.9	20.5	28.2	15.4	100.0
1967-71	42.7	23.8	16.9	16.6	100.0
1972-76	45.0	30.0	10.2	14.8	100.0
1962-86	46.9	26.8	12.8	13.5	100.0

Table 6-4. Ownership structure of IFDI in the Korean DS.
Source. The MOF data and quoted from Won-Young Lee (1988).

(Number of cases)

	1962-1971		1972-1976		1977-1981		1982-1986		Total	
	TL	IFDI	TL	IFDI	TL	IFDI	TL	IFDI	TL	IFDI
Manufacturing	285	336	391	734	1095	191	1878	450	3649	1711
Total	318	388	434	851	1225	244	2078	565	4055	2088

Table 6-5. Distribution of technological licensing and IFDI flows into the Korean DS.
Source. The MOF data and quoted from Won-Young Lee (1988).

(Number of cases)

	US	Japan	Germany	Others	Total
1962-1975	122	397	19	43	581

Table 6-6. Korean DS' technological licensing agreements by countries.
Source. The EPB data and quoted from Sung-Hwan Jo (1980).

Second, technology-intensive investments which could improve Korea's technological level, third, the projects that could bring about domestic structural adjustment, and finally investments that were realised in the export free zones (Won-Young Lee 1987: 20). Moreover, the Korean DS' FDI regime had another distinctive feature of regulating IFDI, namely the performance requirements. The performance requirements required certain amount of export or the usage of local contents.

Meanwhile, contrary to these restrictive and regulatory aspects of IFDI regime, the Korean DS also tried to induce more IFDI by establishing export free zone in which various incentives were provided and regulations on technological licensing and ownership structure were not strictly but flexibly applied. Moreover, in order to maintain labour market stability in the foreign firms, the Korean DS adopted a labour law under which strikes in foreign firms were totally prohibited (Bishop 1997: 33). In sum, the Korean DS' IFDI regime was a combination of regulation and promotion. However, as we have seen through Tables 3, 4, and 5, the regulatory aspects of the IFDI policies overshadowed the promotive aspects. Moreover, in the Korean DS period, "there indeed exists a gap between the law on paper and the law in practice" (Neurath 1984: 21). As we have seen earlier in the section, the FCIPA contained not only regulative but also promotive and supportive aspects. However, the promotive side of the act was heavily overshadowed by mainly three factors: internal guidelines circulated only within concerned ministries; discretionary interpretations of laws by

working level bureaucrats; and finally, disagreement and competition among different ministries such as the EPB, the MOF, and the MOCI. Thus, as Neurath argued, "the rule of men not law is a concept deeply embedded in Korea's bureaucratic tradition" (Neurath 1984: 21).

Inter-ministerial conflicts over IFDI flows were the result of the unique screening structure of the Korean DS. As Wint pointed out, the Korean DS "allowed screening decisions to be made in a diffused manner by various units of government with each unit independently making its own decision" (Wint 1992: 1520). Because there was no dominant or single ministry which could centralise the policy-making processes towards IFDI, the Korean DS witnessed inter-ministerial rivalry and competition. The result was time-consuming approval procedures and contradictory policies among different ministries. The EPB had authority over IFDI from 1962 to 1981, which was transferred to the Ministry of Finance (MOF) in 1981. When the EPB had single dominant authority over IFDI, consistent policies based on developmental beliefs could be implemented. However, after the MOF undertook the authority from the EPB, policy disorientation and zigzag policies emerged. The major background of the emergence of policy disorientation was the liberalisation era after the early 1980s. Under this liberalised era, inter-ministerial rivalry emerged as the EPB lost its developmentalism oriented control on IFDI. We will discuss more about this negative effect of divided ministries in relation to IFDI in the Korean PDS section. All these three factors revealed that although the Korean DS had law which contained the promotive and supportive side of IFDI, it can be argued that the Korean DS' IFDI regime was basically a regulation and prohibition dominated one.

A distinctive structural problem of the Korean DS in regulating IFDI flows was the structural dependence of technology on Japan and increased trade deficit with Japan. Table 6 shows the Korean DS' technological dependence on Japan by illustrating the serious inequality among provider countries and the sole dominance of Japan in the numbers of licensing agreements. The dependent structure of Korean economic relations with Japan was sustained for a long time and caused 'import diversification policy' throughout the Korean DS and PDS periods. However, in terms of amount, America was the dominant technology exporter. According to Steven, Korea's cumulative technological imports from Japan and the US for the period of 1962 to 1983 were 270 million US dollars and 329 million US dollars respectively (Steven 1990: 149). This shows that Japan provided Korea with medium level and relatively cheap technologies while America supplied Korea with relatively high level and expensive technologies. However, what is important here is the quality of the transferred technologies to Korea. According to the survey conducted by the Korea Innovation Research Institute, almost 90 percent of technologies were in the mature stage in the product life cycle. Meanwhile, only 2.3 percent of technologies were at the innovative stage (Requoted from Won-Young Lee 1988: 196). This structural dependence of Korea's technological imports from the two countries has lasted to the present time and brought about Korea's efforts to not only ameliorate structural dependency by improving economic relations with European countries in the later PDS period but also to improve Korea's indigenous innovative capacity by increasing its R&D expenditure.

1-1-2. The Japanese DS period (1950-1980)

($US million)

Fiscal Year[2]	FDI	Fiscal Year	FDI
1950-1955	29[3]	1968	76
1956	16	1969	72
1957	32	1970	94
1958	12	1971	210
1959	18	1972	169
1960	6	1973	-42
1961	44	1974	202
1962	45	1975	167
1963	88	1976	196
1964	83	1977	224
1965	47	1978	236
1966	30	1979	524
1967	45	1980	300

Table 6-7. IFDI flows into the Japanese DS.
Sources: Data from 1955 to 1974 is based on the balance of payments statistics made by the Bank of Japan and quoted from Komiya (1972) and Safarian (1993). Data from 1975 to 1980 is based on the MOF data and quoted from Safarian (1993).

Year	Changes in IFDI related laws
1949	Introduction of the Foreign Exchange and Foreign Trade Control Law (FE & FTCL)
1950	Introduction of the Foreign Capital Control Law (FCCL)
1950-1960	Total approval period
1964	Japan became a member of the OECD
1967	Introduction of the positive list system
	Establishment of the Foreign Investment Council (FIC) under the MITI
1971	Introduction of the negative list system
1973	Introduction of the automatic approval system
1976	Introduction of the notification system
1980	Amendment of the FE & FTCL
	Abolition of the FCCL and incorporation of the FCCL into the FE & FTCL
	Change of the FIC into the Committee on Foreign Exchange and Other Transaction (CFEOT) under the MOF
1990	The amendment of the Security Transaction Law
1992	Change of the prior notification system into the ex post reporting system
1998	Amendment of the FE & FTTCL into the Foreign Exchange and Foreign Trade Law (FE &FTL)

Table 6-8. Changes of FDI related laws in Japan.

The Japanese DS' IFDI regime experienced two distinctive periods. The earlier part of the Japanese DS (from 1950 to 1964) was a period of total approval or regulation. For example, the FE & FTCL required strict approval for all transfers of Yen or foreign currency between residents or non-residents (Safarian 1993: 242). After becoming a member of the OECD in 1964 and registering its first balance of payments

[2] From 1 April to 31 March

surplus in 1967, Japan started consecutive but very slow and strategically calculated liberalisation processes. The reason why Japan liberalised its IFDI policies after joining the OECD was that IMF Article 8 prohibited any restriction on current account transactions for balance of payments reasons (Sekiguchi 1979: 11). Thus, in line with liberalisation, the positive list system was introduced in 1967 and this system changed to a more open negative list system in 1971. In order to simplify the investment procedure, Japan adopted the automatic approval system in 1973, the prior notification system in 1776, and finally in 1980, Japan amended the FE & FTCL. Under the amended FE & FTCL, the IFDI policy transformed into a system of 'approval in principle, prohibition in exception'. In 1990, by the amendment of the Security Transaction Law, Japan allowed hostile takeovers and in 1992, the prior notification system was replaced by an ex post reporting system.

As can be seen from Table 7 and 8, IFDI flows into Japan sharply increased after Japan adopted the negative list system. However, as can be seen from Table 9, before the introduction of the notification system, comprehensive and detailed standards in regulating IFDI flows remained. In green field investment (establishing new firms), industrial sectors were divided into three categories (not liberalised, permission until 50 percent of foreign ownership and permission until 100 percent of foreign ownership) and in purchasing shares of domestic firms, foreign investors' share was strictly limited. For example, in the restricted area, foreign investors could obtain only 5 percent of existing firms' stock in 1952. This ceiling was increased to 15 percent in 1971 and after 1973, one hundred percent of stock purchasing was allowed after obtaining consent from the Japanese domestic company involved and with

[3] Cumulated total for the period

notice given to the Japanese government. It was in 1980 when one hundred percent stock purchasing was allowed without the consent and notice procedures. This means that hostile takeovers were possible after 1980 revision of the FE & FTCL.

What is important but cannot be seen from Table 9 is that the Japanese DS liberalised IFDI flows only in the sectors in which Japanese firms had already attained comparative advantage in the international market (Komiya 1972: 153, Safarian 1993: 243). What is more important is that in the DS period, the reality of IFDI environment was not consistent with the liberalised IFDI related law. In other words, although IFDI policies were gradually liberalised, IFDI into Japan did not increas proportionally. Thus, even though Japan liberalised its IFDI regime after becoming a member of the OECD, the entire Japanese DS period can be characterised by regulation and restriction.

	Establishing new firms (Number base)			Purchasing Shares in existing firms (percentage base)		
	Not liberalised	Foreign ownership 50%	Foreign ownership 100%	Maximum per single investor	not restricted sector	restricted sector
Yen based companies 1956-63			All			
1952	All				8	5
1960	All			5	15	10
1967	Rest	33	17	7	20	15
1969	Rest	160	44	7	20	15
1970	Rest	447	77	7	25	15
1971	7[4]	All but 17	228	10	25	15
1973	5[5]	17	22	100[6]		
1976	5	Notification		100[7]		
1980	4	Notification		100[8]		

Table 6-9. Japanese DS' policy changes on IFDI.
Source. Safarian (1993).

[4] This 7 prohibited sectors include oil refining, electronic computer, data processing, leather, retail, agriculture-fishery-forestry, and real estate.

[5] This 5 sectors indicates above 7 sectors minus electronics and data processing but include mining.

[6] Consent of the company was required. Also notice to the government was required.

[7] Still consent of the company and notice to the government were required.

[8] Just notice to the government was required. This means that hostile takeovers were possible after 1980.

More specifically, the first half of the DS period (1950-1964) was a formal law-based regulative period and the second half of the DS period (1965-1980) was an informal practice-based regulative period. The informal practice-led regulation was characterised by internal guidelines and bureaucrats' discretionary interpretation of the law. This lack of transparency in IFDI regime gave rise to complaints from foreign investors and Japan's major trading or investment partners:

> Foreigners often complain that the criteria or standards according to which the Japanese government approves, requests changes to, or turns down applications have never been made clear in an official document (Komiya 1972: 154).

The underlying belief system of this regulation and restriction towards IFDI flows is also clearly pointed out by Komiya (1972: 158):

> Many government officials, particularly those in the MITI, businessmen, and journalist consider liberalisation of inward direct investment as a sacrifice which Japan must pay for international co-operation or for her membership in the community of advanced industrialised nations, rather than a benefit to Japan itself.

The criteria for approval by the MITI unveiled the mercantilist and regulative aspects of the Japanese DS' IFDI regime: The projects should "(a) make a clear contribution to technological development of Japanese industry, (b) make a contribution to exports or a saving on imports, (c) involve no significant competition with Japanese industry, and (d) involve a percentage of equity less than 50 percent" (The Economist 14 August 1965: 626-7, requoted from Safarian 1993: 243). The informal guideline prepared by the MOF in 1967 also disclosed the informal practice which discouraged IFDI flows into the Japanese DS. The guidelines prepared to minimise the adverse effects of IFDI liberalisation included the following interesting points:

> Seek coexistence and prosperity with Japanese enterprises through joint ventures on an equal partnership basis . . . Avoid suppressing small enterprises when entering into industries characterised by small firms . . . Take positive steps towards developing Japanese technology, and do not hamper the efforts of Japanese industries to develop their own technology . . . Appoint Japanese to the board of directors and top management positions . . . Conform to the government's economic policy (Safarian 1993: 247-248).

Thus, it can be summarised that the Japanese DS was regulative and prohibitive in terms of IFDI. Dunning (1996: 43-46) summarised four government roles in keeping the IFDI flows very low. First, the government's discriminatory policy encouraged either total closure or limits to foreign investment in majority service sectors and some primary or manufacturing industries. More importantly, the foreign firm's M&A was strictly disallowed in the DS period. Second, the Japanese DS induced technology licensing rather than IFDI. Third, Japanese consumer's 'buy Japanese' attitude[9] was implicitly manipulated by Japanese government. Fourth, by applying interventionist industrial policy and liberal competition policy on the IFDI flows, the Japanese government discouraged IFDI flows. As we have seen in Chapter 4, with the combination of interventionist industrial policy and liberal interpretation of competition policy, the Japanese government supported indigenous R&D and tacitly admitted oligopolistic competition among domestic companies in order to improve Japan's international competitiveness. As a result, foreign investment was discouraged because of Japanese firms' improved comparative or competitive advantages through massive R&D expenditures and oligopolistic domestic industrial structure.

[9] It has to be emphasised that this attitude of 'buy Japanese' is viewed as a cultural or institutional characteristic in this thesis. As we have seen in Chapter 2, without considering the influence of this patriotic and mercantilist belief systems of not only Japanese and Korean bureaucrats but also ordinary people, it is hard to understand the rigidity and persistence of developmentalism-oriented

This meant that foreign investors could not exploit their ownership advantages against their Japanese counterparts. Even though foreign investors could get access to the Japanese market, the market was carefully liberalised in areas in which Japanese firms could compete with foreign investors in defending their domestic market share. Moreover, even though foreign investors had ownership advantages in certain industrial sectors, they could not get access to the Japanese market because those sectors were highly protected or regulated by case-by-case screening processes. As Dunning pointed out above, the Japanese DS preferred technological licensing instead of IFDI and managed IFDI flows into joint ventures rather than majority or wholly owned IFDI (Yoshitomi 1990: 124). This reflected the Japanese need to import foreign technologies in the DS period. Japan was behind foreign competitors in terms of technological level (Sekiguchi 1979: 11) in the DS period.

1-2. The post developmental state period

1-2-1. The Korean PDS period (1984-1997)

($US million)

Calendar Year	Total acceptance	Arrival	Calendar Year	Total acceptance	Arrival
1984	422	193	1992	894	803
1985	532	236	1993	1044	728
1986	355	477	1994	1317	991
1987	1063	626	1995	1941	1357
1988	1283	894	1996	3203	2308
1989	1090	812	1997	6970	3086
1990	803	895	1998	8852	4235
1991	1396	1177			

Table 6-10. Total IFDI flows into Korea in the Korean PDS and TS period.
Source. Based on the MOFE data and quoted from the National Statistics Office (1998).

(state interventionist) economic system in the PDS in which market-oriented liberalsation measures were continuously implemented.

(Amount percentage)

	1962-86	1987-90	1991-1995	1962-97	1997	1998
Manufacturing	63.9	66.7	53.4	52.6	33.7	64.8
Non-manufacturing	36.1	33.3	46.6	47.4	66.3	35.2
Total	100.0	100.0	100.0	100.0	100.0	100.0

Table 6-11. Industrial trends of IFDI flows into Korea
Source. Based on the MOFE data and total acceptance. Data except for 1998 is quoted from Joon-Dong Kim (1997). Data for 1998 is quoted from the MOFE (1999a).

The Korean PDS is a period when consecutive, incremental but basically limited deregulation and liberalisation of IFDI policies were implemented. As we will see later in this section, the Korean PDS was a period when zigzag policies between free market and state intervention persisted due to the conflicts between unchanged developmentalism-oriented belief systems towards IFDI and consecutively liberalised laws and policies towards IFDI. As can be seen from Table 8, in 1984, Korea amended the FCIA and adopted a negative list system and removed ownership regulations. Moreover, performance requirements were abolished in 1989 and a prior notification system was introduced in 1991. In 1992, eight businesses that were previously closed to foreign investors became open to IFDI and the number of businesses which required joint ventures were reduced (Monthly Review 1992 November).

($US million)

	1962-86		1987-90		1962-1997		1998	
	Industry	Amount	Industry	Amount	Industry	Amount	Industry	Amount
Manufacturing								
1	Electrical	21.0	Chemicals	195.4	Chemicals	2763.1	Pulp/Lum.	1644.0
2	Chemicals	18.2	Electrical	169.9	Electrical	2457.3	Electrical	1377.0
3	Transport	13.5	Transport	95.1	Transport	1656.3	Chemicals	756.0
4	Text./Gar.	805	Machinery	83.1	Food	1607.9	Food	719.0
5	Machinery	6.9	Food	59.9	Machinery	1154.3	Machinery	588.0
Non-manufacturing								
1	Hotel	36.5	Hotel	198.9	Hotel	5206.1	Finance	506.0
2	Finance	6.8	Finance	84.6	Finance	1869.7	Distri.	474.0
3	Construc.	2.2	Insurance	25.6	Distri.	1477.7	Elec./Gas	344.0
4	Tans./Sto.	1.4	Trade	24.5	Trade	910.4	Hotel	303.0
5	Distri.	0.7	Distri.	10.0	Insurance	289.4	Trade	284.0

Table 6-12. Five leading sectors of manufacturing and non-manufacturing industry in IFDI flows into Korea.

Source. Based on the MOFE data and total acceptance. Data except for 1998 is modified from Joon-Dong Kim (1997). Data for 1998 is modified from the MOFE (2000).

($US million)

	1962-86		1987-90		1962-97		1998	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
U.S.A	42.9	29.5	292.6	27.6	8280.7	33.6	2974.0	33.6
North America total	46.6	32.1	303.0	28.6	8798.9	35.7	3776.0	42.7
Japan	76.1	52.3	474.0	44.7	5832.6	23.7	504.0	5.7
Malaysia	0	0.0	0.1	0.0	1617.9	6.6	262.0	3.0
Asia total	81.9	56.3	516.4	48.7	8637.3	35.1	2015.0	22.8
Netherlands	2.1	1.5	37.7	3.6	2251.1	9.1	0322.0	15.0
Germany	2.6	1.8	58.2	5.5	1118.8	4.5	785.0	8.9
UK	2.6	1.8	40.3	3.8	789.0	3.2	61.0	0.7
Europe total	13.9	9.5	220.8	20.8	6993.4	28.4	2884.0	32.6

Table 6-13. IFDI flows into Korea by country and region.
Source. Same as the Table 6-12.

(Average Percentage between 1986-1991)

Korea	Taiwan	Hong Kong	China	Malaysia	Singapore	Thailand	Japan
1.1	3.5	12.1	2.3	9.7	29.4	6.3	0.1

(1996)

Korea	Indonesia	Malaysia	Philippines	Singapore	Thailand
1.3	8.5	13.2	7.3	27.5	3.2

Table 6-14. The percentage contribution of IFDI to domestic fixed capital formation in East Asian countries.
Source. Average percent date is based on the UN, *World Investment Report 1993*. Requoted from Guan-Ho Kim (1993). Data for 1996 is quoted from the UNCTAD (1998).

	Korea 1993	Korea 1987	Taiwan 1986	Singapore 1989	Hong Kong 1989
100 %	18.6	13.3	30.5	51.2	59.4
50-99.9 %	33.4	38.5	40.3	21.4	-
Under 50 %	48.0	48.2	29.2	27.4	-

Table 6-15. Ownership structure of IFDI in the Asian NIEs.
Source. Based on the UN (1992), *World Investment Directory vol.1*. Requoted from modified data of Guan-Ho Kim (1993).

And in 1993, under the policy of 'Segyehwa' (globalisation policy), Korea implemented 'the 5 year Foreign Investment Liberalisation Plan' initiated by the International Investment Bureau in the MOFE in order to facilitate IFDI development by simplifying investment procedures and providing more incentives to foreign investors. Under the 5 year plan, among 224 restricted businesses, 132 businesses

were liberalised. Moreover, the number of businesses which had been strongly regulated in order to request Joint venture instead of full or majority foreign ownership was reduced from 50 to 7 (Economic Bulletin August 1993, Monthly Review First quarter 1995). The 5 year plan was amended three times after 1993 and in 1994, 57 previously prohibited businesses were further liberalised and in order to induce more IFDI, the clauses concerning the protection of intellectual property rights, financial sector liberalisation, labour market stabilisation, deregulation of foreign acquisition of land, and administrative deregulation were incorporated in the plan. Thus, in order to facilitate administrative deregulation, 'the Special Law on Business Deregulation' was enacted in 1993 and to propel financial liberalisation, the ceiling on foreign share in portfolio investment in each domestic company's total share was increased from 10 percent to 12 percent in 1994 and to 15 percent in 1995. Moreover, in order to ease the restriction on foreign acquisition of land, 'the Alien Land Law' was abolished and replaced by 'the Law on Alien Land Acquisition and Management' in 1993 (Economic Bulletin November 1994, Monthly Review First quarter 1995).

With the help of these consecutive liberalisation processes, Korea's liberalisation ratio became 90.3 percent in 1996 (More specifically, in manufacturing industry 99.8 percent, in service industry 91.7 percent, and in primary industry 79.4 percent) (Seung-Jin Kim 1996:14). In 1996, Korea took further steps towards liberalisation. Under the FI & FCIA, friendly M&As were allowed and various incentives were also provided to foreign investors (Economic Bulletin September 1996). In science and technology policies, gradual liberalisation processes were also introduced in the PDS period. Thus, a reporting system replaced the former approval system in 1984 (Won-Young Lee 1988: 192). Besides these liberalisation processes, the Korean PDS also

endeavoured to remove administrative red tape by establishing 'the Committee for the administrative deregulation' under the 'New 5 year Economic development Plan (1993-1997)' implemented by president Young-Sam Kim (Economic Bulletin 1993 April).

However, the extent of liberalisation was basically limited and liberalisation continued to be accompanied by specified regulations due to the rigidity of working level bureaucrats' belief systems which were strongly embedded in the efficacy of developmentalism (Bishop 1997: 90-91). The belief that the state could control and manage the flow of IFDI in desired or planned direction was rigidly engrained in the bureaucrats' minds. Another important reason which brought about limited liberalisation was inter-ministerial conflicts on IFDI policies[10]. As we have seen in the the section on Korean DS, inter-ministerial conflicts over IFDI policies emerged after the authority over IFDI was transferred from the EPB to the MOF. In the Korean PDS, the MOFE and Ministry of Trade, Industry and Energy (MOTIE) struggled to represent their respective interests (Bishop 1997: 142). The International Investment Bureau of the MOFE actively endeavoured to liberalise the IFDI regime while the MOTIE represented the protectionist attitudes. The MOFE's belief systems for the promotion of liberalisation was strongly supported by top policy makers, the MOFE's subsidiary research institute, namely 'the Korea Development Institute (KDI)' and foreign business representatives especially from the American Chamber of Commerce (AMCHAM) and the European Chamber of Commerce. Meanwhile, the view of the

[10] Michael S. Brown, the president of the American Chamber of Commerce clearly pointed out this inter-ministerial conflicts and working level bureaucrats' unchanged belief in the efficacy of developmentalism in dealing with IFDI: "We are often caught between different ministries on various business problems. Each ministry has an agenda which is not easily influenced by other ministries.

MOTIE was advocated by Chaebol, SMEs, labour unions, and the MOTIE's subsidiary research institute, 'the Korea Institute of Industrial Economy and Trade (KIET)'.

Because of these two regulative and conflicting background (working level bureaucrats' developmentalism oriented belief systems and inter-ministerial conflicts), the Korean PDS had regulative and prohibitive aspects in its IFDI regime. Thus, after the amendment of FCIA in 1984, the clause which contained the protection of strategic or infant industry remained in the changed Act. According to the act, restriction was imposed on projects "which are being supported by the government on a special basis . . . [and] projects in infant industries which are being given protection at the present time" (Monthly Review 1984 September). Although the negative system was introduced, there were 297 industries prohibited on the list out of a total of 999 industries. This meant that almost 30 percent of businesses were prohibited under the negative list system. Although the automatic approval system was adopted, the criteria were strict. Only projects that "are not on the negative list, that have a foreign equity share of less than 50 percent, that involve foreign investment amounting to no more than one million US dollars, and that do not require tax exemption" were automatically approved (Won-Young Lee 1988: 191). And although a reporting system was adopted in technology transfer in 1984, "Korean firms which wish to pay more than US $ 100 thousand or 2 percent of their net sales from the product in question in return for using foreign technology for more than 3 years" had to attain approval as of 1992 (Economic Bulletin 1992: 33). Despite consecutive liberalisation

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Lower level officials are generally not empowered, recognised or rewarded for heloping foreign companies operate in Korea" (The Korea Herald 6 February 1988).

efforts of the Korean PDS, as of June 1995 there remained 150 restricted projects (107 totally restricted and 43 partially restricted) out of 1148 businesses listed in the Korean Standard Industrial Classification. And as of May 1996, IFDI was still restricted in 120 businesses. Thus, even the state acknowledged the limits of slow and incremental liberalisation processes in 1996: "the government recognised that its current liberalisation plan falls short of the level of liberalisation achieved by the advanced countries" (Economic Bulletin 1996 June).

The result of a conflict between slow liberalisation processes and unchanged belief systems of bureaucrats was a breakdown of the congruence among the policies, ideas, and institutions which had underpinned the rapid and efficient economic development of the Korean DS period. This breakdown of the congruence led to inefficient economic policy making and implementation processes and finally contributed to an economic recession throughout the 1990s and an economic crisis in 1997. In an earlier section, we examined thoroughly the increased gap between liberalised IFDI policies pursued by top policy makers and developmentalism-oriented regulative and restrictive belief systems of medium and low level bureaucrats throughout the PDS period. This uncovered the fact that without the change of belief systems of policy implementors (medium and low level officials), liberalised IFDI policies had no substantially positive effects on flows of IFDI.

Moreover, liberalised IFDI policies in the Korean PDS period could be regarded as only for 'show-window display' in order to evade foreign pressures to open the Korean market. For example, in 1989, Korea made an agreement to remove performance requirements, to abolish screenings and to open service industries further

after America intensified its pressures towards Korea after 1986 (Bishop 1997: 109). However, as we have seen above, the extent of liberalisation in the Korean IFDI regime was not necessarily satisfactory throughout 1990s. Although performance requirements were abolished in 1989, the screening system through joint venture recommendation in technology transfer remained and the restriction of IFDI into certain businesses was only very slowly and carefully liberalised. Moreover, the clause which contained the protection of infant industry and the exclusion of foreign investors in such industries still remained in the FCIA (Joon-Dong Kim 1996: 70). The unchanged belief system was of course a major source of persistent red tape and internal guidelines that substantially regulated and prohibited IFDI flows even though the laws and polices related to IFDI were continuously liberalised throughout the Korean PDS period.

IFDI flows into the Korean PDS increased after Korea amended the FCIA in 1984 as part of its process of economic liberalisation. As we have seen in Chapter 5, the Korean state implemented economic liberalisation after 1980 in order to overcome an economic slowdown and recession caused by the side-effects of excessive state intervention in heavy and chemical industries (HCI) in the late 1970s. In order to channel the massive capital into HCI, the Korean state depended too much on foreign loans and as a result, Korea's foreign loans dramatically increased in this period. After witnessing the Latin American debt crisis in the early 1980s, the Korean state started to worry about the snowballing foreign loans and to acknowledge the necessity of IFDI as a way to countervail the tremendously swollen foreign loans (Won-Young Lee 1987: 25). Thus, both reflection on excessive state intervention in the HCI and

the anxiety about the massive foreign loans resulted in the liberalisation of the IFDI regime in the earlier Korean PDS period (Economic Bulletin 1993 February).

Under this liberalisation era, as we have seen earlier, by amending the FCIA, Korea introduced the negative list system and the automatic approval system and abolished the ownership regulation. And after the accomplishment of the first trade surplus in 1986, the foreign exchange law was liberalised and as a result, IFDI into Korea again witnessed a dramatic increase. However, as we can see from Table 14, the contribution of IFDI to domestic fixed capital formation in Korea was insignificant compared with the ASEAN member countries. This small percentage of IFDI contribution to domestic fixed capital formation showed that Korea was not dependent on IFDI flows in channelling investment capital, because Korea still depended heavily on foreign loans instead of IFDI even in the PDS period. Another domestic factor which prevented IFDI development in the Korean PDS period was excessive administrative regulation. Even though the Korean state endeavoured to promote administrative deregulation in the PDS period, foreign investors indicated excessive regulation as the most crucial obstacle in operating their firms in Korea (Joongangilbo 16, 7, 1996, requoted from Joon-Dong Kim 1996: 63).

However, the most interesting domestic factor which hindered further IFDI flows into the Korean PDS was the Chaebol system. Different from the above two preventive factors (high dependence on foreign loans and excessive administrative regulation) which were caused by state regulations, the Chaebol system also prevented the penetration of foreign firms into the Korean market due to the Chaebols' extensive and oligopolistic dominance of the Korean economy. In other words, the Chaebols'

dominant or pervasive presence in the Korean economic structure actually discouraged foreign firms from entering the Korean economy. According to Guan-Ho Kim, among 308 manufacturing subsidiaries of 30 Korean Chaebols, 106 subsidiaries made joint ventures with foreign firms (more than a third) and among 30 Chaebols, 23 Chaebol possessed joint venture subsidiaries with foreign firms. A more interesting phenomenon was that in the ownership structure of 106 joint ventured subsidiaries, only 8 percent (9 subsidiaries) had more than 50 percent foreign ownership (Guan-Ho Kim 1993: 32-33). This showed that like the Keiretsu system in Japan (we will see the Keiretsu system and its negative effects on IFDI in the section on the Japanese PDS), Korea's Chaebol system discouraged IFDI flows into Korea and also contributed to the increase in the ratio of joint venture IFDI in the Korean PDS period (Guan-Ho Kim 1993: 52).

The small amount of IFDI in Korea was also caused by external factors. From the 1980s to before the East Asian economic crisis, the ASEAN countries liberalised IFDI policies much further than Asian NIEs (except Singapore and Hong Kong) in order to promote economic development and exports. And, because of this liberalised IFDI environment, foreign investors preferred the ASEAN countries instead of Korea which still had a regulated market and unfavourable accessibility in terms of the costs of production factors. The reason why the Korean state preferred foreign loans instead of IFDI was that while investment made by foreign loans could be in Korean possession after the repayment of the loans to creditors, investment made by IFDI could not be in Korean possession forever. In a word, Korean attitudes towards IFDI were based on nationalistic and mercantilistic belief systems. Moreover, as we have seen in Chapter 5, the Korean state strongly regulated financial sectors in order to

facilitate state-initiated industrial policy. Thus, the Korean financial sector was useful means of accomplishing the targets of industrial policies. Korean bureaucrats were worried about the possible loss of regulation on IFDI because too much dependence on IFDI meant the loss of tight control on monetary policy by the government.

The Korean state was also worried about the potential exacerbation of foreign currency conditions in Korea caused by sudden withdrawal of IFDI capital. Thus, even though Korean top policy makers tried to induce more IFDI instead of foreign loans after 1980 by pursuing comprehensive economic liberalisation measures, there was no significant change in Korea's IFDI environment. Table 15 shows the unchanged IFDI environment in Korea. This points to the rigid ownership regulation even in the PDS period. Thus, similar to the Korean DS period, the ownership structure was dominated by joint ventures in the Korean PDS, different from other NIEs. In Singapore, thanks to the liberalised and promotive environment for FDI policies, wholly owned IFDI was over 50 percent and in Hong Kong the share of wholly owned IFDI was nearly 60 percent. This table reveals the dirigiste and nationalist nature of the Korean IFDI regime even in the PDS period in which various liberalisation measures were continuously pursued. The reasons for the persistently prohibitive and regulative environment of Korean IFDI regime could be attributed to unchanged belief systems of policy implementators and the Korean populace's economic nationalism[11] which prevented wide and influential presence of foreign companies in Korea.

[11] A survey conducted by the Economist (Korean version) and the POSCO Management Research Institute in 1996 revealed the Korean populace's nationalistic double standard towards foreign firms and investors (Joongangilbo 16, 7, 1996, requoted from Joon-Dong Kim 1996: 67). The result was that 54.5 percent of respondents considered the role of foreign investors in the Korean economy as positive. The reason were the transfer of advanced technology (29%), the supply of satisfiable goods

Table 11 shows that the Korean state, like the Japanese counterpart, liberalised manufacturing sectors earlier than non-manufacturing sectors. Because the service and primary industrial sectors were strictly regulated and prohibited, only manufacturing sectors enjoyed the effects of liberalisation. Table 12 shows the leading sectors of IFDI flows into Korea. In manufacturing industry, electrical and general machinery, and chemicals were the major sectors and in non-manufacturing industry, hotel, finance, trade and distribution were the major destinations of IFDI flows. An interesting phenomenon is that the leading sectors of IFDI flows are also the leading sectors of Korean OFDI into ASEAN countries. This reveals that by carefully regulating IFDI flows into the leading sectors of IFDI, Korea improved its technological level to a more advanced level than that of the ASEAN countries and by this manipulated technological edge, Korea developed OFDI flows into the ASEAN region. Another interesting situation is that in non-manufacturing industry, finance and distribution became top leading sectors in inducing foreign direct investment. This reflects the fact that after the economic crisis in late 1997, Korea's service sectors, particularly the financial sector, were liberalised in order to facilitate financial structural adjustment. We will discuss this in the section on the Korean transitionary state in greater detail.

Table 13 indicates the country and regional distribution of Korean IFDI. Japan was the most important investor country until 1990. But its share in Korean IFDI

(24.95), the transfer of advanced management know-how (20.1%), the creation of jobs (20.1%), and making Korean firms more competative by introducing competitions (4.1%). However, 50.6 percent of respondents answered that they do not have favourable feelings towards foreign firms. Moreover 12.9 percent responeded that they disliked foreign firms. This survey uncovered the Korean populace's nationalistic but pragmatic approach to foreign investment.

dramatically decreased in the 1990s and in 1997, the Japanese share was 3.8 percent and in 1998, the share was 5.7 percent. This phenomenon indicates the fact that Japanese OFDI flows preferred the ASEAN region rather than the Asian NIEs in establishing its overseas production plants in the 1980s and 1990s. In contrast, the share of Europe sharply grew from 9.5 percent for 1962-1986 to 28.4 percent for 1962-1997. The share in 1997 was 35 percent and in 1998 was 33 percent. This sharply increased share of Europe in Korean IFDI flows indicates the importance of the Korean domestic market which cannot be neglected by European investors any longer. The enlargement of the Korean domestic market caused by increased consumption power of Koreans is the major reason for the sharp increase of European OFDI presence in Korea. A survey conducted jointly by 'the Economist' (Korean version) and the POSCO Management Research Centre in 1996 showed that the most important investment motive for foreign investors in Korea was the Korean domestic market (82.4 %). And the most important reason for constant investment in Korea was the purchasing power of the Korean domestic market (71.3%) (Joongangilbo 16, 7, 1996, requoted from Joon-Dong Kim 1996: 63). This survey showed that in the PDS period, Korea became a much more developed economy considering that in the DS period, the most crucial investment motive for foreign investors was the cheap and abundant but relatively well-educated labour force.

1-2-2. The Japanese PDS period (1981-To present)

($US million until 1994, JPY million after 1995[12])

Fiscal Year	IFDI	Fiscal Year	IFDI
1981	432	1990	2779
1982	747	1991	4339
1983	813	1992	4084
1984	493	1993	3078
1985	930	1994	4155
1986	941	1995	369700
1987	2212	1996	770700
1988	3244	1997	678200
1989	2860	1998	1340400

Table 6-16. Total IFDI flows into Japanese PDS period.
Source. Based on the MOF data. 1981 data is quoted from Safarian (1993). Data from 1982-1996 is quoted from the OECD (1993b and 1998a).

As can be seen from Table 17, IFDI into Japan was concentrated in the chemicals and machinery sectors in manufacturing industry and commerce and trade and financial sectors in non-manufacturing industry. Like Korea, Japan also channelled IFDI flows into the manufacturing sectors in which Japan had its majority OFDI amounts. This indicates that sectors which experienced massive IFDI flows into Japan also led the massive OFDI flows from Japan. Thus, it can be inferred that Japanese chemicals and machinery sectors improved their technological levels by inducing IFDI from more technologically advanced foreign companies and with this improved technological edge, Japan developed its OFDI deployment in order to exploit the ownership advantage. Another distinctive feature is that Japan experienced a transition in IFDI flows. In other words, IFDI flows into the service industry surpassed the flows into manufacturing industry. In the service industry, IFDI flows have been traditionally concentrated in the commerce and trade sector. This indicates that in service industry, foreign competitors have continuously tried to penetrate the Japanese domestic market. However, as can be see from Table 17, in 1997 and 1998, the financial sector became a leading sector. This change reflects the Japanese government's efforts to

[12] In order to facilitate the internalisation or regionalisation of Japanese Yen, the MOF has been using the JPY in dealing with FDI flows since 1995.

liberalise and reform the domestic financial sector which suffered from massive non-performing loans after the bursting of the bubble economy.

America is the top investor in Japan. This is not a surprising fact, considering that America has experienced chronic trade deficit with Japan and America is one of the countries which has a competitive edge against Japan in high-tech and knowledge intensive industry. In other words, in order to compensate for its trade deficit, the US tried to enter into the protected Japanese domestic market and in order to exploit US companies' ownership advantages in technologies and management know-hows against their Japanese counterparts, the US also endeavoured to localise its entrepreneurial presence in Japan. A survey conducted by the MITI showed that the most significant motive for foreign firms' investment in Japan is access to the Japanese domestic market (JETRO 1997: 55). However, as it can be inferred from the SII talks between the Japanese and American governments, the institutionally protected Japanese domestic market has continuously prevented American companies from fully taking advantage of their ownership advantages in the Japanese market. Schoppa (1993) clearly summarised the result of the SII talks. According to him, America gained substantial concessions from Japan in the distribution sector by making an agreement that would shorten the delay for notification to the MITI and for adjustment processes between big retailers and small and medium sized retailers. Before the SII talks, the adjustment processes between big and small and medium sized retailers to consider the interests of consumers and small retailers were compulsorily imposed by the law and these processes were intentionally used to delay the granting of permission to the application of big retailers. However, in the talks about exclusive business practices and the Keiretsu system towards new foreign

investors, America failed to gain any concessions from Japan. In order to improve market accessibility, America requested the abolition of cross-share holdings inside Keiretsu member companies and the strengthening of shareholders' rights. However, virtually no concessions were made by Japan.

Against the harsh pressure towards the closed Japanese domestic market, 'the White Paper on International Trade' justified the low levels of IFDI flows into Japan by insisting that the extent of IFDI flows is not determined by the market openness but by the competitiveness of private firms (JETRO 1993: 32). Put differently, the Japanese PDS argued that the protected Japanese market was not the crucial factor causing the low levels of IFDI flows into Japan. Instead, it was weak competitiveness or the weak ownership advantage of foreign firms against Japanese firms that contributed to the low level of IFDI flows into Japan compared with other advanced countries.

However, this argument cannot be supported by the reality of the discouraging IFDI environment in Japan and the sluggish increase of IFDI. Table 19 shows the unequal market accessibility between Japan and other investor countries. Japanese firms could have easy M&As while foreign firms' M&As of Japanese counterparts were strictly constrained. For example, in 1990, Japanese firms took 440 M&As in foreign countries while foreign firms took only 18 M&As in Japan. This massive inequality in market accessibility is caused by several specific features of Japanese corporate structures and institutional and political barriers. The Japanese corporate structure which constraints M&A is the Keiretsu system (Lawrence 1993: 93-94). As we have seen in Chapter 4, this Keiretsu system encompasses unique relationships among member companies. Cross-share holding and long-term relationships between

member companies and banks hindered foreign firms' M&As and long-term relationships between big companies as assemblers and SMEs as parts providers also prevented foreign firms' penetration into the domestic industrial structure. Moreover, the preponderance of the interest of employees and managers rather than shareholders effectively discouraged foreign takeovers of Japanese firms. The specific and complicated Japanese distribution system also contributed to low level foreign acquisitions in this sector (Balassa and Noland 1988: 61). "Excessive regulation by the Japanese government and collusive practices among distributors limited the ability of newcomers (especially foreign producers) to get their products to the market" (Schoppa: 1993: 360) Thus, it can be argued that, one of the primary obstacles of low level IFDI flows was the closed domestic market caused by the Keiretsu system (Yoshitomi 1990: 141).

Safarian (1993: 253) summarised the Keiretsu related background of the Japanese government's and firms' aversion to or dislike of foreign M&As in Japan. First, foreign acquisitions could threaten the life long employment system which is a distinctive feature of Japanese style capitalism. Second, foreign acquisitions could disturb Japanese firms' embedded business practices such as long-term relationships with parts suppliers and banks. Third, increased foreign takeovers could be an obstacle for the government in implementing administrative guidance. Fourth, because of the high debt to equity ratio of Japanese firms, foreign firms' purchasing of certain amount of stock could be a crucial threat to management control.

Another factor which frustrated foreign M&A is the cultural institution of Japanese corporate system which are deeply embedded in business practices and businessmen's

belief system. Hamada clearly explained a cultural restrictive factor towards M&As: "there is an established social norm against hostile takeovers. This norm has a lot to do with the Japanese concept of the company as a community of people based on long-term relationships, and the primary responsibility of the management to serve the welfare of the company community" (Hamada 1989: 192). Japanese people's xenophobia and 'buy Japanese goods attitude' are also cultural institutions which discourage foreign investment (GATT 1995: 35, Graham 1996: 69, 71).

The rapid development of Japanese firms' comparative or competitive advantage against competing foreign firms is also as significant as the institutional barriers in discouraging IFDI flows into Japan. Dunning's eclectic FDI theory of OLI (Ownership advantage, Locational advantage, Internalisation advantage) undergirds this argument. The low level IFDI development in Japan can be attributed to these three factors: first, foreign firms lack ownership advantages such as technological or managerial superiority over indigenous Japanese firms; second, Japan as a location for IFDI is not attractive compared with other foreign markets in terms of government incentives, production costs, people's hospitality; third, even though foreign firms are competitive with Japanese firms, they preferred not to internalise their ownership advantage by engaging in direct investment but to sell their ownership advantage through licensing agreements (Dunning 1996: 14, 22). The superior Japanese ownership advantage in manufacturing industry over foreign firms is reflected in Japan's astronomical and consolidated trade surplus. However, it has to be pointed out that in the service industry, particularly in the banking and distribution sectors, Japanese firms' ownership advantage is far behind foreign competitors. Thus, the increase of IFDI in the service industry can be anticipated as Japan implemented neo-

liberal style financial reform which accompanied total liberalisation and deregulation measures in the financial sector. The locational disadvantage of Japan can be proved by a survey conducted by the JETRO in 1998. The survey showed that the most important problem in business development in Japan was the high business cost (almost 80 percent of respondents) and the order of business costs from the most expensive was personnel expenses, land price or rent, distribution cost, and tax (JETRO 1998: 32).

Thus, it is reasonable to argue that in the Japanese PDS period, the low level of IFDI flows is not due to government policy of regulations or restrictions but due to a combination of institutional factors and unfavourable OLI advantages towards foreign firms. This argument is supported by Graham's statement: "FDI simply does not occur in a country where official policies prohibit or discourage it, and for much of modern Japanese history, such policies have been in effect. But FDI has continued to be low in Japan even after all such policies were removed: to understand why this is so, the theory of FDI -or, at least, the OLI paradigm- is of some utility, but only when merged with some understanding of traits and characteristics of Japan" (Graham 1996: 88). Thus, the announcement from the JETRO in 1989 that "government regulations are no longer an obstacle to foreign investment in Japan" (requoted from Lawrence 1993: 86) is not an exaggerated statement. Hamada supported this argument: "Studies that the legal and regulatory barriers that once kept foreign investors out of Japan no longer have any pervasive impacts on direct investment decisions" (Hamada 1989: 191). A survey carried out by the MITI in 1994 also supported this argument. According to the survey, the most significant problem faced by foreign affiliates in Japan was the harsh competition with Japanese companies and the second most

important problem was difficulties in recruitment, and the third was particular customer preference. The fourth problem was the difference in business practices and the fifth was the high corporate tax. Regulation and administrative guidance was ranked next in eighth place. This survey clearly reflected the reality of Japanese PDS' IFDI regime. Harsh competition with Japanese firms' means that Japanese firms' ownership advantage is either as competitive as foreign companies or more competitive. The particular consumer preference means Japanese people's preference of Japanese goods over foreign goods and the difference in business practices means institutional difference of Japanese corporate or banking sectors. In sum, the survey results support the argument that in the PDS period, the low level of IFDI into Japan is not due to government regulation but due to a combination of institutional characteristics of Japanese firms and the OLI disadvantages towards foreign firms.

Due to these institutional (Keiretsu system and business practices) barriers and unfavourable OLI advantages of foreign firms, IFDI flows into Japan remained very low and this gave rise to tough criticism and pressures from foreign countries. The SII talk between Japan and America was a result of this unequal accessibility to each country's market. While Japanese firms actively used the M&As in developing its OFDI in foreign countries, foreign countries could not equally participate in M&As in Japan. As a result of the pressure from the US, in 1990, the Japanese government amended the Security Transaction Law which effectively restricted hostile takeovers from foreign firms (Wakasugi 1996: 124). Accordingly, there is no legal regulation on hostile takeovers in Japan after 1990. However, the level of IFDI into Japan remains very low compared with other developed countries. Thus, the foreign

pressure to change even the culture surged: "Japan needs to undergo a culture change in the way it deals with its economy" (Jordan 1996: 201).

	1950-1989 Cumulative $US million		1950-1995 Cumulative $US million		1997 JPY 100 million		1998 JPY 100 million	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Manufacturing								
Food	283	1.8	606	1.6	22	0.3	258	1.9
Rubber & Leather	76	0.5	312	0.8	188	2.8	48	0.4
Chemicals	2722	17.4	6583	17.4	740	10.9	397	3.0
Petroleum	692	4.4	1158	3.1	58	0.8	84	0.6
Glass & Ceramics	141	0.9	174	0.5	7	0.1	-	-
Metals	497	3.2	1101	2.9	3	0.0	20	0.2
Machinery	5370	34.3	9411	24.8	1452	21.4	2129	15.9
Others	421	2.7	994	2.4	185	2.7	153	1.1
Subtotal	10202	65.2	20268	53.4	2674	39.4	3126	23.3
Non-manufacturing								
Construction	82	0.5	119	0.3	87	0.1	14	0.1
Real Estate	794	5.1	1255	3.3	482	7.1	416	3.1
Commerce & Trade	2213	14.1	7593	20.0	996	14.7	1759	13.1
Services	798	5.1	3497	9.2	888	13.1	3181	23.7
Transportation	127	0.8	248	0.7	4	0.1	61	0.5
Communication	127	0.8	408	1.1	33	0.5	168	1.3
Banking & Insurance	572	3.7	3467	9.1	1616	23.8	4569	34.1
Others	739	4.7	1069	2.8	87	1.3	111	0.8
Subtotal	5452	34.8	17656	46.6	4108	60.6	10278	76.7
Total	15654	100.0	37925	100.0	6782	100.0	13404	100.0

Table 6-17. IFDI flows into Japan by Industry.
Source. Based on the MOF data. Cumulative data for 1950-1989 is quoted from Yoshiyomi (1990). Cumulative data for 1950-1995 is quoted from the MITI (1996a) and data for 1997, 1998 is quoted from *Monthly Finance Review July 1999.*

In response to this harsh criticism, the Japanese PDS implemented various supportive systems and incentive to raise IFDI flows. Thus, in 1992 Japan announced a promotional package for IFDI (GATT 1995: 26-27), and as a result, the prior notification system changed into an ex post reporting system, while preferential tax treatment, low interest rate loans from the Japan Development Bank (JDB) and loan guarantees from the JEXIM bank were introduced. Furthermore, in 1993, 'the Foreign Investment in Japan Development Corporation (FIND)' was established in order to provide technical support to foreign investors such as expert consultation, recruitment services and training. In 1994, 'the Japan Investment Council (JIC)'

headed by the prime minister was established as an advisory body in order to improve IFDI environment (OECD 1995: 79). In 1995, the Japanese PDS took further steps to improve the IFDI regime by removing unnecessary administrative regulations, extending tax incentives and loan guarantees, and strengthening share holders' right in order to facilitate foreign M&As (OECD 1995: 79).

	1950-1988 Cumulative $US million		1950-1995 Cumulative $US million		1997 JPY 100 million		1998 JPY 100 million	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share
U.S.A	6268	49.0	15613	41.2	1518	22.4	8078	60.3
Canada	152	21.2	1663	4.4	2	0.0	17	0.1
North America total	6420	50.2	17276	45.6	1521	22.4	8095	60.4
UK	518	4.0	1643	4.3	446	6.6	370	2.8
Germany	546	4.3	2062	5.3	552	8.1	335	2.5
France	202	1.6	777	2.1	93	1.4	168	1.3
Switzerland	928	7.3	2250	5.9	191	2.8	288	2.1
Netherlands	482	3.8	3361	8.9	1463	21.6	1280	9.5
Europe total	3013	23.6	11653	30.7	3078	45.4	3023	22.6
Japan[13]	1663	12.9	3951	10.4	843	12.4	1729	12.9
Total	12794	100.0	37925	100.0	6782	100.0	13404	100.0

Table 6-18. IFDI flows into Japan by country and region.
Source. Same as the Table 6-17.

	Japanese Firms acquire Japanese firms	Japanese firms acquire foreign firms	Foreign firms acquire Japanese firms	Total
1980	122	48	6	176
1985	163	100	26	289
1986	226	204	21	451
1987	219	228	22	469
1988	223	315	17	555
1989	240	405	15	660
1990	293	440	18	751

Table 6-19. Number of M&As involving Japanese firms.
Source. Lawrence (1993).

As we have seen from the above, the Japanese state endeavoured to liberalise and deregulate the IFDI regime in the PDS period. As we have seen in the earlier section for the Japanese DS, the Japanese IFDI regime was fully liberalised in terms of

regulations and screenings. The deregulation and liberalisation can be dated back to 1980 when Japan abolished 'the Foreign Investment Council (FIC)' which was under the authorisation of the MITI and established a new organisation named 'the Committee on Foreign Exchange and Other Transaction (CFEOT)' under the MOF. The important thing here was that bureaucrats participation in the FIC was abolished when the CFEOT was founded. The CFEOT was organised by non-bureaucrat, civilian members.

However, in the PDS period, administrative regulations became a primary obstacle which constrained IFDI flows into the Japanese domestic market. In other words, instead of direct regulation or restriction measures, indirect barriers caused by complicated and time consuming administrative processes became the most important factor preventing IFDI development in Japan. Thus, deregulation became a national slogan in the Japanese PDS period. Deregulation was intended to "limit government's interference in the economy to improve the quality of life, by expanding the range of consumer choice and reducing price differentials between Japan and other countries, and to facilitate imports, thereby easing friction with the trading partners" (OECD 1996: 67). Thus, it can be inferred from the above that the deregulation processes pursued in the Japanese PDS were a comprehensive plan to facilitate domestic structural adjustment by opening service sectors to foreign competitors in order to improve the Japanese underdeveloped service industry and to increase market access to foreign trader and investor. Moreover, deregulation was also pursued in order to improve the Japanese quality of life.

[13] IFDI by Japan indicates the amount of investment by affiliates of foreign business in Japan

Governmental efforts to deregulate the Japanese economy started from 1988 when 'the Provisional Council for the Promotion of Administrative Reform (PCPAR)' was founded and eight areas[14] were targeted to be deregulated. In 1993, the 'Hiraiwa Report' by the Advisory Group of for Economic Structural Reform was published. In the report, easing regulations to improve market access by simplifying inspection and custom procedures and reporting requirements were emphasised. 'The Outline of External Economic Reform Measures' announced in March 1994 called for faster deregulation in the distribution system and the financial sector. 'The Japan-United States Framework for a New Economic Partnership' which was agreed in September 1994 propelled the deregulation process further by promising increased market access to the Japanese service industry for American companies. However, the problem of these deregulation processes was that:

> Although numerous measures have been implemented, most represent only partial steps towards complete liberalisation . . . there are few industries where entry barriers have been abolished . . . The 1988 and 1994 packages, for example, covered some of the same issues, such as the distribution system and telecommunications (OECD 1994: 71)

Aware of this criticism, the Japanese PDS continued to propel deregulation processes. In March 1995, 'the Deregulation Action Programme' was introduced and in March 1997, 'the Final Revision of the Three Year Deregulation Plan' was announced. As a result of these deregulation efforts, as of March 1997, 1531 deregulation measures were implemented with 402 unfinished items (OECD 1997: 84). In May 1998, 'the Three Year (1998-2000) Programme for the Promotion of Deregulation' was adopted

[14] The eight areas were distribution system, telecommunications, finance, inspection, testing and qualification system, transportation, energy, agricultural products, car leasing.

by a cabinet decision. In the Programme, the removal of entry barriers affecting foreign companies and foreign products in the Japanese markets, further relaxation of approval or notification systems and the conformity of standards, inspection with international standards were again emphasised (Monthly Finance Review May 1998: 45-46). What is important here is that these deregulation processes are mutually repetitive. The OECD Economic Survey, although it was published in 1995, clearly pointed out the limit of the Japanese PDS' deregulation processes: "many of measures included in the new plan are aimed at the same sectors as previous deregulation plans, suggesting a degree of repetition and overlap and a continuation of a strategy based on incremental change" (OECD 1995: 79). Thus, although the Japanese PDS continuously deregulated service sectors, because of this cautious and very slow pace, Japan's international competitiveness in the service industry is still behind compared with other advanced countries (JETRO 1998: 14).

In sum, the low level of IFDI in the Japanese PDS can be attributed to three major factors. First, slow, cautious, and very incremental deregulation measures in the service industry. Second, the institutional barriers caused by Keiretsu system. And finally, cultural practices of Japanese businessmen and Japanese people's culturally rooted aversion towards foreigners. Government regulation or screening is no longer a determining factor which frustrates foreign investors in progressing their investment in the Japanese PDS.

1-3. The Korean transitionary state period (1998-To present)

The Korean TS period witnessed a fundamental change and transformation of the IFDI regime. Incremental and piecemeal liberalisation processes under the PDS

abruptly turned into full-fledged, comprehensive, and substantial liberalisation after Korea experienced the East Asian economic crisis. Excessive dependence on foreign loans occurred because of rapid but poorly prepared financial and foreign exchange liberalisation under the Young-Sam Kim government. As we have seen in Chapter 5, the Korean state was not passive but very active in coping with challenges from the globalising world economy. In order to actively deal with challenges, the Korean state prepared 'the Segyehwa (globalisation) policy' in which further and more comprehensive liberalisation and deregulation policies were implemented. However, liberalisation in financial sectors was not accompanied by a strengthened supervisory system and as a result, merchant banks borrowed excessive foreign loans in order to exploit the interest rate gap between Korea and creditor countries. The Korean interest rate was much higher than that of developed countries. Moreover, in the liberalised space, big Korean companies (Chaebols) and their subsidiaries also excessively borrowed from local financial institutions. The most important thing was that the Korean government did not reserve sufficient foreign currency to protect the Korean currency, the Won and to stabilise the foreign exchange market. Thus, as the domino effect of the economic crisis spilled over to Korea from Southeast Asian countries, the Korean state had no policy means to escape from the domino effect. Snowballed foreign loans caused by excessive and unregulated borrowings of merchant banks and Korean subsidiaries and the shortage of a foreign currency reserve finally led to an unprecedented economic and social crisis in Korea.

With the help of the IMF, the World Bank, and the ADB, Korea recovered fast and the Korean state changed its fundamental belief systems towards the value and contributions of IFDI to the Korean economy. The changed belief system from

developmentalism to a free market-oriented one was revealed by president Dae-Joong Kim's official addresses which firstly criticised excessive government intervention in the market, secondly strongly committed Korea's embrace of the free market system and thirdly emphasised Korean people's changed attitude towards foreign investment:

> The root cause of the crisis . . . was the continuing undemocratic practice of the government meddling in the private economic sector. Collusion between politicians and businessmen, government-controlled financing and corruption were widespread and, as a result, the function of the market economy was distorted and the country lost its competitive strength (Economic Bulletin 1999 April)[15].
>
> From now on, government intervention will be de-emphasised in favour of private initiative and creativity. Korean will soon adhere fully to the principles of a free market economy (Economic Bulletin 1998 November)[16].
>
> Since the crisis, Koreans, who had not generally welcomed foreign capital, have changed their attitudes. For example, a recent poll showed 87 percent of Koreans now believe foreign investment is beneficial to our national economy (Economic Bulletin June 1998)[17].

Moreover, a statement from the MOFE also reflected the changed belief systems of the Korean TS:

> Measures taken by the Korean government to liberalise the capital market and promote FDI since the outbreak of the crisis reflect not just the changes in policy matrix, but more fundamentally the change in the government's philosophy (Economic Bulletin May 1999).

Thus, Korea fully liberalised its IFDI regime in the TS period and Korea enjoyed a dramatic surge up of IFDI flows in the TS period. With this changed belief systems,

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[15] This adress was delivered at the Pensions 2000 Annual Meeting held in Seoul on 12 April 1999.

[16] This address was delivered at the annual APEC Business Summit meeting held in Kuala Lumpur, Malaysia on 16 November 1998.

[17] This address was devlivered at the US Chamber of Commerce in Washington D.C. on 10 June 1998.

the IFDI regime in the Korean TS underwent dramatic changes. In his speech delivered to the AMCHAM in Korea, the vice minister of the MOFE promised to remove government red tape which had been the most restraining factor to IFDI flows (Economic Bulletin February 1999). As of April 1998, among remaining 52 restricted businesses, a further 10 businesses were opened to IFDI and only 42 businesses out of 1148 business category remained restricted. This brought Korea's investment liberalisation ratio up to 98.4 percent (Economic Bulletin April 1998). In May 1998, the Korean government accelerated the opening of domestic businesses to IFDI by announcing a further liberalising plan in which 20 businesses would be liberalised after 1998 (Economic Bulletin May 1998). Moreover, in May 1998, hostile takeovers by foreign investors were fully allowed and "the ceiling on foreign acquisition of real estate, as well as the ceiling on equity ownership by foreigners of private Korean enterprises, was eliminated in June" (Economic Bulletin May 1999). All these efforts show that, in the aftermath of the economic crisis, the Korean TS undertook full-fledged liberalisation in the areas of M&A and land acquisition and opening the domestic market by reducing the number of businesses closed to IFDI. Thanks to the deregulation on hostile M&As, in 1998, more than 50 percent of IFDI was attracted by M&As (MOCIE 1999b: 1).

The most important change in the Korean TS period was the introduction of the New Foreign Investment Promotion Act in November 1998. In the new Act, various incentives were stipulated. First, tax reduction and exemption were widened. For example, high tech and service IFDI which could improve Korean firms' international competitiveness could benefit from an initial 7 years tax exemption and a half per cent reduction thereafter for 3 years. Second, governmental land or properties could be

provided to foreign investors free of charge for up to 50 years and finally, direct government subsidies could be provided. For example, expenses from job training will be covered by the subsidies (Seong-Bong Lee and Hyong-Keun Lee. 1998: 1-2). After the enactment of the Act, the Korea Investment Service Centre (KISC) under the KOTRA started its service as an one-stop service centre (MOCIE 1999a: 1) and the MOCIE also established 'the Trade and Investment Facilitation Office for Foreign Companies (TIFO)' in order to expedite IFDI and resolve difficulties foreign investors encounter (MOCIE 1999: 1). In order to improve Korea's negative image caused by consistent protective features in imports, the Korean TS also abolished the Import Diversification Program in December 1998 which had lasted for more than 30 years in order to reduce the trade deficit with Japan and technological dependence on Japan and America (The Korea Herald 25 August 1999).

The underlying belief systems of these fundamental and radical liberalisation processes in the Korean TS period is that IFDI flows are now regarded as a sole way to decrease the high dependency on foreign loans. With this changed belief system, IFDI is regarded as positive and beneficial to the Korean economy as long as the flows develop more jobs and promote more technological transfers in high-tech and knowledge intensive industries. Moreover, foreign direct investment could help to facilitate Korea's financial and corporate reforms by improving firms' liquidity condition and by realising transparency due to newly introduced international accounting standards (Joon-Dong Kim 1998: 1). It was revealed that foreign firms which are operating in Korea were better than indigenous Korean counterparts in productivity by introducing more efficient managerial know-how and by staying away

from inefficient corporate behaviour such as cross-debt guarantee and excessive debt to equity ratio.

The official statements from the MOFE again unveils the fundamental changes of belief systems towards IFDI and the fact that the MOFE endeavours to justify the benefits of IFDI by challenging the criticism and scepticism which amplifies the side-effects of rapid and fundamental liberalisation. This statement shows that the MOFE become a strong proponent of IFDI promotion and full liberalisation:

> First, there are those who insist that FDI is no longer useful or necessary since the nation has fully recovered from the liquidity crisis. However, the still weak financial structures suggest that the economy may not be entirely immune to another economic crisis . . . Second, some believe that, in the aftermath of the financial crisis, domestic companies were sold to foreign investors at lower prices than their real values. In reality, however, these domestic firms were sold at market prices (the MOFE 1999b: 2-3).

This statement also reveals that, for the Korean TS, IFDI flows were considered as a kind of panacea in curing the chronic Korean foreign debt problems and inefficient corporate and banking systems. In 1998, Korea introduced the New Foreign Investment Promotion Act (NFIPA) in order to improve the IFDI environment and to increase IFDI flows into Korea. By adopting the new Act, the Korean state introduced various incentives and supporting systems. With the help of these supportive and promotive government policies, IFDI flows into Korea surged up dramatically after 1998 and Korea become a net FDI recipient country after 10 years of having a net investor country (UN 1999: 57). This success for Korea in attracting IFDI is remarkable considering that after the East Asian economic crisis, Singapore, Indonesia, Malaysia, Hong Kong, and Taiwan experienced a down turn of IFDI from foreign investors (UNCTAD 1999:2).

2. Outward FDI

2-1. The developmental state period

Japan's and Korea's OFDI development in Southeast Asia has to be explained with a political calculation. In the discipline of international business (IB), Japanese manufacturing industry's heavy presence in the region has been explicated with only an economic approach. This economic approach argues that even though the Japanese government carefully planned and implemented OFDI development in the region, it was the economic calculations of private firms that actually pursued and accomplished production plant in the region. For the proponents of this approach, economic pull factors from host countries and economic push factors from Japan were the primary and most important driving forces of OFDI deployment in the region. Accordingly, differences in ownership advantage, locational advantage, and internalisation advantage determine the extent and content of global inward and outward FDI flows.

However, what this economically oriented approach neglects is the fact that Japan is a state in which co-operation and co-ordination between government and private firms are systematically realised in the name of national interest. Moreover, this economic calculation also underestimates the social embeddedness of Japanese developmentalism even in the post developmental period. As has been emphasised several times in this thesis, both tangible and intangible institutions last longer than ideas (belief systems) and material interests. This means that even though the institutional legacies of the developmental state became a primary obstacle of further economic development in the more politicised global political economy system, institutionalised developmentalism itself needs much more time to be changed and

adjusted to a greatly transformed domestic or international political economy system. In the Japanese EDS period, we can examine this institutionalised developmentalism in the constructing processes of Japanese production sites in Southeast Asia. In order to add a political approach to the economic approach, we need to closely examine the relationship between Japanese ODA and OFDI development in the region.

Korea also tried to learn from Japan in developing its economic and political ties with the ASEAN countries. In the PDS period, the Korean state's supports towards private firms' OFDI flows was insignificant. Different from the traditional and strong interventionist state in economic affairs, the Korean state's role in OFDI development in Southeast Asia was almost insignificant. However, although actual state policies did not show any supportive or restrictive aspects, in the policy-making processes we find Korea's learning from the Japanese EDS in arranging and preparing the Korean ODA system. In the following sections related to Japan and Korea's OFDI development, the industrial and regional distribution of OFDI will be firstly explained and then the political aspects of Japanese EDS into Southeast Asia and the Korean state's institutional learning (mimetic isormophism) from its Japanese counterpart will be examined. The time span for Korean DS is 1962-1985 and for Japan is 1951-1985. The Plaza Accord which caused the appreciation of the Japanese Yen was a watershed in Japanese OFDI development path. For Korea, the Plaza Accord was also an important watershed. The rise of JPY and the relative drop of the Korean Won against JPY facilitated Korea's trade surplus. As Korea achieved its first trade surplus in 1986, the Korean PDS initiated OFDI and foreign exchange liberalisation. And, due to increased trade surplus with America in the second half of the 1980s, pressures from America also increased and the Korean Won appreciated. With the currency

appreciation, Korean OFDI into Southeast Asia surged. Thus, the Plaza Accord was also a significant turning point for Korean OFDI.

2-1-1. The Korean DS period (1968-1985)

Korea's OFDI dramatically increased after the middle of the 1980s. The background of the increase could be divided into internal push factors and external pull factors. The first balance of payments surplus achieved in 1987, strategic globalisation of private Korean firms particularly the Chaebol, the appreciation of the Korean Won, dramatically rising labour costs, labour market unrest, the shortage of labour force in '3 D' (difficult, dangerous, dirty) industries and dual economic system led by dominant Chaebol and underdeveloped SMEs were the major features of the domestic push factors behind the promotion of Korean OFDI in the PDS period (Yoon-Hwan Shin and You-Il Lee 1995: 179, Economic Bulletin August 1992). The improved balance of payments brought about Korea's liberalisation of the Foreign Exchange Management Law in 1987.

($US thousand)

Calendar Year	Total Acceptance	Total investment	Net investment[18]
1968-71	20178	14314	13364
1972	2739	5115	4767
1973	16609	3907	3717
1974	15278	18149	18045
1975	12027	14171	9701
1976	17800	8220	6943
1977	17484	17795	12331
1978	46522	43418	38761
1979	102412	22772	18820
1980	22816	21095	15456
1981	108530	28212	21925
1982	121396	100837	97578
1983	82969	108917	102591
1984	67448	50186	48184
1985	219190	112774	63752

[18] 'Net investment' means 'total investment' minus 'liquidation'. 'Total acceptance' minus 'cancellation' is 'remaining acceptance'. Thus, there are four standards in dealing with Korean OFDI flows. Total acceptance - cancellation = remaining acceptance, total investment - liquidation = net investment.

Table 6-20. Korean OFDI flows in the DS period.
Source. Data from 1968 to 1980 is based on the Bank of Korea, *Economic Statistics Yearbook*, various issues and requoted from Sakong (1993). Data from 1981 to 1985 is quoted from the MOFE (1999c).

(Percentage)

CY	US	Europe	Asia	ASEAN 5	Latin America	China[19]
1968-80	22.4	3.6	36.5	30.7	3.6	-
1985	11.1	34.4	15.8	14.3	2.5	-
1868-86	23.6	9.7	18.9	13.4	-	-
1987	40.9	1.7	32.2	30.9	-	-
1988	51.5	8.6	20.2	13.0	-	-
1989	29.6	3.5	22.8	15.9	-	-
1990	35.7	9.9	31.3	23.9	-	1.7
1991	35.0	8.1	38.4	29.2	3.7	3.8
1992	28.4	11.8	42.7	20.4	3.0	11.6
1994	22.8	18.6	47.0	7.2	2.1	27.5
1995	17.4	21.0	53.8	13.5	3.9	26.8
1997	22.6	14.3	46.6	13.1	8.0	19.6
1998	22.5	26.2	39.8	9.8	5.3	16.2

Table 6-21. Korean DS' and PDS' OFDI flows by region (Percentage).
Source. Based on the total investment. Data for cumulative 1968-80, 1985, and 1991 to 1998 is modified from the MOFE (1999c). Data for cumulative 1968-86 and 1987 to 1990 is quoted from Si-Joong Kim et. al. (1992). Data for China is modified from the MOFE (1999c).

Also, as we have seen in the Chapter 5, Korea experienced rapid rising labour costs and labour market unrest caused by nation-wide, militant labour movements in the late 1980s under the democratisation process of Korea's political economy. Moreover, as Korea's GDP grew rapidly, labour shortages emerged, particularly in labour intensive industries. With these labour market disadvantages and an unfavourable business environment caused by the dominant Chaebol structure, SMEs which were then focused on labour intensive industries started to move their production sites to Southeast Asia.

As we have seen in Chapter 5, the Korean state underwent a democratisation process in the mid-1980s. Particularly after 1987 when 'the 6. 29 declaration' from the ruling party was announced, labour movements became militant and nation-wide labour market unrest facilitated OFDI flows from Korea to Southeast Asian countries. Under the democratisation processes, the Trade Union Law was amended in 1987. Before

the amendment, the law "legitimised state intervention in strikes, work contracts and decentralised the union movement to the company level and gave the state rights to change the existing union structure at any time" (Yoon-Hwan Shin and You-Il Lee 1995:183). However, after the amendment, the new law "guaranteed three rights of labour (union organisation, collective bargaining, and collective acting) and lifted restraints on unionisation, union activities and leadership selection controlled by deep state intervention" (Yoon-Hwan Shin and You-Il Lee 1995: 184). Thus, under this democratised labour environment, labour movements were intensified. Increased production costs which were accompanied by militant labour movements were the major push factors for Korean OFDI. In other words, Korea's cheap and abundant labour force ceased to exist from the mid 1980s and as Korean manufacturing industry lost its comparative advantage, OFDI from the industry began to increase in order to find cheap production sites in Southeast Asia.

External pull factors for Korean OFDI included Korea's loss of its Generalised System of Preference (GSP) in 1989, the ASEAN countries' liberalised and favourable policies towards FDI throughout the 1980s and 1990s, the trade and technological protectionist trends starting from the mid 1980s in the US and Western Europe, and Korea's economic boom in 1986-1988 which was indebted to the three lows of international interest rates, international oil prices, and Korean Won against the Japanese Yen and finally, rapid changes of comparative advantage in Asia due to massive increase of FDI flows (Sakong 1993: 150, Economic Bulletin August 1992, Ku-Hyun Jung and Moxon 1996: 158-159). As Korea lost its GSP privilege, Korea sought to find a production base for detour exports and the ASEAN countries were the

[19] Korea made diplomatic normalisation with China in 1989. OFDI started from 1990.

perfect places which welcomed foreign investment with liberalised policies and incentives and still enjoyed GSP status and supplied abundant cheap labour. Moreover, as developed countries strengthened their protectionist measures in trade and technology, Korea had to find alternatives in attracting high technology and in overcoming protectionist barriers and blocs. The OFDI provided Korea with not only technology accessibility to advanced countries by takeovers but also stable exports into advanced countries' markets by establishing overseas production sites which were not affected by protectionist measures.

Before the middle of the 1980s (60s, 70s, and the first half of 80s), the Korean government strongly restricted and regulated OFDI in order to take control of the shortage of foreign exchange and snowballed foreign debt. Thus, OFDI was concentrated in natural resources development in order to secure a stable supply of raw materials for exports. The most distinctive symbol of regulatory state intervention in OFDI flows was the establishment of the Overseas Investment Deliberation Committee (OIDC) in 1981. After witnessing specified and detailed screenings by the OIDC after 1981, Korea suddenly turned to OFDI liberalisation in 1987 when a notification system was introduced for investment under one million US dollars and the amount of investment which needed the approval of the OIDC was increased from three million to five million US dollars. Moreover, the amount of investments which needed approval by relevant ministries was raised from one million to three million dollars. As we have seen above, the first liberalisation measure in 1987 was possible because of Korea's first balance of payment surplus realised in 1986. These liberalisation measures were stipulated in 'the Formal Proposal' to improve OFDI in 1987.

In the Proposal, declining industries such as labour intensive and light industries were recommended to pursue OFDI and in order to evade protective barriers in the international political economy system in the 1980s, the barrier circumventing OFDI was also strongly recommended and as a result, regulations towards these OFDI were liberalised and various financial and tax incentives were provided in 1987 (Monthly Review September 1987). What is important here is that by observing these promotive OFDI policies for both declining industries and trade barrier circumventing investment, we could find the Korean PDS' intention to promote the Expansionist Developmental State. Under the Japanese DS, as the MITI strongly promoted Japanese OFDI into Korea in the 1970s in order to adjust and upgrade Japanese economic structure by exporting declining industries (Castley 1996: 73), the Korean PDS pursued the same strategy to upgrade its economic structure by exporting declining industries to Southeast Asia.

Thus, Korean OFDI started from labour-intensive, cheap labour seeking sectors such as textile and garments, footwear, and standardised electrical home appliances. The destination of these OFDI was the ASEAN 5 countries, Vietnam, and later China. As Table 21 indicates, Asia has continuously been a most important destination of Korean OFDI. The share of the ASEAN 5 in Asia was dominant position until the early 1990s. However, as China normalised diplomatic relations with Korea, Korean OFDI into China dramatically increased and in 1994, China surpassed the ASEAN 5 as a destination for Korean OFDI flows. The reasons for the rapid emergence of China as a massive absorber of Korean OFDI can be summarised as follows. First, China's labour cost is much cheaper than the ASEAN countries. Thanks to rapid

economic growth, the ASEAN countries experienced a continuous rise in labour costs. Second, China is much closer than the ASEAN countries to Korea. Moreover, historical and cultural affinities between the two countries also contributed to rapid expansion of trade and investments between the two countries. Third, as Japan had already established systematically organised production networks in Southeast Asia, Korean firms as latecomers in the region experienced difficulty in finding local partners and in penetrating Japanese production and supply networks. Thus, Korean firms chose China as an alternative destination for their OFDI.

2-1-2. The Japanese DS period (1951-1985)

($US million)

Fiscal Year	OFDI	Fiscal Year	OFDI
1951-1956	45	1971	858
1957	34	1972	2338
1958	65	1973	3494
1959	54	1974	2396
1960	94	1975	3280
1961	164	1976	3462
1962	99	1977	2806
1963	126	1978	4598
1964	119	1979	4995
1965	159	1980	4693
1966	227	1981	8932
1967	275	1982	7703
1968	557	1983	8145
1969	665	1984	10155
1970	904	1985	12217

Table 6-22. Japanese total OFDI flows in the DS period.
Source. Based on the MOF data. Data from 1951 to 1962 is quoted from Hamada (1972). Data from 1963 to 1985 is quoted from Steven (1990).

(Percentage)

	FY 1951-74, Cumulative	FY 1951-81, Cumulative	FY 1985
US	23.6	27.1	45.0
Europe	19.1	11.6	15.8
Asia	23.0	29.0	11.6
Latin America	17.6	16.2	21.4

Table 6-23. Japanese DS' OFDI flows by region (Percentage).
Source. Data for 1951-1974 is quoted from Steven (1990) and data for 1951-1981 is quoted from the Economist Intelligence Unit (1983). Data for 1985 is modified from the OECD (1993b).

The Japanese DS' OFDI policy underwent a distinctive change in the second half of 1960s when Japan achieved its first surplus in the balance of payments. Before the surplus, OFDI was strongly regulated. For example, projects over 300 thousand US dollars had to obtain permissions from the BOJ and projects only under 200 thousand dollars were subject to the automatic approval system. The background of the regulation was firstly, concern about the possible deterioration of the balance of payments due to excessive capital outflows, secondly, the concern about the possible ineffective control of monetary policy when OFDI involved large amounts of capital, and finally, the concern about the adversarial effects of OFDI towards domestic industry when OFDI hinders Japanese exports and when there is excessive competition among Japanese firms in host countries (Hamada 1972: 188). However, as Hamada clearly pointed out, the regulation was not substantial but formal and the belief systems of the majority of the Japanese people towards OFDI was positive: "the general attitude of Japanese people towards outward direct investment is commonly favourable. It seems that government, businessmen, most academics agree that Japan should liberalise outward direct investment. This is in great contrast to attitudes towards foreign investment in Japan" (Hamada 1972: 189).

Thus, the OFDI policy was continuously liberalised throughout the Japanese DS period. Firstly, in 1964, liberalisation started by the introduction of the automatic approval system. Investments under 40 thousand dollars were eligible for Automatic Approval. Investment which was automatically approved did not need to contact the MOF. The authority for Automatic Approval was transferred to the BOJ from the MOF. The amount of investments which were eligible for Automatic Approval was extended to 100 thousand dollars in 1969. In 1970, the amount was again raised to

200 thousand dollars and in 1978, the prior notification system to the BOJ replaced the old approval system. In 1980, the Japanese DS took further steps towards liberalisation by reducing the number of restricted businesses and by announcing the system of 'approval in principle, regulation in exception'. From 1984, investment projects under 10 million JPY could proceed without prior notification to BOJ and the amount was raised again in 1987 to 30 million JPY. In 1998, the Japanese PDS abolished the prior notification system by amending the FE & FTCL.

The MITI announced the reasons why Japan had to promote OFDI in its White Paper 'The Long Term View on Industrial Structure' published in 1975: "the need to secure stable natural resources, the need to upgrade Japanese industrial structure by moving declining industry and focusing on more value added industry, the need to overcome the protectionist barrier against Japanese exports" (Requoted from the EIU 1983:12). The intention of economic structural upgrade was written in the official statement prepared by 'the Industrial Structure Council' under the MITI: "industrial branches such as textiles which include a low degree of processing and generate low added value should be moved to developing countries. . . so that Japan can concentrate on high technology and knowledge intensive industries" (Requoted from Suzuki 1991: 146).

Japanese DS' OFDI flows experienced four distinctive stages of development from 1951. In the first stage, Japanese DS' OFDI was concentrated in labour intensive industries and natural resource development. As the Japanese economy developed further, Japan witnessed rising production costs. And as a result of this rise, Japanese SMEs developed labour-intensive OFDI in Asian NIEs countries from the 1960s to

1970s (Ozawa 1996: 159). For example, Korea, after normalising diplomatic relations with Japan in 1965, tried to induce more Japanese FDI by establishing the Export Free Zone. Thus, light industry such as textile, garments, and footwear led to the sudden growth of Japanese DS' OFDI in Asian NIEs. The Japanese DS was constantly eager to secure stability in the supply of raw materials. Because Japan lacks natural resources and Japan is heavily dependent on exports of manufactured goods, securing a stable supply of raw materials was a significant condition for Japan's economic development. Second, the Japanese DS' OFDI also developed through heavy and chemical industries (HCI) (Chng and Hirono 1984: 48). HCI industries facilitated Japanese OFDI in two ways. One was Japan's suffering from pollution caused by rapid development in HCI industry. Thus, the Japanese DS was eager to move pollution industries to foreign countries from the mid 1970s (Steven 1990: 80-81, Suzuki 1991: 143). This was the so-called house cleaning OFDI (Ozawa 1996: 161). And the other was that as ASEAN countries implemented import substitution industries, demands for Japanese exports in HCI industries were massively increased. This is the period when the Japanese DS' OFDI qualitatively transformed its contents from labour intensive to capital intensive ones.

Third, OFDI was also pursued in order to circumvent protective barriers in America and Western Europe (EIU 1983: 5). This type of investment was led by the automobiles and consumer electronics industries from the mid 1980s. Moreover, this was the period when Japan actively invested in the real estate sector in America with the help of the appreciated JPY and surplus capital which emanated from its enormous trade surplus. Thus, after the mid 1980s, Japanese OFDI in the two regions increased rapidly and the amount of investment towards Asia decreased. Fourth, however, from

the first half of the 1990s, Japanese OFDI in East Asia surged dramatically. This is the period when Japan started its project of establishing production networks or export platforms in the region (Ozawa 1996: 163). More specifically, Japanese OFDI dramatically surged from 1985 to 1989. At this time, investment was concentrated in developed countries and the share of ASEAN and NIEs fell. However, the share of Southeast Asia started to increase after 1990 led by massive manufacturing OFDI. The political background of the expansion of Japanese OFDI in the region could be summarised into two major factors: "this FDI shift can be viewed as part of a gradual strategic re-orientation that will lessen Japan's dependence on the US, while expanding its opportunities with developing economies in Asia" (Jun et al. 1993: 28).

(Percentage)

FY	Asia	NIEs	ASEAN 4	FY	Asia	NIEs	ASEAN 4
1951-1970	21.2	5.1	12.9	1978	29.1	12.9	16.2
1971	27.6	11.2	16.1	1979	19.5	12.3	6.8
1972	17.2	9.7	7.4	1980	25.3	8.1	16.7
1973	28.6	12.9	15.6	1981	37.4	8.1	28.8
1974	30.6	8.9	21.4	1982	18.0	9.6	8.1
1975	33.6	8.4	24.5	1983	22.7	13.7	8.0
1976	36.0	6.5	29.4	1984	16.0	8.0	6.7
1977	30.8	10.3	20.3	1985	11.6	5.9	4.9

Table 6-24. Japanese DS' OFDI into Asia, NIEs, and ASEAN 4[20] (Percentage).
Source. Based on the MOF data. Quoted from You-Soo Hong (1993).

	FY 1973 Cumulative $US million	FY 1980 cumulative $US million	1987 Cumulative $US million	FY 1996 JPY 100 million	FY 1997 JPY 100 million	FY 1998 JPY 100 million
Manufacturing	1211	3847	10000	7466	8978	4732
Food	47	139	425	314	215	161
Textile	483	870	1231	403	520	285
Wood/Pulp	71	132	212	258	162	171
Chemical	76	528	1585	1004	1619	759
Metals	99	732	2064	1068	965	704
Machinery	49	242	778	625	647	363
Electrical	183	473	1562	2059	2226	852
Transport	77	238	1028	897	1047	1021
Others	126	492	1115	839	1577	415
Non-manufacturing	1148	4695	16286	4755	5640	3484
Ag./Fo./Fi.[21]	103	259	391	102	223	9
Mining	605	2815	6677	522	1270	375
Construction	11	65	254	174	267	170

[20] ASEAN 4 refers to Indonesia, Malaysia, Philippines, and Thailand.

[21] Ag./Fo./Fi. means Agriculture, Forestry, and Fishery.

Com./Trade[22]	74	331	1482	894	957	1452
Fi./Insurance[23]	128	237	1447	891	706	548
Service	-	-	3173	862	676	487
Transportation	-	-	393	302	486	267
Real Estate	-	-	846	1007	1089	169
Others	228	988	1622	-	65	9
Branch equipment	-	25	336	862	330	141
Real estate	-	77	37	-	-	-
Total	2359	8643	26.658	13.083	14948	8357

Table 6-25. Japanese DS and PDS' OFDI flows into Asia[24] by Industry (Amount).
Source. Cumulative data until 1973, 1980 and 1987 is quoted from Steven (1990) and yearly data for 1996, 1997, and 1998 is quoted from the MOF (1999a).

(Percentage)

	FY 1951-76	FY 1977-86	FY 1986
Food	1.9	1.0	1.2
Textile	13.9	3.0	1.0
Lumber/Pulp	2.3	0.5	0.3
Chemicals	5.7	6.3	2.0
Metals	4.4	9.2	2.7
Machinery	1.8	3.5	4.1
Electrical	5.6	4.8	11.4
Transport	2.6	4.0	5.6
Others	5.1	4.2	6.6
Manufacturing Total	43.4	36.7	34.9
Ag./Fo.	3.0	1.1	0.0
Mining	36.6	27.5	10.6
Construction	0.5	1.4	1.0
Commerce and Trade	3.1	6.7	8.7
Banking and Insurance	3.2	5.3	12.5
Others	10.4	21.1	31.4
Total	100.0	100.0	100.0

Table 6-26. Japanese DS' OFDI into Asia by industry (Percentage).
Source. Suzuki (1991).

Tables 25 and 26 clearly point out the transitions in Japanese OFDI in Asia. In the manufacturing industry, until 1976, the textile industry occupied a dominant position and from 1977 to 1986, chemicals and metals became leading industries. And finally in 1986, electrical machinery and electronics occupied almost a third of Japanese OFDI in manufacturing industry. In non-manufacturing industry, Japanese OFDI flows also revealed a transition from mining to commerce and trade and the financial sector. These tables also reflect the ASEAN countries' historical trajectory of

[22] Com./Trade means Commerce and Trade.

[23] Fi./Insurance means Finance and Insurance.

economic development from natural resource exporting countries to electrical machinery exporting countries.

The increase of Japanese OFDI in the financial sector in the ASEAN countries started with the appreciation of the Japanese Yen after the Plaza Accord. With the expensive Japanese Yen, Japanese financial institutions found their way into the ASEAN countries in order to support Japanese firms' subsidiaries in the region. Moreover, Japanese financial institutions also increased their commercial loans to ASEAN countries. As of 30 September 1998, 18 major Japanese banks had loans worth 16 trillion Yen to Asian companies (Japan Economic Almanac 1999: 24). More specifically, at the end of 1996, Japanese banks' exposure to Asian countries were Thailand (37.5 billion dollars), Korea (24.3 billion dollars), Indonesia (22.0 billion), Malaysia (8.2 billion), and Philippines (1.6 billion) (Japan Economic Almanac 1998: 57). The rise of Japanese investment flows to the financial industry in ASEAN also reflected ASEAN countries' economic structural transformation from a manufacturing industry-centred economic structure to a more advanced service-industry centred one.

The easy access for ASEAN countries to Japanese commercial loans propelled an asset bubble in the region, particularly, in Thailand. Thus, to some extent, the Japanese EDS exported its asset bubble to the ASEAN countries (Whittaker and Kurosawa 1998: 761). Besides this side-effect of financial development, Japanese OFDI also caused other negative side effect of development. The deeply structured technological gap and increasing trade and investment inequality between Japan and

[24] Asia includes Newly Industrising Economies (Korea, Singapore, and Taiwan) and ASEAN countries.

the Asian countries reflect a hierarchical and unequal economic relationship (Suzuki 1991: 149).

The destinations of Japanese DS' OFDI are illustrated in Tables 23 and 24. For the period 1951-1981, both Asia and the US shared almost the same amount of the Japanese DS' OFDI. This indicates that traditionally Asia and the US were the major destinations of the Japanese DS' OFDI. However, in 1985, OFDI into the US was 45 percent and into Asia, it was a mere 11.6 percent. This indicates that because of the upsurge of protectionist mood in the 1980s, Japan needed to overcome protective barriers and the best way was through OFDI into protected markets. Thus, in the 1980s, massive inflows of Japanese OFDI into the US were evident. The other way to evade protectionist barriers in America was to exploit Latin America as a base for detour export. Thus, Japanese DS' OFDI into Latin America also gradually grew throughout 1980s.

2-2. The post developmental state period

2-2-1. The Korean PDS period (1986-1997)

In 1988, 'the proper self capital requirement' which was imposed to Korea investors by government was abolished. The original intention of 'the proper self capital requirement' was to prevent excessive OFDI development beyond the capacity of investor firms and to restrain excessive financial outsourcing from foreign institutions. In 1988, the availability of the notification system was increased to 2 million dollars.

($US thousand)

CY	Total acceptance	Total investment	Net investment
1986	363786	182649	158286
1987	367360	409708	320096
1988	474752	215861	156194
1989	943660	569589	392384
1990	1610549	958935	812713
1991	1524105	1115413	1026902

1992	1343928	1219430	1098254
1993	1875989	1261612	1016396
1994	3581581	2299555	2029824
1995	4949096	3071779	2760705
1996	6286983	4248485	3595095
1997	5819497	3229527	2993614
1998	5134182	3892863	3471512
Total cumulative 1968-1998	35125701	23221468	20293000

Table 6-27. Korean OFDI flows in the PDS and the TS period.
Source. The MOFE (1999c).

However, after Korea returned to a balance of payments deficit in 1990, regulative measures were reintroduced in order to reduce the side-effects of rapid OFDI development. Thus, such regulative measures as the re-intensification of approval procedures were introduced. By strictly applying the approval procedure, the Korean PDS tried to regulate not only over-competition among Korean affiliates in host countries but also excessive projects in which the invested capital in affiliates was larger than the self capital of parent companies.

In contrast with this return of regulative measures, in 1991, the most fundamental liberalisation measures towards OFDI were carried out by the amendment of the Foreign Exchange Management Act. The objective of the amendment was to improve Korean OFDI and promote outfinancing of Korean investors. First, the old system 'regulation in principle and liberalisation in exception' was transformed to 'liberalisation in principle and regulation in exception'. Second, the amounts of investment which required notification, approval, and deliberation were extended in order to facilitate liberalisation processes. More specifically, the notification system was applied to investment under two million dollars, and investment between two to five million dollars was subject to the approval system and investment over five million US dollars was forced to be deliberated by the OIDC. Third, OFDI was

classified into three categories: encouraged, restricted, and general. The announced intention of the classification was that investments "that bring high technology into Korea are encouraged and provided with financial support, while investments which speed up the outflow of Korea's technology and ultimately weaken its international competitive edge are restricted. Those not falling under the encouraged or restricted categories are approved in principle, but financial support is provided on a selected basis" (Quarterly Review November 1992: 10-11). In 1992, the notification system was extended to under five million dollars and the approval system was applied to the projects over 5 million dollars and only the investments over 10 million was forced to receive the approval of the OIDC.

Furthermore, in 1993, the number of businesses restricted from OFDI was reduced from 30 to 17 and the authority organisations for the investment procedure were diversified to include all banks which are permitted to do foreign exchange business. Before the change, only the BOK and the KEXIM were available for notification and approval procedures. In 1994, the restricted businesses were again reduced to 14 and projects under 300 thousand dollars became subject to a simple validation system instead of the notification system. In the liberalisation of 1994, the notification system was extended to investments under 10 million dollars and the approval system was applied to projects over 10 million dollars. The principle underlying these liberalisation processes throughout Young-Sam Kim's regime (1993-1998) was the Segyehwa (globalisation) idea. In January 1994, the Korean PDS identified the 12 most necessary tasks for the globalisation of the Korean economy. Among the 12 tasks, 'formulation of strategies for firms' overseas expansion', 'globalisation of domestic financial industries and capital trade, and the enlargement of foreign direct

investment', 'effectively forestalling the movement toward regionalism' and 'formulation of a basic strategy for Korea's internationalisation' were closely related to Korea's OFDI development.

What is important here is that the task of 'formulation of strategies of firms' overseas expansion' and 'forestalling the movement toward regionalism' could be regarded as the Korean PDS' preparation of the expansionist developmental state (Economic Bulletin July 1994). More specifically, the official statement below from the EPB uncovered the governmental intention of globalisation:

> Globalisation should be pursued with two major objectives in mind: To make Korea the world's best location for foreign investment, and conversely, to allow Korean firms to make use of the optimal combination of production factors around the world (Economic Bulletin July 1994).

The Korean PDS speeded up further OFDI liberalisation by introducing outstanding measures in 1995 such as the reduction of restricted areas to only three real estate related sectors. Moreover, the extent of validation was raised up to 10 million dollars and notification was required for projects over 10 million dollars to less than 50 million dollars. The Approval from the BOK and OIDC was necessary only for investments which exceeded 50 million dollars. The liberalisation measures of 1995 were comprehensive and substantial considering that almost 95 percent of Korean OFDI was carried out by projects under 10 million dollars which only required validation by foreign exchange banks. However, the changes of 1995 also accompanied regulative aspects in order to improve the financial structure of Korean subsidiaries and to minimise the side-effects of the rapid increase of financial outsourcing from Korean subsidiaries by re-adopting the proper share of parent

companies' self capital in subsidiaries and by regulating debt-guarantees of parent companies for their subsidiaries.

This re-introduction of regulative policies in 1995 revealed that although the Korean PDS consecutively and gradually liberalised and deregulated OFDI flows, the state never fully disengaged from its interventionist and regulative belief systems. What is worth mentioning here is that if these regulative policies were for the proper supervision of OFDI and foreign debt control, the economic crisis that occurred at the end of 1997 would not have happened. This showed that the regulative aspects of the liberalisation measures of 1995 were not instituted to strengthen the supervision of OFDI flows and foreign loans borrowed by Korean investors. Instead, they were the result of prolonged and deeply engrained developmentalism-oriented belief systems of bureaucrats in the PDS period. In 1996, the Korean PDS finally opened the remaining three restricted businesses and by doing that, Korea fully deregulated all businesses for the promotion of OFDI. Moreover, in July 1997, just before the economic crisis, the Korean PDS abolished the approval system by the BOK and simplified investment procedures by unifying the notification system to foreign exchange banks. However, the OIDC was sustained in order to induce sound OFDI development. The criteria for OIDC deliberationa were investments over 50 million dollars and projects carried out by heavily debted firms (Economic Bulletin July 1997).

Besides these consecutive liberalisation processes regarding investment procedures, the Korean PDS also provided various incentives and a supporting system in order to promote OFDI development. 'Overseas investment credit' available from the KEXIM bank; 'foreign exchange loans' from foreign exchange banks; the EDCF by the

KEXIM bank; tax incentives; 'overseas investment insurance' provided by the Korea Export Insurance Corporation; provision of investment information by the KEXIM bank, the KOTRA, Regional information centre of the KIEP and KDI; and finally national agreements in order to prevent double taxation and protection of investment were the major incentives and supporting system provided by the Korean PDS (OECD 1993: 128-129, Si- Joong Kim 1996:33-36, Seung-Jin Kim 1997: 118-122).

Korea's OFDI can be variously classified according to the motives of OFDI: natural resource seeking investment, cheap labour costs seeking investment, capital intensive investment, Chaebol's own ownership advantage exploiting investment, and trade-barrier circumventing investment. Korea's OFDI development into the ASEAN countries was basically based on natural resource seeking, production cost saving, trade-barrier circumventing investment. Thus, the majority of the investments were carried out by SMEs. Differing from the Chaebols which have abundant capital and technological edge, the Korean SMEs pursued small and medium sized investment in terms of investment amount in order to take advantage of the host countries' low labour cost. Due to this technological and financial difference between the Chaebol and the SMEs, the Korean PDS' OFDI had a dual structure. First, world-wide, large investments led by Chaebol and second, small and medium sized investments concentrated in Asia led by SMEs (Dent and Randerson 1996: 538, Keun Lee 1993: 167). The most important motives for the large investments conducted by the Chaebol were first, the need to induce more advanced technology by participating actively in M&As and strategic alliances, second, the need to circumvent protectionist barriers in America and Western Europe, third, the need to not only cope with

pressures from the globalising world economy but also take advantage of it, and, finally, the need to explore the domestic markets of the developed countries.

Meanwhile, the motives for the investments by SMEs were first, the need to move out abroad in order to overcome the adversarial business environment in Korea caused by increased labour costs, the labour shortage, and a dominant Chaebol structure in the domestic economy under which SMEs could not compete with. Secondly, OFDI by SMEs was also motivated by the need to take advantage of the rapidly changing regional comparative advantage in labour intensive and capital intensive industries. Thus, the Korean PDS' OFDI into ASEAN was basically 'pro-trade' or 'development spreading'[25] and had close affinity to the earlier Japanese DS' OFDI development in ANIEs and ASEAN (Keun Lee 1992: 11). Two surveys conducted by the KIEP in 1992 and 1996 revealed the same result in indicating the most important motives for Korean OFDI into America and Asia (Si-Joong Kim 1996: 71, Si-Joong Kim et. al. 1992: 97). The motives for investing in America was the massive market size (most important motive), easy access to parts and resources (second important motive) and acquisition of local technology (third important motive). In sharp contrast with the above, the most important motive for investing in ASEAN and China was their abundant, cheap but relatively skilled labour forces.

The economic relationship between Korea and ASEAN underwent a fundamental change in the middle of the 1980s. Before the middle of the 1980s, ASEAN was a

[25] Kasai classified OFDI into development spreading, development obsobing, and finally development promoting. The first refers to the OFDI which is carried out for the exploitation of cheap labour and the second refers to the OFDI for the technology acquisition. The last definition refers to the OFDI which are carried out in order to secure markets and to circumvent trade barrier. (Requoted from Keun Lee 1992: 11-12).

major exporter of natural resources to Korea and Korea exported labour intensive manufacturing goods to ASEAN. However, after the middle of the 1980s, due to the appreciation of the Korean Won, Korea's labour shortage, increased labour costs, and the liberalised FDI environment in the ASEAN countries, economic relations between Korea and the ASEAN countries dramatically increased (Sang-Chul Yoon et al. 1991: 99). Besides this development of their economic relationship, Korea and ASEAN also expanded political and diplomatic ties after the middle of the 1980s. In 1987, Korea became a partial dialogue partner of ASEAN and in 1991, became a full dialogue partner. After this, the Korean government established 'the Special Co-operative Fund for ASEAN' and later businessmen from both sides established the 'ASEAN and Korea Private Economic Co-operation Committee (AKBC)'(Sang-Duk Chun et al. 1996: 145).

Korea's OFDI continuously grew throughout the 1980s and 1990s and total cumulative OFDI reached 35 billion US dollars in 1998. An interesting phenomenon is that even after the economic crisis in late 1997, Korea actually increased its OFDI in terms of net investment. The 1990s witnessed the rapid growth of Korean OFDI, thanks to investment booms in China and Vietnam. Thus, as Table 28 shows, 45 percent of Korean cumulative total OFDI went to Asia. In terms of industrial distribution, manufacturing industry as a whole represented more than 50 percent of cumulative total OFDI. In the service industry, commerce and trade led the OFDI by sharing 20 percent of cumulative total OFDI.

($US million)

By industry		By region	
	Cumulative 1968-98 Amount (Share)		Cumulative 1968-98 Amount (Share)
manufacturing	18261 (52.0)	Asia	15684 (44.7)
Commerce/Trade	7006 (20.0)	North America	8901 (25.4)
Construction	925 (2.6)	Europe	5622 (16.0)
Others	8934 (25.4)	Latin America	2162 (6.2)
		Others	2757 (7.8)
Total	35126 (100.0)	Total	35126 (100.0)

Table 6-28. Korea's cumulative OFDI flows for 1968-98 by industry and region.
Source. Based on total acceptance. The MOFE (1999c).

($US thousand)

CY	Indonesia	Malaysia	Philippines	Singapore	Thailand
1968-85	122802	27068	2110	8149	1811
1986	-	2918	-	232	45
1987	173571	240	1582	-	1567
1988	28809	4255	4840	698	17346
1989	117379	30724	9195	628	14163
1990	270813	63899	69820	2411	33951
1991	198562	32444	39168	14626	32632
1992	67309	33062	21217	6052	33920
1993	63554	10243	34802	3822	12206
1994	66309	170036	91934	3593	25993
1995	362099	79579	32113	28562	37778
1996	219255	67002	88586	75512	71591
1997	376638	85640	82336	57911	227958
1998	82371	23912	95622	291014	105106
Total	2248180	642434	576084	495400	623386
Share in ASEAN 5 (Percentage)	49.0	14.0	12.6	10.8	13.6

Table 6-29. Korean OFDI flows into ASEAN 5 countries.
Source. Data for 1968-1990 is based on remaining acceptance and quoted from Guang-Chul Lee (1995). Data from 1991 to 1998 and total figures are based on the total acceptance and quoted from the MOF (1999c).

(1968-1990 cumulative, $US thousand)

	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN5 (a)	Total (b)	a/b %
Manufacturing	369437 (51.3 %)	126294 (99.4%)	87097 (99.5%)	5703 (47.1%)	63460 (92.1%)	651991 (64.4%)	1766116	36.9
Mining	242707	-	-	-	3702	246409	653963	37.7
Fo./Fi.	44060	380	-	500	-	44940	192157	23.4
Construction	140	456	-	-	441	1042	67911	1.5
Trans./Storage	-	-	-	78	-	78	13438	0.6
Com./Trade	-	1097	274	5605	280	7256	603661	1.2
Others	58030	877	75	232	1000	60214	352903	17.1
Real Estate	-	-	101	-	-	101	48326	0.2
Total	714374	127104	87547	12118	68883	1012031	3698835	27.4

Table 6-30. Korea's OFDI flows into ASEAN 5 countries by industry.
Source. Data is based on the remaining acceptance. Guang-Chul Lee (1995).

(1968-1990 cumulative, $US thousand)

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Total	Percentage
Food/Beverages	82535	-	-	500	3763	84708	13.0
Textile/Garment	143806	-	10254	-	2001	156061	23.9
Footwear/Leather	31187	704	3309	-	3977	39177	6.0
Wood products/furniture	18634	13942	134	-	-	32710	5.0
Paper/Printing	1700	1944	-	-	-	3644	0.6
Petrochemicals	27890	15392	32671	924	5094	82018	12.6
metals	12328	32067	1240	3724	5880	55239	8.5
Machinery	24383	56836	37481	-	29797	148407	22.8
Others	28974	5409	2041	555	12988	49977	7.7
Total	369437	126291	87177	5703	63510	652121	100.0
Percentage	56.7	19.4	13.4	0.9	9.7	100.0	

Table 6-31. Korea's OFDI flows in manufacturing industry into ASEAN 5 countries.
Source. Data is based on the remaining acceptance. Guang-Chul Lee (1995).

(Total IFDI stock in percentage)

	Indonesia	Malaysia	Philippines	Thailand
Japan	20.0	32.0	25.0	30.0
NIEs	28.0	34.0.	16.0	30.0
US	7.0	14.0	30.0	17.0
Europe	28.0	13.0	23.0	12.0
Others	17.0	7.0	6.0	11.0

Table 6-32. IFDI flows in ASEAN 4 countries by investor countries.
Source. Thomsen (1999).

In terms of country distribution, Indonesia attracted almost half of Korea's cumulative total OFDI into the ASEAN 5 countries (Table 29) and in terms of industrial distribution, Korean OFDI into these countries was concentrated in manufacturing industry (Table 30). As can be seen from Table 30, the share of manufacturing industry in the ASEAN 5 countries was 64.4 percent. In Malaysia, Philippines, and Thailand, the share was over 90 percent. However, Indonesia also attracted Korean OFDI in the mining industry with a 34 percent share while Singapore induced over 46 percent of Korean OFDI in the commerce and trade sectors. This reveals the fact that Singapore is used as a base for trade promotion in the region by Korea and Korea is heavily dependent on Indonesia in terms of the energy industry. Table 31 shows Korean OFDI distribution in the manufacturing industry. It reveals that Indonesia is a key destination for labour intensive, cheap labour cost seeking Korean investment

while Malaysia, Thailand, and Philippines are the destinations for capital intensive Korean investment. This table also shows that Indonesia is the most favoured destination for Korea's manufacturing investment among the 5 countries. The reason is that, as can be seen from Table 31, Korea's manufacturing investment is concentrated in labour cost saving sectors such as textile and garment and electrical machinery. Indonesia has a comparative advantage in labour intensive industry thanks to its abundant and relatively cheap labour force. The more interesting phenomenon is that the leading sectors in Korea's OFDI such as machinery and chemicals are the leading industries in inducing IFDI into Korea (Keun Lee 1993: 160). This shows that by attracting IFDI flows into strategically targeted industries, Korea could raise its technological level and with this technological edge, Korea developed OFDI into Asia.

In the 1990s, economic interdependence in Asia deepened as the comparative advantages in the region rapidly changed and not only Japan but the NIEs increased their share in the flow of investments in Asia (OECD 1993: 40). For example, Korea's economic relationship with Asia clearly indicated the deepening interdependence between the two economic actors. In 1996, more than 51 percent of Korean exports and 44 percent of OFDI were carried out with Asian countries (H. J. Kim et al. 1997: 1). As can be seen from Table 32, the share of the NIEs surpassed that of Japan and the US in the ASEAN countries except Philippines which has a traditionally strong relationship with the US. However, the table also indicates that Japan is the top single investor country in the region. What is important here but cannot be seen from the table is the structuralised economic disparity or unequal, dependent economic relationship between Korea and Japan. As we have seen in the

Korean DS section, Korea has been constantly and heavily dependent on Japan in terms of technology transfers and trade deficit. This structural weakness was sustained in the Korean PDS. The result was a vicious cycle. The more Korea exported, the more Korea experienced trade deficits with Japan due to increased capital goods imports from Japan. And, the more Korea exports to America, the more intensified become trade and investment related protectionism and pressures from America. Muraoka clearly pointed out this structural contradiction of Korea: "1. Japan has played a mediatory role as a source of capital goods; 2. The US market has provided the role of absorber of ANIEs' manufacturing exports; 3. The ANIEs have been placed in a peripheral position as a recipient of capital goods from Japan and as a supplier of exports to the US" (Muraoka 1991: 165).

The Southeast Asian countries are also in the same position as the ANIEs. In other words, the Asian countries (NIEs and ASEAN countries) are heavily dependent on Japan's technology and capital in their economic development path. This hierarchical and unequal economic interrelationship in Asia needs to be improved in order to obtain sustainable, long-term economic prosperity in the region and bring about mutual benefits (Sang-Chul Yoon et al. 1991: 101). An equal and reciprocal economic relationship requires first, more reverse imports from host countries to home countries and second, more purchases of local supplies and parts by investor companies. Korea's ratio of reverse imports from the ASEAN countries is very low and the ratio of using local parts and intermediary goods is also very low compared with direct imports from parent companies located in Korea.

According to a survey conducted by the KIET in 1995 (Sang-Duck Chun et al. 1996: 247, 250), the destinations of products produced by Korean subsidiaries operating in the ASEAN were the host countries' domestic market (38.4 percent), the advanced countries (detour export 30.6 percent), Korea (reverse import 17.4 percent) and finally other Asian countries (13.5 percent). The structure of Korean subsidiaries' supply market uncovered a more serious structural inequality. The same survey showed that Korean subsidiaries operating in ASEAN imported 51. 4 percent of parts and intermediate goods from Korea. Meanwhile, 33.9 percent of parts and intermediate goods were supplied by host countries' firms. These two survey results revealed that Korean OFDI has unequal and hierarchical structure. In order to achieve desirable and sustainable economic co-operation in the region, Korea needs to improve its OFDI structure by not only increasing reverse imports from its subsidiaries but also raising the purchase ratio of parts and intermediate goods from host countries.

($US million)

Year	ODA	ODA/GNP	Year	ODA	ODA/GNP
1981	20.9	0.03	1990	61.16	0.02
1982	126.4	0.17	1991	57.48	0.02
1983	233.7	0.28	1992	76.80	0.03
1984	28.0	0.03	1993	111.56	0.03
1985	48.3	0.05	1994	140.22	0.04
1986	109.5	0.10	1995	115.99	0.03
1987	73.0	0.06	1996	159.15	0.03
1988	34.0	0.02	1997	185.61	0.04
1989	33.80	0.02	1998	182.71	0.06

Table 6-33. Korea's ODA flows and percentage to GNP.
Source. Data from 1981-1987 is quoted from Hak-Soo Kim (1991). Data from 1988 to 1998 is quoted from the MOFAT (1999).

($US million)

	1981	1985	1990	1995	1996	1997	1998
Bilateral aid	5.3	14.9	12.25	71.46	123.31	111.34	124.69
Grant aid	5.3	14.9	3.26	50.11	53.41	54.77	67.21
EDCF loan	-	-	8.99	21.35	69.90	56.57	87.48
Multilateral aid	15.6	33.4	48.91	44.53	35.84	74.27	58.01
Total ODA	20.9	48.3	61.16	115.99	159.15	185.61	182.71

Table 6-34. Korea's ODA disbursement.
Source. Same as the Table 6-33.

(Percentage)

	1991	1992	1993	1994
Asia	35.7	36.4	41.6	49.7
Africa	30.4	31.0	25.4	17.3
Middle East	6.3	9.0	8.2	15.1
Latin America	22.5	17.0	17.9	11.2
Eastern Europe/ CIS	5.1	6.6	6.9	6.7
	100.0	100.0	100.0	100.0

Table 6-35. Korea's grant aid expense by region.
Source. Yul-Kwon (1995).

	1963-1981	1982-1986	1991-98
[Invitation of trainees]			
Asia, (Southeast Asia)	79.8 (59.6)	61.9 (35.9)	50.1 (-)
Middle East	9.3	8.5	20.8
Africa	5.5	15.5	2.8
Latin America	4.2	11.0	22.1
Others	1.1	3.2	4.2
Sub-total	100.0	100.0	100.0
[Dispatch of exports]			
Asia, (Southeast Asia)	24.5 (18.4)	54.2 (26.0)	23.2 (-)
Middle East	15.3	1.7	13.9
Africa	30.6	11.9	37.3
Latin America	16.3	23.2	7.4
Others	12.2	8.5	18.2
Sub-total	100.0	100 0	100.0

Table 6-36. Korea's technical co-operation by region (Percentage base)
Source. Data for the cumulative 1963-1981 and 1982-1986 is quoted from Won-Chan Ra (1991). Data for the cumulative 1991-1998 is quoted from KOICA (1999).

Korea's Official Development Assistance (ODA) development has a relatively short history. Technical co-operation started from the mid 1960s and grant aid started from the later 1970s (Yul Kwon 1995: 59). As a result, as the ODA ratio to total GNP shows in Table 33, Korea's ODA amount is insignificant. The Development Assistance Committee (DAC) recommended 0.7 percent of ODA ratio to GNP to the member countries and 0.15 percent of ODA ratio to GNP to the least developed countries. However, the reality of ODA contribution from the DAC member countries is far from satisfactory. The average percentage of ODA of DAC member countries is just 0.22 percent to GNP (Yul Kwon 1999: 1). Given Korea's poor ODA

to GNP ratio, although Korea is not a member country of the DAC, Korea is not exceptional in this disappointing ODA performance. Besides the short history of Korean ODA, another reason for the small amounts of ODA is that Korea became a member of the OECD in late 1996 while it is yet to be a member of the Development Assistance Committee (DAC). Korea as a developing country before entry to the OECD had no great concern for assisting other developing countries. Moreover, the institutional setting for ODA operation was finished when the Economic Development Co-operation Fund (EDCF) and the Korea International Co-operation Agency (KOICA) were established in 1987 and 1991 respectively. However, although the amount of ODA between Japan and Korea is hardly comparable, it is worth comparing the operational systems and responsible governmental organisations. The similarities and differences between the two country's ODA system will reveal Korea's institutional learning from Japan in arranging responsible organisations.

As we will see later in this section, the Korean ODA system has similar structures and organisation compared with those of Japan's. Ra acknowledged Korea's institutional isomorphism (imitation) from Japan in developing an ODA operational system and governmental authorities: "Recently Korea established the EDCF and the KOICA which have almost similar characteristics compared with Japan's OECF and the JICA. The great similarities in the motives for establishing ODA and in the associated operational tasks and in the names suggested raised worries in Korea that Korea just imitated the Japanese system of economic co-operation" (Ra 1991: 64-65).

The Korean ODA system is divided into bilateral and multilateral aid. Bilateral aid is divided into grant aid and loans. Grant aid is again divided into cash grants and

technical co-operation. Grant aid is operated by the KOICA while loans are managed by the EDCF. The Ministry of Foreign Affair and Trade (MOFAT) takes charge of grant aid and the MOFE and KEXIM bank have authority in managing the EDCF.

As can be seen from Table 34, Korean ODA was concentrated in multilateral aid until the 1990. Multilateral aid was associated with both contributions and subscriptions to international organisations and international financial institutions. After the 1990, the share of bilateral aid increased and surpassed the share of multilateral aid. And in bilateral aid, the EDCF loan provides more than grant aid. This reveals that the Korean ODA system needs to be reformed considering that the amounts which are channelled into the grant aid activities such as cash grant and technical co-operation are less than the amount channelled into the EDCF loan. A more problematic phenomenon is that the EDCF loans are almost tied loans (Yul Kwon 1995: 60). The tied loan means that loans are available only when Korean firms are involved in the usage of the loans. Moreover, the terms and conditions of the loans are not favourable to recipient countries (Yul Kwon 1995: 69). The regional distribution of ODA also reveals a problematic structure. As can be seen from Table 35, Korean ODA's grant aid is concentrated in Asia. The combined share of Africa, Eastern Europe and CIS countries was smaller than that of Asia in 1994. To some extent, the concentration of grant aid in Asia can be justified by Korea's geographical closeness and deepening economic horizontal and hierarchical interdependence in East Asia. However, the share of Africa which needs foreign aid the most fell continuously throughout the 1990s. Table 36 shows the regional distribution of Korea's technical co-operation. A distinctive feature is that Korea's technical co-operation in Asia experienced a continuous drop. An almost 80 percent of share in 1963-1981 dropped to 50 percent

in 1991-1998. This feature reveals that the Asian countries, including the ASEAN countries, accomplished their technological and governmental administrative development throughout the 1980s and 1990s. Instead of Asian countries, trainees from Africa and Latin America countries were increased in the 1990s.

The DAC and OECD member countries announced their collective views on the objectives of ODA development in 1996: "(1) humanitarian consideration, which is considered most fundamental; (2) enlightened self-interest, which means that development benefits people not only in poor countries, but also in the industrialised donor countries; (3) solidarity for all people, which enables people from all nations to work together to address common problems and pursue common aspiration" (KOICA 1999: 2). What is important here is that by inserting the second sentence, the developed countries actually tried to justify their usage of ODA development in close line with their economic expansion or development. In this sense, it can be argued that there is no free international grant aid and the grant aid is only for the countries with economic potential which can benefit donor countries. Korea is not exceptional in this respect. KOICA announced its major objectives of ODA development. Three objectives are (1) contribution to international peace and prosperity, (2) advancement of Korea's economic interests, (3) humanitarian concern (KOICA 1999: 2). Korea's intention of relating ODA with its economic expansion and development can be easily found in official government announcements: "Korea intends to concentrate future aid efforts towards the developing countries which should improve economic relations between Korea and these countries" (Economic Bulletin August 1991). Moreover, the strong recommendation for usage of ODA in close relation to Korea's OFDI development can be found in government-funded, semi-governmental research

institutes: "co-operation between government and private firms could be realised when private firms' entrance into a targeted areas is supported and accompanied by the EDCF projects such as the provision of infra-structure or by supporting the needed capital of private firms' projects by the EDCF" (Hak-Soo Kim 1991: 96).

In line with this emphasis on economic development, Korea selected target countries in distributing its ODA funds. The list of targeted countries is managed by the KOICA and the KEXIM bank. For example, the targeted countries of the EDCF loan in 1995 were China, Vietnam, Indonesia, India, Philippines and the targeted countries for grant aid were Vietnam, China, Indonesia (Yul Kwon 1995: 77-78). This revealed that the Korean PDS tried to develop the EDS in Southeast Asia by connecting ODA development with OFDI expansion.

2-2-2. The Japanese PDS period (1986-To current)

($US million until 1994, JPY million[26] after 1995)

Fiscal Year	OFDI	Fiscal Year	OFDI
1986	22320	1993	36025
1987	33364	1994	41051
1988	47023	1995	4956800
1989	67542	1996	5409400
1990	56915	1997	6622900
1991	41586	1998	5216900
1992	34138		

Table 6-37. Japanese total OFDI flows in the PDS period.
Source. Based on the MOF data. Data from 1986 to 1996 is quoted from the OECD (1998a). Data from 1997 to 1998 is quoted from the MOF (1999b).

(Percentage)

	1988	1989	1991	1992	1994	1995	1997	1998
US	46.1	47.7	43.3	40.5	42.1	44.1	38.5	25.3
Europe	19.4	21.9	23.0	18.8	15.2	16.7	20.8	34.4
Asia	11.8	12.2	14.2	20.8	23.6	24.0	22.6	16.0
ASEAN 5	5.8	6.9	8.9	11.3	12.0	10.4	13.9	9.8
China	0.6	0.6	1.4	3.1	6.2	8.7	3.7	2.6
Latin America	11.5	7.8	8.0	7.8	12.8	7.5	11.7	15.9

[26] MOF has been using the JPY instead of $US in indicating Japanese inward and outward FDI flows in order to facilitate internationalisation or regionalisation of the JPY.

Table 6-38. Japanese PDS' OFDI flows by region.
Source. Data from 1988 to 1995 is modified from OECD (1993b and 1998a). Data from 1997 and 1998 is quoted from the MOF(1999b).

The Japanese PDS in OFDI development is basically an Expansionist Developmental State (EDS). In transplanting its domestic developmental state system into Southeast Asia, Japanese private firms played a leading role. However, it is important to remember that supportive and promotive governmental efforts also played a significant role (Machado 1996: 61). In the International Business literature, academic interest has focused on the economic calculations of investors (MNCs or home countries) and host countries. In the IB literature, political and diplomatic variables have been treated as of secondary importance. However, without considering the political and diplomatic calculations and systemic co-ordination between the government and private firms in Japan, it is difficult to explain the historical and phenomenal development of Japanese OFDI in East Asia. As has been emphasised several times in this thesis, the research focus of this thesis is the political and diplomatic aspects of OFDI in explaining the Japanese EDS system. The MITI's official statement of 'The Vision for the economy of the Asia-Pacific region in the year 2000' published in 1993 reveals the Japanese state's intention of transplanting the developmental state system in the region. Sheridan summarised the essential parts of the report:

> [Japan] wishes to establish a production base in the region on the basis of Japan's developed production and management technologies which should be supported by her know-how in industry policy and government business relation (Sheridan 1995: 488).

> the government intends to allocate large amount of public funds . . . for adequate production and social infrastructure facilities in the region. Public funds would also provide education and training facilities . . . This will establish a mixed form of capitalism in Asia

> which will become an alternative to Western market capitalism (Sheridan 1995: 489).

The first sentence indicates the Japanese government's intention of transplanting the core part of the Japanese developmental state system such as the strong presence of industrial policy in which the government could intervene in market and systematically organise co-ordination between government and private firms in accomplishing economic objectives. The second sentence reveals the Japanese government's intention of using the ODA system in order to promote OFDI development in the region. The more important point is that Japan actually endeavoured to challenge America and Western Europe by formulating a conspicuous Asian style capitalism led by Japanese OFDI development in the region.

What is missed here is that the Japanese EDS propelled OFDI into East Asia in order to facilitate domestic economic structural adjustment or the upgrading of the domestic economic structure. In this regard, Japanese OFDI policy can be identified with an economic restructuring policy (Machado 1996: 45). Machado's argument undergirds this point: "From the mid-1980, the economic ministries and agencies began to formulate plans for promoting regional economic integration, primarily as a vehicle for domestic industrial restructuring. In this connection . . . Japan agreed to yen revaluation in accordance with its own industrial policy for phasing out sunset industries at home and for the purpose of accelerating its FDI" (Machado 1996: 61). The plan for the implementation of the EDS in East Asia could be dated back to 1987 when the MITI announced 'the New Asian Industrial Development Plan (New AID Plan)'. In the plan, the MITI revealed its intention to connect ODA development closely with OFDI development and to actively participate in the policy making

processes of Asian countries' industrial policy or economic development plan (Machado 1996: 61).

In order to support and facilitate private firms' OFDI development, the Japanese state not only deregulated OFDI policies but also organised various supporting institutions and incentives. In 1998, by introducing the FE & FTL, Japan abolished the prior notification system in OFDI. And, in financial assistance, there are 'Overseas Investment Credit' and 'Overseas Investment Insurance' available from the JEXIM bank. The main duty of the JEXIM was changed from an export promoter to a FDI promoter in 1996 (Huang 1997: 178). The coverage of the Overseas Investment Insurance was enlarged from only political risks such as war or revolution to commercial risks such as firms' bankruptcies (Tokunaga 1992: 23). This amendment was realised when Japan changed its 'Export Insurance Act' to the 'Trade Insurance Act' in 1987 (Sakurai 1995: 81). There are also quasi-governmental organisations for the promotion of OFDI such as the Japan International Development Organisation (JAIDO) established in 1989 and the Japan ASEAN Investment Company (JAIC) established in 1981. The Overseas Economic Co-operation Fund (OECF) has its equity share in these two hybrid organisations. More specifically, in the JAIDO, OECF has a one third share while the remaining two thirds are held by private firms. The JAIDO's major purpose is to promote OFDI by actively participating in ODA related projects. The JAIC, which also has the equity share of the OECF, intends to promote OFDI by investing its funds to venture companies in the ASEAN countries (Tokunaga 1992: 24, Huang 1997: 180). Besides these financial assistance programmes, the Japanese state provided information services and endeavoured to extend bilateral or multilateral governmental agreements on investment. The JETRO

and the JEXIM bank are the major windows for investment information. The MITI has semi-governmental organisations such as the Japan Small Business Co-operation (JSBC) and the Institute of Developing Economies (IDE) in order to provide available information for potential Japanese investors (Sakurai 1995: 82). The Japanese government also extended the number of Bilateral Investment Treaties (BITs) for the purpose of protecting investment. The BITs include detailed agreements such as the protection of invested assets, the avoidance of double taxation, the guarantee of repatriation of original funds and profits, the promise of national or most favoured nation treatment, and the submission of disputes to international authority (Sakurai 1995: 79).

Thanks to these governmental supporting systems, which were systematically accompanied by pressures from internal and external economic environments such as a strong JPY, the need to recycle trade surplus, protectionist mood in the developed countries, rising costs of domestic production factors, inflated domestic real estate prices, and finally, big business's globalisation strategy, Japan's OFDI dramatically increased from the mid-1980s (Elger and Smith 1994: 20). The expansion of Japanese OFDI in Southeast Asia throughout the 1990s was possible due to low labour costs, constant economic growth, liberalisation and a pro-FDI environment[27] in the ASEAN countries (Kawai and Urata 1996: 63, Soo-Hee Lee 1995: 155). This massive OFDI flows resulted in the emergence of Japanese production networks in East Asia and as a result, Japanese private firms regard East Asia as a kind of

[27] Even though, the ASEAN member countries sustained open and pro-FDI policies before the crisis, it did not necessarily mean that there was no government intervention in FDI flows. On the contrary, the ASEAN countries liberalised FDI flows which were closely related to export promotion. Market seeking FDI was strongly restricted and various regulations on the aqusition of lands, and ownership

domestic market (Dobson 1993: 41). It is important to note that the Japanese OFDI development experienced a conspicuous change in its motives and operational system in the 1990s. The major motives of the Japanese OFDI in the 1980s were the need to resolve trade friction with America and Western Europe by exploiting the ASEAN countries' GSP status and to take advantage of cheap labour costs in the region. However, the most important motives in the 1990s were the strengthening of the already existing export platform or the production networks in the region (JETRO 1995: 23).

The background of the deepening productions networks are mainly two-fold. First, in order to reduce production costs in Japan, the production plants in the region could act as a supply base for cheap, standardised intermediary parts to be imported back to Japan (Tejima 1995: 95). Second, the production networks in the region could also reduce production costs due to the advantage of internalisation. This internalisation advantage gives a competitive edge to Japanese subsidiaries in the export markets of advanced countries. Thus, cheap labour costs in East Asia and the benefits of internalisation are the key factors which underpin Japan's international competitiveness in the world market. Moreover, thanks to economic development, the ASEAN countries' domestic markets also emerged as a major motive for Japanese OFDI in the 1990s. As a result, in East Asia, the amount of reinvestment undertaken by the subsidiaries already surpassed that of their original investment done by Japanese parent companies (JETRO 1996: 25). This indicates that East Asia, particularly the ASEAN 5 countries became 'fixed production sites' for Japan.

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structure were excersied by the ASEAN member countries. Also, in order to promote exports, performance requirements were imposed on foreign investors. See Steven (1999: 5).

Moreover, the procurement structure of Japanese affiliates in the region also shows the intensified consolidation of Japanese production networks. According to a survey conducted by the MITI named 'Survey of Overseas Business Activities of Japanese Companies', Japanese affiliates procured 38 percent of parts from local companies and imported exactly the same 38 percent of parts from Japan (JETRO 1997: 9). This sharp increase of local procurement can be regarded as an index of the consolidation of Japanese production networks in the region. The increase of reverse imports of not only cheap manufacturing goods but also capital goods from East Asian countries in the second half of 1990s (JETRO 1996: 15, JETRO 1998: 28) also supports the above argument regarding the consolidation of Japanese production networks in the region. The profitability of Japanese affiliates in the region is also the highest compared with that of other affiliates operating in North and South America and Western Europe due to the consolidated and deepened production networks in East Asia (Steven 1996: 76, MITI 1997: 2).

However, even though Japanese OFDI contributed to economic structural upgrade from labour intensive to capital intensive industry in the ASEAN countries with the help of massive OFDI flows, the most important investment motive in the region is still the cheap production costs rather than its domestic markets. Given that the most important motives for OFDI to Europe and America are to evade protectionism and to penetrate the domestic market respectively (JETRO 1998: 30), the ASEAN countries are still being exploited by Japanese PDS and private firms as the most suitable place for export platforms and production plants with stable, cheap production costs. Thus, it can be argued that the most problematic feature of Japanese OFDI is its OFDI system which promotes more intensively Japan's capital and high-tech based exports

to the ASEAN countries than imports from these countries. This means that, from the viewpoint of Japanese private firms, Japanese OFDI is basically export-inducing or promoting rather than export-substituting or import-stimulating[28]. This situation resulted in the East Asian countries' experiencing structurally consolidated and chronic increase of technology imports, trade deficits and the repatriation of profits emanating from Japanese subsidiaries (JAPANECHO December 1997: 9-10).

In order to ameliorate this structural inequality between Japan and other East Asian countries, Japan has to boost its domestic consumption and to increase imports from these countries as well as reverse imports from its overseas subsidiaries (Machado 1996: 41, JAPANECHO December 1997: 11)[29]. The more significant structural problem is the amplified conflicts between Japan and America. Japan improved its international competitiveness by establishing and consolidating production networks in East Asia and using the networks as an export platform to the advanced countries. Even though, intra-regional trade sharply increased in East Asia, the value of the American market to East Asian economies has not declined. The American market is still an important destination for the manufactured goods of the East Asian countries. Thus, in this triangular relationship, between America as a market provider and Japan as a high-tech or capital parts provider, the NIEs and the ASEAN countries became intermediary actors. The problematic phenomenon is increasing trade deficits or unequal economic relationships of both America and East Asian countries with Japan.

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[28] The terms of export-inducing, export-substituting, and import-stimulating are quoted from the GATT (1995: 33).

[29] Fred Bergsten emphasised this view in the US Congress' hearing on the East Asian economic crisis. As a chairman of Institute of International Economics in Washington, he argued that "the fundamental resolution of the East Asian crisis is heavily dependent on Japan's increase of domestic consumption and imports because Japan occupies two thirds of Asian economy" (Joongangilbo 6 February 1998).

Without ambitious efforts to improve this structural inequality, Japan's pervasive economic presence in East Asia is basically unstable and subject to continuous criticism. Yoon succinctly pointed out this situation:

> There thus arose an imbalance between the rigidity of Japanese institutions and a rapidly changing . . . world political economy. The Japanese have not been ready and willing to adjust . . . to the new situation. Rather, they have clung to the mercantilist way of life . . . Unfortunately, in an interdependent world, the imbalance could not remain as a purely Japanese problem (Young-Kwan Yoon 1991: 16).

What the Japanese EDS pursued in the region was a hierarchical economic structure based on each country's development level. In other words, Japan is at the top of the structure by devoting itself to knowledge and high technology industry, and the NIEs are in the middle by specialising in capital intensive industry, and finally at the bottom, the ASEAN countries pursue labour intensive industry. This is basically a hierarchical division of labour and the problem of this structure is that chronic trade and investment inequality cannot be easily overcome. Meanwhile, on the positive side, this hierarchical division of labour can promote economic development of developing countries by providing chances for them to participate in economic integration processes occurring in East Asia. In a word, the Japanese EDS' core economic strategy is based on the flying geese model or the product life cycle. By actively participating in this flying geese-like economic integration or interdependence processes in East Asia, the NIEs and the ASEAN countries could attain a certain level of economic development through both increased exports and continuous restructuring of the division of labour as argued by Kojima and Ozawa (Anderson and Linder 1993: 136, You-Il Lee 1999: 467). However, as we have seen in the section on Korea, the East Asian countries' technological dependence and chronic trade deficit

with Japan is the most destructive factor which needs to be ameliorated in order to realise further economic interdependence and co-prosperity in the region.

Thus, it can be argued that current economic relations between Japan and the other Asian countries are based not on interdependence but on dominance, dependence or exploitation (EIU 1983: 73). The side-effects of the dominant Japanese economic position in the region were anticipated by Japanese bureaucrats and the Industrial Structure Council under the MITI suggested guidelines in order to minimise unnecessary friction or tension between Japanese subsidiaries and host countries: "promote industrial co-operation including joint ownership; localise organisation and management; localise parts production; localise research and development; harmonise with the local community; and devote greater efforts to public relations" (Sakurai 1995: 83).

The problematic or destructive aspects of the rapid increase of Japanese OFDI is not confined to host countries. They could also be found in the domestic Japanese economy. The most significant problem was the possibility of hollowing out of Japanese domestic industry. The loss of domestic jobs and the sharp drop of domestic investment caused by massive OFDI flows were the major concerns of policy-makers (Minshall 1998: 42-43). The Small and Medium Enterprise Agency of the MITI prepared its policy measures to prevent rapid increase of unemployment in 1988 and announced a guideline. The guideline contained two measures, "any parent company planning overseas business expansion should notify subcontracting firms at the earlier stage and . . . parent company should introduce other clients so that the subcontractors' business will not drop dramatically" (Japan Economic Almanac 1988:

78). Moreover, due to massive outflow of domestic capital and decreased reinvestment in the domestic economy, Japan's domestic manufacturing facilities became more and more outdated (JETRO 1998: 13). The separation of R&D from production also gave rise to adverse effects to Japanese innovative capacity in technology development (JETRO 1996: 21). Japanese R&D facilities are concentrated in Japan while production sites are transplanted to East Asian countries.

The Japanese PDS' OFDI dramatically rose after 1985 when the Plaza Accord which raised JPY's value against US dollar was agreed between Japan and America (Takenaka 1991: 92). The dramatic surge of Japanese OFDI was also caused by intensified trade friction from the mid 1980s. Another important factor which promoted OFDI was the dramatic increase of Japan's trade surplus in the 1980s. Thus, the appreciated JPY, abundant capital emanating from the trade surplus, and protectionist mood in the advanced countries were three major factors which accelerated Japanese OFDI in the PDS period (OECD 1993: 55). Another factor is the continuous benefit from the GSP by engaging in OFDI development in Southeast Asia (Lim 1990: 175). Throughout the PDS period, Japanese OFDI fluctuated according to changes in the Japanese Yen's value. More specifically, as can be from Table 37, Japanese OFDI responded quickly to the two episodes of high JPY which occurred from 1985 to 1989 and from 1992 to 1993. The rebound of OFDI in 1994 was due to the emergence of a strong JPY in the period. The retreat of OFDI from 1990 to 1992 was due to the bursting of the bubble economy. After the economic crisis in East Asia, the Japanese PDS' total OFDI dramatically fell. As Table 38 illustrates, the Japanese PDS' FDI into Asia witnessed a rise until the East Asian crisis occurred. The more interesting phenomenon is that China does attract much less Japanese OFDI

than the ASEAN 5 countries as a whole. This Table points out that Japan still prefers the ASEAN 5 countries rather than China as a production site for its low cost seeking manufacturing investment. However, in contrast to this table, a survey conducted by JEXIM bank in 1997 showed that Japanese firms actually preferred Vietnam and China instead of the ASEAN 5 countries (Requoted from Thomsen 1999: 13). This contrasting data actually indicates that in the ASEAN 5 countries, Japan has already established a firm and consolidated production network and because of this deepened economic integration, it is difficult for Japan to move to Vietnam or China by quickly responding to changing regional comparative advantage.

In the aftermath of the East Asian economic crisis, Japanese firms are experiencing hard times and Japan's investment into the region dramatically decreased, particularly due to the economic recession at home and low profitability of subsidiaries abroad (OECD 1999: 112). According to a MITI survey conducted in 1999, the adverse impacts on Japanese affiliates are reduced profits (first), exchange loss through foreign currency denominated debt (second), reduced domestic demand-oriented sales (third), higher prices for imported parts (fourth), higher price of domestic procurement (fifth), and reduced exports to foreign countries (sixth) (JETRO 1999: 21). However, the affiliates anticipate that after some adjustment period, economic conditions in the region will improve and they have revealed their intention to sustain the existing economic integration in the region (JETRO 1998: 30, JETRO 1999: 25). The statement from the JETRO reveals the background of Japan's massive aid and support (the New Miyazawa Initiative) towards crisis struck countries: "The Japanese economy and the Asian economies are now inseparably related to each other as the division of labour takes root. This makes it important to help them surmount their

fragilities and achieve further growth" (JETRO 1998:31). However, from the long-term point of view, it can be anticipated that due to the weakened JPY since 1997, Japanese OFDI in the ASEAN 5 countries will be diminished (Thomsen 1999: 13). Moreover, given the changing comparative advantage in labour costs in East Asia, the rise of Japanese OFDI in Vietnam and China can be also anticipated. The OECD supported this view by indicating that investment flows to East Asia underwent two distinctive changes. The first change happened around 1986, when investment fled from the NIEs to the ASEAN countries. The second change happened after 1990, when investment turned its way from ASEAN to China and Vietnam (OECD 1998: 9). The MITI's 'White Paper on Small and Medium Enterprises' also supported the changing destination of Japanese OFDI from ASEAN to China. As of 1993, in terms of the number of cases, China[30] accounted for 53.3 percent of Japanese OFDI pursued by SMEs (Requoted from Itoh and Ohashi 1995: 93). Meanwhile, ASEAN accounted for only 10.7 percent. Anticipating this changes in FDI flows in the region, the ASEAN member countries endeavoured to sustain stable FDI inflows into their countries by facilitating the eastablishment of the 'ASEAN Investment Area (AIA)' and by implementing further liberalisation measures through the AFTA (Thomsen 1999: 5).

[30] Harwit (1996: 983) pointed out the historical background of the Japanese OFDI increase in China. In 1986, China welcomed both export facilitating FDI and high technology inducive FDI. In order to promote IFDI flows, China provided greater incentives and limited bureaucratic interference. In 1988, China promised free remittance of earning back to Japan and started to provide cheap loans to foreign investors at interest rates equal to that applied to domestic firms.

(Fiscal Year, $US million until 92, $US billion since 1993)

	1986	1987	1988	1989	1990	1991	1992	1993	1994
NIEs									
Manu.	573	878	775	1347	805	640	439	0.7	0.8
Non-Man	946	1672	2341	3469	2501	1507	1376	1.6	1.9
Total	1519	2250	3116	4816	3306	2147	1815	2.3	2.7
ASEAN4									
Manu.	193	704	1360	1553	2028	1945	1808	1.5	2.2
Non-Man	358	311	545	1212	1181	1122	1382	0.9	1.5
Total	551	1015	1905	2765	3209	3067	3190	2.4	3.7
CHINA									
Manu.	23	70	203	206	161	309	650	1.4	1.9
Non-Man	151	1156	93	231	185	230	361	0.3	0.6
Total	174	1226	296	437	346	539	1011	1.7	2.5

Table 6-39. Japanese PDS' OFDI flows into Asian NIEs, ASEAN 4, and China.
Source. Data is based on the MOF statistics. Data for 1986-1992 is quoted from Poong-Mo An (1994). Data for 1993 and 1994 is quoted from Sugitani (1996).

(1951-1994 $US million, 1995-1998 JPY million)

Fiscal Year	Indonesia	Malaysia	Philippines	Singapore	Thailand
1951-69	148	35	45	24	78
1971	112	12	5	15	9
1972	119	13	10	42	30
1973	341	126	43	81	34
1974	375	48	59	51	31
1975	589	52	149	52	14
1976	931	52	15	27	19
1977	425	69	27	66	49
1978	610	48	53	174	32
1979	150	33	102	255	55
1980	529	196	78	140	33
1981	2434	31	72	266	31
1982	410	83	34	180	94
1983	374	140	65	322	72
1984	374	142	46	225	119
1985	408	79	61	339	48
1986	250	158	21	302	124
1987	545	163	72	494	250
1988	586	387	134	747	859
1989	631	673	202	1902	1276
1990	1105	725	258	840	1154
1991	1193	880	203	613	807
1992	1676	704	160	670	657
1993	813	800	207	644	578
1994	1759	742	668	1054	719
Cumulative total					
1951-94	16887	6391	2789	9525	7172
(Share)	(39.5)	(15.0)	(0.7)	(22.3)	(16.8)
1995	154800	55500	69200	114300	119600
1996	272000	64400	63000	125600	158100
1997	308500	97100	64200	223800	229100
1998	137800	65800	48500	81500	175500
Cumulative total					
1995-98	873100	282800	244900	545200	682300
(Share)	(33.2)	(10.8)	(0.9)	(20.7)	(26.0)

Table 6- 40. Japanese OFDI flows into ASEAN 5 countries.
Source. Based on the MOF data. Data for the cumulation of 1951-1969 is quoted from Chew et al. (1992). Data from 1971 to 1981 is quoted from Chng and Hirono (1984). Data from 1982 to 1996 is quoted from the OECD (1993b and 1998a). Data from 1997 to 1998 is quoted from the MOF (1999b).

(FY 1951-FY89 cumulative, $US thousand)

	Indonesia	Malaysia	Philippines	Singapore	Thailand	ASEAN5 (a)	Total[31] (b)	a/b %
Manufacturing	3120981	1820571	637094	2667646	2245035	10491327	66127	15.9
Food	69211	37820	57347	478380	137412	780170	-	-
Textile	571463	144459	27555	17442	259035	1021954	-	-
Lumber/Pulp	273837	67613	8856	19709	34915	404930	-	-
Chemical	211120	263696	99624	723057	137793	1435290	-	-
Metals	1428596	232930	94613	103649	315994	2175782	-	-
Machinery	34044	77926	12478	385514	418427	828389	-	-
Electrical	87908	654757	110084	490889	513939	1857577	-	-
Transport	189184	186744	148918	127396	96771	749013	-	-
Others	255614	154822	77614	319607	250745	1058402	-	-
Non-manufacturing	7305361	675695	673311	2969485	922397	12546252	182517	6.9
Ag./Fo./Fi.	226807	35908	43228	3722	48123	357788	1883	19.0
Mining	6398533	173199	418601	3334	6869	7000536	15211	46.0
Construction	33749	99471	16528	167952	106760	424460	2089	20.3
Com./Trade	56316	152414	18013	318500	212035	757278	25159	3.0
Fi./Insurance	313086	90351	58623	890097	52108	1404265	57271	2.5
Service	195266	55394	62415	308376	226773	848224	23375	3.6
Transportation	3440	7617	3318	617864	43446	675685	15269	4.4
Real Estate	13838	38060	33682	552571	211630	849781	34742	2.4
Others	64320	23276	18896	107064	14650	228206	7515	3.0
Branches	521	7348	10463	72095	99884	190311	4659	4.1
Real Estate	8068	2999	837	5489	710	18103	595	3.0
Total	10434931	2506613	1321705	5714715	3268026	23245993	253896	9.2

Table 6-41. Japan's OFDI flows into ASEAN 5 countries by industry.
Source. Data is modified from Sang-Chul Yoon et al. (1991).

Table 39 shows the regional and industrial distribution of the Japanese PDS' OFDI in Asia. While the NIEs induced more non-manufacturing investment than manufacturing investment, the ASEAN 4 countries attracted more manufacturing investment while China also received more manufacturing investment after 1991. From this table, it can be inferred that Asia has a vertical industrial structure. Even though the ASEAN countries, thanks to massive Japanese OFDI presence, improved their economic structure from a labour intensive to a capital intensive one, the NIEs still have a competitive advantage in capital intensive industry compared to the ASEAN countries. This fact was also reflected in Table 32 which illustrates that the NIEs' total OFDI share in the ASEAN 4 countries surpassed that of Japan's.

[31] World total unit is $US million.

Table 40 shows that Indonesia is the top recipient country of Japanese OFDI, with Singapore and Thailand competing for second position in attracting Japanese investment. The ASEAN 5 countries have different economic and industrial structures while their level of economic development also differs. As can be seen from Table 40, Indonesia's non-manufacturing industry attracted twice more Japanese investment than manufacturing industry thanks to the massive inflow of investment into the mining sector. The Philippines and Singapore also induced more Japanese investment in their non-manufacturing industry.

However, while the mining industry led investment in the Philippines, the financial sectors were the top recipients of Japanese investment in Singapore. On the other hand, Malaysia and Thailand attracted more Japanese FDI in their manufacturing sectors. In both countries, Japanese OFDI's primary destination is the electrical machinery sector. This indicates that Japan has established a production base for the electrical and electronics industry in both countries. All these phenomena reveal that the ASEAN 5 countries have different economic development levels and industrial structures. While Singapore is utilised as a financial and distribution base for Japanese investment, Malaysia and Thailand have become the core centre of manufacturing for Japan. Indonesia is not only a stable provider of natural resources for Japan but also a destination for labour intensive Japanese investment.

($US million)

Year	ODA	ODA/GNP	Year	ODA	ODA/GNP
1977	1424	0.21	1988	9134	0.32
1978	2215	0.23	1989	8965	0.32
1979	2638	0.26	1990	9070	0.31
1980	3304	0.31	1991	10950	0.32
1981	3171	0.27	1992	11150	0.30
1982	3023	0.28	1993	11259	0.27
1983	3761	0.32	1994	13239	0.29
1984	4319	0.34	1995	14489	0.28
1985	3797	0.29	1996	9439	0.20
1986	5634	0.29	1997	9358	0.22
1987	7454	0.31			

Table 6-42. Japan's ODA flows and percentage to GNP.
Source. Data from 1977 to 1989 is quoted from the MOFA (1991). Data from 1990 to 1992 is quoted from Steven (1996) and data from 1993 to 1997 is quoted from the OECD (1998b).

	$US million				Percentage of GNP			
	1981-82 Average	1986-87 Average	1993	1997	1981-82 Average	1986-87 Average	1993	1997
Japan	3097	6488	11259	9358	0.28	0.30	0.27	0.22
US	6992	9340	10123	6878	0.23	0.21	0.15	0.09
UK	1996	1804	2920	3433	0.40	0.29	0.31	0.26
France	3007	4646	7915	6307	0.54	0.58	0.63	0.45
Germany	3166	4111	6954	5857	0.47	0.41	0.36	0.28

Table 6-43. Net ODA flows and percentage of GNP from selected DAC countries.
Source. OECD (1998b).

($US million)

Rank	Year 1985-1989 total		1995-1996 average		1996-1997 average	
	Country	Amount	Country	Amount	Country	Amount
1	Indonesia	315964	Indonesia	1444	Indonesia	1208
2	China	294384	China	1353	China	963
3	Philippines	199582	Thailand	884	Thailand	760
4	Thailand	167642	Philippines	798	India	741
5	Bangladesh	141671	India	756	Philippines	714
6	India	96734	Pakistan	409	Malaysia	363
7	Pakistan	81519	Bangladesh	366	Pakistan	327
8	Myanmar	82973	Korea, Rep.	297	Bangladesh	297
9	Sri Lanka	59573	Sri Lanka	276	Sri Lanka	211
10	Malaysia	40198	Mexico	273	Viet Nam	186

Table 6-44. Top ten recipients countries of Japanese bilateral ODA.
Source. Data for the 1985-1989 total is quoted from the MOFA (1991) and data for 1995-96 average is quoted from the OECD (1997) and data from 1996-1997 average is quoted from the OECD (1998b).

(Percentage)

	1970	1980	1986	1987	1988	1994	1995	1996
Asia total	98.2	70.5	64.8	65.1	62.8	57.3	54.4	49.6
Northeast Asia		4.2	12.7	11.0	11.3			
Southeast Asia		44.0	30.4	35.6	34.2			
ASEAN		35.9	23.8	32.0	29.9			
Southwest Asia		22.2	21.6	18.5	17.3			
Unspecified		0.3	0.1	0.1	0.1			
Middle East		10.4	8.8	10.1	9.1	7.8	6.8	6.7
Africa		11.4	10/9	9.8	13.8	11.8	12.6	12.8
Latin America		6.0	8.2	8.0	6.2	8.6	10.8	11.8
Oceania		0.6	1.4	1.3	1.4	-	1.5	2.4
Europe		-	0.1	0.0	0.1	-	1.5	-
Other regions		1.2	5.7	5.8	6.6	14.6	12.3	16.7

Table 6-45. Geographical distribution of bilateral ODA (Percentage distribution).
Source. Data for 1970, 1994, 1995 is quoted from the MOFA (1995 and 1996) and data from 1980 to 1989 is quoted from the MOFA (1992). Data for 1996 is quoted from the JICA (1999a).

(Percentage)

	1954-1980	1954-1987	1954-96	1996
Asia	52.4	49.6	45.7	41.9
ASEAN 5	34.5	33.9	29.4	23.7
Middle East	10.4	8.8	8.9	9.4
Africa	13.2	12.9	13.5	14.4
Latin America	17.5	22.0	21.7	21.0
Oceania	1.6	2.3	-	-
Others	4.9	4.4	10.2	13.3
Total	100.0	100.0	100.0	100.0

Table 6-46. Japan's technical co-operation expenses by region (Percentage)
Source. Data from the cumulative 1954-80 and 1954-87 is based on the *Japan International Co-operation Agency Annual Report, 1981 and 1988* and requoted from Chew et. al. (1992). Data for the cumulative 1954-1996 and 1996 is quoted from the JICA (1999b).

($US million)

	1970	1975	1980	1987	1992	1994	1996
Bilateral aid	372	850	2010	5135	8482	9558	9606
Grant aid	122	202	702	2108	3862	5299	5574
Cash grants	100	115	375	1154	1733	2314	2395
Technical aid	22	87	327	954	2130	2985	3179
Yen loan	250	649	1308	3027	4620	4259	2780
Multilateral aid	87	297	1343	2207	2848	3681	1252

Table 6-47. Japan's ODA disbursement.
Source. Data 1970-92 is quoted from Steven (1996). Data for 1994 is quoted from the MOFA (1995) and data for 1996 is quoted from the JICA (1999a).

	1983	1984	1985	1986	1990	1991
Grant aid as percent of total ODA						
DAC average	79.7	76.8	80.8	84.3	78.5	-
Japan	55.2	48.2	47.4	60.7	39.3	38.1

Table 6-48. Japan's grant aid disbursement compared with DAC average.
Source. Steven (1996).

Japan has a long ODA history. The ODA programme started when the 'Asia Association' was established in 1954 as an initiative of the MOFA. The association took charge of technical co-operation such as inviting trainees and sending experts to developing countries. In 1958, Japan took a further step by providing loans to developing countries by establishing the 'Southeast Asia Development Fund' under the authority of JEXIM bank. This fund was incorporated into the Overseas Economic Co-operation Fund (OECF) which came into existence in 1961. And in

1958, the Yen loan was introduced for the first time. By becoming a member of the Development Assistance Committee (DAC) in 1961, Japan started to feel the need to systematically organise its ODA system. In line with this need, Japan established the OECF in 1961 and the Overseas Technical Co-operation Agency (OTCA) in 1962. With the establishment of the OTCA, the duties of the Asia Association were transferred to the OTCA. Thus, in 1962, Japan accomplished a systematic operational system of ODA by arranging the ODA system into technical co-operation led by the OTCA and financial assistance led by the OECF. The OTCA was incorporated into the Japan International Co-operation Agency (JICA) in 1974[32].

The Japanese ODA system consists of bilateral and multilateral aid. Bilateral aid consists of grant aid and Yen loans (OECF loans) with grant aid divided into cash grant and technical co-operation. Technical co-operation is divided into invitation of trainees and dispatch of exports. Grant aid is under the authority of the MOFA and the Yen loan is under the MOF. Technical co-operation is operated by the JICA and the Association for Overseas Technical Scholarship (AOTS) while the Yen loan is run by JEXIM bank. The share of ODA in total GNP in Japan is around 0.3 percent and this share is under the recommendation of the DAC (Table 42). However, the amount of Japanese ODA surpassed that of the US in 1990 and after that Japan has been the top donor country among DAC member countries for 7 years until 1997 (the Table 43) (MOFA 1998b: 1). However, after the Japanese government announced 'the Fiscal Structural Reform Act' in November 1997, the amount of ODA was contracted as a means to improve Japan's serious fiscal deficit (MOFA 1998a: 1).

[32] The history of Japanese ODA system is referred from Won-Chan Ra and Ha-Yoon Song (1989: 122-130).

Table 44 shows the top ten recipients of Japanese bilateral ODA. This table reveals that all the recipient countries are Asian countries except Mexico and all the ASEAN 4 countries were in the lists except Malaysia in 1995-1996. What is significant but cannot be seen from the tables is the fact that historically, Japanese OFDI flows have been accompanied by Japanese ODA flows (EIU 1983: 67, Steven 1996: 40). This indicates that Japan has used ODA development as a propeller of OFDI development. Table 45 shows the geographical distribution of Japanese bilateral ODA. As can be seen from the table, the share of Asia as a whole gradually decreased from the 1970s to the 1990s. For example, in 1970, the Asian share was amazingly over 98 percent. But the share was reduced to around 60 percent in the 1980s and it became around 50 percent in the 1990s. In Asian countries, the highest shares of Japanese bilateral ODA was in the ASEAN countries. Japanese technical co-operation expenditure is also concentrated in Asia and the ASEAN 5 countries (Table 46). Thus, it cannot be denied that Japanese ODA distribution is characterised by unequal regional distribution and this regional inequality has been a result of Japan's intentional ODA policy to improve its economic integration with the Southeast Asian countries. In other words, Japan's ODA system is a facilitator of Japanese trade and investment in targeted areas and the interests of Japan comes first rather than those of the recipient countries (EIU 1983: 67-68). This argument can be supported by the Keidanren's intention of using the ODA system as a trade and investment promoter: "As the recent involvement of the Keidanren in advising on the use of the ODA budget shows, ODA is increasingly being used to oil the wheels for Japanese FDI in these countries" (Grosser and Bridges 1990: 11). The background of Keidanren's involvement in the ODA development is that ODA activities can reduce the costs of private firms in

developing their OFDI by providing essential infrastructure in recipient countries (Dobson 1993: 67).

The regional concentration of Japanese ODA in Asia is a not unique feature, considering that other DAC member countries also concentrate their ODA in the regions which are closest to these countries and also try to connect the ODA system with FDI development (Grosser and Bridges 1990: 11). What is important here is that ODA is not an instrument to facilitate and improve donor countries' economic presence and penetration into recipient countries. The more important thing is that developed countries like the US, the UK, France, and Germany have no concern or enthusiasm to meet the DAC recommendation of ODA share to GNP of 0.7 percent. The problem is that the DAC has no authority to impose any preferred level of ODA from its member countries. The DAC could only recommend the preferred ODA share to GNP. Thus, it can be argued that in reality, the ODA system is being exploited by the advanced countries as a weapon to expand their economic dominance in the recipient countries (Steven 1996: 239). Detailed figures for Japanese ODA disbursements are illustrated in Table 47. This table shows that bilateral aid has always exceeded multilateral aid and it was after 1992 that the amount of grant aid surpassed that of Yen loans. However, although Japan provided more grant aid than Yen loans after 1992, the share of Japanese grant aid in total ODA is far lower than the DAC member countries' average (Table 48). This low level of grant aid share in ODA together with the regional concentration of ODA in Asia represent the problematic structures of Japanese ODA operation. However, it has to be emphasised that the ratio of untied loans in the operation of Yen loans is very high. In other words, the degree to which the Yen loan is untied to Japanese goods or Japanese

private firms' participation in the projects is higher than that of other DAC member countries. For example, in 1990, it was 82.1 percent for Japan while the average for the DAC was 60.9 percent (Steven 1996: 236).

Thus, the positive aspects of Japanese ODA operations are Japan's highest ODA level among the DAC member countries and the higher degree of untied loan in the disbursement of Yen loans compared with the other countries. In line with these positive aspects of the Japanese ODA system, Japan implemented massive aid to the Asian countries that underwent adverse impacts of the economic crisis. 'The New Miyazawa Initiative' includes various assistances and aid to countries like Korea, Indonesia, Thailand, and Malaysia. The political or diplomatic background of the plan can be found in the statement from the MOFA: "Extending a helping hand to those countries will be beneficial to Japan itself, given the strong ties of economic interdependence it has cultivated with the rest of Asia at large. Additionally, such help can be expected to earn Japan's recognition as a true friend in a time of need" (MOFA 1998: 1).

Under the Miyazawa Initiative, the Japanese government is ready to provide 30 billion US dollars to Asian countries. The initiative to help the countries is divided into three categories: first, direct provision of financial assistance; second, the use of a guarantee mechanism in order to support the Asian countries efforts to raise foreign funds by issuing sovereign bonds or increasing foreign loans; and third, technical assistance. Direct financial assistance is being carried out by extending JEXIM bank's loans to the countries and by the acquisition of sovereign bonds issued by the countries. Moreover, the Yen loan under the ODA system was also extended. By utilising the

guarantee mechanism, the Japanese government extended the JEXIM bank's credit guarantees of bank loans to Asian countries and sovereign bonds issued by the countries. By extending technical co-operation, the Japanese government is ready to assist the Asian countries in their efforts to address financial system restoration or corporate debt restructuring (Monthly Finance Review December 1998: 10-11).

Besides this Miyazawa Initiative, Japan spent 19 billion US dollars in order to contribute to the IMF assistance package towards Korea, Indonesia, and Thailand (JETRO 1999: 28). Moreover, as a part of the 'Comprehensive Economic Measure' which was announced in February 1998 in order to boost the Japanese domestic economy, various assistance measures for Asian countries were introduced. Thus, in total, Japan has extended 43 billion US dollars (the largest contribution as a single donor country) to help Asian countries (MOFA 1998c: 1).

2-3. The Korean transitionary state period (1998-To present)

After the economic crisis, the Korean state actively implemented corporate reform together with financial and labour reforms. The Korean state's official statement indicates the importance of free market-oriented reform in curing the ailing Korean economy in the aftermath of the economic crisis:

> Although the current crisis was triggered by an immediate shortage of foreign exchange reserves, structural impediments deeply embedded in the Korean economy constitute a fundamental, long-term factor precipitating the crisis . . . The lagging development of a democratic, free market economy gave rise to collusive links between politicians and businessmen, as well as a strong tendency on part of government to interfere in the market, particularly the financial sector . . . The failure to address these structural deficiencies and to make adjustments in line with global standards resulted in a significant deterioration in the overall competitiveness of the Korean economy. Given the far-reaching implications of the structural imbalance, short-term measures or a simple Band-Aid fix

> will prove ineffective, or perhaps even counter-effective (Economic Bulletin May 1998).

Thus, big conglomerates such as Chaebols were under harsh pressure to adopt neo-liberal reforms actively pursued by the Korean TS and the IMF. The Chaebols' heavy dependence on external debt and excessive cross-debt guarantees among subsidiaries were criticised as the most important causes which gave rise to the economic crisis. Wang points out the problematic over-borrowing of the Chaebol's overseas subsidiaries: "overseas companies recorded higher debt to equity ratios than domestic companies on the average. In particular, large companies preferred to borrow from international or local financial markets because financial costs were cheaper there than in domestic financial markets" (Yun-Jong Wang 1998: 1). Thus, under the corporate reform strongly pursued by the Korean TS, Chaebol had to cut down its debt ratio to within 200 percent of their assets and cross shareholding was restricted.

Moreover, the Chabols were forced to adopt a transparent accounting system which is equivalent to Western standards. As a result, from April 1999, the Chaebol was forced to have consolidated financial statement covering all their subsidiaries. All these reform measures became discouraging factors which prevented Korea's capacity in developing its OFDI flows. Thus, the sudden contraction of Korean OFDI was anticipated. However, the result was on the contrary. Korea's OFDI after the crisis increased in 1998. As can be seen from Table 27, Korea's OFDI dropped in terms of total acceptance but rose in terms of net investment. The reason for the increase despite so many discouraging factors mentioned above is that because Korean subsidiaries' credit rating weakened after the crisis, Korean subsidiaries could not borrow from local financial markets, so Korean parent companies had to send capital

to their subsidiaries (UNCTAD 1999: 1). Thus, it can be argued that the increase of Korean OFDI in its TS period is not a positive development but a negative one. This can be proved by the increased number of withdrawals of Korean OFDI after the economic crisis.

In terms of regulation, the Korean TS abolished the deliberation by the OIDC on investment which is over 10 million dollars. An interesting phenomenon here is that, as we have seen in the section on the Korean PDS, the Korean PDS took further liberalisation steps by increasing the amount of investment which needed approval from the BOK and the OIDC to over 50 million dollars in 1997 just before the economic crisis. This reveals that although the Korean state liberalised constantly throughout the PDS period, the liberalisation package was repetitive in their contents and was not checked by any governmental authority or private organisations regarding the actual consequence of each liberalisation package. This again proves the foreigner's argument that in Korea the reality is not in accordance with the law. Thus, regarding the Korean TS' OFDI regime, it remains to be seen whether these limits on liberalisation processes are being actually removed with the help of the unprecedented social and economic crisis.

3. Sub-conclusion: The changing role of the state: From restriction and regulation to promotion and support

Korea and Japan's historical trajectory of changes and transformation in FDI policy has been in continuous conflict between free markets and state intervention. However, as we have seen throughout this Chapter, there has been a trend towards the free market. The DS period was a period dominated by regulation and restriction, and

the PDS period was a period of intense conflict between developmentalism style state intervention and neo-liberalism style free markets. Even though consecutive liberalisation and administrative deregulation measures were implemented, there has always been the heavy shadow of developmentalism in the PDS period. The uni-dimensional regulation and restriction policy toward FDI in the DS was a combined result of an unpoliticised, favourable international political economy and a persistent bureaucratic belief system. In other words, under the unpoliticised international political economy, the mercantilistic FDI policies of Japan and Korea were not significantly problematic to their trade and investment partners and the bureaucrats' belief system that they could control and manage FDI flows in order to improve national wealth or to realise economic targets was not seriously doubted or challenged either externally or internally. On the contrary, the bureaucrats' belief system was strengthened or even legitimised as Japan and Korea achieved great growth in the DS period and both countries' technological level was also highly upgraded through strict screening and regulation procedures.

However, as Japan's and Korea's respective economies became crucial members of the international political economy, the mercantilistic and protective FDI policy could not be sustained any longer. Trading and investment partners started to complain about unequal market accessibility. Thus, in the PDS period, Japan and Korea started to liberalise their respective FDI policies in order to pacify foreign pressures and to raise the competitiveness of domestic firms by inducing harsh competition from foreign competitors. Moreover, inside the state, there emerged various interest groups which represented different interests. For example, the Keidanren in Japan and the Jeonkyungryeon (Federation of Korean Industries (FKI)) in Korea represented the

interest of big business and they enthusiastically pursued liberalisation of OFDI policy. State regulation became an obstacle of business operations or expansion in the PDS period. On the other hand, labour groups were opposed to a free market FDI regime because of the threat of job losses from massive overseas investment or hostile takeovers from foreign firms. More importantly, the old, unified bureaucratic organisations in the DS period also could not escape from internal division regarding FDI policy. The MITI in Japan and the MOCIE in Korea were strongly opposed towards the rapid opening of the domestic market to foreign investors in order to protect underdeveloped SMEs in both countries. On the other hand, the views towards overseas investment by domestic firms were divided inside the two ministries. For example, in the case of Japan, in order to facilitate domestic economic structural adjustment, OFDI was recommended with delicate supporting systems such as connecting the OFDI with ODA. However, in order to minimise adverse effects on domestic employment, the MITI also prepared a plan to support SMEs which were deeply impacted by massive transfers of production base of their parent companies.

Thus, in the PDS period, the Japanese and Korean state became fragmented in relation to FDI policy. The loss of unified policy making and policy implementing process in the PDS period in conjunction with FDI was one of the reason for the piecemeal and very slow liberalisation and deregulation processes. The fragmented or divided PDS state in its policy towards FDI was the result of a divided belief system among bureaucrats and businessmen. The limited and piecemeal liberalisation of FDI policy in the PDS was characterised by repetitive and overlapping contents of announced government plans. As we have seen in this Chapter, we could locate the repetition of liberalisation plans in both Japan and Korea's PDS period with relative ease. This

limited liberalisation gave rise to increased criticism and complaints from foreign competitors. The Korean TS, thus, compulsorily and actively undertook fundamental reforms to promote IFDI in order to induce foreign capital necessary for overcoming economic hardship. The term 'compulsorily' is used to describe the realised foreign countries' demands to fully open the Korean financial and IFDI market in exchange for their financial help to crisis struck Korea. The term 'actively' is used to explain the Korean TS' voluntary efforts to fully open the Korean market and to ardently pursue comprehensive reforms in the labour market, the Chaebol structure, and the financial system. As we have seen in Chapter 5, this fundamental and comprehensive reform in the Korea TS was possible due to not only a changed belief system of Korean top policy makers including the president but also the disappearance of ideational divisions among bureaucrats. Compared with Korea, Japan is still in the PDS period. As we have seen in section 2-2-2, the Japanese PDS' deregulation measures were characterised by repetition and slowness. As we have argued in Chapter 4, without a massive shock or crisis, the Japanese PDS will persist for a long time. This argument can be supported by learning theory. As we have seen in Chapter 2, fundamental changes in belief systems could occur when there is a crisis or a massive shock which cause total destruction of old causes and effects or means and ends relations.

In the debate on the roles and effects of IFDI towards host countries, there has been a serious division between the proponents and opponents of state intervention. State interventionists argued that in order to prevent economic and technological dominance of foreign firms and induce IFDI into desired sectors, the state needs to not only regulate the flows of IFDI but also provide various incentives. In contrast, the neo-

liberal approach argues that state intervention will lead to market distortions in resource allocation and the protection of certain business sectors will result in an underdeveloped and inefficient domestic economy in those sectors (Bishop 1997: 29). The problem with this debate is that it lacks an understanding that the two approaches are not mutually exclusive. They are compatible with each other. As we have seen in this Chapter, even though the DS period was characterised by state regulation and restriction, there were efforts to liberalise and deregulate IFDI flows in both countries. Also, in the PDS period, we could easily show the constantly planned and implemented liberalisation policies. However, we could also witness the tenacious shadow of state intervention in IFDI flows.

Thus, it is reasonable to argue that there is no state which adopts a solely free market approach or a statist approach. The two approaches coexist with each other in the reality of the economy. The problem is that according to structural changes in society, the state, and the international system, policies towards FDI are also changed. Put differently, we need to understand the changes and transformation of society, the state, and the international system in order to understand FDI policy changes in a country. From this point of view, we can explain the sluggish development of liberalisation and deregulation processes in both countries' PDS period. The market is not given exogenously but it develops in a certain historical context. Both countries' markets were strongly and systematically regulated in the DS period. This historical and institutionalised protective market could not change swiftly towards a free market system in the PDS period, even though both countries' society grew and became polarised as various interest groups emerged while the international political economy system also became highly politicised in the period. The state also experienced a

process of fragmentation as once unified bureaucrats in the DS period became divided in the PDS period in terms of their belief system. As a result, the PDS period in both countries was characterised by zigzag economic policies pendulating between the free market and a managed market. This disorientation and confusion of state policy in the PDS period is one of the major reason for the economic difficulties and long-term recession in Japan, and the economic crisis in Korea.

In the PDS period, we witnessed the emergence of the Japanese EDS into Southeast Asia and could find the nascent planning of Korea's EDS into the region. The Korean OFDI in the region was dominated by labour-intensive, cost-cutting investments led by SMEs similar to the earlier Japanese OFDI development in the 1960s and 1970s towards the region. The Japanese EDS is distinctive compared with other NIEs given that Japan developed production networks based on capital intensive industry in the region (Steven 1996: 98). The NIEs, including Korea, lack this kind of networks. This is the conspicuous difference between Japanese and Korean OFDI development in the region.

In the operation of ODA, the use of ODA as a supporting system for the expansion of OFDI could be found in both countries' operational trends. However, there were more differences than similarities revealed in the comparision of Japan and Korea. The long history of Japanese ODA and its highest ODA level cannot be compared with the short period of the Korean ODA system and its insignificant amounts. Moreover, while Japan has a high ratio of untied loans, Korean loans are mostly tied. In the aftermath of the economic crisis, Japan extended its ODA and various support in order to help the East Asian countries. As we have seen, Japan is the top donor

country in the world. The important thing here is that these massive Japanese efforts are deeply rooted in the intentional need to sustain and protect the Japanese production networks in the region (Hook 1996: 175). However, it has also to be emphasised that Japanese efforts to help ailing neighbour countries is not necessarily only for Japan's interest. Deepened economic integration and interdependence led Japan to increase its aid to the East Asian countries. Here, we are witnessing the importance of the changes in belief system of not only subjects but also objects. The recipient countries' image or belief system about Japan is as important as changes in the Japanese policy maker's belief system. In other words, despite Japan's massive aid to the countries, "a broad suspicion of Japan's ultimate intentions remains among its neighbours who retain memories of Japanese aggression in the 1930s and 1940s" (Brown 1993: 549). This situation can also be adopted to explain the ever-increasing economic pressures from America towards Japan and Korea even though both countries continuously opened their domestic market and deregulated various regulations. Put differently, although the Korean TS suddenly changed its developmentalism oriented state intervention policy into a free market based neo-liberal policy, as far as America's belief system and image of Korea based on DS period's protective and highly regulated market remains fixed and does not change, pressures and complaints from America will continue.

Japan and Korea's historical FDI development showed that the argument of the Investment Development Path (IDP) elaborated by Dunning is not suitable in explaining the cases of the two countries. According to IDP, one country's FDI development follows the following cycles. First, the IFDI from advanced foreign firms dominates in the country and secondly, small amounts of OFDI from the country

begin as its firms' ownership advantage improves due to transferred technologies and managerial know-how from highly competitive foreign firms. And then thirdly, the amount of OFDI surpasses the amount of IFDI and in the fourth and final stage, the country becomes a pure exporter of OFDI to other less developed or still developing countries. As we have seen, both Korea and Japan highly regulated IFDI flows in the DS period. As a result, both countries skipped the first and second stages of the IDP. Thus, it can be argued that the IDP theory is an idealistic hypothesis that cannot be adjusted to Korea and Japan's FDI case study. However, given the fact that both Korea and Japan upgraded their technological level in manufacturing industry by inducing IFDI with highly strategic and calculated regulations and screenings, the role of IFDI as an efficient way to improve technological levels cannot be denied. In this regard, the underdeveloped service industry, particularly financial sector, in both countries can be attributed to strict protection and slow liberalisation processes.

Korea's IFDI will continuously grow as the Korean TS fully liberalises and deregulates IFDI related policies. Moreover, Korean firms' need to induce more advanced technology will also result in the increase of IFDI, while IFDI into the service industry, particularly finance and distribution sectors, will also grow as the Korean government fully opens these sectors in order to improve their competitiveness. Korean OFDI into East Asia as well as Southeast Asia will also continuously increase in order to actively participate in the rapid change in the regional division of labour and to facilitate domestic structural adjustment. Japan's OFDI will also sustain its trend and increase in East Asia, given the fact that FDI is not as mobile as portfolio investment (Howell 1998: 7). Moreover, in order to protect already existing production networks, constant OFDI from Japan is also necessary.

However, as we have seen in section 2-2-2, the amount of OFDI into the ASEAN 5 countries will not increase over the medium or long-term, given that Japanese OFDI has moved its direction according to changes not only in the regional division of labour but also of each country's comparative advantage. Thus, increase in Japanese OFDI and ODA in China, Vietnam and later in India can be anticipated. However, Japanese IFDI will not experience any crucial changes so long as the Japanese PDS manages the economic recession as it has done for the last decade and as far as the high-costs Japanese economic structure remains. The more important factor which will significantly determine the future IFDI regime in Japan is the political factor: "the question remains . . . whether Japan has the political clout to push through these reforms without sinking into a quagmire of political paralysis" (Howell 1998: 8). The future trends and changes of Japanese IFDI are also heavily dependent on the results of ongoing structural changes and transformation inside the Keiretsu system and the financial system. As we have seen in Chapter 4, each part of the Japanese Keiretsu system is so systematically and efficiently organised or combined, a collapse of any part of the Keiretsu system could result in total collapse of the system. We have witnessed the collapse of the life-long employment system, and the shake out in long-term business relations between SMEs and big companies due to the massive increase of OFDI from Japan. Moreover, as the Japanese government is pursuing financial reform (so-called financial big bang), cross-share holdings among Keiretsu member companies will decrease. In other words, as the Japanese banking-based financial system is being transformed into an Anglo-American style, capital market based financial system, not only will cross-shareholdings, which have been a core part of the Keiretsu system, but also Japanese firms' long-term based strategic investments, which have been a most important base of Japanese international competitiveness,

will be replaced by short-term, high risk but high returns pursuing investments. It can be anticipated that both the weakening or collapse of the Keiretsu system and the changing financial system from a stable, long-term capital supplier to industries to short-term assets managers to investors will widen the Japanese road to induce further IFDI by facilitating foreign M&As.

The major characteristics of each period in both countries can be summarised as follows:

		Korea	Japan
IFDI	The DS	-Strong and strategic regulation period -No transparency in investment procedure -Discretionary law interpretation by bureaucrats -Unified belief system among ministries and bureaucrats towards IFDI -Mercantilistic and negative belief systems towards IFDI	-Strong and strategic regulations period -No transparency in investment procedure -Discretionary low interpretation by bureaucrats -Emergence of ministerial conflicts over IFDI policy[33] -Finished liberalisation measures in terms of formal law in 1980 -Mercantilistic and negative belief systems towards IFDI (Komiya 1972: 158)
	The PDS	-Consecutive but basically limited liberalisation and deregulation period -Repetitive and overlapped liberalisation and deregulation measures -Restrained IFDI caused by high-costs domestic economic system -Tenacious shadow of developmentalism oriented state intervention into IFDI flows in the midst of continuous liberalised IFDI laws -divided belief system among ministries and bureaucrats towards IFDI -Majority Korean people's negative belief systems towards IFDI	-Consecutive but basically limited and piecemeal deregulation period -Repetitive and overlapped deregulation measures -Restrained IFDI caused by high-costs domestic economic system -Restrained IFDI caused by institutional barriers emanating from Keiretsu system -Persistent shadow of developmentalism oriented administrative regulations which are so complicated and time consuming -Majority Japanese people's negative belief systems towards IFDI -Still rigid, fixed foreign countries' belief systems deeply rooted in the Japanese DS' protected and regulated market, although Japanese PDS endeavoured to improve IFDI regime by

[33] Safarian (1993: 248) explained that the MOFA and the Keidanren were the suppotive groups of the liberalstion of IFDI, while the MITI and the MOF were divided internally. The SMEs and the Ministry of Agriculture, Forestry, and Fisheries were oppsed to liberalisation.

			consecutive administrative deregulation measures
	The TS	-Sudden changes of belief systems from developmentalism to neo-liberal free market system -Total liberalisation period -Reconvergence of belief system among bureaucrats -Still rigid, fixed foreign countries' belief systems deeply rooted in the Korean DS' protected and regulated market, although the Korean TS changed its belief system and fully opened the market -Korean people's weakening negative belief systems towards IFDI	
OFDI	The DS	-Strong regulation	-Before the balance of payment surplus: not substantial but formal regulation period due to positive and favourable belief system of Japanese towards OFDI -After the surplus (after 1967): Liberalised period -No production networks -Labour intensive OFDI led by SMEs to NIEs countries first and then to ASEAN countries -Majority Japanese people's positive belief systems towards OFDI
	The PDS	-Nascent planning of the EDS into East Asia -Nascent planning of connecting ODA system with OFDI development -No systematic state support for the promotion of OFDI compared with Japan[34] -Consecutive but limited liberalisation and deregulation processes in 1990s -No production network -No close co-operation between government and private firms in developing OFDI -Labour intensive OFDI led by SMEs -Majority Korean people's positive belief systems towards OFDI	-Fully Liberalised period -Transplantation of the EDS into Southeast Asia -Close connection of ODA development with OFDI expansion -Formulation and consolidation of regional production networks -Close co-ordination between government and private firms -Rigid and fixed foreign countries' belief systems towards Japanese intention of aids and helps for them by ODA and the Miyazawa Initiative -majority Japanese people's positive belief systems towards OFDI
	The TS	-Negative increase period in order to directly finance overseas subsidiaries which suffering from capital shortage -Temporary re-strengthening of government regulation in order to control scare capital[35]	

[34] See, Ku-Hyun Jung and Moxon (1996: 170).

[35] As have seen in the Korean TS section, the Korean TS temporarily strengthened regulation by reducing the amount of investment needed to be deliberated by the OIDC. However, that measure was to control the scarce capital in the aftermath of the economic crisis. Given the full and

Table 6-49. The major characteristics of Japan and Korea's DS, PDS, and TS period in relation to FDI.

comprehensive liberalisation processes towards IFDI, Korea OFDI in the TS period will be sooner or the later fully liberalised. From the medium and long term view, it can also be anticipated that Korean state's supports and incentives will be intensified as the Korean economy grow further and more regionalised or globalised.

Chapter 7
Conclusion:
Learning from the neo-liberal regime or the resilience of the PDS?

Korea and Japan's foreign economic policy, particularly FDI policy, is best analysed using the concept of the post developmental state. This provides a more coherent picture of both countries' FDI development. So far, most of the literature devoted to explaining Korea and Japan's foreign economic policy depends on either the logic of developmentalism or neo-classical economics. These sharply divided views provide only partial understandings, considering that the Korean and Japanese PDS periods were characterised by zigzag and confused policies, that moved like a pendulum between the state-led, managed market and the free, self-regulated market.

The main argument of this thesis is that we need to understand a country's foreign economic policy in terms of transformations and changes. Every human social construction is due to change and transformation. Korea and Japan's trajectory of economic development reveals the dynamically changing nature of the social constructions of the state, civil society and their relations with the external global environment. Both countries' short-term, compressed experience of economic and social development presents us with the chance to testify why the concept of PDS is necessary and why the PDS has a more comprehensive conceptual, descriptive, and predictable analytical value in explicating both countries' dynamic features of socio-economic and political changes and transformations compared with single-sighted developmentalism or neo-classical economics.

The PDS was a state where the characteristics of the developmental state and neo-liberalism co-existed in a complex manner and conflicts between these two were so prevalent that consistent and efficient foreign economic policy could not be implemented or pursued. In this period, contradictions among decision-makers' belief systems, institutions and policies continuously prevented the effective realisation of the planned economic objectives of the state. It is this thesis' main argument that smooth, coherent and consistent triangular relations among belief systems, institutions, and policies are obviously a firm underlying foundation for rapid and effective realisation of economic objectives in both the Korean and Japanese developmental state period. However, as both countries' developmental stage was upgraded, socio-economic and political transformations and changes occurred and led to the period of the PDS.

In the PDS period, the Korean and Japanese state tried to adjust to the globalising world economy by only changing their respective foreign economic policies which were not accompanied by simultaneous changes in institutions and belief systems. The problem was that these changed policies were just for display in order to evade the harsh pressures from the neo-liberalising international political economy. As the Korean and Japanese economies grew and the Cold War bipolar system collapsed, the notorious features of both countries' DS period such as dirigiste policies, domestic market protectionism, export oriented domestic economic structures wholly dependent on open foreign markets, and distortion of prices and the market system by the strong intrusive state became the major sources of both countries' trade and investment conflicts with other countries. This was the period when the cleavages among belief systems, institutions, and policies were so pronounced that only

innovative reforms in institutions and fundamental changes in beliefs system could overcome the deepening socio-economic and political instability or crisis caused by conflicts among the three pillars of economic development (policies, institutions, belief systems).

This whole picture is well presented by the case study of both countries' FDI policy. As we have seen throughout this thesis, FDI is an index of globalisation and the role of FDI in economic development has unprecedentedly increased and cannot be overemphasised, both for advanced and developing countries. Korea and Japan's FDI policies show the dynamic changes and transformations of both countries' DS, PDS, and TS periods. The changes in Korean FDI policies clearly reveal the significance of close, organic, and systemic relations among policies, institutions, and belief systems in accomplishing a state's economic objectives. Policies matter. Well-planned, efficient policies are necessary conditions for economic development. However, institutions and belief systems matter much more. Policies can be efficiently implemented and produce their best results only when supporting institutions and belief systems are closed interlinked with them, and only when these three factors have shared norms, values, principles, ideas and economic targets. These three pillars are absolutely needed to grasp the whole picture of the state's socio-economic and political transformations and detailed changes. A study which only explores any one feature of these three pillars is inadequate and is, at best, only partial research.

This thesis explains Korea and Japan's foreign economic policy using the study of FDI as a case study. Three distinctive period (DS, PDS and TS) and their outstanding characteristics have been investigated with the same emphasis on the three analytical

levels (societal, statist, the international systemic approach). The main argument of this thesis is that for a small country like Korea, it is important to have a strong, efficient state and a strong, mature society in order to check and balance the extremely market-oriented, neo-liberalising international political economy. Globalisation is causing changes and transformations whether they are political, societal or economic. Sometimes, political, economic, and societal changes or transformations occur at the same time by systemic influences from the globalisation process as happened in Korea through the impact of the East Asian crisis.

This means that we need to adopt all three analytical levels in order to comprehend these complicated changes and transformations in a country. The statist approach has an advantage in explaining the characteristics of the DS period. The institutional approach produced the most persuasive explanation of the PDS period while the systemic approach provided the most coherent analysis of the TS period. More specifically, the Korean and Japanese DS periods are historical spaces in which each respective state was a major actor in obtaining its economic objectives. Strategic trade policy, government managed financial sectors, industrial policy, and grand economic development plans were carefully prepared and implemented by the state itself. Civil society was not sufficiently mature and not strong enough to influence policy making processes. The international system was favourable to both the Korean and Japanese DS, mainly because of the ideologically divided and competitive Cold War system. High politics was the primary concern rather than economic interests in inter-state interactions and relations. Thus, the statist approach revealed the distinguishing characteristics of both the Korean and Japanese DS periods.

In contrast, the Korean TS period was caused by the spill-over impact of the East Asian crisis which was originally ignited by unstable, unregulated international and domestic financial flows. Enormously increased financial flows are a conspicuous feature of globalisation. This financial globalisation process was obviously a major reason for the East Asian crisis and the subsequent structural reforms in the area. So the Korean TS period can be efficiently investigated mainly by the systemic approach. The Korean and Japanese PDS periods were respectively spaces of high tensions where conflicts among society, the state and the international system were at their highest. Civil society became mature enough to request from the state its fair share of the gains from economic growth and to challenge the strong state which was administered by military, authoritarian regimes (Korea) or bureaucratic predominance (Japan) over civil society. The international system changed its fundamental nature after the collapse of the Soviet Union. Economic interests came first before security concerns. The neo-liberalising international political economy is pushing every country to adjust to its logic of the free market, privatisation, liberalisation, and deregulation. Economic wars and competition replaced security wars and competition. Global economic interdependence deepened to the extent that a crisis in one state could easily spread to other states or regions.

With this unprecedented domino-effect style of interdependence, neo-mercantilistic economic policies were adopted by major trading and investment states or regions. New phenomena such as new protectionism through non-tariffs barriers, unilateral retaliations, voluntary export restraints, and structural impediment initiatives (SII) emerged in international economic relations. Multilateral institutions and agreements such as the WTO came into existence in order to solve conflicts over economic

interests among MNCs, states, and regions. In the Korean PDS period, this international systemic pressure reached a point that led to the outstanding transformation of the Korean PDS into a TS which is far more compatible with free market demands from the globalising neo-liberal regime. Thus, in this thesis, a synthetic approach which consists of society-centred, state-centred, and system-centred approaches was elaborated. And, both the theory of sociological new institutionalism and learning theory were also adopted in order to specially deal with not only institutional but also ideational resistance, inertia, and reactions towards internally or externally driven changes and transformation in both the Korean and Japanese PDS period.

It is the concept of bounded rationality which produces more congruent explications of the Korean economic system. Sociological new institutionalism emphasises the social and historical embeddedness of institutions, and even culture, customs, and national mentality are subjects of its research. The inefficient and zigzag policies and irrational bureaucratic behaviours in the Korean and Japanese PDS can be revealed and investigated by the theory of sociological new institutionalism. In the Korean and Japanese PDS, the historical, social and organisational inertia and shadows of the DS period were persistently sustained, despite their dark influences and obstacles characterised by corruption between politicians and businessmen (Japan and Korea), and moral hazard in the financial and industrial sectors which led to over-investments and over-capacity in industrial structure (Korea). This extended developmentalism in the PDS period can be clearly explained by sociological new institutionalism. Moreover, even the Korean and Japanese people's economic nationalism and mercantilistic economic mentality can be dealt with by this theory of sociological new

institutionalism.

It is important to remember that mercantilist economic nationalism, and the 'community first mentality' are deeply rooted in both Korean and Japanese society and people. And this mentality is an undeniable factor which not only facilitated economic modernisation and rapid growth but also caused external, systemic pressures comprising complaints of stiff trade and investment barriers formulated by economic patriotism (such as 'buy Korean movements') and economic institutions (such as the Keiretsu system and the Chaebol system). Thus, it is these 'culturally determined institutions' together with the concepts of 'bounded rationality' and 'utility satisfaction' rather than 'utility maximisation' that gives the theory of sociological new institutionalism its advantage in explaining Korea and Japan's domestic institutional resistance, inertia, and reaction to the challenges and pressures from the globalising neo-liberal regime.

Discussions about learning in foreign policy analysis were also adopted in order to distinguish the Korean TS period from the DS period in terms of changes in decision-makers' belief systems towards the efficacy of the intrusive state into markets. As emphasised several times in this thesis, the PDS period was the space where policy-makers' beliefs were divided internally and beliefs regarding developmentalism and neo-liberalism competed with each other to occupy the dominant ideational position. The ideational cleavage, divided belief systems, and competing economic ideologies in this period were not only the major background of the disappearance of the DS style of effective, rapid realisation of economic objectives but also the most important reason for the Korean economic slump in the 1990s and the eventual crisis of 1997.

In dealing with belief systems of policy-makers and decision-makers, learning and adaptation were distinguished in this thesis. It is important to have a concept of adaptation in explaining the Korean PDS period when only FDI policies changed in order to evade international criticisms of domestic market protection. Reciprocity became a fashionable term in defining a state's economic interactions with other states after the collapse of the Cold War order. In the PDS period, Korean policy-makers changed Korea's FDI policies which were however not able to ameliorate international pressures or were more or less unacceptable to the countries pressing for change. In other words, policy changes were not accompanied by institutional and ideational changes. Thus, the Korean PDS was a space characterised by inefficient and incongruent configuration of liberalised FDI policies, and protection and mercantilism oriented institutions and belief systems. This thesis argues that the Korean PDS period was an adaptation period that was accompanied by behavioural changes in foreign economic policy (superficial policy changes). The Korean state's learning could be found in three periods; from Japan's developmentalism in the DS period, from Japan's expansionist developmentalism in the PDS period, and finally from the globalising neo-liberal regime in the TS period.

Learning brings changes in belief systems. In the DS period, Korean FDI policy was based on the belief of the efficacy of both domestic market protectionism and raising indigenous corporations and technologies. Economic nationalism was a key underpinning factor in this dirigiste, state-led FDI management. In the PDS period, policy towards IFDI was more controversial. IFDI policy was basically based on liberalisation, which was in sharp contrast with institutions and belief systems which

were fixed to preserve the major characteristics of the DS (state led managed, distorted market system). However, in OFDI policy, Korean policy-makers once again tried to learn from the Japanese EDS in Southeast Asia. Korea's learning of the Japanese EDS was in its nascent stage and was not realised due to the turbulent East Asian economic crisis. However, it can be predicted that after experiencing a certain period of structural adjustment, the Korean EDS in Southeast Asia will be re-implemented with better-prepared plans and grand ideological slogans. China uses the ideological term, 'Greater China', in order to facilitate and lead the large scale integrating processes of East Asian regionalism (Sum 1996: 231). Japan cautiously tries to realise the 'Greater East Asia Co-prosperity Sphere', pursuing more economic and political weight in the region (Hook 1996: 176). Material interests in trade and investment are important driving factors in East Asian regionalism. However, ideational factors are just as important as material interests in facilitating and promoting a common sense of the 'we identity' in the development of East Asian regionalism. Korea obviously needs ideological preparation in order to participate actively in the development of East Asian regionalism.

In contrast to these two voluntary learnings, coercive learning was observed in the Korean TS period. Learning in the TS period was caused by the economic crisis. And the structures and contents of learning were neo-liberalism. At this stage, it is important to point out that the intensity and extent of coercive learning were much deeper and wider than those of voluntary learning. The Korean people's pains were enormous and the costs of institutional changes and transformations were expensive. Cognitive confusions as well as conflicts between contending belief systems were higher in coercive learning compared with voluntary learning. This means that

coercive learning is abrupt and discontinuous, while voluntary leaning is incremental. Voluntary learning could happen only when old and present belief systems and institutions are similar to or familiar with new belief systems and institutions in terms of their nature and characteristics. In contrast, coercive learning could occur only when differences and incompatibility between the old, present and new belief systems and institutions are greatly amplified to the extent that the complete replacement of old and current belief systems and institutions with new ones is unavoidable. In sum, voluntary learning accompanies incremental changes in belief systems and institutions, while coercive learning accompanies abrupt, discontinuous, and fundamental changes. Simple changes in policy are not learning but just adaptations in this thesis.

Therefore, by dealing with the concept of learning, we can witness ideational or ideological conflicts between developmentalism and neo-liberalism. Korea and Japan showed contrasting reactions towards neo-liberal challenges. The Korean TS moved towards a more liberalised market system which is more or less compatible with and acceptable to the globalising neo-liberal regime. Japan is stuck in the PDS period. The economic war or conflict is not simply about material interests. It is also caused by ideological conflicts between developmentalism and neo-liberalism. As Goldstein points out, "often the environment in which an idea is tested, not the quality of the idea itself, determines perceptions of the policy's success" (Goldstein 1993: 16). This can be interpreted to mean that it is the neo-liberalising international political economy itself that mostly matters for Korean and Japanese foreign economic policies. Goldstein's argument also implies that the question of 'which economic ideology -developmentalism or neo-liberalism- is better for economic development is

not the important question. The significant task for policy-makers lies in identifying determinant or dominant international or domestic environments in which foreign policy is tested[1]. In this sense, Korea and Japan are in the front-line of economic conflict over both material interests and ideational dominance. It is from Korea's and Japan's historical spaces that we can learn a lot about the relations among belief systems, institutions, and policies in accomplishing states' economic objectives.

One of the main arguments of this thesis is that making a simultaneous, short-term changes or transformation of both belief systems and institutions which are compatible with changes in civil society, the state, and the international system is better than having an extended and long-term period of conflict and contradiction among policies, institutions, and belief systems. Put differently, a state's institutions, belief systems, and policies have to change and transform at roughly the same time as that state's developmental stage is upgraded and as domestic society, the state, and the international environment change. Lack of shared norms, values, and principles and the widening chasm and deepening discrepancy among these three pillars of economic development mean ever-increasing economic inefficiency and transformational costs. And, finally, the persistence of this situation can even result in socio-economic and political instability caused by long-term economic recession or a sudden crisis.

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[1] The debates on financial liberalisation supports Goldstein's argument. Neo-liberalism recommends financial liberalisation in less developed countries. However, as the Korean case revealed, rapid financial liberalisation without proper supervisory institutions is very destructive and dangerous. Kapur argues for well planned liberalisation: "although LDCs undoubtedly need to open up to the world's capital markets, they would be well advised to do so at a pace commensurate with their capacity to develop sound regulatory and institutional structures" "(Kapur 1998: 124). The necessity of proper supervision and regulations are also supported by Mishkin (1996: 56). However, Wade and Veneroso (1998: 21) argue against LDCs financial liberalisation: "the great lesson of the Asian crisis is that the desirability of free movements of short-term capital has to be put in question. We have tended to lump together trade liberalisation with capital liberalisation". This view is also supported by Bhagwati (1998). Because of the lack of empirical research, we cannot answer the question of 'which recommendation is better? Rapid liberalisation (IMF) or slow, incremental liberalisation (Kapur and Mishkin) or no liberalisation (Wade and Bhagwati)?. This means that it is not the quality or superiority of economic ideas but the international environment which is neo-

The zigzag and confused policies in the Japanese PDS period simply deepened a decade long economic recession. As we have seen in Chapters 4 and 6, Japan tried to transplant its developmental system into Southeast Asia by a configuration of ODA and OFDI. In other words, in order to avoid domestic structural adjustments, Japan exported its economic problems emanating from the legacy of strong developmentalism to its neighbouring Southeast Asian countries. This artificially delayed and pre-empted domestic structural adjustments in the Japanese PDS period increased socio-economic and political dissatisfactions among its people and in other countries. Developmentalism played an invaluable role in economic growth and in achieving 'catch up objectives' in the Japanese DS period. However, as Japan's international economic position and performance capacity were upgraded to the highest position and as Japan's civil society emerged from its long-term docile subjugation to the state apparatus and acknowledged the value of the individual and the quality of life instead of the rich country mentality, the core parts of developmentalism became important obstacles to further socio-economic development and political stability.

Moreover, dissatisfaction and complaints from the region and the neo-liberalising international political economy increased to the point that Japan's ultimate objectives of becoming a regional leader, not to mention a potential global economic hegemon is being seriously doubted. The core parts of developmentalism such as domestic market protection for trade and investment, and export penetration to other open economies cannot be sustained for a long time. The international political economy

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liberalising that mostly matters for LDCs' foreign policy making processes and outcomes.

has become highly politicised since the end of the Cold War. Reciprocity, fair trade and investment, and liberalised, deregulated domestic markets are the prerequisites to be a member of the neo-liberalising international political economy. Without opening its market and without transforming its institutions and without changing its belief-systems which are firmly fixed to developmentalism, Japan's future is not as bright as it once was.

Japan's delayed financial reform and deregulation processes are the symptoms of the inefficient Japanese PDS system. The bureaucratically planned transplantation of developmentalism into Southeast Asia also revealed its problematic structure. Japan's detour exports from Southeast Asian countries to the US market is in a precarious position as America's indifference to or acceptance of trade deficits with these countries is close to its end. Delayed deregulation increases price differences between Japan and other countries. Because of price differences, consumers as well as producers pay too much to get goods, services and production factors compared with other open economies. Furthermore, the delayed and slow financial reform causes economic deflation with contracted consumption and no further investments. In a word, Japan is deeply stuck in a prototype PDS period. The more discrepancy and inconsistency among policies, institutions, and belief systems, and the more conflicts between the developmentalistic domestic system and the neo-liberalising global economy, the more serious will socio-economic problems and political dissatisfactions become which can lead to a sudden economic or political crisis.

Of course, Japan has an enormous domestic market and it has the capacity even to set an agenda in the international political economy. Moreover, it has the most

competitive industrial capability in manufacturing industry and with this strength it has accumulated large trade surpluses. However, reciprocity and fair transactions matter in the neo-liberalising international political economy. Generating huge trade surpluses by penetrating other countries' open markets means exporting unemployment. This unequal situation can become a political issue, if a state exports unemployment to its trading partners while it has its domestic market closed. Moreover, the terrain of global industry is changing towards more knowledge intensive, information oriented industry. Japan has no outstanding competitive advantage in these areas.

Having said this, it is obvious that an ultimate structural adjustment producing a new economic system which is comfortably compatible with the globalising neo-liberal regime is urgently needed for Japan which is deeply stuck in the PDS period. However, it is very important to notice that all these assertions do not mean that Japan (or Japanese style capitalism) cannot compete with the neo-liberal regime led by Anglo-American capitalism. Japan, with its economic strength and national competitiveness, can compete with the US and Germany to become a new hegemon in the international multi-polar economic system by attaining state of the art technological innovations. Japan can compete and even become a winner in the economic competition for global economic hegemony.

What this thesis argues is that slow but painstaking financial reform, slow and repetitive deregulation packages, policy inefficiency, socio-economic dissatisfaction, and political disorientation which are the externalised phenomena of the enlarged chasm among policies, institutions, and belief systems in the Japanese PDS period can

dilute or disperse a state's capacity to pursue and realise its economic objectives. The extent of a state's diversification and dispersion from its ultimate targets is dependent on the length of the PDS period and the depth of discrepancy among policies, institutions, and belief systems. If Japan copes with this trap of the PDS period, or in other words if Japan successfully completes its structural reforms which will make the Japanese economy compatible with and acceptable to the neo-liberalising global economy, Japan's potential to be a global economic hegemon could be much higher.

This potential of Japan coupled with its big domestic market and its strength in manufacturing industry are what Korea lacks. Korea is a small country with a small domestic market and greatly dependent on exports. Korea also suffers from the lack of high technology and the absence of world-famous brand names. Korea is stuck between advanced countries' high technology and developing countries' cheap labour costs. More importantly, after the economic crisis, Korean people are at a loss as to what to believe in terms of economic ideology. Korean people today do not have any firm beliefs regarding either developmentalism or neo-liberalism. They are trying to demolish the negative legacies of developmentalism such as continuous corruption from the close relationships between businessmen, politicians and bureaucrats, and the government led financial system which finally resulted in moral hazard in the financial sector and policy-finances which eventually caused overcapacity in the car, steel, petro-chemical, and semi-conductor industries. They sufficiently understand the dangerous features of over-extended developmentalism. On the other hand, the Korean people have expressed dissatisfaction and great anxiety watching originally indigenous companies being sold to foreign firms at relatively cheap prices as a means to overcome the liquidity problems during the economic crisis. In a word, the

Korean people are wavering between two belief systems (economic nationalism based on developmentalism and a free market system based on neo-liberalism).

Despite these uncertain and shaken belief systems, the Korean state pursued structural adjustment under the auspices of the IMF. The most powerful Korean decision and policy makers such as the president, presidential secretaries relevant to economic issues, and other relevant bureaucrats have firm beliefs that by being actively incorporated into the free market global economy, Korea can be an ultimate winner in the economic globalisation process. They believe that Korea can be a member of a group of winners in an indefinite process of economic competition among countries. However, what they ignore is that active participation in the globalising neo-liberalism will produce serious distributional inequality in Korean society. Thus, it can be argued that, in the Korean TS period, by actively implementing neo-liberal reforms, decision and policy makers manipulated external neo-liberal pressures in order to attain the ultimate objective of the 'rich state' which was a core feature of the DS, sacrificing people's quality of life and social welfare.

Despite this expected unequal development and social instability caused by neo-liberal reforms, Korea moved into the TS period from the PDS period because there was no other alternative but to accept IMF conditionalities right after the currency crisis. Korea is a small country with many disadvantages. Thus, the currency crisis forced Korea to directly request financial help from the IMF. The neo-liberal regime is organised into core and peripheral parts. The core part consists of the IMF, the World Bank, and leading countries in these institutions such as the US, and Japan while the peripheral part is composed of Wall Street, credit-rating companies, and

other financial companies playing a leading role in global financial markets[2]. IMF conditionalities have two major policy targets in Korea: stabilisation first and then structural adjustment.

Stabilisation programmes which are faithful to neo-classical economics were so inflexibly applied that the Korean industrial base faced total collapse. High interest rates and deflationary fiscal policy only led to an unprecedented high rate of bankruptcy of big conglomerates, not to mention small and medium sized enterprises (SMEs). Subsequent structural adjustment programmes also led to a more serious credit squeeze. Every bank was reluctant to lend, because they had to accumulate their capital to attain the BIS standard. As economic indices seriously deteriorated, the Korean government and the IMF loosened the programmes and the results were a reflationary fiscal system and a reduction in interest rate. This situation shows how inflexible IMF programmes were and how great the shock from the crisis to the Korean government was.

The sudden and abrupt economic crisis was obviously the main reason for coercive learning in Korea, which forced Korea to move into the TS period. In the TS period, some Korean institutions such as economic nationalism, governmental organisations and their norms, principles, and standard operational procedures will not change overnight. It is obvious that institutions last longer than changed belief systems. This means that even though Korean decision and policy makers' belief systems have changed from developmentalism to neo-liberalism, Korean institutions historically

[2] Bhagwati calls this structural feature of the neo-liberal regime the Wall Street-Treasury complex and Wade and Veneroso call this the Wall Street-Treasury-IMF complex. See Bhagwati (1998) and Wade and Veneroso (1998).

and culturally adjusted to developmentalism will reveal some signs of resistance and reactions towards the neo-liberalising domestic economic system. At this juncture, we need more time to predict or decide whether the Korean TS will ultimately move into a complete neo-liberal state (NLS) or stay in the TS which is relatively acceptable to the globalising neo-liberal regime.

The TS period is different from the PDS period in terms of changes in belief systems. In the DS period, we witnessed the shared ultimate objectives and systemic consistency among policies, institutions, and belief systems. In the PDS period, we could observe only superficial policy changes which were not accompanied by institutional changes. Belief systems in this period were not fixed and decision and policy makers' wavering belief systems between developmentalism and neo-liberalism were a key factor in understanding Korea's inefficient and ineffective economic performance and the onset of economic recession and the eventual economic crisis. Inconsistent and conflicting relationships among policies, institutions and belief systems in the PDS clearly revealed their negative, destructive nature in Korea before the IMF bailout and in Japan until the present. In the TS period, policies and belief systems of decision and policy makers' have dramatically and fundamentally changed while institutions have not. Thus the focal points to observe in the Korean TS period are mainly twofold: first, the extent and intensity of institutional reactions and resistance and second, the trend of peoples' uncertain belief systems regarding neo-liberalism. Thus, it can be argued that it is according to the changing conditions of these two significant variables that Korea's socio-economic and political future will be determined. Four scenarios can be provided according to the extent of changes in people's belief systems and institutional resistance.

(1) First scenario: if the Korean people are not satisfied with state-led free market oriented structural reforms and consequent poor welfare system, and if the Korean people replace their paradigm of 'community oriented growth first' mentality with 'quality of individual life' and 'distributional equality', the Korean TS period cannot escape from social instability. And the tensions and confrontation between the state and civil society will be pervasive to the extent that in a worst situation, the entire free market, neo-liberal economic reform programme will go adrift and economic backwardness will remain for a long time. (2) Second scenario: if the Korean people keep their 'community oriented economic growth first' mentality, Korea will soon recover from economic hardship and move forward to be a member of the winners group in the global free market competition among countries at the expense of the 'quality of individual life' and social justice symbolised by 'distributional equality'.

(3) Third scenario: if institutional resistance is sustained for longer, Korea's foreign economic policies will be less efficient and effective because of the discrepancy and inconsistency among policies, belief systems and institutions. (4) Fourth scenario: if institutional resistance is resolved and institutions become consistent with the already changed policies and bureaucrats' belief systems, the Korean economic system will eventually transform into a neo-liberal economy and Korea will regain its momentum of economic growth equivalent to the DS period's economic success.

Considering the rigid legacies and inertia of developmentalism oriented institutions in the Korean TS, the future direction of the Korean TS will lie between the second and third scenarios. Even though the Korean TS' government has insisted several times

that the Korean people's exclusiveness or mercantilistic economic patriotism towards IFDI and import has dramatically changed, the Korean people have revealed their deep aversion towards the rush by foreign firms to buy Korean firms which became relatively cheap in the aftermath of the economic crisis and the domestic structural reform process. Moreover, bureaucrats' reaction and resistance to neo-liberal reform have re-emerged as the Korean economy recovered from the crisis. Bureaucrats simply do not want to give away their old privileges and interests which were possible because of their tight control over and regulation of the whole domestic economy. In a free, open, and transparent market system, bureaucrats' leverage towards private economic actors will definitely decrease.

So far we have focused on Korea's domestic and state environments in analysing its foreign economic policy. Among the international or regional environment of foreign economic policy, the relationships between state and market and East Asian economic integration have been the main topic of this thesis. Globalisation and market forces challenge state power and its capacity. For some globalists, the state has already lost its power against market forces. For them, the roles of MNCs and transnational finance and globalising civil social movements have tremendously expanded to the extent that state regulation and governance is unable to control or manage them. Their argument is undeniable, particularly considering that the Korean economic crisis was, to some extent, caused by uncontrollable transnational financial flows. However, it was the absence of regulation and governance that directly resulted in the currency crisis which subsequently led to a full blown economic crisis. As we have seen in Chapters 5 and 6, the Korean government carelessly deregulated the domestic financial market in order to become a member of the OECD. This abrupt financial

deregulation with no strengthened financial supervisory system was a determining factor in the currency crisis.

In this regard, it can be argued that the existence of state regulation and governance is as important as a free open market system. The Korean state must have its domestic market opened and deregulated in order to cope with the pressures from the neo-liberalising international political economy. An open, free domestic market is also needed to make Korea's industrial and financial sectors competitive with world leading companies in these areas. The absence of competition in the domestic market was another outstanding legacy of developmentalism. Under the developmentalist belief system, the Korean government recommended and even artificially arranged oligopolistic industrial organisation by the help of policy-finance in the name of raising national competitiveness while protecting the domestic market from foreign competitors. This long term government protection of the industrial sector and the government led financial sector finally led to weak competitiveness in these industries.

An open and free market is necessary to make Korean industries competitive with world standards. Also, an open and free market is necessary to reduce price differences between the domestic and international markets. The Korean people have paid too dearly, because of the tightly protected, closed domestic market. In sum, not only a free, open market but also a strong, efficient state for supervision and governance is necessary both to overcome the challenges from economic globalisation and to take a lead in global economic competition. This means that states and markets are not incompatible and not in a zero sum game but they have to be symbiotic and

co-operative in order to attain certain economic objectives. For example, "regulatory oversight and market discipline are . . . complementary means for achieving a stable and robust financial system" (Knight 1998: 1197).

Also, we witnessed 'a paradox of globalisation': a return of the state with much more strengthened capacity and power in the Korean TS period. This paradoxical situation was brought about by the economic crisis. Once the crisis burst, there was only one apparatus which could systematically cope with the pressures from the economic globalisation process and that was the state. The Korean state in the PDS period was squeezed between globalising neo-liberalism and strengthened civil society, particularly trade unions, social movements and the Chaebol. Thus, the Korean PDS was a historical space where state capacity was in the weakest position compared with the DS and the TS period. Therefore, it can be argued that the state as a supervisory mechanism and the state as a last resort in crisis management clearly suggests that a strong, efficient state is a necessary condition for economic development and socio-political stability. The KIEP (Korea Institute for International Economic Policy), a government financed think tank stresses the need to strengthen the role of the state in the aftermath of the economic crisis: "the government should be more active in restructuring the corporate and financial sectors, reducing corruption and educating people" (The Korea Herald 23 November 1999).

A strong and efficient state apparatus should not exist by itself. There must be a balancing counterpart, that is, a strong, mature civil society. A strong, mature civil society is needed to check and balance the strong state. State-led economic management and subsequent success in terms of per capita GDP and people's

educational levels led to the growing capacity of civil society. This is 'a paradox of the strong state'. In the DS period, there was no civil society. The Chaebol were highly dependent on government policy-finances. Trade unions were oppressed and newspapers and broadcasting companies were continuously censored and regulated. Moreover, there was no middle class which could try to pursue its interests in policy making processes. However, as Korea's economy grew, civil society gradually and steadily grew and in the Korean PDS period, civil society reached a point where it became a firm base for Korea's democratisation.

However, this strengthened civil society became relatively weaker in the TS period. Of course, the Chaebol were under intense pressure from the neo-liberalism oriented structural reforms. The reform of the Chaebol was the most crucial but difficult part of Korean structural adjustment and without Chaebol reform, the entire Korean reform process could be in vain. Thus, weakening the Chaebol's bargaining power in the realms of civil society and against the state was a desirable situation. However, the pacified trade union movements in the TS period compared with their militant movements in the PDS period is more difficult to understand. It needs more detailed explanation. The core of labour reform was to obtain labour market flexibility and this meant unstable job markets and inevitably increased lay-offs. Despite the unprecedented high rate of unemployment under the IMF led structural adjustment programmes, Korean trade unions were relatively inactive. Of course, the Korean government actively integrated trade union representatives into the Tripartite Committee which consists of representatives from the government, business, and trade unions in order to resolve conflicts among three parties and to develop a united and co-ordinated national capacity in dealing with the economic crisis.

The outcomes of the Tripartite Committee were disappointing to trade unions. The Chaebol attained their ultimate goal of reducing labour costs with the help of the legalisation of labour market flexibility in the newly amended labour law. Although the unemployment rate was the highest, the social welfare system was terribly poor, and there were no great efforts to extend social safety nets because the government was faithfully following the prescriptions of the IMF's neo-liberal based programmes. However, trade unions did not organise nation-wide strikes because they were afraid of strong criticism from the conservative middle-class that had appealed to economic nationalism. Conservatives were appealing that nation-wide strikes would make the already rock bottom economic situation much more devastated and active trade union movements in this crisis would obviously be regarded as anti-nationalistic behaviour. Instead of 'quality of individual life' and 'distributional equality', the 'rich state first' mentality was a core characteristics of the DS. This mentality is still deeply rooted in the Korean TS period. This pervading false and manipulated consciousness of 'rich state first mentality' is a key factor underpinning Korean civil society's relative inactivity in the TS period.

To be sure, this nationalistic mentality played an invaluable role in Korea's economic take-off and modernisation period. However, it cannot be denied that excessive economic nationalism causes external pressures from the globalising neo-liberal regime. President Dae-Joong Kim, pointed out the problems of excessive 'savings on consumption' and 'buy Korean campaign' in a TV program 'Conversation with the people'. In that program, he argued for reforms in not only institutions but also in people's thinking in relation to IFDI by mentioning that the Toyota factory in the US

is the US' not Japan's factory (Joongangilbo 21 January 1998). 'Buy Korean movements', an excessive nationalistic mentality led to criticisms from America and the persistence of such excessive nationalism could finally result in a Structural Impediment Initiative from America as happened to Japan. Thus, in the era of globalisation, the nationalistic mentality has become an important obstacle in formulating balanced relations between a strong, efficient state and a strong, mature civil society in order to cope with pressures from the processes of economic globalisation.

A balance in relations between the state and civil society is also necessary for Korea in order to actively participate and lead in the economic globalisation process. A strong state without a mature civil society is dangerous, because there is always the potential for abuse of power by the strong state, such as authoritarianism, human rights abuse, and the lack of social welfare and increasing unequal distribution of economic growth. A global neo-liberal rearrangement without a strong, efficient state is also dangerous, because lack of state supervision and a grand development plan could led to socio-economic and political adversity caused by transnational financial flows which are difficult to regulate. In a worst case scenario, a state can lose its economic sovereignty by the intervention of the neo-liberal regime such as the IMF and the World Bank as happened in East Asia after the economic crisis. Moreover, without state supervision and strategic planning, an entire national economic system could be dominated by foreign MNCs or foreign capital and the lack of indigenous capital, companies and technologies as happened in Latin America.

A globalising neo-liberal order without a mature domestic and global civil society is

also dangerous. Neo-liberalism which is absolutely dependent on free markets is not concerned about environmental protections, social welfare, and unequal development among states. These are the shared concerns of domestic and global social movements. In sum, in the age of globalisation, both a strong, efficient state and a strong, mature civil society are necessary conditions not only for overcoming challenges from free marketisation but also in taking a leading position in the economic competition among states which are intensified in the neo-liberalising international political economy.

Globalisation is a process which contains several sub-rearrangements such as regionalisation, sub-economic zones, and localisation. In this thesis, East Asian regionalism has been dealt with by a comparative case study of both Korean and Japanese OFDI development in the region. As we have seen in Chapters 4 and 6, Japan carefully planned and transplanted its developmental system to Southeast Asia. The emergence of East Asia as a world economic locomotive in the 1980s and 1990s before the economic crisis was the result of a tremendous combination of Japanese OFDI and ODA developments in the region. However, Japan's planned transplantation of its developmentalism to Southeast Asia had a problematic feature from the start. Japan's core structure of developmentalism (mercantilistic foreign market penetration by exports while its domestic market remains tightly closed) cannot be sustained longer and cannot escape trade and investment conflicts.

The core structures of Japanese developmentalism were reproduced in Southeast Asian countries: exports to open Western markets while their domestic markets were tightly protected or regulated. The only difference between Japan and the Southeast

Asian countries was the extent of openness and belief systems towards the role of IFDI. While Japan's inward investment environment is not favourable to foreign competitors and there has been insignificant amounts of IFDI, Southeast Asian countries have enjoyed the benefits of open IFDI policies. However, Japan has not opened its domestic market to Southeast Asia countries, it has been reluctant to transfer technology to these countries, and it has enjoyed chronic trade surplus with these countries.

The Southeast Asia countries have been simply used by Japan as extended domestic industrial production sites or export platforms for Japan's accomplishment of its mercantilistic developmental objectives. The long-term transplanted developmentalism in East Asia finally brought a backlash from the globalising neo-liberal regime. In trade, Western open market economies could not compete with East Asian developmental economies which faithfully practised the crucial prescriptions of developmentalism, such as subsidies, tax incentives, policy-finances, domestic market protections, and a high dependence on exports. The sense of unfairness from the view point of Western open market economies led to Trade Related Investment Measures (TRIMs), Trade Related Intellectual Property Rights (TRIPs) and agricultural talks at the Uruguay Round. Agricultural, services and knowledge-intensive industries are sectors where Western open market economies, particularly the US have both comparative and competitive advantage over East Asian countries. With these agreements favourable to both America and Western based transnational finance, the neo-liberal regime punished the East Asian countries right after the onset of the East Asian economic crisis by trying to demolish core parts of the developmentalist structures in these economies.

Thus, East Asia after the crisis became an arena where not only material interest but also belief systems are fiercely contended: manufacturing industries versus agricultural, financial, and knowledge intensive industries as well as developmentalism oriented, managed market versus the neo-liberal free market. To some extent, it can be regarded that the origins of the neo-liberal backlash towards East Asia can be found in the long-term, painful structural adjustment period in America in the 1980s. That painful and costly adjustment period was basically caused by the East Asia countries' comparative advantage over America in manufacturing industry. In that period, America improved its economic system and transformed its industrial structure into knowledge-intensive, information and telecommunication oriented industry. With strengthened competitiveness in these industries and the traditionally strong financial sector, America transferred the adjustment costs of the 1980s to East Asia which suffered from the impact of the economic crisis and forced East Asia to adopt a free and open market system in the name of fair trade and investment. In this sense, America's transfer of adjustment costs to East Asia is a distinctive feature of globalising neo-liberalism.

Korea was not so different from Japan in participating and promoting East Asian regionalism. Of course, Korean OFDI to Southeast Asia was in a nascent position compared with Japan's systematically integrated FDI development. In Korean OFDI development, carefully planned government support and co-ordination between the government and private firms was not found. However, labour oppression, a distinguishing feature of earlier developmentalism was easily found in Korean OFDI development in the region. Korean OFDI expansion in the region was centred around

labour-intensive industry and Korean managers were notorious for their strictness about trade unions in the region. This is not such a different story from Japan's earlier period of OFDI development in the region. Korean affiliates in the region were also reluctant to transfer technology and also preferred to import valuable parts from their parent companies in Korea rather than making contracts with local firms. These negative characteristics of Korean OFDI in Southeast Asia has to be improved in order to attain sustainable economic integration based on equal and horizontal division of labour in the region.

The period of FDI suspension and contraction after the crisis could be used as a period for preparation and reflection. As we have seen so far, while Korean OFDI in Southeast Asia was at a nascent stage, it already showed a lack of careful planning and displayed the negative aspects of developmentalism (such as labour oppression, export penetration into open Western markets, and tightly protected domestic market not only to Western competitors but also to reverse imports from Southeast Asia). This picture is in sharp contrast with Japan's OFDI development in this region considering that Japan's OFDI development has been carefully prepared by co-ordinated plans among bureaucrats, businessmen and even academics. Moreover, in terms of the extent and scale of OFDI, Korea's OFDI development is trivial compared with Japan's massive OFDI presence in the region. However, it is the core parts of developmentalism that both Japan and Korea share in their respective regional developments of OFDI. Of course, the core parts consist of the export oriented organisational structures of OFDI and the intangible mercantilistic mentality behind this tangible material evolution.

Thus, both Korea and Japan can learn from the East Asia economic crisis. From the onset of the crisis to the subsequent structural adjustments in the region, the neo-liberal regime exercised its systemic power and brought the hardest period so far to developmentalist economies in the region. Sometimes, a crisis can be an invaluable, priceless opportunity. In this regard, the East Asian crisis suggested a valuable chance to Korea and Japan to reconsider and reflect on their whole system of transplanted developmentalism into Southeast Asia. The main argument of this thesis is that the main structure and objectives of the exported Japanese and Korean developmentalism in the region have to be changed and readjusted to the globalising neo-liberal regime. In other words, regionalised developmentalism in Southeast Asia has to change its underlying fundamental beliefs and structures in order to cope with and actively take part in the globalising neo-liberal regime. Under the realty of the neo-liberal order, free markets, free trade, and free investment come first before the state, regional and global regulation, supervision, and governance. Reciprocity and fairness in trade and investment constitute the nucleus of the neo-liberal international political economy. Unchanged developmental belief systems and institutional resistance will simply intensify and prolong inefficient conflicts between developmentalism and neo-liberalism in the region. These protracted conflicting relations will be a major obstacle to realising further regional economic growth and integration.

Thus, East Asian regionalism after the crisis has to be based on open and equal processes rather than hierarchical and exploitative processes. Both Korean and Japanese transplanted developmentalism in the region has to be transformed to the extent that the entire regional economic system is compatible with or acceptable to the

neo-liberalising international political economy. This assertion does not mean that Anglo-American neo-liberalism will ultimately triumph over East Asian developmentalism (Emmerson 1998: 48-49). It is important to remember that developmentalism has its positive features composed of an efficient and hard working government and diligent and community-oriented people devoted to the realisation of national objectives rather than individual self interests. A compatible and acceptable economic system to the neo-liberal regime does not necessarily mean the absence of strategic planning, supervision and governance by the state.

The economic crisis in East Asia does not mean the end of the East Asian development model. Changes and transformations in East Asia after the economic crisis "could represent evolution rather than dissolution" (Whittaker and Kurosawa 1998: 762). The market is a historically and institutionally determined social construction. The market is not fully independent from the shadow of history, culture, and institution. There are market failures. Moreover, as we have seen in chapter 3, the market is not an absolutely self-sustaining, self-sufficient and self-correcting system. The market is not a living and reasoning actor but just a place where transactions occur. This is the reason why the market has to be checked and balanced by other social constructions, particularly by a strong, efficient state and a strong, mature society.

This thesis has continuously argued that we need not only a strong, efficient state but also a strong, mature civil society in order to overcome the negative aspects of developmentalism and to cope with systemic pressures from the globalising neo-liberal regime. Abolishing the negative features of developmentalism is not to be

identified with the complete destruction of state strategic planning, supervision, and governance. As we have seen earlier in this Chapter, the less the discrepancy and inconsistency among policies, institutions, and belief systems, the great the possibility of realising the state's economic objectives. In this regard, it is the extent of the compatibility and acceptability between East Asian developmentalism and the neo-liberalising international political economy that matter most.

Thus it can be argued that the future direction of the Japanese and Korean economies and of East Asia economic integration depends on how to keep the positive features of developmentalism (such as efficient, goal-oriented state bureaucrats and community-oriented people) and to ameliorate its negative features while also maintaining an open, free market system compatible with and acceptable to the globalising neo-liberal regime. Gyohten makes the same argument: "most serious challenge now facing the Japanese economy is probably the issue of identifying itself as a model of capitalism, or a model of the market economy, which is compatible with other models of market economies in the world while maintaining its vitality and dynamism" (Gyohten 1994: 31).

What Korea learned from its DS, PDS and TS periods is investigated throughout this thesis and, to be sure, these experiences suggest a valuable case study for other countries which are at a lower stage of development. This thesis shows that Japan and Korea finally diverged in the configuration of the three pillars of economic development (policies, institutions and belief systems). Korea is in the TS period while Japan remains in the PDS period. Korea's transformation into the TS is totally different from Japan and is an unprecedented case in the historical trajectory of the

East Asian economic development process. Now, Korea stands alone and has no state which can be a mentor state after moving into the new, unfamiliar TS period. Korea has to learn by itself. Korea has to explore the unknown territory of the TS period by itself. Thus, in a sense, Korea is a leading state in the region in terms of developmental trajectory rather than in terms of economic strength and scale.

Meanwhile, Japan displays two contrasting verdicts. One verdict is that Japan is struggling to make its domestic economic system compatible with and acceptable to the neo-liberal regime by slow, incremental reforms in order to minimise adjustment costs in its PDS economic system which is under enormous pressures from the neo-liberalising global economy. The other verdict is that Japan is competing for global economic hegemony with America by trying to conserve its arguably competitive developmentalism oriented economic structure. In this judgement, every economy has its long-term economic cycle and Japan is at the bottom of the cycle while America is at its pinnacle (Krugman 1998: 45). In other words, the utility of the domestic developmental economic system and transplanted developmentalism in Southeast Asia is still intact and valuable. For the proponents of this evaluation, the East Asian crisis and Japan's decade long economic recession is not an expression of the limits of developmentalism but they are just usual happenings of the economic cycle. So far, nobody can be sure about which interpretation and judgement is correct and more persuasive.

However, the one clear thing is that the Korean case has no contrasting interpretations unlike Japan. For example, the decade long recession for Japan can be viewed as a soft recession because of Japan's superiority in manufacturing industry and its

astronomical trade surplus and big domestic market sufficient to put up with economic instability and recessions. Korea is different lacking all Japan's economic capabilities[3]. Thus, Korea was eventually forced to transform into the TS. In this stage, the question of which state is on the right track from the long-term view of development needs more time to be evaluated and judged. And this is the reason why Korea's departure from developmentalism and post-developmentalism in terms of changes in belief systems are as equally interesting and carefully observable as Japan's current position in the PDS. The whole thesis has focused on the Korean road to the TS period and Japan's road to the PDS. It reveals the bifurcation point of the two economies' development path and the remarkable differences in the characteristics between the Korean TS and the Japanese PDS period only in terms of changes in belief systems. The focal point of future research lies in Korean and Japan's institutional resistance or reaction to changes in belief systems and the neo-liberalising international political economy. The historical lessons and implications of this bifurcation of these two countries' development path needs more time to be researched, because institutional changes or transformation takes longer than belief system changes.

[3] Criticising IMF prescriptions to Korea, Feldstein (1998: 28) argues that "Korea's outstanding performance combining persistently high grow, low inflation and low unemployment suggests that the current structure of the Korean economy may now be well suited to Korea's stage of economic and political development". However, what Feldstein neglects are not only the side-effects of developmentalism but also the international position of Korea. Korea needs to remove corruption and Chaebol dominance. Moreover, because Korea is highly vulnerable to the international system in terms of security and high dependence on exports, Korea has to adjust quickly to changes in the international system in order to minimise adverse impacts and take advantage of chances given by systemic changes.

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