CONTRASTING THE POLITICAL RESPONSES TO FINANCIAL GLOBALIZATION IN JAPAN AND SOUTH KOREA

by

JENNIFER WOOD

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Maxwell A. Cameron, Ph.D.

Yves Tiberghien, Ph.D.

THE UNIVERSITY OF BRITISH COLUMBIA

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Department of Political Science

The University of British Columbia
Vancouver, Canada

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Abstract

State responsiveness to globalization depends on flexible and adaptive institutions. States can oversee and plan economic activity in an era of financial deregulation so long as they have this adaptable institutional framework. Japan's response to pressures for administrative reform throughout the 1990s illustrates that state capacity can be been preserved, even when faced with domestic political constraint. As a counterexample, I will highlight how South Korea's (henceforth Korea) responses initially diminished the state's traditional institutional capacity, but that the most recent course of reforms (post 1997 crisis) has revived the state's role, though under a different set of goals.

The initial stimulus to change is global constraint, by which I mean international pressure in the form of increased foreign investment—capital and portfolio flows—to open financial markets and increase industrial competition and transparency. Another stimulus falls with domestic political factors, which can be characterized by the vested conservative coalitions that maintain control in Japan's Diet, and the political changes under Korea's democratic transition.

The policies that came forth from each case reveals out two contrasting responses. In Japan, we see that administrative and financial reforms have taken place in response to globalization. Nevertheless, these substantial changes have been continuously blocked by deeply entrenched domestic political interests. This in turn, has rendered the developmental state stagnant. In Korea, we will examine how globalization, combined with simultaneous democratization, forced the state down a rapid path of liberalization. The emergence of a region-wide financial crisis however, required state-led responses and thus resulted in a new role for the state—where it plays a central role in enforcing market-oriented policies. From these different responses we discover that global pressures were managed or mediated differently in each case.

This paper concludes that globalization has had different effects in Japan and Korea—namely that the developmental state has been preserved in the former but dismantled in the latter. In this respect, Japan continues to muddle along, stifled by the inability to pass significant reform measures, but that change is ultimately occurring, notably in the practices of big business. In Korea, the state has turned towards market-based reforms, but has continued to play a significant role formulating industrial policy.

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Over the past two and a half years, my life certainly has taken a series of unexpected turns. From the classrooms in Vancouver to the boardrooms in Hong Kong and back, the ideas contained within this thesis have always been with me—whether as a first priority or somewhere in the depths of my consciousness. While I was away in Hong Kong, I was able to conduct some of my research; but due to security constraints at the University of Hong Kong Library, I had to adopt the pseudonym "Andrew Au Siu-Fai" from a sympathetic colleague at Schroders (thank you Andrew for lending me your HKU alumni card!) Nevertheless, the following pages represent an accomplishment, and are a testament to not only what was learned at the academic level, but also what was *experienced* while living and working in the very "real world." And now, a new chapter in my life begins…

Chapter I: Domestic and International Challenges to the Developmental State

This paper will compare Japan and South Korea during the 1990s, demonstrating how the former has turned into an incapacitated developmental state—unable to implement the reforms necessary to spur solid economic growth, while the latter has abandoned its developmental state legacy altogether. I will look specifically at Korea and Japan's industrial policies throughout this period, and the responses undertaken by each state in adapting to new pressures and challenges posed by global forces as well as domestic politics. Neither globalization nor domestic political changes necessarily spell the demise of a state-led role in economic policymaking. Rather, I assert that state-led responses remain alive and well, despite some fundamental domestic and international shifts over the past decade. While there has been a region-wide shift towards liberalizing or "freeing up" domestic markets, some states have dealt with this through deliberate and concerted institutional responses, aimed at preserving the state's capacity in economic planning. This has allowed for the continued functioning of the state in industrial and economic policymaking, though now with more effective and representative institutional arrangements. That being stated, the case for the incapacitation of the developmental state can also be made where global and domestic forces have proven far too powerful for the state to implement any serious reforms—essentially undermining the state's institutional effectiveness. Nevertheless, the institutional links of the developmental state, which are critical elements in formulating state-led industrial and financial planning policies, remain significant players given their ability to survive through *adapting* and

responding to the effects of freer markets and an increase in global industrial competition.

The effects of globalization differed in each case, thus resulting in different consequences for Japan and Korea. In Korea, the nation faced the dilemma of political democratization as well as economic liberalization at the outset of the 1990s.[1] Japan meanwhile, faced only moderate political opposition and was able to largely accommodate these interests. In addition, the size of the Japanese economy is far greater than that of Korea, which has enabled the former to confront the globalization issue far more effectively than the latter, given its exposure to international financial markets. In fact, while Korea had fallen victim to the contagion effect of the region-wide economic crisis, Japan was largely immune, though still battling its own near decade-long stagnation. In Korea, relationships between industry and the state have been altered significantly, as the chaebol have had to undergo significant restructuring—notably in distancing their previously tight relationship with domestic banks. In Japan, the state's relationship with big business has remained deeply entrenched. I use the analogy of a stone house versus a straw hut to explain the difference in the response of each case. Stone houses are built on solid foundations and have proven able to withstand the tests of time. Straw huts on the other hand, are vulnerable to the elements and cannot endure the forces of nature over time. But they can be rebuilt quickly. Ultimately then, Japan, like the house made of stone, has been able to face up to the challenges posed by

[1] See Joseph Stiglitz, "What I learned at the World Economic Crisis: The Insider," *The New Republic*, (April 17 2000). Stiglitz reveals how pressures to liberalize financial markets in Asia—originating from the US Treasury Department—"provoked" a flood of short-term capital into the region, which caused a property bubble in Thailand in 1997, then resulted in a region-wide economic meltdown.

globalization by keeping its developmental state[2] intact. Its fate however is uncertain, as bureaucrats have become incapable of implementing serious structural changes. Korea meanwhile represents the straw hut—unable to withstand the combination of these forces—and has consequently had to undergo a substantial dismantling of its developmental state in response. Yet unlike Japan, Korea's fate appears more promising, as the state has reemerged under a different guise in the reform process.

The case of Japan highlights how globalization played a small role in state responsiveness to heightened international competition in industry and financial markets during the 1990s. The reform movement or drive came largely from domestic elements, but that it was ultimately hijacked by entrenched interests in the Diet. Following a crash in the nation's asset markets in 1990, Japan has pursued numerous reforms to its industrial and financial sectors and has been open to encourage the expansion of foreign investment and the development of new types of industry. Institutional arrangements between state and private sector have thus undergone a tremendous shift in terms of economic agenda setting; yet, many of the concrete attempts towards structural reform have been ineffective. As such, Japan's developmental legacy has been preserved, yet has emerged as stagnant and debilitated.

On the other hand, the case of Korea varies considerably from that of Japan. In Korea, the state was initially unable to effectively respond or cope with the effects brought on by globalization, and retreated from its central role in economic policymaking and planning. This was due in large part to the simultaneous democratic transition in

[2] The developmental state refers to state that is plan-rational—led largely in part by state bureaucrats who collaborate closely with the private sector and business federations in setting the nation's economic development agenda. Market forces are therefore subverted to state objectives. For a more in depth definition of the developmental state, please see Chapter 3 of Chalmers Johnson, *Japan: Who Governs?* (New York: WW Norton, 1995).

which the nation faced at the outset of the 1990s. As such, previous arrangements such as long-term economic planning and strategic support of Korea's giant chaebol firms were abandoned in 1998, primarily due to domestic and international pressures. The state's role had thus changed: in an era dominated by global markets and rising social groups, the state would have to move aside, thereby enabling these elements to oversee the nation's transition towards more open, liberal markets.

The theory surrounding developmental states holds that the state plays a significant role in advancing its economic development. This notion emerged out of the experiences in postwar Japan, where bureaucrats were entrusted with a great deal of discretion in shaping the nation's economic and political direction, resulting in what many declared as "an economic miracle."[3] From this stems the goal of developing and maintaining international competitiveness. The model pioneered by Japan was adopted by other states in the region, particularly by Korea and somewhat by Taiwan. The state then plays a crucial role in setting up economic regulation, thereby putting the interests of the national whole ahead of those of the individual and consumer. While this statist theory alone may have been useful in accounting for the rise of the developmental state in a historical context, it is insufficient alone in understanding the differences between the two cases of Japan and South Korea and their responses to globalization. From a theoretical standpoint, we must examine the effects that state-private sector institutional relations had on policymaking throughout the past decade. In both cases, state and private institutions within the developmental state faced new conditions that required dynamic responses. It would be erroneous then to regard the state as a unitary actor. As

[3] As argued by Richard Samuels in *Rich Nation, Strong Army* (Ithaca: Cornell University Press, 1989), Johnson in *Japan: Who Governs?*, and Chalmers Johnson, *MITI and the Japanese Miracle* (Stanford CA: Stanford University Press, 1982).

such, approaching this issue from a perspective that regards the institutional relationships between state and industry as critical, given that their formation affects the process of industrial policy choice and implementation,[4] will provide the analytical foundations necessary in order to understand the differences of state responsiveness in Japan and Korea.

So what does comparison hope to achieve? First, I hope to demonstrate that the neo-liberal argument alone, which cites market forces as the source of state retreat and subsequent reform, holds little weight.[5] In fact, globalization has not had a homogeneous effect on the region, as both cases illustrate differing levels of state responsiveness. Second, I hope to demonstrate that globalization has not made the state redundant. As the case of Japan illustrates, the state has the *ability* to play a pivotal role in overseeing a nation's economic growth and development, provided it can implement its agenda effectively. The case of Korea demonstrates that a state under tremendous domestic and global pressures can embrace market-based policies and continue to play an influential role in setting an economic policy and planning agenda.

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[4] Haeran Lim, *Korea's Growth and industrial Transformation* (London: MacMillan Press, 1998), 156. For a more detailed look into the shortcomings of statist versus coalition theory, please see introductory chapter.

[5] See Suzanne Berger, "Introduction," in *National Diversity and Global Capitalism*, in Suzanne Berger and Ronald Dore (Eds.) (Ithaca: Cornell University Press, 1996), 11-16. Berger advances the convergence argument; citing the inevitability of a change in state priorities away from national welfare and toward shifting market forces are major indicators of the expanding face of global capitalism. Berger also touches upon factors such as political pressures, citing the 1989-90 US-Japan trade talks), and internal pressures from politicians, bureaucrats and interest groups. See also William W. Grimes, "Japan and Globalization: From Opportunity to Constraint," *Asian Perspective 23* (4), 1999, 168-169. Grimes asserts that globalization has left Japan's financial system inefficient and ineffective, thereby moving from "opportunity to constraint."

Figure 1.1: Framework for the Comparative Argument: Japan

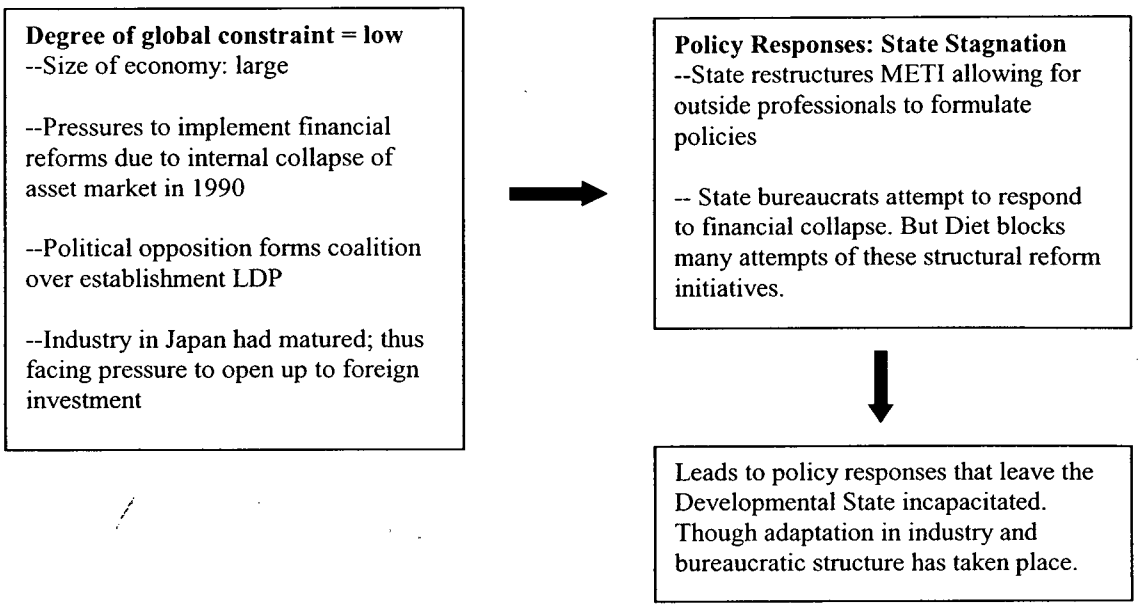
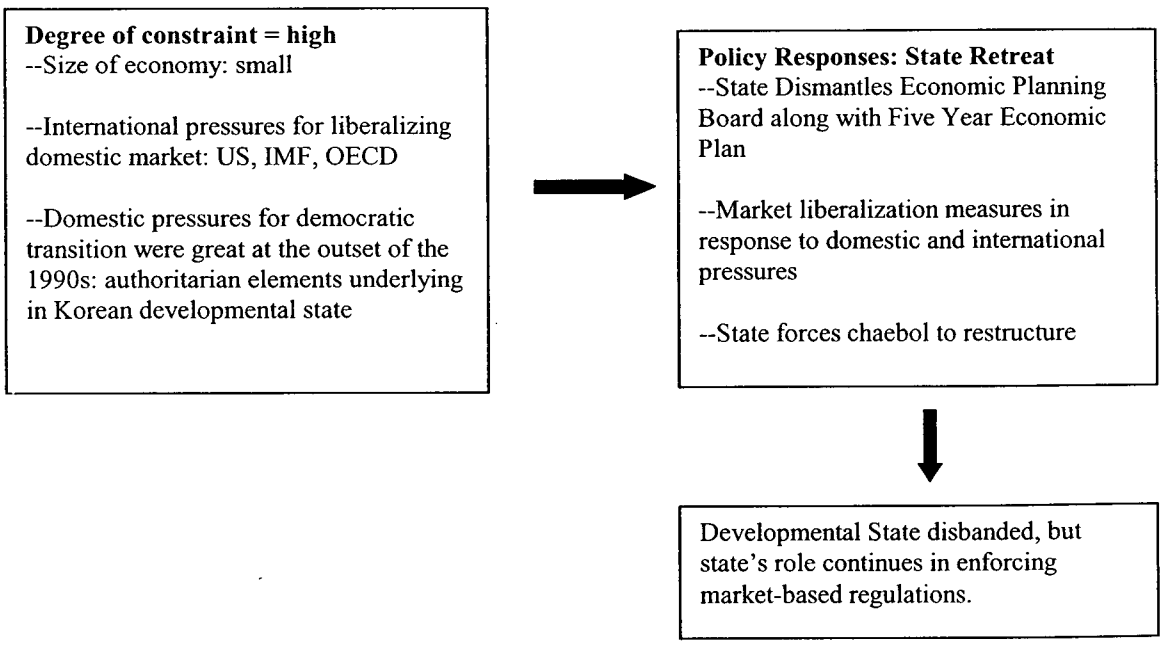


Figure 1.2:Framework for Comparative Argument: Korea



The capitalist developmental state emerged from the experiences of postwar Japan, specifically the period between 1945-1980, the an era which transformed Japan in to an "economic miracle." The term developmental state was conceived by Chalmers Johnson and presents the notion that Japan's high-growth system was state-led.[6] Johnson refers to this model as being bureaucratically dominant, and in this framework contains the workings of the cooperative relationship between government and business that resulted from long standing and evolving historical ties.[7] The policies that emerge from this relationship aim ultimately at developing and maintaining international competitiveness. The state works to realize this national goal through establishing order in what may be the fluid and unpredictable marketplace.[8] The state then plays a crucial role in setting up economic regulation, thereby putting the interests of the national whole ahead of the individual and consumer interests.

Japan began its journey as a developmental state in the early twentieth century during its initial stage of industrialization, although it was not until Japan's defeat in World War II however, with capitalism replacing imperialism, as the dominant economic rallying cry. An essential component to Japan's postwar reconstruction was the heavy-handed role played by the Japanese state in rebuilding from the great destruction suffered from the war.

In Korea meanwhile, the developmental state term has been applied to the period between the mid-1960s to the end of the 1980s. During this time, the government sought to promote policies of export led growth and rapid industrialization to compete with the

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[6] Johnson, *MITI and the Japanese Miracle*, 309.
[7] Johnson, *MITI and the Japanese Miracle*, 311. See also Yves Tiberghien, "Critical Book Review of Chalmers Johnson, *MITI and the Japanese Miracle*," Unpublished Manuscript (1997), 2.
[8] Mark Tilton, from Lonny E. Carlile and Mark C. Tilton (Eds.), *Is Japan Really Changing its Ways? Regulatory Reform and the Japanese Economy* (Washington DC: Brookings Institution Press, 1998), 164.

communist North. By the 1970s, Korea rose to prominence in shipbuilding, chemical and heavy industrial manufacturing. Within three decades, Korea transformed itself into one of the world's most prosperous nations.

The end of the 1980s however marked a significant turning point for both economies. Financial globalization had been introduced to East Asia, prompting both Japan and Korea to cope with these global forces. This quickly spelled trouble for state-led developmental policies; as market forces gained increasing prominence, the role of the state intervention was regarded as inefficient and unnecessary. Over the next decade, a severe crash in Japan's asset market, followed by economic stagnation, as well as political transition in Korea, followed by an economic crisis would alter the course of each nation's economic and industrial policies. Japan responded through attempting to implement financial and administrative reforms, with little concrete results. Rather, entrenched domestic interests represented in the Diet—from such sectors as construction and agriculture—effectively stonewalled bureaucratic initiatives. Korea however, faced greater global constraints—beginning with pressure from the US Treasury Department to turn towards market liberalization policies—leading to a dismantling of institutional coordination between state and private sector. What each case illustrates then is that the degree of constraint from domestic and global forces can indeed affect state capacity, ultimately resulting in different responses and consequences for the state.

There are, of course, some caveats to point out. First, it is important to note that this paper does not seek to measure the success or failure of the divergent policies and responses pursued by both Japan and Korea over the past decade, as each faced different levels of global and domestic constraint. In addition, this paper does not seek to

prescribe how each state *should* respond or what policies would prove to be the most ideal to the pressures posed by global forces, as these ideal prescriptions have yet to exist anywhere. Rather, what is of primary concern is how individual states have responded to or mediated these global forces and domestic pressures, and to determine what factors led to the dismantling of one state's developmental institutions, and the stagnation of the other's. My ultimate goal is to highlight the enormous relevance that the state continues to play in a nation's economic development agenda.

Karl Polanyi argues that prior to the existence of free market capitalism, societies were organized along a combination of reciprocal, re-distributive or householding principles, each of which were institutionalized under a specific form of social organization:

> [m]an's economy, as a rule, is submerged in his societal relationships. He does not act so as to safeguard his individual interests in the possession of material goods...Neither the process of production nor that of distribution is linked to specific economic interests attached to the possession of goods...the economic system will be run on noneconomic motives."[9]

The transition from feudalism to capitalism (which began in Japan with 19th century European mercantilism, and the mid 20th century in Korea after the Japanese occupation) however, disrupted these principles and organizational institutions; essentially reversing the influence, with society now becoming subordinated by economic imperatives. Polanyi notes that,

> [T]he control of the economic system by the market is of overwhelming consequence to the whole organization of society...Instead of economy being embedded in social relations, social relations are embedded in the economic system.[10]

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[9] Karl Polanyi, *The Great Transformation* (Boston MA: Beacon Press, 1957), 46.
[10] Polanyi, *The Great Transformation*, 57.

The evolution of the market economy thus resulted in an entire societal shift. In a market economy or capitalist state, the nature of which characterizes competition and the act of 'buying' and 'selling' between atomistic actors, self-interest becomes the guiding principle. Society therefore comes to realize the importance of individual gain (and loss). In addition the market is all encompassing and affects all elements of production, turning attributes such as land and labor into purchasable commodities; this effectively subordinates society to the market's principles. The market economy is thus "an economic system controlled, regulated, and directed by markets alone...An economy of this kind derives from the expectation that human beings behave in such a way as to achieve maximum money gains."[11] The existence of international economic treaties and arrangements, national monetary policies and anti-monopoly laws, however, has managed to keep markets in check. Nevertheless, the scope and presence of international markets has come to determine the shape of individual political realities, requiring domestic economies to become increasingly open and transparent. The developmental state meanwhile, has attempted to exert control over the market economy.

Theda Skocpol asserts the crucial notion of state autonomy. Skocpol, in essence, gives greater depth to the meaning of the state, defining it as a "set of administrative, policing, and military organizations headed and more or less well co-ordinated by an executive authority...[which] extracts resources from society and deploys these to create and support coercive and administrative organizations."[12] The state's ability to carry this through is realized through its institutions, which "social interests are represented in state policymaking," and institutions through where "nonstate actors are mobilized to

[11] Polanyi, *The Great Transformation*, 68.
[12] Theda Skocpol, *States and Social Revolutions* (Cambridge UK: Cambridge University Press, 1979), 29.

participate in policy implementation."[13] Though Skocpol cites the revolutions of France, Russia and China in her work, she provides insight into how these regimes reflect not just class interests, but "the structures of state organizations and their partially autonomous and dynamic relationships to domestic class and political forces, as well as their positions in relation to other states abroad."[14] Skocpol thus advances the notion that the state is a separate entity made up of influential interests and institutions, (rather than solely the interests of dominant classes) capable of pursuing policies that can advance its own interests, which for the purposes of this paper, refer to national goals of development. The emergence of the developmental state in the mid-twentieth century, demonstrated that the state—working with the market—could advance the collective interests of society. The self-regulating market mechanism, which Polanyi criticized, has failed to take hold as the organizing agent within the developmental state. Instead, political, social and economic actors formulate development policies through institutional cooperation and coordination. This form of networking is a fundamental component of the developmental state, which functions according to the success of these relationships.

Chalmers Johnson represents the foremost authority on theories surrounding the developmental state. Johnson's concept of the developmental state—citing specifically Japan—represents an attempt to counter the sociological effects of the market. In essence, the developmental state has attempted to reverse the notion of economic relations embedded in society:

> [t]he Japanese have built their economic system on a sociological rather than an economic theory of the market—one that recognizes the links and connections between manufacturers and consumers and tries to make the

[13] Skocpol, *States and Social Revolutions*, 29.
[14] Skocpol, *States and Social Revolutions*, 284.

> most of them...In short, the Japanese theory of the market rests on tan assumption of the naturalness of oligopoly.[15]

Johnson's developmental state thus, is essentially critical of the assumptions advanced by neoclassical economics. As Albert Hirschman notes, the market ideology has neglected to account for societal-based distortions:

> the argument cannot be made for the ideal market with perfect competition...Under perfect competition, there is no room for bargaining, negotiation, remonstration or mutual adjustment...In this manner, [economists] have endeavored to endow the market with economic legitimacy. But, by the same token, they have sacrificed the sociological legitimacy that could rightfully have been claimed for the way...most markets function in the real world.[16]

Some features of the developmental state, such as distributional conglomerates (keiretsu or chaebol), links between banks and business, as well as business groups are based not on the *assumption* of anonymous buyers and sellers, perfect competition and information; but rather upon the *reality* of imperfect competition in the market. The developmental state then, represents a response to the societal constructs which neoclassical economics ignores.

The institutions within the developmental state are made up of a traditionally conservative alliance between public and private sector interests. In Japan, this alliance consists of the Liberal Democratic Party (LDP), economic bureaucracy, and keiretsu affiliated business interests; in Korea, the President (or political executive), economic bureaucracy, and chaebol affiliated businesses form this conservative coalition.

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[15] Johnson, *Japan: Who Governs?*, 43.
[16] Albert O. Hirschman, *Rival Views of Market Society and Other Recent Essays* (New York NY: Viking Press, 1986), 123.

The linkages between the public and private sector represent the basic elements of any developmental state.[17] The formation of these linkages is therefore important element in establishing the characteristics of a developmental state. Peter Evans asserts that the internal cohesiveness among state bureaucrats is necessary before setting forth in engaging with private actors.[18] These bureaucrats follow long-term career paths, and are thus highly professionalized—operating in a realm where rules and established norms are strictly followed. As such, they represent a Weberian ideal-type,[19] where individual interests become a part of pursuing collective goals of national growth and advancement.

This is the fundamental element in Evans' notion of embedded autonomy, which builds upon Skocpol's notion of state organization. Embedded autonomy combines bureaucratic insulation—where bureaucrats are separate from societal influences, ideally uncorrupted, rational actors—with intense connection or awareness towards the surrounding social structure. Embedded autonomy works when states have a deep knowledge and understanding of societal interests and dynamics and it is what enables ministries such as Japan's Ministry of Economy Trade and Industry (METI—previously the Ministry of International Trade and Industry) to "address the 'collective action' problems of private capital, helping capital as a whole to reach solutions that would be

[17] In this section I describe the developmental state in the abstract—so that it applies to both the Japanese and Korean experiences. Two key institutional differences however, lie with the names of their respective ministries; second, that in Japan, the legislative branch wields considerable power in implementing policies (ie: the Liberal Democratic Party), as opposed to the executive branch (ie: the President) in Korea.
[18] Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton NJ: Princeton University Press, 1995), 50.
[19] Weber refers specifically to the West (Europe) arguing that "Only the occident knows the state in the modern sense, with a professional administration, specialized officialdom, and law based on the concept of citizenship...Only the occident knows rational law...further distinguished from every other by the presence of men with a rational ethic for the conduct of life." The modern state thus, contains a highly professional, highly rational bureaucratic structure. See Max Weber, *General Economic History* (New Brunswick NJ: Transaction Books, 1981), 312-314.

hard to attain otherwise."[20] The embedded function then represents the state's ability to implement and form its objectives, while the autonomy function represents the capacity of state bureaucrats to carry out this process uncorrupted. Embedded autonomy therefore allows the developmental process to form, so that goals and directions can be determined, and policies can be put together. The state's capacity is such that it becomes a necessary and legitimate element in the nation's economic development. In any state, the bureaucracy is the key policy-implementing element. In bureaucracies where interests are accommodated and policies are implemented in pursuit of a common societal goal, they function according to the Weberian ideal-type. Evans asserts though that the notion of embedded autonomy is ultimately time-bound.[21] States will enter phases of their development where societal or international factors will overwhelm a state's embedded autonomy. The state ultimately loses its independence in formulating policy, as new interests will have to be accommodated.

Embedded autonomy does not mean that the state functions in isolation from other societal interests. In fact, these highly developed, coherent bureaucracies are capable of recognizing societal interests through a connection with the private sector. Eisuke Sakakibara paints a more accurate picture, where "neither the public sector nor the large corporate sector predominates. Rather they coexist in generally separate fields."[22] The role of the state then, is to secure its economic interests, strategizing actively in sectors where it can create an advantage. The relations between state and private are then

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[20] Evans, *Embedded Autonomy*, 50.
[21] See Charles Polidano, "Don't Discard State Autonomy: Revisiting the East Asian Experience of Development," *Political Studies* 49 (2001), 520.
[22] Eisuke Sakakibara, *Beyond Capitalism: The Japanese Model of Market Economics* (Lanham MD: University Press of America, Inc., 1993), 6.

best characterized as networks, as negotiation between state and private interests with common goals is an essential feature of the developmental state.

Ziya Onis introduces the notion of the institutional arrangement, or what different levels of relationships exist among these actors. While acknowledging that cooperation exists on a macro level between a "highly centralized and meritocratic bureaucracy" and private business interests, "attention must be paid to the micro-level institutional arrangements that play a key role in generating cooperation and consensus in the system."[23] Two distinct Japanese elements in this micro level arrangement are lifetime employment and the sub-contractual relationship between large and small firms, or keiretsu. In Korea, this included a deferential population (in the beginning, though organized labor groups gained increasing prominence during the 1980s) and the handpicked large chaebol firms. It is this crucial micro level element that stabilizes the competing interests within the private sector, turning it into a similar *en masse*[24] type of institutional arrangement as the state bureaucracy.

The developmental state was used to characterize many of the high growth East Asian economies—specifically Japan, Korea and Taiwan, whose immense success in recent years is undeniable. Their success is often attributed to the relationship in which the state holds with the domestic economy, specifics include:

> where governments have acquired control over a variety of things presumed critical to economic success: they can extract capital; generate and implement national economic plans; manipulate private access to scarce resources; coordinate the efforts of individual businesses; target

[23] Ziya Onis, "The Limits of Neoliberalism: Toward a Reformulation of Development Theory," *Journal of Economic Issues* XXIX, I (1995), 104.
[24] By this I am implying that societal groups were "silenced" through arrangements between state and industry.

> specific industrial projects; resist political pressures from popular forces such as consumers and organized labor...[25]

The developmental state seeks to cushion the effects that the market may have on national development, thereby enabling growth to be politically driven, rather than left to the "invisible hand" of the free market.

Perhaps the most striking feature of this political instrument then rests with the principle of "administrative guidance," which refers to the relationship among the state's elite economic planners. In Japan, administrative guidance has historically given ministries such as METI and the Ministry of Finance (MOF) the ability to plan and initiate policy changes in an extralegal manner.[26] In Korea, the Economic Planning Board (EPB) and the Ministry of Commerce and Industry (MCI) have played a key role in planning and development. [27] This tightly knit relationship among government ministries is therefore important in maintaining the state's legitimacy and capacity in policymaking.

The private sector is in no way marginalized in this process. There exists a definite coordinative relationship between major government ministries and the private sector, based on long-term mutual understanding:

> What becomes apparent...is the relative autonomy of the public and corporate sectors and the formation of a process of 'mutual understanding' and continual negotiation that is based precisely on this premise of independence...the role of the public sector does not necessarily involve 'political' intervention in the private sector.[28]

Thus, within the developmental state, it is the public sector's central task to ensure that specific economic interests are being met and that these interests are realized through

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[25] TJ Pempel, "The Developmental Regime in a Changing World Economy," in Meredith Woo-Cumings (Ed.) *The Developmental State* (Ithaca NY: Cornell University Press, 1999), 138.
[26] Johnson, *Japan, Who Governs?* (New York NY, WW Norton, 1995), 13.
[27] Sung Deuk Hahn and L. Christopher Plein, *After Development: The Transformation of the Korean Bureaucracy* (Washington DC: Georgetown University Press, 1997), 65.
[28] Sakakibara, *Beyond Capitalism,* 5-6.

promoting competition between industries, rather than a top-down command approach. As such, the state fully preserves the benefits of spontaneity and freedom at the bottom of the system while retaining the advantage of coordination and united purpose at the top.[29] The developmental state remains a unique arrangement in the context of modern capitalist states. The competition that takes place (ideally) enables the survival of the strongest industries, with the state being able to coordinate the goals for the nation, rather than dictate the means on how to achieve them.

What the theoretical foundations of the developmental state reveal then is that relationships between public and private sector are critical in carrying out the developmental agenda, notably in economic policy planning. As Manuel Castells asserts, "a state is developmental when it establishes as its principles of legitimacy its ability to promote and sustain development...both domestically and in its relationship to the international economy."[30] Where globalization has proven an important factor in challenging these current arrangements, and thereby questioning the long-term viability of the developmental state; states that can adapt their institutional arrangements to internal and external forces are able to preserve these relationships, while states that cannot, have no other option but to dismantle their current arrangements.

Over the past decade, Japan and Korea have both been the subjects of intense debate over issues of globalization and state capacity. As many neo-liberal economists argue,[31] both have had to acquiesce to market forces, leaving behind their respective

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[29] Thomas Huber, *Strategic Economy in Japan* (Boulder CO: Westview Press, 1994), 14.
[30] Manuel Castells, as quoted in Emma Edigheji, "The institutional mediation of globalization: reconceptualizing the role of the state in the postdevelopmental era." *Society in Transition* 30, 2 (1999), 107.
[31] See Takatoshi Ito and Anne O. Krueger (Eds.), *Deregulation and Interdependence in the Asia-Pacific Region* (Chicago IL: University of Chicago Press, 1997); D. Lal and S. Rajapatirana, "Foreign trade regimes and economic growth in developing countries," *World Bank Research Observer* 2, 2 (1987), 189-

state-centered models of economic development. These perspectives cite the increased presence of foreign ownership, corporate restructuring, economic trouble, and deregulatory policies as indicative of state failure.[32] What they have failed to recognize however, is that although both nations have had to deal with the challenges posed by globalization, their respective responses have not been similar. As state institutions in Korea faced overwhelming pressures from global sources, as well as domestic political challenges, the state has had to undergo extensive liberalization measures. In Japan, these institutions proved very capable and effective of formulating policies—yet faced staunch resistance from deeply entrenched interests.

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217. Although centering their arguments in favor of free trade, both articles emphasize that government should be limited to a minimalist role in economic development. Development therefore rests on comparative market advantage. See also David Henderson, "The Myth of MITI," *Fortune* (August 8 1983) 113-116, who attributes Japan's growth to successful *laissez-faire* policies in banking and labor.

[32] For some opposing views, please consult: Gary Gereffi, "More than the Market, More than the State..." in Steve Chan, Cal Clark, Danny Lam (Eds.), *Beyond the Developmental State: East Asia's Political Economies Reconsidered* (London: MacMillan Press Ltd., 1998); Linda Weiss, *The Myth of the Powerless State* (Cambridge UK: Polity Press, 1998); "Chronic Sickness," *Economist* 359 (June 2 2001), 71-72; Jagdish Bhagwati, "Samurais No More," *Foreign Affairs* 73, 3 (1994), 7-13.

Chapter II: State Responses and Industrial Policy In Korea and Japan

Policy networks are essential institutional features of the developmental state, in that they act as a forum for coordination between different interests. These networks contain an important institutionalized mechanism that reconciles divergent interests into agreed policies and common goals, ensuring the exchange and dissemination of information between the state and business.[33] These networks are crucial in facilitating efficient exchanges of information between state and industry, as well as in arranging swift measures to counter both short-term and long-term environmental changes; thereby enabling the state to flexibly respond to domestic and international changes and pressures. This relationship lies at the heart of state capacity in economic planning. In Japan, these networks are headed in part by METI and its relationship with the Japan Business Federation, while in Korea these networks comprised of the Economic Planning Board (EPB) and its relationship with leading business and family groups affiliated with the chaebol.

The impact of globalization over the past decade has undoubtedly affected the operation of these networks. In Japan, while these relationships have been able to withstand much of the challenges posed by global forces, and have attempted to coordinate more open and responsive policies, these institutions remain partially paralyzed in implementing any serious reform. In Korea however, the institutional capacity of these networks has weakened, as globalization resulted in greater liberalization, which effectively placed free market interests ahead of state-led ones. The

[33] Hisahiro Kondoh, "Policy Networks in South Korea during the democratic era," *Pacific Review* 15, 2 (2002), 226.

state does however continue to play a significant role, as it was the driving force behind Korea's liberal transition.

Korea: Disbanding and Rebuilding

The developmental state in Korea had been built and perfected during Park Chung Hee's authoritarian regime. The Park regime set out to control every step of Korea's industrial development, fostering close relationships between government and the chaebol conglomerates, which were loosely modeled after Japan's keiretsu. In the early 1960s, Park sought to industrialize the agrarian economy, and pushed an export-led strategy that first focused on light manufacturing and textile production, then moved into heavy industrial manufacturing and chemical production by mid the 1970s. Park was able to achieve these goals because of the extensive control his administration exercised over the economy. As such, at the roots of Korea's developmental legacy lie authoritarian elements.[34] With the advent of globalization however, these arrangements between state and industry became increasingly difficult to manage. Park's successor, Chun Do Hwan, began the push to modernize the Korea's developmental state by taking on a more neo-liberal path. Chun implemented policies based on fiscal restraint and macroeconomic stability, which catapulted Korea out of the economic troubles suffered at under the Park regime. Despite Chun's policy successes however, the regime's legitimacy had grown weaker. Chun's reforms had alienated his core bases of support, namely big business and agriculture:

[34] Bruce Cumings argues that these roots are not wholly authoritarian; rather, they are bureaucratic authoritarian where the state hold greater weight than the market, and state coercion is not fully legitimated as a punitive force. Please see chapter 3 of Meredith Woo-Cumings (Ed.) *The Developmental State*, 68-70.

> The combination of stabilization and structural reform had distributional and thus political consequences...Big business was consciously chosen as a prime target...[Chun] attempted to squeeze the chaebols...At the same time, the Chun regime undermined the conservative coalition by alienating farmers.[35]

Chun's policies for fuelling Korea's economic growth thus resulted in weaker state control over national economic development. The authoritarian elements that enabled state dominance over the industrial and economic agenda had been loosened, as Korea's chaebol soon looked elsewhere to raise investment capital, in order to avoid many of the rigid standards set by the Chun regime. Political opposition had also consequently surfaced, which in turn began the process of democratization.

Social and political democratization had taken hold in Korea since the late 1980s, and this, combined with the internationalization of Korea's economy suggested that policy successes threatened the stability of the state's institutional arrangements,[36] thereby leading the state to retreat in finance, policy formation and industry. The election of Roh Tae Woo in 1987 began the drive toward liberalizing much of Korea's economic policies, and with this came a shift in the state's policy goals. In an unexpected move, the government undertook serious efforts towards improving ties with the business sector through currency depreciation, easing of credit controls, and interest rate cuts. By the outset of the 1990s, the Roh government had developed a channel between government and business officials, which combined information sharing, through the analysis of economic trends and prospect with discussions on how to work out potential economic problems. Although in the beginning these meetings were largely on an *ad hoc* basis,

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[35] Stephan Haggard and Chung-in Moon, "The State, Politics, and Development in Postwar South Korea," in Hagen Koo (Ed.), *State and Society in Contemporary Korea* (Ithaca: Cornell University Press, 1993), 86-87.

[36] Hahn and Plein, *After Development...*, 130.

they became a regular occurrence by 1992.[37] This new dialogue had therefore become institutionalized, and marked the start of a new era for the Korea's economic policies, one where the state would have to adapt to accommodate new and increasingly powerful interests. This period would become the initial testing ground for the developmental state and its policy networks and was so far proving itself effective in adapting to political change.

One unintended consequence of Roh's pro-business policies however, was that as big business strengthened its political power, the state's autonomy and allocative powers began to decline. The government's shift towards political openness meant the development of a more liberal political environment, which "stimulated the mushrooming of voluntary associations and all varieties of social and cultural movements."[38] The state's influence was thus eroding as new domestic forces gradually permeated into the domestic political realm.

By 1993, the newly elected administration under Kim Young Sam went even further to move forward a more democratic and liberal political and economic agenda. Kim had to contend with a new exogenous set of demands, which included pressures from the US Treasury Department to liberalize domestic financial markets which would allow for the inflow of short-term investment capital, deregulation measures from the OECD in order to gain admission, as well as bilateral and multilateral demands for trade liberalization from the US and the Uruguay round of the World Trade Organization (WTO) talks. Kim's administration was pivotal in shifting Korea's economic policies to

[37] Kondoh, "Policy Networks in South Korea during the democratic era," 229.
[38] Hagen Koo, "Strong State and Contentious Society," in Hagen Koo (Ed.), *State and Society in Contemporary Korea* (Ithaca: Cornell University Press, 1993), 247.

embrace free market forces, as globalization provided the rationale for pursuing this agenda:

> Deregulating economic life and correcting government failures are thus signaled out as major goals of globalization...rationalization constitutes another important component of globalization. State intervention has been gradually replaced by market principles. Institutional reforms aiming at rationalization and accountability have been undertaken in virtually all sectors of the state and society. Globalization has become a new, omnipotent ideological tool of governance...[39]

As such, the institutional arrangements formed under the Roh government were dismantled. The first victim in Kim's sweeping reform drive was the Five Year Economic Plan, which was a policy tool that began under the Park regime and was designed to set growth targets for specific industries and was central to the functioning of the Korean developmental state.[40] Kim instead replaced this with the New Five-Year Economic Plan, which emphasized economic justices and private initiatives in the economy and also withdrew from selective industrial policies, except for hi-tech research and development initiatives. Thus macroeconomic management in industrial policy was being abandoned, leaving market forces free to dictate the direction of Korean industry.

Kim also disbanded the EPB by merging it with the Ministry of Finance, forming the Ministry of Finance and Economy (MOFE). The EPB was formed under the Park regime to formulate, implement and monitor the government's industrialization strategy.[41] Kim's decision to consolidate the two ministries enabled MOFE to become a more responsive super-ministry and would work to "drastically transferring the state's

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[39] Chung-in Moon, "Democratization and Globalization as Ideological and Political Foundations of Economic Policy," in Jongryn Mo and Chung-in Moon (Eds.) *Democracy and the Korean Economy.* (Stanford CA: Hoover Institution Press, 1999), 12.
[40] Yun Tae Kim, "Neoliberalism and the Decline of the Developmental State," *Journal of Contemporary Asia* 29, 4 (1999), 451-52.
[41] Yoon Hyung Kim, "An Introduction to the Korean Model of Political Economy," in Lee-Jay Cho and Yoon Hyung Kim (Eds.), *Korea's Political Economy: An Institutional Perspective* (Boulder CO: Westview Press, 1994), 49.

role in economic development to the private sector following the line of neoliberal free marketism."[42] The writing was on the wall: long-term planning initiatives were no longer appropriate in an era where dynamic responses to market forces were necessary.

In addition to the government's drive toward economic liberalization came the simultaneous push to democratize many of the state's authoritarian elements. Direct elections were held after 1987, interest groups previously silenced were given a voice and space in domestic political affairs—labor unions in particular, gained increasing prominence during this time. Korea's policymaking circle was therefore expanding, with the state having to accommodate an explosive array of interests.

The period between 1987 and 1993, which represented the height of Korea's democratic transition, has weakened Korea's developmental state in a number of ways. First, the erosion of political support and legitimacy under the Chun regime led to the Roh government's decision to incorporate a more pro-business agenda, which effectively activated or politicized Korea's now powerful industries. Leading figures in these businesses had introduced the importance of capital in party politics, making the state vulnerable to manipulation by big business. Second, institutional reforms implemented under the Kim Young Sam government were key in decentralizing state or administrative power. Third, labor groups and mass media entered into the political realm, in response to decades of prior government repression and mismanagement. Korea's democratic transition undermined its developmental legacy by devaluing the dominant ideological template of a "good society", where economic growth and development the effects of tight security policies, and the erosion of the shield that insulated policymaking from

[42] Kondoh, "Policy Networks in South Korea during the democratic era," 229.

political and social pressures.[43] In other words, the state's authoritarian and repressive policies could no longer serve as justifications for economic growth and prosperity as new interests had entered into policymaking process.

This radical new stance did not last very long. Economic downturn combined with labor dissatisfaction in the mid 1990s brought the government back onto the policy stage. This time however, its role would change. Rather than taking on its dominant and traditional institutional role in economic planning, the state had emerged as reactive and less regularized, which made it increasingly difficult to coordinate policies over the long-term.[44] This was seen through the constant shift between the liberal and pro-business agendas. By setting the state down a path of reactive policies, Kim consistently mismanaged and misinterpreted the nation's economic conditions. As such, the state became alienated and incapable of effectively intervening in domestic economic affairs.

Korea's experiences with globalization have thus led to serious adjustments in its policy networks. Traditional state capacity has diminished significantly, and market forces have been accommodated to steer the direction of the nation's economic development agenda. Given that the origins of Korea's developmental state were authoritarian, the state had to play a central role in economic planning because it had subverted domestic social groups, while insulating the economy from international forces. However, as the nation's economy expanded and society became increasingly wealthy, educated, and skilled these domestic groups strengthened and with that came greater pressure on the state—specifically in the form of democratization.[45] At the same

[43] Moon, "Democratization and Globalization…" 9-10.
[44] Kondoh, "Policy Networks in South Korea during the democratic era," 230.
[45] John Minns, "Of miracles and models: the rise and decline of the developmental state in South Korea," *Third World Quarterly* 22, 6 (2001), 1032.

time, Korea's export-led strategy for development also catapulted it onto the global stage, as industry became increasingly prominent in global markets.[46] Thus the simultaneous conflict between industry, society and government essentially paralyzed the state's capacity in carrying out developmental goals, especially in coordinating policies between these two competing groups. The state's initial withdrawing from economic planning measures disbanded a long established policy network, in favor of market-based solutions. The state could no longer properly coordinate economic policy between government and private sector interests; its autonomy therefore eroded and incapable of and the developmental state as a consequence, receded.

The election of Kim Dae Jung in 1997 at the height of a region-wide economic crisis brought about further dissolution in the institutional arrangements between state and private sector. Kim Dae Jung went beyond Kim Young Sam's reforms by changing the nation's parliamentary structure—making the presidential or executive branch more accountable.[47] This deliberate restriction of executive power served to further undermine the Korean developmental state as any future attempts to secure control over economic planning initiatives during the financial crisis failed:

> He [Kim Dae Jung] wanted to create an Office of Planning and Budget, rather like America's Office of Management and Budget, reporting directly to the president. This would shift power away from the finance ministry. But the GNP [opposition Grand National Party] kicked up a fuss about that, too. As a result, the budget office will be divided into two groups, with the planning side reporting to the president and other functions to the prime minister.[48]

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[46] Minns, "Of miracles and models: the rise and decline of the developmental state in South Korea," 1034.
[47] Scott Walker, "A Tale of Two Tigers and a Giant: Comparing the Responses of Japan, Korea, and Taiwan to the Asian Financial Crisis," *Asian Perspective* 24, 2 (2000), 42.
[48] "Kim's Welcome," *Economist* 346 (28 February 1998), 45.

Kim's measures were only partially successful as the planning aspects of the office were placed under the domain of the office of the President while the implementation of aspects remained under the control of the finance ministry. Overall though, Kim Dae Jung's administration marked a significant turn of events in Korea's reformist agenda. In fact,

> [T]he leeway of the Korean government in the process of corporate reforms was larger than in most issue-areas (such as interest rates and budgetary issues)...it was the driving force in the area of *chaebol* reforms...Korean bureaucrats saw the IMF agreement as the golden chance to push for corporate and financial reforms...[49]

Kim Dae Jung's government therefore revived the state's role in overseeing reform to the chaebol. The period under the Kim Dae Jung administration witnesses a significant transition where the state's role is revived by the role it plays in responding to global pressures.

The period of liberalization and internationalization of the economy and politics that Korea experienced during the late 1980s and early 1990s essentially weakened the foundations of the developmental state. In essence, the ability of the authoritarian executive-bureaucratic arrangement to manage the economy was compromised, now that the state was "less able to protect business interests by insulating capital and labor from foreign competitors."[50] In other words, Korea's brand of developmental statism was widely regarded as authoritarian—from both within and outside the nation. The effects of globalization—as evidenced by the drive toward social and market liberalization have challenged Korea's current institutional arrangements. As such, state influence has continued to decrease as the authoritarian elements within Korea are dismantled. Given

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[49] Yves Tiberghien, "State Mediation of Global Financial Forces, Different Paths of Structural Reforms in Japan and South Korea," *Journal of East Asian Studies*," 132-133.
[50] Hahn and Plein, *After Development*..., 46.

the state's inability to adapt to these challenges, these forces have consequently gathered strength, while the state has become increasingly marginalized, retreating from its role in economic and industrial policy planning.

Industrial and state relations

The Korean case illustrates that during the 1990s the present institutional arrangements became incapable of inciting change and reform and nowhere was this more apparent than in the changes that Korean industries—specifically the chaebol, and the transition from manufacturing to a knowledge-based economy—underwent during this time. Global challenges posed first by the US and subsequently by the IMF and OECD forces proved much too significant, and Korea's developmental state was ultimately unable to adapt to these changing realities. Where they failed, the state consequently retreated, leaving market forces to determine any future direction of the nation's economy. Nowhere was this more present than in Korea's industrial and technological sectors.

The outset of the 1990s ushered in a new era for the Korean economy. The role that technology and technological innovation would play in economic growth was becoming increasingly important. In the United States, the Silicon Valley region was proving itself as the world's leading innovator in technology. Other economies would have to follow suit to keep pace, thus beginning the global drive toward the development of information technology. When Kim Young Sam was elected president in 1993, the developmental priorities of the state had consequently changed to reflect the critical need for policies that would promote the technological innovation witnessed in the US. The

new administration stressed three areas where Korea needed to refocus: the promotion of private sector research and development (R&D), the development and acquisition of high-caliber technological manpower, localizing key strategic technologies, as well as the expansion of information and technology-intensive industries.[51] The state had entered a new phase in its economic development, and would seek to promote these directives towards major industrial players.

The state had every intention to follow through with its plans. However, directing Korea's leading industries to undergo this type of transition would prove far more difficult than in previous times. During the 1970s when Korea's economy was experiencing rapid growth, the chaebol conglomerates were highly controlled by the state. The state was therefore capable of using this leverage to guide the direction of investment and the development of specific sectors. As such, Korean firms conformed to the industrial policy goals of the state.[52] A decade later witnessed policies of structural adjustment combined with deregulation, industrial re-organization, privatization and financial liberalization, in an effort to prepare the Korean economy for global level competition. These measures led to the chaebol controlling some domestic banks and financial investment firms,[53] giving these conglomerates essentially free reign in financing their own expansionary agenda. Financial controls previously exercised by the state to keep the chaebol in check were no longer effective. During the 1980s the chaebol had expanded astonishingly through investing in foreign markets, due to steps taken by the Korean government to liberalize its markets.

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[51] The Ministry of Science and Technology, as quoted by Hahn and Plein in *After Development*..., 72.
[52] Meredith Woo-Cumings "The State, Democracy, and the Reform of the Corporate Sector in Korea," in TJ Pempel (Ed.), *The Politics of the Asian Economic Crisis* (Ithaca NY: Cornell University Press, 1999), 123.
[53] Kim, "Neoliberalism and the Decline of the Developmental State," 446.

The effects of this industrial expansion then led to a breakdown in the traditional (or developmental state) ties between state/government and the business community. The political ties between state and business had weakened as Korea's economy underwent gradual liberalization during the 1980s. The network developed between these two actors was an essential characteristic of the Korean developmental state—as it permitted the state to develop and implement a national economic development agenda. By the time the government had sought to intervene in staving off over-competition between the chaebol in the early 1990s, the chaebol had had enough of the state's meddling, and were strong enough to say so. Political challenges against the government began to mount from business leaders, citing their frustrations with state inefficiencies.[54] By the middle of the decade, the government officially abandoned its industry specialization policy and ceased pressuring business over the separation of ownership and control,[55] which were originally the measures aimed at curbing their expansion. In addition, the government introduced specific measures aimed at improving the global competitiveness of the chaebol through: market transparency, elimination of certain debt-guarantees, business consolidation and accountability in management.[56] The chaebol have consequently taken initiatives to invest in new sectors—notably technology and communications, in which they have become global leaders.

Yet another example of the breakdown between state and private sector ties can be illustrated in Korea's ambitious industrial transition from a manufacturing to knowledge-based economy at the conclusion of the Kim Young Sam administration.

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[54] Kim, "Neoliberalism and the Decline of the Developmental State," 450.
[55] Kim, "Neoliberalism and the Decline of the Developmental State," 452.
[56] Carl Dahlman and Thomas Andersson (Eds.), *Korea and the Knowledge-based Economy: Making the Transition* (Washington DC: The World Bank and OECD, 2000): 118.

Although Kim's government would pledge to lead the nation's transition through institutional means: primarily in having the Ministry of Science and Technology at the forefront, Kim explicitly forged the link between technological and economic development and the global market.[57] In other words, Korea's transition would depend on trends and developments international markets; thus having policy setting subordinated to market movements. With the election of the Kim Dae Jung's government in 1997, this policy continued as the new administration pledged to upgrades in Korea's information sector as well as enhance its domestic science and technology base to match the levels of the G7 nations.[58]

These economic and policy responses reflected, in part, a response to Western pressure to open markets and Korea's own need for greater penetration of foreign markets.[59] Specific to this was Korea's drive to gain admission into the OECD. The OECD members sought out Korea as the latest example of success in economic development through liberalization, and the nation's ambitious attempt at stepping into a knowledge-based realm meant serious institutional overhaul:

> The Korean Government has played a key part in the country's rapid development, and will indeed play a critical role in the transition to the knowledge-based economy. However, this new role calls for the interventionist policies of the past to be abandoned. Meeting the requirements of the knowledge-based economy means making markets work more effectively. [60]

Given Korea's marginal global economic position, these pressures easily emanated into government policy responses. The state would retain a passive role in this process,

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[57] Hahn and Plein, *After Development...*, 91.
[58] Dahlman and Andersson (Eds.), *Korea and the Knowledge-based Economy*, 31.
[59] Hahm and Plein, *After Development...*, 46.
[60] Dahlman and Andersson (Eds.), *Korea and the Knowledge-based Economy*, 41.

yielding much of its authority to the market. Korea's future development agenda would, according to OECD prescriptions, be met through greater liberalization measures.

The state's drive towards placing Korea on an internationally competitive plane has meant the promotion of market-oriented strategies. Korea's drive towards admission into the OECD meant that any economic or industrial transformation would have to be met through market-based strategies, thereby marginalizing the role that the state would play in managing the transition. While the state continues to play a role in "promoting," the source of technological development ultimately stems from more liberalized market-centered strategies. The state has shifted from playing a central role in guiding industrial development to a more peripheral one in ensuring that market-based solutions are being followed. Although the state initiated the technological drive, these goals would have to be realized through market competition.

The Asian financial crisis, which began in 1997, also marked a turning point for Korea's industrial developmental policies. The near bankrupt state of the economy prompted the government to accept the terms of a US$58 billion bailout from the International Monetary Fund (IMF). The IMF asserted that Korea's economy operated largely from highly leveraged businesses lacking any sort of market discipline.[61] President Kim Dae Jung's government revealed the fundamental flaws in state-business relationships—specifically, collusion between state and private sector and the over-expansion of the chaebol—as causes of the financial crisis in Korea.[62] Prior to the 1997 financial crisis however, the chaebol were the product of state-led development

[61] Bruce Cumings, "The Asian Economic Crisis, Democracy and the End of 'Late Development,'" in TJ Pempel (Ed.), *The Politics of the Asian Economic Crisis* (Ithaca NY: Cornell University Press, 1999), 26.
[62] Sun-hyuk Kim, "Korea: the Politics of Three Transitions," in The Korea Economic Institute of America, *The Political Economy of Korean Reconciliation and Reform* (Washington DC: 2001), 111.

strategies. Companies such as Hyundai, LG, Samsung, Daewoo, and Hanbo were national (and in many cases world) leaders in steel production, automobile manufacturing and shipbuilding. By the 1990s the chaebol had grown to enormous proportions, while still feeding off their privileged positions with the state. With this growth however came the need to expand to stay internationally competitive. Many of Korea's chaebol began to leverage themselves in foreign markets to keep up with expansion. In this respect, the position of the government in setting a development agenda for Korean industries was becoming increasingly marginal, given that the state could no wield any direct control over the huge chaebol. In addition, the recent rise of labor groups meant that new demands would have to be met.

As the 1997 financial crisis swept the region, Korea was already overwhelmed by industrial and financial damage. Two of Korea's major chaebol went bankrupt during that year, with the state, by this time, unable to bail these corporations out of their debt troubles. Just prior to the crisis, Korea had faced mounting pressure from the OECD to reform its banking and industrial policies. Of particular concern was the safety of foreign investment, which the OECD required as a precondition for Korea's membership into the prestigious organization. Therefore, market liberalization and transparency measures would have to be implemented. As such, Kim Young Sam led Korea down the path of OECD-delegated reform. Meredith Woo-Cumings however, does make the point that the state brokered the reforms of Korea's chaebol—ending the system of loan guarantees and using deadlines for the debt-to-equity ratio requirements for the most heavily indebted of the conglomerates. These ambitious reforms were pursued specifically under the new administration led my Kim Dae Jung. Corporate reform became the rallying cry for the

Kim Dae Jung government, in efforts to dig the suffering Korean economy out of its deep financial troubles. Kim Dae Jung's "Big Deal" proposals called for swaps of key subsidiaries so that the large-sized chaebol would emerge stronger in areas of their "core competence," thereby avoiding unnecessary overlap. In addition the government created a set of legal and regulatory policies to restructure the medium-sized chaebol, which facilitated mergers and acquisitions activities, and creating greater overall corporate efficiency.[63]

Though instrumental in leading the chaebol towards financial solvency, the state, by this time, had essentially disbanded its developmentalist links in favor of market-based policies designed to curb the insolvency troubles of the chaebol. As Woo-Cumings notes, "the crisis and subsequent bailout...also inserted international financial institutions, mainly the IMF and the World Bank, deeply into the reform process in Korea."[64] This left the state in a position where it could only threaten, rather than make the adequate or decisive adjustment of its policy priorities to meet the challenges posed by competitive global forces.[65] As such, the "Big Deal" went beyond the traditional developmental state prescriptions as it clearly represented a market-centered solution to the nation's industrial troubles. Ultimately, Kim's "Big Deal" proposals were unsuccessful, as unemployment in Korea tripled by late 1998,[66] nevertheless, the state demonstrated its capacity to intervene and prevent what would most certainly have been a large-scale industrial collapse.

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[63] Woo-Cumings, "The State, Democracy, and the Reform of the Corporate Sector in Korea," 132.
[64] Woo-Cumings, "The State, Democracy, and the Reform of the Corporate Sector in Korea," 130.
[65] Hun Joo Park, "After *Dirigisme*: globalization, democratization, the still faulted state and its social discontent in Korea" *Pacific Review* 15, 1 (2002), 66.
[66] Woo-Cumings, "The State, Democracy, and the Reform of the Corporate Sector in Korea," 133.

The government then embarked on an ambitious plan to reform state-business relations and policy, notably through changing the structure of Korea's massive chaebol and improving the nation's corporate governance practices. The state sought to enhance market transparency, eliminate cross debt guarantees,[67] improve capital structure, and consolidate operations into core competencies. Korea's initiatives thus were a mixture of market-oriented measures, designed to liberalize and stimulate competition, and interventionist policies designed to force the chaebol to restructure.[68] While the state continues to play some role in overseeing industrial restructuring, it is the market that emerges as the guiding force in promoting competition and industry efficiency. The state has essentially retreated from its traditional role as a guide for business; rather, it has become a mechanism for enforcing market-based rules.

According to the characterizations of the developmental state, Korea has abandoned its developmental principles in its industrial policies. However, its ability to implement swift reforms to chaebol conglomerates at the outset of the Asian financial crisis demonstrates that the state's function is far from irrelevant. As Peter Evans and Bruce Cumings argue: a functioning developmental state requires a robust and coherent state apparatus to facilitate the initial and subsequent organization of industrial capital, combined with an organized class of industrialists who simultaneously facilitate a joint project of industrialization, in order to legitimize both interests.[69] This is certainly applicable to the Korean development experience prior to the 1990s. However, when

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[67] This occurs when firms (chaebol) are permitted to borrow from one another, as well as from banks under their control in order to finance expansion.
[68] The World Bank and The Organization for Economic Co-Operation and Development, Korea and the Knowledge-based Economy: Making the Transition (Washington DC: World Bank and OECD, 2000), 118.
[69] See Bruce Cumings, "Webs with No Spiders, Spiders with No Webs: The Genealogy of the Developmental State," in Meredith Woo-Cumings (Ed.), *The Developmental State* (Ithaca NY: Cornell University Press, 1999), 61-92 and Evans, *Embedded Autonomy*, 227-250.

examining how Korea dealt with its industrial policies during the 1990s, the Korean developmental state ultimately lacked the facilities to organize and direct the chaebol, once they had expanded into a global realm. This robust apparatus had become less useful in directing Korean industry, and the state's role was consequently becoming less legitimate in the eyes of the chaebol—due to their enormous size and scope. However, it was not until after the region's financial crisis during the late 1990s when the state reappeared in a different role, one that required enforcement of market-based regulations.

The politicization of Korea's labor movements during the 1990s resulted in a state incapable of flexibly adjusting and accommodating new socio-economic demands. In fact, the politicization issue was especially important in that unions became the driving force behind Korea's democratization movement. After 1987, Korea's labor protests, "demonstrated a high level of class solidarity and organizational skills...[as] the union movement was not confined to blue-collar workers but to white-collar workers as well."[70] As such, the movement began to represent not just traditional labor issues but also broader social and political concerns.

Rather than looking towards the long-term productivity and industrial competitiveness, the state compromised its developmental principles—considering only short-term goals. With the transition towards democracy, Korea became more involved in regulatory-based policies—seeking to improve upon industry practices—and as a consequence industrial policymaking decisions became increasingly functional and non-

[70] Hagen Koo, "The State, *Minjung*, and the Working Class in South Korea," in Hagen Koo (Ed.), *State and Society in Contemporary Korea* (Ithaca: Cornell University Press, 1993), 159.

sector specific.[71] Where specific ministries once dominated the direction of development policies, the gradual permeation of new interests meant an entirely different direction for industrial policy in Korea. The sudden shift towards improving upon corporate governance procedures meanwhile, illustrates that market principles would now determine the direction of Korean industry, with the state moving away from the apex of influence. Global constraints, combined with domestic challenges, have indeed had an effect on dismantling Korea's developmental legacy. As international influence and domestic industrial and societal demands grew, the state could no longer hold onto its institutional legitimacy—which was deeply rooted in authoritarian elements—in balancing these interests. Once a region-wide financial crisis hit, the pressures to improve upon corporate governance procedures proved far too much for the state to manage. Globalization then had a tremendous effect on Korea's state capacity. As industry leaders challenged the legitimacy of state-led policies, the state had no other option but to decrease its policy instruments over the private sector, essentially reducing its role in setting any kind of agenda for industrial development.

One of the most important characteristics of a developmental state is its ability to allocate resources effectively toward select industries, in an effort to promote the nation's economic development. In Korea, the effects of globalization combined with domestic political change—specifically the movement toward democracy at the outset of the 1990s resulted in an institutional retreat from this type of industrial planning, where the state distanced itself from industry through cutting its ties to the large chaebol firms. The impasse prevented the state from making the necessary transition towards technological

[71] Seok-Jin Lew, "Democratization and Government Intervention in the Economy," in Jongryn Mo and Chung-in Moon (Eds.), *Democracy and the Korean Economy* (Stanford CA: Hoover Institution Press, 1999), 166.

development and innovation, as any support directed towards the chaebol would be regarded as unpopular both within and outside the country.[72] As such, the state, despite its policy prescriptions was rendered incapable of directing an industrial shift from manufacturing towards technological innovation. According to Alice Amsden, the complexities surrounding the growth and expansion of the chaebol not only pointed out the sophistication of Korea's industries, but also demonstrated that the state could no longer intervene in the past—as the economy had grown too complex.[73] In effect, the state was incapable of keeping up with the pace of industrial development.

Some states lose their developmental efficacy not because bureaucracies deteriorate, but because capital and other social forces grow stronger, displacing bureaucratic agenda setting. This is exactly what transpired in Korea. The developmental state was deeply rooted in the authoritarian underpinnings of the Park regime. As globalization permeated into Korea, first on an industrial level then on a social level, these forces became far too great for the state to contain. Korea's deliberate turn towards market-based industrial policies—through dismantling state ties to the chaebol, and in abandoning its role in long-term economic planning initiatives demonstrates that the developmental state had no other option than to abandon its institutional role.

The story of Korea's industrial policies during the past decade reveals that the chaebol were far too massive and leveraged at the time of the economic crisis, rendering the state incapable of rescuing many of them from bankruptcy. By 1996, Korean industries across the board had one of the lowest profit rates accompanied by the highest

[72] Alice H. Amsden, "The Spectre of Anglo-Saxonization is Haunting South Korea," in Lee-Jay Cho and Yoon Hyung Kim (Eds.), *Korea's Political Economy: An Institutional Perspective* (Boulder CO: Westview Press, 1994), 102.
[73] Amsden, "The Spectre of Anglo-Saxonization is Haunting South Korea," 102.

rates of corporate indebtedness in East Asia, with much of this financing coming from external sources.[74] Globalization brought opportunity for Korea's chaebol to not only expand the scope of their influence, but to borrow and rely on international markets to finance their operations. The state had to essentially move aside, as these factors proved far more influential. On the domestic front, state efforts to contain the chaebol during the 1990s resulted in the chaebol becoming more actively involved in political processes, "by creating their own [political] party...or by challenging for the presidential election."[75] As such, the expansion of the chaebol contributed to the dismantling of the developmental state. The chaebol essentially undermined the state's embedded autonomy. As the state took measures to gradually open and liberalize the Korean economy during the 1990s, the chaebol relied on global markets and private means to expand their scope and operations. The state was unable to retain any oversight on the direction of industrial development, thus unable to promote the necessary shift toward technological innovation in its domestic industries. The gradual liberalization brought forth by the state therefore sealed the fate of the Korean economy: globalization dismantled the developmental state as societal and capital interests gained greater influence, thereby undermining the state's capacity to oversee industrial development and transition. However, after a region-wide crisis, due mainly to the external pressures Korea faced in its drive towards liberalization, the state proved capable in implementing market-based policies which reformed its bloated chaebol industries.

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[74] Woo-Cumings, "The State, Democracy, and the Reform of the Corporate Sector in Korea," 123. According to Woo-Cumings, between 1988-1996, the comparison of corporate leverage (total debt over equity) for Korean industries reveals that Korean firms had the highest ratio of leverage in the world at 348 percent.

[75] Kim, "Neoliberalism and the Decline of the Developmental State," 450.

Japan: Stagnant and Stalling

Globalization's most visible effect in recent years has been the importance played by the information-dependent marketplace, where technology and knowledge are exchanged swiftly among countries, corporations, and investors. The traditional function of the state consequently becomes problematic, as the expansion of this phenomenon forces the state to either grow weaker or actively respond.[76] In either respect, globalization fundamentally alters the role of the state in international markets. The power of the state still retains a political function, yet its place in economic affairs becomes subordinate to expanding global markets.[77] The case of Japan, according to many critics represents an example of the former, where the role of the state has become gradually weakened from the expansion of global financial markets. The "old" methods of interventionist state planning initiatives, which had created the foundations of the "Japanese miracle," could no longer thrive in an increasingly fluid economic context and like Korea, faced a similar fate in being forced to dismantle.

Japan's decade long struggle with deflation and subsequent economic restructuring may be a sign of dismantling, as Japan has been forced to embrace economic liberalization measures in order to fully recover from its economic doldrums. Featured prominently are issues of increased economic transparency and greater political accountability, which have been brought to the forefront and are championed as signs of liberalization within Japan. Of course, the Big Bang reforms implemented by Ryutaro Hashimoto's administration seem to indicate Japan's willingness to conform to

[76] Gereffi, "More than the Market, More than the State...," 56-57.
[77] Linda Weiss, T*he Myth of the Powerless State* (Cambridge UK: Polity Press, 1998), 194-95.

international financial standards through removing barriers to entry in financial services.[78] In addition to this, critics point to the recent initiatives put forth by the Japanese government in adopting more consumer-friendly policies. However, Jagdish Bhagwati contends, "[T]he globalization of the Japanese economy and modern communications imposes its own logic on the nation."[79] In other words, Japan has responded uniquely to the pressures of globalization. Having witnessed the recent successes of its industrialized neighbors, notably their successful transition into the world of information technology, Japan has recognized that the previous methods of economic planning and coordination seem grossly outdated, though are not entirely inadequate. As such, Japan's responses to globalization seem to indicate the adaptability of the state and its economic institutions, where new interests and directions are accommodated and pursued.

Scott Walker argues that in Japan, "The state's ability to act is dependent in part on the high level of industrial concentration and the density of corporate networks... which makes it easier and more efficient for the government to oversee, monitor, sanction, and bargain with the business sector."[80] In Japan, the state has preserved its capabilities in setting goals for economic policies through these network channels, and these network channels have remained intact through adapting to globalization, not by being overwhelmed by it. In fact, these networks exist at all levels of Japanese society—between companies as well as individuals, often playing a more important role than formalized agreements (such as organizational structure, contracts of employment, commercial contracts) and are often communicated by means of proverbs, idioms and

[78] Carlile and Tilton, *Is Japan Really Changing its Ways?...*, 130.
[79] Bhagwati, "Samurais No More," 9.
[80] Scott Walker, "A Tale of Two Tigers and a Giant...," 36.

company mottos.[81] These networks therefore play a central role in the functioning of the developmental state and are preserved through a paternalistic relationship between its members. Although crucial in fostering changes to the direction of Japan's economic policies, globalization has yet to erode these network relationships. The case of Toyota and its relationship with local parts suppliers provides a striking example of the working, flexible network relationship, where management stands "between the twin poles of autonomy and total internationalization...which guarantees maximum flexibility and maximum utilization of resources."[82]

The crash of Japan's domestic asset markets in 1990 presented a confounding problem to Japan's policymakers; where reform to the nation's economic development and industrial strategies was necessary in order to contend with financial globalization. The fallout from the collapse of Japan's asset market in 1990 led to a serious recession, followed by signals that Japan's economic troubles were far from just cyclical. Structural concerns, notably the problem of non-performing loans (NPL), undermined (the viability of) Japan's banking and financial sector. In addition, new political pressures also surfaced, out of frustration with the perpetually governing LDP,[83] and its inability to break from its traditional support base—notably construction and agriculture interests. Confronted with these challenges, the period following the collapse of the asset market would witness a watershed in the workings of the Japanese developmental state. Japan had reached its economic zenith during the 1980s, and now required some vital restructuring in order to keep up its pace among the world's leading economies. The path

[81] Rainer Kensey, *Keiretsu Economy—New Economy?* (New York NY: Palgrave Press, 2001), 121.
[82] Kensey, *Keiretsu Economy—New Economy?*, 199. It is important to note the domestic and global scope of Toyota. Despite its position as a major multinational auto manufacturer, Toyota continues to operate as a keiretsu.
[83] Until 1993, the LDP enjoyed nearly 40 years of uninterrupted governance.

toward reform in Japan stems from a plethora of challenges, both domestically and globally. The Japanese state has recognized these as an indication of a new "era," resulting in an unprecedented level of state responsiveness—through institutional adaptation to these conditions. Specific concerns include the impact of global markets, which have placed Japan in a position where it had to contend with greater competition for regional and international influence:

> The international system is moving away from a uni-polar focus on the United States to become far more multi-dimensional and multi-layered...with Japan lending weight to the regional economy as a unit. The challenge in this context will be for Japan to display initiative in developing a new economic order.[84]

Japan's position as the world's second largest economy gave it an advantage in being able to hold considerable weight in this new multilateral order; however, with this emerged the task of having to lead the region's economies, a role in which Japan has never had to assume, while simultaneously having to compete with other emerging economies for market share. Perhaps a more important element of this is the increasingly significant role played by foreign investment—specifically portfolio investment—that has come to influence a significant amount of Japan's domestic economic performance:

> Financial globalization transformed the political game in Japan...by changing the incentives of the government. Once it becomes clear to the government that the continuing competitiveness of industry and stable long-term growth become dependent on the availability of cheap direct financing through the stock market and that the stock market's movements are increasingly determined by the decisions of foreign investors, the game of economic management is changed. Equity investors become an important new constituency. [85]

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[84] "Challenges and Prospects for Economic and Industrial Policy in the 21st Century—Building a competitive, Participatory Society," *The Industrial Structure Council: Ministry of International Trade and Industry*, http://www.meti.go.jp, (March 16 2001).

[85] Tiberghien, "State Mediation of Global Financial Forces, Different Paths of Structural Reforms in Japan and South Korea," 114.

Indeed, the impact of portfolio flows could not be underestimated in the government's reform agenda. Adding to the difficulty of increased global constraint are domestic pressures of an aging population where, "the major challenges presented by the new era will be inter-generational income distribution...and the optimal exploitation and utilization of abilities, knowledge, experience and purchasing power of each individual."[86] Indeed, in the 1993 election, Japan's LDP was defeated by a coalition led by Morihiro Hosokawa. The LDP's historic defeat was entirely due to its own internal fragmentation—as new political interests had split up previous conservative strongholds:

> The socio-economic base of 'conservatism' was continually expanded but never realigned...The LDP had been able to attract significant segments of these new constituencies, but had been unable to provide an institutional framework or consistent economic policy profile that would enmesh them in regular and continuing support for the party.[87]

The defeat then highlighted two important factors: the rise of new societal influences in domestic Japanese politics and the need for institutional change to accommodate them. This would lead Japan down a different path of political and economic development, notably in having to address issues of long-term sustainable economic (and hence industrial) development within Japan's economy.

The Hosokawa coalition in the end proved to be short lived as the LDP regained power ten months later. However, the LDP has struggled between the entrenched interests and reformist camps within the party, thus making the process of reform slow to progress.[88] The coalition led by Hashimoto realized a breakthrough with the

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[86] MITI, "Challenges and Prospects..."
[87] TJ Pempel, *Regime Shift: Comparative Dynamics of the Japanese Economy* (Ithaca NY: Cornell University Press, 1998), 198.
[88] In Japan, these so-called "losers" of industrialization (construction and agriculture) have been traditionally compensated by the government, which had not created any problem until the 1990s when economic growth came to a standstill. See Edward J. Lincoln, *Arthritic Japan* (Washington DC: Brookings Institution, 2001), 95.

implementation of the "Big Bang" reforms, which were aimed at deregulating the nation's financial sector— and specifically to rely less heavily on Japan's debt-ridden banks and more on securities instruments.[89] The government of Keizo Obuchi, following in Hashimoto's footsteps, implemented significant accounting reforms, forcing Japanese businesses to become more open and transparent. These reforms sought to eliminate cross shareholding practices and increasing overall flexibility and required "corporations to use consolidated accounting and market-to-market evaluation of securities, [the reforms included] as well as tougher approaches to unfounded pension liabilities."[90]

The election of Junichiro Koizumi as prime minister in 2001 signaled a new direction for the LDP, where the new PM pledged that his reform agenda would not be hijacked by anti-reformers within the party.[91] The structural issues that the Koizumi administration viewed as problematic go a long way in at least recognizing the realities faced by Japan's lagging competitive performance, and need to attract more foreign investment. As a result, Koizumi has pledged to guide Japan in a new direction where,

> In order to usher in a competitive industrial society we will promote the creation of new industries and employment opportunities...I intend for Japan to be a nation built on the promotion of science and technology. In this context, I will promote strategic investments in research and development in science and technology areas that form the foundation of industrial competitiveness.[92]

Koizumi's assertions, although setting the course for a new economic direction in which government protection will not come at the expense of competitiveness, reveal a

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[89] Lincoln, *Arthritic Japan*, 160.
[90] Yves Tiberghien, "Japan is Changing," Paper prepared as part of the Asia-Pacific Foundation of Canada Initiative on Canada's 2003 Foreign Policy Update (March 6 2003), 7.
[91] Tiberghien, "Japan is Changing," 3. See also William W. Grimes and Ulrike Schaede, "Japanese Policy Making in a World of Constraints," in Grimes and Schaede (Eds.), *Japan's Managed Globalization* (Armonk NY: ME Sharpe, 2003), 22-23. Grimes and Schaede note that the split between traditional and reformist elements of the LDP resulted in the accession of Koizumi.
[92] "Prime minister's policy speech," *The Japan Times Online,* http://www.japantimes.co.jp/cgibin/getarticle.pl5?nn20010508b6.htm, (May 8 2001).

continuing commitment toward strategic investment, as well as the state's ongoing supervisory role in managing Japan's economic transition.

Nevertheless, Koizumi has faced a number of impediments in carrying out his reformist agenda. Political setbacks emerged in the Diet, with respect Koizumi's lack of control over the ruling LDP-led coalition, and a broad array of interest groups made up of farmers, construction workers and small and medium-sized industries. Koizumi's reformist plans were thus weakened, leaving the government stalled in pursuing its policy goals.[93]

Despite the intense efforts to block reform in the Diet, METI's response to pressures for reform has been unprecedented through the creation of the Research Institute for Economy, Trade and Industry (RIETI) in May 2001. RIETI's role is to act as a research institute, separate from the ministry, bringing together experts from public, private and overseas organizations. Among their primary research areas are information technology and regional economic deregulation. RIETI represents a significant moment for the Japanese developmental state, conceived as a new platform for creative policy formulation and for the dissemination of new ideas and the exchange of information.[94] The previous styles of policy making were far too rigid and closed, bureaucrats have thus been increasingly unable to respond effectively. Masahiko Aoki, a RIETI Director, noted that,

> Japan is in the process of a great transformation where it isn't just firms that are evolving; but that a new mentality is taking shape among bureaucrats. At METI, we have no choice but to become more market-

[93] Tiberghien, "State Mediation of Global Financial Forces, Different Paths of Structural Reforms in Japan and South Korea," 129.
[94] Brad Glosserman, "Blazing Policy Paths in Kasumigaseki" *The Japan Times Online* http://www.japantimes.com, (May 21 2001).

> oriented...No coherent national policy making is possible...Bureaucrats need help to break out of their old ways.[95]

The forming of an institution such as RIETI demonstrates the enormous resolve of the Japanese state to recognize and cope with the policy inefficiencies of some METI bureaucrats. As such, the state still retains its coordinative relationship, though now it rests with a wider range of elites. The priorities of Japan's developmental state therefore remain firmly in place, which is to carry out effective policies in the face of domestic and international challenges. Additionally, its ability retain the organizational arrangements—through the inclusion of academics and outside experts in forming policy, as well as its institutional arrangements—by encouraging RIETI's close coordination with METI, establish that the state has every intention on retaining its coordinative relationship among (perhaps a more effective group of) elites in future policy decisions.

Throughout the 1990s, METI recognized that international economic conditions had been forever altered after Japan's devastating asset market crash in 1990. METI recognized that "globalization of the world economy is progressing rapidly and we are witnessing the age when business corporations can choose the country where they locate...[thereby] transcending international borders."[96] METI then undertook the task of realigning Japanese industry (through with limited result, given strong opposition in the Diet), promising to facilitate the creation of new industries as well as to make Japan more internationally attractive for foreign investment.

Specifics of these policies reveal that METI has, indeed, adopted a series of measures that respond to domestic and international realities. Changes to the

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[95] Glosserman, "Blazing Paths..."
[96] General Affairs Division, Industrial Policy Bureau: Ministry of International Trade and Industry "An Outline of Economic Structure Reform," *Journal of Japanese Trade and Industry*, www.meti.go.jp, (May/June 1998).

administration of funds—in the form of increasing risk capital to emerging companies—are being undertaken in order for new industries to develop.[97] A particularly striking feature of METI's proposals is the new direction for research and R&D strategy. Japan's traditional R&D sector lags seriously behind that of the US—arguably, the world's leading innovator. The reasons behind Japan's poor R&D performance can be traced to the basic tenets of Japan's developmental state, where advancement is stressed to benefit "process technology" across many industries, or "multiplier-effect benefits."[98] R&D strategies have been traditionally viewed as a means of improving current production for the whole economy, rather than encouraging the development of innovative technologies. However, Japan's conventional R&D strategy has been transformed significantly in recent years and METI's role has been central in overseeing this. From streamlining the flow of information from universities into industry, to concentrating investment towards emerging technological sectors,[99] the state has recognized the need for a new direction within Japanese industry; one that is prepared to embrace innovation and creativity, rather than the traditional course of improving industrial productivity. In setting these policies, bureaucrats have not retreated from guiding the direction of future industrial ventures. Rather, they are actively seeking to promote the development of new forms of industry. It is this type of change that ensures the state continues its role in commanding Japan's future economic direction. Japan's bureaucrats have demonstrated that a state led organization such as METI can continue to play a significant role in coordinating with the

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[97] "An Outline of Economic Structure Reform," MITI notes that the Diet was presented with a bill that would "fund sources and diversify risk capital." The Bill for reforming Japan's financial system, which involved amendments to 24 laws altogether, was passed through the Diet and implemented in December 1998.

[98] Daniel Okimoto, *Between MITI and the Market* (Stanford CA: Stanford University Press, 1989), 68-69.

[99] "Plan for the Creation of New Markets and New Jobs—Hiranuma Plan," *Ministry of Economy, Trade and Industry*: http://www.meti.go.jp/english/information/data/ cPlan010525e.html, (May 25 2001).

private sector in setting industrial policy, and even forming new, innovative strategies and objectives.

Japan's Economic Planning Agency (EPA), a branch of the Prime Minister's Office, also recognized the challenges that Japan had faced after the 1990 collapse. Although Japan had achieved great wealth by the end of the 1980s, it had failed to develop the mechanisms to cope with a rapidly changing global environment, in particular, the shift from production-based to knowledge-based industries. Despite a series of economic stimulus measures during the 1990s, which injected over ¥60 trillion into the economy, significant levels of growth failed to materialize.[100] As such, Japan's EPA has identified that the objectives for future growth have to focus on the significance of knowledge and innovation. According to former EPA Minister Taichi Sakaiya, the reforms implemented by the MOF during the 1990s—in banking and securities deregulation and in overhauling accounting procedures—have prompted a similar need for change in Japanese industry. Standardized mass production, which resulted in the domination of the keiretsu conglomerates, could no longer be the principal source of industrial activity in Japan. Rather, small and medium-sized enterprises need to be promoted and the EPA has brought forward policies that "stress supporting the establishment of new firms as well as assisting the development of existing companies."[101] These new policy directions set forth by the EPA demonstrate that while policy towards industrial development may change (according to global and domestic forces as is the case here) it still remains the primary objective for the ministry to take an active role in developing this new direction. This is made possible through efforts to

[100] Taichi Sakaiya, "The Present and Future of the Japanese and Asian Economies," Speech from *the APEC Economic Council Symposium The Future of the Asia-Pacific Economy*, (December 6 1999).
[101] Sakaiya, "The Present and Future…"

establish a greater number of small and medium-sized companies. Japan's bureaucrats have thus recognized that the transformation from a production based to a knowledge-based economy is essential and they still have every intention of seeing that industry is guided towards these new objectives.

One of the most visible signs of institutional adaptability emerges with the role played by Japan's Fair Trade Commission (FTC) in promoting competition in Japanese industry. An institution originally formed during the US occupation following the Second World War, the FTC's role was to prevent the formation of the zaibatsu-type monopolies seen by the US as major contributors to the imperialist regime. Though largely muted during the so-called "miracle" stages of Japan's economic growth, the 1990s brought about a surge in the FTC's popularity and functionality. Globalization made evident that many of Japan's industries were engaging in unfair practices, and as this pressure mounted, the state responded through its commitment toward increasing enforcement against exclusionary cartels, and to make the keiretsu more competitive, as well as the reliance on more formal and public enforcement and prosecutions. The FTC has worked through forming education study groups to recommend policy directions for some of Japan's major industries, and has itself become a more effective mechanism through improving its formal enforcement capabilities, strengthening its guidelines on horizontal and vertical networks, modernizing its merger standards, adding to its staff and budget, and raising its profile in advocating competition issues at other ministries.[102]

The heightened role of the FTC then represents a clear state-led effort in responding to globalization. Japan improved upon the capabilities of the FTC in promoting and ensuring that Japan's industries are domestically strong and globally

[102] OECD Reviews of Regulatory Reform, *Regulatory Reform in Japan* (Paris: OECD, 1999), 65, 67.

competitive. The FTC has become an effective regulatory enforcement agent, thereby demonstrating Japan's ability to adapt its developmental-based institutions.

Globalization has undoubtedly affected the overall direction of the Japanese developmental state. The policy responses by the state indicate that these networks or relationships between government and industry continue to play a significant role in economic agenda setting. In creating RIETI, the state recognizes that a new and wider set of interests must be incorporated into the policymaking process. By actively tackling R&D initiatives, METI eagerly recognized the importance of innovation in furthering economic development, rather than traditional methods of productivity. The one striking feature of Japan's policy responses has been the adaptability of these institutions to new international and domestic demands. Japan's mammoth economic size, as well as being a leading participant in global markets has enabled it to absorb much of these difficulties. In addition, domestic voices and interests calling for reform were incorporated into the policymaking circle, previously inhabited by the most elite members of the Japanese bureaucracy. As such, the subsequent policy responses have enabled the state to work within its institutions—through adapting to changing global constraints, rather than having to dismantle them. This accommodation has continually preserved the legitimacy of the institutional elements that make up the developmental state, thereby ensuring its preservation.

Industrial and state relations

The face of Japanese industry once represented the pinnacle of the nation's economic development. Japan's large keiretsu distribution networks were viewed as

model corporations for their efficiency and productivity. During the 1990s however, this perspective shifted as Japan's once mighty keiretsu began to show signs of their vulnerability. Globalization in particular had a tremendous effect on their financing and productive capabilities, as competition from overseas corporations began to crowd their market share.

The OECD soon urged Japan to undertake serious efforts at opening its economy through a series of regulatory reforms designed to open Japan's domestic market for foreign investment and to lower barriers within its convoluted domestic distribution networks.[103] At this point, Japan prepared to take on the inevitable—the need for regulatory reform for the keiretsu and for big business overall. Efforts at reforming Japan's industries however reveal a preservation of ties between state and private sector, in upholding strategic industrial initiatives, while also recognizing the importance that transparency and corporate responsiveness play in being able to compete on a global level. The most recent measures taken by the Japanese government are somewhat promising in revealing that sound state-led restructuring is taking place, and consequently, that coordination between public and private sector elites has not broken down. In particular, Prime Minister Junichiro Koizumi has pledged a two-step approach to end Japan's current economic troubles, characterizing his technique as "structural reforms without sanctuaries... shift[ing] emphasis from his predecessors' reliance on debt-financed spending to correcting structural woes."[104] Koizumi's reformist agenda however, has yet to take hold.

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[103] OECD, *Regulatory Reform in Japan*, 270.
[104] "Koizumi vows no sanctuaries from reform," *The Japan Times Online*, http://www.japantimes.co.jp/cgibin/getarticle.pl5?nn20010508a1.htm, (May 8 2001).

One of the most difficult challenges to Japanese industry surfaced when after the 1985 Plaza Agreements, when the newly revalued yen would no longer a guarantee cheap Japanese exports. As such, many Japanese companies implemented a strategy that would work to strengthen their position by moving many of their production facilities to Southeast Asia, where labor costs were much lower. This strategy was enormously successful, as Japan's keiretsu had penetrated a rapidly developing region, thereby reversing the conventional perception of Japan as an export dependent economy. They were now supply-side efficient, as a stronger currency yielded cheaper investment opportunities.

The second challenge to Japanese industry came after the 1990 collapse. The Nikkei's devaluation left property investments worth only a fraction of their original value, and cash hungry banks were recalling loans. Japanese big business had no choice but to respond yet again in an unprecedented manner. A significant case of this corporate restructuring took place in 1998-1999 in Japan's automobile industry, which has long been hailed as the classic example of a (horizontal) keiretsu network. The keiretsu are "a mutual support association, with member companies owning a small portion of each other's shares which are not traded."[105] Recent reforms Nissan, after being bought out by French auto maker Renault, have practically dismantled the system of networks between suppliers and the company, in efforts to improve technological and product innovation. Among other sweeping changes are decreases in corporate cross share-holding schemes, thereby giving more authority to individual investors. Yves Tiberghien notes that the

[105] Linda Weiss, "Developmental states in transition: adapting, dismantling, innovating, not 'normalizing,'" *The Pacific Review* 13, 1 (2000), 48. Also see Lincoln, Arthritic Japan, 25-26, 31-32. Lincoln distinguishes the horizontal keiretsu (leaderless groups of companies, with member firms drawing their largest loans from the group's banks) from vertical keiretsu (one dominant holding company with a complex sub-contractual distribution network.

1999 Revitalization Law provides tax incentives for companies that undergo these types of restructuring.[106] The law therefore, was designed as an incentive for those companies willing to restructure their production practices, as well as managerial organization, in order to remain competitive and by taking advantage of this new incentive to overhaul its internal corporate structure, Nissan was demonstrating just that.

One essential feature of Japan's corporate make up is the position of the (horizontal) keiretsu or the giant conglomerates with complex financing and distribution networks. The keiretsu have come under much scrutiny as their informal conventions, notably their impenetrable distribution system, have created what critics label as inefficient and outdated features in need of a centralized decision-making body so that in cases of financial difficulty, the right steps to cut costs and restructure can take place.[107] Japan's keiretsu however, are showing signs of adapting to changing global conditions. The troubled state of Japanese banks, which emerged shortly after the infamous 1989 market collapse, forced many companies to distance themselves from banks for their future financing plans. As such, by the late 1990s, an unprecedented trend of disintermediation took hold—where companies used capital markets (rather than bank loans) to raise cash.[108] This trend highlights the increasing importance that returns on capital have come to play in Japanese corporate strategy, which has traditionally been based on notions of gains in market share. The state however, continues to play a significant role in capital formation:

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[106] Tiberghien, "State Mediation of Global Financial Forces, Different Paths of Structural Reforms in Japan and South Korea," 123.
[107] Hideo Otake, "Developments in the Japanese Political Economy since the mid-1980s: The Second Attempt at Neoliberal Reform and its Aftermath," *Government and Opposition* 34, 3 (1999), 391.
[108] Over the first 11 months in 1999, equity (shares) and equity-linked debt (convertible shares) reached a record US$65.1 billion. See, Paul Abrahams, "Dressing a new economic model," *Financial Times Survey, Japan: Corporate Fund Raising* (December 19 1999), 1-2.

> [I]n an effort to slow the rate of bankruptcies and prevent unemployment reaching new post-war heights, the state has been providing ever-larger volumes of loans to small and medium-sized companies...nearly 50 percent of all outstanding loans are backed by the state or quasi-state organizations.[109]

As larger industries have turned towards outside sources of financing, the state continues to provide financing for Japan's emerging industries. This is a solid indication of the developmental state in action. As mature industries seek gains in outside markets, the state has had to adapt to secure financing for less mature Japanese industries. Industrial policy has thus embraced a new direction, one that promotes or fosters the development of emerging industries.

It cannot be denied that globalization has played a role in shifting the direction of Japan's corporations toward a more liberal US model, where industries take on more domestically and internationally competitive practices. However, the issue at hand remains whether the fundamental relationships between state and private actors have been eroded. The case of Nissan highlights that state incentives for improving corporate performance in order to remain domestically and internationally competitive are indeed working on Japan's most rigidly organized and traditional corporate bodies. Different operating procedures do not change the fact that Japan's strengths in automobile production remain firmly in place. Therefore, despite what may resemble "convergence" of Japanese corporate practices; (given the deeply rooted differences in the role, behavior and function of corporations in Japan versus the more liberal Western, or US model) the drive toward corporate restructuring in Japan should be "accepted as an indication that

[109] Abrahams, "Dressing a new economic model," 1.

there are indeed different forms of capitalism and that in many ways the US and Japanese forms lie at the polar extremes among the advanced industrialized countries."[110]

R. Taggart Murphy further emphasizes this, by arguing that the unexpected resurgence of the US hi-tech industry during the early 1990s meant that Japan's own technology industry would eventually follow, rather than lead, its US competitors. Instead of following the new "free-wheeling, entrepreneurial culture of Silicon Valley...[with its] highly developed venture capital markets immune to bureaucratic interference," Japan's bureaucrats began the drive "to ensure that key hardware components are dominated by Japanese manufacturers."[111] The state has thus attempted to maintain a strategy of gaining market share, rather than innovation within the technology sector. The enormous economic and even cultural challenge posed by the sudden ascendancy of Silicon Valley has done little to erode the fundamental make up of Japanese industry. While regulatory reforms are pursued along the lines of OECD recommendations, Japan is hardly towing a "market-leads" line. Rather, state and industry have responded to global pressures through adapting some structural elements of Japan's industries, though ultimately preserving their relationships.

The deep relationship between state and business is often misunderstood as bureaucratically led; as such, industrial policy reflects the interests of state bureaucrats and interests. A more accurate characterization however, reveals a fine balance between public and private sector, where "[T]he bureaucrats depend on industry actors to provide necessary information and to cooperate in the implementation of policies...the bureaucrats must rely on the industry for accurate information as well as policy

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[110]Glen Fukushima, "The 'Corporate Governance' Debate," *The Japan Times Online* http://www.japantimes.com/cgi-bin/getarticle.pl5?eo20020408gf.htm, (April 8 2002).
[111] R. Taggart Murphy, "Japan's Economic Crisis" *New Left Review* (January-February 2000), 35.

advice."[112] These industry actors are institutionalized as associations—such as the Japan Business Federation, and serve an important political advantage in that they "provide the industry with a forum for coming to an intra-industry consensus and allow industry actors to speak in a more unified, organized voice."[113]

A significant change to have recently hit Japan's private sector involves the merging of two traditional institutions—the Japan Federation of Economic Organizations (Keidanren), and the Japan Federation of Employers' Association (Nikkeiren)—into the Japan Business Federation. As the two groups once represented the pinnacle of private sector interests in areas such as labor and general business interests, the new Japan Business Federation seeks to build upon the agendas of the two former lobbying institutions. Essentially, the decision to merge was carried out in order to create an environment that will revitalize corporate activities in the midst of rapid societal changes.[114] The level of institutional change that state endured has now permeated into the private sector.

The merging of these two institutions represents a continuation of the coordinative relationship between state and private sector. The interests of Keidanren and Nikkeiren, which traditionally dealt with separate aspects of corporate interests, have now merged—with new considerations such as competitiveness through innovation. Additionally, the merging of these two organizations demonstrates that the newly formed Japan Business Federation is seeking out its own distinctive path toward promoting business interests. According to Toyota Chairman Hiroshi Okuda "the era of using the

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[112] Robert M. Uriu, *Troubled Industries: Confronting Economic Change in Japan* (Ithaca NY: Cornell University Press, 1996), 27.
[113] Uriu, *Troubled Industries...*, 25.
[114] Akemi Nakamura, "Top business lobbies tie knot, hope to better sway politics," *The Japan Times Online* http://www. japantimes.com/cgi-bin/getarticle.pl5?nn20020529a1.htm, (May 29 2002).

United States and Europe as models has ended...We as a new economic organization must carry out various activities in a powerful manner and forge our own way."[115] The merging of the two organizations then, is a reflection of corporate interests seeking to not only influence government industrial policies in a more efficient manner, but also in contributing to the continuance of a unique industrial path for Japanese businesses. Okuda's remarks illustrate that Japan's business networks will continue to engage with the state in fostering future industrial policies. The numerous policy and institutional shifts that Japan has undergone over the past decade demonstrate that the developmental state is alive and well. In fact, these responses are a testament to the workings of the developmental state.

Japan's developmental state, then, continues to survive despite the impact of globalization. However, it remains inert, and attempts at implementing serious reforms have often been thwarted by vested interests represented in the Diet. What have emerged in recent years though are micro-level signs of institutional adaptation. Japan did face some outside pressures to liberalize its financial markets after the 1990 asset market collapse—especially in the areas of transparency and financial reporting, through much of the push to reform came from within, beginning with domestic political opposition from the Hosokawa coalition in placing the issue of reform into the spotlight. Japan's industrial conglomerates were also facing a crisis with maturity, which required the state to set out future development paths that would enable greater productive capability, as well as efficiency through foreign investment and technological innovation.

The state then responded through a series of reforms that not only addressed these demands, but also managed to preserve the fundamental institutional relationships

[115] Nakamura, "Top business lobbies tie knot..."

between state and private sector. First, Japan's policy networks therefore remained firmly intact, even as newer, more professionalized elements were incorporated into the policy-making realm. As such, societal interests could be accommodated, rather than take over. Institutions were then created to ensure that regulatory changes were being carried out effectively, with serious enforcement mechanisms established. Japan's industries have undergone a series of regulatory changes as well, leaving them more competitive and open to foreign investment—thereby better responding to global competition. Of course, only time will tell whether these changes have been positive or beneficial overall. Absent from Japan's series of policy responses is the notion of market supremacy. Rather as Japan has grappled with the pressures of globalization over the past decade, the state and private sector continue to coordinate economic development policies, and with their relationship regarded as legitimate and essential.

The key to the survival of Japan's developmental state lies partially with the weak effects of globalization, and most heavily with vested conservative interests within the LDP blocking many attempts by the bureaucrats to implement serious structural changes. While this has enabled the survival of Japan's developmental state, it has become increasingly incapacitated. Japan's bureaucratic institutions, through their relationships with major industries, have attempted to implement an agenda for change and reform—thereby demonstrating their capability in adapting to changing domestic and global conditions. In essence, state and industrial relations in Japan were able to evolve in tandem with political and economic challenges. The collective goals between public and private were maintained through their institutional ties, as well as through accompanying the rise of domestic and international challenges. As Evans argues, "Institutionalizing a

more encompassing set of state-society ties may be the only way to keep embedded autonomy from losing its effectiveness."[116] This raises the point that the developmental state, as characterized by the experiences of the Japanese over the past decade, may only be able to thrive where its institutions and networks have already become deeply embedded. The lesson that can be learned from Japan points out that despite deep-rooted traditional oppositional factions, institutions can continue to play an influential role in agenda setting, despite all the market-centered claims; precisely in their ability to be flexible and adaptive.

[116] Peter Evans, "State Structures, Government-Business Relations, and Economic Transformation," in Sylvia Maxfield and Ben Ross Schneider (Eds.), *Business and the State in Developing Countries* (Ithaca NY: Cornell University Press, 1997), 67.

Chapter III: Globalization and the Future of the Developmental State

Without a doubt, the most critical elements in the make-up of any developmental state are its institutions. Without them, the state could neither plan nor coordinate any of its economic policies with the private sector. The institutions within any developmental state ideally enable government, bureaucracy, industry and finance to function smoothly, in order to carry out the objectives of policy planning and implementation, regardless of endogenous or exogenous forces.

The manner in which these institutions function is best characterized through their networking capacity, or the effectiveness of the relations between the state and private sector. These policy networks then are institutionalized mechanisms that work to ensure the exchange of information between government as well as reconcile the interests of government and industry into agreed policies and common goals. Therefore, they enable the formulation of long-term policies designed to support the goals of national development, as opposed to the short-term reactive solutions.

These policy networks have proven to be pivotal in the functioning of both the Japanese and Korean developmental state. In Japan, policy networks facilitated the transition towards a more open, internationalized economic system; from the formation of the keiretsu corporations out of the prewar zaibatsu, to the development strategies and initiatives issued by MITI and MOF. In Korea, policy networks enabled the development and growth of the chaebol industrial conglomerates, as well as development directives set forth by EPB and MCI.

Globalization has unquestionably affected the industrial policy objectives of both Japan and Korea—leading to fundamental shifts in their industrial policies. In Japan, while the keiretsu have undergone extensive reform, the network between state and industry in terms of fulfilling development objectives has not been compromised. Meanwhile, the Korean case demonstrates how the effects of globalization led to a reform that broke down the state-industry networks, which ultimately left the chaebol out of the developmental "loop" and thereby answerable only to market forces.

What in fact caused the breakdown of these networks in Korea, and hence the breakdown of the developmental state however was the onslaught of globalization combined with democratization and the pressures both had brought. Korea's rapid economic growth made it a global example of development success, and with this success came membership into prominent international organizations, namely the OECD. At the same time, society began to voice simultaneous demands for economic liberalization and democratization, with the state could no longer able to hold on to its grip over economic and industrial policymaking. As Korea's chaebol expanded into foreign markets, the state could no longer control or direct their industrial agenda. Rather than accommodating these forces, the state retreated altogether from its role in economic planning, and instead took on a more market-responsive role. What the case of Korea illustrates therefore is that of a state incapable of adapting to these outside pressures, a complete inflexibility on the part of the state to work alongside market and emerging social and political forces.

Meanwhile, the case of Japan highlights how globalization and caused certain state bureaucratic institutions and industry to become more flexible, adapting to changing

international conditions. Unlike Korea, Japan's developmental state had not faced overwhelming domestic and international pressure for political change. The networks between public and private sector have adapted to enabling outside professionals to become a part of the policymaking process, which has in turn added greater legitimacy towards state-led planning initiatives. Industrial policies with respect to big business have also changed—enabling foreign ownership and more flexibility in distribution and investment. This has facilitated the process of forming global partnerships between Japanese firms and foreign firms. Japan today remains a plan-rational economy, given the enormous role that state institutions such as METI continue to play in setting the nation's economic agenda.

Although globalization has had a tremendous effect in shifting the direction of state economic policies, it has not rendered the developmental state obsolete. Despite the rapid rise in influence of international financial and capital markets, the state continues to play a crucial role in setting national economic goals. The case of Japan demonstrates that globalization brought about an institutional adaptation—in its policy networks and specifically in industrial policy. While this has occurred, any attempts to implement serous reforms have been stalled by vested interests in the Diet. The case of Korea meanwhile illustrates that the initial effects of globalization brought about institutional ineffectiveness, leading to a breakdown in policy networks and coordinated industrial policies, while the Asian financial crisis revived the state's role in enforcing market-centered industrial policies.

The factors that have resulted in these different responses to globalization can be traced to the underlying elements of the developmental state in our respective cases. In

Korea, the developmental state had largely authoritarian roots, with the state—through the executive branch—exercising a near monopoly of control over policy implementation and agenda setting. In Japan, the developmental state existed within a democratic realm—control over policies existed between government and bureaucrats. The size of Japan's economy compared to that of Korea's also had an effect on how each responded to globalization. Korea faced immense pressure from the US, and subsequently the IMF OECD to liberalize its markets, even in the wake of a region-wide financial crisis. Japan had already introduced its economy to international financial and capital markets the previous decade and had thus not been subjected to the same intensive pressures to pursue liberalization policies. In addition, Japan had been largely spared from the Asian financial crisis, though was undergoing its own struggle with a prolonged recession.

The degree in which globalization affected our respective cases demonstrates therefore that in Japan, adaptation was possible, given the ability of the state to retain its embedded autonomy from global forces; whereas in Korea, embedded autonomy was compromised my the sudden rise in influence of competing political forces. Evidence of this can be seen in the specific policy outcomes and how they differed in each case. In Korea we see the dissolution of state and private sector policy networks and a major shift away from state support of the chaebol conglomerates. In Japan, we witness a preservation of the policy network, where new interests are accommodated, as well as a continuation of support for the nation's industries, though allowing for greater expertise in management through foreign ownership and investment.

Polanyi's argument that the evolution of the market economy resulted in a shift in societal relations provides crucial insight into the debate surrounding the survival of the

developmental state. The evolution of the developmental state represents a response to the market economy, where the state takes an active position in advancing its economic development agenda. In Japan, the developmental state evolved from prewar imperialist arrangements into a postwar quasi-democratic structure. In Korea meanwhile, the developmental state was a product of a repressive political regime. How each state has responded to international and domestic change ultimately demonstrates the ability of the developmental state to manage the influence of the market. In the case of Korea, globalization and its accompanying pressures permeated deeply into its political arrangements—weakening the ties between state and private sector, and dismantling the developmental state framework. The face of industry also changed, as the chaebol conglomerates grew larger and more independent of the state. In essence, the authoritarian elements underlying Korea's developmental state, which kept these networks and policies together, were defeated by forces of democratization and liberalization. Attempts to revitalize the state's role in economic planning policies, notably in reforming the chaebol and overseeing the transition towards a knowledge-based economy succeeded, and the state proved very capable in implementing market-oriented solutions.

In the case of Japan however, global and domestic changes were managed or mediated largely through the state-led efforts. Japan has thus been successful in maintaining its developmental institutions, and has done this through adapting its policy networks and industrial relationships. Unlike Korea, Japan's bureaucrats had been accommodating competing interests thereby reinforcing the legitimacy of its developmental institutions. This reflects Skocpol's notion of an autonomously

functioning state, where the autonomous and dynamic political relations among institutions effectively enabled societal and other non-state interests to be a part of the policymaking process. Although the pressures brought on by globalization incited many of these changes or adaptations, the relationship between Japan's bureaucratic elite and the private sector remains sound.

From our cases, we can conclude that globalization alone is not a phenomenon that leads to inevitable state decline. As the case of Korea illustrates, while international pressures to pursue financial liberalization were strong, it was the combination of these pressures with domestic political factors that have played a tremendous role in the breakdown of the developmental state. However, Korea's rapid liberalization in the end, did not spell the demise of the state either—in fact, the state played a key role in reforming industry and restructuring the economy during the 1997 region-wide financial crisis. What the case of Japan has taught us though is that the state—particularly state-led institutions that are effective and can adapt to accommodate competing interests—can continue to play an important role in coordinating economic policy.

The developmental state thus, has not been swept into the dustbins of history. Rather, it is the anachronistic interests that have stalled the pace of reform from within. The onslaught of globalization—accompanied by the domestic challenges it has influenced— has indeed proven a challenge for the developmental state, though it has not necessarily resulted in its demise. Ultimately, provided that states build their institutions upon solid foundations, and can preserve the relationships or networking capacity with industrial and societal interests, its role will continue to play enormous significance in setting national development goals.

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