POLITICAL ECONOMY OF INDUSTRIAL TRANSFORMATION:

A CASE STUDY OF THE DEVELOPMENT OF AN AUTOMOBILE INDUSTRY IN KOREA

by

MOON-SOO LEE

(Under Direction the of Christopher Allen)

ABSTRACT

The automobile industry in developing countries has been led by a few transnational corporations. There is one significant exception to this rule: the Korean automobile industry. Not only has the Korean automobile industry, within a relatively short time span, increased its production capacity to the level of advanced nations, but has also been able to maintain managerial independence over its developmental period by producing its indigenously-designed models.

However, a careful examination reveals that the process of auto industrialization in Korea has been characterized by the variances of performance across not only different periods but also different companies. Contending paradigms cannot successfully explain such variances. For them, either the market-confirming initiative of private capital or market-distorting and top-down state policies seem to be a decisive factor in determining Korea's successful automobile industrialization.

The variances of performance over time are explained in this study by what type of coalition between state managers and local firms prevails at a specific time. Two types of coalitions are highlighted: (1) the neomercantilist coalition made between the nationalist section of state managers and independent-oriented local firms and (2) the liberal coalition made between liberal-minded economic bureaucrats, stability-oriented political leaders and TNC-dependent local firms.

To explain the dynamism of coalitional politics, I examine the structures governing industrial policymaking processes in Korea. Specific attention is paid to the insulation of the Ministry of Commerce and Industry from other economic ministries, particularly from the Economic Planning Board, to the organizational and financial prowess of individual local firms, and to the characteristics of state-business nexus. It is also pointed out that these institutional structures are not constant, but shifting as a result of previous industrial policies and the performance of the automobile industry.

With this theoretical model, I examine the history of the Korean automobile industry, dividing it into six periods on the basis of the varying performance of the industry over time. One critical implication comes from this study. The achievement of the Korean auto industry is very precarious one. Once there appears the crack in the neomercantilist coalition, the degeneration of the Korean automobile is inescapable.

INDEX WORDS: Industrial Policy, Automobile industry in Korea, The Role of Government in Korea, Political Economy of Korea.

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LIST OF ABBRREVIATION

CBU	Completely-Built-Up
CKD/SKD	Completely-Knock-Down/Semi-completely-Knock Down
CMES	Comprehensive Measures for Economic Stabilization
DPM	Deputy Prime Minister
EOI	Export-Oriented Industrialization
EPB	Economic Planning Board
FKI	Federation of Korean Industrialists
FTC	Fair Trade Council
HCC	Hyundai Construction Company
HCI	Heavy-Chemical Industrialization
HCIPC	Heavy and Chemical Industry Promotion Committee
HMC	Hyundai Motor Corporation
IBRD	International Bank of Reconstruction and Development
IDCC	Industrial Development Civil Council
IDL	Industry Development Law
IMF	International Monetary Fund
IPDC	Industrial Policy Deliberation Council
ISI	Import Substituting Industrialization
KAICA	Korean Auto Industries Cooperative Association
KAMA	Korean Auto Manufacturers Association

KCIA	Korean Central Intelligence Agency
KDB	Korea Development Bank
KDI	Korea Development Institute
KERI	Korean Economic Research Institute
KIET	Korean Institute of Economics and Technology
KIST	Korean Institute of Science and Technology
LDCs	Less Developed Countries
MCI	Ministry of Commerce and Industry
MITI	Ministry of International Trade and Industry
MOFE	Ministry of Finance and Economics
MOF	Ministry of Finance
MOST	Ministry of Science and Technology
MTI	Ministry of Trade and Industry
NICs	Newly Industrializing Countries
NIF	National Investment Fund
OEM	Original Equipment Manufacturing
POSCO	Pohang Steel Company
SCNR	Supreme Council for National Reconstruction
SCNSM	Special Committee for National Security Measures
SCT	Special Consumption Tax
TNCs	Transnational Corporations
VER	Voluntary Export Restraint
WCDA	Working Committee for the Development of the Automobile Industry

CHAPTER I

INTRODUCITON

1. Purpose of the Dissertation

Three decades of sustained, high economic growth have made the East Asian countries a "model of development." The performance of other less developed countries (LDCs) is now often judged against the development of the East Asian Newly Industrializing Countries (NICs), including South Korea (hereafter Korea). A large body of literature has developed to interpret and explain the dynamism of the Korean political economy.[1]

A central debate in this literature concerns the relative roles of the state and market in explaining Korea's economic success during the 1970s and 1980s. As indicated by the World Bank's report (1993), which conceded the state's extensive role in Korean economic development, however, the current debate bogs down over the interpretation of this role; the extent to which state intervention was "market conforming" versus "market-distorting" and/or the extent to which the state "led" rather than "followed" the market.[2]

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[1] The literature is wide-ranging. Some of the major works with a political economy focus include Balassa(1982), Amsden (1989), Cumings (1984), Deyo (1987), Haggard (1990), Jones and Sakong(1980),Westphal (1990), Woo (1991), Chang (1994), Evans (1995), and Woo-Cumings (1999).

[2] This debate is well presented in Aoki, Kim, and Okuno-Fujiwara eds. (1997) and Wade (1990).

While we try to clarify the genuine relationship between the state and market in the course of rapid economic growth in Korea, another more manageable question remains unanswered; why has Korea been more successful in establishing internationally competitive firms in such sectors as steel, shipbuilding, consumer electronics, and automobile industries, where advanced countries have maintained a relatively exclusive footing, than other NICs? Among these industries, the automobile industry (hereafter auto industry) presents the most critical research question since this industry has been said to have higher entry barriers and oligopolisitic market structure that deny an easy access of new firms to the industry. Accordingly, the attempts to build an indigenous auto industry by several developing countries have failed to see the intended outcome, with domestic auto firms either becoming subordinate business partners to global auto firms or specializing in the production of certain auto parts.[3]

Nevertheless, the development of an auto industry, along with that of a steel and consumer electronics industries, has become the symbol of economic growth in Korea. As indicated by table 1.1, the auto industry occupied 9.6 percent of industrial outputs, 8.2 percent of value-added, and 7.5 percent of employment in 1995. In addition, 17.6 percent

[3] Automobile industrialization in developing countries began in 1916 when Ford installed assembly operation in Argentina. But as Kornish and Mericle (1984, 263) point out, since then the development of the automobile industry in the Third World has been accompanied by "its near total denationalization." Furthermore, the remaining domestic automobile firms in developing areas are mostly state controlled, operating either under foreign license or with significant foreign participation (see Jenkins 1987). Reflecting the long history of automobile industrialization, plenty of studies on the automobile industry in Latin American countries exist. For the automobile industry in Latin America, see Jenkins (1987), Kornish and Mericle (1984); for Mexico, see Bennett and Sharpe (1985); for Brazil, see Shapiro (1994); for Southeast Asian countries, see Doner (1991). Although there is no book-length, detailed study on Korean auto industrialization in English, we have a few studies that address the importance of the Korean type of auto industrialization. See Kim (1997), Chu (1993), Lew (1992), and Amsden and Kim (1989). Most of the studies written in Korean that deal with the development of an auto industry approach the theme from economic and sociological perspectives. As a representational study, see Cho (1992), Oh and Cho (1997), and KAICA (1983).

Table1.1
The Importance of an Auto Industry in Korea

YEAR		1980	1985	1990	1995
Employment (1,000)	Auto Industry	63	82	186	220
	Manufacturing	2,015	2,438	3,013	2,948
Production[1]	Auto Industry	120	328	1,624	3,500
	Manufacturing	3,628	7,703	17,644	36,448
Export[2]	Auto Industry	122	648	1,936	10,409
	Manufacturing	17,508	30,283	65,016	129,715
Value Added[3]	Auto Industry	29	103	584	1,306
	Manufacturing	1,186	2,674	7,078	15,920

Source: KAMA (1997)
Notes: 1) billion won; 2) million dollars; 3) billion won

Table 1.2
Top 10 Automobile Producing Countries in the World (in thousand)

1960	1970	1980	1990	1997
U.S. 7,905	U.S. 8,283	Japan 11,042	Japan 13,486	U.S. 11,859
Germany 2,055	Japan 5,289	U.S. 8,009	U.S. 9,783	Japan 10,975
U.K. 1,810	Germany 3,842	Germany 3,878	Germany 5,163	Germany 5,023
France 1,369	France 2,537	France 3,378	France 3,769	**Korea** **3,010**
Italy 644	U.K. 2,098	Soviet 2,199	Soviet 2,143	France 2,580
Soviet 523	Italy 1,854	Italy 1,611	Italy 2,121	Spain 2,562
Japan 481	Canada 1,159	Canada 1,323	Spain 2,053	Canada 2,173
Canada 397	Soviet 916	U.K. 1,312	Canada 1,926	Brazil 2,070
Australia 326	Spain 536	Spain 1,181	U.K. 1,567	U.K. 1,940
Brazil 133	Australia 473	Brazil 1,165	**Korea** **1,326**	Italy 1,817
Korea ***n***	**Korea** **28**	**Korea** **123**		

Source: This table is based on *Market Data Book* published by *Automotive News* (1999).
Notes: For years 1960 through 1980, Korea was not in the top 10.
n denotes negligible.

of total tax revenues was collected in the auto and related industries in 1995, and the auto industry represented 8.0 percent of total exports in 1996. The status of the Korean auto industry in the world auto industry has also experienced a dramatic change. In terms of a production volume, as table 1.2 shows, Korea became the 4th in the world in 1997, contributing about 5 percent to world's total production.

To help understand the marked nature of the Korean auto industry, I simplify it into three elements. First, the Korean auto industry shows a distinct development pattern in terms of ownership structure. It has developed with relative independence from the transnational corporations' (hereafter TNCs) influence, while the development of other LDCs' auto industries has to a greater degree depended on TNCs' capital, technology, and marketing networks. The quest for independence has led auto firms such as the Hyundai Motor Company (HMC) to maintain managerial autonomy since its establishment. In the process, the Korean auto firms have been able to build backward linkages to local parts suppliers and independent marketing networks throughout the world.

Second, the Korean auto firms have become major exporters of finished vehicles with their own logos attached to them, while the auto industries in other LDCs have either exported vehicles on the OEM basis (i.e. Volkswagen's Fox built in Brazil) or specialized in exporting auto parts (Mexico and Taiwan). Moreover, whereas the exports of vehicles or parts by most LDCs have had limited destinations, Korea has exported vehicles to a much wider range of countries. In 1997, 27.5 percent of Korean auto exports went to Western Europe, 18 percent to North American, 14.2 percent to Eastern Europe, 15.2 percent to South America, 13.2 percent to Asia and Australia, and 11.8 percent to Africa and the Middle East (KEI 1998).

Finally, Korea has a different socio-economic foundation of auto industrialization, particularly from those of Latin American countries. Whereas the auto industrialization in Brazil, Mexico, and Argentina has proceeded hand in hand with increasing income inequality, that in Korea has been carried out without significant enrichment of a small segment of wealthy population. In addition, whereas direct repression or selective co-optation of militant labor has contained wage levels of auto workers in most LDCs, average real wages of Korean auto workers have increased, largely keeping abreast with the increase in productivity. Consequently, autoworkers are now among the highest paid workers in Korea and no less paid than those in many advanced countries. This becomes clear when we compare the hourly wages of Korean autoworkers with those in advanced countries. Strikingly enough, given a far lower GNP per capita, Korean autoworkers were paid more than French and Italian workers and almost the same hourly wages as Britain's and Sweden's workers in the mid-1990s (see table 1.3).

Table 1.3
The Hourly Wage of Autoworkers in Selected Countries (year: 1994, unit: US dollar)

	KOREA	ITALY	GERMANY	US	JAPAN	FRANCE	BRITAIN	SWEDEN
Wage	10.97	7.9	20.2	16.9	23.7	9.9	11.8	13.6

Source: Cho (1998)

The main purpose of this study is to investigate and explain the distinct nature of Korean auto industrialization by focusing on the formulation and implementation of the state's auto policies as well as on the interactions between state agencies and domestic auto firms in this policy-making process. Auto industrialization is meant in this study as the processes, in which a country builds up the productive facilities either to assemble or to manufacture automobiles and attempts to advance into a higher level of production by, for instance, making indigenously designed cars, upgrading production processes and manufacturing technology, and exporting its finished products.

Today, it has been universally accepted that we live in a so-called "globalized" society. In this world, it has been argued that the economic system of every country should be open, liberalized, and de-regulated because the borderless movements of commodity, capital, and labor make the traditional way of economic management obsolete or even detrimental to the growth of a national economy. From this perspective, the financial crises in the Asian countries, starting in Indonesia and Thailand and culminating in Korea by the end of 1997, marks the end of the era of state-led development and the beginning of a new economic paradigm that stresses more than anything else the free movement of capital between countries. Such a development was the critical blow to the exponents of developmental state as well as a mercantilist trade regime as the engine of rapid growth in both Japan and Korea. Interpreting rapid economic growth in the region, neoliberals have posited that it was achieved primarily by increasing the volume of inputs without concomitant increase in productivity, which was in turn possible because the state was able to mobilize and channel the resources into the sectors that it thought strategic and growth-spreading. Neoliberals have concluded that such a way of managing the national economy, as typified by the heavy-handed leadership of the state and the stifled initiatives of private firms, would not be suitable within the changed environment. The momentum of growth should be transferred from nationalist and *dirigiste* state policy toward the free play of private firms.

So currently dominant neoliberal view asserts that the strategy based on the strong leadership of the state and the neomercantilist coalition between the state and selected local firms has proved bankrupt in a liberalized international economy. This is particularly true in the promotion of capital and technology intensive industries, to which the auto industry belongs. Another purpose of this study is to examine such an argument by placing the Korean auto industry within the dynamic context of state power and private initiative. As opposed to the standard interpretation of the development of the Korean auto industry, which focuses exclusively either on direct state intervention or on private initiative, I will argue that it has been consistently pulled and pushed by both neomercantilist and liberal ideas and interests throughout the whole development period. In the Korean auto industry, the battle between statist and liberal strategies did not begin to appear when the former revealed its intrinsic problems and the latter gained power largely by the help of external forces, particularly during the 1990s. The battle between the two ideas has been ongoing and has required some types of resolutions from the beginning of auto industrialization in Korea.

According to the interpretation suggested in this study, even during the period of economic reforms after 1997 crisis, the key to understanding the Korean political economy in general and the auto industry in particular must not be confined to the march towards a liberalized economic order and the demise of statist strategies. Still, the battle line has been clearly drawn between neomercantilist and liberal strategies. Just as the conflicts of these two strategies did not suddenly appear after the failure of one strategy but have underlain the whole process of auto industrialization in Korea, we can expect that the primary causes of its development as well as its prospects also lie in these conflicts.

2. Why an Auto Industry?

The selection of an automobile industry as a case is based not only on the empirical uniqueness of the Korean automobile industry. It is also based on my observation that this industry best highlights the predicaments faced by LDCs in their pursuit of national economic development within the context of deepening globalization. As an oligopolistic sector *par excellence*, the auto industry has a long history of flexing its economic muscles in negotiations with developing states. This sector's bargaining power remains enormous, as the industry employs millions of workers who work directly for assemblers or auto parts suppliers. According to the list of *Fortune*'s global 500 in 2000, 8 out of 50 largest firms in the world were auto multinationals.[4] In addition, although this industry is over one hundred years old, the industry continues to develop advanced technology and employ the most modern organizational techniques (Womack and Johnson 1989; Law 1991).

For the last 30 years, we have witnessed a paradox concerning LDCs' policies toward auto TNC's investments. Contrary to the prediction that increased inter-firm competition enhances the bargaining leverage of host states, the latter has continuously granted generous incentives to attract TNCs' investments in the industry. In other words, the international automobile industry has not supported Raymond Vernon's (1971; 1998) thesis of "obsolescing bargaining," which postulated a shift in bargaining power from the

[4] See http://www.fortune.com/lists/G500/index.html.

foreign investors to the host state over the course of foreign direct investment. Host governments have tried to induce foreign automakers with the provision of several general incentives, even knowing that the TNCs will always side with their subsidiaries in the disputes with host governments. Moreover, TNCs remain much more preoccupied with their global standing than with the economic development of the countries in which they are established. These firms will simply move to other countries when the domestic market shrinks, or they will cease to invest during downturns (Thomas 1997).[5]

Another significant characteristic of the auto industry is that it has political and social implications, to a degree unparalleled by other industries. The vicissitudes of the auto industry are not a regional problem, but easily become a national issue. Accordingly, when the auto industry is in serious trouble, the stability of the regime may be threatened. In addition, although this industry has become globalized faster than any other industry, it is still the industry that most typically emphasizes the nationality of firms. This industry has the same status that soccer has in the world of sports; international competition among auto firms is likely to become heated by the insertion of national sentiments or prestige. The competition between the U.S. and Japanese automakers in the 1980s and the grief felt by the British people who lost all of their nationally owned auto firms seem to demonstrate this case.

Moreover, the political/social characteristics of an auto industry have another source. The auto industry in each country has developed through the establishment of a distinctive production system. The different production systems have been the foundation

[5] The latter actually occurred in Argentina in the 1980s, with negative consequences. Despite these threats, governments in the developing countries still do not hesitate to grant generous incentives to the auto TNCs.

of varying competitiveness between international auto firms. Accordingly, it may not be an exaggeration to argue that the competition among auto firms is nothing other than the competition between different national production systems. Although Fordist and Toyota's production systems have their origins in specific firms, they are more or less the products of institutional features of the states these firms belong to. Therefore, we have often been told that the competitiveness of the auto industry in specific countries best represents the competitiveness of the states.

Overall, the international auto industry seems to illuminate best the dynamism of growth and stagnation, autonomy and dependence, and conflicts and their resolutions in the path of economic development in LDCs. As a result, a careful investigation of the Korean automobile industry from the perspective of comparative political economy can throw fresh light upon possible ways to break up the vicious cycle that still characterizes the bargaining between TNCs and host countries in the international auto industry.

3. The Korea's Auto Industry in a Comparative Perspective

The auto industry has played a pivotal role in achieving economic development in major advanced countries largely because of its diverse forward and backward linkage effects. The economic policymakers in many LDCs have tried numerous measures to promote the auto industry, keenly noticing its importance in the national economy. A representative case is the active involvement of the state in promoting the auto industry in some Latin American countries, particularly in Brazil and Mexico. Both countries, which had already started producing automobiles before the Second World War, rapidly developed an auto industry through the state's industry promotion policies during the

1960s and 1970s. Considering the strong involvement of the government commonly witnessed in the development of the auto industry in Korea, Mexico, and Brazil, however, we are left with different outcomes. Only Korea's auto industry, although having started most recently, has become an internationally influential actor. This distinctive characteristic of Korea's auto industry can be highlighted by comparing it with those of Brazil and Mexico, particularly focusing on three facets of auto industrialization: industry organization, localization policies, and export activities.

3.1 Industry Organization

The development of an auto industry presupposes a certain level of demand for automobiles as well as a production capacity efficient enough to satisfy the existing demand. In the initial phase of auto industrialization, however, the demand for automobiles is limited primarily due to a low level of economic development and restricted purchasing power among potential buyers. Hence, the major concerns in the initial phase of auto industrialization center on how many assemblers are allowed, how much they should produce, how to introduce needed capital and technology, and how to deal with auto TNCs. This means that industry organization (or market structure) is discussed and determined before the industry is put on a track of rapid development. The specific type of industry organization, which tends to be established in the initial phase of auto industrialization and later consolidated by the creation of auto firms that have vested interests in it, has a significant implication for the pattern of auto industrialization each country will take. Moreover, the type of industry organization is likely to affect how a particular country's auto industry is incorporated into the international division of labor.

We can find a number of common traits in the history of industry organization in Brazil's and Mexico's auto sectors. In both countries, auto TNCs had been deeply involved in assembling automobiles before the Second World War. After the war, both countries allowed for the establishment of auto firms that were 100 percent owned by auto TNCs. In this process, they left the domestic auto industry dominated by a handful of foreign firms, for they failed to limit the number of auto firms and models within the restricted domestic market.

In the late1940s, two domestic auto firms were established in Brazil. One was Vemag, the shares of which Brazilian local capital owned 82 percent, and the other was FNM(Fabrica Nacional de Motores), which was owned and managed by the government. During the 1950s, however, the Brazilian auto market experienced a rush of foreign makers, including Willys, Volkswagen, Mercedes Benz, Scania, and Toyota, over and above the preexisting firms of Ford, GM, and Fiat. This rush was occasioned by a shift in the government's auto policy in 1953 that prohibited the import of completely-built-up (CBU) vehicles. These auto TNCs, unable to export their vehicles, decided to engage in foreign direct investment for fear of being left out of a potentially lucrative Brazilian market (Shapiro 1994).

During the 1960s, the existing auto firms began the process of industrial readjustment, largely under the leadership of the big auto TNCs. The noticeable feature in this process was the disappearance of Brazilian local capital from the auto industry. Volkswagen and Alfa Romeo took over Vemag and FNM, respectively, during this period. In addition, Chrysler began its operation in Brazil by taking over Simca, thereby creating an industrial structure that was dominated by the U.S. Big Three as well as the German Volkswagen.

In Mexico by the Second World War, Ford and GM had already assembled automobiles, together with FAM (Fabricas Auto-Mex), the shares of which Chrysler owned 33 percent. After the war, Mexico's private capital was eager to enter the auto industry, giving rise to 6 new domestically owned auto firms (VAM, DINA, Selta, Reo, Impulsora, Promexa) by 1961. The Mexican government had formulated a number of industry promotion policies, largely aiming at helping local capital not fall behind foreign makers in competition for the domestic market. It attempted to limit the number of domestic firms to 4 or 5, allow only one model for each assembler, and disallow a change in models within 5 years. The government even assigned a production quota to each firm and carried out price control. However, primarily because of resistance from foreign makers, all these policy measures had failed to produce the intended results or to retard the "denationalization" process of domestic auto firms by the late 1960s.

During the 1960s, the three firms that were 100 percent owned by Mexican capital (Reo, Delta, Impulsora) went bankrupt as a result of financial difficulties. In addition to the collapses of domestically owned firms, foreign capital took over the surviving firms one by one. VAM handed over 60 and 40 percent of its shares to the government and U.S. capital, respectively. Promexa was bought off by Volkswagen. The largest domestically owned firm, FAM, reduced its shares from 67 to 55 percent by selling the difference to Chrysler.

The denationalization process was accelerated when the government imposed an export requirement policy on the firms in the 1970s. First, FAM, thinking that Chrysler would not follow the government policy with its 45 percent of shares, sold the remaining shares (55%) to Chrysler. The only firm that was 100 percent Mexican owned, DINA, had a hard time satisfying the government's export requirement policy, so it decided to establish a new firm, Mexico Renault, by selling 40 percent of its shares to French Renault. By the late 1980s, Mexican capital had totally retreated from the auto industry, resulting in an industrial organization in which 5 auto TNCs (the U.S. Big Three, Volkswagen, Nissan) dominated auto production and Renault concentrated on the production of engines.

The most distinctive feature that differentiates the Korean auto industry from the Brazilian and Mexican ones in the realm of industry organization is the strict control having been exerted by the Korean government over foreign direct investment by auto TNCs. Throughout the whole period of auto industrialization, there were no 100 percent foreign-owned auto firms in Korea, and the government has persistently insisted on a maximum of 50 percent of total shares, which would be owned by foreign makers when they formed a joint venture company with local firms. In addition, the Korean government maintained relatively consistent and powerful policies of entry restriction and thereby succeeded in controlling the proliferation of small-sized assemblers and maximizing the effect of scale economies.

In the mid-1960s, the Korean government sought a unitarization policy in the area of industrial organization. Saenara Automobile Co. began to assemble passenger cars by importing knocked-down kits from Nissan in 1962. The government formulated an auto industry protection law in 1962, according to which the import of CBU vehicles was prohibited and the existing assemblers were to be incorporated into a single permitted assembler, Saenara. As Saenara collapsed due to the lack of foreign currency in 1963, Shinjin took it over and became the sole auto assembler in Korea by the mid-1960s.

The unitarization policy did not last long, however. As early as 1965, Asia Automobile Co. was permitted to assemble passenger cars, and the Hyundai chaebol decided to enter the auto industry in 1967. In 1971, Kia Motors Co., which had focused on the production of bicycles, motorcycles, and three-wheeled vehicles, announced that it would build a comprehensive auto plant. So the Korean auto industry began to be dominated by four assemblers in the early 1970s, and this structure persisted well into the mid-1990s, although there were minor changes in it (e.g. Asia was taken over by Kia in 1976, Kia was not allowed to produce passenger cars from 1982 to 1986, and the Ssangyong chaebol entered the auto industry by concentrating on producing SUVs in the late 1980s).

3.2 Localization

Developing countries tend to begin auto production as a way of saving foreign currency and so the state's industry promotion measures usually take the form of import substitution policies. By enforcing a market protection policy with such policy instruments as a ban or high tariffs on the imports of CBU vehicles, the government attempts to localize the production of as many parts and components as possible. In carrying though such policies, the government often imposes an obligatory localization rate on the existing auto firms and increases the rate in accordance with the level of development of the parts industry.

The Brazilian government was the most stringent in pursuing a higher degree of localization even at the early stage of auto industrialization. First, it enforced a ban on the import of auto parts that were being domestically manufactured in 1952. The next year, it also banned the import of engines and CBU vehicles, including completely-knocked kits. In 1952, the government established the Executive Group for the Development of the Automotive Industry (GEIA), which would supervise the progress of localization rates among the auto firms. Such government efforts bore some fruit. The Brazilian owned firm Vemag produced the first domestic-made automobiles in 1956. By 1965, the domestic content rate for every auto firm exceeded 95 percent, which means that almost complete localization was achieved within ten years of the government's active involvement.

This success in enhancing the localization rate within a relatively short period, however, failed to lead to the independent development of the Brazilian auto industry. We can point out two factors that contributed to the decline of the Brazilian auto industry, particularly with respect to localization. First, the efforts to enhance the localization rate continued without any serious attempt to develop indigenous models. This means that the heightened localization rate was only the result of manufacturing foreign models with as many locally-manufactured auto parts as possible. Second, the government did not pay much attention to promoting final assemblers and parts manufacturers separately. As final assemblers, which were mostly foreign-owned, increased the in-house production of many important auto parts and components, the small and medium-sized part manufacturers, which were mostly locally-owned, lost their major buyers and soon collapsed.

The Mexican government decided in the late 1950s to bring about a transition from the stage of assembly to that of manufacturing. Initially, the government had wanted as high a level of local content as had already been achieved in Brazil. To this end, it had tried to restrict the number of firms and models produced and to limit the frequency with which models were changed. After considerable bargaining, however, a Decree passed in 1962 was not as strict as the initial plan. The Decree required a 60 percent local content, permitted 100 percent foreign-owned subsidiaries in the terminal sector, and made obligatory majority Mexican ownership in the parts sector.

The progress in local content was so slow in Mexico that, by the late 1960s, imports were higher than they had been in 1960 (Bennett and Sharpe 1985). Nevertheless, Mexico's auto industry promotion policies were quite different from those seen in Brazil in one crucial way. Granting that the terminal sector would be dominated by foreign firms, the Mexican government paid more attention to promoting the parts industry as it divided categorically the terminal and parts sectors, prohibited the former from manufacturing any auto parts except engines, and limited the shares of foreign capital to 60 percent. In the end, although the terminal sector was dominated by foreign firms and local content was not as high as that achieved in Brazil (60 percent for domestic use and 30 percent for export use), the Mexican auto industry brought about a highly developed parts sector. This was also occasioned by shifts in business strategies among the U.S. Big Three. By the 1980s, U.S. firms, under increasing pressure from Japanese manufacturers, sought to meet this competition through importing certain parts from Mexico and by building new greenfield plants which could meet Japanese productivity standards, such as the Ford plant at Hermosillo (Jenkins 1995, 634).

Throughout the 1960s, the Korean government announced several ambitious localization policies to little avail. Typical of these were the Three-Year-Localization Plan in 1965 and the Basic Plan for the Promotion of an Auto Industry in 1969, which aimed at accomplishing 100 percent local content by 1972. However, during this period, the Korean auto industry was assembling a few foreign models by importing knocked-down kits, and the assemblers were not interested in engaging in manufacturing activities at all. As a result, at the end of the 1960s, the rate of local content was less than 30 percent.

However, the Korean government began to adopt in 1973 and 1974 an innovative combination of promotion policies that had never been seen in either Brazil or Mexico. First, it required existing assemblers to make original models. Second, it aimed at increasing the local content rate to 95 percent by the end of 1970s. Finally, to facilitate efforts to enhance local content, the government treated the terminal and parts sectors separately. The final assemblers were forced to manufacture only engines and bodies while the rest of the parts and components were to be manufactured by the parts firms. It was also encouraged that each parts firm should specialize in manufacturing only one part or component. Another noteworthy policy was that an industry association of the parts sector (KAICA) was given the authority to allow or prohibit the import of auto parts and components. All these policies performed well enough to make the Korean auto industry one of the internationally meaningful actors by the end of 1970s.

3.3 Exports

In 1972, the Brazilian government initiated an export promotion policy with the introduction of the BEFIEX (Export Fiscal Benefits) Program. Firms that undertook to export under the program received a number of benefits, including a 10 percent reduction in local content requirements, exemptions from restrictions on imports, and a number of special tax incentives (Jenkins 1987, 193). By 1976, all the major auto firms operating in Brazil had signed the export agreement. As a result, exports grew rapidly in the 1970s, although they slowed down in the 1980s.

This export promotion policy was successful in increasing production volumes with few changes in industry organization and local content. Two factors seem to have contributed to the limited success of Brazil's export of automobiles in the 1970s: first, an emerging international division of labor in the 1970s, according to which certain parts would be spatially separated from assembly to take advantage of large economies of scale and/or cheap labor; second, an allocation by the auto TNCs of world markets between their subsidiaries, which made it possible for Brazil to supply certain Third World markets, particularly in Latin America and Africa. Nevertheless, the increase in exports did not upgrade the Brazilian auto industry to a qualitatively different level, primarily because the vehicles made for exports were still low priced and low quality foreign models. This can be indicated by the fact that the increase in exports during the 1970s and 1980s had been made without meaningful increases in facility investment and productivity. In the end, we can conclude that increased exports during the 1970s and 1980s were undertaken not under the combined leadership of the government and local capital but by the needs of the auto TNCs to globalize their production according to shifts in the international division of labor.

The deliberative effort to increase exports was also strengthened in Mexico when the government in 1969 began to impose export requirements on the industry as a means to try to reduce the trade deficit. The 1972 Decree forced the auto firms to compensate for their trade deficit by exporting at least 30 percent of their total imports. This export ratio was supposed to increase 10 percent each year so that it could reach 100 percent by 1979. Although exports grew during the 1970s, they represented a relatively small proportion of total output, and the industry continued to have a substantial trade deficit. The devaluation crisis of 1976 and the debt crisis of 1982 both focused attention on the industry's contribution to Mexico's balance of payments problems and led to further Decrees intended to promote exports in 1977 and 1983.

The 1983 Decree provided a variety of incentives to promote exports. If the firm's trade balance was positive and it exported more than half of its total output, it could add a model to its production line. In addition, the required local content rate for the vehicles produced for exports was reduced according to the export ratio. When the firm exported 80 percent of total output, for example, its local content rate was set at 30 percent. In the mean time, when the firm exported 56 percent, its local content should be over 48 percent. All these measures eventually contributed to a substantial increase in exports in the 1980s.

In terms of total output, Korea's auto industry went ahead of Mexico and Brazil in 1986 and 1987, respectively. Such increases were made possible primarily by rapid increase in exports starting in 1986. The export of total output ratio was 50.9 percent in 1986, 55.8 percent in 1987, and 53.2 percent in 1988. In contrast to the Brazilian and Mexican governments, the Korean government never used any coercive measures to promote exports, although it placed the auto industry as one of its "export strategic industries" in 1977 and as one of its "10 export strategic industries" in 1979. The government's policy measures neither imposed any export requirements nor correlated imports with exports; they only focused on providing the firms with financial subsidies, primarily in the form of price differentials between domestically used and export vehicles, marketing channels, and country-specific information.

Hence, the rapid increase in exports after 1985 was not so much the result of the state's promotional policies as the outcome of strategic choices of local firms that had already developed export models and waited for an appropriate time to enter foreign markets. As a result of this difference between Korean auto firms and their Latin American counterparts, the former could target the markets of advanced countries, particularly the U.S. market, as their launching pad for further export activities, whereas the main market of Brazilian and Mexican auto industries was confined to their neighbor Latin American countries or other developing countries.

3.4 Implication

The above discussion reveals that the most distinctive characteristic of Korea's auto industry, compared with those of Brazil and Mexico, is the weaker influence of the auto TNCs. It is well known that TNCs have influenced the implementation of a host government's policies, often distorting a government's initial policy objective. Sometimes, they have debilitated the intention of fledgling local firms to develop an indigenous auto industry. Moreover, given the tendency that TNCs hardly invest in the development of a host country's industries but operate in accordance with their global strategies or changing international division of labor, the active involvement of auto TNCs can eventually restrict demand for and supply of automobiles in LDCs.

In Brazil and Mexico, where auto TNCs have dominated the industry, a domestic sales strategy was developed on the basis of product differentiation (non-price competition): a fairly large number of models and frequent model change were key components of this strategy. However, as such a strategy was predicated on the inequality of wealth, it reduced domestic demand, particularly after both countries suffered from two oil crises in the 1970s and contraction of consumer credit in the 1980s. This means that auto TNCs' marketing strategy inhibited the growth of a domestic market. The export strategies employed by auto TNCs was not of much help to stimulate an increase in direct investment, largely because most exports were carried out by existing models and restricted by the supply scheme on a global basis. In contrast, the Korean auto industry, on which the influences of auto TNCs have been checked to a significant extent, pursued more aggressive business strategies and adapted itself more flexibly to shifts in the international market condition.

Another significant difference that accounts for the Korean auto industry's rapid development lies in the connection between localization and export promotion policies. In both Brazil and Mexico, the localization rate applied to the vehicles for export has been consistently reduced simply because the vehicles made from domestically manufactured parts are thought to have no chance to compete in the international market. In Korea, however, export promotion policies have been designed in close relation with localization policies, particularly since the mid-1970s. Such connectedness between two kinds of policy would have been impossible to accomplish had it not been for the domestically owned firms that developed their own models and marketing networks. Once vehicles made by domestically owned firms with domestically manufactured parts and components can compete in the international market, localization and export are no longer different policy objectives but become different sides of the same coin.

In sum, the development of the auto industry in Korea is quite distinct not only from those in advanced countries but also from those in other newly developing countries such as Mexico and Brazil. The most significant features can be found in its industry organization, where domestically owned firms have led the development with only slight influence from auto TNCs. Nevertheless, the path taken by the Korean auto industry has been filled with no fewer policy shifts, no less resistance from the private sector, and no less strategic interference from auto TNCs than can be seen in the cases of Brazil and Mexico.

4. Research Design, Methodology, and Data

4.1 What is to be explained? - The Dependent Variable of the Study.

This study is the case study aiming at explaining the shifting developmental potential of the Korean auto industry. In most industry-specific case studies, the focus of explanation has been confined to rooting out the causes of development or decline in the industries concerned. To explain the successful development of Taiwanese electronics industry, for instance, Kuo (1995) posited the strength of the business association as the most critical variable, while Johnson (1982) and Amsden (1992) put greater emphasis on the autonomy and insulation of the state bureaucracy as the main cause of the success of some of Japan's and Korea's heavy industries, respectively. Though this kind of research provides us with valuable insight in sorting out the key elements through complex data and thus offers a clear view of the hidden causes of the development (or decline) of certain industries, there are some problems that should be re-examined.

In a world that is characterized by rapid technological changes and the incessant advents of new products, it may be dangerous to assert that certain industries in certain countries epitomize success or failure stories. The textile industry in 19th century England, the steel industry in early 20th century America, and the shipbuilding industry in mid-20th century Japan were once hailed as models of successful industrial development, only to find the reverse to be true at a later time. For instance, the cause of rapid development of the shipbuilding industry in Japan after 1945 was argued to be the strong state initiative and the formation of a close state-business linkage. When the Japanese shipbuilding industry fell behind international competition and thereby needed a fundamental restructuring, however, the same factors that were believed to have helped it grow were later held responsible for inhibiting the smooth exit of troubled firms and the upgrading of production technology (Uriu 1996).

To sidestep such inconsistency and contradiction in explaining the developmental process of certain industries, the dependent variable should be a more dynamic one, taking into consideration not only the evolutionary character of industrial development but also the disjunction and leaping moments of industrialization, which have often played a more critical role in determining the peculiar pattern of industrial growth in certain nations. The peculiar pattern of Korea's auto industrialization is well represented in Figure 1.

This figure indicates that the development of the auto industry in Korea has hardly been incremental. It has experienced rapid growth as well as periods of stagnation or even decline. Up to 1974, the pace of auto industrialization in Korea had been quite slow, particularly compared with other NICs such as Brazil and Mexico, which had already established mass-producing facilities. The year 1974 was the first critical moment of auto industrialization in Korea, as there occurred rapid growth of production volume and capacity from this year to 1980. The drops in production volume in 1980 and capacity in 1981 tell us that the trend of accelerated growth from 1974 stopped for some reasons, and the stagnation of capacity increase during the first half of 1980s indicates that this interruption was not accidental but had an enduring foundation. In the latter half of the 1980s, the Korean auto industry witnessed a remarkable growth rate in all areas of production volume, capacity, and exports. Although not indicated in the figure, this growth trend continued well into the mid-1995, though not at rates as dramatic as those shown during 1985-1987. The signs of crisis in the Korean auto industry began to surface after 1995, largely due to financial problems in many firms. The business failure of Kia Motors in 1997 was followed by the bankruptcies of many Korean auto firms in the late 1990s.

What happened to the Korean auto industry in 1974, 1980, 1985, and 1994? Why did this auto industry, which had been stagnant for several decades, begin to grow rapidly from 1974 as well as from 1985? How can we explain the relatively stagnant performance during the first half of the 1980s? What made what was once an exemplary model for auto industrialization in the Third World fall apart right after a booming period? Finally, does the Korean auto industry still have potential to become an internationally competent contender in the world auto industry? A proper explanation of the pattern of Korea's auto industrialization must answer these questions.

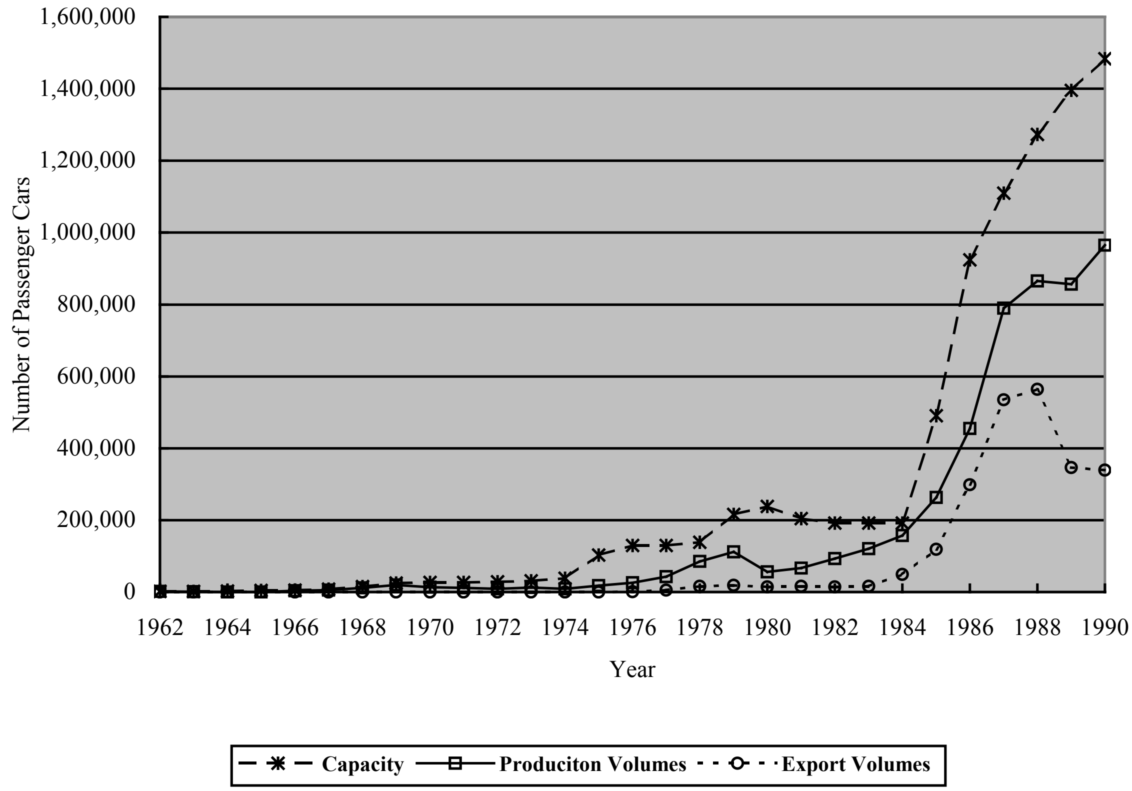

Figure 1: Performance of the Korean Auto Industry

Source: Data from Korean Automobile Manufacturers' Association (2002), *http://www.kama.or.kr.*

Accordingly, my dependent variable is the performance of the Korean auto industry. The performance of certain industries can be specified by a number of indicators. In this study, I draw on such broadly used indicators as the volume of production, productive capacity, the domestic content rate, the technological level of production, and the volume of exports.

As a study of comparative political economy, this study aims at finding the political foundation of industrial performance, focusing on the changes in state policies and the dynamism of state-business relations. A number of outstanding studies have already demonstrated that state policies and entrepreneurship have played a significant role in driving or retarding the performance of the industry (cf. Gerschenkron 1962; Schumpeter 1987). Therefore, this study assumes that the variation of industrial performance has critical relations with changes in the state's industrial and macroeconomic policies as well as in the interactions between state agencies and private firms.

Accordingly, the performance of the Korean auto industry over time is expected to have close relations with changes in state policies and business strategies of the firms. Table 1.4 informs us that each phase of industry performance began with the formulation of a new automobile policy by the government. In addition, the strategies used by Korean auto firms are quite various over the different phases of industry performance. Particularly significant are the diverging developmental paths of the two largest auto firms in Korea, Hyundai and Daewoo, especially after the formulation of the long-term promotional plan in 1974.

Ultimately, the analytical focus of this study is to explain the shifting state policies as well as business strategies throughout the period of auto industrialization in Korea. As Goldstein and Keohane (1993, 12-3) have emphasized, change in the policy paradigm (e.g. from the policy of auto industrialization through joint-venture with foreign firms to that of indigenous industrialization) is not an easy task, largely because the existing policy paradigm tends to establish an institutionalized norm within the government and through this norm it exerts persisting influences on the motivations and incentives of policymakers, even after the interests of the original proponents of the policy paradigm have already changed. Hence, the formulation of a five-year plan in 1963, a long-term promotion plan in 1974, a merger policy in 1980, and an industry development law in 1987, as well as the allowance of Samsung as a new assembler in 1974, must be carefully examined, in part because they represent a significant change in the policy paradigm and in part because they preceded each phase-shift of industry performance.

Table 1.4
Industry performance, State Policy and Business Strategy

	Performance of the Korean auto industry	Agendas of State's Auto Policies	Business Strategy
Phase I (1962-1972)	Low	•Five year plan (1963) •Unitarization policy (1964) •Localization of auto parts • Allowing other assemblers, thus making four assembler system (1970)	• Assembly of many foreign models in a small quantity • Complete dependence on TNCs as the source of capital and technology
Phase II (1973-1979)	High	•Targeting the auto industry as a strategic industry (Long-Term Plan in 1974) •Complete localization of auto manufacturing •Promotion of parts manufacturers separately from terminal firms	•Development of an original model, build-up of mass production facilities, and enhancement of the local content rate (Hyundai) •Weak influence of TNCs •Maintenance of three automakers throughout the period •Adherence to the traditional way of business (GM Korea)
Phase III (1980-1984)	Low	•Failed merger attempt between Hyundai and GM •Compulsory exit of Kia Motors •Liberalization by reducing state's subsidies	•Groping for a new opportunity by expanding productive facilities (Hyundai) •Incorporation to the global production network of GM (Daewoo) • preparation for reentry (Kia)
Phase IV (1985-1994)	High	•Designation of an auto industry as a sunrise industry and limiting the number of firms to the present number (Industry Development Law in 1986) •Promoting mass consumption of autos by reducing taxes	•Engaging aggressive export activities (Hyundai) •Providing GM and Ford with sub-compact cars by Daewoo and Kia respectively
Phase V (1995-2000)	Low	•Enhancing international competitiveness while allowing more liberalization •Allowing the entry of Samsung and intensifying domestic competition (December 1994)	•Challenging political power (Hyundai) •Competition for capacity expansion to gain a dominant position before Samsung's entry • Entry of Ssangyong and Samsung as the passenger car makers

4.2 Theoretical Framework

This study is based on the theoretical premise that the performance of certain industries is an outcome not only of economic processes but also, more significantly, of political processes, in which various political actors, including top political leadership, executive branches, business firms, and workers interact to enhance their interests within the constraints of preexisting institutional structures. To be more specific, I will argue that the performance of the Korean auto industry varies according to the type of dominant coalition made between the state and business in the policy process.

For most of the developmental period, contrary to the common notion of the monolithic and strong Korean state suggested by many works of comparative political economy, state managers in Korea have been divided on the issue of the development of capital and technology intensive industries. The presence of a "strong" state does not guarantee a unified state purpose and preference. The Korean state consists of a multitude of agents: politicians who must seek political support from various social groups, bureaucrats who seek to have their proposals adopted and promoted, and so on. There are often divisions even within each of these groups. The same is true for business. While the so-called chaebol groups have all engaged in an aggressive diversification strategy since 1960s, they have revealed a critical difference among themselves in terms of the main field of business activities, the relationship with multinationals, and the way to mobilize capital. In case of an auto industry, Hyundai has persistently sought to become an independent actor, while Daewoo and to a lesser extent Kia have depended, from the design and selection of models to their international marketing, on foreign automakers.

This study, therefore, is premised on the recognition that an appropriate analysis of Korean auto industrialization must take into consideration such divisions in both state agencies and business firms as well as the shifting patterns of coalition between the state and individual businesses in realizing their common policy interests. In this respect, the two existing dominant paradigms, one emphasizing the role of the state and the other private initiative, seem to fail to address the conflicts of interests within both the state and business and the consequent coalitional politics by regarding the state and/or business firms as an identifiable entity that has more or less homogenous interests. As a result, the analytical focus of this study does not confine itself to the exploration of the issue of whether the state or private firms have led the auto industrialization in Korea in whatever capacity; rather, it dissects both the state and business firms and examines the preconditions for the ascendance of specific coalitions between state agencies and business firms over other competing coalitions.

The implementation of an auto policy requires close cooperation between the private sector and the government. Every regime has a set of allied interests and coalition partners that buttress its ability to govern. At the same time, societal groups try to ally and collaborate with state incumbents when the alliance improves their interests. In this study, I place great emphasis on the power of one type of coalition -- this coalition is called the "neomercantilist" coalition for its overwhelming focus on the independence from foreign automakers in developing the domestic auto industry -- as a precondition for enhancing the overall capacity of the Korean auto industry. While its constituent members have shifted according to the regime type and the developmental phase, the invariable members have been the mercantile-minded policymakers in the Ministry of Commerce and Industry (MCI) and the independence-oriented auto firm, Hyundai Motor Company. The center of the anti-neomercantilist coalition -- this coalition will be termed a "liberal coalition" because of its reliance on the logic of static comparative advantage in deciding what industry should be promoted -- was the Economic Planning Board (EPB). Its coalition partners have also varied, but they often consisted of the Ministry of Finance (MOF), the local firms specializing in light industrial goods, and some international organizations like the World Bank and IMF. The EPB also attempted to mobilize consumers and the general public in its fierce battle for stabilization and liberalization in the 1980s.

It is one thing to argue for the explanatory power of coalitional politics in analyzing the pattern of auto industrialization in Korea, but it is another to explore when and how a certain coalition wins or loses vis-à-vis its competitors. With regard to the second question, I suggest two hypotheses: first, the institutional arrangements that govern inter-ministerial as well as state-business relations in industrial policymaking processes have a significant bearing on deciding which coalition will have an upper hand; second, these institutional arrangements are not given as a stable parameter, but are likely to change, particularly during a period of severe economic crisis. The politics of Korean automobile industrialization has been associated with changes in institutional arrangements of economic policymaking that were occasioned by general or sectoral economic crises and the rise and fall of authoritarian regimes. The Korean economy experienced two crises during the early 1970s and the early 1980s and is in the process of recovering from the so-called IMF crisis, which began in December 1997. These crises tended to make existing institutional arrangements of industrial policymaking look problematic and defenseless. The economic and political crises resulted in changes not only in state managers' and social groups' interests but also in power relationships among them, which had been shaped and constrained by the existing institutions. Top political leadership tried to fix institutional disarrays and put new types of institutions in place of the old ones. For instance, President Park set up the Heavy and Chemical Industry Promotion Committee (HCIPC) at the center of industrial policymaking in 1973, while President Chun strengthened the power of the EPB by setting up the Industrial Policy Deliberation Council (IPDC) in 1980, which was headed by the ministry of the EPB. Such institutional shake-ups, in the end, provided a fertile condition for the ascendance of a new type of coalition that would have quite a different policy orientation and implementation capacity. After all, this study argues for the usefulness of institutional as well as coalitional approaches in analyzing auto industrialization in Korea, instead of exclusively focusing on state power or a market-determined product cycle.

My theoretical model could be falsified if there exist such conditions as; (1) industry performance has little correlation with the shifts in the dominant coalition in government's industrial policymaking, (2) the institutional structures of state's industrial policymaking and business firms cannot satisfactorily predict what type of coalition prevails at a specific point in time, and (3) political and economic crises has little to do with the institutional shifts in the government and business firms. All these points will be examined in detail in the chapter three of this study.

4.3 Methodology

Although the main part of this study will be a case study, the analytical parts will offer comparisons with Latin American and Japanese cases by citing the scholarly works on those countries when appropriate, with a view towards locating the role of the Korean state and distinct coalitions in the industrialization process of the developing nations.

In terms of data, this research relies on primary documents and data as well as secondary documents. Documents include government publications, annual reports and publications of automakers and business associations, and various formal and informal papers by individual firms. The Ministry of Commerce and Industry, the Economic Planning Board, and the Ministry of Finance are the main government agencies, the documents of which will be examined. In addition, along with major daily and economic newspapers, specialized weekly and monthly journals on the automobile industry are also used as a source. Monthly and annual reports published by business associations such as the Korean Auto Industries Cooperative Association (KAICA) and Korean Auto Manufacturers' Association (KAMA) also provide useful statistical and general information. Lastly, the economic research institutes of each automobile firm also provide much of the data.

5. Organization of the Study

This study is comprised of ten chapters, including the Introduction and Conclusion. In Chapter II, I analyze the two representative approaches to the study of industrial transformation (market-centered and state-centered approaches). The market-centered approach tries to explain the peculiar pattern of the Korean auto industry by stressing the product-cycle and the role of local capitalists in availing themselves of a new market opportunity. To many scholars, particularly from the field of political science, the success as well as the recent decline of the Korean auto industry simply highlights the waxing and waning of the so-called "developmental state." I argue that both approaches are insufficient because each only magnifies one factor at the expense of another, thereby becoming the mirror image of its counterpart theory. In addition, I point out that the disadvantages shared by both approaches originate from their static view on the state and its relationships with business as well as from their relative negligence of the microfoundation of political exchanges, which is to say, the diverging interests and unequal power resources among the relevant actors.

In Chapter Three, I suggest a theoretical framework of the study. My theoretical model is based on the appreciation of the importance of diverging interests among both the state agencies and private firms and their attempts to make a coalition in the context of shifting institutional structures that govern the industrial policymaking process. In this chapter, I argue that a particular type of coalition between the industrial policymaking agency and local firms, supported by top political leaders, is more likely to enhance the performance of the industry largely by evading the rent-seeking tendency among local firms and by facilitating information exchange with each other. To explain which coalition gains the most dominance, I examine carefully the shifts in the policymaking structure and the state-business nexus. At the end of this chapter, I provide the figure that sums up the causal directions of my major variables.

I explain the history of the auto industry up to the beginning of the political and economic crises in the early 1970s in Chapter Four. In the first part of the chapter, I briefly review the history of the Korean auto industry up the 1962. In this period, there were few deliberative efforts by the state to develop the industry, and local capital did not attempt to get into the business of modern style auto assembly. In the second part of the chapter, the ISI (Import Substituting Industrialization) phase of the Korean auto industry is discussed. Although at this stage Korea could produce modern vehicles by assembling imported auto parts, specific focus will be the rent-seeking nature of state-business relationships in the auto industry as well as the inconsistency and incoherence of the state's auto policies in promoting the auto industry. The formation and ascendance of the rent-seeking coalition is in turn explained by the organizational confusion of auto policymaking agencies as well as by the dominance of the auto industry by shabby local capital.

Chapter Five scrutinizes the economic and political crises at the turn of the 1970s. The main cause of the crises is argued to have originated from the contradiction of the growth strategy in the 1960s, which can be recapitulated as the incongruity between exports of light industrial goods and imports of raw materials and capital goods (i.e., as the exports grew, so did the imports, thus exacerbating a payment imbalance). To deal with the crises, the state executed some inordinate measures that violated the principles of private property and democratic representation. In the process, there appeared changes in the institutional structures that ruled the state's economic policymaking process. Specific focus in this context is directed to the institutional strengthening of President's Economic Secretariat and the MCI at the expense of the declining power of the EPB as well as to the formation of the chaebol structure in local auto firms.

The main analytical focus of Chapter Six is to explore how the Korean state and independent local firms, particularly Hyundai, allied to each other, restricted the role of TNCs, and chose an independent developmental path. My argument is that the choice of the independent developmental path was the outcome of a struggle between two different coalitions. The neomercantilist coalition between the nationalist segments of the state economic bureaucracy and the independent-oriented local firm, Hyundai, prevailed in a struggle against the liberal coalition centered on the EPB. This outcome is analyzed in connection with the institutional changes that occurred during the previous years of political and economic crises.

The independent developmental path of the Korean auto industry was not without some critical problems. Because both the state and local firms desired to reach the stage of mass production as early as possible even in the slowly growing domestic market, Overproduction and the fatally low utilization rate in the late 1970s resulted. In conjunction with the political crisis that was triggered by the assassination of President Park, the above problem gave rise to another crisis in the Korean auto industry. This will be the focus of Chapter Seven. The main theme of this chapter is the "Forced Merger Attempt" by the state during 1980 and 1981. By closely tracking the process of this attempt, I highlight the weakening of institutions that gave rise to the neomercantilist coalition in the previous decade, along with the emergence of a new industrial policymaking structure. Special attention is paid to the revival of the EPB as the bastion of liberal and market-oriented policy reformers and to the strengthening of state's regulation on chaebol groups with the legislation of the Fair Trade Law. The creation of the Industrial Policy Deliberation Council (IPDC) under the leadership of the minister of the EPB is also emphasized because intra-bureaucratic politics between the proponents of functional industrial policy and of sector-specific industrial policy played a key role in its creation. All these institutional shifts paved the way for the liberal and international coalitions to gain the upper hand in the Korean auto industry.

The ascendance of a liberal coalition during the early 1980s within the changed institutional structures, however, was not as far-reaching as that of the neomercantilist coalition in the 1970s. This was to a large extent because of the tenacity of policymaking structure that had been built in the 1970s. Thus reappeared the neomercantilist coalition at the center stage of state's auto policymaking in the mid-1980s. The main focus of the Chapter Eight is the clash between the two coalitions around such themes as liberalization and new industrial policy. Both serious bureaucratic infighting regarding the future of the auto industry and the enhancement of local capital's capacity to maneuver this infighting to its own advantage occurred in this period. For a more complete understanding of this process, I also conduct an in-depth case study on the legislation of the Industry Development Law (IDL) since the passage of this law signified the resurgence of the neomercantilist coalition during the later half of the 1980s.

In Chapter Nine, which is the last chapter of the analytical part, I examine the decline of the Korean auto industry, particularly during the later half of the 1990s. Two sources of institutional changes are highlighted: democratization and globalization. These two macrosocial phenomena simultaneously brought about the intrusion of popular interests backed by vote-maximizing politicians in the state's industrial policymaking process, on the one hand, and the deep penetration of a liberal idea into the top economic policymakers, on the other. The outcome of this institutional change was the increasing competition among local firms and the pulling down of a neomercantilist coalition. To illustrate the upheaval of the Korean auto industry more visibly, I focus on the question of the Samsung's entry into the market, which divided not only economic ministries but also domestic auto firms and the general public. The business collapses of Kia and Daewoo Motors are also mentioned in connection with the ascendance of a liberal, international coalition in the Korean auto industry.

In Chapter Ten, I will provide a brief examination of the Korean auto industry after the 1997 financial crisis. Coalitional politics will be the lens through which we can interpret the specific result of state policies. I also provide concluding remarks regarding the match between my hypotheses and empirical evidence in the last section of the chapter. Finally, some suggestions for further research will be provided in the final chapter.

CHAPTER II

EXISTING APPRAOCHES TO INDUSTRIAL TRANSFORMATION IN DEVELOPING COUNTRIES

Over the past four decades, the auto industry in Korea has experienced a number of crucial changes in production capacity, production technology, industrial structure, and marketing strategy. In the mid-1960s, for example, the auto industry in Korea was confined to the assembly work of imported parts and components. One decade later, Korean auto firms began to manufacture indigenously designed automobiles. With the transition of the government in 1980, the central policymakers reasserted economic liberalism (that is, the inappropriateness of an auto industry in capital-poor Korea) and moved boldly to institutionalize a liberal economic order. Nevertheless, some local firms were able to maintain their growth potential, particularly by continuing the cooperative relationships with the pocket of mercantilist-oriented state agencies within the government. During the 1990s, when the issue of globalization was hotly debated, the focus of the auto industry moved to the issue of state intervention itself (e.g. whether the state should abandon its crucial policy tool that had controlled the entry and exit of local firms) and the need to enhance international competitiveness of the sector within a more liberalized context.

Why were particular state policies selected and promoted at particular stages of automobile industrialization in Korea? How did the industry transform itself and upgrade its productive capacity? Who was behind these substantial changes in the industry? What aspects of Korea's political and institutional arrangements favored or hindered the industrial transformation of an auto sector? Assuming the resistance to industrial transformation from affected sectors, how did policymakers use the change in the macropolitical environment, economic crisis, and shifting social demands strategically to promote their economic ideas? How did the state and private local firms collaborate or contest each other in each stage of industrial upgrading in the auto sector?

To answer these questions in a theoretically meaningful way, we need a theory. Luckily or not, we have two powerful approaches, one state centered and the other market centered, that have been developed to address the question of the rapid industrial growth in East Asian countries. As the following argument indicates, these existing approaches have their own strengths and weaknesses. However, it will be argued that these approaches must be supplemented, primarily because they have relatively dichotomous views of the relationship between the market and state and, thus, lose sight of the political processes that are located at the center of industrial transformation.

After reviewing these two approaches, I will provide a coalition-centered approach as an alternative analytical framework in the next chapter. The main hypothesis is that the formation of neomercantilist coalition between the government and private firms is the key to understanding auto industrialization in Korea. Such a coalition, however, has not always been dominant, as some statist writers have argued, nor has always resulted in distributional conflicts and rent-seeking, as neoclassical writers have insisted. It could either dominate the policy process or retreat behind the scene, depending upon the constantly shifting institutional structures that govern policymaking processes and state-business relationships. All these institutional factors will be scrutinized in the latter part of this chapter.

1. Contending Approaches Explaining the Rapid Industrial Growth in the East Asian Countries

The rapid economic growth in some LDCs, particularly in the East Asian region, has generated wide arrays of theoretical perspectives. In broader terms, however, there are still two dominant paradigms. One approach, which is often called the market-centered approach, maintains that East Asian success provides the case of the ideal combination of vigorous market competition and free trade as the key of economic growth. The alternative approach, which appeared as a critique of the above approach and has been called the state-centered or statist approach, argues that the state should be credited as the central factor contributing to the rapid economic growth in the region. The market-oriented approach is often identified with neoclassical economic theory, while the statist interpretation of East Asian economic success could be traced back to mercantilist theories as well as state-centered social theories developed by List (1966), Gerschenkron (1962), and Skocpol (1985). In fact, many theories cannot be neatly classified into either theoretical camp because, on the one hand, there is no clear-cut dividing line between the two and the roles of the market and, on the other, the state often overlap and are mutually reinforcing. Nevertheless, the critical comparison between these two paradigms is necessary not only because they have been the dominant approaches until recently but also because the new perspective should address the advantages and disadvantages of each paradigm to advance into higher theoretical sophistication.

In the following sections, I will examine the nuts and bolts of each paradigm, particularly within the context of the establishment of a new industry and its later upgrading. Particular attention will be given to how each approach explains the same phenomena (in my case, the development of a Korean auto industry) differently in terms of its central causes and future prospects.

2. The Background of the Emergence of Market-Centered Approach

The renewed interest in neoclassical economics in explaining the rapid economic growth of East Asian countries was occasioned by the triumph of an export-oriented industrialization (EOI) strategy over the import-substitution industrialization (ISI) strategy. The early researchers in development economics such as Rosentein-Rodan and Nurkse saw the economic stagnation in LDCs as resulting from the lack of coordination among domestic economic actors. In other words, it was argued that continuing underinvestment would be the norm in most LDCs because decentralized entrepreneurs could hardly invest when it was uncertain that concurrent investment by others would occur in order to create demand for one's output. The coordination of concurrent and timely investments by private entrepreneurs, therefore, became the key to economic growth, and this job was seen as being accomplished best by no other individuals or organizations than the state.[1]

[1] The role of the state justified by early development economics, however, was not confined to the coordination of private investments by local capital. Another important factor, as emphasized by Hirschman, was the entrepreneurial role of the state in an environment of considerable uncertainty, where individual capitalists had incomplete knowledge and complex motivation. In this vein, Hirschman (1958, 210) argued that development requires “calling forth and enlisting for development purposes, resources and abilities that are hidden, scattered, or badly utilized.”

The emphasis on the coordinated investments by many LDCs was later combined with the focus on the import substitution growth strategy, given the slim chance to penetrate into the market of advanced countries with their industrial goods (this is often called "export pessimism") as well as the deteriorating terms of trade for primary exports. The emergence of an auto industry in some LDCs as the major project of the import substitution of consumer durables was then justified as economically rational if it assembled or manufactured automobiles on their own soil, no matter who owned the company and whether the industry realized scale economies.

Yet, the ISI strategy revealed its limitation once it reached the stage of import-substitution of intermediary and capital goods. The upgrade of an industrial structure needed new technology and massive capital, but the exclusive focus on domestic market with protectionist and market-distorting state policies hindered the smooth transfer of industrial structures from consumer goods industries to capital goods industries.[2] Such an impasse experienced by many LDCs, coupled with the success of the East Asian countries that were claimed to have adopted an outward-looking EOI strategy on the

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[2] Once a popular term for some developing countries such as Brazil, Argentina, Korea, and Mexico, the Bureaucratic-Authoritarian regime (B-A regime) was developed by O'Donnell at this juncture. O'Donnell (1979) claimed that the "exhaustion" of the ISI of consumer durables necessitated the transition to the ISI of producer and intermediary goods, and this job required more authoritarian regime that could attract foreign capital more easily than the previous populist regime. Focusing on the Brazilian auto industry, Kurth (1979, 31) provides another plausible argument for the emergence of the authoritarian regime in Brazil: "Since Brazil had and continues to have a much lower per capita GNP than other large automobile producers, the greatly-increased consumption of automobiles in Brazil required a special form of income distribution, that is, redistribution to the middle class from the lower classes. This has been accomplished through government measures that repressed working-class real wages, reduced welfare and public health programs. . . . These policies. . . . could be imposed far more easily by an authoritarian government . . . ."

basis of comparative advantage, provided the fertile ground for the neoclassical resurgence in the 1970s and 1980s.

3. Market-Centered Approach: Product Cycle Theory

The neoclassical approach[3] has a long tradition. Since the summary of neoclassical arguments concerning the engine of economic growth is provided in the footnote, I focus here on how it explains the transformation of industrial structure in developing countries.

David Ricardo was the first economist who claimed that countries would export and specialize in the production of goods for which they enjoyed comparative advantage. Later Hecksher-Olin developed Ricardo's idea one step further by proposing a two-country, two-factor (capital and labor), two-commodity model, which predicted that a country would specialize in the product for which the abundant factor was used more

[3] The neoclassical approach is often called a "market-centered approach." To explain economic growth in general, this approach suggests two main arguments (see Balassa 1982; Krueger 1974, 1990; Little 1982). First, rapid economic growth in the East Asian countries was the result of "openness" or "neutrality" of the trade regime. This means there has been equal incentives for production in both the domestic and international markets. In other words, individual producers were free to choose whether industrial inputs were to be supplied from domestic or international markets. Secondly, another significant factor of rapid growth is "free market" in the sense that state intervention is limited to the smallest degree and directed to providing an environment within which a self-regulatory market and free enterprises operate without hindrance. This means that the rapid growth of the East Asian countries was due to the absence of "the distortion of relative prices" as there developed relatively complete markets for commodities, capital, and labor. After all, we can point out that neoclassical writers attribute the economic success of the East Asian countries to the following four factors:
1) The growth of export economy was based on the comparative advantage of the region.
2) The relatively high interest rate in the region reflects the scarcity of capital and the competitive nature of capital market.
3) The labor markets in the region has also operated according to the market signals such as price and productivity.
4) The role of the state has been confined to maintaining a stable inflation rate, an effective exchange rate, and conservative fiscal spending.

intensively (see, Rogowski 1990; Frieden 1991). No matter what approaches we may take, however, the development of an auto industry in most LDCs is seen as an anomaly, for this industry can distort the efficient allocation of resources, which has been thought by neoclassical economists as the primary source of growth.

Yet such a simple notion of comparative advantage needed to be revised as the theory and reality began to diverge. Two new trends seem to have dealt a severe blow to the simple factor model: the growth of trade between countries with similar factor endowments and the initiation of capital intensive industrialization in some labor-rich LDCs. Confronting such a divergence between reality and theory, the neoclassical approach devised a new concept to make the idea of comparative advantage more empirically relevant: the product-life-cycle theory (Yoffe 1993, 6). This theory offers an effective way of understanding the rise and fall of industrial sectors, which is the main feature of industrial transformation.

According to this theory, industries and individual products undergo several important changes over time. In the introductory phase, a new product is manufactured by an innovative method in technologically developed countries. The second phase is distinguished by mass production and mass consumption. As the market gets saturated, the products in the growth phase enter into a third, mature phase. The production process at this phase becomes more standardized. Since the standardized production process allows the utilization of less skilled labor, the location of production moves to LDCs. Foreign direct investment by firms from developed countries significantly increases at this phase. In the end, products from foreign countries are exported to the original home market. According to this line of thought, Vernon (1966, 1971) and Hirsch (1967) made it clear that an evolution of a technology or product (e.g. the introductory or innovative phase, the maturing or process-development phase, and the standardized or mature phase) would dictate the locational shift in the production site from the most advanced to less advanced countries in the second phase, and to developing countries in the third phase. In this model, developing countries offer the locational attraction of cheap labor costs for the manufacture of products entering the mature phase of both their product design and process technology.[4] Then, the initiation of automobile assembly in certain developing countries is explained by the transfer of standardized manufacturing facilities to these countries following the maturation of auto-manufacturing technologies.[5]

There are, in fact, two kinds of product-cycle theories, depending on their implications for the technological catch-up of LDCs. On the one hand, the classical version, exemplified by Vernon's and Hirsch's theories, implies that there is little hope for less developed countries to catch up with developed countries, since new products are always developed in developed countries and later produced in LDCs. Another version, which is often called the "wild-geese-frying model" and was developed by a Japanese economist, Akamatsu Kaname, in the 1930s, emphasizes the aspect of diffusion of technology through industry transfer. According to this latter view, the diffusion of

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[4] Vernon later revised the theory by arguing that foreign direct investment was caused by the desire of oligopolistic TNCs to erect entry barriers in foreign markets in order to maintain the market share (1977, 89-101). According to this later version, TNCs' manufacturing activities in developing countries occur primarily because of their desire to maintain the dominant market position in the global economy.

[5] Yakushi (1984, 305), for instance, argues that the development of the Japanese automobile industry largely resulted from closely following the prescription of Vernon's product-cycle model.

technology may help less developed countries catch up and close the technology gap with developed countries (Ohkita 1987; Yamazawa 1990).

To some extent, these theories, particularly the latter one, provide us with a valuable means to escape from the fatalism underlying the neoclassical argument about the comparative advantage based on factor endowment because they open the way to develop a capital-intensive industry in LDCs once the industry reaches the phase of maturation in developed countries. However, no matter which version we apply, the product cycle theory stresses that the stage of economic development reached by a country significantly determines the kind of products that this country must specialize in manufacturing. From the viewpoint of product-cycle theorists, after all, seeking independent automobile industrialization in Korea during the 1970s, given its lower economic status than Brazil, Taiwan, and Mexico, where the auto industry was still in the grip of auto TNCs, was seen at best as an economic gamble or at worst as an economic disaster.

Finally, it must be added that most market-centered approaches[6] insist that in this process of industry transfer between countries, the role of the state should be restricted to such minimal tasks as providing a stable environment for private contracts, fostering internal order, and building basic infrastructures such as a road system and communications network (Buchanan, Tollison, and Tullock 1980, 9). The primary reason

[6] Chowdhury and Islam (1993) present more detailed roles of the state justified by a neoclassical view: (1) the state should primarily rely on market-based, private-sector driven initiatives in the mobilization and allocation of resources for growth promoting activities; (2) the state should intervene only in the case of a clearly established market failure; (3) even in case of proven market failure, the appropriate policy responses should be parametric measures; (4) the state should provide "pure public goods," including the proper assignment and enforcement of property rights; (5) the state should provide a stable and predictable macroeconomic environment; (6) the state should adopt a free trade regime as the core component of a neutral policy regime.

for limiting the scope of state intervention lies in the fact that the states in the underdeveloped regions are likely either to divert private entrepreneurship into unproductive rent-seeking activities or to engage themselves in predatory practices of bureaucratic self-seeking. Accordingly, state activism represented by plan-rational industrial policies in Korea and Japan (Johnson 1982; Amsden 1989; Wade 1990), argues Krueger (1974), is doomed to generate forms of inefficiency - that is, the cost of creating a monopoly. It is therefore the restraint of state power rather than pervasive market-shaping state activism that, according to neoclassical writers, underlies the economic success of East Asian countries in general and the automobile industrialization in Korea in particular.

To sum up, the market-centered approach[7] argues that industrial transformation and upgrading are the consequences of following the logic of factor endowment, product cycle, and/or private initiative. It tends to view the achievement made by the Korean auto industry as nothing more than the result of pouring in capital and human inputs without the consideration of productivity increase and technological sophistication, as we have seen in the case of Soviet industrialization in the 1930s. Implicitly, this approach suggested that Korea would not be able to overcome the bottleneck resulting from the

[7] Theory in itself has little power to affect the course of national economic growth unless it is embodied in powerful institutions. In this respect, the neoclassical theory has influenced the economic policies in most LDCs because the two most powerful international financial organizations, the IMF and World Bank (IBRD), have represented the hegemony of the neoclassical theory in the world. Sometimes, the influences of neoclassical growth theory through international organizations have been more direct. When the Korean government requested the World Bank for the Structural Adjustment Loan in 1980 because of the deteriorating balance of payment problem, the World Bank provided the loan on the condition that the loan not be used in the auto industry, urging the government to move away from the auto industry. In return, the Korean government promised that "the government will defer further actions to promote expansion of the auto mobile industry pending completion of a task force study. . . ." (EPB 1981).

deepening of ISI and thus should have concentrated on EOI for of its abundant and highly educated human capital.

Critique

The neoclassical approach has been criticized not only because of its simplistic assumptions about economic exchanges but also because of its failure to explain the variations of industrial upgrading among developing countries.[8] First, even if it is true that the move to a more market-oriented economy improved the static allocative efficiency of the economy by moving it closer to its comparative advantage, such a logic does not explain why certain countries can go beyond this economic logic and accomplish a newer type of competitiveness in a specific industry.[9] As Evans (1995, 26) pointed out, if the transformation of industrial structure is required, maximizing marginal revenues may leave productive capacity stagnating at a local maximum, thus making it irrational for potential investors to initiate a risky new project. More importantly, when the growth of a particular industry involves innovation and active entrepreneurship, as in the Korean auto industry, there may exist a conflict between the achievement of static allocative efficiency and growth. As Schumpeter (1987, ch.8) emphasized, under conditions guaranteeing perfectly free entry and, thereby, allocative efficiency, there will be little incentive for innovation, because any monopoly rent, or what he calls "entrepreneur profits," will instantly be competed away.

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[8] For the criticism of the neoclassical approach, see Shapiro and Taylor (1990), Chowdhury and Islam (1993), and Chang (1994).

[9] It might be said the other way that the neoclassical approach is more apt to explain the experiences of other developing countries' automobile industrialization than Korea's, for they more closely follow the pattern of comparative advantages.

Concerning the concept of comparative advantage, a similar counter-argument can be applied. The prescription of comparative advantage is a static proposition more concerned with the *status quo* than future potential, and it does not give enough weight to the possibility of dynamic gains from short-term distortions or to the possibility of creating comparative advantage through rapid structural change for countries concerned with long-run development.

Secondly, as convincingly argued by Hymer (1976) and Kindleberger (1969), many TNC's investments in manufacturing activities, particularly in the automobile industry, were forms of oligopolistic expansion. Challenging the neoclassical view that direct foreign investment is analogous to portfolio capital flows, some scholars argue that TNCs, in the imperfect market of their home countries, possess certain monopoly advantages, such as patented technology, well-differentiated products, and access to capital. As a result, it was argued, their foreign investments stemmed not from the pursuit of higher marginal rates of return abroad, but from the pursuit of better returns that these monopoly advantages could yield in new, foreign markets in comparison with further applications domestically. In line with this second criticism, we may also say that the neoclassical theory provides no meaningful answer to the basic problem of the structural tension between the interests of TNCs and host developing countries.[10] TNCs are not

[10] In this respect, Raymond Vernon (1998, 62) emphasizes as the key question in the study of foreign direct investment how we theorize in a meaningful way the "fundamental tension between the multinational enterprises and the nation-bound interests" in developing countries. Stephan Krasner (1985, 179) voiced exactly the same problem, saying, "developing countries are involved in a mixed-motive game with multinationals. There is an inherent tension between the corporation's desire to integrate its activities on a global basis and the host country's desire to integrate an affiliate in its national economy". Therefore, the presence of the continuous tension between a TNC's pursuit of interest on a global scale and the host country's efforts to draw what it wants as much as possible from a TNC's operation must be the baseline of searching for an appropriate theory.

merely the beneficent agents of change bringing capital, technology, and management skills to LDCs.[11]

Finally, if the world operates according to the model of perfect competition, the governments of developing countries should not deliberately seek to develop new industries because a less efficient use of resources will result. However, the fact that an industry is unprofitable in a developing country at present prices does not mean that it should not be promoted. To bridge such a gap between theory and practice in economic development, the role of the state must be reconsidered. Lacking both individual capitalists able to assume risky projects such as automobile manufacturing and private institutions that will allow large risks to b e spread across society, as Gerschenkron (1962) forcefully argued, the state should actively intervene the operation of national economy by bringing together the necessary funds, providing incentives through tariff protection and other forms of state-created rents, and encouraging their application in transformative activities.

[11] By contrast, it has been intensely argued by the members of *dependencia* school that investments by TNCs have posed a threat to domestic capital accumulation and that manufacturing industries dominated by TNCs have been shaped more in response to world market conditions and the global strategies of TNCs than in response to the needs of the populations of developing countries. The representative works that stress the benevolent role of the TNCs include Johnson (1977), Drucker (1974), Bauer (1984), and Gillis et al.(1996). For works criticizing the role of the TNCs, see Cardoso and Faletto (1979), Bornschier and Chase-Dunn (1984), Caves (1996), and Newfarmer and Marsh (1992). For a comprehensive view on the role of the TNCs in the economic development of host countries, refer to Moran (1998), Grieco (1985), and Eden and Potter(1993).

4. State-Centered Approach

The neoclassical argument does not place much emphasis on the state as a "catalytic" agent for industrial transformation.[12] Thus appears the counter-argument that takes domestic structure and the state seriously because it is only by examining these elements that we can get closer to the essence of the speed and magnitude of certain countries' economic development and sectoral transformation (Gourevitch 1986).[13] The core variable of a state-centered approach in explaining the development of the Korean auto industry is the strength and/or the capacity of the state as measured by its organizational and financial resources and by its institutional autonomy from societal pressures.

The state-centered approach challenged the neoclassical approach by focusing on the active role played by the state in leading the process of economic development. One conclusion of this approach is that "the Korean miracle" was not a triumph of laissez faire, but of pragmatic government intervention (Jones and Sakong 1980, 3). This

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[12] Empirical findings that there had been intense state intervention in East Asian countries prompted the revision of neoclassical arguments (see Gereffi 1989). The central element of this revised argument is summarized as follows. It was certain that the state actively intervened in the market. But this intervention was the state's deliberate effort to strengthen the market with "market-friendly" or "market-simulating" measures. This perspective is well delineated by the World Bank's 1993 report, which was entitled *The East Asian Miracle: Economic Growth and Public Policy* (1993). No matter how much neoclassical writers concede the acceptability of state activism, however, they still deny the effectiveness of a sector-specific industrial policy. Specifically, they argue that the promotional industrial policies have not resulted in the increase in productivity of the sectors receiving support. The growth of certain sectors is then claimed to have resulted from the increase of factor inputs without concomitant increase of productivity (Krugman 1994; Kim and Lau 1994). To this argument, Amsden (1989) suggested a counter-argument.

[13] Using Peter Evans' (1995) terminology, the essence of the state-centered approach can be briefly noted to be that the rapid industrial growth of East Asian countries was possible because the state successfully played the roles of "midwife" and "husbandry," in addition to the traditional role of "custodian."

recognition of the state as an engine of growth has deepened since the late 1980s.[14] Rapid economic growth, particularly in Japan, Korea, and Taiwan, was credited to a great extent to the strong, hard, and autonomous states, which guided private investment into industrial sectors of the states' own choosing (Kim 1997; Chang 1994; Woo 1991). Therefore, by the early 1990s the "developmental state"[15] interpretation achieved something close to paradigmatic status, compelling grudging recognition even from the key exponents of neoclassical argument, such as the World Bank (1997).

Though differing in details among scholars, we can sum up the main elements of state-centric arguments as follows:[16] 1) the government stakes its legitimacy on the achievement of rapid economic development; 2) the state does not directly supplant the role of private enterprise, but it does seek to guide private investment into priority areas, such as steel and automobile sectors, identified by the state; 3) the state exerts leverage

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[14] The State-centered approach has been expressed differently according to the various emphases placed on the specific nature of state intervention by different writers. For example, emphasizing the timing of industrialization as the key factor deciding a state's role, Amsden (1989, 1992) used the term "late industrialization" as the synonym of a state-centered approach. Meanwhile, Wade (1990) called the same phenomena a "governed market" while Johnson (1982) used "developmental state." Newer terms such as "embedded autonomy" and "governed interdependence" indicating similar phenomena have been developed by Evans (1995) and Weiss (1998), respectively. Such terms will be used interchangeably in this study as demanded by the specific context.

[15] The idea of the "developmental state" was first applied to an East Asian context by Johnson (1982) in his exploration of the institutional bases of Japanese economic growth. When Johnson used this term, he intended to indicate the "plan-rational" character of Japanese state's broad intervention in contrast to "market-rational" regulatory states, such as the U.S. and U.K. He subsequently extended the label to describe policymaking arrangements in Korea and Taiwan (Johnson 1987). His definition of the developmental state can be summed up in three points: 1) An elite bureaucracy [such as the Ministry of International Trade and Industry (MITI) in Japan or the Economic Planning Board (EPB) in Korea] staffed by the best managerial talent in the system; 2) An authoritarian political system in which the bureaucracy is given sufficient scope to take policy initiatives; and 3) Relatively close government-big business interactions.

[16] For a detailed explanation, see Onis (1991), Chang (1994), and Leftwich (1995).

over private capital through instruments such as credit control, import protection, and a variety of discretionary investment incentives; and 4) the state has an coherent bureaucracy consisting of qualified professionals recruited on merit and insulated from political pressures. These features, argue statist theorists, protect East Asian policymakers from the ravages of distributional coalitions, while at the same time they limit the predatory behavior of state officials through the inculcation of a coherent development vision (Amsden 1989; Woo 1991).

Such a sketchy outline of the developmental state, however, does not provide sufficient answers to the question of why the Korean state has distributed scarce resources to the risky project of domestic automobile manufacturing rather than focusing on the production of auto parts or on automobile assembly from imported parts. In other words, the developmental states may pursue a variety of policies, and we need a specific causal link that connects the characteristics of the state policies to the industrial upgrading of certain sectors.

One group of scholars (Dosi, Tyson, and Zysman 1989; Dosi, Pavitt, and Soete 1990; Porter 1990; Mattews and Ravenhill 1994), specifically from the tradition of the strategic trade theory,[17] suggests a plausible answer to this difficult question. The starting point is the recognition that countries specialize in producing different products for

[17] The meaning of “strategic” must be scrutinized, as used in the literature of the state-centric, strategic trade approach. In an oligopolistic industry such as the automobile industry, a firm’s position in the marketplace will depend on its interaction with others -- where there are only a limited number of firms in an imperfectly competitive market, the profit of one company will be determined in part by what its rivals do. Firms or states, therefore, may be able to improve their position by acting strategically. In this interpretation, the logic of comparative advantage degenerates into secondary importance in promoting certain sectors. The term "strategic" thus means an action which is undertaken not because it is immediately profitable in itself but because of the anticipated impact that it will have on actual or potential competitors (Helpman and Krugman 1989; Brander 1987).

reasons that often have less to do with relative factor endowment than with the advantages that established firms gain from being the first to occupy a particular sector. Among these "first mover" advantages is a firm's ability to reduce average and marginal costs of production by manufacturing large quantities of a given product (economies of scale), to improve production technologies through practice over time ("learning by doing"), and to establish a recognized brand name that differentiates its product from those of competing firms. Advantages of this sort are powerful deterrents to potential new entrants to an industry. In such a situation of imperfect competition, oligopolistic firms may be able to earn abnormal profits ("rent") even in the medium to long term.

According to this line of thought, the role of developmental states is to assist firms to capture (quasi) rents by providing various subsidies. Amsden (1992) sums up this point as follows:

> The main problem of late industrializers is that they cannot compete at market-determined prices because their productivity is so low. . . productivity gaps between developed and underdeveloped countries widened in the 20th century, overpowering the competitive advantage of cheap labor . . . Foreign competitors may be expected to introduce a stream of new innovations in productivity and quality to retaliate for their loss of market share, and it takes time for late industrializers to build a team of engineers and a workforce with the capabilities to keep abreast of these advances . . . Devoid of major innovation, [late industrialization] is predicated on borrowing technology and then improving it incrementally, [thus] leading enterprises in twentieth century industrialization must be subsidized . . . During what may be lengthy periods of subsidization to arrive at productivity levels that are cost-competitive, market forces cannot be relied upon to discipline business to act efficiently – i.e. to invest heavily in adapting foreign technology, and then to invest further in incremental improvements in quality and productivity in order to compete against foreign imports or capture export markets. [They] do not have the incentive to compete to the extent of becoming as efficient as the firm at the world technological frontier.

Government action, therefore, can alter the strategic game played by domestic and foreign firms by offering subsidies to the domestic firm. An export or production subsidy, by effectively lowering costs, may enable the domestic firm to expand production and gain market share at the expense of its overseas rivals. Krugman (1984) also points out that protection of the domestic market by the government may assist a domestic firm by lowering its production costs. That is, if a government closes off its domestic market to foreign competition, the domestic producer will enjoy longer production runs than would otherwise be the case and thus reap benefits from economies of scale.

In addition, recognizing the acquisition of technology as the key determinant of a country's growth trajectory,[18] the state-centered theory attributes a central role to the state in implementing selective measures that foster the development and application of new technologies. Here particular emphasis is given to "leading" industries, ones that "drive and mold economic progress across a broad front" (Nelson 1984, 1). From such a theoretical perspective, then, the indigenous development of the automobile industry in Korea is observed to have occurred, primarily because the state intentionally

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[18] In promoting these industries, Dosi, Pavitt, and Soete (1990) suggest, firms and governments may have to choose between three types of efficiency: "Ricardian efficiency," the neoclassical idea of distributing existing factors of production in a manner that generates maximum profits; "Keynesian efficiency," the maximizing of future profits through investing in goods and industries that have the greatest growth potential in international markets; and "Schumpeterian efficiency," the allocating of resources to maximize the possibilities for innovation and technological dynamism. It is argued, therefore, that states should intervene to promote future national welfare by fostering Keynesian and Schumpeterian patterns of efficiency. The targets should be industries judged to be in line with the country's long-term comparative advantages, those whose products have high income elasticities of demand.

implemented the industrial policies that got the relative price wrong for the purpose of putting local capital into a venture characterized by high risk as well as high returns.[19]

Critique

Isn't the state-centered approach just a reflection of the experiences of certain advanced developing countries that can hardly be generalized into a theoretical model? Don't we have to see the developmental state as a time and space-bound entity lacking generalizable components, or as a "wasting asset," in the sense that economic growth strengthens both capital and labor and gradually whittles away the state's freedom of action? In the realm of industrial policies, is it realistic to claim that the state can act like an omnipotent and omniscient "philosopher king" able to pick a winner among competing industries? If the state might be able to remedy market failures through active intervention, then is there any possibility for this state to commit "government failures"? All these are thorny questions that must be addressed to improve our knowledge about the genuine role of the developmental states.

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[19] In fact, there still remains one more question with regard to the success of the developmental state in promoting a domestic strategic industry such as the automobile industry: why should state intervention be necessary? In other words, why have private firms not attempted to reap oligopolistic rents by themselves? For most state-centered scholars, the answer to this question lies in market imperfections, or market failure (Wade 1990; Amsden 1989). First, imperfection in capital markets can give rise to "short-termism"-- the desire to see immediate high returns on investments. This myopia may derive from the structure of capital markets. In countries where companies are more dependent on equity than on long-term bank lending to finance major investment projects (e.g. the U.S. and U.K.), corporate managers will be under pressure from their shareholders to deliver high returns in the short term. It may also derive from the highly uncertain and risky nature of high technology R&D, and the tendency of the market to discount heavily the possibility of future profits from technological breakthroughs. Second, as Dosi, Tyson, and Zysman (1989, 17) argued, in imperfect product markets characterized by increasing returns, current market signals can be misleading indicators of future profitability. Consequently, for members of the state-centered approach, the possibility that market signals may fail to yield socially optimal outcomes for the nation is a strong justification for government intervention to target strategic industries, such as the automobile industry in Korea.

First, it must be stressed that there is no single general model of the developmental state that can be applied throughout the East Asian region. Among five typical developmental states in East Asia (Japan, Korea, Taiwan, Hong Kong, and Singapore), Singapore relied on foreign investment to a much greater extent than the other countries, exercising less direct control over private capital. Taiwan relied less on large conglomerates and more on public enterprise than did Japan and Korea. In Japan, politicians were kept at an arm's length from economic and industrial policymaking, whereas the President was personally involved in Korea and Taiwan (Haggard 1990; Smith 2000).

Secondly, most state-centered theories base their explanations on what Haggard (1994b, 270) calls the "state capacity" argument, that is the argument that the developmental states have enjoyed the advantages of competent, meritocratic bureaucracies. Nevertheless, the notion that these states are unitary, "rational actors" with an organizational coherence and policy competence began to be debunked by a number of empirical studies. Moon and Prasad (1994) pointedly argued that there have been pervasive bureaucratic infightings and turf battles within the governments of developmental states, as revealed, for instance, by the rivalry between Korea's Economic Planning Board (the top economic decision-making body) and other economic ministries.[20] Such a realistic view of the structure of the developmental state propelled T.J. Pempel (1999, 144) to emphasize the vacuous nature of the state-centered approach; he claimed that "developmental state theorists too often treat the national bureaucracy as

[20] Similar arguments have been forwarded to explain the inconsistency of Japanese industrial and financial policies by Okimoto (1989) and Samuels (1987).

totally depoliticized, socially disembodied, and in rational pursuit of a self-evident national interests."

The third critique is concerned with the omnipotence of the developmental states to choose the winner industry. Even if we concede Bhagwati's (1984) contention that an underdeveloped economy is characterized by endemic market failures,[21] another possibility that the rectification of market failures could be nullified by government failures has not been thoroughly appreciated by the state-centered theorists. This argument has two major strands, which will play a significant role in my next chapter about model building. One is the informational argument, which points out that the state may be able to collect and process all the information relevant for the correction of market failures only at costs that are greater than the benefits from such correction. The other is the theory of "rent-seeking," which argues that state intervention creates additional wastes that may more than offset the benefits it produces. Viewed from this line of argument, the state-centered theories may help us understand the active roles played by the state in economic development in the NICs, but they do not provide sufficient explanation for what makes state activism so effective in some cases, and not in

[21] In fact, neoclassical (or neoliberal) economic theorists such as Bhagawati (1988) and Krueger (1990) would concede that markets may fail seriously, warranting government intervention to offset these distortions. However, what differentiates neoclassical economic thoughts from state-centered theories is that the former deny any kind of sectoral or industry-specific industrial policy by the state because it distorts the relative price of factor which is the basis of the efficient allocation of resource. It follows that the appropriate state action would be to intervene as closely as possible at the source of market failure. Even this kind of state intervention is denied by some writers. Because of the possibility of government-induced policy errors (or government failures), Lar (1983) insists that the free working of the market is nevertheless the best means for economic growth and coordination by saying, "there are few, if any, instruments of government policy which are non-distortionary, in the sense of not inducing economic agents to behave less efficiently in some respects. . . . The best that can be expected is second best."

others. Putting it another way, it may be the effectiveness of state industrial policies in sidestepping the problems arising from government failures rather than state activism itself that most matters in the case of Korean automobile industrialization.

My final criticism is closely related to the argument above. That is, the state-centric approach employs a concept of state power as coercive-arbitrary and portrays state-society power relations as adversarial and zero sums. Many statist writers thus appear to rely on the idea of a relatively hard state that is able and willing to impose its own objectives and decisions, regardless of private opposition.[22] With this interpretation, we are only provided with either a state-led or a society (or business)-led model of economic growth, where each exponent advises the other to take either the state or capital seriously. Weiss (1998, 25), however, argues that "power-sharing arrangements involving government and industry are a feature common to all transformative states." It may be said, then, that the effectiveness of the state's industrial policy is more likely to emerge from the active cooperation by business sectors.

5. Conclusion

The major weaknesses of the existing approaches have been identified as failures to account for the internal organizational dynamics of the state, to recognize the changing role of the state in accordance with the developmental stage, and to understand the nexus of state-business as a critical variable in explaining the performance of certain industries. To make up for these shortcomings, I suggest an approach in the following chapter that

[22] For example, Skocpol (1985, 9) defines state capacity as the ability of states "to implement official goals, especially over the actual or potential opposition of powerful social groups or in the face of recalcitrant socioeconomic circumstances."

locates the political process of coalition building and the struggle among competing coalitions as central to an understanding of the workings and performance of the Korean auto industry.

As the development stage of auto manufacturing advances, there appears a new policy agenda that all major actors, including the state's policymaking agencies, political leaders, local firms, and TNCs, have profound interests in maneuvering to their advantage. The formation of coalitions among these actors is the natural outcome of this policy debate. In the formation of and the struggle between coalitions, the state is not a unitary agent but divided between ideologically incompatible segments. In addition, the shifts in the agenda of the state auto policy have a crucial impact on the character of a new winning coalition. Lastly, whether the coalition encourages rent-seeking or independent growth of an auto industry depends on the institutional structures governing state economic policymaking processes.

CHAPTER III

THEORETICAL FRAMEWORK OF THE STUDY

The central hypotheses of this study consist of two arguments: (1) the characteristics of a dominant coalition made between the state agencies and business firms have had a significant effect on the performance of the Korea's auto industry and (2) the ascendance of a specific coalition at the center of the state's economic policymaking process has been determined by the institutionalized relations between industrial and macroeconomic policymaking agencies as well as the nexus formed between the government and private firms. According to these hypotheses, this chapter is divided into two sections. In the first section, I will address the first hypothesis by clarifying the essential concepts and variables it contains. In the second section, after examining possible coalitions between the state and business firms, I will make clear the institutional context that facilitates the ascendance of specific coalitions in the industrial policymaking process.

1. Major Concepts of the Study

As delineated above, state-centered and product-cycle approaches have provided valuable insights along with critical problems. However, they share some methodological traits and theoretical orientations that pose another kind of obstacle to the study of industrial transformation. Above all, my argument is that both approaches shed insufficient light on the effects of interest, power, institutions, and ideas on state economic policy as well as on the performance of certain industries. On the one hand, both approaches seem to underplay the issue of power in explaining economic transformation. Any pattern of economic arrangement is serving a particular interest in society, having its own way of distributing power and resources across social groups. Exclusive focus on market logic or on the power and capacity of the monolithic state may obscure power relations among key actors, such as domestic firms, TNCs, and various state agencies, in the process of economic transformation. On the other hand, given the fact that the operation of a market mechanism has been always underpinned by specific non-market institutional arrangements (cf. Polanyi 1957), we must pay more attention to the degree to which the operation of markets is affected by non-market institutions, including both the structure of the state and other sorts of social relationships.

In the following, I will search for a new theoretical approach by clarifying interests of state and business actors and the types of coalitions that are possible to form between them. To a great extent, my approach is based more on the state-centered approach than on the product-cycle one because the role of the state in promoting the auto industry in Korea has been so profound and pervasive that it should be the focus of any analysis. However, the concept of the state as conceived by most state-centered scholars needs to be revised primarily because, first, it takes a reductionist view of the state, thereby obliterating the dynamics of political power struggle from the analysis, and, second, it pays little attention to the changing roles of the state, which have to vary in accordance with economic progress. Rather than viewing a developmental state like the Korean state as a monolithic entity that has a unitary purpose, well-coordinated bureaucratic agencies, and a significant degree of autonomy from social interests over time, I contend that the Korean state has consisted of several actors that have had different policy preferences throughout the period of rapid economic growth. More specifically, there have always been two trends of policy preference within the Korean state, one emphasizing free market economy and comparative advantage in industrial upgrading, the other emphasizing a self-sustained and independent growth strategy and the dynamic notion of comparative advantage. Individual economic ministries, top political leaders, and the government's research institutes have all had their own preferences for a growth strategy and struggled to promote their ideas as official policy largely through forming an alliance with those who have had the similar policy preferences. In the process, government actors have tried to obtain business cooperation and thus increased the degree of "embeddedness" of the state in the society.

Like the state's economic agencies and top policymakers who have never had a unitary policy preference with respect to the growth strategy, Korea's auto firms have also been divided among themselves, primarily on an axis similar to the one that divided state agencies. Some firms wanted to maximize short-term profits by assembling (later manufacturing) foreign models with little consideration of developing indigenous models and realizing scale economies while others deliberately attempted to seek long-term profits by first denying being the junior partner of auto TNCs and then investing in uncertain but indispensable projects that could make the firms independent international automakers. Such a division of interests among the Korean auto firms has provided fertile ground for the formation of coalitions with relevant state agencies and top policymakers. Depending on the character of broader institutional arrangements, there have appeared shifts in the dominant coalition in the auto policymaking process; the relative power of coalitional partners has changed so as to dissolve the support coalitions for past patterns of policy and to make possible the formation of more powerful coalitions in support of new patterns of policy. In the rest of this section, I will clarify the essential concepts contained in this argument about automobile industrialization in Korea. These concepts are the diverging interests among business firms as well as within the government, the changing roles of the state, and the connection between the state and business firms. The types of coalitions and institutional constraints are dealt with in section 2.

1.1 Diverging Interests among Business Firms

Auto industrialization in LDCs demands both the state and private capital to carry out enormous tasks within a short time span. They have not only to "catch up" with the internationally oligopolistic auto industry but also, once they set up the basis of self-reliant auto manufacturing, to manage to "keep up" with rapidly changing technological and marketing paradigms. This difficulty can be seen more easily by dissecting the components of auto industrialization into three dimensions: production, ownership, and market. Auto industrialization seen from the productive dimension refers to the increases in the volume of production, in the domestic content rate, and in the technological level of production. Here, we also must ask to what degree the industry has internalized manufacturing skills, including the design of an indigenous model, and whether it has achieved scale economies. The ownership dimension is related to the question of who takes charge of the company and thus can be regarded as another expression of the auto TNCs' relations with local auto firms. While technological independence from foreign automakers lays the foundation for independent auto industrialization, it may increase the cost of manufacturing and thereby have a harmful effect on the international competitiveness of the industry. Finally, the market dimension refers to how many companies operate in the domestic market. Given the limited domestic market, there might exist the optimal number of firms, over which we can find the low facility utilization ratio and thus the waste of resources. From the perspective of these three dimensions of auto industrialization, the most critical problem for LDCs is that the efforts to upgrade one dimension may have a negative impact on other dimensions. For instance, the effort to realize scale economies by increasing production is hard to pursue without being assisted by foreign TNCs in the areas of technology and management. Optimizing the number of manufacturing firms largely through the state's visible hands may not only result in unproductive rent-seeking but also reduce private initiative and consolidate the power of a few subsidiaries of auto TNCs.

The difficulty in enhancing the potential of the auto industry in all dimensions can also be highlighted by the general nature of the private firm: a search for profit by firms cannot automatically guarantee productivity-enhancing investment. Because business is in general averse to risk and transformation involves exploring unknown territory, many industries in developing nations have rarely been able to attain a degree of capability sufficient to enable them to upgrade and internalize production skills and achieve scale economies. Just as industrial transformation in advanced countries was accompanied by what Schumpeter (1987) called a "gale of creative destruction," developing countries also require no less a degree of transformative activities. However, the business norm in many developing countries is to avoid the risks involved in transformation by staying with activities into which major costs have already been sunk and for which successful routines have already been established (Hirschman 1958). Hence, many firms in the region usually construct an oligopolisitic cartel to retain stable income or flee to environments that are more developed and predictable. Under the circumstances created by such business practices, industrial upgrading would be an almost impossible task. Korea's auto industry has never been an exception to this rule.

This brief review of the character of auto industrialization in LDCs indicates that clarifying the diverging interests among major actors, which include local firms having different business outlooks, auto TNCs, and the state, should be the first task. The identification and theoretical relevance of different interests, be they material or ideological, among different social and political actors in determining state policy have been the main theme of political science.

In the field of comparative political economy, however, there have been few studies that deeply appreciate the importance of varying interests among different groups in determining economic outcome. In the neoclassical framework, the interests of both economic and political actors are assumed to be the maximization of utility, though how this utility is concretely defined within a given situation is under-theorized. Although bureaucrats are no less self-seeking than ordinary citizens, there might be diverging interests among different agencies, the origin of which has more to do with history and path-dependence than an *a priori* assumption of human nature. Likewise, the assumption that business firms seek profits seems to be meaningless unless we make clear how the specific firms define their concept of profit. As Knetter's (1989) study showed, when confronting the same predicament, which was the appreciation of currency, British firms refused to lower their price in order to protect short-term profits while German firms generally responded by reducing their prices in order to preserve market share even at the cost of lowering short-term profits. This example, although focusing only on the cross-country comparison of firms' behavior, illustrates the need to look carefully at the interests of business firms.

A group of scholars have emphasized the importance of varying interests among social and political groups as the foundation of coalition building (cf. Gourevitch 1986; Ferguson 1984; Kurth 1979). Their core argument is that producers, including business firms, are positioned so differently relative to the international and domestic economies that they will have quite different interests in policies bearing on protectionism and the stimulation of domestic demand. Ronald Rogowski (1989) developed this logic one step further by arguing that the dominant cleavages in an economy run along factoral lines and are determined by a country's resource endowment and exposure to trade. Relying on the three-factor model (land, labor, and capital) and assuming factor mobility, he concluded that abundant factors in an economy gain from trade while scarce factors lose. Consequently, the investigation of diverging interests and the coalition between these factors becomes the key for explaining the different patterns of national trade policies.

While Rogowski assumes that capital has homogenous interests and that coalitions occur between factors of production, Jeffry Frieden (1991) pointed out that such an assumption is unwarranted in a world hardly guaranteeing complete factor mobility. Frieden's argument emphasized the division of interests among capitals by arguing that the more specific or dedicated the assets, the greater the costs of policy adjustments and the greater the incentives to lobby against them. The "asset specificity" of the firms thus becomes an important variable in determining their interests and policy preferences.

The different degree of "asset specificity" between, for instance, heavy and light industries could explain their different policy preferences, particularly with regard to economic reforms such as liberalization and de-regulation. However, even in an industry that has the same "asset specificity," we can find different interests among the firms regarding state policies and corporate strategies. Korean auto firms have apparently revealed the discrepancy of their interests since the day of their establishments. Hyundai has had little concern with securing short-term profits by assembling foreign models under the technical leadership of auto TNCs since the early 1970s and has attempted to build a comprehensive auto firm with a vision of exports since the mid-1970s. In the mean time, Daewoo and Kia had long been indulged in assembling and selling foreign models and thus avoided investing in a highly risky project of building a comprehensive auto plant that could manufacture indigenously designed automobiles. These diverging interests among the Korean auto firms have not only made collective actions among them more difficult but also strengthened the need for coalitions with other social and political groups in order to induce state auto policy to favor them.[1] A little paradoxically, the impetus of rapid auto industrialization in Korea lies not in the relatively unified auto sector, in which individual firms more or less overcome the obstacles of collective actions and contend against rival industries for more state subsidies, but in the cross-secting division of interests in both the state agencies and auto firms.

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[1] The diverging interests among auto firms and thus the difficulty of collective action are institutionally indicated by the fact that an industry association among the Korean auto firms had not been present by the middle of the 1980s. By contrast, auto parts firms, which are numerous, have maintained their industry association throughout the latter half of the 20th century.

This argument contradicts many empirical investigations dealing with the performance of specific industries in certain countries. For instance, Thorp and Durand (1997) attributed the success of Columbia's coffee industry to well-coordinated and organized coffee producers demanding favorable state policies, while Biddle and Minor (1997) stressed the importance of collective action and an industry association among Turkey's textile producers in performing governmental functions, such as monitoring the use of export and investment subsidies. We cannot deny the positive impacts of well-coordinated collective actions as well as the existence of an industry-wide association in the performance of the industry concerned. This has been firmly established in the research of interest group politics. However, the absence or lack of collective actions or an industry association seems not necessarily to mean a lower degree of performance. What this study suggests is that the lack of collective action among the firms as well as the absence of an industry association could positively function in enhancing the performance of an industry if the interests of leading firms and the progressive section of state agencies coincide in pursuing auto industrialization. An analysis of Korea's auto industrialization, then, brings to the forefront the diverging interests of business firms that are located in the same sector, a subject which has been relatively neglected in current comparative political economy.

1.2 The Realistic View of the State

Even though business firms seen as capital have common interests in strong property rights, low taxation, and favorable regulation, there could be more points of conflict than those of consensus, not only between different sectors but also among the firms located in the same sector, when they are faced with a specific decision. This is also true for the state. Every modern state wants to achieve political stability as well as economic prosperity. Even the relatively malevolent states are constrained by the fact that the state is identified as the defender of "national interest" (O'Donnell 1979). Nevertheless, the conflicts of interests not only between different branches of the state (e.g. legislature, executive, and judiciary) but also within the executive branch can be said to be the rule, not an exception, not only in democratic states but also in the most highly authoritarian states, although differing in degree. The problem for our case is that such recognition of diverging interests among the constituencies of the Korean state has been persistently overshadowed by the idea of a "developmental state." The scholars who have applied this concept to the explanation of East Asian economic growth seem to assume that only when the state attains a unity of interests among its constituencies and is able to defend it against diverse social interests can the country achieve "plan-rational" economic policy. However, they seem mistaken in two respects; first, they tend to define the state too narrowly; and second, the division of policy preferences among state agencies are not necessarily detrimental to the realization of the ultimate policy goal of the state. In the following section, I will deal with these issues more in detail by clarifying the complexity of the policymaking process and changing role of the state over time.

1.2.1 The State and Policymaking Process in Korea

The classical studies of East Asian economic growth, such as the works by Johnson (1982), Wade (1990), and Amsden (1989), more or less equated the state with a unified bureaucratic apparatus.[2] Bureaucrats in East Asian countries are seen as united in purpose and as showing an unusually high degree of congruence with organizational and national goals. Such unity of purpose minimizes bureaucratic in-fighting and enhances inter-agency consensus and coordination. This view seems too mechanical, defining the state as the one that makes economic policies according to a prescribed routine and that implements them without much consideration of the friction and conflicts arising either from within the state or between the state and society.

However, Jonhson's (1987) claim that bureaucrats "rule" and politicians "reign" in the East Asian countries may have oversimplified the politics in this region. Ruling or reigning depends on leadership style, political calculation, and institutional constraints, which are constantly shifting in this region. Besides, the bureaucrats in East Asian countries are not the exception to generalized "bureaucratic politics." Bureaucratic agencies in Korea are not unitary, but reflect organizational complexities with diverse and often conflicting ideologies, preferences, and interests.[3] Inter-agency rivalries, compartmentalization, and sectionalism are the rule, not the exception, in the Korean economic bureaucracy throughout the development period. Even the highly authoritarian state in the 1970s consisted of various economic ministries that had quite different views of the ideal path of future industrial transformation. Choi (1991, 24-25) asserts that:

> The increasing demand for political control over the bureaucratic system, on the one hand, and the fragmentation of the bureaucratic structure in line with the rapid economic and social transformation of the country, on the other, had reduced significantly, if gradually, the degree of

[2] To emphasize the dominance of the executive branch of the state over politicians, Johnson (1982; 1987) argued that in East Asian countries, politicians do not "rule," but "reign."

[3] For "bureaucratic politics" in Japan, see Calder (1993), Okimoto (1989), and Samuels (1987). For the inter-agency rivalries in Taiwan, see Nobel (1987) and Wu (1991). For Korean bureaucratic politics, see Moon (1988; 1990; 1993), Cho (1992), and Kim (1991).

> centralization of economic decision-making in Korea. . . . . The complexity of economic policy problems has led the top policymaker to solicit a wider range of policy analyses and advice. Divergent institutional interests have been entrenched, intensifying competition of policy ideas. . . . characterizing the economic policy-making in Korea as "top-down" is too simplistic a view.

In addition, the power of business, particularly with respect to its potential to ruin the top executives' intention of rapid economic growth, should be reckoned with even during the initial phases of industrial growth. In Korea, as in other capitalist countries, bureaucratic agencies have not been "organizational islands," but beholden to corresponding business groups and obliged to protect their interests and solicit their support. In the authoritarian regime where political parties and legislative branches do not play proper roles of interest aggregation and representation, social constituents are likely to interact directly with bureaucratic agencies and attempt to influence policy outcomes and implementation. Throughout the whole process of economic growth, therefore, it would have been unthinkable for the Korean state to have just commanded an order while the private sector followed it with no hesitation.[4]

The view that equates the state with the national bureaucracy, then, gives rise to the relative negligence of concrete policy processes in which inter-agency rivalries and the conflict between technical rationality and political rationality becomes the rule.[5] The processes of policymaking and implementation are negotiated processes from the start, even in such highly authoritarian settings as the East Asian countries. Actors, whether

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[4] In the mean time, the state defined by neoclassical writers is also viewed as a monolithic entity, in this case acting either as a predator or an omniscient regulator of market transactions.

[5] As will be seen in the last chapter of this study, the debates that occurred around the issue of Samsung's entry in the auto market exemplify this aspect.

they came from bureaucratic agencies, from groups of political leaders, or from the chaebol, are connected through a myriad of formal and informal channels and engage in endless negotiations across various areas of concern. Many societal actors are not pacified agents of the state, and they also control resources of strategic value over which they are perpetually engaged in negotiations of reciprocal exchange with others.

As a result of this consideration, we should focus on the concrete process of policymaking that is ridden not only with "reciprocal consents" between the state and business firms but also with strains and conflicts among policy participants. Even if policy is assumed to be a product of deliberate consideration in an organization of a technically rational design, the range of policy alternatives from which the bureaucracy chooses is bound to be circumscribed by political considerations. In the real world of politics, technical rationality is bound by the political calculus. Bates (1981) argued that policy is the means through which political rulers reward the friendly, coop the neutral, and punish the hostile. Even Wade (1990, 33), who is the pioneering scholar of a state-centered approach, conceded that the "need of political survival" makes a difference in shaping economic policies. Industry-specific sectoral policies are not immune to diverse political influences. They are, like macroeconomic policies, subject to the political calculus of legitimacy building, power consolidation, and regime survival (Moon 1993; Haggard and Moon 1990). Ultimately, the focus of the study should not be confined to the questions of who gained predominance over whom with what capability, but extended to such questions as under what conditions a cooperative relationship between state and business firms develops and how actors (e.g. political leaders, economic bureaucracy, industry associations, private firms) interact with one another with the result of either successful policy coordination or policy failure.

1.2.2 The Changing Role of the State

Both neoclassical and state-centered approaches seem to be the mirror images of their counterpart because they presuppose the one-to-one and zero-sum relationship between market power and state capacity. Simply put, both approaches assume that the growing power of the market brings about the decrease in the state's capacity to lead the national economy. Yet both approaches seem to underplay one possibility, that strong market force also requires a capable state. The capable state in this case is surely different from the traditionally conceived strong, hard, and autonomous state in the East Asian region. As industrial upgrading progresses into a higher phase, for instance from the phase of “catching-up” and massive capital investment to that of innovation and “keeping-up,” the appropriate model of the capable state should be concerned more with policy flexibility and indirect support to the private sector than with top-down political direction.

The late 20th century has revealed a fundamental change in production paradigms. Piore and Sabel (1986) contended that the mass-production technologies that emerged in the 19th century limited the growth of flexible manufacturing technologies that had existed in parts of Western Europe. The profitability of mass production depends on the stabilization of markets through the formation of an ever-increasing middle class and the Fordist system of production. In their view, the present deterioration in economic performance of the industrialized world has resulted from the limits of the model of industrial development founded on mass production. The "second industrial divide," which we are now living through, Piore and Sabel contend, calls for “craft production technologies.”

Korea, as one of the developing countries, has faced more serious obstacles than those of advanced countries. While it has to catch up with advanced countries in a very short period under the rules set by the latter, it also has to cope with changing technological requirements in the course of industrialization. In the auto industry, while Korean automakers needed to acquire mass-production technologies to achieve economies of scale, they at the same time had to shift their strategies in order to cross the "second industrial divide" and become internationally competitive producers.

According to Poter (1990), there are four distinct phases of national competitive development: factor-driven, investment-driven, innovation-driven, and wealth-driven. As is well known, Korea began to grow rapidly or “take off” as it concentrated its resources on the production and export of labor-intensive products such as textiles, clothes, and consumer electronics. This is surely factor-driven industrialization. In turn, the establishment of an auto industry together with other capital-intensive heavy industries signified the movement from a factor-driven to an investment-driven industrialization.

This process could, in theory, be initiated by the private sector. Nevertheless, leaving this task only to the private sector may lead to a permanent concentration on factor-driven industrialization for two reasons. First, unless the private firms are sure about the concomitant investment by other firms in the relevant sectors, they are not likely to invest for fear of the uncertainty about inputs and outputs of production. The importance of investment coordination by the state looms large in such a context. Second, although the state can arrange the schedule of investments among domestic firms, individual firms in most developing countries lack capital resources needed to build the factories that are efficient and large enough to realize scale economies. Therefore, the state should grant subsidies and other financial incentives as a way to promote certain strategic industries.

Even after the industry is firmly set up and gains a modicum of international competitiveness, it faces more serious tasks, for instance, the task of incessantly economizing production process by incorporating new methods of production and innovation and the task of competing domestically and internationally with a new line of products. Therefore, in this process of moving beyond the investment-driven to the innovation-driven stage, private firms seem increasingly to become the prime movers.

However, we must be reminded that even at this later stage the role of the state hardly diminishes, as conceived by the writers who posit the dichotomous view of the state and market.[6] As the task of industrial transformation changes its main feature from investment to adaptation and innovation, the types of state intervention also change, for example from firm and industry-specific policy measures to such functional ones as developing new technology through state-sponsored research institutes. Although these kinds of state policy measures are relatively invisible and often bottom-up, it should not

[6] According to Okimoto (1989) and Yoffe (1993) the role of the state is likely to change in response to the shifting stages of industrial development in the same sector. Specifically, Okimoto (1989) suggests a U-shapes curve to explain the shift in state's industrial policy. At the early stage of industrial development, state intervention is likely to be intensified because of the lack of capital and marketing opportunity on the part of private firms. During the maturation stage of certain industries, the need for state intervention is greatly reduced, the role of the state being limited to the supply of a stable internal and external environment. At the stage when the industry loses its international competitiveness, the need for state intervention is again intensified, as the industry requires structural adjustment.

be seen as the demise of state activism or the capacity of the state. The strong state defined as the one capable of unilaterally imposing its will on societal actors is surely not productive at the later stage of industrial transformation. However, if we define the strong state as being able to shift its policies according to the task at hand while still holding its leadership role, the increasing initiatives held by the private sector do not automatically diminish the role of the state.[7]

1.3 The Connection between the State and Business

Both market and state-centered approaches share a pessimistic view of the institutionalized relationships between the state and business firms: "wherever capitalists organize and meet with government officials, consumers and taxpayers should hold on to their purse" (Haggard et al. 1997, 51). The central reason for such a negative view on the connection between the state and business seems to lie in the pluralistic conception of politics in general, in which policy favors are exchanged on the political market for

[7] For the sake of analytical convenience, we can suggest different types of the state in accordance with its relations with overall national economic development. First, there is likely to be the case of a leading state that makes a long-term plan for each industry, stimulates capital investment by private firms, and socializes risks through several policy measures. This type of state could be identified with Johnson's (1982) "developmental state" or Wade's (1990) "proactive state," which can "twist the arm of private firms" to make them accept the state's leadership. When the private sector grows bigger and gains financial autonomy, the role of the state becomes more indirect, and so becomes a cooperative state. At this stage, the mutual consent and cooperation between the state and private firms become the main features of state-business relations. At the final stage of industrial development, we can suggest a responsive state, which only carries out a task that is demanded by the private sector. This state plays a role of "followership," as depicted by Wade. However, it should be emphasized that these different types of states do not indicate differences in capacity. The capable state is the one that can fulfill all these tasks as demanded by the situation. Although a leading state tends to show more visible and coercive power, it may be the sign of its incapacity. In addition, even though the cooperative nature of state-business relationships is clearly magnified in the responsive state, it should be also kept in mind that the characteristics of state-business relationships are the key element for evaluating the other states.

various forms of support. Therefore, we have heard of iron-triangles, rent-seeking, policy whirlpools, subgovernment and so on as the politically inevitable but economically disastrous result of democratic pluralism.[8] This is also the case with political clientelism, which has often been blamed for economic injustice in developing countries.

When we see public officials and businessmen having a private dinner and later hear about a new economic policy that may have a significant implication for the industry these businessmen are engaged in, is it obvious that this policy will automatically hurt public welfare in the sense that it will divert public resources from more productive uses? The answer requires a more careful analysis of the policy itself. Nevertheless, one clear thing is that there is no small scope of possibility that the contact between public officials and businesspersons and the resultant state policy can enhance the overall economic welfare of a country if certain preconditions exist. Efforts to vindicate this argument with systematically collected empirical evidence covering a range of developing countries have only recently begun. Nevertheless, in the case of Japan, we have plenty of studies emphasizing the intimate and frequent contact between high-ranking policymakers and businesspersons as the source of rapid economic growth (Okimoto 1989; Samuels 1987; Calder 1993).

Given the assumption that the connection between the state and business has a dual potential, our question is directed to the conditions and mechanisms that are likely to promote economic growth. The most typical answer to this question easily found in

[8] The public choice theory is the representative variant of this tradition. Mancur Olson (1982) emphasizes the formation of a “distributional coalition” between the government and interest groups that may divert resources away from their efficient and socially optimal use. More to the point, Ann Krueger (1974; 1990) has persistently argued the inevitability of rent-seeking activities by private actors in the context of strong state activism.

current literature is that the public side of the network should be anchored in a Weberian bureaucracy. Peter Evans (1997, 66) has most forcefully advanced this argument: "depending on the internal structure of the state, similar business-government networks have different implications. When the state apparatus has the corporate coherence necessary to pursue collective goals, dense ties with the business community can become vehicles for the construction of joint public-private projects in pursuit of economic transformation."

However, this argument reveals two critical problems. First, it throws insufficient light on the organizational and ideological divide among bureaucratic agencies, each having distinct policy preferences. Second, granting the division of interests among business firms, we should also consider the private side of the network as a significant factor influencing the nature of state-business nexus. As a result, a proper analysis of the networks between the state and business should consider the divide of interests in both the state bureaucracy and business firms and look for the preconditions for economic growth or deterioration within a more dynamic context.

In this study, I assume that diverging interests in both the state and business are likely to result in a distinct coalitional pattern. The central issue that has divided the actors is whether indigenous automobile industrialization in Korea is a feasible project, considering comparative advantage and international and domestic market conditions. On the state side, economic ministries such as the Economic Planning Board and the Ministry of Finance and government research institutes such as the Korea Development Institute have persistently maintained a pessimistic view of the auto industry while the Ministry of Commerce and the Korea Industry and Economic Institute have embraced the idea of independent auto industrialization since quite early on. On the private side, as I mentioned, Hyundai was most adamant in seeking an independent strategy while the other two firms were more or less saddled in being the junior partner of auto TNCs. Within the context of differing ideas about the auto industry not only in the government but also in business firms, then, it is expected that the connection between the state and business will take different connotations, depending on the constituencies and policy orientation of the dominant coalition in industrial policymaking processes.

Emphasizing the coalition between sections of state agencies and business firms in the explanation of the pattern of Korea's auto industrialization brings to light two relatively neglected points in comparative political economy. The connection between the state and business can bring about positive results in terms of economic transformation not only because it creates a well-designed institutional structure governing state-business relationships, called "embedded autonomy" by Evans or "governed interdependence" by Weiss, but more importantly because a particular type of coalition gains the upper hand over its rivals. Consequently, we need a more micro-level oriented approach to explore the interests and power of each actor and to suggest the conditions favoring one type of coalition against others in the policymaking process.

Another point is concerned with the organizational preconditions for effective economic management. From Olson's (1965) theory of collective action to the (neo)corporatist theory of interest intermediation, it has been widely agreed among social scientists that the encompassing business organization can enhance economic performance. This proposition is based on two arguments: first, the collective action of business firms can enhance economic performance by limiting the pursuit of particularistic benefits; second, collective self-governance of business, or private-interest governance, can be equally and often more efficient and effective than direct state intervention or regulation. Against this proposition, the case of the auto industry in Korea represents a critical anomaly. Throughout the period of rapid growth in the 1970s, auto firms in Korea did not have even a rudimentary form of an industry association, not to mention the encompassing type of association covering terminal and parts sectors, which can commonly be seen in other LDCs' auto sectors.

Moreover, Olson emphasized "small number" as the most important facilitating factor in collective action because it allows for monitoring and either sanctions free riders or absorbs the costs of organization. This argument leads us to expect that final assemblers are more likely to succeed in engaging in collective action than parts manufacturers that outnumbers assemblers. However, Korea's parts sector consisting of hundreds of firms has long been able to maintain its industry association quite effectively. Nevertheless, failing to achieve collective action or to form an industry association among Korea's auto firms had not led to industrial decline and the burgeoning of "distributional coalitions" in the auto sector. Consensus does not necessarily result in progress while the advent of a maverick and conflict of interest may lead to economic success. The connection between the state and business as the critical variable in explaining industrial transformation, therefore, should be examined through a more open-ended perspective, specifically focusing on the concrete interests and power of state agencies and firms, the possibility of coalition-building between them, and the conditions circumscribing coalitional politics.

1.4 Obstacles Preventing Productive State-Business Relations

Why does coalition A enhance the performance of an industry while coalition B retards it? The answer lies in resolving the two critical problems that often lead the state and business relationships into economic decline in general and sectoral relapse in particular: information asymmetry and rent-seeking. Before scrutinizing the specific configuration of each coalition and its supporting institutions, we need to clarify what is at issue in the specific configuration of coalitions.

1.4.1 Informational Asymmetry

When the state contemplates a policy, it uses resources to collect and process information to make a decision. Even after new policy is established, it needs to do the same to monitor the compliance of lower-level bureaucrats as well as the private actors at whom the policy is targeted. In this process, informational asymmetry becomes the most significant problem, particularly between the state and the policy target entity (e.g. firms, income groups, individuals), since both the state and firms attempt to manipulate their own information strategically.[9] A good example is the existence of firms under infant-

[9] In this respect, the neoclassical perspective promotes a hands-off policy by the state in industrial transformation since the state lacks the necessary information to "pick the winners" and is hence incapable of deciding the future industrial structure of the economy. Therefore, the argument goes, the state should support a generalizable industrial policy rather than adhering to a selective industrial policy targeting particular industries. But the policy implication calling for the hands-off and functional industrial policy may not be tenable and justified. As Chang (1994, 106) notes, "the Korean state has kept very close track of priority industries through the obligatory reporting system. And, in some respects, the state may often be better informed than the private sector, as exemplified by the important role played by the information collected by Korean state agencies, including the diplomatic service, and, more importantly, KOTRA (Korean Trade Promotion Corporation), in the penetration of new export markets by Korean Firms."

industry protection that persistently fail to grow out of their infancy in many developing countries (see Bell et al., 1984).

The institutional approach, however, suggests that such an informational asymmetry can be reduced through institutional design. For example, Okimoto (1989, 156) argues that state-promoted industry associations in Japan have acted as information-transferring agents between the state and business by enhancing the willingness on the part of business to reveal necessary information. In Korea, the establishment of laws for regular reporting from targeted industries can be another example of reducing informational asymmetry through deliberate institutional design.

As a result, we can argue that informational problems are not too tremendous to be lessened or overcome, but are amenable to being kept in check, depending on the nature of state-business relationships and on the institutions that can reduce the transaction costs involved in any economic activities (cf. Williamson 1985).[10] As my empirical study reveals, the auto policies in Korea during the mid-1970s, when the neomercantilist coalition was firmly established, were formulated with frequent exchanges of information between the firms and state agencies. When the state announced the broad policy direction toward indigenous auto industrialization in 1973, it required each firm to present not only its business plan but also its analysis on the current condition and future prospect of the auto industry. Therefore, Hyundai prepared a

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[10] Chowdhury and Islam (1993, 51) sum up this point as follows: "[Williamson] identifies a generic class of market failure (i.e. the market will not be efficient in organizing transaction) . . . All transactions are characterized by either implicit or explicit contractual arrangements. There are both ex-ante and ex-post costs of negotiating, implementing and enforcing contracts. These transaction costs. . . stem from bounded rationality and opportunistic behavior. . . [thus] in the presence of pervasive transaction costs, market failure is common. The internal organization - such as a firm - may be seen as a response to market failure."

sophisticated analysis on this subject, which became the basic material for formulating a more detailed auto policy in 1974. Such a division of labor between state agencies and private firms, in which the state suggests a general policy direction and business provides industry-specific information, has functioned to reduce informational problems in Korea's auto industrialization.

1.4.2 Rent-Seeking

The theory of rent-seeking argues that state intervention incurs costs when resources are diverted into unproductive activities by private agents in order to capture rents generated by state intervention (see Tollison 1982; Buchanan et al. 1980). Rent is defined as "that part of the payment to an owner of resources over and above that which those resources could command in any alternative use" (Buchanan 1980a, 3), that is, a receipt in excess of the opportunity costs of the resources. Accordingly, the central argument of rent-seeking from the public choice perspective is that when the state intervenes to create "artificial rents" by blocking free entry, the resources spent to capture them may be worth expending from the individual point of view but are wasted from the social point of view, since they are spent in resource reallocation rather than resource creation (Buchanan 1980a, 8). It is therefore concluded that state intervention, be it good-willed or ill-willed, is doomed to generate overall inefficiency.[11]

Yet, we may find some conceptual confusion in the rent-seeking argument. First, rent-seeking costs are fundamentally transaction costs expended in the process of seeking

[11] According to this argument, import restrictions or state-imposed entry barriers are always presumed to be motivated by the rent-seeking interests of domestic producers, rather than by the more general aim of developing indigenous industries. For an excellent study on this issue, see Khan and Jomo (2000).

rents and have to be strictly differentiated from the rent itself, which is a pure transfer. Therefore, the mere existence of state-created rents - and therefore the opportunity of rent-seeking - does not mean that resources will actually be spent on rent-seeking. The realized magnitude of rent-seeking costs in a society will then depend on how state-created rents can be obtained and through which process - that is, how institutions structure rent-seeking activities. In other words, rent-seeking is only unambiguously harmful for society when it can be assumed that, as Buchanan (1980b, 356) argues, “the initial institutional creation of an opportunity for rent seeking ensures a net destruction of economic value.” As a corollary to this argument, it can also be asserted that the costs of rent seeking may well be more than offset by the dynamic gains of productivity growth that the rent allows (e.g. by enabling firms to increase R&D expenditure). In this respect, Evans (1995) makes a stronger argument, viewing rent-seeking as a necessary evil on the way to industrialization. Without some state-provided inducements to invest, local capital might neglect the potential market. He concludes that Schumpeterian rent-creation is worth the risk of liberal-style rent-seeking (Evans 1995, 247-250).

It is clear from the foregoing discussion that Amsden (1992, 14-15) seems right when she argues that "instead of viewing rent-seeking as unbounded, it seems more reasonable to argue that. . . . . a development process. . . . [can] emerge wherein rent-seeking is present, but not to the point where it miscarries industrialization." Hence, we need a perspective that can take into account the possibility that rent-seeking has not been an obstacle to, and may even have facilitated, industrial transformation.

Throughout the period of auto industrialization in Korea, the threat of rent-seeking has always been present, characterizing the earlier phase examined in my case study. From 1963 to 1967, the Korean government sought to limit the number of auto firms to one (unitarization policy). Such a state-imposed entry restriction created a huge monopoly rent for the firm selected as the single assembler and therefore provided ample opportunities for politicians, bureaucrats, and businessmen to engage in rent-seeking activities.

As long as the state maintains the policy of entry restriction, the threat of rent-seeking will not disappear, but the wastes coming from rent-seeking seem to vary according to the nature of state-business relations. In this respect, we can say that the more firmly the coalition between the state agencies and business firms is based on the consensus of upgrading and transforming the industry, the less serious the rent-seeking costs will be, primarily because the rent-seeking costs are likely to be upset by the productivity gains. Although this study will not directly deal with this issue, examining the shifts in the state's auto policies, coalitional patterns, and corrupted political exchanges over time could suggest that rent-seeking has not been so serious an obstacle to auto industrialization in Korea.

2. Institutional Factors Determining the Outcome of Coalitional Politics and the Conditions of Their Changes

In the above section, I argued that the diverging interests both within the government and between business firms lay the ground for different types of coalitions, and the result of this coalitional politics in the industrial policymaking process has a critical effect on the performance of the industry. In laying out this argument, I also emphasized how the connections between the state and business firms can facilitate or retard industrial transformation. Contrary to the pluralist argument assuming the negative effect of the close relationships between the state agencies and particular firms, the essence underpinning this argument is that they can have a positive effect,[12] depending on the type of dominant coalition. It also reveals the problems in the currently popular approach to state-business relations, for the "embedded autonomy" argument downplays the private side of relations and the collective action argument, including the corporatist theory, seems to put too much explanatory stake in an organizational unity of business sectors.

In the remaining sections of this chapter, I try to build a model to examine the shifting capacity of the Korean auto industry. Particular focus will be placed on the political processes of coalition building among relevant actors and the institutional and political factors that affect the outcome of coalitional conflicts. The most critical issue in this model is to explain under what institutional arrangements and political regime the neo-mercantilist coalition between the state agencies and business firms prevails and/or gives way to its rival coalitions.

2.1 The Types of Coalitions in Korea's Auto Industrialization

Pursuing industrial transformation entails formidable political constraints since they inflict substantial social costs and elicit intense political opposition from the affected sectors of society. This is precisely because industrialization is usually predicated on a

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[12] This argument is opposed to early works of Migdal (1988) and Skocpol (1985), since both authors looked at a state-society relationship as a zero-sum concept. In other words, for both authors, the social power of local elites signifies, almost by definition, a diminution in the power of the state. They imply that there is little scope for developing the capacity of the state and local firms simultaneously by conducting a joint project.

realignment of incentives and benefits among contending social forces.[13] Providing subsidies, controlling money supply, disciplining labor, readjusting credit allocation, closing the once liberated domestic market, and so forth produce a precarious political equation of winners and losers, politicizing the entire process of economic policymaking.

Historically, a certain type of coalition between the state and producer groups, including landowners and industrial and financial capitals, has played a critical role in transforming industrial structure. Specifically, "the alliance of iron and rye" in Germany and *Meiji* Restoration in Japan in the late 19th century have been recurrently noted as the model cases for rapid industrial transformation on the basis of changed ruling coalitions. In both cases, the state selected parts of capitalist and landed classes and formed with them exclusive policy coalitions with the aim of both maintaining conservative rule under the threat of democratic forces and catching up with more advanced imperial nations.[14] In the process, the economic order in both countries became highly "organized," and the institutions supporting them took on different characteristics from those in Anglo-Saxon nations.

To this general rule, the history of Korean auto industrialization is hardly an exception. After the landed classes were completely demobilized by successful land reform, there were no traditional conservative forces able to block state-led industrial growth in the 1960s. Capitalist classes were also relatively underdeveloped because of Japanese colonial rule from 1910 to 1945, the Korean War, and the highly corrupted

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[13] For the study of the relations between industrialization and its political repercussions, we have such excellent works as those by Barrington Moore (1977), Gerschenkron (1962) and Polanyi (1957).

[14] This point is well documented in the work by Moore (1977). For Meiji Restoration, see Pyle (1996), and for "the alliance between iron and rye," see Gerschenkron (1943).

political regime in the 1950s. Therefore, when the military junta seized power in 1961, they were able to arrest a handful of big business owners for illicit property accumulation and confiscate their property with little resistance. As the military government took economic growth as well as national security as the first national agenda, however, it needed the help of capitalist classes and thus acquitted key figures in business in exchange for the nationalization of the commercial banks owned by them.

While democratic forces, including labor and student groups, were constantly repressed throughout the 1960s and 1970s, the power of business had gradually increased, to the point that the implementation of state policy ended in failure because of implicit and explicit resistance from business firms. The divergence of interests not only between different industrial sectors but also among the firms located in the same sector began to magnify as economic development entered the stage of "take-off" in the middle of the 1960s. At every juncture of a policy shift, newer types of coalitions have appeared and provided an impetus for its further change. Devaluation hurt firms by raising the cost of imported inputs while a lower exchange rate hurt the firms that aimed at exporting their autos. Upward adjustment of interest rates hurt investors while lower interest rates hurt the banking sector. The raising of the domestic content rate hurt the interests of the final assemblers, while allowing lower domestic content rates hurt parts manufacturers, and so on.

Over the course of auto industrialization in Korea, we can discern three types of coalitions between the state and business. The first, which is called in this study the neomercantilist coalition, is basically composed of the nationalist or mercantilist section of the state economic bureaucracy and the parts of business firms that are characterized by their willingness to invest in heavy industries and their eagerness to charge into risky ventures. Of course, the nationalist section of the bureaucracy has always been represented by the Ministry of Commerce and Industry (MCI, later known as the Ministry of Trade and Industry, or MTI). During the hey days of heavy industrialization in the 1970s, however, the center of the nationalistic section of the bureaucracy moved to the Planning Office of the Heavy and Chemical Industry Promotion Committee (HCIPC), which was headed by the Presidential Second Economic Secretary.

With respect to the business firms that favor risky projects, it is hard to classify one specific firm into a particular category because it can change its business strategy with relative ease according the changes in its business environment. Nevertheless, it can be argued that the firms that have relatively weak connections with agriculture or light industries, on the one hand, and that are managed by the entrepreneurs who are highly risk-prone and select capital goods industry as the core of their business, on the other, are likely to hit the path of nationalistic and expansionist investment. Representative auto firms belonging to this type include Hyundai[15] and to a lesser degree Kia.

Within different institutional and political contexts, market-oriented policymakers and another group of industrialists could gain leadership in state's economic policymaking process. In such a situation, however, we cannot categorically say that industrial development would slow or regress. Endogenous growth theory makes the case

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[15] Clifford (1998, 113) brilliantly summed up the character of the founder of Hyundai Morots, Chung Ju-Yung, as follows:"'I shall go to Korea,' Dwight Eisenhower promised U.S. voters...Hyundai's Chung Ju-Yung was one of those who benefited most directly from the fulfillment of that campaign pledge, for he had a contract to see that the barren cemetery Eisenhower would visit had a lawn. Figuring Eisenhower would not notice, Chung cut corners by transplanting barley shoots and walked away with windfall profits. It was a characteristic gamble for Chung, a brash peasant's son who had run away from home as a teenager. By the 1970s, he had moved on to the bigger things than barley shoots - ships and cars."

that economic growth can accelerate in a liberalized market economy that lacks the visible hands of the state, largely due to learning effects and network externalities that foster learning-based improvements to productivity (cf. Romer 1991, Krugman 1990). Nevertheless, this group of policymakers, researchers, and industrialists have generally viewed the initiation of some large projects (e.g. big-push heavy industrialization in 1973, of which auto industrialization was one critical part) as economically unjustified because they would get the relative price wrong and distort resource allocation.

In fact, the second type of coalition is hard to define because its constituent members have not been fixed and their policy appeals not as coherent as those of the neomercantilist coalition. Nevertheless, it has insisted on a balanced growth strategy, the autonomy of the private sector in investment decision-making, and following the economic logic of comparative advantage. In this study, this type of coalition is called the liberal coalition primarily because of its relatively heavy reliance on the market as a coordinating mechanism. The key constituents of this coalition have been the Economic Planning Board (EPB) and to a lesser extent the Ministry of Finance (MOF), along with the business groups that have had a relatively long business tradition in such fields as textiles and food industries. The business groups that rapidly developed on the basis of the state promotion of exports in light industries in the 1960s can also be included. The other constituent members of this coalition include some international organizations such as the World Bank and IMF, which have influenced economic policymaking in Korea on the basis of their financial lendings, and general consumers, who have often suffered from higher inflation, the byproduct of big-push heavy industrialization.

These two types of coalitions suggested different strategies of auto industrialization throughout the period between the 1960s and 1990s. The neomercantilist coalition insisted on the development of an indigenous auto industry that is independent from foreign automakers in the realms of investment, product development, and marketing networks. The main strategy was to get technology licenses from foreign companies and to upgrade and internalize imported technology by the processes of "learning by doing" and imitation. The role of the state in this process was to provide subsidies to domestic firms in the form of low interest rates, tariff exemptions on imported equipment, and the protection of the domestic market by prohibiting the import of completely-built vehicles from abroad. Business firms had to economize production costs by investing in production facilities and technology acquisition, thus realizing scale economies, and penetrate into the foreign markets to overcome the constraints of a small domestic market. This coalition recognized that state-created rents could be used to enhance the growth potential of auto firms in the realms of investment and innovation, hence compensating for the inevitable costs incurred by rent-seeking, while the problems of informational asymmetry between the state and business could be greatly reduced by building up the formal and informal policy networks between the two.

The liberal coalition, in the mean time, considered this aggressive strategy of auto industrialization to do little more than cause severe distortion of resource allocation, reducing growth potential in labor-intensive industries in which Korea had comparative advantage, and bring about macroeconomic maladies such as inflation and unrealistically low interest rates. Labor-intensive light industries could provide plenty of jobs,[16] and thus its promotion was seen as eminently more sensible to the liberal coalition than the grand notion of building up an indigenous auto industry. Moreover, the liberal coalition worried that the formal and informal connections between the nationalist sections of the state bureaucracy and some local firms might either promote critical rent-seeking and "structural" corruption or result in excess productive capacity, overproduction, and finally the severe inflation that would stifle future economic growth.

Finally, we can suppose another situation in which neither a neo-mercantilist nor a liberal coalition gains an upper hand, while there is rampant rent-seeking by private capitals as well as by politicians. Under this situation, there would be no coalition between the state agencies and business firms formed to achieve any goal other than attaining state-provided privileges and rents. The connection between the state and firms would therefore be more between traditionally entrenched capitalists and politicians than between newly emerging national capitalists and the state's economic ministries. Indigenous auto industrialization is by definition out of consideration in this coalition. Getting the monopoly right to assemble automobiles and seeking other privileges such as tariff exemption on imported parts for assembly are the main concerns. A summary of these three coalitions between the state and business in the Korean auto industry is presented in table 3.1.

[16] In the early stage of industrialization, the EPB officials and the international advisers thought that heavy industrialization, including auto industrialization, was foolish because they worried about the post-Korean baby boom generation, which would be hitting the employment market in large numbers between 1975 and 1985. Unless the economy expanded rapidly enough to provide about 500,000 new jobs every year, unemployment would increase to dangerous levels. The bureaucrats in the EPB believed that the country was in a race against the demographic bomb, which could be defused only by quickly developing a labor-intensive light-manufacturing sector.

2.2 Institutional Factors Determining the Power of Coalitions

At the beginning of this chapter, I stated that coalitional politics in Korea's auto industrialization has been greatly influenced by shifts in institutional arrangements that rule the industrial policymaking process. Three institutional variables are selected as the most critical factors that determine the result of coalitional conflicts between competing coalitions as well as the characteristics of state's auto policy: (1) the insulation of industrial policymaking agencies; (2) individual firms' organizational structures and ways of financing; (3) the nexus of state agencies and business firms.

In a nutshell, we may say that <u>the more insulated the state agencies that make national auto policy are, the more the business strategy of a firm is oriented toward independence, which is in turn determined by the firm's financing and organizational structure as well as the owner's philosophy, and the more the relationships between state agencies and individual firms are predicated upon trust, credibility, and reciprocity, the more likely it is that the neo-mercantilist coalition will gain the upper hand over its rival coalition in the auto policymaking process.</u> The crux of my argument turns on the instability of these institutional structures in the sense that they are not immutable. To the degree that the core institutional variables are subject to change, the focus of the analysis must also shift toward economic and political circumstances that underpin them and toward a more dynamic analysis of institutional determination. At a minimum, a proper political analysis of Korea's auto industrialization must address the complex issue of institutional determination of power relations among relevant actors as well as political determination of institutional arrangements, particularly in periods of political and economic crisis.

Table 3.1
Coalitions and Their Policy Goals

Types of Coalitions	Major Constituents	Policy goals of Coalition
Neo-mercantilist coalition	Government side: MCI, HCIPC, and KIET Business side: Hyundai, KAICA, and KAMA Others: Construction industry and Farmers	Indigenous auto industrialization without interference from TNCs Enhancing localization rate by promoting parts sector Constructing highways and reducing tax rate in small passenger cars Import ban on finished vehicles
Liberal coalition	Government side: EPB, MOF, and KDI Business side: Daewoo (GM-Korea) and Samsung Others: International organizations, light and labor-intensive industries, TNCs, and consumers	Incremental approach to the development of an auto industry Inducement of auto TNC through equity participation and technological tie-ups Liberalization of a domestic auto market
Rent-Seeking coalition	Politicians in the governing party and auto firms in the 1960s	Monopolization of a domestic auto market by a single firm Few efforts to go beyond CKD/SKD production

2.2.1. The Standing of Industrial Policymaking Agencies

In the growth period following the military coup in 1961, the Korean state acted as a surrogate for a missing capital market while at the same time helping business firms make risky investment decisions. In this process, there appeared strong economic agencies such as the Economic Planning Board (EPB) and the Ministry of Commerce and Industry (MCI) that oversaw economic transformation. Given their roles in the credit allocation mobilized by domestic savings, their authority over foreign currency allocations for industrial purposes and licenses to import foreign technology, their ability to provide tax breaks, and their capacity to set tariff and import quotas, these state agencies were in a perfect position to direct industrial transformation in general and automobile industrialization in particular.[17]

Yet, all these policy instruments contained the seeds of information problems and unproductive rent-seeking. In this context, it has been vigorously argued by some writers that overcoming such predicaments requires technically efficient economic bureaucrats "insulated" from direct interest-based pressures from business, labor or other groups in society as well as from pork-barrel political pressures (Zysman 1983; Shapiro and Taylor 1990; Johnson 1987). Such bureaucratic insulation (not isolation) is related to the presence of a small and centralized economic bureaucracy that is endowed with well-defined authorities for certain policy areas and characterized by Weberian traits such as stable career paths and meritocratic recruitment and promotion criteria. Such institutional characteristics allow bureaucrats to develop a shared identity and purpose that facilitate unified decision making, deter corruption, and help professionalize the policy process.

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[17] For detailed studies on industrialization in Korea just after the military coup, see Cole and Lyman (1971), Jones and Sakong (1980), Song (1990) and Woo (1991).

Along this line of thinking, Biddle and Milor argue that in a bureaucracy that "approximates Weberian characteristics, the self-interests of bureaucrats is firmly anchored to institutional goals and thus not easily diverted toward private ends" (1997, 282).

To measure the degree of insulation of state agencies, many writers have claimed the usefulness of three indicators: the quality of bureaucracy represented by recruitment patterns and promotion criteria, the capacity of in-house information gathering, and the organizational map of state bureaucracy (Johnson 1982; Weiss 1998; Fields 1995). As there have been many studies stressing the first indicator, I briefly comment on the other two.

The importance of information-gathering on the part of the state, specifically when making industrial policies, has increased in proportion to the need to know "where technology is headed and where the most promising commercial opportunities lie" (Okimoto 1989, 73). To avoid informational asymmetry, every state seeks various ways to gather information. Anglo-American states, for instance, "contract out" most or a large part of their research and information requirements. By contrast, some other states, for instance Japan, Korea, and Taiwan, have tried to marshal and analyze economic information in-house. In addition, the Korean state has strengthened its informational capacity by establishing a mandatory reporting system. We can thus say that these different patterns of information gathering activities by the state are another indicator of the variance of the institutional insulation of economic agencies.

The degree of insulation can also be measured by the organizational map of the state bureaucracy. Particularly important here is the presence of the "pilot agencies" charged with the task of coordinating economic policies. In this respect, Korea's superministry, the EPB, which has experienced a dramatic history in its own right, is a good example. This agency had had broad mandates, combining planning, budgetary, and economic management functions.[18] One reason for the EPB's ability to provide such a strong coordinating role is the way it was organized. Standing outside and astride the individual ministries, the EPB during its thirty-three years of existence had no direct relationship with the private sector. Hence, we might say that, without such a pilot agency maintaining arm's length relations with the private sector, Korea's economic policy would have been as much tarnished by corrupt political exchanges and rent-seeking as those in many developing countries.

Yet, as many state-centered writers have failed to see, the Korean economic bureaucracy has never been a homogenous and conflict-free organization. In other words, although the Korean economic bureaucracy in general has had a higher degree of corporate coherence than those in other developing countries, primarily owing to its higher capacity of informational gathering and the presence of a socially detached economic ministry such as the EPB, we must admit that it could not escape normal bureaucratic politics, in which divergent economic thoughts and mutually conflicting organizational interests play a critical role. The relative negligence of intra-bureaucratic discords in the Korea's bureaucracy is, as I noted in the previous section, due to the assumption that bureaucratic consensus is better than competition among agencies in promoting economic growth. However, this assumption is weakly based on empirical

[18] For English works about the EPB, see Short (1964), Song (1962), and Jones and Sakong (1980). The EPB has also published it history. These include the EPB (1982) and Kim (1999).

reality. Policy competition between rival agencies can be as productive and growth-promoting as a thoroughly consistent policymaking procedure. In this respect, this study emphasizes intra-bureaucratic discords and policy competition among agencies as the major source of innovative policymaking. Focusing on the Korean state's auto policy, it can be pointed out that the interests of the MCI and EPB have been anything but the same and that their conflicts of interests sometimes have resulted in intense organizational strife.

When I refer to the insulation of industrial policymaking agencies, therefore, it denotes not the autonomy of state bureaucracy from social and political pressures, but to the capacity of industrial policymaking agencies such as the MCI and HCIPC to pursue their policy goals independently of other economic agencies as well as business, legislature, and public opinion. More narrowly speaking, the policy battles between the MCI, which has taken charge of industry-specific policy, and the EPB, which has administered macroeconomic policy, will be highlighted. Depending on the shifting policy agendas and the types of presidential leadership, other important economic agencies such as the Ministry of Finance, the President's Economic Secretary, and the Ministry of National Defense could be the allies with the MCI. Therefore, we need a brief overview of the organizational imperatives and predicaments of the MCI and the EPB because they represent the pillars of two different growth strategies.

The Ministry of Commerce and Industry (MCI) as the Bastion of Industrial Policies[19]

The MCI has experienced a number of reorganizations and expanded into new areas in its history. Until 1961, MCI's core bureaus were mining, electricity, energy, and trade. After the military coup in 1961, its major task became nurturing manufacturing industries and promoting exports of these industries. As the Bureaus of Mining and Energy were separated from the MCI to constitute the Ministry of Energy and Resources in 1977, the MCI became the bastion of manufacturing industries (Choi 1991).

The push toward heavy industrialization in the 1970s provided the MCI another opportunity to strengthen its relationship with industry. To promote fledgling heavy industries, such as the auto industry, the MCI tried to channel more resources into these

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[19] The MCI has experienced a number of reorganizations. Accordingly, its name has also changed several times from the "MCI" to the present name, "The Ministry of Commerce, Industry and Energy (MCIE)." However, in this study, I use the term MCI to represent the ministry in Korea that has specialized in the formation of industrial policy, no matter what its real name is at the time. Some important changes can be summarized as follows:

November 1948: Ministry established with one secretariat, six bureaus, and 25 divisions (The Secretariat, Commerce Bureau, Trade Bureau, Mining Bureau, Fisheries Bureau, Electric Bureau, and Industry Bureau).

June 1962: Established two vice-ministries (Vice-Minister of Trade and Vice-Minister of Industry. Industrial Bureau is divided into the First Industrial Bureau and the Second Industrial Bureau. Planning Coordinator is upgraded into the Office of Planning Coordination.

January 1973: Increased the number of vice-minister into five. The First Industrial Bureau was divided into chemical Industry Bureau and Textile Industry Bureau. The Second Industrial Bureau was divided into Heavy Industry Bureau and Machinery Industry Bureau.

December 1977: Branched out the energy division from the MCI and established the Ministry of Energy and Resource (MER).

July 1985: Reorganized the Office of the Industrial Policy Officer (established in 1981) as the Industrial Policy Bureau.

March 1993: Ministry of Trade and Industry merged with the Ministry of Energy and Resources to form the Ministry of Trade, Industry, and Energy (MTIE).
December 1994: Renamed Ministry of Trade and Industry (MTI) and abolished the Second Vice-Minister.

February 1998: Renamed Ministry of Commerce, Industry, and Energy (MCIE).

industries. Yet the policy instruments that the MCI possessed were limited to quantitative import control while the EPB had the instruments of budget and the distribution of foreign borrowing, on the one hand, and the MOF had its jurisdiction over tax, tariff, and other financial resources, on the other. As a result of this institutional discrepancy between organizational imperatives and available policy instruments, the autonomy of the MCI was always precarious, hence necessitating powerful allies both from industries and top political leaders.[20]

Organizationally, the key departments of the MCI have been the industrial bureaus such as the Bureaus of Machinery Industry, Textile Industry, and Chemical Industry. These industrial bureaus were therefore in a good position to build close relationships with industrial associations and big local firms and to mobilize their clientele supports when necessary. For instance, the industrial bureaus brought their industrial constituents' influence to bear on promulgating industry-specific promotion laws, which provided more privileged access to preferential policy loans, favorable tax incentives, heavier import protection, and preferential treatment in attracting foreign technology.[21]

Too intimate relationships between the industrial bureaus and individual industries, however, are likely to create the balkanization of industrial policies, organizational parochialism, and unproductive rent-seeking. To prevent these, the MCI began to strengthen the function of inter-bureau coordination in the 1980s by setting up

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[20] In this respect, the MCI is quite different from the Japanese MITI since the latter has had powerful policy instruments such as the distribution of foreign currency and the right to approve technology import. See, Johnson (1982).

[21] This resulted in the proliferation of special laws for industry promotion in the 1970s. As of 1976, there were 46 individual industry promotional laws (EPB 1982, 178).

the Bureau of Industrial Policy in 1981 as a staff organization and by vitalizing inter-ministry and public-private policy councils.

It can be inferred that the organizational insulation and policy coherence of the MCI have varied, for the main task of industrialization moved from export promotion in the 1960s to heavy industrialization in the 1970s and lastly to liberalization in the 1980s and 1990s. The key elements that have determined the insulation of the MCI are its relation with the EPB and MOF, on the one hand, and its relations with the firms and associations belonging to certain industries that have been promoted by the MCI, on the other. Another crucial factor that has had an indelible impact on the insulation of the MCI is its relationship with the President. Depending on the policy orientation of the President [i.e. President Park (1961-1979) was more oriented toward rapid industrial growth at any cost, President Chun (1980-1988) toward stabilization within the economic framework set by the President Park, and President Rho (1988-1993) and Kim (1993-1998) more toward opportunistic economic policies and liberalization], the leverage of the MCI vis-à-vis its rival ministries has increased or decreased.

<u>The Economic Planning Board as the Organ of Planning and Coordination</u>

The EPB was created in July 1961, immediately after the military coup. The rationale behind the creation of the EPB was the need to formulate and execute long-term economic planning. To strengthen the power of the EPB and thus manage the planning process rather smoothly, the new military government equipped it with the functions of setting investment priorities and allocating budget resources. In addition, the minister of the EPB automatically became the Deputy Prime Minister (DPM), who took charge of coordinating a wide range of economic policies for effective execution of an economic development plan.[22]

Although its life started as the central apparatus of economic planning, the EPB's role has changed significantly over time. Largely because its functions were to manipulate macroeconomic variables such as the level of inflation and exchange rates and because it had little contact with specific industries, its role changed from promoting higher economic growth in the earlier periods to that of laying the groundwork for stable but sustained economic growth in later periods. In terms of industrial policy, the EPB's policy changed from acknowledging the usefulness of industry-specific policy to questioning its harmful effect on efficient resource allocation. Particularly after the 1970s, the EPB tended to deny the positive role of an industry-specific policy and advocated functional and cross-industry measures, such as upgrading human capital through educational investment. At the same time, the EPB gradually became the promoter of liberalization and privatization measures.

In line with the change of its organizational mandates, the EPB also instituted significant organizational changes. For instance, after it began to embrace economic liberalism in the 1970s, the EPB sought structural industrial adjustment by creating the Industrial Policy Deliberation Council (IPDC) and the Office of Fair Trade in the early 1980s. With this organizational consolidation, the EPB, particularly after 1980, tried to change the direction of industrial strategy from the selective growth of some strategic industries (a so-called unbalanced growth strategy) to the market-oriented balanced

[22] Other economic ministers were required to have prior consultation with the DPM when they wanted to initiate major policy proposals. This mandatory consultation, however, seems to have increased the potential of inter-ministerial conflicts between the EPB and other ministers in pursuit of economic leadership.

strategy. Such a shift in policy direction contained the seed of inter-ministerial conflicts as well as the resistance from the local businesses that had been promoted by previous state policies.

2.2.2. The Characteristics of Business Firms

Even the highly autonomous developmental state could not alone have been able to achieve rapid economic growth without the dynamism of the private sector, because investment decisions, together with other economic functions, are made almost exclusively by private capital. Having noticed this problem, several political economists, including Evans (1995), Doner (1992), Weiss (1998), have emphasized that a state needs to cultivate the support of business if its developmental goals are to be achieved. For instance, Doner (1992, 431) argues that "development requires the consent, indeed the active participation of diverse economic actors. State domination does not necessarily translate into national power. The latter is above all a function of active cooperation among capable groups rather than domination." Similarly, Evans (1995) notes that an effective developmental state is characterized by external linkages, which facilitate state capacity, and internal coherence, which preserves state autonomy. The distinct feature of Evans' argument is that development requires state autonomy and its embeddedness to go hand in hand. Put another way, in a state lacking a strong bureaucracy, external linkages are predicted to result in corruption and the capture of the state by vested interests. On the other hand, insulating an ineffective state might simply facilitate its evolution into a predatory state similar to Mobutu's Zaire.

This study fully endorses these arguments, with one significant exception. Most existing works on state-business relations in the East Asian context still place the analytical priority on the roles of the state, arguing that the power of the state at first determines the degree of its embeddedness in business, not *vice versa*.[23] In doing so, they implicitly or explicitly take it for granted that enhancing the power of business in developing countries will erode the autonomy of the state, thereby reducing the overall capacity of the state (cf. Weiss 1998). As a result, these works argue, maybe unwittingly, that the state can have unsurpassed capacity only while business remains in a relatively dependent-subordinate relationship with the state. In this way, current works on state-business relations seem to fail to go beyond the statist framework by regarding state power as a "wasting asset." As Evans (1995, 229) puts it, a developmental state calls forth its own gravediggers.

However, given the cleavages of interest in both the state agencies and business firms, the different types of corporate financing, and shifting power resources available to them, it seems hard to accept Wade's argument on leadership and followership between the state and business in Korea without some revisions. First, the ostensibly strong state might not be as strong as it appears. According to an old saying, "If you owe the bank a little money, the bank owns you. If you owe the bank a lot of money, the bank owns you." This means in our context that if industrialization has been carried through business firms that mobilize their capital resources largely through bank loans (rather than through capital markets), the voice of these firms can not be easily muted since the health of these firms determined the financial institutions and ultimately the general economic condition

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[23] This insight is greatly indebted to the works of Weiss. See Weiss (1998) and Weiss and Hobson (1995).

of the country. Moreover, private firms can enhance their leverage *vis-à-vis* the state by drawing upon foreign loans, playing different ministries against each other, and, as a final means, refusing loan repayment. The last case actually happened in Korea in the early 1970s, and, worrying about the stability of the national economy, the Korean state could not but freeze private nonbank (curb market) loans owed by most large firms. Korea's auto firms also greatly benefited from this extraordinary measure since they had the highest debt/equity ratio of the world's auto firms.

When there exist a relatively autonomous and resourceful state and firms that seek corporate expansion by relying on "state-administered banking institutions," we usually can discern the presence of a bilateral monopoly or oligopoly in the market. A bilateral monopoly is more productive in raising overall social welfare than a unilateral monopoly because the former can easily overcome the problem of collective action and reduce transaction costs to a significant degree. So too can the relations between a strong state and strong business, as they facilitate the desire to increase the economic pie beforehand (Amsden 1997). In political terms, such a balance of power creates the "mutual hostage" situation. In this situation, both the state and business are powerful enough to harm the other, but neither can gain the upper hand. Cooperation to achieve a common goal may be the most rational choice for each to make.

The strength of business can also be measured by its organizational structure. Leff (1978) has argued that in developing countries firms merge and affiliate in order to gain greater leverage vis-à-vis a threatening state. However, in Korea, concentration (large firm size) and conglomeration (multisectoral diversification) of firms and the consequent birth of the chaebol as the main business actor have been attributed more to the state's industrial policy, formulated in the belief that such concentration is required to achieve international competitiveness. No matter what the real cause of business concentration in Korea was, the existence of an economic structure dominated by a handful of diversified business groups carries a significant implication for industrial transformation and the type of coalition that can dominate in industrial policymaking. The first implication of concentration is the power that large firms are likely to wield from their sheer weight in aggregate economic activity. So, when Hyundai kept in contact with top policymakers in both the MCI and the Blue House to build a comprehensive auto plant during the mid 1970s, it was able to draw upon its other business branches, such as shipbuilding and overseas construction, as a means of strengthening its commitment to developing an indigenous auto industry. For the perspective of policymakers, a firm that had plenty of experience setting up factories in other related industries would be more ideal partner in launching a new risky venture than those firms concentrating on a single industry.

Nevertheless, concentration of firms could have another implication that destabilizes the specific coalition formed between state agencies and firms, particularly after the industry solidify its footing. Multisectoral conglomerates in Japan and Korea, in fact, have promoted rather than retarded competition. According to Amsden (1989, 130), the chaebol in Korea has had an interest in competition because of a desire to maintain overall parity with other chaebol. A large chaebol can consider entry even into activities where technological or financial barriers to entry are high, because it wants to avail itself of what Alfred Chandler (1990) calls “economies of scale and scope.” Hence, when the auto industry begins to be viewed as profitable and the auto firms, which are member companies of the chaebol, grow bigger and powerful, there is more likely to be an attempt by the competing chaebol to enter the auto industry and thereby destabilize the existing state-business coalition.

So, when there exist business firms pursuing an expansionist strategy (e.g. investing in building a factory for manufacturing indigenously designed autos) on the basis of financing though domestic and foreign borrowings rather than through utilizing either capital markets or financial assistance from auto TNCs, we can expect that these firms are more likely to form an alliance with state's industrial policymaking agencies. In the early stages of auto industrialization, this tendency may be more apparent when the firms belong to multisectoral conglomerates. Hence, what is critical to industrial transformation as well as the formation of a growth-oriented neomercantilist coalition in Korea's auto industry is the existence of business firms that dare, along with insulated policymaking agencies, to invest in a risky project through a specific financial system and organizational structure.

2.2.3 The Characteristic of the Linkage between the State and Business

In the above sections, I have argued that specific characteristics of the economic bureaucracy and firms have a significant implication for the power relations between competing coalitions. However, another important factor that seems to be left out is one that links the effects of the two ostensibly separate variables. Given abundant chances to use their strength strategically and thus bring about sub-optimal outcomes in their interactions, there need to be some "domestic linkages" that connect state agencies and firms in their collective endeavors. These include an array of institutional ties, policy networks, deliberative councils, and the like, all of which link the government and industry in the information-sharing and policymaking process. The functions of these linkages are to allow information to pass rapidly among bureaucrats and businesspersons, to encourage business input in policy discussions, and to generate consensus about policy direction.

When state agencies target certain industries and begin to contact the firms in these industries to achieve their policy goals, there appear many problems that jeopardize their collective endeavors, which can be expressed in terms of costs: information costs, monitoring costs, uncertainty costs, and rent-seeking costs. In order to reduce these costs as well as to strengthen their coalition vis-à-vis other rival coalitions, close communicative relations between state agencies and firms, such as credibility and reciprocity, are required. The need for reciprocity is amplified when economic growth is predicated on the provision of state subsidies (e.g. low interest rates, tariff exemption, and entry control) and the observance on the part of firms of the conditions for receiving subsidies. Amsden (1989) noted that such reciprocity is premised on state capacity to monitor firms and to punish their noncompliance, on the one hand, and business firms' willingness to provide information and abide by sanctions, on the other. So she concluded that reciprocity has meaning only when "in direct exchange for subsidies, the state exacts certain performance standards from firms" (Amsden 1889, 146). Accordingly, this reciprocity between the state and business is strengthened when performance targets are clear and measurable enough to reduce opportunities to manipulate information and the government has the ability to discipline or punish subsidy abusers. Viewed from this perspective, it was not a mere coincidence between the ascendance of a neo-mercantilist coalition in the first half of the 1970s in Korea on the one hand and the formation of a highly authoritarian political regime that had enhanced disciplining power and the establishment of more specified, realistic, and numerically calculable policy goals as the conditions for receiving state subsidies on the other.

Even when the state promises to provide subsidies, capitalists will not invest unless they have a modicum of thrust in the government's long-term commitments to their shared objectives. This may be a problem of the credibility of government policy. Because the government in general has much discretion in making and changing policies, the private firms that follow the government's direction are always in an unstable position. In such a situation, we cannot expect the emergence of a strong coalition between the state and firms. The general factors used to measure credibility include the type of policy, the informational exchange, the relative status of policymaking agencies within the government, and the degree of institutionalization of the policymaking process. However, in a relatively underdeveloped political condition, such as Korea's during the 1960s and 1970s, the most critical factor in determining government credibility are rather the policy goals of the regime itself, the possibility of regime change, and the informal relations between political leaders and business leaders. As long as the regime proclaims a certain long-term goal, the possibility of regime change is relatively slim, and the leaders in both the state and business are able to communicate with each other with relative ease, credibility in government policy is likely to increase. This increased credibility is likely to strengthen a specific coalition between specific firms and state agencies.

Finally, I would argue that the role of political leaders, particularly the President, should not be exaggerated in determining the nature of the relations between the state and business in Korea. The roles of President Park Chung-Hee in occasioning Korea's rapid economic growth in general and auto industrialization in particular were broadly recognized not only in academic works but also in journalistic ones.[24] However, the Presidents in Korea have not been able to exact voluntary compliance from business through their own power and will. Even a strong and hard-willed President like Park attempted to induce local firms to develop manufacturing capability in auto production by using various policy instruments in the 1960s, but to no avail. Only when he proclaimed a grand vision of economic development with the establishment of a dictatorial regime in the early 1970s did business firms begin to trust in the commitment of the government to indigenous auto industrialization and invest in a risky project by forming a coalition with neo-mercantilist sections of state managers. Hence, we may say that the role of the top political leaders must be seen in the context of strengthening the nexus between the government and business by increasing the credibility of state's long-term goal of auto industrialization. Put another way, when there are a close and institutionalized relations between the firms and state agencies on the basis of reciprocity and credibility, the formation and ascendance of a neo-mercantilist coalition are more probable, and this is evidenced by its resurgence without strong political leadership in the latter half of the 1980s.

2.3 The Conditions of Institutional Changes

The ideal explanation of the changes in state industrial policy as well as their impacts on the development of certain industries requires the examination not only of the

[24] For typical works belonging to the former category, see Cho, In-Won (1998) and Cole and Lynman (1971). For the latter category, see Clifford (1994).

institutional arrangements determining the outcome of coalitional politics but also of the conditions leading to the change in institutions themselves. Every country has specific institutions of economic policymaking, and they play a critical role in determining the contents of economic policy adopted by the states. Whether they are the products of conscious design or the evolutionary results of processes of human interaction, the significance of institutions has been acknowledged to be in their ever-lasting existence and long-term effects. Put another way, policymaking institutions not only constrain the behaviors of policy participants in a specific time, but also influence the future course of policy development through so-called "institutional consolidation" (Goldstein 1993, 3; Goldstein and Keohane 1993, 11-12; Hall 1989, 361).

However, policymaking institutions in LDCs are not as solidly and profoundly consolidated as those found in advanced nations, in part because such critical institutions as the nation state and capitalist market system have been imposed from the outside and thus lacked a socio-economic foundation, expressed usually in such phrase as the class base of social power supporting specific institutions. To explain the relatively frequent changes in policymaking institutions in LDCs, political scientists have suggested three theoretical perspectives, which I classify as the honeymoon theory, external pressure theory, and economic crisis theory. In the rest of this section, I provide a brief overview of these theories and examine what theory best explains the changes in policymaking institutions in Korea.

2.3.1 Three Perspectives

The honeymoon theory highlights the importance of regime change in explaining the reform of policymaking institutions. Most of the governments in LDCs, including both the democratic and authoritarian ones, have a hard time carrying out structural reforms in the normal period because they may have a destabilizing effect on current political rule. In the mean time, policy reformers have a greater degree of policy autonomy immediately after a new regime replaces an old one (Williamson and Haggard 1994, 571). Moreover, structural reforms aiming at the redistribution of power within the government and between the state and business are more likely to be adopted when there is an unanticipated regime change, especially because the factions opposed to the reform are in serious confusion as a result of power transition (Haggard and Kaufman 1992, 30-31; Nelson 1990, 23-24).

The external pressure theory argues that the reform of policymaking institutions and policy itself can be explained by examining the political pressures exerted by international organizations and creditor countries' governments. The unequal power relations between creditor and debtor countries as well as the possible economic constraints on debtor countries make policymaking institutions in debtor countries extremely vulnerable to external pressures. In reality, the spread of neoliberal economic reform among the highly debt-stricken developing countries during the 1980s is said to exemplify the pressures of liberal international organizations such as the IMF or World Bank (Grindle and Thomas 1991, 102-103; Haggard and Kaufman 1992, 9-11).

According to the crisis theory, institutional reforms and policy changes are brought about as a response to crisis. Economic and political crises are seen as having a significant effect on the traditional way of policymaking, largely through demolishing groups opposed to the policy reform and exerting pressures upon politicians to change failed policies. Despite the ambiguity of the concept of crisis, this theory has a great degree of empirical relevance, particularly when we look into the impact of social-economic crisis on subsequent changes in policymaking institutions in many LDCs during the 1980s. The economic turmoil that occurred in many Latin American countries during the early 1980s facilitated the collapse of the military governments in Brazil and Argentina and laid the ground for the shift in power both in the government agencies and between the state and business in Mexico (Kaufman 1990, 108-9). In theory, crisis itself is not a sufficient condition for institutional reform to happen. However, it plays the most important role in initiating reform efforts among political actors and provides a good opportunity for their views to spread across the broad spectrum of policy participants. In the end, crisis brings about intense policy debates within the government, thereby making necessary the rearrangement of policymaking institutions. All these processes may be either accompanied by a change in the regime or carried through by the current government as we can see in Indonesia in 1982 (Williamson and Haggard 1994, 562-65).

2.3.2 The Case of Korea

Throughout its period of economic development, Korea has witnessed several changes in policymaking institutions. Of special importance among them are the changes made in the early 1970s, around 1980, and in the mid-1990s. The first case, which occurred with the initiation of heavy industrialization in 1973, had nothing to do with the honeymoon effect. The institutional consolidation of liberal and stability-oriented economic policy in the early 1980s can be seen as the work of a newly formed government in 1980. However, as will be brought to light by my empirical study, the shift in policymaking institutions in the early 1980s was actually initiated in the late 1970s. In April 1979, President Park Chung-Hee conceded the formulation of the Comprehensive Measures for Economic Stabilization (CMES), which would be the master plan for institutional reforms in the 1980s, in response to increasing inflation and overinvestment in some heavy industries. The relevance of the honeymoon theory is generally acknowledged in the institutional reforms during the mid-1990s because they were pursued intensely at the early period of the President Kim Young-Sam's government. Even in this case, however, we may say that the changes in policymaking institutions were not the result of the deliberate efforts of the policy reformers in the new government, but a belated response to the trend of globalization as well as democratization in national economic management.

The relations between institutional changes and external pressures in Korea have not been as profound and direct as can be seen in cases where international organizations have led structural reform programs. The shift in policymaking institutions in the early 1970s was even against the recommendations of international financial organizations and creditor countries. The influences of external forces were more obvious in the early 1980s, when the IMF provided about $ 0.5 billion worth of structural loans. However, these loans aimed at addressing the short-term balance of payment problems and thus had relatively generous conditions required for the recipient country to abide by. When Korea achieved a large amount of trade surplus against the U.S. during the latter half of the 1980s, the pressures to open the market and liberalize economic structure, particularly from the U.S. government, were intensified. Nevertheless, such pressures in themselves were not strong enough to initiate overall changes in policymaking institutions, although they were one important factor facilitating the ongoing process of policy and institutional reforms.

The crisis theory seems to explain the changes in policymaking institutions and policy reforms in Korea better than the other two approaches. The ascendance of the MCI and the formation of symbiotic relations between the state and business in industrial policymaking processes in the early 1970s followed a severe economic crisis, the resolution of which required an extraordinary policy measure that negated the principle of private property by freezing the loans incurred by private firms at the curb market. Likewise, the EPB's regaining of policymaking power and the appearance of adversarial relations between the state and big businesses because of stabilization and anti-monopoly policies were largely occasioned by the economic crisis of 1980, which produced a negative growth rate for the first time since Korea had begun the process of economic development. Several institutional reforms during the 1990s, however, were not initiated as a response to a life-threatening crisis like those of the previous decades. Nevertheless, the Korean economy was viewed as being on the threshold of crisis, primarily because of the decreasing international competitiveness of major industries and the belated liberalization policy.

It is beyond the purpose of this study to explore completely the causes of the changes in the institutional arrangements of industrial policymaking in Korea. The above three theories all have an important theoretical implication and empirical relevance when we address the question of institutional changes in LDCs and even in Korea.

Nevertheless, the crisis theory has more explanatory power, particularly in the case of Korea, and other scholars such as Haggard, Kaufman, Williamson and Moon also highlight crisis as the main factor causing institutional changes in Korea. Therefore, I put relatively heavy emphasis on the crisis factor when I trace the origin of the changes in policymaking institutions in Korea. Although considered to have a secondary importance, the other two factors, regime change and international pressure, are also seen as having a critical effect on institutional changes, especially when they are combined with the crisis factor.

3. Analytical Model

In the above sections, I have argued that the performance of the Korean auto industry varies according to the type of dominant coalition made between the state and business firms in the state's industrial policymaking process. It is also argued that three institutional factors have a significant bearing on deciding which coalition will prevail. The last thing that should be kept in mind is that these institutional factors shift as a result of political and economic crises. These shifts in turn occasion an increase in the opportunities of competing coalitions to redirect the pattern of auto industrialization in their own liking, thereby increasing or decreasing development potential of the industry. This whole process is illustrated in figure 2.

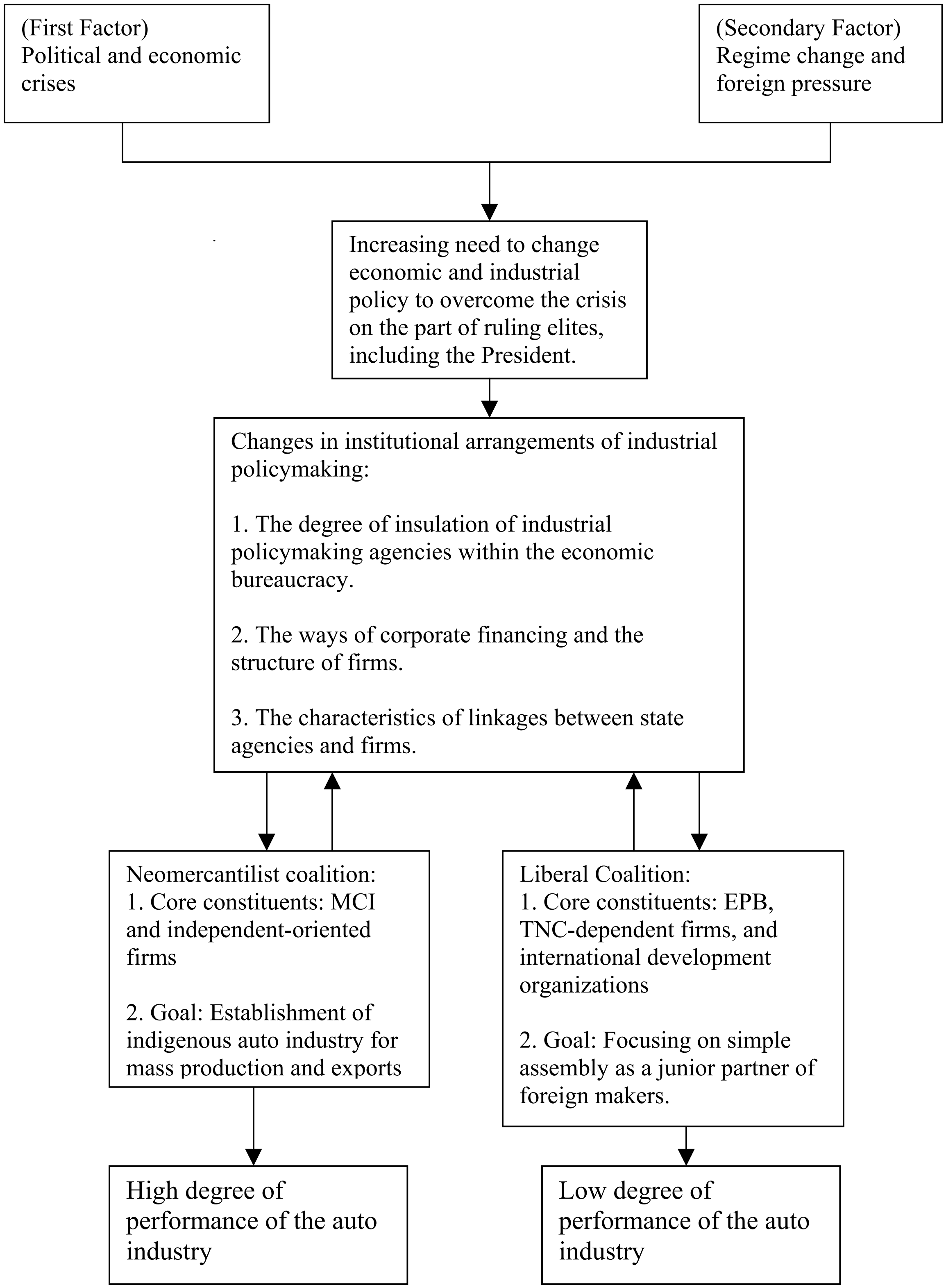

Figure 2: Coalitions and Performance of the Korean Auto Industry

CHAPTER IV

PRE-1970S: SETTING THE STAGE

The South Korean automobile industry, in any meaningful sense, began in the mid-1970s with the mass production of an indigenous model. Before that time, the auto industry in Korea had been almost at the same level as those in other developing countries, focusing exclusively on simple assembly of the imported complete-knock-down (CKD) or semi-knock-down (SKD) kits from advanced automakers. With the strong push by the state in the name of heavy-chemical industrialization (HCI) from 1973, however, the Korean auto industry began to take a different path of auto industrialization from that of other late industrializers, the essence of which may be summarized as the development of an original model, the pursuit of scale economies by establishing plants that had no less production capacity than those found in advanced countries, and the concentration on exports to overcome a small domestic market and realize scale economies. Explaining such a radical shift in state policy and business strategy will be the main theme of the next chapter. In this chapter, I address the pre-1970s history of the Korean auto industry, particularly focusing on the question of how peculiar state-business relations before 1970s gave rise to the stagnant auto industry in Korea.

The pre-1970 auto policies in Korea generally revealed characteristics normally seen in most less developed countries: lack of insulation of industrial policymaking agencies, underdeveloped domestic capitals, and state-business relationships characterized by personalized, multifaceted, and unequal exchanges. As a result of these institutional traits, there had not yet appeared the growth-oriented collaboration between the state and business that would have laid the basis for the expanded accumulation of capital and technology in the auto sector. Under this circumstance, the auto industry became important only as a main source of rent-seeking activities. Both the business and state agencies concentrated on rent-seeking activities from the short-lived SKD or CKD assembly operations. The state artificially erected entry barriers in the auto sector for the purpose of amassing political funds from the permitted auto assemblers, while the private industrialists did nothing more than obtain the monopoly rights to assemble vehicles without paying earnest attention to the development of indigenous manufacturing capacity. In this context, the development of an indigenous auto industry could not be a policy agenda of the state, nor could the genuine purpose of SKD assemblers be to manufacture automobiles in the future. The history of state-business relations in the Korean auto industry up the late 1960s is now in order.

1. Background of the Korean Auto Industry

1.1 Colonial Period

There existed no auto industry in Korea during the Japanese colonial rule (1910-1945) in the sense of producing auto vehicles either by assembling imported parts or by manufacturing imported models. After the outbreak of the Sino-Japanese war in 1931, the Japanese Governor of Korea announced the promotion of a machinery industry in Korea. But this policy was not aimed at developing a machine industry *per se*, but facilitating the supply of military goods from Korea to the Manchurian area.

The auto industry in Japan before 1935 had also been in the infant stage, with two American automakers (GM and Ford) capturing an almost 90 percent market share (Cusamono 1985, 16-17). In 1936, startled by the American companies' success and worried about the relative decline of the domestic auto industry, the Japanese Diet passed the Automobile Manufacturing Law to prohibit foreign ownership in the auto industry and to prohibit Japanese companies from entering into joint venture with foreign firms. By 1939, the entire Japanese auto industry was taken over by such firms as Nissan, Toyota, and *Jidosha Kogyo* (now Mazda). So only after 1939 did Japanese automakers begin to subcontract with small auto parts companies and set dealer networks in Korea to meet the increasing demand of military vehicles. However, all the auto firms established in Korea during the first half of the 1940s had primitive production facilities and were owned by the Japanese. The only area where the Koreans were allowed to enter was the auto service industry. Among these Korean industrialists was Mr. Chung Ju-Yung, the former chairman of the Hyundai Chaebol (KAICA 1983, 101-104).

In sum, the influence of the colonial period on the subsequent development of the Korean auto industry was almost negligible with regard to the accumulation of industrial capital and the development of productive capability.[1] However, it should be emphasized that although capital accumulation and technological learning were not advanced during the colonial period, this period gave birth to and cultivated the essential personnel who played crucial roles in Korean auto industrialization in the postindependence period.

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[1] There are some scholars who emphasize the legacy of the colonial rule in the development of Korean economy. See Kohli (1999), Cumings (1984), and Eckert (1991). Specifically for the auto industry, Woo (1991, 143) emphasizes the colonial legacy, saying "Japan had bequeathed to Korean the essential know-how for parts manufacturing." But it seems that Woo's assertion is a bit exaggerated since the auto parts that were made in colonial Korea were such basic parts as springs and bearings.

1.2 Auto Industry in the 1950s

After Japanese colonial rule ended in 1945, industrial development in Korea up to the early 1960s was largely limited to the import substitution of basic consumer goods such as sugar, flour, and paper. The most important source of capital accumulation was foreign aid.[2] Reconstruction and rehabilitation following the Korean War were financed with foreign aid of various forms. When aid was allocated for specific projects, political favoritism was the fundamental source of early accumulation.

Concerning the relations between the state and business, this period represented the prototype of a “predatory state” and a “rent-seeking society.” The state did not have any vision of national economic growth, but only focused on increasing its extractive power by manipulating its monopoly of key resources. To use Michael Mann’s (1986) words, the peculiar strength of the Korean state in the 1950s resided more in its authoritarian and arbitrary use of power (“despotic power”) of the state than any use of “infrastructural power” – the capacity to mobilize resources for developmental ends. Corresponding to this nature of the state, a considerable amount of business energy was used to extract favorable concessions from the government in return for providing various forms of bribery to politicians and government officials. These concessions took the form of import rights, allocation of foreign currency at favorable rates, and procurement of government properties that had been expropriated from the Japanese.

[2] In 1957, for instance, the US provided 1.2 million dollars as an aid for purchasing auto parts (KAICA 1983, 109-110).

Hence, close and often corrupt relationships between some large industrialists and state managers grew apace as some powerful government bureaucrats and politicians were courted by businessmen in order to gain more favors and subsidies. Although the seeds for the development of the Korean type of business structure, which is often called the chaebol, were laid down in this period, most business firms benefited enormously from monopolistic, or at least oligopolistic, market positions (Ryu 1990, 16-19).

In this circumstance, the Korean auto industry hardly had any chance to develop the capacity to manufacture auto vehicles. The state did not have any long-term vision to promote an auto industry, while large private firms concentrated only on some consumer goods industries, which could make easy profits.[3] The only way to learn something about making automobiles was through meeting the U.S. army's demand for auto repairs and procurement of simple auto parts. From the early 1950s, some workers who had worked for Japanese-owned auto parts firms started manufacturing some automobile parts for the U.S. military, such as piston rings and pins, gaskets, springs, bolts and nuts, and brake linings. As of 1957, Korean companies provided 124 different auto parts to the U.S. Army (Kim and Lee, 1983, 288). In this way, the US Army taught some necessary technical know-how to the Korean workers.

The first complete car, called *Sibal* (or "Starting" in Korean), was manufactured in September 1955 by a small firm. But this car was nothing more than a jeep type vehicle using a rebuilt 4-cylinder engine and transmission from second-hand US military

[3] The local capital's evasion of an auto industry was also occasioned by the character of U.S. aid. In the ICA aid, which amounted to 67 percent of the total aids between 1945-1960, the aid for manufacturing industries was only 4 percent. This was also the case with the UN aid (UNKRA). In this aid, only 5 percent went to the automobile related industries, such as tire-making and steel (Ryu 1990, 18).

vehicles, with a locally-produced cylinder head and body that was handmade out of steel drums (MCI 1988, 33). The primitiveness of the Korean auto industry was also indicated by the short-lived fate of the *Sibal* Automobile Co., which closed its operation in 1962, having produced only about 3,000 units during its entire life span, primarily because of the advent of a modern assembly plant in 1962.

The underdeveloped condition of local capital in the auto sector was even worsened by state policy, which generally regarded automobiles as luxury goods consuming oil that should be wholly imported. To dampen the demand for automobiles, on May 8, 1956, the government announced the “May 8th Line” (the date of announcement): it would not permit the registration of a new vehicle unless the old vehicle in use was put to junk. With this legislation, the increase ratio of new auto registration, year to year, dropped substantially: 18,356 units in 1955, 25,328 in 1956, 28,086 in 1957, and 28,933 in 1958 (KAICA 1983, 112). The purpose of this legislation was to prevent the unnecessary consumption of fuel from the increased use of automobiles. No matter what the direct purpose of the government in issuing such a policy was, the reduction the already small size of the domestic auto market destroyed many auto parts manufacturers.

In brief, the Korean automobile industry during the 1950s provided little to make later auto industrialization easier. From the perspective of the government, the automobile and auto parts industries simply did not deserve to be the main sector having the potential to drive overall economic growth, considering the level of industrialization and the industrial structure of the Korean economy at that time.

Despite the lack of a long-term perspective among policymakers and the inability of local capital to accumulate capital and technology through the 'learning by doing process,' we may still point out one crucial unanticipated contribution of state policy; the restriction of domestic market size with its "May 8th Line" both prevented the proliferation of small-sized domestic automakers and retarded the intrusion of foreign automakers into a potentially growing domestic market. This is sharply contrasted with the experiences of Latin American auto industrialization in general. In Latin American countries, specifically Brazil and Mexico, the large market size coupled with state policies that promoted auto consumption had allowed, from the early stage of auto industrialization, many small domestic firms to assemble imported SKD/CKD kits with little consideration of scale economies and technological autonomy (Kornish and Mericle 1984, Jenkins 1987). It is widely acknowledged that the proliferation of small-sized domestic firms was the crucial factor constantly frustrating the state's efforts to rationalize the auto sector in this region. Moreover, the accelerated intrusion of foreign automakers, particularly during the 1950s and 1960s, made small-sized domestic firms unable to compete against them, thereby laying the ground for the "denationalization" process of the auto industry in Latin America.

2. Auto Industry in the 1960s

After General Park Chung-Hee took power in 1961 through a military coup, he made national economic growth the primary goal of a military government. Although some scholars have seen his slogan of the reconstruction of the country through rapid economic growth as an instrument or a façade to compensate for his lack of political legitimacy, there was much evidence that his exclusive obsession with national economic growth was real and derived from his political philosophy.[4] The best and shortest way to reach such a goal for President Park was to redirect the developmental strategy toward export-oriented industrialization (EOI).[5]

Park was also captivated by big, capital-intensive projects that would allow the country to become economically more self-sufficient. To realize his ambition, Park relied on economic planning that had been utilized by the Soviet Unions as well as by war time Japan. In fact, Park had earlier been exposed to state planning in *Manchukuo*, where he served as a Japanese army official.[6] In any case, Park had a familiar model for Korea to follow in war time Japan, and this militarized model left an indelible mark on the path of Korean economic development that remains even today. As a result of his preference for capital-intensive industries even at the early stage of economic development, the auto industry became the major concern of state's economic policymakers.

The 1960s were the starting point of establishing and consolidating a state-led growth strategy, as the state took hold of various policy instruments that facilitated state

[4] The core of this philosophy can be summarized as follows: only an economically rich and independent country can produce strong military forces, upon which a nation can participate and make a meaningful voice in the international society, thereby completing the task of national liberalization from the interference of surrounding superpowers as well as from the threat of North Korea. For details of his political philosophy, see Park (1970).

[5] For a good account of the shift in developmental strategies from ISI to EOI in this period, see Haggard (1990), pp. 51-75.

[6] Clifford (1998, 47) seems to catch the essence of Park's economic strategy when he argues that "his training as a Japanese cadet and his experience in managing logistics in Pusan gave him the confidence and organizational abilities to manage a small, primitive economy like Korea's. His experience in Manchukuo allowed him to see how the state could direct economic growth, and how government needed the cooperation of private businesses to be successful."

intervention into the economy.[7] At first, the state established the so-called "system of policy loan" by nationalizing private banks, establishing special purpose banks, and revising The Law of Central Bank. In addition, the government's mandatory deliberation and payment guarantee in the case of borrowing foreign capital strengthened its financial control over private capital. However, the state's primary policy objective at this time was the promotion of export industries, largely composed of light industries, primarily because of the deteriorating balance of payments problem. Thus, although having often announced ambitious auto policies, the state's support for the auto industry in the 1960s remained passive and reluctant, lacking a realistic policy goal as well as specific support measures.

In the following sections, I will address the details of state auto policies in the 1960s. Then follows the analysis of the dynamics of policymaking processes, particularly focusing on the rent-seeking nature of state-business relationships. Careful examination of auto policies and the responses by local firms in this period is critical because they point to the factors that facilitate or hinder indigenous auto industrialization in Korea.

2.1 Support from the State in the 1960s

The Korean auto industry in the 1960s was exclusively centered on the import substitution of completely-built vehicles, importing major auto parts in the form of SKD/CKD kits and assembling them with a primitive level of process and manufacturing

[7] One Western journal characterized the economic policy of a new regime as "guided capitalism," saying, "throughout the plan period, the economic system will be a form of guided capitalism, in which the principle of free enterprise and respect for the freedom and initiative of free enterprise will be observed, but in which the government will either directly participate in or indirectly render guidance to the basic industries and other important fields" (FEER , September 7, 1961, 449).

technology. Accordingly, the roads began to be filled with many foreign models as domestic auto firms simply put together many models in small quantities. In such a situation, the development potential of the auto industry was at its lowest because the local firms only tried to get assembly licenses from foreign automakers and made few efforts to manufacture automobiles with their own skills.

In this period, there appeared, for the first time in the history of the Korean auto industry, the state's deliberate attempts to promote the auto industry by promulgating a number of auto-sector specific industrial policies. To begin with, the state announced the five-year plan (April, 1962) and protective law (May, 1962) as the first steps for import substitution, by which the import of completely-built vehicles was prohibited until 1967. However, the government's auto policies, which were announced at least once every year until 1970, failed to attain anticipated policy outcomes. Although there were some successes in eliminating a large number of small-scale assemblers in the auto industry, the ultimate policy aim, the unitarization of automakers, was drifted to "three-makers" (1967) and "four-makers"(1970). Along with this policy failure to control the number of automakers, it must be noted that there were few effective efforts by the state to enhance the local content rate and to induce existing auto firms to make a limited number of models that would appeal to Korean consumers.

Why did the state's auto policies drift and fail to strengthen the productive capacity of the auto industry throughout the 1960s? This will be the major question tackled in this section. Before examining the question in detail, let me make clear what kinds of support the state provided for the auto industry in the 1960s.

2.1.1 State's Support of Production

In general, we can consider the state's support of production by dividing it into the financial and tax support for local firms, technology assistance, labor control, and other support measures. In the area of financial support, as the auto industry had not yet become the targeted industry for export promotion, it only could receive general financial assistance, largely through the system of policy loans. Although there are no data concerning the amount of financial assistance received by local firms through this system, we can guess there was a good amount of assistance because over 50 percent of bank loans went to the manufacturing sector during the 1960s (KIET 1987, 53). Only in 1967 did the government establish the fund for machinery industry, in which the auto industry occupied the central position. This establishment of an industry-specific fund was possible because of the legislation of "The Promotional Law of the Machinery Industry" in 1967, which would become the legal basis of state auto policies until its replacement by the Industry Development Law in 1987.

In the area of technology support and labor control, there were no serious state efforts to assist local firms. During the 1960s, the Korean auto industry was confined to assembling imported auto parts, which required only a moderate level of skills (thus, the auto industry was called "a screwdriver industry"), thereby making it unnecessary for the local firms to import high-level technology. As there was little demand for technology import on the part of the local firms, so too the state remained silent on this matter. Likewise, as an organized and militant labor movement did not appear in the auto sector until the early 1970s, the state did not need to consider labor control in its policy agenda.

2.1.2 State's Support of Consumption

Given the low level of productivity and production volume, the sale of autos was necessarily restricted to the domestic market. Therefore, the important question regarding the state auto policy boils down to whether the state had supportive measures to facilitate the domestic consumption of autos. Although the manufacturing costs and thus selling price of domestically-built cars were much higher than those of imported ones, higher price could be compensated for by the state's sales subsidy. But the Korean state proceeded in the direction of restraining, rather than promoting, domestic consumption. The tax structure governing auto sales was operated to repress the demand for autos among potential buyers.[8] For instance, the government imposed a commodity tax of 10 percent starting in 1967, and even increased it to 30 percent regardless of the type of auto, thereby making it more difficult for local firms to find buyers.

This policy of repressing domestic consumption of autos is clearly contrasted with the policies made by Latin American states to facilitate the ISI for consumer durables. To complete the ISI of autos, some Latin American countries such as Brazil even tried to maintain the unequal distribution of income among the people. In 1974, the Brazilian Finance Minister, Mario Henrique Simsonsen, argued that:

> A transfer of income from the richest 20 percent to the poorest 80 percent probably would increase the demand for food, but diminish the demand for automobiles. The result of a sudden redistribution would be merely to

[8] The Korean state deliberately repressed the consumption of passenger cars for several reasons. First, as Korea had to import all its oil from abroad, the consumption of autos, particularly passenger cars, was seen as extremely luxurious. Second, the development of an auto industry is possible only if the road system is good enough to connect different parts of the country rapidly and efficiently. On this point, Korea still relied on railroad for the transportation of people and cargo throughout the 1970s. Only in 1969 did Korea build an expressway connecting the two biggest cities, Seoul and Pusan.

> generate inflation in the food-producing sector and excess capacity in the car industry.[9]

Viewed from a comparative perspective, the Korean state's measures to repress the domestic demand for autos during the early periods of auto industrialization seems to have had an unanticipated effect on the later development of the auto industry. That is, although the state's repressive measures might have inhibited the growth of the auto sector at the early stage, it paved the way for the mass production of people's cars in the mid 1970s. Put another way, if the state had promoted the consumption of autos, most of which were relatively large foreign models, in the 1960s, the opportunity to develop a domestic auto industry by mass-producing small, indigenously designed passenger cars would have been missed. Once domestic consumers had become accustomed to high-quality and refined foreign models, the sales of domestically designed people's cars would not have been as sensational as they actually were in Korea in the mid 1970s. Moreover, as Doner (1991) emphasized in his study on the Southeast Asian auto industry, the early introduction of foreign models created several groups that had intense interests in continuing simple assembly operation. These groups included dealers, repair shop owners, parts suppliers, and consumers, and they more or less suppressed the demand for indigenous auto industrialization in this region.

By and large, the state's auto policies in the 1960s can be said to have had few consistent support measures. Next, I will examine why and how the seemingly strong and autonomous state staggered in making and implementing auto policies by investigating policymaking processes. The key concept will be the rent-seeking activities of both local auto firms and politicians in the industrial policymaking process.

[9] Quoted from Kurth (1979, 31).

2.2 The Ascendance of the Rent-Seeking Coalition in Auto Policymaking Processes

2.2.1 Auto Policies in a Flurry

From 1962 to 1967, there had been one unique feature of auto policy in Korea, which has rarely been attempted in other capitalist developing countries: to allow only one firm to assemble imported SKD or CKD kits (unitarization policy), while merging or vertically integrating existing auto parts manufacturers into this single firm.[10] While such a policy might have had an economic rationale to some extent in terms of scale economies and localization of auto parts, the entire abolition of competition in the auto sector might well have resulted in the creation of enormous rents and thus brought about the intense involvement of diverse political and business interests in the state's policymaking process. In this section, the question of why such a seemingly irrational policy had been maintained for a considerable time period will be examined.

In 1962, one year after the military coup, the government made two crucial auto policies: "the Five-Year Plan for the Promotion of the Auto Industry" and "the Law for the Protection of the Auto Industry." The former plan stipulated that "the government will allow the construction of a single plant each for respective production of large and medium-size vehicles, small-size vehicles, and diesel engine vehicles" (KAICA 1983, 733). As small-size vehicles meant the passenger cars, according to this plan, there would be a single assembler of passenger cars for at least five years in Korea. The core characteristics of the latter law were (1) a prohibition on the import of finished vehicles, (2) a prohibition on the import of auto parts except for the assembly of finished vehicles,

[10] This policy is sharply contrasted with those in Latin American countries. For instance, in Brazil and Mexico, there have been around 10 auto firms, while Argentina has had around 20 firms since the 1950s. See Kornish and Mericle (1984).

and (3) a tax reduction on parts imports for the assembly of finished vehicles (Oh and Cho 1997, 22-23). Simply put, these two government policies, one in the form of a plan and the other a law, attempted to give monopoly power to a single assembler within the context of a strictly protected domestic auto market. The government designated Saenara Automobile Co. as the sole producer of the small-size vehicle. The importance of Saenara in the history of Korean auto industrialization lies in the fact that it built, with the technical tie-up with Nissan of Japan, the first modern assembly plant in Korea. Although beginning operation by assembling imported SKD kits with minimum skills and technology and collapsing the next year due to a lack of foreign exchange, Saenara played a significant role for the development of the auto industry in Korea, particularly in the area of training skilled laborers and engineers.[11]

Paving the ground for the import substitution of autos with these policies, the military government announced “the Plan for the Unification of the Auto Industry” in December 1963. This plan was seen as more radical than the policies proclaimed a year before since the government would not only allow only one assembly firm, but also attempt to make it the unified auto manufacturer, producing not only a whole range of passenger vehicles but also parts and components under one roof. Given the long history and the diversity of the auto parts sector, the feasibility of this policy was doubted right after its announcement. Confronting severe criticisms not only from existing assemblers and parts manufacturers but also from the general public, the government could not but

[11] After the shutdown of the Saenara assembly plant in 1963, the Shinjin Automobile Co. was made the sole licensed assembler of small-sized cars (KICA 1983, 117). Shinjin was actually the firm that was licensed to build an assembly plant specializing in medium and large-size vehicles, replacing Shibal, which went bankrupt in 1962.

abandon the law a year later. This event apparently disclosed the underdeveloped nature of the Korean state even when the power wielded by the military government was enormous.

The government announced another revised plan on August 20, 1964: “the Integrated Promotion Plan of the Auto Industry.” This renewed plan was made to achieve the objective of the previous year’s plan with some relaxed measures regarding the status of parts manufacturers (Oh 1996, 88-89). While the previous plan aimed at establishing a national champion firm to produce both the completed vehicle and auto parts under one factory roof, the 1964 plan aimed at the vertical integration of a single assembly firm with 75 parts manufacturers.[12]

As the first deliberate measure to enhance the local content ratio, the state in January 1965 also announced a five-year plan for localization, with an aim of achieving 100 percent local content rate in 1969. The setting of 100 percent by 1969 as an objective was one typical example of bureaucratic ignorance of the reality of the auto industry at the time. In 1966, the local content ratio of Shinjin, which took over Saenara, was only 21 percent. The problem was that Shinjin did not bother to enhance the localization rate because it was satisfied with taking advantage of its monopoly position and thus able to gain handsome profits by assembling various models using imported parts. The creation of monopoly rents by the state without corresponding policy measures to induce the firm to use domestically produced parts worked against its initial intention of building an

[12] The specific contents of this law are as follows: (1)In order to strengthen the auto parts industry, auto parts firms will be systematically affiliated to one assembler and will get financial aid from the government to enhance facilities; (2) The Shinjin Automobile Co. will be designated as the sole assembler of automobiles (KAICA 1983, 117-118).

indigenous auto industry by allowing only a single assembler. Shinjin's local content rate was only 23.7 percent in 1967, an increase of 2.6 percent from the figure of 1966, and reached 38.2 percent in 1969, the year when the rate was supposed to reach 100 percent (Oh and Cho 1997, 28).[13]

2.2.2 Constituents of the Rent-Seeking Coalition

As mentioned above, from 1962 to 1966, the Korean state announced new auto policies at least once every year. The common thread passing through the cores of these policies was to establish a single auto firm to monopolize the domestic market. Accordingly, our natural question is why the state persistently pursued the policy of a single auto assembler in the face of intense resistance from most existing auto firms in both the terminal and parts sectors.

After examining relevant documents and conducting interviews with the persons who were in the government at that time, I conclude that the above laws were promulgated mainly for political reasons, rather than as the measures to promote auto industrialization itself. In January 1962, Kim Jong-Phil, a nephew of General Park and one of the core members of the military junta, founded an auto firm, Saenara Motor Co. Kim’s purpose for establishing the firm was to collect much needed political funds. As the number two man in the government, Kim played a crucial role in organizing the ruling party (the Democratic Republican Party) and the Korean Central Intelligence

[13] As a result of the failure to enhance the domestic content ratio, the amount of foreign exchange spent importing auto parts increased significantly. It increased from 3.29 million dollars in 1966 to 42.38 million dollars in 1969 (Oh and Cho 1997, 29). This outflow of dollars to import auto parts became one factor contributing to the crisis of foreign exchange in the early 1970s, which will be dealt with in the next chapter.

Agency (KCIA). It is easily conjectured that such an ambitious action by Kim might have required him to engage in some questionable practices to collect political funds. Saenara began assembly operation on August 8, 1962, importing SKD kits of Nissan's bluebird model duty free. The assembly operation of Saenara was very lucrative and almost a monopoly operation, given the small number of existing automakers, who focused their operations on reassembling old U.S. military vehicles. For instance, Saenara imported a SKD kit for 130,000 won and sold a car for 250,000 won. Moreover, Saenara was granted a duty exemption for imported parts in accordance with the Law for the Protection of Auto Industry as well as a corporate tax exemption for its operation for five years (Park 1982, 223-224).

Yet such abnormal rent-seeking by political leaders and business firms did not last long. As a co-establisher and managing director of Saenara, Park No-Jong disclosed the outflows of political funds by sending a complaint to the National Assembly, mainly because he did not receive his promised amount of kick-backs from Kim. Along with the disclosure of the scandal, Korea experienced a severe foreign currency crisis in 1963, making Saenara unable to pay for the SKD kit in dollar. After declaring bankruptcy in 1963, Saenara was placed under the joint management of the government and Hanil Bank.

At this point, the military government announced the above-mentioned plan for the unification of an auto industry. According to this plan, the now-bankrupt Saenara and nine other small assemblers would be merged into a new firm, to be called the Korean Machinery Corporation. This plan, however, was never implemented because of the resistance from the would-be merged firms.

Nevertheless, the government did not abandon the idea of one big national champion that would monopolize a domestic passenger car market. Thus came the state's second attempt to unify auto assemblers, at this time pursuing the vertical integration of a single assembly firm with 75 parts manufacturers. According to the government plan, the purchaser of the collapsed Saenara would be selected as the single assembly firm. Understandably, there was heated competition for the takeover of Saenara simply because the new owner of Saenara was expected to monopolize the profitable passenger car market. Although five companies participated in the bidding, it was a battle between two companies, Sammisa and Shinjin, because each company was backed by two politically powerful figures, Kim Jong-Phil, the Chief of KCIA and Lee Hoo-Lak, the General Secretary to the President. The competition between Sammisa and Shinjin was not only a power struggle between the two political coalitions, but also a competition between two Japanese auto makers, Mitsubishi and Toyota, because each coalition leader had cultivated the connection with the major Japanese automakers (Chang 1985, 118-132).

After several months, during which the initial decision to pick Sammisa as a winner was called off by the MCI, the final purchaser of Saenara was announced to be Shinjin.[14] In any case, the process and outcome of the Saenara take-over revealed the

[14] At first Sammisa was designated to acquire Saenara Motors. However, Shinjin lobbied the government to change its decision. Various interviews indicate unanimously that political contribution by the owner of Shinjin to a certain faction of the ruling party that was stronger than the faction connected with Sammisa was the main reason for the change of the decision.

complex power struggle between two rival political factions, and the final winner was the Lee-Shinjin-Toyota connection.[15]

All the facts described above, from the foundation of Saenara through the designation of Shinjin as the single authorized assembler, clearly demonstrate the politicized features of industrial policy making, the essence of which can be summarized as the rent-seeking nature of state intervention. Dave Kang (1999, 17) emphasizes the political nature of economic policymaking during the 1960s in Korea by saying, "allocation of bank loans, foreign loans, import licenses, and other policy decisions were based on a political funds system that required donations from the capitalists. During the 1960s, the expected kickback became normalized between 10 and 20 percent of the loan." Accordingly, we must ask why the military government, which aimed at modernizing the economic structure with an EOI strategy, was not able to overcome the growth-inhibiting, rent-seeking tendencies of the major actors. In the next section, I explore the institutional structures that circumscribed the state's auto policymaking processes.

2.3 Institutional Conditions for the Rent-Seeking Coalition

The drifting and inconsistent auto policies, along with the intense penetration by corrupt politicians into industrial policymaking processes, were to a large extent the logical outcome of the institutional structures that shaped the interests and strategies of

[15] It must be said from the outset that both coalitions were more concerned with rents that would accrue from the monopoly position. Another characteristic of both coalitions is that they did not include bureaucratic agencies, which meant that key economic decisions were still made through the power struggle among political leaders.

the relevant actors, which largely consisted of the state's economic bureaucrats, local firms, and money-hungry politicians. Two factors will be highlighted: the low-level autonomy enjoyed by the MCI and the legacy of President's Park's bashing of the capitalist class.

2.3.1. Lack of Institutional Insulation of the Policy-Making Agency

As I pointed out, the main feature of auto policymaking in the 1960s was the dominance of political logic over economic consideration. This was surely facilitated by the institutional confusion caused by the reshaping of economic bureaucracy immediately following a military coup. What needs a more careful examination in this context is the jurisdictional confusion between the Economic Planning Board (EPB), the economic super-agency overseeing the health of the overall national economy, and the Ministry of Commerce and Industry (MCI), the agency mandated to make sector-specific industrial policies.

Immediately after the coup, Park's military junta established the Supreme Council for National Reconstruction (SCNR), which was composed of four military and four civilian members. Two measures issued by the SCNR draw our attention; one concerned with the compromise made between the military regime and business leaders, which will be dealt with in the next section, and the other concerned with the sweeping reforms in public bureaucracy.

Representing an administrative reform after the coup, the EPB was established in July 1962 in order to strengthen state leadership in economic management by putting together such tasks as planning, statistics, and budgeting into one ministry. In October

1961, the EPB absorbed the function of foreign exchange from the Agency of Supply. In 1963, the EPB further strengthened its role in economic policymaking, as the Director of the EPB was promoted to Deputy Prime Minister (DPM). Accordingly, the EPB had become the most powerful economic agency in Korea, and it had continued to wield power by establishing successive national economic plans, formulating the national budget, and regulating all foreign capital and technology inflows until it was actually absorbed into the Ministry of Finance in 1995.[16]

The establishment of the EPB was largely motivated by the success of the Japanese Ministry of International Trade and Industry (MITI) in guiding national economic growth. Yet the founders of the EPB seem to have misunderstood the workings of MITI since they separated sectoral planning (sectoral industrial policy) from the mandates of the EPB, thus ignoring the conflicting nature of macroeconomic management and sectoral industrial policies. In Japan, MITI had the authority to make sectoral industrial policies by acting as the "pioneering" agency or "gatekeeper" of foreign currency and technology (Johnson 1982), whereas, in Korea, the task of making industrial policies was delegated to the MCI, which had no other policy instruments than setting the items of import prohibition. In other words, Japanese industrial policy was made in the context where a proactive and expansionist agency like MITI, having crucial policy instruments such as the licensing of technology inflows and foreign currency allocation, gained the upper hand over the more conservative and macroeconomic-oriented agencies such as the Ministry of Finance and the Bank of Japan.[17]

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[16] For a complete history of the EPB, see EPB (1982) and Kim (1999).

[17] For details of the MITI's achievements, refer to Johnson (1982) and Fallow (1994).

In contrast, the MCI in Korea had the mandate to make sectoral policies with fewer policy instruments than those of MITI, with its policy initiative quite often held back by the EPB for reasons of macroeconomic stability. From its inception, the EPB was famous for sticking with the logic of comparative advantage in planning processes. From the EPB's perspective, the channeling of resources into the promotion of light industries was the most critical task facing the Korean economy in the 1960s. Such a divide of interests between the two agencies and the consequent potential of inter-ministerial conflicts were magnified as industrialization progressed, and the main key to successful industrial policies increasingly became how to strengthen the position of the MCI among economic ministries, particularly vis-à-vis the EPB, either through the direct support of top political leaders and other economic ministries or through the organizational decline of the EPB. This theme will be examined in detail in the following chapters.

Hence, the ability of the MCI to make independent auto policies during the 1960s was greatly reduced by the increasing organizational hegemony of the EPB within the economic bureaucracy. The EPB's policy priority was, throughout the 1960s, the import substitution of basic industrial products, such as cement, fertilizer, and basic chemical goods, and the promotion of labor-intensive light industries for export purposes. When the EPB made the first five year economic plan in 1962, the MCI also announced its five year plan for the auto industry. But this MCI plan had no meaningful effect on the later development of an auto industry, because while the production of large and medium-sized and diesel engine vehicles was specified as a government planned project, that of small-sized vehicles was categorized as an unplanned project (KAICA 1983, 733). This is mainly due to the EPB's conception that the economic situation at that time required only the production of large-size vehicles such as trucks and buses for transportation purposes. From the EPB's perspective, the production of passenger cars was a waste of precious resources. So the MCI's concurrent effort to promote the small-sized passenger car industry was to become an echo without any meaningful response from other economic ministries, including the EPB.

The autonomy of the MCI in making auto policies was severely encroached upon not only by the EPB's emphasis on light industries as an engine of growth, but also by the rent-seeking activities by corrupt political and business leaders. According to my interview with a director of the MCI at that time, the Saenara Motor Co. was "all of a sudden" founded without any prior consultation with the MCI. Knowing that this firm was backed by a powerful political figure, the MCI had no alternative but to accept the firm as the monopolistic company in the domestic auto market. At a later time, it was also revealed that the formulation of the Law for the Protection of the Auto Industry by the MCI was actually intended to protect the Saenara Co. According to the record of the investigation of the Saenara scandal by the National Assembly, it was found that the above law was first drafted by a government agency other than the MCI (probably by the KCIA) and that the MCI was forced to present it to the National Assembly (Oh 1996).

The autonomy of the MCI was also damaged when its unitarization policy of auto assemblers was scrapped before its expiration date. In July 1965, Asia Motors was established, and, in December 1969, it obtained a license to introduce foreign loans from the EPB. The entrance of Asia into the auto industry was strongly opposed by the MCI, but to no avail. The rent-seeking activities by Asia were the most rampant, since it spent most of its resources not in building plants but in lobbying and bribing politicians. Asia also made use of the disparity of political power between different regions in Korea. Given the skewed power center toward the southeast region in Korea, it made issue of the "ill-treatment of *Honam* region" to gain political favor from the government, as it was the firm based in the southwestern (*Honam*) region. According to the memoir of an assistant manager of an auto vehicle section in the MCI, the top managers, including the president, of Asia Motors visited the MCI to beg permission for auto assembly almost everyday. Unable to move the MCI officials, they tried to persuade top politicians at the Blue House (Presidential residence) and National Assembly to put pressure on the MCI. Finally, the policy independence of the MCI was to a great extent encroached upon by Asia's rent-seeking activities.[18]

2.3.2 Local Capital Indulging in Securing Rents from State Policy

In the above section, I mentioned briefly the SCNR's measure to draw cooperation from local business leaders. Immediately after the coup, the SCNR arrested leading business figures at that time in the name of rooting out institutionalized corruption. They included the founders of Samsung, Lucky-Goldstar (LG), and Ssangyong, which later developed into the big Chaebol in Korea. Since most important business leaders were fined, punished, and imprisoned, General Park's dilemma was whether to purge them forever or to bail them out to carry out the much needed goal of economic development. Park decided on the latter course.

[18] My interview with an MCI official at the time indicates that the automobile division at the MCI was the one that most bureaucrats in the MCI did want to be assigned. This was mainly due to the noise made by illegal lobbying and bribing incidents. The average tenure of the divisional chief was no longer than 6 months. At one time, all the members of the division, including typists, were replaced.

Under the accusation that these business leaders accumulated capital by illegally taking advantage of the aid from the U.S. and other relief funds, they were forced to "donate" their holdings of commercial banks to the state; as a result, all the commercial banks in Korea were quickly nationalized. Moreover, some factories were taken from their holdings and put under government control. In this process, the military government collected about four billion won (about $16 million) by bailing them out. In July 1961, the thirteen most fined business leaders created the Council for Economic Rehabilitation and Promotion in order to participate in Park's push for economic development, and Park later allowed them to participate in the construction of infrastructure and the *Ulsan* Industrial Park to attract foreign investments and loans (Lee 1990).

The condition of local capital in the auto industry was far worse than that in other sectors. As a result of the state policy that put a ceiling on the number of cars produced each year (May 8th Line), a small number of auto manufacturers could not rise above the level of handicraft manufacturing, still relying on used parts coming out of the U.S. Army to assemble various vehicles. The first modern auto assembler, Saenara, was the result of a political decision to collect political funds. Though many engineers at Saenara tried to upgrade assembly skills from the SKD to the CKD level, the top management did not listen, given the abundance of profit prospect within a SKD framework (Kang 1986).

The top managers of Shinjin were no different. Though the state gave monopoly power to Shinjin in order to enhance the rate of local content, Shinjin only focused on selling cars that were assembled on a SKD basis. As of 1966, Shinjin's local content rate was only 21 percent. Unable to tolerate Shinjin's insipid efforts to localize auto parts, the MCI ordered Shinjin to achieve at least 32 percent of a local content rate in 1967.

However, Shinjin achieved only 23.6 percent in that year. Such a low rate was compared to the rate of small-sized bus assemblers, which had already achieved 64 percent, even though they assembled various types of buses. Given the fact that Shinjin assembled only a few models of a passenger car, the increase of only 2.6 percent between 1966 and 1967 meant that it had turned away from any effort to upgrade manufacturing skills.

The business strategy of Asia Motors was the worst of all. Although it succeeded in entering the auto industry in 1965, it did not assemble automobiles until 1970. Largely owing to its exclusive attention to rent-seeking, rather than to productive activities, it was categorized by the government as an insolvent enterprise in 1969. So the managerial control was transferred to Dongkook Steel Co. in December 1969 and later taken over by Kia Motors. The first assembled car by Asia (Fiat 124) appeared on the market only in 1970. The local content rate of this car was only 30 percent.

3. Conclusion

In the 1960s, the Korean economy developed at an astonishing rate. The progress of manufacturing sectors was preeminent, thus providing the basis for developing an auto industry. At the same time, the construction of infrastructure led to an increase in the size of the auto market. The construction of modern assembly plants set the stage for further development in the next decade. The technical tie-ups with foreign automakers, first made with Nissan by Saenara and later with Toyota by Shinjin, also provided Korean automakers with precious experience in dealing with foreign automakers.

Nevertheless, the state-business relations in the 1960s were characterized by pervasive rent-seeking. Most government auto policies, particularly during the early

1960s, aimed at providing artificial monopoly rents to the specific firm by erecting entry barriers. In return, top political leaders could amass a good amount of political kickbacks from the companies that received the government's favor. Within such a corrupted bargaining structure, the main focus of local business activities was naturally directed toward such unproductive activities as lobbying, bribing, and building collusive connections with powerful political leaders, thereby wasting resources and reducing overall social welfare.

The lack of insulation of the relevant state agency (in my study, the MCI) in the policymaking process, not only from the political intervention of politicians but also from the more powerful state agencies such as the EPB, contributed to the oscillation and the incoherent character of an auto industrial policy during the 1960s. The weakness of local auto firms in terms of capital equipment and technology accumulation made them not only an easy target of political manipulation by political leaders, but also incapable of resisting the temptation to make profits through unproductive rent-seeking, rather than investing in such productive activities as raising a local content ratio and upgrading assembly operation (e.g. from SKD to CKD, and from CKD to local manufacturing). Under such circumstances, the institutional linkages between the state and business were unable to develop beyond the particularistic connection that functioned only as the channel for bribes and firm-specific favors. When the state-business linkages take the form of an exclusive profit sharing circle, these linkages are more likely to function as growth-inhibiting obstacles, rather than as the central coordinating mechanism that helps the parties exchange information, coordinate investment arrangements, and enhance the potential of industrial upgrading.

CHAPTER V

THE EARLY 1970S: CRISIS AND SEARCHING FOR A NEW STRATEGY OF INDUSTRIALIZAITON (HCI PROJECT)

By 1969, a high-growth strategy faced important economic limitations: increasing current account deficits, a sharp increase in external indebtedness, a decline in international competitiveness, and increasing pressure on real wages. The most pressing sign of economic crisis was the continually deteriorating balance of payment problem. With assistance from the IMF, an adjustment effort was launched in 1970.

With economic crisis came political crisis. Because the survival of Park's regime, which innately lacked political legitimacy, depended to a large extent on economic achievement, the growing deterioration of economic conditions around 1970 posed a great threat to political leaders. Specifically noteworthy was the increasing unrest among workers and students. The growing discontent felt by the people were explored in the 1971 presidential election, in which Park was able to defeat his opponent, Kim Dae-Jung, by only a narrow margin.

The insecurity felt by the dominant political leaders was also intensified by the rising offensives by North Korea, including the guerrilla attack on the presidential residence in 1969 by 33 commandos. The withdrawal of one third of the U.S. Army from Korea, one piece of the changed U.S. foreign policy toward the East Asia, was another critical threat to the political leaders.

All these crises combined to give rise to new institutional arrangements and political choices, which had in turn a persistent impact on the formulation and implementation of auto policy in Korea during the 1970s. In this chapter, I will focus on the former question, that is, the creation of new institutional arrangements and the seeking of a new industrialization strategy. This chapter is divided into three sections. In the first section, I will address and examine the shape of the auto industry around 1970. There was some progress in the industry during this time, mainly due both to the renewed efforts by the state to upgrade its productive potential and to the entry of more adventurous local firms into the industry. Nevertheless, the state's auto policies still lacked vision and feasible policy plans. Two issues will illuminate the predicament faced by the Korean auto industry in this period: failed trials to establish joint venture companies with foreign auto TNCs and the state's unilateral attempt to enhance a localization rate. In the second section, the crisis of the Korean economy in general and the auto industry in particular during the early 1970s will be examined. The implication of this crisis to the future shape of the auto industry, particularly with respect to its impact on institutional variables and hence on the configuration of a new coalition between the state and business, will also be emphasized.

Economic crisis tends to bring about a regime change. So too did Korea's political system become highly authoritarian by 1972. This regime change was followed by the shift of the growth strategy from EOI to Heavy-Chemical Industrialization (HCI). Such changes in the systems of political rule and economic management in 1972 and 1973 provide us with a critical clue for analyzing the formation of nationalistic auto policies in

1973 and 1974. These changes in political rule and economic strategies will be the main theme of this chapter.

1. Automobile Policies in Korea between 1967 and 1971

From 1962 to 1972, the Korean state announced many critical automobile policies without any significant policy outcomes.[1] Until 1967, the main trend of the auto policies had been oriented toward the unitarization of auto assemblers; Shinjin Motor Co. became the sole authorized assembler in a passenger car industry. Faced with criticism that pointed out the harmful effects emanating from the monopolistic practices of Shinjin, the Korean government nullified the unitarization policy in 1967 and allowed other firms to enter the passenger car market.[2] As a result of this policy shift, Asia Motor Co. began to build an auto plant in 1967 in technological cooperation with Italian Fiat.[3] In the same year, Hyundai Motor Co. was also founded and began to produce passenger cars with

[1] To straighten out state auto policies in the 1960s,

April 1962:	The Five Year Plan for the Promotion of the Auto Industry
May 1962:	The Law for the Protection of the Auto Industry
December 1963:	The Unification Policy of the Auto Industry
August 1964:	The Comprehensive Promotion Plan of the Auto industry
January 1965:	The Three-Year Plan for the Localization of Auto Parts
December 1967:	The Announcement of Three-Assembler System in the Auto Industry (Shinjin, Asia, and Hyundai)
December 1969:	The Basic Plan for the Promotion of the Auto Industry The Three-year Plan of Complete Localization of Auto Parts

[2] The most important reason for abandoning the unitarization effort by the state was the insipid attitude shown by Shinjin toward enhancing the local content rate, even as a monopoly in the domestic auto industry. This event reveals the limited power of Korean economic bureaucracy in the 1960s.

[3] Asia was able to assemble autos only in 1970 because it was classified as an insolvent enterprise by the government in 1969, and its managerial control was transferred to Dongkook Steel and later Kia.

SKD kits and technological assistance from Ford.[4] By 1970, the Korean auto industry had been dominated by three major assemblers: Shinjin (later GM-Korea), Hyundai, and Asia.[5] Shinjin was the industry leader with more than 50 percent of the market share. The three firms had business tie-ups with three different Auto TNCs: Toyota from Japan, Ford from the U.S., and Fiat from Italy.

1.1 The Trials of Joint Venture with Auto TNCs

Two features distinguished the auto policies between 1967 and 1971 from those of the previous and later ones: the emphasis on both the technological links with foreign advanced automakers and the enhancement of a localization rate.[6]

As mentioned above, the government scarped the unitarization policy in 1967 as the monopolized firm, Shinjin, did not try its best to enhance a localization rate. The government announced a new policy, "the Permission Criteria of the Automobile

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[4] The entrance of Hyundai into the auto market has had the most significant impact on the development of the Korean auto industry, since this firm sought the independent strategy in the early 1970s for the first time in Korea and succeeded in becoming the first internally competitive automaker in Korea. The story behind Hyundai's decision to enter the industry was also quite interesting. Clifford (1998, 255) explains: "When Chung Ju-Yung was building the new Seoul-Pusan highway in the mid-1960s, Park Chung-Hee supposedly asked him, 'Do you know anything about cars?' When Chung said that he had run an auto repair shop in Seoul during and after World War II, Park encouraged him to start producing passenger cars. 'You're building the road. Now we need the cars,' the president is said to have told Chung."

[5] Kia entered the auto industry in 1970. Kia was established as a company that made bicycles and later small trucks with three tires.

[6] These two features were the main characteristics of 1969 auto policies: “The Basic Plan or the Promotion of the Auto Industry” and “The Three-year Plan of Complete Localization of Auto Parts.” Though the specific policy goals of these policies were not achieved, we cannot deny that these plans became the basis line upon which the 1973 policy was drafted.

Manufacturing Plant," in April 1967 to allow entry to new auto firms if they satisfied the conditions stipulated in "the Permission Criteria." The most critical condition included in "the Permission Criteria" was that the candidate firm had a technological alliance with advanced automakers.[7] This recognition of the need for technological tie-up with advanced automakers represented the view of state planners, particularly those who worked for the EPB, and continued until the state shifted the focus of auto policy from import substitution and relying on foreign capital to indigenous auto industrialization in 1973.

In particular, EPB's conservative planners saw TNCs' participation in the Korean auto industry as indispensable for two different reasons. First, they considered auto manufacturing in Korea without the participation of foreign automakers an unrealistic and wasteful project, largely because of Korea's excessively low level of auto manufacturing technology and small domestic market. Given a market size of less than 10,000 units per year, scale economies that were indispensable to establishing an efficient auto industry could not be expected. Moreover, since the auto industry was sought with an aim of import substitution and with little consideration of an export objective, the resources needed for the advancement of an auto industry had to be channeled into promoting internationally competitive industries at the time. As a result, it was claimed, Korea had little prospect to go beyond being the junior partner to advanced automakers by letting their subsidiaries or joint-venture firms dominate the passenger car market.

[7] The other conditions were (1) whether the price of productive equipment was over US $7 million and the firm got the approval of introducing foreign capital, (2) the area of the factory site was over 300, 000 pyong and that of buildings was over 10000 pyong, (3) the price of assembly equipment was over US $1 million, and (4) the constructing price of body and frame was over US $1 million.

Second, the Korean government saw the presence of big auto TNCs like GM or Ford in Korea as representing the persistent U.S. interest in Korea. As I noted in the previous chapter, the scheduled withdrawal of the U.S. military force was one of the most significant causes of a security dilemma in Korea during the early 1970s. Within such a precarious security context, the Korean government tried to avoid any hostile actions toward a few U.S. big corporations. In the auto industry, as a result, the Korean government's preference for U.S. firms as partners of joint venture was more an outcome of political consideration.

Largely owing to these two reasons, when the government set the criteria for allowing new assemblers in 1967 and announced the plan to build a single engine plant in 1970, it firmly declared that technological links with foreign firms were preferred. Accordingly, the firms that attempted to enter the auto industry or to build an engine plant had to place the task of searching for foreign partners above other considerations.[8]

Unfortunately for Korean firms and government, however, the international auto industry around 1970 was still in the mold of previous decades, during which the significance of the Third World for major auto TNCs was only as a market for their own products, either by export or by foreign direct investment. The new type of international division of labor in the world auto industry, which is characterized as the world car concept and international sourcing, had not been fully developed at that time (Jones and

[8] However, it must be noted that the state's promotion of joint venture with foreign automakers did not mean that the majority ownership by the foreign firms could be admitted. This was illustrated when Shinjin presented the plan for building an engine plant with the joint venture with Toyota. This plan was rejected by the MCI, which demanded at least 50-50 capital participation from both parties (Oh and Cho 1997, 39).

Womack 1985).[9] Given the relatively small auto market, it might be easily conjectured that the Korean firms and government had less leverage in dealing with the auto TNCs, simply because Korea was not as attractive as other developing countries that had a potentially big auto market like Brazil, China and India.

The weak leverage of Korean auto firms and government vis-à-vis auto TNCs was clearly demonstrated in the two cases. When the Korean government announced its plan to allow only one engine plant and to let this plant monopolize the production of all passenger car engines in 1969, all existing assemblers competed with each other to obtain government permission. In fact, this plan was another expression of the unitarization of manufacturing firms, which had been the central auto policy in Korea during the mid-1960s and later abandoned by allowing two more assemblers. According to the plan, the selected auto firm would monopolize the production of engines and distribute them to other assemblers. Therefore, the firm producing auto engines would have the dominant position in the auto industry in Korea. As a result of this plan, therefore, there occurred intense competition among existing auto firms to be selected as the sole engine producing firm. Moreover, since this plan, like the "Permission Criteria" announced in 1967, stipulated the requirement of technological alliance with advanced automakers as the

[9] In fact, some advanced automakers began to see Korea as a potential production site as early as 1967. Ford dispatched the research team in 1967 to examine the developmental potential of the Korean auto industry. GM also had some interest in entering Korea. Therefore, Hyundai contacted GM to find out about the possibility of a technological tie-up. However, GM preferred to take over the existing firm and, if this was not possible, insisted on participating directly in management by occupying a larger share of equity. The President of Hyundai, Chung Ju-Yung, had a firm belief that managerial control should not be abandoned under any circumstance, so the deal with GM was stopped (HMC 1987, 37).

precondition to be the engine producer, the existing firms were eager to search for foreign partners.

As a leading auto company in Korea at the time in terms of market share and accumulated technology, Shinjin announced a plan for a joint venture with Toyota and submitted an application for an engine plant to the MCI faster than any other firm. A few months after the submission of the application, however, Toyota suddenly canceled its plan for the joint venture with Shinjin for reasons related to international politics. On April 15, 1970, the Prime Minister of China, En-Lai Chou, announced a policy that prohibited Japanese firms doing business with South Korea and Taiwan from operating in China (*Chosun Daily* April 16, 1970). Toyota then decided to withdraw from Korea, simply because, from its point of view, China had a far bigger auto market than Korea. Right after the breakup of the alliance with Toyota, Shinjin began searching for another foreign partner and finally succeeded in signing a 50-50 joint venture with GM in June 1972. Yet this joint venture contract was full of questionable clauses, for instance, GM's control of finance, a royalty of 3 percent of total sales and a management fee of $750,000 a year from the new firm (Oh and Cho 1997, 39-41).

Another case that illustrated the weak status of Korean automakers vis-à-vis auto TNCs was Hyundai's attempt to build an engine plant in a joint venture with Ford. In this case, the bargaining between Hyundai and Ford fell apart not only because of the lack of enthusiasm on the part of Ford about the prospect of a new plant, but also because of Hyundai's insistence on managerial independence and on the use of Ford's marketing network. Initially, Ford regarded the planned engine plant as the supply base of a diesel engine to worldwide Ford auto factories. For Hyundai, Ford’s attempt was unacceptable because it did not aim at manufacturing passenger cars that had a gasoline engine.[10]

Hyundai and Ford had been bickering for more than two years before both parties abandoned their joint venture contract. As will be dealt with in detail in the following chapters, Hyundai's insistence on managerial autonomy was extraordinary at the time, and Ford did not have any reason to make a new firm that it was unable to manage to its own liking. It was well-known fact that Ford, as well as GM, did not like to set up firms anywhere around the world as a minority shareholder. According to William Hartigan, who was in charge of the Hyundai-Ford negotiations and the president of Ford Motor Products, part of Ford's Asia/Pacific operation, "We weren't interested in putting our interests in an effort that would have left us with no substantial investment." As the negotiations continued, Hartigan was impressed only by the toughness of Hyundai. He said, "I've been negotiating for Ford all over the world and found them (Hyundai) by and large thorough negotiators wanting to discuss everything." Even at this time, Hartigan noticed the nationalistic fervor in Hyundai's pursuit. So Hartigan said, "Chung Ju-Yung (the owner of Hyundai) by and large adopted the view, this thing is for the nation" (Kirk

[10] Before negotiating with Ford about the matter of an engine plant, Hyundai had already received technological assistance from Ford, as it began to produce vehicles with SKD kits imported from Ford. Before establishing an auto company, initially, Hyundai approached GM, but negotiations failed because GM insisted on participating in management and equity, while Hyundai wanted to keep management and ownership itself. In 1967, Hyundai contacted Ford, which had already searched for a Korean partner. Ford evaluated several potential firms through the American Embassy, banking institutions, and even information agencies. Ford finally decided to provide SKD kits for assembly and technological assistance to Hyundai rather than build a wholly owned subsidiary, largely because Ford wanted to wait a few more years before deciding to enter the Korean auto market directly. On February 23, 1968, the Overseas Assembler Agreement was signed between Hyundai and Ford (HMC 1987, 35-37).

1994, 124-136). In the end, Hyundai decided to go alone without any equity participation from auto TNCs (Ryu 1990, 24). As proved by later development, this aggressive posture of Hyundai toward auto manufacturing was an occasion of long-range significance - perhaps for Ford too (HMC 1987, 160).

From Shinjin's and Hyundai's attempt to sign joint-venture contracts with foreign firms, we learn that, although government policy generally put domestic assemblers in an inferior position in the negotiations with foreign makers, the business strategy of individual firms also mattered in determining the course of auto industrialization in Korea. Given the diverging interests of domestic auto firms, the appearance of independent-oriented policymakers in the government would propel the formation of coalitions between sections of business and state managers and lay the ground for a new type of auto industrialization. This will be the subject of our next chapter.

1.2 The Failed Attempt to Enhance a Local Content Rate

The second feature distinguishing Korean auto policies around 1970 was the attempt to localize auto parts and components by imposing an "unrealistically" high state-made rate of local content on existing firms. When developing countries began promoting their auto industry by sector-specific industrial policies, the first thing they did was to impose a stringent schedule of localization of auto parts on the existing auto assemblers, whether they were domestic firms or the subsidiaries of auto TNCs. With this policy, Brazil's and Mexico's auto industries were able to pass from the stage of simple assembly of imported CKD kits to that of assembly of auto parts produced in their countries, thus upgrading the level of import substitution in the auto industry (Jenkins

1987). Such a course of events may have been usual considering the fact that the auto parts sector was still in the hands of local capital, in contrast with the terminal sector, which was largely dominated by foreign capital. Hence, the Brazilian state in the 1950s and the Mexican state in the 1960s placed the increase in a local content rate at the center of their auto policies by allowing only the firms that satisfied the localization schedule provided by the state to operate in their territories (Shapiro 1994, Bennet and Sharpe 1985).

While Brazil and Mexico were able to raise the local content rate to a significant degree up to 1970, the Korean state failed to implement its localization policies until the policy shift in 1973. This was mainly due to two factors, both of which revealed the inconsistent and incoherent nature of Korean auto policies around 1970. The first factor was related to the unrealistically tough localization schedule made by the state without consulting local assemblers. In 1965, the government announced for the first time a three-year localization plan (KAICA 1983, 736). The plan specified a target of a 100 percent local content rate by 1969 with an initial local content rate of 21 percent (Kim 1982, 26). However, this projected rate of a local content ratio was so unreal that the actual rate remained well below 50 percent until 1970, as table 5.1 indicates.[11] Again, the government in December 1969 announced another auto industry development plan, according to which the target of the local content rate was set at 100 percent by 1972.[12]

[11] The actual increase in the local content rate from 21 in 1966 to 60 in 1972 looks significant in itself. However, considering the fact that an increase in the local content rate up to 70-80 percent can be made without localizing key auto parts and components such as engines and transmissions, an increase of about 40 percent for six years was a disappointing outcome, given the declared target of 100 percent by the early 1970s.

Table 5.1
The Rate of Local Content (1966-1972)

Year	1966	1967	1968	1969	1970	1971	1972
Rate (%)	21	23	27	38	52	58	60

Source: Kim (1982) 27.

Despite its proclaimed efforts to deepen the import substitution of auto parts, the Korean government was unable to push its localization plan through because such a plan was established largely as a result of the pressure from existing auto parts manufacturers. In the policymaking process, the interests of local assemblers in using imported parts were not sincerely considered. With the tariff exemption for auto parts imported for assembly purposes, a rise in a localization rate meant to local assemblers lower quality and higher prices for assembled vehicles, thus reducing profit rates. Hence, it might be concluded that the Korean state's localization policies had their origins not in the state's sincere efforts to promote an auto industry, but in its desire to contain the discontent of local parts producers and the general public with assemblers' amassing of profits through easy CKD assembly operation.

Another more fundamental reason that led to the failure of localization policies lay in the fact that the Korean state tried to achieve two contradictory objectives in one stroke: a high local content and a joint venture with auto TNCs. As seen in the cases of Toyota's withdrawal and the failure of the joint venture negotiations between Hyundai

[12] According to my interview with one old parts manufacturer, this unrealistically high local content rate was sought in part to placate the parts manufacturers, who were very vociferous in criticizing the state for its weak measures to induce assemblers to enhance the localization rate.

and Ford, auto TNCs had limited interest in the Korean market at that time.[13] Even if they had some interests, they did not want to engage in business by using the auto parts manufactured in Korea. As the major reason for foreign direct investment in an auto industry was to guarantee the long-run of auto parts, thus achieving scale economies of auto parts in their home countries, auto TNCs resisted any pressure, whether coming from the host government or from local parts firms, to increase the local content rate of the developing countries they invested in (Doner 1991). The Korean government policy that promoted both joint venture and localization at the same time was like attempting to hit two running rabbits with one stone. As usual, the Korean state was not able to catch even one rabbit.[14]

In sum, the Korean state's auto policies before 1973 were short-lived and badly implemented because the government had neither a deep understanding of the auto industry nor the proper means of policy implementation. The rent-seeking nature of state auto policies did not disappear. The state initiative to build a single engine plant in 1969 only invited intense inter-firm competition to obtain the government's permission, which would give that firm monopoly power in distributing engines to other firms. As this policy required joint venture with foreign firms as the precondition to be a candidate for

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[13] The resistance of TNCs to the localization efforts by the Korean state was tenacious. For instance, Ford, the foreign partner of Hyundai, insisted that they would remove the Ford logo if the state forced Hyundai to change the transmission to a localized one. When Hyundai began to use a localized transmission, Ford indeed took its logo out off the cars (Cortina) Hyundai assembled.

[14] Some countries, particularly those having a larger domestic markek like Brazil and Mexico, could enhance the domestic content rate and at the same induce auto TNCs to manufacture autos in their countries. In these countries, Auto TNCs could do little but to follow the state policy of local content lest they should lose the growing domestic market. Given small domestic market, however, the Korean policymakers should not have anticipated such a result in their country.

the sole engine plant builder, the state unintentionally reduced the bargaining leverage of local firms in negotiations with the auto TNCs. The contradictory nature of the government policy was also revealed in its attempt to increase a local content rate within the context of encouraging joint venture. In a word, the auto policies between 1967 and 1971 were not immune to the rent-seeking activities of both the private capital and the state and were mutually contradictory.

2. Economic Crisis and its Institutional Repercussions

2.1 Crisis of the EOI Strategy

President Park's economic strategy in the 1960s was export-oriented industrialization of labor-intensive, light industries. Along with an EOI strategy, though not given as much attention as export promotion, Park also attempted to continue import substitution of such basic industrial goods as steel, synthetic fiber, cement, and automobiles, as well as to construct a broad array of infrastructure. The government was providing at least 38 export promotion incentives, such as tax and tariff reduction, financial incentives, and discounts on electricity rates, until the mid-1970s. The firms engaging in export activities were also given loans from both domestic and foreign banks at the interest rates far below the market clearing level. According to one observer,

> He (A businessman) can buy input materials from abroad at world market prices, add value, and sell the products overseas at world market prices. He can import capital goods for export production at world market prices (that is, without tariffs and taxes) and pay world market rates (much lower than domestic rates) of interest on foreign loans (or domestic loans) to purchase capital goods. Yet, wage rates for Korean labor are substantially lower than those of developed countries such as Japan and the United States, Korea's major trading partners (Lim 1981, 18).

The Korean government even acted as an insurance company by promising foreign moneylenders that it would take responsibility for any loan failures (Woo 1991). Accordingly, it might be expected with no difficulty that such an export inducement package triggered a boom in the export industries.

However, the state's export promotion was too generous for export industries and was widely abused. Many export firms imported production facilities without tariffs and taxes and borrowed working capital from the banks with ease. When the business went down, these firms borrowed more money to pay the debt. When foreign lenders and domestic banks became reluctant to lend more money, they turned to the domestic curb market to borrow money at a 3 to 5 percent monthly rate of interest. Accordingly, the debts owed by exporting firms were snowballing and finally caused a serious economic crisis in the early 1970s.

Sensing the imminence of economic crisis, Park's government began cleaning up the mess in 1969. In 1969 alone, of all companies using foreign loans, 85 companies turned out to be under the control of banks and 123 companies settled for bankruptcy (KERI 1995, 229). One hundred twelve firms were forcefully merged, absorbed, taken over, and abolished between 1969 and 1971 by government measures. However, these government measures largely lacked consistency and fairness. Although the major chaebol also suffered financial crises,[15] they were given the opportunity with financial support from the government to expand their group size by absorbing troubled firms. Only small- and medium-sized firms were "cleaned up" by the government. Hence, the

[15] In 1970, the internal financing percentage of ten major chaebol was below 20 percent.

government measures, which were initially intended to strengthen the foundation of the Korean economy by cleaning up the mess, ultimately made the size of the chaebol bigger (Cho 1994, 174-175).

Another sign of economic crisis around 1970 was a sharp rise in balance of payment deficits, as shown in table 5.2. Along with the deficit problem, the burden of external debt also rose precipitously. Despite Korea's exemplary export performance, the debt-service ratio on long-term debt jumped from 7.8 percent in 1969 to 18.2 percent in 1970, an increase that mirrored consistently high levels of investment relative to savings (Haggard 1994, 29).

Table 5.2
Balance of Payment Deficits: 1968-1974 ($ million)

Year	1968	1969	1970	1971	1972	1973
Deficit	-245.8	-548.6	-622.5	-847.5	-372.2	-279.5

Source: *Dong-A Annual* 1975

Financial difficulties began to be acutely felt even by big corporations in 1971. Besides suffering from the pressure of repaying foreign loans, these firms, which had also borrowed in the curb market with high interest rates, found themselves in serious trouble. In 1971, the Federation of Korean Industry (FKI), which represented the owners of the big corporations, officially called for an emergency government measure to overcome the current economic crisis. It even threatened the government with a tax revolt that would have cut the state budget by half (about 600 billion won) if the government had failed to control the curb market, provide tax breaks and reduce interest rates. More specifically, in two meetings with the President, the president of FKI recommended measures to relieve the financial burden of the corporations, which would include corporate tax cuts and the takeover of curb-market loans by the banks.

In response to these problems, a number of EPB and MOF technocrats argued that greater emphasis should be placed on price stability. Nam Duck-Woo, who became the minister of the MOF in 1969 and the DPM in 1974, argued for a 3 percent cap on price increases, to be achieved by a variety of measures, including a freeze on the prices of public services. Therefore, in 1970, stabilization measures were launched to reverse the expansion of credit and money. The rate of domestic credit expansion was cut from nearly 95 percent a year in 1969 to 29 percent in 1970, and foreign borrowing limits were also imposed.

At the same time, under standby agreements with the IMF in 1970 and 1971, foreign exchange policy was constrained.[16] In June 1971, the exchange rate was devalued. After an initial 13 percent devaluation relative to the dollar, the won was allowed to depreciate gradually until June 1972, when the exchange rate was fixed at 400 won to the dollar, still above the 450 won to the dollar that the IMF had sought in its June 1971 review of Korea's standby. Given the adjustments of the dollar in relation to other currencies in the wake of the breakdown of Bretton Woods, the won depreciated by 11.9 percent in real terms between 1970 and 1972, and a further 15.6 percent in 1973.

If such austerity measures had succeeded in becoming a dominant economic policy in the first half of the 1970s, the whole picture of the Korean political economy would have changed. Beginning in 1972, however, political and economic pressures combined to reverse the stabilization effort, and monetary and fiscal policies turned in a more expansionist direction. Before looking into this theme, I will examine the auto industry within this crisis context.

[16] In 1971, this increasing deficit led the IMF to place a ceiling on loans from commercial sources and to cancel 61 loans to Korea already approved for that year.

2.2 Crisis in the Automobile Industry

The Korean auto firms had also experienced severe financial difficulties around 1970 due to their mismanagement of financial matters. At first, Asia, the firm that heavily relied upon foreign borrowings, became the target of the government's "clean up" policy for insolvent firms. Even Shinjin, the largest auto firm, went under bank management because of the risk of its insolvency.

Looking carefully at the details of commercial borrowings by Shinjin, we find that most borrowings came from Toyota, the company that had provided the CKD kits to Shinjin from 1965 to 1971. As table 5.3 shows, a large portion of borrowings had been used for investment in equipment, and, specifically, more than a half was used to purchase auto parts. This table also tells us that, from Toyota's perspective, the borrowings by Shinjin were the means to earn a handsome amount of interest as well as to sell its auto parts, thereby killing two birds with one stone. Still worse, from Shinjin's perspective, the use of borrowings to secure basic materials and auto parts meant the abandonment of any efforts to develop automaking technology and skills.

Table 5.3
The Details of Shinjin's borrowings from Toyota ($ thousand)

Month/Year	The Amount of borrowing	Use
July 1966	10,000	Factory Construction
December 1970	5,066	Purchase of Parts
August 1971	5,013	Purchase of Parts

Source: The Ministry of Finance (1972).

The situation was almost same for Hyundai. As table 5.4 indicates, the amount of short-term borrowings as well as paid interests increased tremendously from the late 1960s to the early 1970s. Hyundai borrowed several billion won at the rate of 45 percent a year from the curb market and was paying about 100 million won a day in order to amortize its debt during 1970 and 1971 (HMC 1987, 147). Thus, Hyundai desperately needed some kind of government measure to continue investing.

Table 5.4
The Amount of Borrowings and Paid Interests by Hyundai (thousand won)

YEAR	1968	1969	1970	1971	1972
Short-Term Borrowings	254,650	1,589,000	3,461,407	3,797,682	2,984,660
Long-Term Borrowings	-	-	-	-	3,407,124
Paid Interest	6,358	240,203	1,389,388	1,410,548	1,237,722

Source: HMC (1987) 139.

As I mentioned above, the Korean auto industry during the 1960s was characterized by the production of multiple models in small quantity as well as the sale of a small number of autos at high prices. Moreover, domestic production was in fact restricted to the final assembly of imported parts, with few productive activities that could be value-added. As a result of these characteristics, local auto firms sought to accumulate the price differential between imported parts and completely-built vehicles, rather than to accumulate profits by engaging in the process of "expanded reproduction of capital."[17] Therefore, the financial difficulties in the auto sector to a large extent revealed the weak structure of capital accumulation. In sum, the crisis of the auto industry around 1970 resulted rather from the stagnation of productive activities because of the weak structure of capital accumulation than the overproduction or labor resistance that have often been the main causes of crises in the auto industries of other advanced countries.

[17] So we can confidently say that Korean auto capital in the 1960s was closer to commercial capital than to industrial capital since its main source of profit came from the circulation of money capital and interest differential.

2.3 Government's Economic Policies to Cope with the Crisis

The importance of "business confidence" and private investment in maintaining political order in a capitalist economy has been noted by some scholars, including Block (1987) and Lindbrom (1984). In a sense, we can say capital influences politics both through the organized pressure it can bring to bear on the political process and through its investment decisions. Likewise, the Korean state had to intervene into the capitalist economic system, even by using anti-capitalist measures, to boost investments by firms, most of which were in critical financial trouble.

The combination of stabilization efforts and devaluation led many firms with foreign debts close to bankruptcy. Business uncertainty was compounded by the collapse of the Bretton Wood system in 1971, which marked the beginning of the end for the fixed exchange rate system, followed in September by new American restraints on East Asian textile exports. In the latter part of 1971, the FKI began to resist government efforts to achieve price stability, calling the economic technocrats in both the EPB and MOF "contractionists." The FKI, as briefly noted, also sought the conversion of curb market loans into bank claims, a reduction of the corporate tax burden, and lower interest rates (FKI 1983, 267). In the end, largely to avoid jeopardizing Korea's standing in international credit markets and boost investment, the government chose to bail out ailing firms as part of its wide-ranging emergency measures. On August 3,1972, President Park declared the "August 3 Emergency Decree," the purpose of which was to relieve or rescue private enterprises from the burden of a 3 to 5 percent monthly interest rate in the curb market.

By 1972, private companies owed the curb market over 350 billion won or about 29 percent of all loans. The decree froze all the debts from the curb market, and the debts were converted to long-term loans at a monthly rate of 1.35 percent to be repaid in five-year installments after a three-year grace period. For the chaebol, which had already benefited from absorbing the "ill-managed" companies and chronically suffered from financial pressures from the curb market, the decree was what they desperately needed at that time because they were using 64 percent of the total funds from the curb market.

Moreover, the decree even helped the chaebol expand their productive activities, as the state established "the Fund for Industrial Rationalization," which would be used mostly for strategic industries such as iron and steel, shipbuilding, electronics, and automobile industries, in which the major chaebol had invested heavily. Seventy-three percent of the total funds was released between 1972 and 1975 and was invested in these industries (Kim 1997, 149). In short, the August 3 Decree was an emergency economic measure to aid the big corporations and relieve their financial burdens, at the expense of the middle class and interest-bearing capital.

According to the company record of Hyundai Motors, emergency economic measures by the state helped it recover from severe financial distress. As can be seen in Table 5.4, the amount of interest payments by Hyundai began to decrease after 1971. The performance/capacity ratio also increased from 22.2 percent in 1971 to 25.8 percent in 1972 after a steep decrease for three consecutive years (HMC 1987, 138). Thus, the official history of Hyundai Motors contributed its reversal of fortune around 1972 to the state's emergency measure by saying, "with the 8.3. Decree, HMC was relieved of the financial burden of the high interest rate loans from the curb market. This contributed to the turn-around into black in 1973 from the red in 1971" (HMC 1987, 254-255).

2.4 The Effects on Institutional Arrangements of Industrial Policymaking

The economic policies between 1969 and 1972, largely initiated by the need to contain economic crisis, had two critical effects on the change of institutional structures that later laid the ground for the formation of a neomercantilist coalition among factions in the government and business circles. First, the two policy measures, which were intended to overcome the imminent economic crisis, made the relations between the state and chaebol more symbiotic and interdependent. On one hand, it appears that these government measures were a political gesture by the Park government to solidify its ties to the chaebol. By helping the chaebol avoid financial collapse through extraordinary policy measures, the Park government could expect the business to be loyal to the government. Evidence even suggests that the August 3 decree was leaked to a handful of the chaebol prior to the announcement, and this implies that the relations between the state and some of the chaebol had become quite close and direct. On the other hand, the fact that the decree had many provisions to protect the heavy and chemical firms, which were the main business fields of the chaebol, indicates that the state was willing to forge a much closer tie with select chaebol.

Another effect of the state emergency measure on the later development of state-business relations was a shift in the power center of the government's economic ministries. As described before, the 1960s were the era of the EPB, which had guided the Korean economy through a Five-Year Plan by locating itself firmly at the center of

Korean economic policymaking. Its monopoly of economic planning and resource allocation made this agency a kind of “super” ministry, orchestrating the individual policies made by other ministries. As the Korean economy escaped the dismal condition of permanent poverty around 1970, however, the policy stance of the EPB shifted to orthodox-liberal, mainly due to the massive infiltration of liberal economists who had been trained in U.S. universities. Amsden (1994, 91) called them A-TKEs (American-Trained Korean Economists) and characterized their economic view as one espousing "the Anglo-Saxon model as the best solution to their country's economic woes."

When the Korean economy disclosed serious problems by the early 1970s (e.g. high inflation, increase in balance of payment deficits, and increasing corporate failures), which were mainly the by-products of rapid growth in the 1960s, the policy consensus within the EPB was first to reinstate the market mechanism in resource allocation by adopting a policy of stabilization and austerity. Rejecting the expansionist and anti-cyclical policy relying on Keynesian budget deficits, the EPB thought light industries that could absorb a large pool of labor were to be the primary sector (EPB 1982). Focusing on heavy industries, including the auto industry, the EPB insisted on the premature nature of full-scale auto industrialization and on the gradual transition to heavy industrialization by concentrating only on such labor-intensive heavy industries as shipbuilding and consumer electronics (Kim 1990).

For the majority of these scholar-bureaucrats in the EPB, therefore, such an emergency measure as the August 3 decree was unthinkable simply because it violated the principle of private property and free play of a capitalist market. Noticing the conservative attitude prevalent in the EPB, President Park ordered his secretary of foreign capital to develop policies for freezing curb market loans and providing relief funds to businesses in secret. The secretary, then, formed an Ad-Hoc Committee on Economic Policies that consisted of his closest aides and excluded the EPB technocrats. It was the first time that the EPB had been alienated from the nationally critical economic policymaking process since its establishment in 1962.

In addition, this was the first moment that triggered institutional instability in the system of economic policymaking in Korea. The EPB represented the market-oriented and conservative stance of economic policymaking and became the center of a liberal and international coalition that consisted of liberal-minded economic bureaucrats, internationally oriented industrialists, particularly from the light industries, and advisers from international organizations such as the IMF and World Bank. To counter the gradualism and market-conforming policies of the EPB, there appeared another center of the state's economic policymaking. Its pivot was the MCI, while the President and his economic secretaries also played significant roles depending on the issues and general economic condition. Their allies in business were some chaebol, particularly those known for their aggressive and risk-taking business operation. In the end, as will be seen in the next chapter, by the end of 1972, there appeared a dual structure of economic policymaking in Korea, one through the routine bureaucratic process under the leadership of the EPB and the other through the economic secretary of the President and the MCI. Obviously, it was the latter structure that became dominant throughout the rest of the 1970s. The repercussion of this institutional shift was vividly manifested in the state’s attempt at heavy-chemical industrialization in 1973 in general and the auto promotion policy of the same year in particular.

3. Political Crisis, the Formation of an Authoritarian Regime and the HCI Plan

3.1 The Formation of an Authoritarian Regime

The ultimate source of political instability in Korea around 1970 was the decline of U.S. hegemony in the world political economy. The trigger for the change in the rules of Pax Americana was the deterioration in the U.S. balance of payments. To defend the dollar and rectify the deficit, Americans had entertained a variety of solutions. However, it was the Nixon administration that provided a drastic solution to the deficit program.

Among the new policy stances of Richard Nixon, the one that had the most critical impact on Korean politics was the change in defense strategy, which was initiated largely to solve the deficit problem. Nixon's new policy design, first unveiled to Congress in early 1970, revealed a switch from what was hitherto known as a two-and-a-half war strategy to a one-and-a-half one. The former had meant initial defense of Western Europe against Soviet attack and a sustained defense against an all-out Chinese attack on Southeast and Northeast Asia. In the new strategy, the second category was simply dropped. Such a change in U.S. foreign defense policy eventually resulted in the withdrawal from Korea of some 20,000 American soldiers by the middle of 1971, with the rest to be phased out in the next five years (Cho 1969; Lee 1974).

In the same years when the U.S. was considering the withdrawal of its troop from Korea, North Korea intensified its guerrilla warfare. Of some 629 guerrilla-related incidents reported in 1968 alone, the most noteworthy was the North Korean commando attack on the presidential residence, which claimed some 100 casualties and was a near miss on Park's life. In the same year, an American spyship, Pueblo, was captured by North Korea. Then, in what Henry Kissinger called the first major crisis in the Nixon

Administration, North Korean downed an unarmed American reconnaissance plane, the EC-121, in the high seas in 1969. Despite Kissinger's urging that several North Korean airfields be bombed in retaliation, Nixon refrained from a tit-for-tat with the North, thus causing Korean political leaders to doubt the U.S. government's resolution to defend the Korean peninsula (Kissinger 1979, 321).

All these events fostered national insecurity among political leaders in Korea, including the President, to a degree that justified the restructuring of a national security system. The government placed far more emphasis on self-help, while negotiating the terms of troop withdrawal with the U.S. government, hoping to get some monetary and technological help to upgrade the weapon system of the Korean Army. President Park (1979, 132) described the situation around 1970 as follows: "among the nationals within the free world, a broad relationship of credibility and fraternity existed. In time of emergency, friends could be counted upon. Not so any more".

Under security uncertainty around 1970, the Park government concluded that the first provision for survival was to purge all uncertainties from both the body politics and economic management. Thus came the resolution by Park to eliminate electoral uncertainties and to replace a self-regulating market with a regulated market. A state of the martial law was promulgated on October 17, 1972, to prepare for President Park's palace coup. The martial law's decrees suspended the existing constitution, dissolved the National Assembly, withdrew the freedoms of speech and assembly, and banned activities of political parties. On December 23, 1972, Park proclaimed the *Yushin* Constitution, which enabled him to become President with unlimited consecutive terms. The new constitution also greatly enhanced the President's authority and led to executive dominance over the legislature and the judiciary. In this way, the bureaucratic-authoritarian regime was firmly established in Korea by 1973 (Im 1987).

3.2 The Heavy and Chemical Industrialization (HCI) Plan[18]

A series of political and economic crises in Korea culminated in the establishment of an authoritarian regime. This new regime was called *Yushin* (Revitalizing) regime and was modeled on the 19th century Japanese *Meiji* Restoration in its ultimate goal of "Strong Army and Rich Country."[19] With his expanded power, Park turned his attention to the economic sphere, pursuing accelerated industrial entrenchment with the aim of national self-reliance and industrial upgrading. The new strategy was clear in the principles of the HCI plan. Because a new direction of industrialization required large-scale and risky investments, it was unlikely that such investments would be undertaken by private firms without decisive government leadership.

President Park had a choice between the EPB's soft reform plan and Blue House/MCI's aggressive plan. While the EPB's favored approach emphasized the

[18] There is no consent among scholars and economic policymakers regarding which industries should be characterized as heavy industries. When Korea announced the HCI plan in 1973, its targeted industries were six strategic industries: iron and steel, non-ferrous metals, petrochemicals, shipbuilding, electronics, and machinery (EPB, 1973). The auto industry was promoted as a sub-category of a machinery industry. In 1979, the auto industry was selected as an independent strategic industry (EPB 1982).

[19] As a former military man and one who received Japanese education and military training in his youth, President Park was known to be envious of Japanese rapid industrial growth. For him, defense-related heavy industries were symbols of national strength.

"civilian-initiated mode," the latter group, a group gathering around Mr. Oh Won-Chul[20] and espousing sectoral policies, emphasized a strong "government-led mode" for the purpose of promoting exports in the heavy and chemical sector. The members of the Oh group argued that, given the requirements of enormous capital investment and economies of scale, government initiation was absolutely necessary (HCIPC 1979). The balance of power had already shifted toward the latter group since the time when the tone of macroeconomic policy had changed from one emphasizing price stability and austerity to one emphasizing expansionist and anti-cyclical measures in 1972. The strengthening of institutional power of the MCI and HCIPC accelerated such a transition. Hence, the organizational decay of the EPB at this critical moment had a tremendous effect on determining the nature of auto industrialization in Korea, mainly by endowing MCI bureaucrats with the autonomy necessary for laying out an ambitious auto policy.

Financial support from the government was crucial to the development of HCI. In order to channel capital to strategic sectors, the Korean state adopted two basic approaches: (1) encouraging an inflow of foreign capital in the form of public and commercial loans rather than foreign direct investment and (2) mobilizing domestic savings, instituting the national fund for investment, and allocating these capital resources through the so-called "policy loan."

[20] Mr. Oh is a key figure in understanding the HCI project in the 1970s. After graduating from the engineering college of Seoul National University, he served in the Air Force. He was the manager of the Shibal automobile Co., which made the first domestically assembled car in 1955. From 1961, he served at the MCI where he was the Assistant Minister for mining and manufacturing. In 1971, he became the Second Presidential Secretary for Economic Affairs. He prepared the HCI proclamation by the President in 1973. When I interviewed him, he emphasized that his approach for Korean economic growth focused on "engineering" productive forces in a way to upgrade industrial structure, rather than on considering economic rationality.

First, the state attracted long-term foreign capital in the form of $8.4 billion in loans and $1.6 billion in foreign direct investment from 1973 to 1979. During the same period, the EPB channeled 32 percent of total foreign loans, whose payments were guaranteed by the Korean Development Bank (KDB), toward heavy and chemical industries. From 1977 onward, the trend accelerated, with these industries accounting for more than 80 percent of the foreign loans, leaving less than 20 percent for light industries (Bank of Korea, 1982).

Secondly, policy loans for strategic sectors were provided at interest rates substantially lower than commercial rates. Among the numerous policy loans, the National Investment Fund (NIF) was mainly responsible for channeling fiscal resources to heavy and chemical industries. Policy loans consisted of more than 35 percent of manufacturing investment in 1973-1980. In 1975, the NIF lent 66 percent of its portfolio to HCI projects, whereas in 1973 this figure was only 35 percent.

Despite various kinds of support measures from the state, the private firms in the beginning unsurprisingly hesitated investing in risky and huge capital consuming projects. However, the ongoing inducement policies assured private firms of limited risks and provided an excellent opportunity for expansion. Choi illustrated the chaebol's rush to heavy industries as follows:

> Despite high market risks and uncertainties involved in making investments in the technologically unfamiliar lines of business, major chaebol groups rushed into these new privileged sectors. They believed their future lay in these sectors. They also believed that once they commit some of their resources, the government would support them. President Park's extraordinary commitment to heavy industries and his apparent control of the microeconomic policy actions governing cash flows made investment in this sector subject to relatively low levels of strategic

> uncertainties... They also believed that the sheer size of heavy industrial investments would preclude the possibility of the government's rollback of its promotional efforts (1991, 108).

Hyundai's and to a lesser extent Kia's massive investments during this period might have been impossible without such state inducement measures as subsidized credit, entry control to assure monopoly rents, and the establishment of dual price structures that made the domestic selling price of passenger cars twice as much as that paid by foreign consumers. By joining the government's HCI program, the chaebol enjoyed many financial and extra-financial supports from the state. In return, big business provided the state with material abundance that it needed to legitimize its authoritarian rule.

4. Conclusion

The Korean economy was in crisis at the beginning of the 1970s, largely due to its unbalanced growth strategy. The exclusive promotion of exports of light industrial goods, while importing intermediary and capital goods, exasperated the endemic shortage of foreign currency. The increasing protectionism by developed countries on such items as textiles and clothing, coupled with credit crunch, gave rise to many insolvent firms, particularly in the sector of light industries, which relied heavily on foreign commercial borrowings. The crisis had spread all over the economy by the early 1970s, verging on a domino of business failures even among big corporations. The state intervened with an extreme measure, that is, the freezing of all corporate debts incurred at the curb market for a certain period. It is noteworthy that this emergency economic decree signaled the demise of market-oriented policymakers at the center of the state's economic policymaking structure.

The economic crisis alone did not demand the shift in state institutions and policies. From the late 1960s, North Korea's aggressive military attacks had intensified while the U.S. began to withdraw its troops from the Korean peninsula. The economic recession also fueled protests from various disaffected groups, particularly from workers and students. Most importantly, the opposition leader, Kim Dae-Jung, whose political ideology was doubted by many conservative politicians, became a powerful contender in the presidential election of 1971.

Finally, President Park and his close aides decided to put an end to most democratic political processes by establishing a new regime. With this new authoritarian regime established, President Park needed some kind of political rhetoric as well as a realistic goal to justify his dictatorial rule. President Park's new year's press conference in January 1973 purported to do that: he presented a bold vision of "$10 billion worth of exports and a $1,000 per capital income by the early 1980s" as a mid-term goal of the *Yushin* regime. At the same time, he proclaimed that "Korean industrialization has already entered into a stage of heavy industrialization" and that "his government would direct all the energies to the development of heavy and chemical industries in an effort to achieve those goals." Considering the total exports had been $1.62 billion and per capita GNP $318 in 1972, Korean exports had to increase sextuple and per capita income had to triple in eight years. His ambition seemed unrealistic. (*Chosun Daily*, January 13 1973).

In the next chapter, I examine how such institutional changes of the Korean state affected the state's policy toward an auto industry. The analytical focus is placed on how the neomercantilist coalition could be constructed, replacing the liberal and international one. The different responses from local firms to the state's initiative are also examined.

CHAPTER VI

THE 1970: NEW DIRECTION OF AUTO INDUSTRIALIZATION

In 1973, the Korean state announced an ambitious plan for auto industrialization. For the first time, the auto industry was selected and promoted by the Korean government as a strategic industry that would have broad linkage effects with a number of upstream and downstream industries.[1] The performance of the auto industry greatly increased during 1973-1979 in all dimensions (e.g. increase in production volumes and capacity, limited influence of foreign automakers, and the stabilizing number of automakers). From this time on, the promotion of the auto industry was to be carried out in close connection with the industrial upgrading program of "The Heavy and Chemical Industry (HCI) Plan" (FKI 1996, 205; MCI 1988).

More specifically, the government declared "The Long-Term Development Plan for the Auto Industry"[2] in 1974, in which it encouraged a few "selected" companies, such

[1] The Korean state in its HCI plan chose not the auto industry itself but the machinery industry as a strategic industry, to which the auto industry belonged as a centerpiece. The auto industry was selected as the export strategic industry in 1977, and as one of ten export strategic industries in 1979 (Shin 1990, 178).

[2] The MCI prepared he draft of a long-term development plan and reported to the Prime Minister on June 20, 1973 with the cooperation of the Heavy and Chemical Industry Planning Committee (HCIPC). On September 6, 1973, to strengthen the long-term plan the President issued a directive to develop the auto industry. On December 19, 1973, the final draft of the Long-Term Development Plan was submitted to the Prime Minister. The core idea of the long-term plan was contained in the mimeograph by HCIPC (1973) entitled *Reform of Industrial Structure in Accordance with the Policy Announcement of Heavy-Chemical Industrialization* . The government finally approved it on January 16, 1974 (HCIPC 1979).

as Hyundai, GM Korea, and Kia, to attain economies of scale by developing indigenous models with less than 1,500 cc engine capacity and setting the minimum annual production capacity at 50,000 for each producer.[3] This plan included detailed local content requirements scheduled to achieve 95 percent localization by the end of the 1970s. The plan called for the production of a so-called "people's car" at certain designated manufacturing sites. The production of people's car was supposed to begin in 1975. In implementing the new plan, the MCI restricted manufacturing of small passenger cars to three primary auto firms. Each was required to submit its people's car development plan for approval. Once approved, the producer was not allowed to introduce replacement models within the period set by the MCI (KIET 1982).

The plan also provided special policy measures to the parts and components sector. Of particular importance was the prohibition of terminal firms from manufacturing auto parts and components other than engines and transmissions. Other auto parts and components had to be manufactured by non-terminal auto firms. The state constantly selected new auto parts and component items and their designated domestic suppliers for special promotion. Once the local production of a particular component met governmental standards, it was protected under a complete import ban.

In the plan, the government designated the auto industry as an export industry. Starting in 1977, all three firms were required to set their annual export targets. During

[3] This policy is similar to the one adopted by the Japanese government in 1955: MITI launched another plan in 1955 to stimulate the development of a 'people's car' by 1958. "The Minister decided that Japan should manufacture a 4-passenger 'minicar'. . . . MITI then asked firms to submit prototypes in a sort of contest, with the winner to receive an official designation from the Ministry, exclusive manufacturing rights, and subsidies to improve the vehicle's performance" (Cusumano 1985, 20-21; see also Chung 1995).

the initial export drive, in addition to subsidized export credits and direct export subsidies, the three designated producers were also rewarded with the privilege of being allowed to assemble a limited number of imported CKD kits for the domestic upscale market. This lucrative import quota was rationed among the three in proportion to their export performances. In addition, the government induced the automakers to set an export price well below manufacturing costs while allowing them to sell to domestic consumers at substantial profit margins.

Upon reviewing the shift in auto policy in 1973, our question is obviously directed to how the Korean state was able to shift the auto policy from the sources of monopoly rents to the engine of growth within a relatively short time span. To answer this question, we need to examine carefully the shift in institutional structures that facilitated the ascendance of a certain type of coalition over its competitors in industrial policymaking in Korea. In chapter four, it was claimed that the lack of insulation of the state agency that was assigned to make sector-specific industrial policies, coupled with the weak financial and organizational power of business, and collusion-oriented state and business relations, fostered the ascendance of a rent-seeking coalition during the 1960s. In addition, in chapter five, it was shown that such institutional arrangements began to change in the early 1970s as a result of economic and political crises.

What the new coalition wanted was self-sustained industrialization with a specific focus on establishing “national champions” in key strategic sectors. This shift in growth strategy was almost impossible within the institutional arrangements of the 1960s, which let the coalition of EPB technocrats and the industrialists from light industries gain the upper hand. In order for the new coalition to command the height in industrial policymaking, some things had to change in the existing institutional arrangements that had centralized the power of economic policymaking in the EPB and maintained uncoordinated and collusive relationships between state agencies and business. The political and economic crises in the early 1970s provided a good pretext for the change in institutions of industrial policymaking. During the period between 1970 and 1973, hence, the power of a liberal coalition had been greatly reduced as a consequence of the increase in policy autonomy of the MCI as well as the advent of multi-sectoral conglomerates as proponents for a new type of industrialization. Within the renewed institutional context, the new coalition between the nationalistic bureaucrats and a few big business groups set up a new agenda of “big push” heavy industrialization and ultimately sought industrial “big bang” and upgrading as the *raison detre* of the existence of the strong state and bigger business.

In the following section, I will first make clear the enhanced performance of the Korean auto industry during 1973-1979. Then follow the details of state support of the auto industry from 1973 to 1979. After that, a careful examination of the shifts in the institutions will be carried out, specifically focusing on the formulation of the 1973 and 1974 auto policies that have had an enduring effect on the development of the Korean auto industry, even up to today.

1. Enhanced Performance of the Korean Auto Industry during 1973-1979.

The most important objective of the 1973 auto policy was the production of a Korean style small-size passenger car.[4] According to a MCI document (1974,132), such a small car 1) enables the model type to be simplified and continuous, 2) allows the parts to be standardized, 3) achieves the economies of scale that make export possible, and 4) enhances international competitiveness by accelerating technological accumulation.

All these policy objectives were considerably achieved by the end of the 1970s. There were three characteristics, which deserve to be examined carefully, in the implementation process of 1973 auto policy, particularly in connection with its role of enhancing the performance of the Korean auto industry. First, the state did not limit the number of possible producers of a small passenger car. This time, the long tradition of limiting the number of final assemblers was deserted in favor of introducing the principle of competition. Though Hyundai was the most aggressive proponent for the 1973 policy and had very close relations with the state in formulating the policy, it was not given any other privileges than those given to other authorized firms.

The MCI sent out the directive on July 12, 1973 to the four exiting assemblers. The directive specified that each of the companies had to reply with its business plan for investment, finance, and production by August 5, 1973 (MCI 1974, 153). After surveying

[4] The specification for the Korean style small-sized passenger car were as follows:

Model:	Original design with long-life span
Engine:	Below 1,500 cc
Localization:	Above 95 %
Volume:	50,000 units per year
Price:	Around $2,000
Production Date:	1975

each proposal, The MCI decided that three companies would participate in the production of the small passenger cars – Hyundai, Kia and GM Korea – excluding Asia, which failed to submit a feasible investment plan. Foreign model assembly would be allowed for the vehicles that had over 1,500 cc engines. Whether to produce a foreign model would be the decision of each company. However, the total volume of foreign models would be limited to 20% of the total demand for the passenger car (MCI 1974, 165). In the end, we can say that the 1973 auto policy did not aim at either promoting a single giant auto firm or allowing unchecked competition among existing firms, but at combining state direction and private entrepreneurship to achieve the development of the Korean auto industry.

The second characteristic of the implementation processes of the 1973 policy was concerned with the selection of the "people's car." As I have indicated, the government permitted three assemblers to produce a small passenger car. However, the three models that were supposed to be produced by these assemblers were not to be the people's car. According to the MCI plan, the government would name one of the three models as the people's car only after 1976. The people's car would then be given financial support, tax breaks, and administrative conveniences so that it could occupy more than eighty percent of the passenger car market in Korea by 1980 (MCI 1974, 145-146). This way of selecting the model of the people's car could restrain the rent-seeking activities of local firms, because the provision of state support was based not on the written plan of the firms for the production of a people's car, but on the actual models that developed by the firms.

The result of the 1973 policy was also noticeable in numerical figures. As a result of the new state policy that emphasized the independent path of auto industrialization for the first time in peripheral auto manufacturing countries, Hyundai, among others, laid the foundation for mass production and exports. Thanks to financial support from the government and favorable economic conditions, the total production volume of passenger cars increased from 12,751 units in 1973 to 113,564 units in 1979 (Oh and Cho 1997, 52). The average annual increase rate between the two oil crises reached almost 100 percent. The production capacity also increased dramatically, more than seven-fold from 1973 to 1980 as Table 6.1 shows. The export of passenger cars, however insignificant it may have been, began in 1977.

Table 6.1
The Production Capacity of Korean Automakers (passenger cars only), 1973-80 (unit: thousand)

YEAR	1973	1975	1979	1980
Hyundai	7.8	56.0	116.0	116.0
Daewoo (GM-Korea)	16.0	16.0	50.0	76.0
Kia	-	24.0	50.0	46.0
Asia	7.2	7.2	-	-
Total	31.0	103.2	216.0	238.0

Source: Korean Development Bank (1984) 355.

The last point that must be emphasized in interpreting the result of the 1973 auto policy was that the market dominance of auto TNCs could be avoided, depending on the contents and implementation processes of state auto policies. On purpose or not, the 1973 auto policy crowded foreign automakers out of the domestic auto industry.

In contrast with the Korean experience, the auto policies in other LDCs failed to deter the delaying tactics of the auto TNCs. The delaying tactics indicated that auto TNCs tended to regard the auto policies in LDCs as unstable, thereby requiring no immediate response to a new state policy on their parts. Thus, when the Brazilian government announced a mandatory manufacturing policy, instead of the simple assembly of imported parts, in 1956, the major U.S. automakers did not accept the government policy immediately and began to bargain with the state concerning the terms of participation in the Brazilian auto industry. Ten years after the formulation of the state policy, for instance, Ford presented a new proposal in 1966, and it was accepted by the Brazilian government. Shapiro (1994, 118) comments on this by saying, "Ford gambled that it would eventually be allowed in the Brazilian market on its own terms. It correctly bet that the Brazilians would be forced to accept a company with Ford's international stature and clout."

Yet, such calculation and gambling by the auto TNCs were not applicable to the 1973 auto policy in Korea. This is revealed by examining GM-Korea's response to the state policy. In a 50-50 joint venture between GM and Shinjin, GM-Korea introduced the Rekord 1900 and the Chevrolet 1700 in 1972. These two models failed in the U.S. and European market. As a common practice, GM had transferred outdated and obsolete models to Korea in order to compensate for losses in the U.S. and European markets incurred from these models. With the oil price hike after the oil shock in 1973, these two models proved a complete failure in Korea, too. The introduction of fuel-efficient cars – Kia's Brisa (1,000 cc) and Hyundai's Pony (1,300 cc) - further eroded GM-Korea's market share.

Shinjin, then, had to be removed from the auto industry because of its financial failure in 1976, and Daewoo took the place of Shinjin as the domestic partner of GM. The name of Saehan replaced GM-Korea and introduced a new model, Gemini, 75 % of which was localized. But the belated introduction of a small sub-compact car by Saehan was not enough to recover the lost market share, which was well over 50% before 1974. In sum, GM-Korea was never able nor prepared to meet the content and standard of the 1973 auto policy. This incapacity came not only from the inability of Shinjin to pursue an independent strategy but also from the unwillingness of GM to foster indigenous and genuine development of the auto industry in Korea.

From the above argument, we can conclude that the performance of the Korean auto industry between 1973 and 1979 was greatly enhanced in every dimension. In other words, an increase in production volumes, capacity, and exports, the maintenance of three firm system throughout the period, and the exclusion of auto TNCs all indicated that the growth potential of the Korean auto industry advanced in this period. Next, I will consider how the state promoted the auto industry by dividing state auto policy into production and consumption support measures.

2. Auto Policies during the Era of HCI.

The promotion of HCI required the mobilization of far larger amounts of capital than the creation of the light industries required. Gerschenkron (1962) argued in his analysis of "late industrialization" that the task of mobilizing a huge amount of capital led to the need for financing by large investment banks (as in 19th century Germany) or by the state (as in 20th century Japan). Later, this role of the state as the main conduit of the allocation of financial resources was again emphasized by Zysman (1983), when he attributed the root of rapid industrial growth in Japan and France to the "credit-based, price-administered" financial system of these countries.

To this role of the state as the provider of credit, Amsden (1989; 1992) added another role of assisting in the "learning process" of local firms. Whereas the late industrialization in Germany and the U.S. was rooted in their "innovation" and "pioneering technology" (i.e. the second industrial revolution), argues Amsden, industrialization in Korea, Japan, and Taiwan was a process of borrowing technology that had already been commercialized by firms from more advanced countries. These latter countries had to grow through a process of "learning." Denied the competitiveness asset of new products and production techniques, state intervention in these countries had to be greater than in advanced countries.[5]

Taking up the task of HCI, the Korean government made a general plan about the future shape of an industrial structure, prepared sector-specific promotional plans, and provided subsidies and incentives to the firms that decided to follow the government's direction. To be more specific about the state's support of the auto industry, I will divide them into production and demand support and examine them separately.

2.1 State's Support of Production

To promote HCI, the state prepared a number of support measures in various respects, and they included fiscal policies (i.e. the establishment of National Investment Fund) and financial and tax policies (i.e. the reduction of corporate taxes and tariffs). However, the most distinct characteristic of state support was in the area of financing. At

[5] Amsden (1989; 1992) argue that, along with active state intervention, the late industrialization on the basis of the learning process entails that (1) firms have had to be more diversified into technologically unrelated industries, and (2) the strategic focus within these firms has initially had to be on the shop floor rather than the R&D laboratory or other administrative functions.

first, as we can see in table 6.2, the portion of policy loans taken up in general loans increased to a significant extent over the latter half of the 1970s, and, more to the point, the portion of industrial loans in policy loans also increased significantly. Although I do not have data on the portion of industrial loans channeled to the auto industry, it surely was one of the recipients given the lion's share because the state regarded the development of the machinery industry as top priority in its drive for HCI. This can also be seen through the examination of the details of the National Investment Fund (NIF).[6]

Table 6.2
The Details of Industrial Loans and Policy Loans, 1974-1979 (100 million won, %)

Year	Gross Loans (A)	Policy Loans (B)	Industrial Loans (c)	B/A	C/A
1974	30,118	14,556	10,045	48.3	36.3
1975	38,568	19,579	10,937	50.8	37.3
1976	48,672	25,767	14,404	52.9	37.8
1977	63,433	36,116	18,407	56.9	40.5
1978	93,160	60,627	25,667	65.1	44.3
1979	130,642	84,530	41,289	64.7	46.4

Source: KIET (1987) P. 53, 57.

In particular, since Korean auto firms relied on loan financing from various lending institutions rather than on the capital market in channeling their needed capital, the role of the government became more obvious. The essence of a growth-oriented neomercantilist coalition between the state and business lay in how they cooperated in mobilizing required financial resources in the direction of indigenous auto industrialization. For instance, the government authorized Hyundai to borrow $72 million from banks in Japan, England, and France and got its own banks to come up with the rest of the $100 million needed to build a plant capable of producing 56,000 cars a year. The

[6] The NIF was established to fund HCI as a fiscal measure. In 1982, of all the financial support measures by the NIF, 33 percent flowed to the machinery industry, the highest among the industry that received the support from NIF (MCI 1982, 12).

collaborative efforts by both the state and Hyundai succeeded in persuading Barclays Bank in England to loan about $50 million. Backed by the Export-Import Bank's export credit guarantee department, this loan, according to an official account, was "the first project loan that a Korean company had received from a foreign bank." Redeemable in seven years with a three year grace period, the loan was all the more remarkable considering that Hyundai's paid-capital then was only $5 million (UPP 1992, 7-8).

To promote the auto industry, the government also exempted the direct tax on the construction of factories and equipment investment and provided long-term loans at a much lower interest rate than that applied to general loans from banks.[7] Yet the most important source of financing during the latter half of the 1970s was foreign borrowings. As indicated in table 6.3, the share taken by foreign borrowings in the total financing of auto firms was over 45 percent. Since the state placed severe restrictions on capital inflow[8] and the interest rates of foreign borrowings were greatly reduced due to the overflow of oil dollars, thus widening the gap with domestic interest rates, the ability to finance needed capital from abroad meant getting the state's financial support in an indirect way.[9]

[7] From 1974 to 1979, the interest rates on the policy loan were lower than those on general loans by 3 to 5 percent (Shin 1990, fn20).

[8] For instance, according to the revised law (1973) regulating the inflow of foreign capital, domestic banks had to guarantee the repayment of every loan borrowed by private firms. Given the strict supervision of banks by the state, then, borrowing foreign loans meant that the firms could get the state's indirect subsidies.

Table 6.3
The Structure of Financing of Korean auto Firms, 1977-1981 (100 million won)

Source	Amount	Percentage
Equity Capital	1,021	33.8%
Domestic Policy Loans	633	20.9%
Foreign Borrowings	1,374	45.3%
Total	3,025	100.0

Data: KAICA (1983: 303)

As the level of auto production advanced from assembly work to manufacturing, there appeared an intense demand for technology among local auto firms. Nevertheless, given their scant financial resources, existing auto firms were satisfied with importing individual technology from foreign firms while attempting to renovate it. Given the limits of local firms to invest in technological acquisition, the Korean state took the place of private firms by investing in technology development and training skilled labor. The active role of the state in facilitating technology and human resource development is clearly demonstrated by comparing investment in R&D by the state and by the private sector. As table 6.4 indicates, the state took the leading role in R&D activities, investing larger amounts of money to strengthen the scientific and technological foundation of key strategic industries.

Still, there was another significant state production support that has often been overlooked in the works on the Korea's auto industry. The development of an auto industry may be extremely difficult, if not impossible, without the concomitant development of a steel industry simply because about 75 percent of a car is made of steel

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[9] From 1973 to 1979, the EPB channeled \$3.8 billion, 32 percent of total foreign loans, whose payments were guaranteed by the Korean Development Bank (KDB) and other banking institutions, toward heavy and chemical industries (Bank of Korea 1984). From 1977 onward, the trend accelerated with these industries accounting for more than 80 percent of total foreign loans in the manufacturing sector, leaving less than 20 percent for light industries.

products. The construction of an integrated steel mill began in the late 1960s and gave birth to the one of the world's most efficient steel company, Pohang Steel Company (POSCO), in 1974. POSCO was able to provide its steel to domestic automakers at a cost of $320 per ton compared to Japanese and American producers who had to pay $550 and $430 respectively. This is also revealed when we compare the prices of imported steel and those of POSCO's steel for domestic consumption. Table 6.5 indicates that the gap between the prices of imported steel and POSCO's steel for domestic consumption had widened during the period of 1979-1982. Increased production in the auto industry, in turn, helped the steel industry by increasing demand and thus leading to the higher capacity utilization rate in the steel industry (*Economist*, May 14, 1988, 68-70).

Table 6.4
The Composition of R&D Investment, 1976-1980 (million won)

Year	Total R&D Investment	Government : Private Sector
1976	106,220	80 : 20
1977	158,869	64 : 36
1978	202,218	61 : 39
1979	242,900	67 : 33
1980	316,946	68 : 32

Source: composed in reference to MOST (1985) 14, 15, 23

Table 6.5
The Price Differences between Imported steel and POSCO's Steel for Domestic Consumption (dollar/thousand ton)

YEAR	1979	1980	1981	1982
Average Price of Imported Steel (A)	410	456	470	567
Domestic Price by POSCO (B)	305	311	333	329
A-B	105	145	137	238

Source: Institute of Social Science, Seoul National University (1987), 323

2.2 State's Support of Consumption

Some writers such as Lew (1992) have pointed out that the Korean state's support for the auto industry in the 1970s was unsystematic and counter-productive since the state persistently repressed the demand for passenger cars among potential consumers. Although there is a grain of truth in this argument, I disagree with it since the deliberate promotion of consumption by the state, particularly under the economic condition of low per capita income,[10] might have had a more debilitating effect on the future growth of an auto industry. With the low level of national income, promoting the consumption of expensive consumer durables like a passenger vehicle would have resulted in the proliferation of models and makers, which made it difficult for local firms to achieve efficient scale economies. In addition, promoting auto consumption during the early stage of industrialization would have accelerated the concentration of wealth into a few people who could afford to buy passenger cars.[11] This would in turn have stifled the potential of a growing mass market for affordable vehicles in the future.

A careful examination of the state's policies in the area of auto consumption reveals the dilemma faced by policymakers in Korea. The solution was to break through the problem by way of promoting local firms' export activities, while encouraging domestic consumption only in small-sized cars. In the first place, the state provided a number of incentives to encourage the export of automobiles. These included the

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[10] The process of mass consumption of automobiles (sometimes called motorization) has been argued to occur when per capita GDP exceeds $2000. For most of the 1970s, the per capital GDP of Korea was well under $2000. It recorded $1,734 in 1981.

[11] This has actually happened in many Latin American countries.

provision of short-term and long-term export financing and the special depreciation of productive equipment as a means to cut taxes. Yet the most important incentive was to allow auto firms to mark relatively higher prices on the cars sold in the domestic market. Given the domestic firms' higher costs to manufacture automobiles than those of international automakers, the success of auto exports depended to a great extent upon transferring the burden of higher prices to domestic consumers. Since the domestic auto market was dominated by three local auto firms and protected from the import of foreign cars, Korean consumers could not but pay extra costs to buy a passenger car. This can be indicated by comparing the selling prices of three popular models at the time (see table 6.6).

Table 6.6
The Differences between Domestically Selling Prices and Export Prices among Three Popular Models, 1980 (thousand won)

Model	Pony (Hyundai)	Brisa (Kia)	Gemini (GM Korea)
Selling price in the domestic market	2,414	2,105	2,380
Export price	1,043	897	1,164

Source: KAICA (1980); Shin (1990: 86)

At the same time, to promote the sale of small-sized passenger cars, the government reformed the tax structure applied to auto sales in December 1974. Previously, the purchasers of passenger cars had to pay 30 percent for a special consumption tax regardless of the engine capacity of the cars. But the government assisted the production of small-sized passenger cars by lowering the tax to 15 percent for vehicles under 1,500 cc and to 20 percent for those between 1,500-2,000 cc, and by raising the tax rate to 40 percent for vehicles over 2.000 cc.

From the brief review of the state's support for the auto industry, particularly between 1973 and 1979, we can conclude that the role of the Korean state in promoting the indigenous development of an auto industry cannot be exaggerated.[12] Although the state did not provide assistance as visibly and directly as it did to the steel and shipbuilding industries, its production and consumption support had two significant implications for the future development of the industry.

First, the 1973 and 1974 auto policies, along with subsequent support measures, represented, for the first time in the history of the Korean auto industry, the state's sincere effort to exclude the influences of foreign automakers and to seek out an independent strategy. Recognizing technological weakness and capital shortage of local firms, the state had encouraged local firms to sign joint-venture contracts with foreign auto firms before the launching of HCI. However, in 1973, the government revised the law governing foreign direct investment in the direction of excluding foreign interests from key industries. More specifically speaking, the Foreign Capital Inducement Act was changed in 1973 to limit majority ownership in foreign investments to firms that brought in government-specified technology for targeted import substitution or that exported over

[12] It sounds paradoxical that the government allowed for higher prices for domestically-consumed cars and at the same time reduced the tax rate for small cars to alleviate consumer burdens. However, it should be understood as the effort of the government to promote the consumption of only the small people's cars within the general policy stance of the repression of auto consumption due to higher oil prices. This policy had also a signaling effect on the manufacturers in that, given the state policy occasioning the widening gap of prices between large and small cars, the manufacturers were more likely to concentrate on producing small-sized cars.

80 percent of their output (Mardon 1991).[13] From 1973 to the financial crisis of 1997, therefore, Korea effectively pursued a highly restrictive strategy toward foreign ownership in most manufacturing industries.

Second, the state supports for the auto industry was firmly based on the criteria of achievement, thereby having discriminatory effects on local auto firms. In this respect, Hyundai was able to boost its market share and productive capacity during the latter half of the 1970s because of its willingness to follow, or even go ahead of, the state's initiatives, while GM Korea (previously Shinjin and later Daewoo) fell behind its competitors as a result of its insistence on the old pattern of auto industrialization (e.g. exclusive reliance on the introduction of foreign models and few efforts to realize scale economies).

The various industry support measures by the state and the cooperation of some local firms were surely the foundation of rapid growth of the auto industry during the latter half of the 1970s. However, there was the potential of industrial decline even on such an ideal foundation: that is, the state's emphasis on scale economies by encouraging local firms to build huge plants and to engage in export activities could have resulted in overcapacity. This actually became a serious problem hindering further growth of the auto industry, particularly after 1979.

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[13] Korea is famous for an extremely low figure of FDI. In a study of sixty-six countries conducted in 1977, Korea ranked lowest in the proportion of wholly foreign-owned firms - approximately 17 percent. The second-lowest was Israel with 30 percent; Japan was third with 33 percent (Malon 1991).

3. The Formation of a New Coalition

About four weeks after the proclamation of the *Yushin* Constitution and near-absolute rule over society in December 1972, President Park declared at the New Year's presidential press conference on 12 January 1973 that Korea was entering the age of heavy and chemical industrialization. The auto policy was formulated as part of this nationalistic Heavy and Chemical Industrialization Plan. More specifically, the auto industry's role as the pioneering industry to promote the development of the machinery and defense industries was emphasized (MCI 1974, 36-37). On June 20, 1973, the government (MCI) announced a draft of "the Long-term Plan of the Promotion of the Auto Industry, "[14] the essence of which was, as I noted, the development of original models through mass production and with an aim of exports.

By and large, the 1973 auto policy, together with the state's production and consumption support delivered to complement the 1973 policy, had succeeded in

[14] The Long-Term Plan of the Promotion of the Auto Industry was formally announced in May 1974. Its main contents can be divided into two categories (completed vehicles and parts) and summarized in a table.

Table 6.7
The Main Contents of the Long-Term Plan

	Contents
Completed Vehicles	1. Complete localization of passenger cars by 1975 (Local content rate: 95 %) 2. Export of 75,000 vehicles by 1981 3. Establishment of a specialized and mass producing system according to the type of vehicle 4. Development of sub-compact passenger cars (original model within the price of $2,000, producing at least 50,000 vehicles by each assembler)
Parts	1. Separate Promotion of assembly firms and parts firms. 2. The principle of specialization: one factory produces only one auto part. 3. Encouragement of joint venture with foreign auto parts firms (the equity participation of foreign partners not exceed 50 %) 4. Construction of industrial park at Changwon 5. Provision of various financial and tax incentives.

Source: KIET (1982)

accomplishing its stated aims, and exerted a crucial impact on the business strategies and developmental pattern of the Korean auto industry. To explain such a result, we must understand the shift in dominant coalition in the process of the formulation and implementation of auto policies. In the remaining parts of this chapter, I will address how coalitional change occurred during the mid-1970s.

3.1 The Waning Power of the EPB and the Increasing Autonomy of the MCI

In the previous chapter, I argued that the EPB's policy suggestions in response to deteriorating economic conditions were mostly refused by the state in the 1970s. Why did the EPB, which had been the entrusted apparatus of economic policymaking in the 1960s, have to witness the institutional decline of its power within the government in the early 1970s? The answer seems to lie in diverging interests between political leaders and economic technocrats as the economic structure became more complicated. During the 1960s, both the EPB technocrats and political leaders had a common interest in export-led economic development on the basis of a relatively open market, realistic interest rates, and debt-financing. The exhaustion of the easy phase of EOI produced an imbalance of economic structure by the end of 1960s, the main features of which were balance of payment problems, corporate failures, and increasing foreign debts. To rectify the situation, both the EPB technocrats and political leaders agreed to upgrade the economic structure to one that could balance the development of consumer goods and capital goods industries as well as light and heavy industries. Nevertheless, both parties revealed differences in policy preference when it came down to the specific details of a new economic policy.

The EPB suggested incremental and market-conforming measures as a new economic policy. To rectify the imbalance between light industries and heavy industries, which had resulted in the severe foreign exchange crisis, the EPB proposed to invest only in such labor-intensive heavy industries as shipbuilding and to expand heavy industries only gradually in accordance with the shifts in comparative advantage enjoyed by Korea. Besides, recognizing that the source of the crisis was in part the government's intervention into the market mechanism, the EPB began to emphasize private initiative and autonomy in making investment decisions as the new operational principle of the Korean economy. In brief, the EPB's stance on a new economic policy was to strengthen private initiative, restore the market mechanism, and focus on incremental heavy industrialization.

However, the interests of the political elite were constrained more by political exigencies brought about by economic problems. For them, the political and economic crises of the early 1970s required radical measures that could not only salvage debt-ridden capital but also provide internal protection to the general public from the threat of the communist North. Orthodox-austerity policy and the reduction of state intervention were in theory the optimal principles in an economy that suffered from lax monetary control and balance of payment problem. However, the result of such a policy would have been the increased collapse of big capital that failed to finance debts as well as increased unemployment. Although such a policy could have revamped a price mechanism and thus rationalized resource allocation in the long-term, it had a potential to drive the economy into severe disorder in the short-term. Considering the political risks involved in deflationary economic policy and the political and economic conditions demanding swift government actions, the incremental approach offered by the EPB had only a slim chance to be accepted as state policy unless political leaders could be convinced that the long-term effects of stabilization policy were beneficial.

In the end, the state was determined to break through the crisis by relying on *dirigisme* policy measures. In this process, planning was highly centralized in the Blue House and the MCI, bypassing the more orthodox EPB. Moreover, the government increasingly centralized control over the policy instruments required to implement its designs. From 1977 to 1979, 80 percent of total investment in manufacturing went into the heavy and chemical industries, largely in the form of policy loans from the state-owned banking system. Accordingly, confronting the evidence that the state showed more policy activism throughout the 1970s, the explanation of the formulation and execution of a sector-specific auto policy in 1973 must first of all be sought in how the EPB's policy dominance was surmounted and in what kind of institutional arrangement was formed to replace the EPB-dominant policymaking structure.

3.1.1 Background

After 1965, Korean export industries were booming, and the economy began to grow over 10 percent annually. Although oil refineries, chemical fertilizer factories, and cement factories were largely financed and built by foreign loans and foreign technical assistance during the First Five-Year Economic Development Plan (1962-66), the heavy and chemical industries were at too primitive a level to sustain the Korean economy.

Even facing the economic crisis during the late 1960s and early 1970, the technocrats in the EPB and advisors from such international organizations as the IMF and

IBRD claimed that Korea would still have to stick with its light-industry based export strategy because of Korea's comparative advantage in these industries. Given the fact that the post-Korean War baby-boom generation would be in the labor market in the mid-1970s, argued an EPB bureaucrat, such labor-intensive industries as textiles and wig-making were the best potential employers of this large influx. Thus, Chang Ki-Young, the EPB minister, advised President Park to move slowly in building up the heavy industry.[15] Even after the EPB's exclusion and humiliation in the formulation of the August 3 emergency decree in 1971, the EPB did not abandon the neoclassical creed of stability and comparative advantage. Thus, in the Third Five-Year Economic Development Plan (1972-76), the EPB planned to achieve an advanced and balanced industrial structure with "gradual" heavy and chemical industrial promotion for import substitution. Only such labor-intensive heavy industries as electronics and shipbuilding were considered in due time as export-oriented industries.

While the political and economic crises in the early 1970s strengthened a liberal creed among economic technocrats, they at the same time prompted another group of bureaucrats and politicians to embrace more radical measures. President Park at first followed the EPB's lead in economic policymaking and thus allowed the EPB and the Prime Minister to announce a new framework of economic policy that emphasized private initiative at the end of 1971. However, Park was not comfortable with the new direction of economic policy at all, at least because it somewhat denied his contribution to Korea's economic growth.

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[15] Hyung-Ki Kim edited a book containing a lot of monographs and memoirs of former and current bureaucrats in EPB. This book helped me comprehend their genuine policy orientation. See Kim (1999).

So right after the announcement of a new economic policy, President Park expressed his genuine thought at a ceremony for Export Day as follows (Secretary Office of the President, 1973 vol.3, 83-84):

> Now, our industry is reaching the stage that could be advanced into heavy industrialization and, I believe, exports is also reaching the turning point where the government-led export regime should shift toward the private-led one.
>
> However, the recent changes in international politics and foreign markets cast shadow over our export prospect, and press us to make strenuous efforts. . . .We have to overcome these obstacles at any cost and win at intense international competition. In order to do that, manufacturing firms, exporting firms, bureaucrats and general citizens should unite under the banner of "exports and strong state" and continue to exert creative efforts. . . . *The foundation of state power is economic construction while the driving force of economic construction is export promotion*. (my italics)

From this speech, we can see that a mercantilist creed was still deeply ingrained in Park's mind. Although he recognized the need to shift toward private-led growth, he at the same time urged economic actors to unite under the leadership of the state. Such an inconsistent policy orientation of President Park met another momentum in November 1971, after which his idea became more apparent. As I discussed above, the withdrawal of a U.S. military forces from Korea was one of Park's serious worries in the early 1970s. Park, then, ordered the cabinet to formulate a plan for military self-defense, including the construction of an arms factory (HCIPC 1979, 421-426). The government under the leadership of the EPB formulated a construction plan of " four core factories," according to which the government would select casting steel, special steel, heavy machinery, and shipbuilding industries as the "strategic priority industries" and achieve the self-sufficiency in basic arms as rapidly as possible (Kim 1990, 322). The EPB chose Japanese companies as the project partners and signed the contract introducing commercial loans with these firms. In doing this, the EPB thought that the project would be successful since it was based on the relatively well-established international division of labor: Korea provided manpower and factory sites and Japan offered capital and technology.

However, this project did not progress as expected. According to one daily newspaper (*Seokyong Daily* August 9, 1971), "it [the project] should be revised because of the lack of cooperation on the part of Japan and the uncertainty of domestic producers." Under such a situation, the EPB could do little other than search for other partners in the U.S., Norway, and Sweden. After all, the project was destined to be discarded. President Park's disappointment in the EPB's dealing with the project can be read in the memoirs of his secretary (Kim 1990, 267): after hearing the EPB's briefing that the project did not progress, "President Park, who had worried about the rapid construction of the defense industry to strengthen military self-sufficiency, confessed frankly his frustration and disappointment in the car."

In the end, such a way of dealing with economic and political problems by the EPB made the technocrats in the EPB look unpatriotic and harmfully pedantic in the eyes of President Park. As a result, Park began to regard EPB bureaucrats as obstacles to his desire to build a strong nation (KDI 1982).[16] Without the backing of a strong President, the institutional power of the EPB was no longer taken for granted within the government.

[16] President Park did not have much confidence in liberal-minded economic bureaucrats from the start. Once Deputy Prime Minister said, "through the 1960s Park despised American-trained economists" (quoted in Clifford 1998, 59).

3.1.2 The Emergence of Dualistic Policy-Making Processes

On the same day that President Park received a briefing from the EPB regarding the gloomy future of the project to build "four core factories," the Assistant Minister of the MCI, Oh Won-Chul, who had a different thought about the construction of a defense industry from that of the EPB, went to the Blue House and met the President. The idea that Mr. Oh brought to the President was that the defense industry could be constructed as a part of more general heavy-chemical industrialization. Mr. Oh also emphasized that heavy-chemical industrialization, from the beginning, should aim at exports, scale economies, and concentration in one location and construct an "all-out posture of public and private cooperation" as a way to encourage the participation of private firms.[17] As soon as Mr. Oh left the Blue House, President Park made an order that Mr. Oh begin work at the Blue House as an economic staff member the next day (November 10, 1971). It is needless to say that the status of the MCI within the government was greatly enhanced as its assistant minister took charge of every detail of heavy-industrialization, excluding the EPB technocrats.

Hence, EPB technocrats began to be excluded from sectoral planning, budgeting, and industrial policymaking processes in late 1971. Instead, their functions were reassigned by the President to the ministerial level. President Park and his close aides

[17] Mr. Oh's idea was well summarized in one government document, which he said was written by him just like the way that he painted something in a white paper. See HCIPC (1973).

were slowly taking over economic policymaking in Korea, while the despised technocrats were marginalized.[18]

Thus appeared a dualistic institutional structure of economic policymaking and implementation. To deal exclusively with HCI, Park organized the Planning Office of the Heavy and Chemical Industry Promotion Committee (HCIPC), headed by Presidential First Economic Secretary, Oh Won-Chul. Its task was to take the initiative in maintaining the coherence and cooperation among the economic ministries, including the EPB, for effective implementation of heavy and chemical industrialization policy. The EPB continued to centralize and coordinate macroeconomic management policies that were clearly differentiated from sector-specific heavy and chemical industrial policies. By 1973, the Planning Office had made a detailed plan for heavy and chemical industrial promotion. Afterwards, its major functions were to coordinate and control the economic ministries' measures for policy sectors. The general strategy of heavy and chemical industrial management was to distribute specific tasks for policy sectors to the bureaucratic organizations, under the jurisdiction of the Planning Office. Then, the Planning Office was to synthesize the practical ministries' policy planning and implementation (Rhee 1994, HCIPC 1979).

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[18] The demise of the EPB-based, incremental, and liberal approach to the economic crisis was not only due to President's park's orientation toward an aggressive, investment-driven growth strategy, but also the result of policy debates between two groups of economic policymakers in Korea. One group of policymakers, largely from the EPB and MOF, claimed that the crisis of the early 1970s was a temporary economic recession that had a cyclical nature. So they argued that such macroeconomic measures as the early implementation of public fundings, indirect import control, and the restriction of money supply would handle the crisis. In the mean time, in another corner of the economic bureaucracy, there appeared a group of policymakers who argued that the crisis was "structural" in nature, thus making necessary more fundamental and radical measures to cope with the crisis.

Along with the appearance of a dualistic structure on top of the state's economic policymaking processes, the MCI, the ministry that was in charge of making auto policies, had a chance to increase its policy independence from the intervention of other ministries. Once the EPB lost its power and the Planning Office asserted the primacy of a sector-specific industrial policy, the MCI was finally able to step into the limelight, taking it away from the EPB, as the most important economic ministry responsible for industrial growth. Unlike the MITI, the most prestigious and influential ministry involved in industrial policymaking in Japan, Korea's MCI had always been second-in-command to the EPB. Now, with the launch of HCI, the MCI would be able to attain policy autonomy from both other economic ministries and socio-political pressures.

The strengthening of the MCI with respect to sector-specific policies in general and auto policies in particular was also organizationally backed. In January 1973, the MCI made three Assistant Minister posts in charge of heavy industry, light industry, and international cooperation, in addition to the existing two posts covering trade and resources. The Assistant Minister for heavy industry supervised three bureaus: the bureau of heavy industry, the bureau of industrial planning, and the bureau of machine industry. Under the bureau of heavy industry, the MCI created the automobile division. Previously, there had been only a shipbuilding division and steel industry division.[19] The new institutional arrangement for the auto industry reflected the importance the government had assigned to the auto industry.

[19] In 1978, the automobile division moved to the bureau of machinery industry. In 1981, this division was renamed the Transportational Machinery Division.

All these institutional factors contributed to the formulation of the Long-term Development Plan of Auto Industry in 1973. Because the plan was founded on the enhanced power and autonomy of the MCI and the automobile division in it, one long-time MCI bureaucrat said in an interview with me that while the previous policies were initiated for a "demonstration purpose," the 1973 plan was really intended to develop the industry with "appropriate policy instruments."

Lastly, it must be emphasized that although the organizational configuration was perfect for the promotion of an auto industry, the auto policy would have been derailed without the change in personnel in charge of industry promotion. In this respect, the Korean auto industry could not have been more fortunate in finding the right people in the government at the right time. As briefly mentioned, the architect of HCI was Oh Won-Chul, who had been the President's Economic Secretary and the Chief of the Planning Office throughout the 1970s. Actually, he was not an economic bureaucrat, but an engineer, having worked as a factory manager in an automobile firm (*Sibal* Autos) before entering the MCI. Reflecting his background in the auto industry and the MCI, he strongly argued that the government should consider the auto industry a strategic sector for development because of its "complementarity with other industries and its potential for technological accumulation and diffusion" (Oh 1996).[20]

Another important person in the development of the Korean auto industry was Kim Jae-Kwan, who was appointed in 1973 as the Assistant Minister for Heavy Industry, which supervised the automobile division. It was known that his appointment was

[20] Mr. Oh is still active in disseminating his idea of national economic development. He also designed a web-site, on which he has collected his publications. See http://owonchol.pe.kr.

strongly recommended by Mr. Oh. As a former director of the Korean Institute of Science and Technology (KIST), he was the one rare person who advocated a national auto industry with its own model and technology. As early as 1970, he had presented a report to the EPB, in which he argued, “The fundamental problem in the localization plan and in the promotion of the auto parts industry is that of mass production. To solve this problem, there must be the long-term production of standardized people's cars that fit for the specific condition of our country. ” The report goes on to argue that "the government should lead the development of Korea's representative indigenous model and its intense promotion as the national project" (KIST 1970, 111-113). Yet his report did not draw attention of the EPB technocrats, who thought the development of an indigenous auto industry contradicted the current comparative advantage of the Korean economy.

However, as the project of building four core factories was well underway by 1972, the development of the auto industry again became the focus of interest as the industry leading various machinery industries. The MCI's view on the developmental potential of the auto industry was also enhanced as the withdrawal of U.S. military forces pressed the government to modernize military equipment and promote military industry, in which the auto industry took the central place.

In summary, the EPB wanted economic policymaking not to be sidetracked too far from the market principle. Nevertheless, the EPB planners understood that there was no way to resolve the fundamental conflicts between the EPB and MCI after the onset of HCI, while they fought a battle on the merit of the theory of comparative advantage. Although the EPB had argued that investment plans in the auto industry and other machinery industries in which Korea could not expect to attain international competitiveness should be discouraged, the MCI attacked the EPB, arguing its claim was naïve and premature. The MCI argued that fledgling heavy industries needed to achieve economies of scale and thereby the strict import protection for some period until they could compete in the international market.

In the end, The EPB could not claim its organization predominance over the MCI largely due to MCI's increased organizational insulation in formulating and implementing industrial policies. The faction that espoused the importance of growth, expansion, exports, and market share under the guidance of state leadership had gained a clear upper hand within the state's economic bureaucracy. It was composed of the President himself, his economic secretary, and the MCI. However, this did not bring about complete subordination of the EPB and MOF because both ministries still had enormous power, largely coming from their grips on planning, budgeting, and allocating financial resources. Nevertheless, having such powerful policy instruments was not enough to defend their policy stances against the newly formed coalition that espoused the strong leadership of the state in reshaping Korea's economic structure.

3.2 The Development of Domestic Auto Firms

As late as the end of the 1960s, auto firms in Korea had attempted few times to go beyond simple assembly of CKD kits imported from foreign automakers. Called at that time "a screwdriver industry" because of its simple production process, the Korean auto firms had few incentives to forego current rents accruing from import protection and government-imposed entry barriers. Yet the circumstances that fostered rent-seeking relations between the state and business slowly changed from the late 1960s. As discussed before, the government relaxed entry barriers to the auto industry in 1967, thus allowing two more firms (Hyundai and Asia) to assemble imported CKD kits.[21] The government also increasingly emphasized the localization of auto parts, stipulating that financial and other kinds of support to each firm would be dependent on the rate of local content achieved by it. Moreover, the negotiations between Korean firms (Hyundai and Shinjin) and foreign automakers (Ford and GM) to build an engine plant brought to light the structurally inferior status of the local firms vis-à-vis auto transnationals in the bargaining process. In particular, experiencing the failure to found a joint-venture company with Ford, the top executives at Hyundai decided to go alone in building an engine plant. In the next section, I will carefully examine the development of local firms before and after the 1973 auto policy, focusing on the different strategies adopted by each firm to expand its business activities beyond simple assembly.

3.2.1 The Change of International Division of Labor in an Auto Industry

The stable division of the global auto market in the 1960s was broken by the Japanese competitive advantages acquired from their enormous productivity increase in the early 1970s. Specifically, the Japanese export invasion into the U.S. and Western European market dramatically altered the future of the world auto industry. Japanese firms had already accounted for about 20 percent of total world vehicle production in the

[21] Kia also entered the auto industry in 1970. This company was quite different from other companies, because it was not a member company of a chaebol, and it started its business by making bicycles in 1944. Just like Japanese Honda, which expanded its business area from two-wheeled motorcycles through three-wheeled trucks to four-wheeled automobiles, Kia also developed by increasing the number of wheels (Kia Motors Corporation 1990).

early 1970s, and their share was growing rapidly. These significant inroads into a stagnant world auto market caused a structural crisis in the world auto industry. The crisis led to profound structural change in the industry. It expedited the internationalization of capital, which brought about a fully integrated global industry. Jenkins (1987, 163) argued that whereas the 1960s was characterized by the development of three major regional blocs, North America, Western Europe, and Japan, the 1970s was characterized by the increasing unification of the three blocs to create a single world industry.

To reap the benefits of scale economies in a homogenized world automobile market, the leading auto TNCs chose a strategy of international sourcing of auto parts, and began to consider the idea of a "world car." These changes in the world auto market as well as in the major TNCs' corporate strategies provided LDCs' auto industries with both opportunities and constraints for further development. Therefore, in the late 1960s and early 1970s, both GM and Ford dispatched their market research teams to Korea to investigate its potential as either the production site or the market for their products.

Yet, unfortunately for the Korea's auto industry at that time, major auto TNCs' business concern was concentrated only on the countries with larger market potential. Thus, it was the big Latin American countries such as Brazil, Mexico, and Argentina that became the chief investment targets for auto TNCs around 1970. Instigated by TNCs' interests in the expansion of productive activities in their territories, Latin American states attempted to obtain sizable export commitments from TNCs, while leaving the TNC-dominant industrial structure untouched. Not only did the TNC's expansionism toward new markets coincide with domestic policies of income concentration in the upper class (the potential buyers of automobiles), but the heated market competition caused by the entrance of Japanese TNCs also put the large Latin American countries in a superior bargaining position. Latin American governments attempted to take advantage of the inter-core rivalry in order to bargain for the terms and conditions on which auto TNCs were allowed access to their internal markets.

In the mean time, a small market size coupled with a low level of manufacturing capability made Korea not so attractive as to induce desirable investment and technology transfer from TNCs. This was clearly revealed in the bargaining processes between Korean auto firms and TNCs in the early 1970s. Within the context of reduced bargaining leverage, local firms might have had two alternatives. One was to forego any hope to establish itself as an independent firm having its own models, thereby being incorporated into the global network of auto TNCs as a supplying depot of auto parts or world cars. The other was to strengthen the productive capability of automaking independently of auto TNCs, with an aim to manufacture its own models and export them through independent marketing networks. The former strategy seemed to guarantee short-term profits, though the long-term vision was unclear. Meanwhile, the latter strategy contained many short-term risks, not only in terms of financing the needed capital for the construction of the plants, but also in terms of the uncertainty in marketing its products in both domestic and foreign markets. Once established, however, the firms adopting the latter strategy might have been able to become another contending competitor in the world auto market. In Korea, Shinjin (later GM Korea-Daewoo) took the first strategy, while Hyundai adopted the second strategy. Kia Motors was located between these two poles.

3.2.2 Independent Strategy by Hyundai

Since its inception in 1967, Hyundai Motors has shown quite a different strategic attitude toward auto manufacturing in general and toward relations with foreign automakers in particular. Its owner, Chung Ju-Yung, was not a normal type of businessperson. Unlike other chaebol owners, he from the start had almost no business interest in light consumer goods fields, such as textiles, food, and consumer electronics, which might have been less risky than heavy, producer goods industries. Whenever he moved into a new field, his ultimate goal was to build a company that would be as competitive as the world's leading ones. Although a technological tie-up or joint-venture with foreign firms might help launch a new business, he regarded such attempts as a temporary loss of corporate sovereignty to be overcome soon. Mr. Chung's optimistic stance toward auto industrialization is well indicated in company's official document (HMC 1987, 33):

> I am confident that I know better than anybody else about the mechanical details of automobiles since I have run the repair shop of automobiles and the factory of heavy equipment for construction. Although I have not accumulated the knowledge about production technology, it does not matter much because the advanced automakers would have to assemble automobiles in the less developed countries and in this process we can be helped by them. So it does not matter whether we have the experience in auto production. Who in the world began auto production with sufficient experience?

He began his business by establishing a small auto repair shop in the colonial period. The Hyundai group began to amass its fortunes as early as the Korean War through the Hyundai Construction Company, which received enormous U.S. procurement contracts during and after the war. The company also made unprecedented profits by doing business in wartime Vietnam. When the new Hyundai Motor Company was founded and required capital to develop its own model, then, it had a relatively large amount of accumulated capital compared to other Korean firms to overcome the initial capital requirements of the entry into the market. The diversified business structure, in this process, helped diffuse the financial risks involved in developing an indigenous model and acted as a buffer in times of financial crisis. Diversification also helped it accumulate technological capacity. Hyundai Cement Company, for instance, was a training ground for incoming managers and engineers. As Amsden (1989, 267) noted, "Hyundai used its cement plant as a laboratory to train its managers with backgrounds in construction, before assigning them to other manufacturing affiliates. Trainees gained experience in inventory management, quality and process control, capacity planning, and so on, thus spreading basic production skills throughout the Hyundai organization."

As discussed in the previous chapter, Hyundai management's preference for an independent strategy was most clearly seen in its deal with Ford, its foreign partner from the inception. The negotiations between Ford and Hyundai conducted around the issue of the construction of an engine plant reveal the importance of corporate strategy in deciding the national pattern of auto industrialization. After the government announcement of allowing only one engine plant in Korea, Hyundai proposed a joint engine project to Ford. Ford's response was a counter-proposal, which called for the establishment of a new joint-venture company with which Hyundai Motor Company was to be merged. After lengthy negotiations, a formal agreement was signed on November 30, 1970 and received formal government approval on December 29, 1970. As Ford insisted, the new company was a 50-50 joint venture between Hyundai and Ford. If Ford invested its share into the new company within 18 months, the new company would begin to operate. In spite of the formal agreement, a new-joint venture company was never established due to disputes between the two sides.

There were two major issues on which both parties disagreed. First, Ford insisted that the new joint venture's operation be limited to the engine plant. Ford was less interested in building a new comprehensive auto firm in Korea and intended to develop the new firm as an engine plant for the sake of world sourcing. Meanwhile, Hyundai forcefully resisted Ford's idea of making a new joint venture a simple supplying depot of auto components. The other issue was access to Ford's worldwide sales network. One main advantage that Hyundai expected from the joint venture with Ford was easy access to the world market. However, Ford was not interested in Hyundai's export proposal, which called for Hyundai to produce cars with Ford technology and capital and to export them through Ford's dealer networks. Ford never wanted to share its marketing networks with Hyundai.

These and other issues were discussed throughout 1971 and 1972. Although the government extended the negotiation deadline, the last deadline expired on January 16, 1973, and the two sides were informed by the EPB that the prior authorization for a joint venture had been canceled.

In fact, during the protracted negotiations with Ford, Hyundai took into serious consideration the possibility of becoming an independent firm without any capital and technology relations with advanced automakers. In order to become an independent automaker and auto exporter in the long-term, Hyundai managers thought that the new development of an original model was a crucial step. The problem, however, was that there was not much possibility that an independent automaker with its own models was able to compete with other firms that still relied on the assembly of imported KD kits.[22]

There were various barriers for an underdeveloped automaker to overcome to become an independent automaker: capital requirements, technological gap, and trained workers. As a result, it was the business strategy that had never taken by any auto firms in developing countries. According to Hyundai Motors' company history, when Hyundai decided to develop an original model, even many board members of the company were extremely skeptical about the success of the venture.[23] Nevertheless, Hyundai decided to take an uncharted path as soon as the negotiations fell apart.

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[22] Here, we must be clear about the meaning of an original model to understand the daunting tasks faced by the firm that pursues an independent strategy. When we say that a firm produces an original model, it does not mean that this firm makes all parts and components, such as an engine and transmission, with its own technology. It only means that the firm carries out the task of designing, engineering, and assembling the parts and components with its own responsibility. It does not matter whether the key auto parts, such as the engine, is imported or manufactured with technology licensing. But for an automaker in developing countries, the production of an original model poses great risks and uncertainties because not only can nobody be sure about its working as well as CKD vehicles but it also needs a great amount of investment, capital, and manpower, which would be diverted from more profitable activities such as the simple assembly of SKD/CKD kits.

[23] The official history of Hyundai Motors put this as follows: "The chairman, Chung Ju-Yung's and the president, Chung Se-Yung's decision to abandon joint venture and to make investment independently caused fierce oppositions from some high ranking officials in the company. Managing an auto industry independently meant to build a comprehensive auto plant, including an engine plant, and to produce economical passenger cars with an original model. However, this strategy meant an abandonment of every advantage that came from assembly productio. . . . .Specifically, there were three arguments raised by opponents against an independent path of auto industrialization: (1) the difficulty of raising at least 300-400 billion won as an investment fund by the firm whose invested capital was only 17 billion won; (2)the enormous burden of interest and principal repayment in case of relying on foreign and domestic loans; and (3) the fact that the size of an domestic auto market did not reach 10,000 units even though the minimum level of production that could realize scale economies was well over 50,000" (HMC 1987, 191).

Even after Hyundai decided on an independent path, it was very wary of being in the position of permanent dependency on a few technology providers. This fact was clearly demonstrated in its pattern of technological acquisition. First of all, Hyundai adopted the strategy of acquiring technology through licensing rather than joint venture - this policy changed slightly as the company deepened a partnership with Mitsubishi in 1982 and then sold 10 percent of its equity to Mitsubishi. Moreover, Hyundai tried to diversify its sources of technology by signing licensing contracts with several sources (e.g. 18 licensing contracts for technological transfer to make Hyundai's first indigenous model, Pony). In the same vein, technology was sought in a less packaged form, so that sometimes two sources were used for the same technology. This feature of Hyundai's technological acquisition is summarized in table 6.8, specifically in comparison with its rival firm, Shinjin-GM Korea-Daewoo.

All these facts mean that Hyundai was determined, on purpose or otherwise, to bear the extra costs incurred by an increase in transactions and uncertainty of technological acquisition. The main advantage of making a joint-stock company over relying on individual licensing contracts to get required technology and capital from diverse sources is the reduction of transaction costs and uncertainty even at the cost of weakening managerial autonomy. Besides, there were a number of other advantages of the joint venture that Hyundai had to abandon: (1) the timely selection of profitable models, (2) the saving on R&D investment, and (3) the easy realization of profits with a simple assembly line. As a result, we might conclude that top managers at Hyundai saw an increase in transaction costs as being controllable and/or even being able to be converted to their advantage, while the issue of managerial autonomy was beyond negotiation.

Table 6.8
Technological licensing 1962-1986

COMPANIES	HYUNDAI	SHINJIN-GM KOREA-DAEWOO
# of technological licensing	57	36
Source of technology		
Country	9	5
Firm	31	8
Level of technology (7pt)		
mean	3.83	2.44
(standard deviation)	(1.23)	(1.69)
Packagedness (6pt)		
mean	2.35	3.52
(standard deviation)	(1.85)	(1.29)

Source: Hyun (1987)

Why did Hyundai, unlike other automakers such as Kia and Shinjin, choose to be an independent automaker, even though such a strategy was likely to forego short-term profits and to require massive investments? A careful comparison with other auto firms suggests three factors that contributed to the formation of Hyundai's independent strategy. Needless to say, the first factor was the shift in the state's automobile policy within the context of a new state-business coalition. The second is the orientation of a business owner toward the character of auto industrialization in general and the alliance with foreign firms in particular.

The final factor that can explain the different strategies of Hyundai and Shinjin reflects a more broad difference in the organizational features of local big businesses. Hyundai Motor Company had belonged to one of the largest diversified conglomerates (chaebol) in Korea. Shinjin, however, had remained a single company with no meaningful corporate expansion into related or unrelated business fields. Although the advantages of diversified multi-sectoral business groups in facilitating independent auto industrialization cannot be generalized throughout LDCs, we can safely point out that HMC has taken advantage of its diversified business structure to an utmost extent. When it decided to build a large scale auto plant in 1973, it could minimize the construction costs by letting Hyundai Construction Company (HCC) do most of the construction work. As I noted earlier, Hyundai Cement Company provided the training ground for the middle level managers to acquire know-how concerning production processes. Even under the crisis of the first oil shock in 1973, HMC could rely on the financial buffer provided by its sister companies, particularly from HCC. The abundance of oil dollars in the Middle East gave rise to a construction boom in this area and HCC accumulated a tremendous amount of profits by actively participating in a series of large scale construction projects. From 1975 to 1979, HCC earned more than 5 billion dollars from foreign construction works, most of which came from those in the Middle East (HHI 1992, 354). HMC, then, accelerated its expansion and development plan during the latter half of the 1970s with the financial assistance from its sister companies. This was in sharp contrast to the experience of Shinjin, which could not but file for bankruptcy after it went into a continuous red in the wake of the first oil crisis.

In every chaebol, there has been a centralized headquarters under the direct jurisdiction of the group chairperson. This headquarters have planned a long-term investment strategy and coordinates various operations across sectors. Even though big multi-sectoral conglomerates have some disadvantages, such as the lack of adaptability to a changing market situation and bureaucratic rigidity, the experience of HMC vindicates that they have important advantage, particularly in such areas as financing, risk-sharing, and the rotation of human resources. So multi-sectoral conglomerates can be said to concentrate resources on the firm they want to strengthen (Cho 1994). HMC was chosen as a strategic firm and was promoted by the Hyundai chaebol with group-wide resources and expertise.

In the end, the independent strategy of Hyundai was almost immediately borne out by the numbers. The embarrassingly low production figures of the early 1970s, less than 3,000 cars assembled each year for the first three years of the decade, soon turned around. Hyundai had surpassed GM Korea (a joint venture of Shinjin and GM) by 1974 and pulled far ahead with the introduction of the indigenous model, Pony, two years later. The numbers for 1976 were tiny - Hyundai's output was 14,826 against 6,991 for Kia and 3,788 for GM Korea - but Hyundai never faltered. By 1978, the Pony had hit stride. HMC that year built 57,054 cars, 65 percent of the national output, setting the pattern for the future.

3.2.3 Dependent Strategy by Shinjin

As said before, Shinjin had been producing passenger cars with the technical tie-up to Toyota until 1971. After the normalization of relations between Japan and China, however, Toyota left Korea for better business opportunities in China. To change Toyota’s mind, Shinjin offered 80 percent majority equity ownership. However, in complying with the Chinese Prime Minister Chou’s "Four Principle,” Toyota refused the offer in order to smooth its political-economic relationship with China (Chung 1987). Shinjin was desperate to find another foreign partner. So it rushed into a 50-50 joint venture with GM in 1972. This joint venture made Shinjin change its name GM-Korea. This hasty joint venture was riddled with unfair and degrading terms and conditions (due to GM's reluctance) that later critically constrained its flexibility in marketing and management (KEB 1987).[24]

Though investing in Korea, GM's ultimate goal was to enter the Chinese market by using GM Korea as a stepping stone. Korea was viewed as a platform for future expansion into China. Accordingly, GM brought only outdated unpopular models into the Korean market, although the government urged the auto firms operating in Korea to produce a small sub-compact car. Such a corporate strategy expedited the decline of the firm in the Korean market. In 1973, GM-Korea had the highest market share (36 percent), but in 1977, it occupied only 16 percent of the market. Its Chevrolet 1700 and Camina were too heavy, large, and fuel-consuming to be used in the Korean market, which was completely dependent on imported oil. After the oil crisis, it was a critical strategic mistake. If GM-Korea had chosen to introduce more appropriate models, it would have been much tougher for Hyundai to dominate the Korean market.

GM-Korea, along with Hyundai Motors, presented a business plan in accordance with the government initiative of a long-term plan in 1973. However, the business strategy contained in this business plan was totally different from that of Hyundai. While Hyundai made clear its intention to develop and export a new model with its own initiative, GM-Korea responded to the government plan with a strategy that focused on

[24] As an afterthought, I think the withdrawal of Toyota from Korea in the early 1970s might be another hidden factor that made the Korean auto industry stand on its feet as early as the mid-1970s. If Toyota had stayed in Korea as the technology and capital provider of Shinjin in the 1970s, it would have prevented Hyundai from being the market leader because Hyundai's new small passenger car, Pony, which boosted Hyundai's market share, would not have been able to compete against Toyota's small passenger cars in the domestic market. By contrast, Shinjin's selection of GM as the foreign partner seems to have made it easy for Hyundai to lead the market because GM's models were relatively bigger and more expensive for Korean consumers.

the domestic sale of an imported model that was developed by GM's German subsidiary, Opel, and revised by the GM's Japanese partner, Isuzu. In such a business plan, there was little room for GM-Korea's technical personnel to participate in the process of learning and upgrading key technological skills. The objective of the Korean state's 1973 long-term plan was to make each auto firm follow such a sequence of automobile industrialization: technology import → technology learning → developing an original model → technology independence → achieving international competitiveness. However, GM-Korea's response was a far cry from this government intention as it largely depended on such a simple sequence of auto industrialization: import of a model → production of an imported model → domestic sale.

Why, under the same government auto policies, did GM-Korea respond with such a different business strategy from that of Hyundai? The same factors that explain Hyundai's independent strategy can be applied to the GM-Korea's case. First, the corporate governance structure of GM-Korea, in which GM had managerial authority owing to its 50% capital participation, prevented any efforts to develop an original model. GM did not feel any necessity to make massive investments in the limited Korean auto market because it was already guaranteed handsome profits coming from the dividend of invested capital, interest of loaned capital, technology fees, and instructional fees for management, all of which were contained in the initial joint-venture contract between GM and Shinjin.[25] Given GM's reluctance to develop an original model, it was rather

[25] As a response to Hyundai's attempt to develop an independent model, GM-Korea's vice-president, H.W. Benzi, said, "It is absolutely impossible for Hyundai to succeed in developing and exporting cars manufactured on the basis of an original model" (HMC 1992, 152)

natural for Korean management to stick with the existing business strategy that emphasized CKD assembly and domestic sale. Such a dependent and conservative approach to the auto industry continued even after Daewoo acquired Shinjin's 50 % equity in 1977.

Second, in terms of a business structure of Korean partners (Shinjin and Daewoo), Shinjin Motor Company had not yet been a member company of a diversified and multidivisional business group, the chaebol. Shinjin had not been able to intrude into business fields other than auto manufacturing and thus continued to be a single auto firm until its dissolution in 1976. Similarly, Daewoo did not develop into a chaebol group until the mid-1970s. Its main business activities were concentrated in textiles and clothing, and it lacked resources, whether capital or manpower, to take the initiative in upgrading its auto manufacturing.[26]

The last factor that determined Shinjin-GM Korea's business strategy was its way of obtaining required technology. Because of the nature of joint venture, sources of technology were limited to GM and its affiliated companies (mostly Opel in Germany). Most of the parts and components as well as production technology came from GM.

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[26] Daewoo's hesitance to get into auto manufacturing as dictated by the government's long-term plan can be seen in its frequent reversals of a business plan presented to the government. Only after Hyundai succeeded in developing an original model at the end of 1975 did Daewoo present the application for technology import to produce Isuzu's Gemini model. According to this application, Daewoo would completely localize the body at the end of 1979 by completing its body-pressing plant by the October of 1979. But the state gave permission to build a plant on the condition that Daewoo complete the plant-building by the end of 1976. Daewoo continuously postponed the time of 100% localization of a body, from the end of 1976 to October of 1977 and to April of 1979. As a result of such a lukewarm effort of localization, the local content rate of Daewoo's vehicles was only 22% in 1978, while Hyundai had already approached 95% by 1976.

Although Daewoo gained managerial control in 1983, its technological sources were not as diversified as those of Hyundai, as table 6.6 indicates.

The decline of GM-Korea[27] was directly opposite to the pattern of denationalization in the Latin American auto industry, in which local firms were absorbed into foreign subsidiaries. It was also inconsistent with the thesis of the *Dependencia* perspective, which argues the inverse relationships between the direct foreign investment and the autonomous industrial development in the developing countries. The reason for GM-Korea's decline, then, strengthens my argument that domestic factors such as the state's policies and local firms' business strategies rather than world systemic factors have a more significant effect on the national pattern of auto industrialization. Next, I will examine the relations between the state and business firms in Korea during the 1970s as the third institutional element that brought about the indigenous auto industrialization through the formation of a neomercantilist coalition between state agencies and domestic auto firms.

3.3 The Relations between the State and Local Firms - The Formation of a Neo-Mercantilist Coalition

Although the enhanced insulation of industrial policymaking agencies such as the MCI and the presence of independence-oriented auto firms such as Hyundai were the necessary condition for the formation of the neo-mercantilist coalition between the state

[27] GM-Korea lost its market share, and its Korean partner, Shinjin, was in financial difficulties. In 1976, Shinjin sold its 50 percent equity share of GM-Korea to the Korean Development Bank; it was sold again to the Daewoo chaebol in 1978. When Daewoo became a partner of GM, the name of the company changed to Saehan Motors, and it changed again in 1981 to Daewoo Motors.

and business, they alone could not have been a sufficient condition for two main reasons. First, there were two other auto firms in Korea (GM-Korea and Kia) that were disposed to enter joint-ventures with TNCs and thus were generally opposed to an independent strategy. The presence of such firms would have made hard the formation of the coalition between the industry as a whole and relevant state agencies very difficult. However, as discussed in chapter three, the divergence of interests among firms in the same sector (or, put it other terms, the difficulty of collective action) can function as a catalyst for the formation of another type of coalition, particularly one between specific firms and state agencies, if the nexus between the two is predicated on reciprocity and credibility, on the one hand, and the their ultimate goals more or less coincide, on the other.

Second, indigenous auto manufacturing required not only a comprehensive automaker, but also a developed auto parts industry. Without arranging the division of labor between final assemblers and parts firms in an efficient and productive way, indigenous auto manufacturing was more likely to fall into a high-cost and less-efficient business trial, as can be seen in the Indian and Malaysian auto industries. Next, I examine these matters by looking closely at the state's relations with final assemblers and parts manufacturers separately.

3.3.1 State's Relations with Final Assemblers

As of 1973, Korea had four final assemblers in a market that could not guarantee the realization of scale economies even to a single firm. In this condition, there seem to be three alternatives that could have been chosen by the state to increase drastically the developmental potential of the domestic auto industry: compulsory unitarization of existing auto firms into one; reliance on voluntary collective actions among existing firms to coordinate investment decisions of one another; and the formation of an intimate policy network with a specific firm that chose an independent strategy. The first option was out of the question because it was actually pursued in the middle of the 1960s and discarded thereafter because of the baleful effects resulting from monopolization.

Regarding the second option, we have been often told that an industry-wide association among the firms would be the precondition for industry-wide collective action. However, there was not anything similar to an industry-wide business association in the Korean auto industry until 1987. The interest representation of big auto assemblers at the industry level had been made only through the Federation of Korean Industries (FKI), which was formed by President Park in the early 1960s to represent big business (chaebol) interests. As a whole, the FKI's role was limited to recommending big business's opinion about policy issues to the government. Besides, as discussed above, the different business strategies among the firms were another barrier for collective action within the Korean auto industry. Therefore, the second option did not attract much attention in the government.

In such a situation, it is predictable that the government's contact with domestic auto firms would become more firm-specific and direct, and thus it is more likely that the government would adopt the third alternative if it aimed at a wholly different style of auto industrialization. This direct linkage between the state and the particular firms bypassed big business associations like the FKI. One common conclusion from the studies that explored state-business relations is that firm-centered interactions are more likely to lead to unproductive rent-seeking, while the industry-centered one to a favorable outcome (

Schneider and Maxfield 1997). But the careful examination on the Korean auto industry in the 1970s reveals that this is not always the case. In other words, when a specific industry is at an infant level, requires economies of scale to be an internationally competitive industry, and lacks an industry-wide association, its performance could be enhanced by establishing firm-specific state-business linkages, if both the state agencies and the selected firm have the institutional traits delineated above.

In this firm-specific state-business relation, the government provided certain firms (or chaebol) with such subsidies in the form of policy loans with low interest rates and easy access to foreign capital and technologies. In return, the state was able to obtain information not only about the current state of the economy, but also about the problems confronting specific industries or big businesses. Thus, throughout the period of HCI, some selected business leaders frequently met with top executives, including the President and ministers, either as a small group or on an individual basis through regular or irregular channels: the monthly export promotion meeting, extraordinary conferences to adjust heavy and chemical industrial projects and big business competition, and informal meetings.

But, as Amsden (1989) has rightly pointed out, the success of state-business collaboration not only depends on the amount of state subsidies, but also on the disciplinary power of the state over the firms that fail to achieve the performance criteria set by the state. In the case of auto firms' non-compliance with government policies, the Korean government also threatened with and imposed such economic penalties as suspending the anticipated loans and rejecting the request of technology import at the firm level. This was clearly seen in the case of Shinjin's collapse. The fact that the

Korean state did not bail out the largest auto firm is in contrast to the American experience with bailing-out Chrysler in the early 1980s. The Korean state, which has been popularly known for its policies of "getting the price wrong" to achieve artificial investment coordination, got the price right in GM-Korea's case.

In the mean time, Hyundai had many firm-specific characteristics, including aggressive and independence-oriented business strategy, being a member company of a multisectoral conglomerate that could mobilize larger resources and diffuse risks, and loan-based capital mobilization, that made itself ready and apt to form a close coalition with the mercantilist sections of the economic bureaucracy and build intimate relations with them on the basis of reciprocity and credibility. This "firm-specific" state-business coalition during the 1970s helped Hyundai to act swiftly in accordance with and in anticipation of the shifts in government policies. It was a well known fact that President Park and the owner of the Hyundai chaebol, Chung Ju-Yung, had many chances to meet personally in the 1970s. It was also rumored that President Park liked Mr. Chung more than any other chaebol owner because of the latter's business strategy emphasizing the indigenous growth of heavy industries such as shipbuilding, construction equipment, and automobiles (Chung 1989). Such a close relations between the top political and business leaders played a significant role in preparing Hyundai to consider a shift in its business strategy as early as 1972.

It is an extremely difficult task to find evidence concerning the relations between the state and specific firms that goes beyond journalistic descriptions. The personal relations between the President and a few leading businessmen may be the typical case of such descriptions. Therefore, we need a more careful examination to determine the character of the firm-specific state-business relationship.

When Hyundai was in trouble dealing with Ford in their joint venture project,[28] Hyundai was informed of a shift in the government's auto policy in early 1973. In January 1973, President Park announced the HCI plan. Noticing that there would a new auto policy, Hyundai, in March 1973, decided on a new business strategy, which was totally different from the previous one. The essence of the new strategy was (1) to seek out an independent strategy of auto production without equity participation of foreign TNCs; (2) to introduce technology from diverse sources on the basis of individual items; and (3) to engage in mass production of small passenger cars with an aim to export the majority of them.

Such a shift in business strategy would have been impossible without the information exchange between the state and Hyundai primarily because a new strategy meant the abandonment of an easy-going way of making profits through the joint venture with foreign firms. Foregoing this advantage in order to initiate the uncertain and risky project of indigenous auto industrialization was even unthinkable to some executives in Hyundai, and so there was intense resistance within the firm (Kang 1986). However, the top executives in Hyundai were firm and tenacious in their view on the firm's proper business strategy. To persuade dissenters within the firm and to provide business

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[28] At this time, Hyundai was in difficulty mainly due to the time consuming negotiation with Ford for establishing a joint venture company to produce automobile engines. This difficulty was doubled as its competitor, Shinjin, signed a joint venture contract with GM because, unless Hyundai concluded the joint venture negotiation as soon as possible, Shinjin would be selected as a company monopolizing the production of automobile engines. Although this worry was alleviated as the government abandoned the plan, Hyundai was still confused about what it could do with or without the alliance with Ford.

information to the government, the president of HMC ordered the planning office to conduct research on future demand for automobiles in Korea. According to the prediction about future auto demand made by Hyundai, which was almost identical to MCI's, there would be a demand for 4,6000 units in 1976, 105,000 in 1978, 198,000 in 1980, and 28,5000 in 1981 (HMC 1987, 172). Given the production volume of 9,525 in 1972, such a prediction was effective enough to quell resistance within the firm and give credence to the shift in auto policy by the government.

Thus, when the Korean government announced the long-term plan for an auto industry in July 1973, Hyundai could be the first company to present its business plan. It can be inferred from such an account that the government and Hyundai began to interact closely during the stage of auto policymaking. This is also revealed in Hyundai's company history:

> Hyundai Motors presented "The Business Plan for Building A Comprehensive Auto Plant" in August 1973 in accordance with the government's policy of mass production of Korean style passenger cars. Hyundai already made a draft plan on the subject of a new auto plant in June of the same year. Because this draft plan was in accord with the new government plan, Hyundai was able to present its final plan within shortest days with a minimum revision. Specifically, Hyundai already initiated the processes of the introduction of technology, capital and factory facilities from foreign firms, so with the estimates and various resources obtained through the negotiations with these firms it was possible to present the final plan faster than any other firm (HMC 1987, 194).

When we look carefully at the "Planning Report of Constructing the Comprehensive Automobile Plant for the Production of Korean Style Automobiles" prepared by Hyundai in 1973, it becomes obvious that there was agreement in the purpose of initiating a new type of auto industrialization between the government and Hyundai. This was an appeal to nationalism expressed in the form of self-sustained and independent industrialization in the key industrial sectors. This kind of orientation was shared by top policymakers in the Blue House, MCI, and Hyundai and continued to be the ideological foundation of a neomercantilist coalition up to the late 1970s. The purpose of Hyundai expressed in the report can be summarized as follows:

> 1. It is inevitable for the Korean auto industry to be dependent on foreign automakers in both areas of technology and capital because the existing four domestic automakers have assembled automobiles with imported parts and components in the forms of joint venture and technological alliance while paying for a large amount of license fees.
>
> 2. Our company will construct the base for supplying completely localized automobiles to the domestic market with our own technology and equipment and for making the auto industry the export industry by strengthening international competitiveness with a quality and production scale equal to those of advanced automakers.
>
> 3. The efforts made by our company will facilitate the technological development of the related machinery industry, material industry, and auto parts industry. As a result, as other auto firms that have relied on foreign automakers would shift from the dependent business strategy to an independent one, the Korean auto industry will be able to be fully localized in both realms of technology and capital, escaping the dependence on foreign business power (HMC 1973).

Against all odds, Hyundai succeeded in developing an original model in 1975 and began to dominate the Korean auto industry in 1976. With a new model, Pony, Hyundai was able to penetrate the world car market, although not in significant volume until it entered the Canadian market in 1984. It can be concluded that this achievement was not the result of either state policy or business strategy *per se*, but the outcome of combined efforts of both the mercantilist sections of the economic bureaucracy, including the President himself, and an independence-oriented private firm.

This conclusion is supported by the records left by Mr. Oh Won-Chul (1996), who said that the 1973 policy was prepared in close consultation between nationalistic government officials headed by the Deputy Minister of MCI, Kim Jae-Kwan, and Hyundai's top management. In this process, the state policy and Hyundai's strategy were influenced reciprocally. He also commented that one major difference of the state-business relations during the 1970s from those of the 1960s in the auto industry was the absence of politicians in policy-making process. So there was no need to furnish political funds to the political leaders on the part of private capital, and thereby the latter had fewer incentives to expend its resources on unproductive rent-seeking activities.

3.3.2 State's Relations with Parts Manufacturers

The interests of the firms in a terminal sector (final assemblers) often diverge from those of the parts manufacturers. When the development of an auto industry stays in the stage of CKD/SKD assembly, the assemblers may as well resist using the parts made by local manufacturers, since they have low quality and high prices compared to imported parts. If the assemblers are forced to use domestically made auto parts, the price of automobiles will increase, and their international competitiveness will decrease. On the other hand, if the assemblers can freely choose auto parts, it will soon lead to the collapse of domestic auto parts industry, thereby foregoing any chance to develop an indigenous auto industry in the near future. Thus, given such a discrepancy of interests between the final assemblers and parts manufacturers, it becomes a very important matter for the states in developing countries to bring into balance the interests held by each sector.

The common pattern seen in the Latin American countries was the active promotion of the auto parts sector after many final assemblers had been absorbed by auto

TNCs. Having witnessed increasing "denationalization" of national auto firms, the governments of Brazil, Mexico, and Argentina all attempted to reduce the TNCs' outflow of profits by requiring final assemblers to use domestically made parts (thus enhancing local content rates). Such a policy that focused on enhancing localization rates was also instigated by the pressure of the auto parts sector, which was largely owned by domestic capital. Against this backdrop, the peculiar nature of Korean auto industrialization is also clearly seen in the concurrent development of final assemblers and an auto parts industry. The key to such a developmental pattern lies in the state's relations with the parts sector that were distinguished from those established with final assemblers.

During the 1960s, the development of an auto industry in Korea was also achieved mainly by a few final assemblers, all of which had some kind of tie-up with auto TNCs, at the expense of the local parts sector. According to MCI documents, the aim of granting monopoly power to Shinjin in 1964 was to enhance a domestic content rate by magnifying scale economies. However, as table 6.9 reveals, the increase in domestic rates by Shinjin was still well below government expectations.

Table 6.9
The Rates of Domestic Content and The Number of Produced Vehicles by Shinjin

YEAR	1966	1967	1968	1969
Domestic Content Rates	21.0	23.6	27.6	38.2
No. of Produced Vehicles	3,117	4,983	11,629	19,494

Source: Oh and Cho (1997, 28)

There were also growing protests from domestic parts firms concerning the import of knocked-down parts. As they contended, the import of knocked-down parts was against the government policy of localizing the auto parts industry. This protest was led by the Korean Auto Industries Cooperative Association (KAICA), which was formed in 1962 to represent the interests of auto parts manufacturers. Since its inception, the

KAICA has been the industry association most active in small and medium-sized auto firms. The number of members increased 7.5 times from 49 in 1962 to 366 in 1981. The role of the KAICA ranges from making policy recommendations and petitioning the government, surveying industry status (9 times during the period of 1962-1982), promoting the export of parts industry, gathering and processing information (various publication efforts), quality inspection, and financial assistance for the parts industry. In contrast with final assemblers, which had not had an industry association until 1987, the auto parts industry in Korea has always been well organized and thus used a unified voice when necessary.[29]

Given the strength of the KAICA, the 1973 auto policy aimed to promote assemblers and parts manufacturers separately largely through accomplishing horizontal integration between the two sectors. According to this policy, each parts manufacturer would have to specialize in only one auto part and produce at least 50,000 units, thus achieving scale economies and high quality.[30] The government allowed each assembler to make only engines and prevented it from making such key auto components as transmissions, axles, steering systems, and breaking systems by itself. Even when Hyundai lobbied for permission to produce in-house transmissions and axles, the government sided with parts manufacturers, rejecting Hyundai's request. When the MCI

[29] The long history of industry-wide association in the auto parts sector seems to refute Olson's theory of collective action since this sector has had a lot more constituents than the terminal sector, which has had only a handful of final assemblers and could not found an industry-wide association by 1987. Accordingly, we can argue that a small number is not necessarily favorable to collective action and vice versa.

[30] The origin of "an one auto part for one factory policy" was in the unitarization policy of the 1960s. Because the state failed to unify auto assemblers into one firm, it attempted to assign each parts firm to make only one auto part, thus realizing the policy goal of a unification policy at least in the parts sector.

approved Hyundai's plan of building a comprehensive auto plant, it attached a condition that "the manufacturing technology of transmission and axle must be transferred to the newly established auto parts firm." Even though Hyundai strongly argued that the in-house production of a transmission and axle was an international norm and an indispensable part of making an original model, the MCI responded that there already existed two parts firms specializing in the production of these two items and that it was desirable for Hyundai to help these firms to sign contracts of technology transfer from parts firms in more advanced countries.

Yet, the most significant institutional factor that consolidated the state-parts firm relations was the delegation of importing authority of auto parts and components to the KAICA from the state in 1975. The reason underlying such a delegation of authority was to block the import of auto parts that were manufactured by domestic parts firm. As a cooperative industrial association of parts firms, the KAICA never had any reason to give permission to import auto parts that could be produced domestically to the assemblers. According to my interview with a manager in HMC, this institutional change dealt the final blow to the possibility of going back to CKD/SKD assembly operation and contributed to a constant increase in local content rates in the latter part of the 1970s.

4. Conclusion

The decade of the 1970s was the most significant period for the Korean auto industry. During this period, the Korean auto industry moved not only into the manufacturing stage, but also into the stage of designing its own models and exporting them overseas. Among the firms, Hyundai was the most advanced and able to establish itself as a potential contender in the international auto industry. Its Pony model used an independently engineered body and an engine and transmission wholly manufactured in Korea from designs licensed by Mitsubishi. During this period, the Korea's auto industry took on a distinct pattern of development, in sharp contrasted with the “denationalization” type of auto industrialization that had been commonly witnessed in many LDCs.

To explain such a divergence of auto industrialization is not a simple task. Traditionally, the explanatory emphasis has been exclusively placed on the international movement of capital according to the ever-changing international division of labor (Lipietz 1987; Jenkins 1987; Frobel et al. 1980). According to this explanation, factor endowment or the size of a domestic market in LDCs is the most critical factor determining the intensity of foreign firms’ penetration into the auto industry in these regions. However, as was carefully examined in this chapter, this explanation seems insufficient because it ignores the fact that the international movement of capital and its effects on the auto industry in LDCs were greatly mediated by the state and local firms’ strategic choices.

This chapter also emphasized that either the state or local firms alone cannot be credited to be the exclusive mover of the Korean auto industry during the 1970s. The strong push by the state in the name of HCI might have been another example of Soviet-style industrialization without the collaborative efforts of private firms. In a similar logic, given the hostile environments that limited the indigenous auto industrialization in LDCs, the aggressive and independence-oriented business strategy of private firms would have resulted in a great loss of material and human resources without the timely backup from the state.

Nevertheless, this chapter pointed out that the launching of indigenous auto industrialization was not a process led by a consensus among private firms and state agencies of the right type of auto industrialization. Given the divergence of interests not only within the state bureaucracy but also between domestic firms, the new type of auto industrialization required the ascendance in power of a new type of a coalition between the state and business. The shift in the structure of industrial policymaking as well as the increasing multi-sectoral diversification of a few chaebol obviously helped a new coalition gain the upper hand over its rival coalition. What distinguished the new auto policy in this period was the deliberate attempt by the new coalition to accomplished three seemingly different policy objectives simultaneously: (1) optimization of industrial structure (e.g., the number of final assemblers and their relations with auto TNCs); (2) localization of major auto parts and components; and (3) seeking exports even in the earlier stages of auto industrialization.

CHAPTER VII

THE EARLY 1980S: COLLPASE OF *YUSHIN* REGIME AND THE POLITICS OF STRUCTURAL ADJUSTMENT

In the previous chapter, we saw the rise in the performance of the Korean auto industry in the 1970s as an outcome of a change in the dominant coalition between state agencies and local firms in the process of industrial policymaking. Our analysis now shifts to another principal task of this study: explaining the weakening of this coalition in the auto industry vis-à-vis a liberal coalition and its ramifications into the late 1980s. Although the complete dissolution of the neomercantilist coalition can be said to have happened around 1995, there appeared some significant signs that started to erode the base of cohesive actions between the state and major auto firms in the late 1970s.

In this chapter, I will examine the two issues that largely determined the general contour of Korean auto industrialization during the 1980s: the rationalization of an industry, particularly the state's attempts to merge the firms in the early 1980s, and the liberalization of an industry, which included the abolition of entry barriers, import liberalization, and the deconcentration of industrial structure. Both measures were initiated because of a change in economic policymaking structure. Of specific importance were the resurgence of the EPB and the MOF at the center of the economic policymaking structure and the increasing tension between the state and big business groups. However, both measures failed to have their policy aims fully accomplished because the coalition formed between the auto firms and mercantilist-oriented bureaucrats were still in existence and frustrated these policy measures.

1. The Legacy of Heavy-Chemical Industrialization Policy

1.1 Economic Legacy

The economic rationale underlying a neomercantilist coalition can be found in the government's concern with the structural limitations of the EOI strategy based on light industries, and a fear of exhausting the comparative advantage of cheap labor in these industries. Therefore, the state, together with a small number of chaebol groups, initiated "deepening" or "vertical integration" of the economy in a way that allowed the EOI strategy based on light industries to turn toward promoting capital-intensive and technology-intensive industries.

The overwhelming emphasis on HCI, however, resulted in a number of economic difficulties, particularly in 1979 and 1980. First, by 1979, it had become obvious that some heavy industries, including the auto industry, were overinvested. One expert on the Korean economy put this as follows: "Within manufacturing, heavy industry took up the major portion of fixed investment: light industry's share of fixed investment. . . . was only 20% during 1977-79. In retrospect, it seems apparent that some of this investment was excessive in relation to market size and South Korea's financing capacity" (Suh 1980, 1144). The operating ratios of HCI sectors in August 1979 were as follows: general machinery (64.4 percent), electrical machinery (72.5 percent), transport machinery (43.8 percent), iron and steel (73.9 percent), and non-ferrous metal (54.8 percent) (Korea Exchange Bank, 1980). Overinvestment in the auto industry was the most serious as

Table 7.1 reveals.[1] Passenger car plants operated at only about 25% of capacity in 1980, down from about 55% in 1979.[2]

Table 7.1
Capacity Utilization of Motor Vehicle Production, 1979-1980 (thousand units)

	1979			1980		
	Capacity (A)	Performance (B)	B/A (%)	Capacity (A)	Performance (B)	B/A (%)
Passenger Cars	204	112	54.9	235	56	24.8
Buses and Trucks	74	88	119	115	67	58.2
Total	278	204	75.6	350	123	32.3

Source: EPB 1982, 129.

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[1] It is likely that the problem of overinvestment represents another facet of a neomecantilist coalition. To enhance the growth potential of an auto sector, the Korean state emphasized the importance of scale economies, and, given the limited size of its domestic market, encouraged the firms to engage in export activities in order to realize scale economies. Encouraged by a number of production and consumption incentives, the local firms began to invest heavily during the latter half of the 1970s, and this resulted in overcapacity by the end of the decade. The rush of investment was peaked in 1979, as indicated by table 7.2.

Table 7.2 Investments by Korean Auto Firms, 1977-1980 (million won)

Year	1977	1978	1979	1980
Investments	23,967	57,357	507,000	77,321

Source: KIET (1982: 78) Notes: Investments include the money invested by Hyundai, Saehan(Daewoo), Kia, Asia, Dongwha, and Geowha automobile companies.

[2] Dave Kang (1999, 19) attributes the problem of overcapacity in the auto industry to political favoritism, indicating: "In the context of an authoritarian regime that is selectively handing out favors, size was an advantage. . . . The state's inability to control firms and their growth led to endemic overcapacity. Firms rushed willy-nilly to expand at all costs, whether or not it was economically feasible. The result was that in most major sectors of the economy there was excess capacity, and overlapping and duplication of efforts as each chaebol to be the biggest." However, this politicized interpretation of the problem of overcapacity fails to consider the industrial source of the problem. The auto industry, along with other heavy industries, is not able to be competitive unless it realizes scale economies. So overcapacity, to a certain extent, has been a rather normal phenomena observed in the auto industry. Consequently, the problem is not overcapacity itself but how to expand productive capacity with a feasible plan of its utilization through active domestic and foreign sales.

Second, the need to mobilize massive financial resources and to channel them selectively toward the heavy industrial sectors added far more rigidities to the financial system and further segmented the financial market. In addition, prompted by the inflow of a large amount of foreign capital needed for installing heavy industrial facilities, the external debt doubled between 1977 and 1980, from $8,472 million to $16,274 million (World Bank 1982). It rose to $40 billion in 1981, making Korea the fourth largest borrower among less developed countries, following Brazil, Mexico, and Argentina. Furthermore, the hike in oil prices after the second oil shock in 1979 was another critical blow to the Korean economy. It caused high rate of inflation (38.9% in 1980) and led to huge deficits in the current account balance.

Lastly, allocating financial resources for specific investment projects had the side effect of further concentrating scarce capital in the hands of a small number of chaebol groups. By 1977, the percentage of the number of manufactured goods for which the largest three firms took up more than 70 percent and 90 percent of the market reached 76.6 percent and 51.8 percent respectively. Against the monopolizing power of the chaebol, the Korean government proclaimed an economic principle concerning the ownership structure of the chaebol in 1973, according to which chaebol firms should offer stocks for public underwriting to diffuse ownership. However, this principle was not enforced, and the number of firms included in chaebol groups multiplied in the 1970s. Between 1973 and 1978, Korea’s largest five chaebol groups’ share of the GDP rose from 3.5 percent to 8.1 percent and the largest ten chaebol groups’ share from 5.1 percent to 10.9 percent, indicating that larger chaebol groups grew more rapidly than smaller ones (Jones 1980, 18-21).

1.2 Political Legacy

The state's exclusive attention to HCI resulted in not only economic difficulties but also a number of serious political problems. The political and social beneficiaries of HCI were the military, defense industry, big businesses, construction industry, and agriculture. President Park thought that, as long as he could cement the support of this dominant coalition and sustain rapid economic growth, other groups outside the coalition, such as small and medium-sized businesses and middle income groups, could easily be cajoled. Other more radical groups, such as opposition parties, students, and militant labor, he thought, could be repressed.[3]

Yet economic difficulties, particularly high inflation, hit those disfavored groups hard. Facing high inflation, high-income groups engaged themselves in extensive, hectic speculation in commodities, securities, and real estate. Middle and low-income classes, who had no means to hedge inflation, witnessed their purchasing power continuously erode. Accordingly, social alienation increased while repressed labor became more radicalized. Industrial workers' consciousness grew as a result of the side effects of growth-oriented industrialization through labor repression: increasingly unequal income distribution and a sense of relative deprivation in a rapidly growing economy (Choi 1989). Though not as extreme as other LDCs, the unequal income distribution worsened on a national scale. The income share of the lowest 40 percent of urban households

[3] For the details of political authoritarianism and the exclusion of popular sectors in politics in Korea during the 1980s, see Sohn (1989), Choi (1989), Kihl (1985), and Ogle (1990).

decreased from 18.9 percent in 1970 to 15.3 percent in 1980, while that of the highest 20 percent increased from 43.0 percent to 46.9 percent in that period (Suh 1985, 9).

Facing increasing threats to his regime by discontented groups, President Park, nonetheless, was at first determined to continue expansionist economic policies with high inflation. He may have thought that economic contraction, which would be brought about by strict anti-inflation policies, would have had graver political implications than high inflation. However, the elections for National Assembly in December 1978 saw the opposition party win more popular votes than the ruling party.[4] It was only after the election that President Park really came to grips with the seriousness of the inflation problem. Park reshuffled the cabinet right after the election and selected someone (Shin Hyon-Whack) who was known as a strong advocate for economic stabilization as the Deputy Prime Minister (DPM). Nonetheless, in the midst of increasing political and social tension,[5] President Park was assassinated in October 1979, and the *Yushin*-HCI regime, which had been so closely identified with him, collapsed (Lee 1980, 63-76).

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[4] Despite winning majority popular votes in the election, the opposition party failed to earn majority seats in the National Assembly because of the constitutional provision that gave the President the power to appoint a third of the members of the National Assembly.

[5] The immediate trigger of political crisis was the prohibition of the opposition party (New Democratic Party, NDP) leader, Kim Young Sam, from acting as NDP head. After his dismissal from the National Assembly, all of the opposition assemblymen tendered their resignations to protest against his expulsion. In the end, in October, massive and violent anti-government demonstrations took place in the cities of Pusan (the home of Kim Young Sam) and Masan. A number of students and citizens called for the overthrow of President Park and protested Kim's expulsion from the National Assembly in the wake of economic hardship and political repression. The government declared martial law in Pusan and imposed military rule on Masan. Park was assassinated during this political turmoil by the Chief of KCIA on October 26, 1979.

1.3 The Confusion of Institutional Structures of Economic Policymaking

Even with the warnings of excessive capacity due to overinvestment and inflation due to the lax monetary policy to finance HCI projects, the economic ministries, particularly the MCI and the Ministry of Construction, were eager to promote their organizational interests and the interests of their constituents by continuing and even enlarging investments. For example, in early 1979, when high inflation became a serious political and economic problem, the newly appointed MCI minister presented the President with the overly ambitious export targets of ten major industries, which MCI would develop as "ten major strategic export industries," and called for continued support for expanding the production capacities of these industries.[6] To a considerable degree, the MCI's added emphasis on capacity expansion exhibited its industry-specific bureaus' competition for more support for their client industries. Since the allocation of financial and tax privileges and the provision of import protection became increasingly industry-specific, individual industrial bureaus sought to enlarge their lots in the ministry.

For the Korean government, the most important rationale for protecting and promoting some strategic industries was that, despite the significance of these industries in the task of achieving self-sustained economic structure, private business alone did not

[6] This plan was announced at the President's annual investigation tour to the MCI in early 1979. At this time, President Park was uncomfortable about a policy suggestion by the EPB that stressed a shift in industrial policy toward stabilization and liberalization. In this tour to the MCI, the minister said "the government plans to expand the facilities of the ten strategic industries by three times and to develop the machine industry as a major export industry." After hearing the announcement by the Minister of the MCI, President Park expressed his frank feelings about the EPB's proposal, saying, "recently, there are some absent-minded persons who see export in a negative regard." (Rhee 1994, 98).

have the capacity and willingness to engage in these industries because of externalities.[7] Given the reluctance of private firms to invest in heavy and capital-intensive industries, which has a long gestation period, achieving international competitiveness was a secondary matter to the state.

However, as some strategic industries solidified their footings during the 1970s, the state began to worry about the efficiency of their operations. To prevent infant industries from willingly remaining an infant for an unlimited time under government protection, the state increasingly focused its attention on enhancing the competitiveness of these industries. This became more imperative since the survival of these industries would ultimately depend on how well they competed in the international market, given a small domestic market. Therefore, the top economic policymakers could do little but allow more private autonomy and initiatives, and at the same time remove competition-inhibiting and market-distorting policy measures one by one. In the area of industrial policy, there appeared the demand for a more market-conforming policy. It would be more limited in scope, more regulatory than developmental, and would move from "discretionary, sector-specific intervention" to "indirect, non-discretionary supports,"

[7] This means that the Korean state did not intervene into the management of national economy for the purpose of aggrandizing its power, as sometimes is claimed by the scholars who emphasize the predatory nature of the developmental state. Even the highly interventionist Korean state in the 1970s left many economic decisions in the hands of private capital if the latter had the capability and willingness to invest in the project the state deemed necessary. The state intervened only when the project had many important positive externalities (e.g. forward and backward linkages of an auto industry) but would not be carried out by private capital because of the discrepancy between the costs to individual firms and the benefits enjoyed by society at large (Chang and Rowthorn 1995).

such as incentives for research and development and for personnel training (Moon 1988, 73).

Though seldom having a unified voice, young, liberal-minded, and US-trained bureaucrats in the EPB began to produce critical policy analyses, particularly concerning the competitive expansion of productive capacity in some heavy industries by chaebol groups.[8] The MOF was in the middle of the EPB and the MCI. As the major ministry that controlled credit allocation through its authority over the Bank of Korea and public and commercial banks, the MOF recognized that a tight monetary policy was necessary to curb the high inflation trend of the year. However, it feared the radical measure of the liberalization of the financial sector espoused by the EPB, since it would take away its policy instruments such as its right to set interest rates. As a result, the MOF did not consider a fundamental change in financial policy.

Given President Park's unrelenting commitment to HCI as the core economic strategy, the EPB could not wage a frontal attack on this strategy. The EPB's strategy was first to make inflation the President's problem and then induce other ministries to cooperate with the EPB (Kim ed. 1999, 275-280). Once the President recognized the significance of inflation for his political survival after the national assembly election in 1978, the EPB's main policy target shifted to import liberalization, which was thought by

[8] The EPB's attack on HCI was initiated in 1977 when the Korea Development Institute (KDI), which was the research arm of the EPB, compiled a report at the request of the EPB. In August 1978, the EPB's works gave rise to the internal report entitled "Current Problems of the Korean Economy," in which the EPB advocated financial liberalization, anti-inflationary measures, and import liberalization (KDI 1981, 17-24, EPB 1982, and Whang 1997, 113-150).

EPB technocrats to be a policy option not only potentially effective in achieving price stability but also politically acceptable to the President.

But the MCI blocked the EPB's attempt to liberalize imports as a means of containing inflation by claiming its jurisdictional right over trade policy. Instead, the MCI created in 1978 the Import Liberalization Countermeasure Committee within itself to monopolize the issue of import liberalization. While the MCI as a ministry dealing directly with sectoral-industrial policies could draw upon the political and economic influences of individual industries that would be badly affected by import liberalization, the EPB lacked outside supporters except for disorganized export firms and consumers. The coalition between the MCI and a few chaebol groups was supported by institutional arrangements that insulated the industrial policymaking structure and encouraged the formation of in-group sympathies between the state's policymakers and the owners of the chaebol. This coalition was also based on a broader political coalition made among the authoritarian regime, the military, big corporations, farmers, and construction companies, all of which shared the ethos of "strong state on the basis of heavy industries and modernized army," even at the cost of severe inflation. Lacking institutional links with much aggrieved political and social groups due to its organizational mandate of guiding the national economy by manipulating macroeconomic parameters, the EPB could do little but increase public awareness of the sources of inflation.[9]

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[9] Another obstacle to the EPB's efforts of import liberalization as a way of price stabilization was the fact that the adoption of the import liberalization was predicated upon the maintenance of the existing expansionary macroeconomic policies. The import liberalization policy was only a small modification to the existing economic policy framework. The ascendance of the EPB over other economic ministries would await the demise of Park's regime.

However, the institutional base that supported the dominance of a growth-oriented, neomercantilist coalition in the realm of industrial policymaking began to show cracks in 1978. The souring inflation rate resulted in the electoral defeat of the governing party in the 1978 election, and this caused, the President to reconsider the existing economic policies, particularly in the area of inflation control. The change of the DPM to the person who was known for his liberal creed from the one who sided with expansionist economic policy was critical in invigorating the EPB. The new DPM placed the U.S. trained technocrats at the forefront of the EPB to counter forcefully MCI's industry-specific promotional policies.

As the inter-ministerial disputes between the EPB and MCI intensified, the EPB held the Conference of Economic Ministries on April 12, 1979, a week after the Ministry of the MCI went abroad for business. According to the resolution of this conference, the EPB announced the Comprehensive Measures for Economic Stabilization (CMES) on April 17, 1979, which focused on the stabilization of inflation and the rearrangement of investments in heavy industries. This was indeed a coup d'état within the economic bureaucracy to gain the control over the direction of the national economy.

The announcement of CMES was considered a triumph of liberal-minded reformers in the EPB as it intended to set up the foundation for long-term economic stability for the purpose of ending the "30 year-old inflationary trend."[10] Its main contents included the reinstatement of market mechanism in resource allocation, tight

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[10] Although allowing the EPB to announce the CMES, President Park was not totally inclined to the position of the EPB. He regarded the CMES not as a long-term economic strategy for fundamental policy change but as a short-term management policy for containing high inflation (Rhee 1994, 101).

fiscal policy to generate fiscal surplus, adjustment of HCI projects, and improvement of the banking system (KDI 1981, 345-87; EPB 1982, 201-3). Given the growth-oriented bias of the MCI, the Presidential Secretariat, and big businesses, the CMES was formulated without having built a consensus inside the government and with the private sector.

The confusion of institutional arrangements of industrial policymaking was manifested in the ascendance of the EPB at the center of policymaking with little cooperation from the other economic ministries. Therefore, bitter bureaucratic infightings were expected to occur in the process of implementation even after the announcement of the CMES. In particular, the MCI and the Planning office of HCIPC still argued for the continuation and completion of planned HCI projects even under the CMES, while the EPB wanted to suspend or delay new projects and adjust overlapping investments. Moreover, chaebol groups sided with the MCI in criticizing the CMES. The peak business organizations, for instance the Federation of Korean Industrialists (FKI), denounced the measure, demanding the mitigation of the tight fiscal and monetary policy in order to reduce current financial difficulties (*Chosun Daily*, May 1, 1979). Although increasingly criticizing heavy-handed policies imposed by the state, big businesses still wanted to remain a partner of a growth-oriented coalition.

Therefore, when the minister of MCI returned from abroad, the implementation of CMES was viewed doubtful. The MCI claimed that the massive rearrangement of investment projects would curb the will to invest among businessmen, which had been strenuously reared by the state, and in the end hold back the development of heavy industries for at least 10 years (*Maekyong Daily,* May 6, 1979). The key issue dividing the EPB and MCI was how much and in what ways the excessive and redundant investments in some heavy industries were to be readjusted. By the second oil crisis in 1979, some industrial sectors producing power-generating equipment, industrial machines, diesel engines, and automobiles were in real trouble: their utilization rate was extremely low; market prospects were bleak; and their financial burdens were enormous.

The EPB argued for complete readjustment, not only in future projects but also in ongoing ones. However, the MCI conceded the necessity of readjustment only in future projects. After intense discussion between the EPB and MCI, the government announced the "Investment Adjustment in Heavy-Chemical Industries" on May 25, 1979. A careful reading of this announcement indicates that the proposed adjustment plan reflected the interests of the MCI more than the EPB because most of the investment projects dealt with by the announcement were those scheduled in the future. Moreover, this plan was not abided by, largely due to the uncooperative actions by private firms and the passiveness of the MCI as the supervising ministry of investment adjustment. By the end of 1979, most efforts to rationalize the investments were unsuccessful in the wake of conflicts both between the state and big businesses and between the EPB and MCI. It was only after the collapse of the regime that a renewed attempt at rationalization was carried out.

2. The Politics of Restructuring the Auto Industry, 1980-1981

2.1 Searching for New Institutions for Industrial Policy-Making

While bureaucratic infighting continued and the economic situation became worse, President Park was assassinated by the chief of the KCIA in October 1979. After a brief political opening, the military junta seized power under the leadership of Major General Chun Doo-Hwan. Political instability and regime change aggravated the troubled economy. 1980 had been the worst year for the Korean economy since the early 1960s. Growth rates that had averaged almost 10 percent a year between 1962 and 1978 fell to just over 2 percent between 1979 and 1981, with a particularly sharp contraction in 1980. The growth rate of the GNP for 1980 was negative 5.7 percent. At the same time, inflation rose to 26 percent from an annual average of 16 percent between 1962 and 1978. Exports fell from a 27 percent average annual rate of real growth between 1962 and 1978 to 7.5 percent between 1979 and 1982. The current account deficit widened from $1.1 billion in 1978 to $4.4 billion in 1981 (EPB 1988).

The economic slowdown was felt more seriously by international bankers and other lending institutions. In particular, the U.S. Federal Reserve urged bankers to be wary of making new loans to Korea, citing Korea's current account deficit, its dim prospects for exports, and the risk of increased domestic political instability (Clifford 1998, 171). Confronted with such internal and external threats, the new cabinet formed after the death of President Park, and thus relatively detached from the influences of big-push industrialization, took a bold step toward restoring the country's credibility among international lenders by squeezing the excesses out of an economy that had grown on the basis of inflation and overvalued currency.

The policies announced on January 12, 1980 were a radical challenge to the existing economic policy paradigm. Bank interest rates rose five to six percentage points. The interest rate for an ordinary bank loan, for example, jumped from 19 percent to 25 percent. The *won* was sharply devalued by nearly 20 percent. It was the first devaluation since 1975, in spite of inflation that consistently ran over 20 percent a year.[11] Domestic firms, which had counted on inflation to raise prices and make their interest payments, were hit hard. Foreign borrowing costs rose because of the *won* devaluation, while domestic borrowing costs also rose as a result of the interest rate reform. In fact, such a radical shift in macroeconomic policy was an extremely risky exercise. The Prime Minister of the new cabinet, Lee Han-Been, testified to the dilemma faced by policy reformers as follows:

> I became very unpopular in the National Assembly, [questioned] nightly by television networks and tormented by businessmen and housewives for having raised the exchange rate, wiped out fertilizer subsidies, raised the gasoline price, coal prices, and bank interest rates. The only place I got approbation was at the IMF and the IBRD [World Bank](Quoted from Clifford 1998, 175).

The drive of heavy industrialization brought up many social groups who had a stake in continuing an expansive macroeconomic policy. These included the nationalist segment of the economic bureaucracy, conservative politicians, military, a few selected chaebol groups, and farmers. The sudden disappearance of their power center provided the opportunity for policy reformers to reorganize the existing arrangement of policymaking structures. The radical policy shift started under interim President Choi Kyu-Hah. When Chun Doo-Whan took power and dismissed the civilian cabinet later that year, he continued these orthodox economic policies. The new President, Chun, wanted to maintain some distance from the former president, and thus was rather easily persuaded by technocrats to seek a different economic strategy from that of HCI.

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[11] For Structural Adjustment in Korea, refer to Corbo and Suh (1992) and Haggard et al. (1994).

The power vacuum occasioned by the collapse of the *Yushin* regime also made possible the resurgence of liberal-minded and internationally oriented technocrats, whose roles were secondary under Park's leadership. After becoming DPM in December 1978, Shin Hyon-Hwak forged close bonds with some leading younger technocrats in the EPB. Prime among them were Kim Jae-Ik and Kang Kyong-Shik at the EPB and Kim Mahn-Je, who headed the EPB's research center, the Korea Development Institute (KDI). They were all professionally trained, had diplomas from highly renowned U.S. universities, and were aware of the promise and the perils of a high-growth, heavy industrial strategy. Like the Chicago Boys in Chile who took charge of a radical liberal reform under the Pinochet regime (Silva 1997), the technocrats in the EPB and MOF, who were called A-TKEs (American Trained Korean Economists) by Amsden (1994), espoused a liberalized free market economy. They also knew what needed to be done at this time of crisis, and they had the permission of the Prime Minister (Lee Han-Been) and the DPM (Shin Hyon-Hwak) and, through them, President Choi, to take whatever action was necessary.

To recapitulate, the political and economic crisis of 1980 weakened the institutional foundation of a neomercantilist coalition by taking away an agenda setting role from the MCI and Presidential Office and transferring it to policy-reformers located in the EPB. The symbiotic relations between the state and big businesses also revealed the signs of fissure, largely due to the policy of retrenchment. However, the consolidation of new institutional arrangements governing the state's industrial policymaking structure had not been completed by 1982, when the state initiated the liberalization policy with full force. Next, I will examine the shift in the state's auto policy during the crisis period, particularly focusing on its attempt to merge existing firms into one national champion.

2.2 The Regime Change and Changing Auto Policy: Merger Policy

In pursuit of a supreme policymaking organ, the military organized a 25-man Special Committee for National Security Measures (SCNSM).[12] From late May to early September 1980, when General Chun assumed the presidency, several Economic Subcommittees of the SCNSM practically held economic policy initiatives and undertook radical policy reform measures. Although economic bureaucracies dealt with ordinary economic issues, important policy decisions were made by this committee.[13]

The most crucial economic issue dealt with by the economic committee of the SCNSM was the reorganization of heavy industries, including the auto sector. Though revealing various internal debates and conflicts between proponents of sector-specific industrial policies and macroeconomic stability, the economic committee of the SCNSM adopted the latter's position. Dubbed as "stabilizationists" by the mass media, this latter group was very pessimistic about the growth potential of the Korean auto industry. They argued that Korea should not try to develop an independent auto industry, not to mention promote the auto industry as an export sector. The main theoretical source for this position was classical comparative advantage theory. Because Korea lacked technology

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[12] The SCNSM was established immediately after the Kwanju uprising, which protested against the military coup of May 17, 1980. This organization was ostensibly meant to assist President Choi and the interim government in directing and supervising martial law affairs and examining national policies in order to facilitate the coordinating mechanism between the cabinet and the Martial Law authorities. But, in reality, this organization functioned as a political organization to gain political power (*Chosun Daily*, May 1980; Kihl 1984, 80-83).

[13] The main sources about policy debates on structural adjustment are KDI (1982), Mitchell (1981, 60-67), KEB (1980), and The ROK (1983).

and capital, they argued, it was not possible to develop a competitive auto industry. Thus, they suggested that the assembly operation of imported parts was the only viable strategy for the Korean auto industry and that labor-intensive industries should be promoted as the main export industries. Kim Jae-Ik, a chairperson of the committee, had an even more pessimistic view of the prospect of the Korean auto industry. He suggested the complete abandonment of the auto industry and the takeover of the Korean firms by foreign automakers.[14]

Officials within the World Bank and the IMF gave similar policy advice. They suggested that only the parts sector, not the terminal sector, had growth potential in the Korean auto industry. Thus, when the World Bank provided the structural adjustment fund in early 1980, they insisted that the fund should not be used for the auto industry.

However, the MCI's position was quite different. Although conceding that overinvestment was the main cause of difficulties experienced by the industry at the time, the MCI argued that the complete scrapping of the industry by forcing existing firms to be taken over by foreign TNCs would have a harmful effect on the industrial upgrading

[14] As a former staff member of the Bank of Korea and a Stanford economics Ph.D., Kim Jae-Ik began his public career as a staff secretary to the DPM. Soon he became a Deputy Director General of the Economic Planning Bureau of the EPB. When President Chun called him to take the post of the head of the Economic Scientific Subcommittee of the SCNSM, Kim was the Director General of the Economic Planning Bureau. He was appointed First Economic Secretary to the President and remained President Chun's closest and most trusted economic advisor until his tragic death in Rangoon in 1983. He was an unflinching believer in the free market. To him, any industries in which Korea did not have comparative advantage should be shut down. There was no consideration from him of infant industries or the Korean need for self-reliance. Kim was bold enough to talk privately of importing rice and letting the country's agricultural sector wither away, a policy that was an anathema to the professed ideology of support for the rural sector.

of the Korean economy. The KIET's (the research arm of the MCI) report summarized this point as follows (KIET 1982, 57):

> If the Korean auto industry is incorporated into the global network of world car production by the auto TNCs, it can facilitate technological development, save a massive amount of R&D for developing a new model, and increase exports by selling the cars to the region where the world cars are not produced. However, as the advanced countries monopolize all design works and the production of key components, we would be left with no technological capacity other than simple assembly, thereby intensifying technological dependency on the advanced countries. Moreover, since exports would be limited to a few countries where world cars are not produced, we cannot promote the auto industry as an export industry. . . . As a result, if we allow existing firms to be junior partners of the auto TNCs, it will solidify the oligopolisitic status of the auto TNCs in the international auto industry by supplying them with the domestic market and the labor for simple assembly.

In the mean time, the military junta, including General Chun, thought the big push of HCI was the major factor causing the economic crisis, characterized particularly by overinvestment and high inflation, in 1979 and 1980. Mr. Chun also wanted to disconnect his military regime from Park’s authoritarian regime, which represented rapid economic growth at all costs. For a new economic ideology that underpinned the emerging regime, then, the new military leaders chose liberal and stabilization-oriented policy options. Mr. Kim Je-Ik’s role was crucial in this respect. When the SCNSM was organized, Kim was the General Director of the EPB and was recruited as the chairperson of the economic committee of the SCNSM. Kim also served as a private economics teacher for General Chun and later became the Senior Advisor for Economic Affairs when Chun became President. As a Ph.D. from Stanford, Kim was known for his monetarist and liberal economic creeds. Because General Chun did not have any systematic view of the economy, under Kim’s influence, Chun began to adopt the economic ideology of economic liberals. During his presidency, the Chun government emphasized inflation control and stability rather than any other economic objectives.

Then came the state initiative to merge the two biggest auto firms (Hyundai and Daewoo) in Korea while preventing Kia from producing passenger cars. The electricity generator industry and the auto industry were chosen as target sectors of the merge plan. Both sectors had similar problems of surplus capacity, and two chaebol, Hyundai and Daewoo, were the main producers. The proposed policy was to force Hyundai and Daewoo to choose and concentrate on a single industry and give up the other. The committee's specific plan was to reallocate the auto industry to Daewoo and the electricity generator industry to Hyundai.[15] In this decision, the policymakers in the committee did not pay much attention to Hyundai's more advanced productive and technological capacities than Daewoo's because they assumed that an independent auto industry was in any way beyond Korea' economic potential. Instead, they believed that the auto industry in Korea should develop a cooperative relationship with auto TNCs. Accordingly, they thought that Daewoo, a 50-50 joint venture with GM, was a better candidate for the auto industry.

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[15] The story behind the choice of an auto industry by Hyundai is as follows: Convinced that Hyundai would choose an electric generator industry, the government gave the owner of Hyundai, Chung Ju-Yung, the priority in the selection process ostensibly because he was older than the owner of Daewoo, Kim Woo-Joong. By giving the priority of selection to Hyundai, the government calculated that it could justify its intention of transferring the responsibility of an auto industry to Daewoo, a 50-50 joint venture with GM. However, Mr. Chung selected the auto industry, thus shocking the policy planners. It was still not clear why he chose the risky venture at the expense of one guaranteeing stable profits. According to the official HMC's documents, this decision was based on the patriotic purpose of continuing a nationally strategic industry such as an auto industry at any cost (HMC 1987, 1994).

Hyundai strongly resisted this merge attempt by the state. Even the military government was unable to force private capital to accept the state initiative. In fact, the electricity generator industry was less risky and more profitable from a short-term perspective because the government was the main purchaser and guaranteed monopoly status to the new firm. Hyundai had already invested a lot in the electricity generator industry. However, Hyundai announced on August 19, 1980 that it was determined to continue auto manufacturing even at the cost of the electricity generator industry. Hyundai's choice of the auto industry can be explained by Hyundai management's commitment to the auto industry as a high priority sector. As has already been noted, Hyundai internalized a risk-taking attitude among its business executives as it undertook indigenous auto industrialization after the aborted joint venture negotiations with Ford.

Shocked by Hyundai's intransigence, the Industrial Subcommittee within the SCNSM announced another merge plan, in which Hyundai and Daewoo would establish a new auto company with a 50-50 equity share while Kia and Dong-A Motors would specialize in the production of commercial vehicles such as buses and trucks.

The problem of this second merger attempt by the SCNSM was that the Daewoo Motor's foreign partner was GM, the largest automaker in the world. Hyundai proposed that GM's equity in the new firm be based on a formula that took into account GM's equity in Daewoo (50%) and the relative asset ratio of Daewoo and Hyundai. At that time Hyundai's assets amounted to 38.2 billion *won* and Daewoo's assets were 26.5 billion *won*. If Hyundai took over Korean equity from Daewoo, Hyundai's assets in the new firm would be 51.5 billion *won* and GM's assets would be 13.2 billion *won* (50% of Daewoo). GM's equity in the new firm would be only 20 % of total assets and management rights would belong to Hyundai. GM, on the contrary, insisted on having 50 percent equity or at least 33% equity to preserve veto power.[16]

Still, there was another issue that made the negotiations between Hyundai and GM hardly resolvable. They had different corporate strategies. GM insisted that the joint venture company be one of GM's international manufacturing subsidiaries and that only GM's models based on GM's designs and technology would be produced. On the contrary, Hyundai wanted to remain independent in management rights and product selection. In addition, Hyundai argued that the new firm should be free to export its products wherever it wanted without restriction.

As a result of these differences, negotiations between the two sides stalemated. The Korean government tried to intervene and play a mediating role, but to no avail. As long as the military-backed SCNSM had policy initiative, Hyundai could not but protract the negotiations, neither acceding to GM's demands nor challenging state policy. However, the military junta became a civilian regime on September 1, 1980. At the same time, the SCNSM was dissolved and the MCI again took over the task of industrial rationalization. Even during the time of SCNSM rule, the MCI had voiced that if Hyundai accepted the GM proposal, the Korean auto industry as a key sector would become a parts supplier to GM and that the development of the auto parts industry and technological development could not be expected. After MCI's resumption of the authority over industrial policy, hence, Hyundai began a frontal attack on the merger policy. Hyundai announced that, without the merger with GM, it was ready to produce

[16] According to the Commercial Law in Korea, any person who has a third of equity is able to veto decisions made by the board of directors.

300 thousand units and to export 100 thousand units. In the end, on February 28, 1981, the government announced another revised version of the rationalization measure. According to this measure, the merge of Hyundai and Daewoo was called off. Both were allowed to specialize separately in passenger car production. However, Kia was still excluded from the passenger car market, specializing only in the production of small and medium-sized trucks (Oh and Cho 1997; HMC 1992).

In sum, the restructuring efforts by the state in the auto industry reveal two contradictory tendencies that existed in the economy bureaucracy. First, there emerged at the center of industrial policymaking a group of bureaucrats who regarded the development of heavy industries such as the auto industry as beyond the capacity of the Korean economy. For these adherents to the principle of static comparative advantage, Korea should not have concentrated on developing heavy industries in the 1970s. The remedy favored by these bureaucrats was to scrap the plan of indigenous auto industrialization by inviting foreign automakers such as GM or Ford to dominate the industry.

In contrast, the nexus between the MCI and two domestic firms, Hyundai and Kia, was still powerful enough to frustrate the reformers' plan in its original form. Hyundai could maintain its independent corporate structure while Kia began to contact foreign TNCs to re-enter the passenger car market as early as 1983, although it had the monopolistic position in the production of small trucks and buses. As a result of such contradictory tendencies among policymakers, the state's auto policies vacillated between neoliberal and mercantilist policies during the 1980s.[17] To understand the auto policies in of 1980s, therefore, we need to investigate what happened in the institutional links between the state and business, particularly after the state's failed merger attempts.

3. Conclusion: Institutional Legacy of the Merger Policy

The merger policies in 1980 and 1981 had both anticipated and unanticipated effects on the later development of the Korean auto industry. First, as has already been discussed, the merger policy was practically carried out by liberal technocrats, particularly those from the EPB, as a way of bringing the Korean economy back into the mold of the liberal theory of economic development. Along with price stability, rationalization of investments, in accordance with Korea's position in the international division of labor, was their ultimate policy objective. Focusing on the auto industry, liberal technocrats tried to achieve two objectives. The first objective was to rationalize the industry by reducing the number of auto firms. Its main economic rationale was to reduce surplus capacity and to increase scale economies. The second objective of the merger policy was to push local firms to give up the independent strategy and to integrate the resulting Korean firm with General Motors.

In fact, both objectives revealed the contradictory nature of liberal's offensive. While aiming at reinstating the market principle through the measures of industrial

[17] For instance, the state allowed only Hyundai and Daewoo to produce passenger vehicles after 1981. However, this policy measure was time limited. That is, while the Korean state directly intervened in the auto market, it, at the same time, claimed to pursue the liberalization policy. Therefore, the state proclaimed the liberalization schedule, which consisted of opening the domestic market in 1987 except for the vehicles between 1,000-2,000 cc, the abolition of model limitation in 1987, and the abolition of entry restriction in 1989.

rationalization, the liberal's efforts presupposed the enhanced role of the state. In other words, reform-oriented policymakers sought the retrenchment of the Korean state and the reinvigoration of the market mechanism with the help of a strong and authoritarian state.[18] Rhee (1994, 210) correctly pointed out this anomaly by saying, "in the 1970s, the government had intervened to efficiently allocate credits to companies and industrial sectors that it regarded as promising. On the other hand, in the 1980s, the government intervened to correct the distortions created by the past state interventions."

After all, both objectives were not accomplished for reasons that related both to the hostile attitude toward the merger plan by the MCI bureaucrats and to the resistance by Hyundai to any attempt to reduce its managerial autonomy. Nevertheless, as long as the hegemony of liberal technocrats within the economic ministries continued well into the mid-1980s, it became extremely hard for the previous neomercantilist coalition to be dominant in the process of industrial policymaking.

Second, the bargaining among the state, the local firms, and GM in the process of implementing the merger policy revealed the changing nature of state-business relations. Because the merger policy was initiated by liberal technocrats who put stress on import liberalization, the inducement of foreign direct investment, and the cutoff of subsidies for big businesses, it entailed the cleavage between the Korean state and big businesses, for the merger policy was pursued in spite of Hyundai's strong opposition. Hyundai began to voice strong discontent with the state's merger policy by arguing that this policy was

[18] This point was also emphasized by Polanyi (1957) when he explained the emergence of a capitalist market economy. In particular, he argued that the development of a capitalist market was based on the expropriation of landed laborers, which in turn presupposed the repressive role of the state.

particularly interventionist and contrary to the proclaimed policy aim of a market-oriented economy and the reduced role of the state in economic management. Although Hyundai and the MCI connection was still alive, it was not as strong as the one formed during the 1970s. As the main trend of economic policies turned toward liberalization and stabilization in the early 1980s, the MCI was increasingly unable to maintain its traditional role of industrial promotion even by breaking the market principle. As a result, private auto firms such as Hyundai, relying on its increased corporate power, increasingly opted for arms-length relations with the state.

Finally, the changed business-state relations reflected the increasing economic and political power of local firms, in particular Hyundai, vis-à-vis the state. Hyundai's commitment to an independent strategy and its risk-taking attitude, in spite of the dismal market condition at that time, appeared to reflect the organizational strength and productive capacity of the Hyundai chaebol. In the 1970s, the Hyundai chaebol was one of the most rapidly growing chaebol in Korea since it heavily invested in such heavy industries as the shipbuilding, petrochemical, and automobile industries. With its increased assets and technological capabilities, the Hyundai chaebol could say "No" if the government policy contradicted its business strategy.

CHAPTER VIII

RECOVERY OF THE AUTO INDUSTRY AND SEARCHING FOR A NEW INDUSTRIAL POLICY

It was argued in the previous chapter that after Park's death and the subsequent economic crisis, the basis of a neomercantilist coalition between state agencies and private firms began to erode. The rationalization policy of merging existing firms in the auto sector clearly revealed the uneasy nature of state-business relations at the turn of the 1980s. The failure of a joint venture between Hyundai and GM, even under strong urging by the state, seemed to presage state-business relations during the 1980s different from those in the 1970s.

However, in spite of the resurgence of liberal-minded technocrats at the center of economic policymaking structure, mercantilist-minded bureaucrats still occupied the key posts of the MCI, which was still in charge of sector-specific industrial policies. Moreover, top politicians, particularly young colonels who executed the military coup of 1980 and later turned into politicians, were by nature at odds with the ideology of deregulation, liberalization, and political openness. Although there was consensus between liberal technocrats and military-turned politicians regarding the short-term need for rapid stabilization of the economy using austerity policy, they had different views on the long-term goal of state economic policy. The MCI was the most vehement opponent to the EPB's drive for liberalization because the EPB-based reformers' first target was focused on the removal of the sector-specific industrial policy.

Reflecting the internal division of economic policymaking agencies in the government, big businesses chose discriminatory measures to respond to the state's economic policies. While big businesses embraced most of the economic policies in the 1970s without expressing serious discontent, they began to use their own voices rather loudly during the 1980s, particularly concerning the state's attempt to regulate the concentration of economic power in the chaebol groups. In addition, big businesses attempted to contact directly the top political leaders, bypassing EPB-based policy reformers, to express their discontent with liberalization policies. In this way, the policymaking process became highly politicized again, with the increased potential of rent-seeking and organizational corruption.

Such a conflict between two different types of economic ideologies and coalitions was the driving force of auto industrialization in Korea during the 1980s. In spite of the dominance of economic liberals over the broad spectrum of economic policies during the first half of the 1980s, auto policies in this period did not completely correspond with liberal policy prescriptions. The main agenda of auto policy during the 1980s can be termed "liberalization and deregulation." Its specific contents were the import liberalization of passenger vehicles (the outline was announced in 1983, and actual import began in 1987 except for the vehicles that had an engine capacity between 1,000cc-2,000cc), the abolition of model limitation (January 1987), and the admittance of new entrants into the auto market (July 1989). However, these measures of liberalization and deregulation hardly meant that the Korean state would place the auto industry in the free-play of market force. On every attempt to liberalize the auto industry, there appeared persistent state's efforts to limit the range of its effects. For instance, even though the state in principle gave away the entry restriction policy in 1989, it still had several policy instruments that could block any firms' attempt to enter the auto industry and wielded this authority in several occasions (for instance, the MCI controlled the number of final assemblers by using its authority to accept or reject the proposals of technology import by local firms). This ambivalent nature of the liberalization policy during the 1980s was clearly shown in the formulation of the Industrial Development Law (IDL) in 1986. As will be examined in the latter part of this chapter, this law represented the compromising nature of the auto policies of the 1980s.

Why did the liberal coalition fail to make and implement the auto policy in a way that corresponded with its initial design of liberalization? This will be explained in this chapter by the institutional compromise between state-centric and private-centric economic orders, as well as by the challenge of a reinvigorated neomercantilist coalition between the state and local firms, particularly after the mid-1980s. The structure circumscribing the state's auto policymaking, which was formed in the previous decade, was not easily replaced by the new one that policy reformers in the early 1980s preferred to be established. Accordingly, the growth-oriented, neomercantilist coalition among top politicians, state agencies, and auto firms was able to withstand attacks from diverse economic and political forces that placed free competition, deregulation, and market-opening at the center of the state's auto policy agenda.

The Korean auto industry recovered rapidly from the crisis of the early 1980s. Its production and export figures revealed an accelerated growth rate by the early 1990s. Therefore, this chapter begins with the demonstration of the recovery of the Korean auto industry in the 1980s, focusing on its aggressiveness in capacity expansion and marketing strategy. To explain the enhanced performance of the auto industry, an analysis of auto policymaking will follow. The main theme in this explanation is the EPB's attempt to reshuffle the structure of industrial policymaking with an aim to consolidate its coalitional power and the counterattack waged by the coalition that opposed the EPB's mandate. To shed light on the dynamic nature of coalitional conflicts, an in-depth case study on the process of the formulation of the Industry Development Law (IDL) will be conducted in the last part of this chapter.

1. The Recovery of the Korean Auto Industry in the 1980s

After the crisis and restructuring of the early 1980s, the Korean auto industry recovered rapidly and entered a period of accelerated growth by the mid-1980s. From 1982 to the end of the 1980s, the Korean auto industry had increased the production of automobiles over 20 percent annually. This rapid recovery of the Korean auto industry from the dismal condition at the turn of the 1980s was the result of a combination of two main factors: the rapid expansion of the domestic market and an export boom.

1.1 Realizing Scale Economies

The Korean auto industry had achieved enormous exports of small sub-compact vehicles by the late 1980s. In addition to the favorable conditions in foreign markets, this was made possible as major auto firms could realize scale economies by mass-producing the strategically designed small passenger cars for export purposes. Of the total number of passenger cars produced by three major firms (865,685 units) in 1989, small passenger cars occupied 81.1 percent (702,208 units).

Industrial experts say that scale economies in the auto industry can be realized from the production of 50,000 units per year. Although the optimal capacity capable of realizing complete scale economies might increase up to the production of 400,000 units annually because of the advance of automation, auto assemblers still see a drastic reduction of manufacturing costs begin at the annual production of 50,000 vehicles (Womack et al. 1990). In this respect, Hyundai took advantage of its leading position in the Korean auto industry by producing 465,726 units of its Excel model in 1988, thus fully realizing scale economies. Meanwhile, the other two export models by Daewoo (Le Mans) and Kia (Pride-Festiva) could not reach the optimal level of production (400,000 units), but they also benefited from scale economies since both models exceeded the annual production of 100,000 units. Such production figures of three auto firms in Korea in 1988 show an 8.8 fold increase from the total production of 123,000 units in 1980 to more than 1 million units in 1988. Specifically, there was an annual increase rate of 70 percent during the four years between 1985 and 1988, when the Korean auto firms sent exports to the U.S. market.

1.2 Domestic Market

There was a change in the domestic consumption of automobiles during the 1980s. The domestic consumption of passenger cars recorded 318,010 units in 1988, 7.1 times the figure in 1980 (44,748 units). Specifically, there appeared the sign of "motorization" in 1987, when domestic consumption reached 246,714 units, a 59.6 percent increase of the 1986 figure.

Three reasons explain the increase in the domestic consumption of automobiles. First, there was a drop in the price of passenger cars. While the average whole sale price of manufactured goods rose more than double from 1980 to 1988, the average increase in passenger car prices was only 20 percent, given the improvement in quality of most passenger cars. The average price of passenger cars even began to fall in 1987.

Second, there was a cut in taxes that were imposed on the sale of passenger cars. During the 1970s, the Korean government had levied relatively high taxes on the selling of passenger cars, because the state considered passenger cars as luxury items. Among several taxes imposed on the selling of the passenger cars, the Special Consumption Tax (SCT) most significantly dampened domestic consumption. The rate of SCT was 30 percent of the manufactured retail price up to 1974, irrespective of models and engine capacity. In 1974, there was a change in the rate of SCT, differentiating the rate according to the engine capacity (15% for below 1,500 cc vehicles, 20 % between 1,500cc and 2,000cc, and 40% above 2,000 cc). As the demand for small-sized vehicles exploded during the mid 1980s, the state revised the 1974 SCT tax rate, this time only cutting the rate applying to small-sized vehicles (below 1,500cc) to 10.5%.[1]

The final factor contributing to the expansion of a domestic market was the increase in middle class families, particularly during the economic boom between 1985 and 1988. In general, it is widely recognized that the demand for passenger cars is likely to increase rapidly when the price of the vehicle reaches a point below half of the average

[1] As indicated in chapter six, the continuous reduction of taxes specifically for a small-sized vehicle functioned as a significant factor that drove auto firms to concentrate on the production of small passenger cars. This in turn helped the Korean auto industry gain technological sophistication in small car production and thereby advance into the upper level of auto production with more ease and speed.

annual income of the laboring class. In 1987, the average annual income of a city-dwelling laboring class was about 10 million *won* while the average price of a small passenger car was about 5 million *won*. In the same year, the domestic consumption showed a drastic increase of 59.6 percent. From this data, then, we can conclude that Korea began to enter the era of motorization in the mid-1980s primarily because of the increase in mid-income earning families and tax-cuts.

1.3 Export Market

In the early 1980s, the highly concentrated oligopoly of the world auto industry experienced a deconcentration. Previously, 8 to 10 companies had occupied 80 percent of the world market. By the early 1980s, about 15 companies competed over the same share (OECD 1983), which meant a decreased share of the pie for each TNC. The deconcentration resulted mainly from the new Japanese competitiveness. However, the more notable change in the 1980s was that the main arena of TNC competition shifted from the periphery back to the core market. The 1970s's intense competition over rapidly growing markets in the LDCs caused investment competition among auto TNCs. However, the overly fragmented markets in Latin America and Southeast Asia did not grow as rapidly as expected.

In the 1980s, the TNCs' competitive focus again centered on the U.S. and Western European markets, which accounted for about 70 % of world sales. While U.S. auto giants tried to regain the lost market, Japanese auto firms fought to maintain their existing market share (KAMA 1989). This competition in the advanced countries affected the market strategy of the Korean auto industry. The U.S. automakers' new global sourcing strategy of finished sub-compact vehicles (not just parts and components) and the Japanese firms' transplantation strategy prompted by the market protectionism of the U.S. government, provided some possibilities for the export promotion policy of Korea, possibilities that were not present in the 1970s.

By the end of the 1980s, the U.S. had become the world's largest automobile market, consuming about 1.5 million vehicles per year. It accounted for almost 40 % of the global market (KEI 1990). The new export strategy of the Korean auto industry can be understood in the context of a new competition between the Big Three and Japanese firms over the US market. In the U.S., sub-compact cars have traditionally been neglected because of their small profits compared with the larger size cars. However, after two oil shocks, the sub-compact market share rose to over 60 % of the total market. The Big Three participated in the sub-compact segment through the Saturn Project (GM), the Alpha Project (Ford), and the Liberty Project (Chrysler) to recapture the home market. However, realizing that they could not compete with the Japanese or even the Korean makers, an alternative they chose was to separate their strategies between sub-compact and intermediate- or full-sized segments (Dyer et al, 1987). While retaining the production of the larger-sized car segment in which they had competitive advantage, they decided to let Japanese and Korean firms with which they had equity partnerships supply "finished" sub-compact cars through the U.S. firms' marketing channels. Thus, via the new international division of labor between marketing, technology, and production, the American Big Three made use of the excellent sub-compact car manufacturing technology of Japan and the cheap costs of production in Korea, yet retained control over their marketing channels.

Another significant change in the structure of the world automobile industry was Japan's strategic shift from export to direct investment through transplantation in the late 1980s. The main impetus of this shift was the formal and informal arrangements constraining Japanese imports into the U.S. and European markets. The huge trade imbalance between the U.S. and Japan resulted in the VRA (Voluntary Restraint Agreement) enacted in 1981 (UNCTC 1988). This agreement provided unanticipated market opportunities for Korean exporters. In other words, the quantitative limitation on Japanese imports to the U.S. market led the Japanese automakers to upgrade their exports from the sub-compact to compact and intermediate-sized cars. The vacuum in the sub-compact segment was temporarily filled by Hyundai in the late 1980s. In addition, GM and Ford were supplied sub-compact cars from Isuzu and Mazda in which they had 34.2% and 24% equity ownership, respectively. However, due to the VRA against Japanese imports, GM and Ford could not be supplied enough sub-compact cars from their Japanese partners. Thus, they decided to incorporate Korean automakers, Daewoo and Kia, against which no regulations had yet been imposed, into their global sourcing strategy of "finished" sub-compact cars.

Due to the changing global strategy of auto TNCs and the export restraining efforts by Japanese automakers, the export of Korean sub-compact vehicles dramatically increased in the late 1980s, as shown in Table 8.1. Between 1984-1987, the annual average increase reached 100%. In 1987, over a half million units were exported. This represented more than a 25-fold increase since 1982.

In sum, the successful export promotion strategy of the Korean auto industry in the late 1980s cannot be properly understood without examining the dynamic market strategies of the U.S. and Japanese auto TNCs. The U.S. government intervention limiting Japanese import via VRA forced Japanese firms to upgrade their exports or even to launch transplantation. This change in market strategy by Japan created room for Korean exporters. In addition, the new international sourcing strategy of finished sub-compact cars for the U.S. TNCs in the 1980s made the export promotion industrialization strategy of Korea attractive.

Table 8.1
Export and Production of vehicles in Korea (1980s)

	EXPORT(A)	PRODUCTION(B)	%(A/B)
1981	26,283	133,084	20
1982	20,284	162,590	12
1983	24,510	221,019	11
1984	52,350	265,361	20
1985	123,110	378,361	33
1986	306,369	601,546	51
1987	546,310	979,739	56
1988	576,134	1,083,655	53
1989	342,335	1,129,470	30
1990	321,772	1,321,630	24

Source: KAMA (2002)

1.4 Strategic Alliances with auto TNCs

Indigenous auto industrialization does not mean that every auto manufacturing process should be conducted by domestic technology and capital. It only means that industry leadership is retained in the hands of domestic capital and that the latter can lead auto industrialization, particularly in the areas of investment decision, model selection, and marketing, with little interference from foreign makers. Thus, there is much room for strategic alliances with auto TNCs unless they leave the above key areas in the hands of domestic firms. Given the still low level of technology, therefore, it was predictable that the Korean auto firms would attempt to form some types of alliances with advanced foreign automakers. In the mean time, the types and contents of alliances have significant implications for the development of the Korean auto industry. There were two types of strategic alliances in the Korean auto industry throughout the 1980s.

1.4.1 The Hyundai-Mitsubishi Alliance

To strengthen its technological foundation, Hyundai approached the globally renowned firms such as Volkswagen, Renault, and GM to inquire about the possibility of an alliance after the late 1970s. However, all these negotiations failed because of the problems of management participation (Volkswagen and GM) and royalties (Renault). Hence, Hyundai, even though it preferred an alliance with a global giant, chose Mitsubishi in 1981, which was among the second tier of automakers in Japan, as its partner, largely because the latter did not demand management rights. In fact, Mitsubishi had maintained close relations with Hyundai throughout the latter half of the 1970s because the key components of Hyundai's first indigenous model, Pony, were manufactured under a technology transfer contract with Mitsubishi. The final joint venture contract was signed in October 1981. Mitsubishi took a 10 percent share of Hyundai, and Hyundai began to build a new comprehensive auto plant with an aim of developing export-oriented high quality compact cars. Details of this project will be dealt with later in this chapter, particularly in connection with the strengthening of private initiative. At any rate, we can find in this alliance how much importance Hyundai still placed on managerial autonomy.

Mitsubishi, in fact, had been the junior partner of Chrysler throughout the 1970s. Mitsubishi made an alliance with Chrysler by selling 15 percent of its total share to the latter in 1971, and Chrysler increased its ownership of Mitsubishi by 35 percent in 1973.

Through this alliance, Mitsubishi produced a large car using Chrysler's KD parts and also tried to enter the U.S. market, using Chrysler's marketing networks. In the 1980s, however, the power balance between the two changed in the direction of Mitsubishi's favor (Dyer *et al.* 1987, 171). Mitsubishi's increasing capacity for auto manufacturing, coupled with Chrysler's financial crisis, drove Mitsubishi to seek independence in the international auto industry and thus to reduce Chrysler's ownership by 20 percent in 1985. On a relatively even power balance, both firms established a joint venture, called Diamond Motors, in 1986 to produce 180,000 compact cars in the US market. By the end of the 1980s, then, there appeared a triangular alliance among Hyundai, Mitsubishi, and Chrysler. Mitsubishi provided technology and certain parts to Hyundai in return for 10 percent of ownership and royalties, Chrysler allowed Hyundai to use its dealership in the U.S. in return for sales profits, and Chrysler and Mitsubishi jointly developed and produced compact cars. In this alliance, Chrysler's influence on Hyundai was limited only to the marketing of certain models in the US market, while that of Mitsubishi to the provision of key technologies and components. As the manufacturing capability of Hyundai rapidly increased in the latter half of the 1980s, the cooperation between Hyundai and Mitsubishi leveled out to more equal footing, as both firms exchanged technologies and auto parts in the production of a full-sized car.

This brief review of the Hyundai-Mitsubishi alliance reveals that the developmental potential of the domestic auto industry, particularly in ownership structure, can be largely intact even when domestic auto firms depend on advanced foreign makers for the provision of technologies and some auto components. This is sharply contrasted with another type of alliance made between Daewoo and GM.

1.4.2 The Daewoo-GM Alliance

GM had had a 50 percent share of Saehan Motors (former Shinjin, GM Korea and later Daewoo) since 1972 and actually controlled management. After merger negotiations with Hyundai failed in 1981, GM decided to use Saehan as a strategic partner for the global market. In this process, the interests of GM constantly prevailed over its domestic counterpart, Daewoo. First, in 1981, GM announced the plan that Saehan would produce 300,000 units of transmission a year and would supply GM assembly plants in various countries. The purpose was nothing more than to incorporate its Korean operation into the world car strategy that GM had adopted in the late 1970s. Yet this plan was not carried though since the world car project failed. Therefore, GM attempted to use its Korean operation as a supplier of small compact cars to the U.S. market.

In the mean time, GM's Korean partner, Daewoo, had shown rapid growth and taken the form of a multi-sectoral conglomerate by the mid-1980s, largely by taking over bankrupted firms in the fields of shipbuilding and electronics with government financial subsidies. Reflecting the enhanced corporate power of Daewoo, the name of the company changed from Saehan to Daewoo, and there appeared a new division of labor between the two firms. The essence was that Daewoo took over management rights in the domestic market while GM took charge of the export market. Given GM's low level of interest in the domestic market and its increasing emphasis on Daewoo's role as the supplier of compact cars to the U.S. market, this new division of labor corresponded more with GM's interests than with Daewoo's. Although Daewoo regained management rights in the domestic market, they were meaningless if the provision of models and manufacturing technology were entirely determined by the need for exports.

In 1984, GM and Daewoo agreed to produce jointly small compact cars, Le Mans, with a volume of 167,000 units in 1987 and to export 50 percent of their production under the sales network of Pontiac. The Le Mans, although produced in Korea, was not an indigenously designed car but was designed and produced by GM's German subsidiary Opel under the name of Cadet. Initially, GM provided compact and sub-compact cars to the U.S. market by relying on its Japanese partners such as Isuzu, GM's 34 percent-owned Japanese affiliate, and Suzuki, of which GM owned 5 percent share. This GM strategy, however, confronted obstacles due to the extension of the voluntary export restraint agreement (VER), which began in 1981 and was extended in 1983. Originally GM planned to import 200,000 units from Isuzu and 80,000 units from Suzuki, but GM could import only 50,000 units from Isuzu and 17,000 units from Suzuki because of the VER. Therefore, GM took Daewoo as an alternative supplier of compact cars to the U.S. market.

Under this corporate governance structure, Daewoo was unable to develop its own cars as late as the end of the 1980s. Moreover, even though it could develop and manufacture indigenously designed cars, it was impossible to export them under its own brand name because of the contract with GM, which stipulated that GM had every right in the exports of Daewoo cars. These obstacles were lifted only in 1994 when Daewoo bought off all the shares owned by GM. In any case, Daewoo continued to fall short of Hyundai in most indicators of performance throughout the 1980s. As table 8.2 indicates, for instance, Daewoo's R&D activities were still far behind Hyundai in the 1980s.

Table 8.2
R&D Activities of Hyundai and Daewoo

	HYUNDAI		DAEWOO	
	1983	1986	1983	1986
# of Personnel	1,122	2,254	254	495
Investment ($million)	20.0	79.0	3.7	17.4

Source: Oh and Cho (1997)

2. The State's Auto Policies in the 1980s

The performance of the industry, as measured by production capacity, volumes, and export accomplishment, had reached a level by the end of the 1980s that had been unthinkable during the recession of the early 1980s. As discussed in the previous section, it is true that the international environment to a great extent helped the Korean auto industry upgrade its productive capacity. Nevertheless, such a change in international environment influenced not only Korea but also most other auto producing LDCs that had a potential for rapid auto industrialization. Seen from the fact that only the Korean auto industry was able to avail itself of the opportunity provided by the shift in the international auto industry, the proper explanation of the enhanced performance of the Korean auto industry in the 1980s must be sought in the domestic sources of development, including state auto policies and state-business relationships.

The general trend of Korean economic policies in the 1980s can be termed "economic liberalization" and "private initiative." The Korean state tried to continue an export-oriented economic strategy on the basis of a more intense integration into the international division of labor while guaranteeing private-led economic management and the autonomy of the market. But this general trend was questioned by some bureaucrats and industrialists who had regarded the managed and sometimes strictly controlled state-business relations as the key contributor to economic success in Korea. The discord between different economic views, specifically with regard to the scope of the applicability of the market principle, also characterized auto policymaking in Korea throughout the 1980s. This conflict between the liberal and mercantilist camps of economic policy gave rise to a compromising solution by the end of the 1980s. But more careful reading of the context as well as the policy debates themselves reveal that the neomercantilist coalition between the MCI and major auto firms still operated well enough to prevent any swift policy shift in favor of liberal-minded policy reformers. Why and how this was possible even under the pressure of liberalization will be the main topic of the following sections.

2.1 Economic Liberalization and Private Initiative

Why did the Korean state choose liberalization as the central economic policy in the 1980s? This is partly answered by the reemergence of liberal-minded reformers, mostly from the EPB, at the center of economic policymaking processes. As I discussed in the previous chapter, however, these reformers' policies of stabilization and liberalization were not, at first, a full-scale attack on a state-led growth strategy, but sort of supplementary measures intended to contain high inflation resulting from the government's relaxed monetary policy (Haggard 1994a). Import liberalization and deregulation of the domestic economy became the formal governmental policy objective only after 1981. This turn of the state's economic policy from emphasizing "development at all costs" to emphasizing private initiative and market principle was occasioned by both external and internal factors.

In fact, the Korean economy had been relatively more liberalized and dependent on the condition of world economy than those of many other LDCs because its growth strategy focused on international trade. As a consequence of the recession of world economy and high interest rates, particularly after the second oil crisis in 1979, the Korean economy underwent a serious foreign exchange problem.[2] Therefore, Korea requested the World Bank (IBRD) to provide an emergency loan to get through a foreign exchange crisis. The World Bank assisted the Korean government by providing a relatively massive package of "structural adjustment loan." The total amount of this loan was $ 55 hundred million, which was a huge amount for Korea at the time. However, the World Bank attached "action programs," a package of policy suggestions that should be fulfilled by the recipient government, as a precondition for getting the loan. These action programs were very specific, listing requirements such as import liberalization, a change in tariff structure, a change in an energy-price setting mechanism, a change in industrial structure, and the abolition of agricultural subsidies. The World Bank also provided industrial financing loans, which totaled $67 hundred million. In this case, the World Bank requested the Korean government to deregulate interest rates, provide much autonomy to domestic financial institutions, open the financial market, and abolish policy loans. There was a criticism among government agencies against the World Bank's and IMF's demands for a structural reform in economic policies because they jeopardized the autonomy of economic management by the state. Nevertheless, the deterioration of the

[2] Remember that the rapid growth of the Korean economy in the 1970s was largely based on loaned capital from various international banks and institutions. Therefore, the fluctuation of interest rates and trading conditions has severely restricted the working of the Korean economy since the mid-1960s.

balance of payments problem and high interest rates made the World Bank's policy suggestions the most feasible alternatives for state economic policy (Moon 1988; 1993).

The second external factor that prompted the agenda change of economic policy was pressure from the U.S. pressure to open the market. The U.S. began to press the Korean government to open its market as early as 1979. At this time, the U.S. threatened to take a retaliatory measure against Korean exports to the U.S. unless the Korean government allowed market access for 37 items. In response to this demand from the U.S. government, the Korean government dispatched a trade mission to the U.S. and made use of the construction of a nuclear power plant in Korea as a lever to appease hard-liners in the U.S. government.

As the Korean economy recovered rapidly from a foreign exchange crisis and recorded increasing surplus from trade with the U.S. during the 1980s, the U.S. again expressed its discontent with an unfair foreign trade scenario because of the numerous tariff and non-tariff import restrictions in Korea. In a response to this pressure, particularly in such areas as currency appreciation, market opening, and the protection of intellectual property rights, the Korean government had to satisfy U.S. demands. So the Korean government proposed to advance the date of opening the capital market and the import of some agricultural produce, while focusing on holding back the demand for currency appreciation (Lee 1991, 257-262). As a result, the rate of import liberalization increased from 74.7% to 91.5% and the rate of the liberalization of foreign direct investment from 49.9% to 79.0% between 1981 and 1986.

The internal need for a shift in economic policy was encapsulated in the reformers' claim that excessive state intervention gave rise to the monopolization of market structure, the distortion of price mechanism, the inefficiency of resource allocation, and the reduction of market flexibility. The EPB's official document concluded that the state's protection and assistance provided the fertile ground for the survival of firms having low productivity by allowing high prices and low quality in the domestic market, thereby ultimately weakening the competitiveness of all industries (EPB 1980, 71).

Hence, private initiative under its own responsibility as well as liberalization became the critical issues both in the government and in the private sector throughout the 1980s. It is a well-known fact that initiative in investments, particularly in the heavy industry sector, had been largely wielded by the state in Korea during the 1960s and 1970s. Such a state-dominant economic structure began to face a challenge in the 1980s. The challenge came from two sources. On the one hand, policy reformers in the new government regarded the state-led growth strategy as the mainspring of economic inefficiency. The second challenge was the empowerment of the private sector, particularly a number of big business groups, as a result of state policies of previous decades. Moon (1988) called such a phenomena “the demise of a developmental state” in Korea in the 1980s. The ironic nature of the weakening of state power vis-à-vis big businesses is well summarized by Kim, Eun-Mee (1997, 215):

> Institutions of development, especially the state, changed in the course of economic development. The South Korean state was pressured to give up the very key to its success-i.e., the comprehensive developmental state-upon the attainment of its goal. The ironies are that not only did the comprehensive developmental state’s weakening come as a result of its

success but also that its challengers included the chaebol, which the state helped to created and flourish.[3]

In the end, both the internal and external factors provided a crucial impetus for policy reforms. Accordingly, the newly established government reexamined the general direction of its economic policy. In the process, industrial policy became the main target of policy reforms. Thus, liberalization and the emphasis on private initiative prompted economic ministries to undertake measures toward these policy objectives. Needless to say, the EPB was the most active proponent of new policy measures. The MOF also began to privatize domestic banks in 1981 and partially enforced several measures of financial liberalization. The MCI, as a bastion of sector-specific industrial policies, was also compelled to change its policy stance, largely from a protectionist and market-shaping role to a regulatory and market-conforming role.

How did such changes in the main agenda of the state's industrial policy affect the Korean state's automobile policy during the 1980s? This question will be examined in the following sections, with particular focus on the support measures given to the auto

[3] However, the thesis that the Korean state dug its own grave by strengthening a few big chaebol must be seen from a somewhat different perspective. First, even though big businesses asserted more autonomy in many corporate affairs during the 1980s, they were not yet as powerful as the state to the extent of challenging the overall dominance of the state in the management of the national economy, largely because they still lacked financial independence as indicated by an extremely high debt-equity ratio as of the late 1980s. The empowerment of business to the extent of challenging state power was witnessed only in the 1990s, particularly when the owner of the Hyundai chaebol, Chung Ju-Yung, ran for President in 1992. Hence, when they argued for liberalization measures, their intention was to deregulate the financial market while fiercely objecting to tariff reforms and import liberalization. On the other hand, the increasing power of business did not necessarily mean the weakening of the state. As Weiss (1998) pointed out, the developmental state in the real sense has the ability to upgrade its capacity according the shifting tasks. Therefore, she claimed that the disappearance of the heavy-handed, interventionist state does not automatically mean the demise of a developmental state, but may indicate a transformation into another more capable state.

industry by the state as well as the on the specific details of the Industry Development Law of 1986, which exemplified the general feature of auto policy in Korea particularly after 1985. The central point that I will attempt to shed light on is that the aforementioned liberalization and deregulation efforts by the state were not carried out without confronting great obstacles from both inside and outside the government. Moreover, I contend that the role of the Korean state in managing the national economy was not reduced, as assumed by the writers who stress the "demise of the developmental state," but simply changed from direct, sector, and firm specific intervention to functional and economy-wide intervention. In this process, the Korean state was able to strengthen, rather than weaken, the overall capacity of what Weiss called "governed interdependence" in key strategic sectors. Finally, the achievements gained through the campaign of liberalization and deregulation in the first half of the 1980s were transitory in nature, easily reversed by counterattacks from the social groups that suffered loses from the state's forced liberalization efforts. .

2.2 The State's Production Support

How did the policy agenda of liberalization and private initiative dictate the state's automobile policy in the 1980s? To answer this question, I will examine the state's supports for the industry in detail, dividing them into production consumption support. Many writers who take the view that the Korean state was the engine of growth because of its crucial role in credit allocation (Woo 1991; Zysman 1994; Kim 1997) tend to look at the 1980s as an era of decline of developmentalism in Korea. They present as evidence the decrease in industrial loans among policy loans in general. Since sector-specific industrial policies had to a great extent depended upon the allocations of industrial loans to targeted sectors, it seems natural that a decrease in industrial loans might have vindicated the reduced role of the state as a result of its financial liberalization efforts.

However, such an argument may not be true. A decrease in industrial loans could only reflect the convergence of interest rates between state provided loans and general loans. Table 8.3 apparently reveals the convergence of loan rates. Nevertheless, the decreasing share of government subsidized credits in private capital, whether it was caused by interest convergence or the government's deliberate effort to reduce sector-specific intervention, made traditional support measures seem obsolete and ineffective. Two more factors accelerated this trend. First, the state began to recognize the risks involved in credit allocation, particularly as the big businesses, which had been the major beneficiaries of policy loans, came to be targeted as the source of economic injustice in Korea. The democratization process that began in 1987 intensified such a perception among the Korean people. Second, major auto firms in Korea grew big enough to mobilize capital in their own efforts, largely from the international capital market, which presented far lower interest rates than attainable in Korea.

Accordingly, the role of the state as the provider of needed capital and credit to local firms had to decline. However, this does not automatically mean that the role of the state in promoting the performance of the auto industry dwindled. In particular, the state began to see the limitation in the export of autos exclusively on the basis of low prices. So the significance of technology was perceived among policymakers as the key for the further development of an auto industry. While R&D investment by local firms increased dramatically during the 1980s, it can be argued that this would have been impossible without the state's provisions of incentives, particularly the tax and financial incentives provided in the name of technology development.[4]

Table 8.3
Comparison of Interest Rates of Selected Loans (percent)

	Loan for export promotion	Loan for equipment in export industries	Equipment loan by Korea Development Bank	General loan
1975	7.0	12.0	12.0	15.5
1976	8.0	13.0	10.0	18.0
1977	8.0	13.0	13.0	16.0
1978	9.0	15.0	15.0	19.0
1979	9.0	15.0	15.0	19.0
1980	15.0	18.0	18.5	20.0
1981	15.0	16.0	16.5-18.5	17.0
1982	10.0	10.0	10.0	10.0
1883	10.0	10.0	10.0	10.0
1984	10.0	10.0	10.0-11.5	10.0-11.5

Source: KIET (1987: 58)

The state's support in the area of technology development was also in accordance with the shift in industrial policies in the direction of liberalization, because the state's support for technology and innovation did not require the sector-specific policies. It was functional and horizontal in its effects, as it benefited all industries nearly equally. In the auto industry, the state also helped local firms not only substitute imported key auto components with those made in-house but also develop high-tech components. The representative case of the state's support for technology development was the "Study on the Fuel Injecting System of a Diesel Engine," which was conducted as one part of "The

[4] Some financial incentives provided by the state to the local firms that tried to upgrade technology included the Industry Development Fund (6% interest rat), Fund for Industrial Technology Advancement (5% interest rate), and Technology Development Fund by Korean Development Bank (10-11% interest rate). In addition, when the firms conducted R&D activities in consultation with the MCI in the area of industrial basic technology, the state provided up to 70 percent of total costs. This was also the case with the R&D activities in the area of specific technology, which was conducted in consultation with the MOST (KAICA 1988).

Specific R&D Project" by the state. The state's deliberate efforts to enhance technology in the areas of both final assembly and parts manufacturing were clearly stipulated in the legislation of the Industrial Development Law in 1986, which we will examine in detail in the following sections.

2.3 The State's Consumption Support

As mentioned above, the Korean state had levied relatively higher taxes on passenger cars. Although the state had deliberately promoted the consumption of small-sized vehicles by continuously lowering the tax rate applied to these vehicles since the mid 1970s, Korean consumers had to pay relatively higher costs to maintain their vehicles than those paid by people living in other developing nations. This is indicated in table 8.4.

Table 8.4
Comparison of Maintaining Vehicles among Selected Developing Countries, 1982 (US dollar)

	Korea	Taiwan	Chile	Malaysia	Hong Kong	Singapore
Gasoline price per liter	1.02	0.75	0.51	0.44	0.50	0.45
Annual tax	457	272	127	84	119	360
Annual maintenance fee	3,007	2,147	1,402	1,184	1,369	1,485

Source: KIET (1982: 220)

With regard to consumption policies, it might be said that the Korean auto policies might have been insignificant in promoting the auto industry. However, such a claim seems to lead us in the wrong direction. Since the formulation of nationalistic auto policies in 1973 and 1974, the Korean state had intended to develop the auto industry as an export industry. Recognizing the small size of the domestic market and the potentially debilitating effects of policies promoting domestic consumption on the basis of the unequal distribution of income, the state had not placed much importance on the domestic consumption of passenger cars. As my interview with one of the MCI bureaucrats revealed, the policymakers simply assumed that "the era of owning automobiles by most citizens would come rather naturally as the GNP per capital increased, not as a result of state's deliberate efforts." Nevertheless, as indicated in the previous chapter, the highly discriminatory policy of auto consumption in favor of small-sized cars could be interpreted as the positive factor encouraging domestic firms to concentrate on the production of (sub) compact vehicles.

In the mean time, the state actively intervened in the promotion of auto exports of small-sized cars through various means. For instance, when the Canadian government investigated Hyundai to decide whether it had committed dumping, the Korean government mobilized various measures, such as sending formal letters and dispatching government representatives, to get a favorable decision. As a result of the state's active support, Hyundai could get out of the dumping indictment with relative ease (HMC 1992).

Nonetheless, the most critical measure by the state that promoted the consumption of domestically built vehicles had been the prohibition of importing completely-built-up (CBU) vehicles until 1986. As the export of passenger cars to North America increased, however, the government could not maintain such a measure because the possibility of conflicts with the U.S. and Canada over automobile trade increased. Combined with the general trend of import liberalization, the government completely liberalized foreign car imports in April 1988. The lifting of import prohibition, however, had had an almost no effect on the Korean auto industry. By the mid-1990s, the market share of foreign-made cars had not exceeded one percent of domestic consumption. This remarkable result was mainly caused by the deliberate efforts of the government to limit the impact of import liberalization.

First, the government liberalized imports of autos step by step, thus giving local firms the time for preparation and adaptation: it liberalized imports of specialized vehicles in 1986, and buses, trucks, and medium and large-sized passenger cars in 1987; all kinds of vehicles were allowed to be imported freely in April 1988 (MCI 1988, 53). Second, the government insisted on prohibiting imports of Japanese-made vehicles until 1995 for the reason of Korea's huge trade deficit with Japan. Even though U.S. and European-made cars were freely imported, the Korean automakers could maintain their market shares because the real threatening force, the Japanese-made cars, were still kept at bay and the relatively large-sized and fuel-consuming U.S. and European cars were not the ones the Korean consumers could afford to buy. Finally, liberalization of auto imports was not accompanied by immediate and corresponding changes in the tariff and tax system levied on the imported vehicles. As a result, the average tariff ratio of imported CBU was 25 percent in 1989, a figure quite enough for imported vehicles to lose price competitiveness *vis-à-vis* domestically built vehicles.

During the 1980s, the Korean state could no longer depend on sector-specific industrial policies and protectionist trade policies to promote a handful of strategic industries. The increasing emphasis on liberalization and private initiative, along with the changes in state's production and consumption measures indicated such a trend. Nevertheless, the collaborative relationships between the state and business in driving the auto industry in a certain direction were strengthened again in the 1980s. This is clearly illustrated by examining the changes in the institutional structure of industrial policymaking and the increasing power of businesses, which will be the themes of the next sections.

3. Institutional Structures of the Auto Policies in the 1980s

The characteristics of political rule revealed fundamental continuities between the *Yushin* regime and the new Fifth Republic: a strong president, a weak legislature and judicial system, limitations on political activity, and an even more restricted press. However, there appeared a clear distinction from the previous regime in the area of economic policymaking institutions. First, economic policymaking was again centralized in the EPB. The technocrats in the EPB and MOF had wider freedom to maneuver in seeking their economic agenda, including liberalization of the financial market, privatization of the commercial banks, and liberalization of imports and previous restrictions on foreign direct investment (Choi 1994; Haggard and Collins 1994). Second, the nexus between the state and business became loose and sometimes reflected a tone of mutual hostility. A few of the big chaebol groups became stronger in terms of political and financial prowess and often waged a frontal attack against state economic policies (Kim 2000). In response to this concentration of national wealth into a few chaebol groups, the state made a tougher policy toward big business, as can be seen in the formulation of A Monopoly Regulation and Fair Trade Law, the restructuring of the heavy industry sector, and the limitation on credit given to chaebol groups.

Nevertheless, the institutional shift in the direction of favoring the liberal segment of technocrats could not completely eradicate the deeply entrenched institutional structures that had been formed in the previous decade. As a result, the neomercantilist coalition made between the nationalistic segment of the MCI and local firms was still alive, even though it had been on the defensive during the first half of the 1980s. Hence, it might be said that the increase in performance of the Korean auto industry, particularly during the latter half of the 1980s, was the consequence of reinvigorating the neomercantilist coalition and its policy compromise with the dominant liberal coalition.

In the following, I will examine the institutional changes in the economic policymaking structure, focusing on the power game between the EPB and the MCI and the changing relations between the state and local firms. To gain a realistic view of the compromising nature of the state's auto policies in the 1980s, I will conduct an in-depth case study on the policymaking process of the Industry Development Law of 1986 in the next section.

3.1 The Politics of Industrial Policymaking within the Government

3.1.1 The Ascendance of EPB

This study identifies the process of economic liberalization and stabilization during Chun's presidency (1981-1988) with the rise of the EPB in the constellation of economic policymaking machinery in Korea. Why did the top policymakers tend to rely more heavily on the EPB? How did the EPB take advantage of major economic changes as an opportunity to increase its institutional capacity?

First, as long as the macroeconomic strategy of the new political regime was to distance itself from the previous one, it was out of the question to inherit the economic policy of the previous government without major amendments. The new military leaders thought they had to manifest their ability to bring about political and economic stability by dealing swiftly and decisively with policy legacies of Park's government: high inflation, high concentration of economic power in the hands of a few chaebol groups, excessive investment in heavy industries, a financial sector entangled with too many regulations and non-performing debts, and so on. The task of dealing with these policy legacies, however, could not be entrusted to the economic ministries, such as the MCI, that were part of these legacies. To regain its role as a super-ministry, the EPB diligently sought reform policy measures and embraced new roles that would restore its powerful economic policy coordination role and its institutional prestige.[5]

The second reason for the political leaders' heavier reliance on the EPB than ever before can be found in the institutional mission of the EPB. As an economic agency responsible for economic policy coordination, the EPB had maintained a broader perspective toward the health of the economy as a whole. Its broad mandate had kept the EPB planners concerned with both inflation and unemployment. Being located at an

[5] The enactment of the Anti-Monopoly and Fair Trade Law is a clear example. The obvious aim of the proposed law was to curb the exorbitant growth of chaebol groups and regulate abuses of their monopoly or oligopoly market positions. The proposed legislation had been initiated in the EPB a month before President Park's assassination, but because of its potentially profound impact and repercussions on the economy, the proposed legislation had not been made public but had been confined to internal discussion. After the demise of Park's regime, the EPB began to advocate strongly the need for fair trade regulation. Though faced with harsh opposition from chaebol groups and MCI bureaucrats, the proposed law was signed into law in late 1980. As an economic banner of the new government, the swift enactment of the law signaled its stern approach to big businesses.

arm's length from any particular industrial sector or chaebol group, the EPB planners were relatively free to pursue the policy reform that would affect the interests of various groups differently. It was for this reason that the EPB first took a critical look at the economic policies of the 1970s, including heavy industrialization. For these reasons, the military leaders saw the EPB as the most appropriate agency to carry out economic policy reform.

3.1.2 The EPB's Initiative to Determine the New Direction of Industrial Policy

As was indicated in the above section, the Chun government readily accepted economic policy prescriptions that had been strongly proposed by reform-minded liberal policymakers in the EPB since the late 1970s. These prescriptions were that price stability should and could be achieved only through promoting domestic and foreign competition by eliminating anti-competitive structural arrangements.[6] President Chun's inaugural address indicated his unqualified endorsement of the policy prescriptions advocated by the reform-minded policymakers in the EPB.

> The unforeseen events of last October 26 [the assassination of President Park] marked the closing of an era. All of us in contemporary life share the historical mission of boldly departing with the climate of the past to build a clean, just society in mutual trust. . . . the government will abolish the previous overprotection of enterprises, reexamining and modifying support measures in order to strengthen the organization of business and industry as a whole. In other words, private initiative will be at the heart of the nation's economy. An economic environment will be sought which promote enterprises both big and small to hold themselves finally responsible for results of their management.

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[6] Reformers attributed the crisis of 1980 to anti-competitive structural arrangements that were claimed to underlie heavy industrialization in the 1970s. Against these arrangements, reformers espoused the "transformation of mode of economic management." It had three major components: (1) price stability, (2) the private sector autonomy, and (3) the open economy system.

In fact, the EPB had since 1979 attempted to legislate a law that would replace many individual industry-specific laws and to apply a single yardstick in allocating financial resources and other government assistance among industries. In an effort to combat increasingly unruly inflation in 1978, the EPB had accentuated such a legislation attempt. However, it was shelved because of opposition from members of the neomercantilist coalition. President Park's unflinching commitment to the heavy industries and his tendency to secure a full range of government support for each major heavy industry had been an insurmountable obstacle for the EPB. The MCI and MOF, which had jurisdiction over those industry-specific laws, strongly resisted. Both ministries were suspicious of the EPB's attempt. They even understood it as a covert scheme of the EPB to consolidate its leadership over industrial policy issues.

In late 1980, at the moment when General Chun took political office, Kim Je-Ik, who had been a trenchant high ranking official in the EPB and became the Chairman of the Economic Committee of the SCNSM, began to take the legislation seriously. Kim and his liberal colleagues' first objective was price stability, which was to a large extent dependent on the change in monetary and credit policy, rather than on industrial policy. Initially, the reformers' measures proved successful in managing the growth of the money supply. During the peak of the boom period (1977-1978), the money supply (M_2) grew more than 35 percent per year. During 1980 and 1981, the first two years of stabilization, this growth rate declined to 25 and 27 percent, and it dropped to 15 and 8 percent in 1983 and 1984. The primary tool of monetary policy was credit control, so credit to the private sector was limited. The annual growth rate of domestic credit expansion fell from just over 40 percent in 1980 to 13 percent in 1984 (EPB 1988).

While the implementation of economic stabilization had been pushed with a relatively high degree of consensus among the economic ministries, that of economic liberalization was to produce considerable conflicts among them. This meant that although the policymakers of economic ministries agreed on the goal of economic management to promote a more market-oriented economy, they still had conflicting views on the degree of economic liberalization and the way to bring it about. In particular, the MCI and the MOF did not want to lose their own organizational interests and vested policy instruments in the process of liberalization. Liberalization, together with deregulation, threatened to usurp the instruments of import control in the MCI and those of setting interest rates and tariff rates in the MOF.

Perceiving the MCI's opposition as the most critical hindrance, Mr. Kim decided to use the Federation of Korean Industries (FKI), which was the association of chaebol groups, in order to preempt the MCI in mobilizing the private sector's support of mounting opposition to the EPB's move. Therefore, Kim requested the FKI to present its own view on international competitiveness of Korean industries. Unfortunately for Kim, the FKI failed to present the report because of internally divergent opinions. After failing to draw support from big businesses, Kim and other reform-minded policymakers decided to promote the new direction of the industrial policy by forming an alliance with the general public[7] and with the MOF.[8] For the former objective, reformers decided to

[7] To get support from the general public for its economic policies, the EPB began a nationwide campaign for economic education. During January-September 1983, for example, there were 99,745 sessions of economic education for 47.7 million people from all walks of life. The EPB even established the Economic Education Planning Bureau in November 1982 to coordinate national economic education and develop course materials.

make broad use of public education. Whang (1997, 143) summarized this strategy as follows:

> To overcome these difficulties, "*Kyung-jae Kyo-yuck*" (economic education) program has been introduced at virtually all levels of social organizations, private and public. The programs were developed to explain the background, motivation, contents, and expected results of the policy innovations. In addition, they attempted to gain wider and firmer support from the audience, including government officials and the general public, for the major policy shifts. . . . The basic assumption underlying this [educational program] was that the intra-governmental conflicts and the resistance from some business groups would be fragmented in natures, caused primarily by bureaucratic inertia. Therefore, government strategists believed that the resistance could be surmounted in the long run, once the government had built a critical mass both within and outside government of those who agreed with the new policy ideas.

Along with direct contact with the public through various kinds of economic educational programs, EPB reformers attempted to weaken the resistance from the MOF and MCI to its liberalization efforts by persuading the President to appoint so-called EPB men to the highest posts in both ministries. In 1982, the trenchant reformer Kang Kyong-Sik became the Minister of the MOF. Kang's objective was to accelerate deregulation in the financial sector as well as to complete tariff reforms, all of which had been intensely opposed within the MOF because they would take away central policy instruments from

[8] Traditionally, the MOF followed the lead of the MCI in the area of industrial policy. Because the MOF had authority over tariff and tax measures, the MCI had an undiminished interest in keeping a good relation with the MOF. To break this long-standing tie between the MCI and MOF, Kim Je-Ik persuaded the President that for continued pursuit of liberal economic policies, it was necessary to send EPB officials to the MOF. The personnel exchange between the upper echelons of the EPB and MOF was extraordinary. Reformers used the opportunity strategically to make the MOF, which had been reluctant to undertake financial sector deregulation, more cooperative with the EPB. So Kang Kyong-Sik, a long time EPB official, became Vice-Minister of the MOF in May 1982. Under his direction, substantial progress in financial sector deregulation was made during his tenure. Tariff reform was also completed under his personal direction (Kang 1991).

the MOF. Likewise, Kim Ki-Whan, the president of the Korea Development Institute (KDI- a research arm of the EPB), was appointed Vice-Minister of the MCI. Kim's objective was to accelerate import liberalization, advocating the total liberalization of imports by the end of 1980s.

These offensives by a new coalition among EPB reformers, the President's Economic Secretariat, international organizations, some business sectors, and consumers to achieve stabilization and liberalization, however, were relatively short-lived. This was because a new coalition was unable to put firmly to rest the new kinds of institutional arrangements of industrial policymaking that would replace those established in the previous decade. As will be seen in the next section, the new structure of industrial policymaking was not commanding enough to erase inter-ministerial discords on key economic matters at the time. After the Korean economy recovered from the crisis of 1979-1980, industrial policy in Korea began to be the subject of jurisdictional disputes between the EPB, MOF and MCI, all of which had to some extent mutually contradictory policy objectives.

3.1.3 The Formation of a New Structure for Industrial Policymaking

In September 1980, the EPB completed its first draft of the "Industrial Assistance Law," which contained the essence of the EPB's stance on industrial policy. The main contents of the proposed law were as follows. First, no industry assistance would be provided on an industrial basis (for example, "strategic industries"), and investment for capacity expansion, technology development, and manpower development would be treated equally. Second, the type of assistance would be restricted to tax incentives; tariff exemption or reduction would be abolished. Third, various kinds of preferential policy loans would be consolidated to support only a few "promising" infant heavy industries. Fourth, "promising (sunrise)" industries would be protected for only a pre-specified period of time (3-6 years). Fifth, for effective coordination of related policies, the Deputy Prime Minister (DPM) would be empowered with authority to allocate industrial assistance through deliberation of the Industrial Policy Deliberation Council (IPDC), to be chaired by the DPM.

In this proposed law, the EPB's intention was clear: first, reducing government intervention in the economy by strengthening its grips on industrial policy instruments currently put in the hands of the MCI and MOF; second, directing limited resources to technology and manpower development over which the EPB had much influence and control. The MCI and to a lesser extent the MOF resisted strongly the EPB's proposed law. The MCI Minister Suh Suk-Joon attacked the proposed law as "strengthening government (EPB) control rather than promoting private sector autonomy"(Lee 1991, 143).

Unable to draw support for its new initiative of industrial policy either from the MCI or chaebol groups, reform-minded Kim Je-Ik and Kang Kyong-Sik could not get the new law through. Instead they persuaded President Chun to pronounce "Presidential Special Directives Concerning Operation of Industrial Assistance System" in August 1981. The most important gain from this directive was the establishment of the IPDC. The council's power was strengthened by another Presidential Directive on December 1, 1981. The Council was chaired by the DPM, and the chair held veto power to reject or modify any industrial policy proposals and requests from ten ministries, including the

MCI and MOF (Rhee 1994, 190-191).[9] This was a mandate for the EPB to control all important industrial policies. Under the IPDC, the EPB established the Industrial Development Civil Council (IDCC), which was composed of experts, business executives, and professors, in March 1985, in order to avoid policy input through indirect and irregular channels and to exchange information openly with the private sector (EPB 1994, 141). The creation of the IPDC provided the DPM with a formal channel through which he could play a leading role concerning industrial policy issues.

The establishment of the IPDC represented the compromise between the liberal EPB and the mercantilist MCI. The MCI was able to defend its role as a policymaking apparatus of sector-specific industrial policies by keeping intact the existing industry-specific promotional laws. Meanwhile, the EPB began to be able to request changes in policies initiated by the MCI (with regard to import liberalization, for example) when the EPB considered them hardly being in accord with its overall industrial policy objectives.

3.1.4 The Challenges to the New Structure for Industrial Policymaking

The EPB's attempt to gain predominance in the industrial policymaking process by legislating the "Industrial Assistance Law" failed. Nevertheless, it was able to position itself at the center of the policy process by way of establishing the IPDC under the leadership of the DPM, who was also the minister of the EPB. With this new organization, the EPB made every effort to instill its liberal policy agenda into industrial policy. For instance, the EPB led the IPDC to announce the "Policy Direction and Basic

[9] The Directive stipulated that "each economic minister ought to get the DPM's prior sanction on every major economic policy proposal requiring the President's or Prime Minister's final approval."

Task of Industrial Policy in the 1980s" in May 1983. This policy guideline indicated that (1) the selective assistance program for major industries should be changed into the functional assistance program of manpower development and technology development; (2) the government should enlarge the scope of liberalization and competition by removing regulation in such areas as import restriction and entry control; and (3) the government should entrust the function of resource allocation to the market. In the same vein, the EPB revised the "Fifth Five-Year Plan of Social-Economic Development" in December 1983 in the direction of settling down the market economy principle by employing policy measures that were suggested in the above guideline (EPB 1994).

Along with the EPB's renewed efforts to consolidate its policy stance, the MOF also began to consider the legislation of a new industrial assistance system in the fall of 1984. While temporarily terming it "Industry Rationalization Law," the MOF tried to make this law a comprehensive policy package that would deal with most areas of industrial policy, covering industrial subsidies, the concentration of industrial power, the arrangement of troubled industries, and the formation of recession cartel in limited cases (Ahn 1989, 53-54). However, the MOF's attempt without a doubt was faced with intense resistance from the MCI, and so it was soon abandoned.

These strikes on the domain of the MCI by other economic ministries were possible because the MCI had been in a defensive position owing to the economic crisis of the early 1980s, which was agreed among political leaders to have been caused by excessive investments in heavy industries. However, after rather successfully making its way through the tide of the liberals' assaults, the MCI began to consider revising the current industry support system, this time under its firm leadership.

The power of the EPB's technocrats slowly declined after 1985. In the first place, the powerful rival force against policy reformers came from the former colonels who had participated in the coup and also closely had advised President Chun. These relatively young colonels were not friendly with the liberals' creed of free market, self-regulation, competition, and liberalization, but more akin to the control-oriented, top-down management of the national economy. While trying to distance themselves from big businesses in order to justify their participation in politics in the name of "social justice," they were nonetheless advocators of a "guided capitalism" rooted in President Park's economic legacy. The colonels asked Chun not to listen carefully to "naive" economists' advice but to be "independent" from the technocrats who contributed nothing in seizing power by force.[10] To isolate liberal-minded technocrats from the center of the state's economic policymaking, they revitalized the connection between the Blue House and the nationalist segments of the economic bureaucracy (Kim 1991).

Another factor speeding up the demise of liberal reformers was the rebirth of illegal political bargaining between the owners of chaebol groups and the President. As revealed by the indictment and imprisonment of President Chun for political bribing in 1997, the President amassed an astronomical amount of slush money from the kickbacks from the owners of chaebol groups in return for granting a variety of favors. Rhee (1994, 213-214) provides an excellent account on this matter:

[10] One example showing the hostility of colonels toward the economic technocrats was, according to Rhee (1994, 198) that the two presidential secretaries, who had been colonels before the coup, attempted to prevent the technocrats' drastic economic liberalization plan by secretly instructing the KDI [Korea Development Institute, a research arm of the EPB] and the Bank of Korea to provide data that would criticize and oppose the technocrats' policy.

> In general, under Chun's regime of the early 1980s, the techno-bureaucrats' basic policy guidelines of economic stabilization, liberalization, and industrial adjustment had brought about many conflicts with big business interests. More importantly, President Chun himself controlled political funds through the unified direct channel between the President and the business groups' owners, a large part of which was made of concerned business groups' acquisitions and/or mergers of financially ill-managed business group's large firms. As a result, the politicized institutional structure between the government and big business had greatly reduced the bureaucracy's autonomy from the political leaders. Thus, the bureaucrats were vulnerable to political pressures in their decision-making for policy formation and implementation.

Finally, it can be pointed out that the decline of the EPB's power was inevitable in view of its decreasing role in national economic planning in the 1980s. In the era of rapid growth, the EPB was credited by President Park as "the pioneering organization of national guidance." However, the following President relied more on the President's Economic Secretariat than on the EPB and tended to see national planning as an indicative measure devoid of coercive directions. Moreover, as the authority on foreign exchange transferred to the MOF and the freezing and contraction of national budget in the early 1980s reduced the power of the EPB over budget allocation, the policy instruments available to the EPB were also greatly reduced (Lee 1993, 195).

In this way, the heyday of liberal-minded policy reformers whose institutional basis was the EPB seemed to have passed by the mid-1980s.[11] The institutional arrangements that were created in the era of President Park's authoritarian rule were not easily eradicated, as hoped by liberal reformers. Likewise, the neomercantilist coalition among the segments of economic bureaucrats, political leaders, and big businesses demonstrated its capability to survive the harsh period of the liberals' attacks. In short, the dominance of the liberal coalition was temporally allowed to control industrial policymaking, but when the economy was stabilized, another coalition, which had a very close connection with the neomercantilist coalition of the previous decade, began to dominate the state's economic policymaking process. The military-turned-politicians in the Blue House, with the support of the MCI and big businesses, recaptured the commanding height of the state's economic policymaking, and major industrial policies were greatly influenced by this shift in dominant coalition.

In the following, I will examine the processes of new policy formation and its legislation in detail because only by conducting an in-depth analysis of policy processes can we understand the complex nature of the MCI's autonomy and its relative power position among the Korean economic ministries.

3.2 The Legislation of Industrial Development Law (IDL)

As I indicated in chapter four, the sector-specific promotional industrial policy in Korea had been predicated on the individual sector-specific laws that began to be promulgated from 1967. For instance, when the auto industry was granted the policy loans that had a far lower interest rate than those available in the market, this privilege was based on the Law for the Promotion of Machinery Industry. So, by the middle of 1980s, there existed a number of such laws, which were thought by EPB reformers as the central cause of the distortion of industrial structure in Korea. The EPB's failed trial to legislate the Industrial Assistance Law was an effort to repeal all sector-specific laws.

[11] Several key reformers, including Kim Je-Ik, were killed by North Korean terrorists in Rangoon, Burma in 1983.

While having succeeded in blocking the EPB's attempt, the MCI also felt the need to revise these industry-specific laws in line with the general economic trend of liberalization and private initiative. So came the legislation of the IDL in 1986.

The processes of the legislation of the IDL can be summarized as follows: Formulation of the MCI’s Bill (September 1983-March 1985) → Formulation of the Government’s Bill (April 1985-October 1985) → The Legislation Processes in Congress (October 1985-December 1985) → Promulgation of the IDL (January 8, 1986). The legislation of the IDL progressed by taking steps toward intra- and inter-ministerial coordination, coordination with business, and getting approval from political parties. In these stages of policy formation, the MCI tried to maintain its prerogative in industry policy, sometimes drawing upon the support from big business groups or sometimes using cleavages among economic ministries to its favor.

While the first attempt to revise an industry support system was made by the EPB in 1981, the MCI on its own initiative undertook a review and revision of the current legal system of industry support and rationalization. With eighteen months of internal preparation by the MCI, the IDL was put up for inter-ministerial coordination and discussion among the academic circles, business circles, and the press. Six months’ cooperative efforts produced the final version, which was then sent to the National Assembly and was legislated on January 8, 1986. This process needs to be examined more thoroughly because it highlights the ascendance of the MCI in the process of industrial policymaking.

3.2.1 The Processes of Policy Formulation inside MCI[12]

The in-house policy formulation took steps toward the planning of a new law by the Bureau of Industrial Policy and policy coordination between different divisions and sections within the MCI. The need for a new law governing industrial policy was first conceived by the Bureau of Industrial Policy in May 1983.[13] The Minister of the MCI, Keum Jin-Ho, strengthened the planning effort by saying in the internal meeting, "We (MCI) should consider the comprehensive preparation or the improvement plan for the change of the existing system of industry regulation in accordance with the new internal and external circumstances" (*Chosun Daily*, May 27, 1983). In February 1984, the Bureau of Industrial Policy presented a draft law for intra-ministerial consideration.

While it made apparent the MCI's intention to maintain sector-specific industrial policy in selected industries, the most significant feature of the draft was that it espoused a unitary legal system for industry promotion as well as the measures that would strengthen the market economy, competition, and private initiative. This seemingly radical departure from the existing policy stance was possible mainly because the Bureau of Industrial Policy was a kind of staff organization functionally dealing only with policy development, and thus free from the influences of other bureaus that dealt with individual industries. This compromising nature of the draft was also necessary to persuade other

[12] The tracking down of policymaking process is based on the interviews with former MCI officials and on the reading of government's internal documents, newspapers and journalistic articles.

[13] It is noteworthy that the consideration of revising existing industrial support laws was initiated by the Bureau of Industrial policy. This bureau was a staff organization relatively detached from the management of individual industrial policies. Hence, by nature, this bureau was the one most susceptible to the influence of the EPB, primarily in the area of liberalization of a currently highly protected industrial support system (Ahn 1989).

economic ministries, given the prevalence of economic liberalism in many economic ministries.

As expected, this draft was intensely opposed by the bureaus that had implemented individual industrial policies. At the deliberation meeting of bureau chiefs in November 1984, the individual bureaus taking charge of steel, petrochemical, aircraft, machinery industries argued for preserving the current industry-specific laws and policy instruments. In contrast, the Bureau of Industrial Policy and ministerial advisors demanded the introduction of a unitary industrial law and the application of broad market principles to the industrial support system. As there appeared no sign of convergence of opinions after holding inter-bureau meetings 11 times, the final decision was entrusted to the Minister of the MCI. Given the divergence of opinions among bureaus, he could do little but suggest a compromising solution, according to which the MCI would make a new unitary industrial law on the basis of the opinions of individual bureaus (Ahn 1989, 61).

The reason behind the MCI's speeding-up of a new industry law was closely related with the EPB's renewed effort to make "The Law for Advanced Industrial Structure and Rationalization" in 1984. This law was the second attempt by the EPB to streamline the industry support system and was intended to unify the existing seventy industry promotion laws into one legal system. What surprised the MCI was that it had already bee reported to the President. In order not to lose its hegemony in industrial policymaking, the MCI swiftly decided upon its draft of a new industrial law entitled as "The Promotional Law For the Advancement of Industrial Structure," which would unify eight individual promotional laws except for the Promotional Law of Aircraft Industry.

3.2.2 The Processes of Policy Formation inside Government: Bureaucratic Politics

The MCI knew that its proposed law would face intense resistance from other economic ministries. Nevertheless, it tried to strengthen its position in the government by passing a new law that would provide a solid legal base for the promotion of strategic industries and for the management of an industry-specific assistance system in order to enhance productivity. The proposed law also incorporated some measures of strengthening market economy by removing various competition-restricting factors and thus accepted the general direction of liberalization advocated by the EPB. The responses of other economic ministries to the proposed law were quite different from one another, reflecting their relative jurisdictional authority. This lack of a unified opposing voice certainly prevented an alternative proposal from having any chances of being formulated as a government proposal backed by liberal bureaucrats. Next, I will look more closely at the different attitudes of some economic ministries toward the MCI's proposal, and how the MCI's proposal became the law with minor revisions in 1986.

As expected, the EPB's response to the MCI's proposal was anything but cooperative. Although it agreed with the necessity of replacing the seven industry-specific promotion laws with a unitary law, it vehemently opposed the concept of "sunrise industry" and to the proposed policy instruments to realize a policy goal. Specifically, the EPB claimed that rationalization should be carried out by means of incentives rather than compulsory measures and that there were no objective criteria for selecting a "sunrise industry." Among the EPB's bureaus, the Bureau of Fair Trade was the fiercest in criticizing the MCI's plan. It made clear its overt opposition by asserting that (1) while the selection of a sunset industry was relatively possible in view of the current economic condition, it was almost impossible to select a sunrise industry due to the subjectivity of prediction about the future industrial structure; (2) the MCI's criterion of selecting a sunrise industry ("the sector that needs the enhancement of international competitiveness") was so vague and abstract that it could result in excessive government intervention; and (3) the MCI's plan contained elements that could lead to the dilution of the Fair Trade law, and it could result in the excessive concentration of industrial power (Choi 1991, 102).

The opposition of the MOF was centered on defending its jurisdictional authority. Specifically, it argued that rationalization efforts were effectively made by skillfully using the "Regulatory Act on Tax Breaks and Exemption for the Industry," which was the domain of the MOF. Moreover, it expressed its discontent with the creation of a new fund for industrial development, and instead argued that the National Investment Fund (NIF), which had been managed by the MOF, should continue to be the single source for industry financing. The Ministry of Science and Technology (MOST) also requested the revision of the MCI's draft by arguing that its clauses relating to technology would produce confusion and friction with existing technology laws. The MOST also announced its intention to formulate the "Basic Law for Science and Technology Innovation" in August 1985 as a countermeasure to the MCI's intrusion into its own jurisdictional area (*Maekyong Daily*, September 14, 1985).

The basic strategy chosen by these economic ministries to counter the MCI's draft law was to erase it by pursuing the formulation of ministry-specific industrial laws. However, the MCI's position to this draft law was unwavering. This partly reflected the organizational consolidation of the MCI during the mid-1980s. The strengthening of the MCI, though not as apparent as in the 1970s, was greatly influenced by the appointment of a politically powerful bureaucrat as the Minister by the President.[14] Witnessing this enhanced autonomy of the MCI during the mid-1980s, the EPB and other economic ministries could do little but change their strategies. The new strategy was to induce the revision of the law in the direction of reducing the power of the MCI while accepting the necessity of a new unitary industry law.

Given the divergence of opinions regarding the future industrial law among economic ministries, policy coordination at the level of career bureaucrats was never successful. In the end, the MCI attempted to get through the impasse by coordination at the level of the Economic Ministers' Conference, thus bypassing the intense turf battle between the economic ministries waged at the level of career bureaucrats. In other words, a political solution was preferred by the MCI to any administrative solutions. At this Economic Ministers' Conference, the decision was made to legislate the new industrial law on the basis of the MCI's draft law. Once the top government officials reached a political solution in making a new law, the individual economic ministries could not but follow this solution, and, in the processes of policy coordination at the administrative level, the MCI's original position was not much challenged. Table 8.5 shows how the original MCI's draft law was revised in the process of policy coordination.

[14] The MCI's Minister, Keum Jin-Ho, was a career bureaucrat. However, his connection with the core of a military regime was guaranteed by the fact that he was the cousin of the next President, the number two man at the time, Rho Tae-Woo.

Table 8.5
The Changes of MCI's Original Draft Law

ORIGINAL DRAFT	OPINIONS OF OTHER MINISTRIES	REVISED PLAN	RESULT
Promotion of investment inducing industry	Opposition by EPB and MOF	Prospect of industry development	Revision (EPB)
Promotion of sunrise industry	Opposition by EPB and MOF	Incorporate it into rationalization plan	Maintenance (MCI)
Encouragement of industrial rationalization	Opposition by MOF	Encouragement of rationalization	Maintenance (MCI)
Acceleration of industrial technology development	Opposition by MST	Promotion of basic research in industry	Revision (MST)
Fund for advancement of industrial structure	Opposition by MOF	Incorporate it into National Development Fund	Maintenance (MCI)

Source: remade from Kim, Yong-Bok (1996) 156-174.

3.2.3 The Process of Legislation

As the new industrial law would affect the business environment of individual industries and firms, we can assume that there would appear some kinds of rent-seeking activities by private actors to influence the government's decision in their favor. The IDL certainly had many elements that might limit the extent of competition and elect entry barriers, particularly in the industries chosen as sunrise industries. Given the opportunity for rent-seeking by imposing competition-restricting measures on the chosen industries, the state took the risk of either inducing inefficient resource allocation and thus reducing social welfare or taking advantage of using quasi-monopoly rents to accelerate rationalization of industrial structure.

One indication of the effect of government intervention into the market economy by making the law is how its legislation proceeds, that is, to what extent the government's initiative is extenuated by the pressures of private actors and politicians. The more pressure exerted by business and politicians in the process of the legislative deliberation of a new law, we may say, the less autonomous the government agency is that formulates a new law, and the less efficient the policy outcome will be because of prevalent rent-seeking activities. Contrary to expectation, however, the legislation of the IDL proceeded without any significant pressure from concerned business circles or from politicians.

At first, after the government decided upon the MCI draft law, MCI bureaucrats engaged in publicity to incorporate the opinions of the private sector into the new law. Such a sequence proceeding from the formulation of the government law to listening to the private sector was uncharacteristic, viewed from the vantage point of the mid-1980s, when the power of business was noticeably strengthened. Yet a careful examination of the legislation process reveals that the seemingly authoritarian character contained in this sequence was another expression of the "embedded autonomy" of the Korean state. In other words, the MCI was autonomous enough to carry out its industrial policy without estranging the demands and interests of concerned industrial sectors. This also reveals that the MCI's draft law was prepared in close consultation with individual industries, and thus it only needed the consent of the business circle in general once it became law.

As for the big business groups, the new legislation contained elements of state support, particularly to the industries that were not yet competitive but had much potential to become key industries in the future. Small- and medium-sized industries also welcomed the legislation because it would provide the opportunity to regulate market forces in declining industries. So there was not as intense opposition from business to the proposed law as seen in the case of the formulation of the Fair Trade Law by the EPB in the early 1980s. The Federation of Korean Industry (FKI), the Federation of Korean Trade Unions, and the Korean Federation of Small-Medium Business presented their official opinions regarding the proposed law. While expressing general agreement with the main contents of the law, they only demanded higher sophistication of the industry support system and more participation of the private sector in the policymaking process. In October 1985, the Korean Chamber of Commerce and Industry held a roundtable of industries regarding the proposed IDL. At this meeting, there were not active voices demanding any crucial change of the law, and even some participants requested that the scope of the IDL be expanded to cover more industries (*Maekyong Daily*, September 11, 1985).

Finally, the IDL had to pass the legislative deliberation at the National Assembly to have any effect as a law. Contrary to democratic societies in which the legislative institution plays a significant role in determining the power balance among state institutions, Korea, during the mid 1980s, was still ruled by an authoritarian regime in which the role of the legislative body was nothing more than a rubber-stamp on the government's proposed law. The National Assembly passed 92.9% of government proposed laws in the 12th National Assembly. Therefore, the passage of the government proposed IDL through the legislative process was not a big problem for the government. As expected, the National Assembly passed it even without adding any minor revisions on December 31, 1985.

3.2.4. The Auto Industry under the Industry Development Law

The specific contents of the IDL are as follows: (1) the acceleration of industry rationalization (i.e., the designation of rationalized industries and the formation of a rationalization plan), (2) the improvement of industry technology and productivity (i.e. the project for developing basic industrial technology and the project for promoting industrial technology), (3) the establishment of the "Industry Development Fund" for securing necessary financial resources, and (4) the establishment of the Industrial Development Civil Council (IDCC) as a forum for connecting the government and business in the industrial policy area. The IDL took on the character of a unitary measure governing all areas of industrial policies and replaced the existing seven individual industry promotional laws.

According to the new law for industry development, if the industry were designated as one that needs rationalization, it would receive several financial and non-financial subsidies and incentives. The law stipulated that the designated industry should be either a sunrise or sunset industry. Confining our attention to only sunrise industries, being so designated meant that the industry would become a strategic sector that would draw numerous supports from the government.

With the enactment of the IDL in 1986, the IPDC in consultation with the Industrial Development Civil Council recommended the automobile industry as a rationalization target. According to the MCI report, the designation of the auto industry as a rationalization target was "to achieve the economies of scale in production of the automobiles ahead of time schedule, to enhance technology level for production of the better quality vehicles, and to provide the basis for the development of the auto parts industry" (IPDC 1986, 22). The other industries designated for rationalization are shown in table 8.6.

Table 8.6
Rationalized Industries According to IDL

REASON FOR RATIONALIZATION	INDUSTRY	PERIOD
Competitiveness (Sunrise Industry)	Automobile Heavy Electrical Equipment Diesel Engine (Ship) Heavy Construction Equipment	7/86 – 6/89 same same 7/86 – 6/88
Restructuring (Sunset Industry)	Textile Alloyed Steel Dyeing Fertilizer	7/86 – 6/89 same 1/87 – 12/88 12/87 – 11/90

Source: Kim 1989, 47

The automobile industry was given three years to rationalize. MCI officials argued that the recommendation for extending the rationalization period was at the initiative of local capital. No new entrant would be permitted from 1987 to 1989. The MCI stipulated that the current specialist system of production would continue until the end of the rationalization period. Moon (1988 83) succinctly pointed out the implication of the designation of an auto industry by saying, "Despite its overall tone directed to non-discretionary intervention, the law allows the government to intervene and support the automobile, automobile parts and heavy machinery industries on a discretionary basis."

The designation of the auto industry as a rationalization target indicated that the neomercantilist coalition between the MCI and domestic auto firms was largely intact at least in the automobile sector, given the dominance of liberalization and privatization as major economic agendas of the Korean government during the 1980s. When industry rationalization became a hot issue in the mid 1980s, Hyundai Motor Company and some MCI officials asserted that the government should not change the business environment during such a crucial time as the introductory phase of the Hyundai Excel to Canada (1985) and to the U.S. (1986). The MCI also thought that the oligopolistic structure of the automobile industry in the advanced countries had advantages over the competitive structures displayed in other developing countries such as in Argentina, Brazil, and Mexico. The initial opinion and proposal by the Transportation Division of the MCI was to extend the rationalization period to longer than three years. However, difference of opinion within the MCI over the balance of the government's favors among the industries and the opposition from other ministries, especially from the MOF and EPB, made them settle for a three-year proposal.[15]

The persistence of the neo-mercantilist coalition in the auto industry throughout the 1980s was extraordinary not only because of the general trend of liberalization and privatization in the government's economic policies, but also because of the frequent conflicts between the state and business in other industrial sectors. In the following sections, I will try to explain the persistence of such a coalition by examining the private side of a coalition.

3.3 The Increasing Power of Business during the 1980s

In the above section, I argued that the coherence of the state's economic policies during the 1980s became weaker, largely because of bureaucratic in-fightings between liberal-minded reformers and mercantilist-minded bureaucrats. To win the battle, it can be assumed, each camp of bureaucrats had to try to attract business actors to its side.

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[15] This fact was indicated by my various interviews with former MCI officials in 2000.

In addition, there was another factor that enhanced the leverage of business vis-à-vis the state. This was the growing role played by the chaebol in determining the level of economic growth in Korea, particularly after the mid-1980s, notwithstanding the government's endeavor to limit business concentration. As can be seen in table 8.7, the share taken by Korea's four largest chaebol groups in value added had steadily increased up to the mid-1990s. By the end of the 1980s, big businesses were no longer instruments of economic growth that could be rather easily controlled by the state. They began to use their own voices, or even express overt opposition to certain government economic policies. As a result, it became much harder for both camps of bureaucrats to form a coalition with big businesses, without making some concessions to their demands.

Table 8.7
Value Added to GNP of Korea's Four Largest Chaebol (percent)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Hyundai	1.9	1.9	1.9	2.1	2.0	2.2	2.3	2.3	2.4	2.9
Samsung	1.2	1.3	1.6	2.2	2.0	1.8	1.9	2.0	2.4	3.1
LG	1.2	1.2	1.3	1.4	1.4	1.4	1.6	1.6	1.8	2.1
Daewoo	1.4	1.3	1.1	1.2	1.2	1.2	1.2	1.3	1.2	1.2
Total	5.7	5.7	5.9	6.9	6.6	6.6	7.0	7.2	7.8	9.3

Source: Choi (1997), 41.

The Korean auto firms were not the exception to this general trend of reinforcement of business power vis-à-vis the state in the 1980s. First, the rationalization effort by the state in the auto sector in the early 1980s failed to produce an intended result, as seen in Hyundai's insistence on managerial autonomy and consequently in the aborted merger attempt between Hyundai and GM. Second, as will be seen in the next section, the bargaining power of auto firms vis-à-vis individual state agencies greatly increased by the end of 1980s, largely because they succeeded not only in building large-scale factory facilities but also in penetrating into the U.S. and European auto markets.

On the basis of such increased power resources, the Korean auto firms could reinforce the MCI in its power struggle against the EPB, and thus lay a fortified foundation for the maintenance of a coalition with the MCI against the liberal reformers, particularly after the mid-1980s.

It should be emphasized that the increased leverage of the chaebol as well as unmitigated business concentration was achieved at the cost of small businesses and in spite of the government's accelerated effort to control chaebol's behavior. Kim Seok-Ki (1987, 317), an expert on Korean government-business relationships, offered three elements that combined to give the chaebol advantage over small businesses. First, the chaebol’s extensive, high-level government contacts and good business track record usually made for more effective and efficient communication with top decision makers in the government. Second, the chaebol’s much larger resource base than that of small, independent firms made for easier and more cost-effective monitoring of highly complex government decision-making processes. Third, the chaebol’s superior information networks minimized the cost of dealing with the high uncertainty caused by the ad hoc nature of the government’s discretionary intervention.

On the other hand, President Chun and his reform-minded liberal supporters issued some measures to reduce the increasing power of big business groups. The most significant of these was the Fair Trade and Anti-Monopoly Act enacted on April 1, 1981. The political purpose of this act was similar to that of the earlier Law for Dealing with Illicit Wealth Accumulation under the Park regime. The new act was aimed at supporting a regime that suffered from lack of legitimacy. The act blamed the concentration of wealth in the hands of a few chaebol on the corruption of both the government and big business.[16]

However, this anti-chaebol policy was neither effectively implemented nor enforced. For example, by 1983, two years after its enactment, there were 487 cases of the founding or merging of firms. No fewer than 258 of these cases were the direct result of efforts by the major chaebol to increase their horizontal integration by acquiring independent firms. This failure of state policy was a strong indication that relative power of big business groups had increased to the extent that they could resist government policy if it contradicted their business strategies.[17]

Despite liberalization efforts in the early 1980s, the structure of business concentration could not be corrected. This was because the Korean economy was relying so heavily upon the big business groups that it became very difficult to curtail the chaebol's activities without adversely affecting economic growth. Most of Korea's

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[16] The specific contents of the law are as follows:
1. Any business activity that impeded normal market competition will be prohibited.
2. Price-fixing by monopoly capitalists is prohibited.
3. Price-fixing through negotiation among oligopolists will be prohibited, unless registered and approved by the EPB.
4. All government offices planning or implementing any policy concerning fair trade and monopoly must consult with EPB.
5. Contracts or any act involving foreign capital or foreign technology must follow the Fair Trade and Anti-Monopoly Act. 6. The Committee on Fair Trade and Anti-Monopoly will be formed, which will be in charge of examining and prosecuting violation.

[17] The strengthening of chaebol's power relative to the state was also revealed in the state's failed attempt to sell non-business related real estate. The so-called "September 27 Measure" in 1980 required the chaebol to sell off real estate which was not used for business purposes but for improving their capital structure. This action was rigidly enforced in the first year of its jurisdiction, but enforcement was relaxed in the following years. For example, some 257.1 billion won worth of real estate was sold in the two-year period following the measure, but the same companies concerned acquired eight times more in new properties.

chaebol have developed on the basis of the credit-based financial system, contrary to the capital-market based one in Anglo-Saxon countries (Zysman 1983, 1994). In this financial structure of firms, as table 8.8 reveals, the debt-equity ratio of manufacturing firms had been much higher than that of other capitalist countries, even higher than that of Taiwan. This insecure financial condition of the Korean chaebol put restrictions on the state's anti-monopoly policy primarily because the business failure of the chaebol would lead to difficulties in the banking sector and because failure in the banking sector would result in the collapse of the entire Korean economy. In other words, the Korean economy increasingly became a hostage to the economic condition of big business groups. And this process continued well into the late 1990s as the next chapter demonstrates.

Table 8.8
Debt/Equity Ratio of Manufacturing Firms in Selected Countries, 1972-1984

YEAR	KOREA	U.S.	TAIWAN
1972	313.4	-	-
1975	339.5	60.6	99.3
1980	487.9	177.0	82.5
1984	342.7	134.5	110.1

Source: Kang (1999), 48.

The strengthening of chaebol’s power was largely caused by President Park’s drive to heavy and chemical industrialization. The institutionalization of a chaebol type of business organization spread over all the industries during the 1970s. In this process, the Korean economy began to take the form of a “quasi-internal organization,” in which the transactions between the chaebol groups and the state resembled more intra-firm, hierarchical relations than inter-firm, market relations (Lee & Naya 1988; Lee 1992). The journalistic term of “Korea Inc.” was also widely used to depict the institutionalized relations between the state and big businesses. Under such relation, the reforms of big businesses, primarily initiated for political reasons, were likely to lead to struggles between political and economic elite and the institutions they represented. Whenever institutions resist change, new approaches to policy cannot be executed. Therefore, new goals cannot be met. In the early 1980s, reforms were targeted at reducing chaebol power. However, chaebol power actually increased instead.

The increasing power of big businesses to the extent of blocking the liberal coalition's attempts to rationalize the Korean auto industry can be illustrated by examining the renewed offensive strategy used by Hyundai during the early 1980s. Although there was not explicit support from the state because the liberal reformers dominated the economic policymaking, Hyundai, with the implicit support from the MCI, was able to expand its production capability up to the scale of making automobiles efficiently and exporting them aggressively in the latter 1980s. This will be dealt with in the next section.

3.4 An Irrational Business Strategy? : Hyundai's Expansion Plan under Harsh Condition

In 1981, Hyundai announced their plan to build an assembly plant that could assemble 300,000 front-wheel drive passenger cars by 1985 using an investment of $582.79 million. The project would be financed in part by foreign loans (US $393.96 million) and in part by all of Hyundai's credit. Mitsubishi Motor Corporation was supposed to provide the main source of technology for a new car, the Pony Excel (HMC 1987, 429-435).

This announcement was a shock to liberal reformers who insisted on the rationalization of the Korean auto industry in the direction of making it a junior player in the international auto industry. We can understand the reformers' disbelief since this expansion plan was announced within an environment hardly favorable to another round of massive investment. The economic recession of the late 1970s and the early 1980s decreased available capital and the demand for cars. Government policies discouraged the development of a new model, as the liberal coalition hostile to new investment increased its strength within the government. Political turmoil and increasing labor disputes also made it difficult for auto firms to set up a plan for a new model for export. As far as the environmental factors were concerned, Hyundai's expansion plan was considered at the time too risky to maintain its dominant position in the Korean auto industry.

Although the MCI expressed its support for Hyundai's new venture, it was not able to mobilize nation-wide support with promotional auto policy, as had been done in 1973 and 1974. The early 1980s were an era of economic contraction and stabilization, so the MCI had few instruments, particularly in the fields of financial support, except for entry control and import restriction. Considering all these facts, it can be concluded that the risk-taking entrepreneurship of Hyundai's top decisionmakers was one of the most critical factors in the new expansion plan. Reflecting the increasing capability of the chaebol in deciding their own fate with a minimum of state intervention, top managers of Hyundai, particularly its president, regarded the on-going economic recession as another opportunity for the firm. For instance, Chung Se-Yung, the president of Hyundai Motor Company, said "the vitality of an enterprise is proved by showing its courage and wisdom in crises. Our company can exploit the economic recession because we can make factories at much lower prices in economic recession than in economic boom" (Back 1990, 118).

Another indicator that suggests the independent capability of Hyundai to manage its business with its own hands is its dealing with foreign automakers when a new model was under consideration. As early as the summer of 1978, Hyundai began to look for a supplier of technology for a new model. The supplier was required to provide the most advanced technologies of emission, fuel economy, and design sufficient to produce a new model for export into the U.S. market. First, Hyundai contacted Volkswagen because the latter proposed the lowest royalty - $26.5 per car - and an export guarantee of 100,000 cars from Hyundai. However, Volkswagen asked for equity participation, demanding at least 25 percent of Hyundai's total equity share. As we have seen in the negotiations with Ford in the early 1970s and GM in the early 1980s, Hyundai was so firm on this issue that it forgot the deal and looked for another supplier of the necessary technology. Hyundai then contacted Renault and Ford, but the negotiations were soon interrupted because of the issue of equity participation.

Hyundai then found their technology provider in a second tier auto firm in Japan, Mitsubishi. Mitsubishi was willing to provide advanced technology while requesting royalty of $ 42 per car, which was higher than that asked by Volkswagen but lower than those by Renault ($ 62) and Ford ($ 53). However, the most important reason for choosing Mitsubishi as a technology provider was its indifference to management intervention, satisfied with Hyundai's offer of 10 percent equity as a bonus. The final contract was signed in October 1981.

The technological tie-up with Mitsubishi was the best choice for both parties. On the one hand, Hyundai was able to import critical technology in making front-wheel drive small passenger cars with efficient emission control without the concession of its management. On the other hand, Mitsubishi also benefited from a considerable royalty from Hyundai as well as from the export of its auto parts. As a minor firm in Japan, Mitsubishi was able to achieve better economies of scale through its cooperation with Hyundai.

Hyundai's new investment drive proved extremely successful. The market conditions in both the domestic and international auto industries improved rapidly after 1982. The emergence of the Japanese auto industry as a dominant actor in the international auto industry and the consequent imposition of voluntary restriction on the export of Japanese small passenger cars provided the opportunity for Hyundai to penetrate into advanced auto markets. Accordingly, it could be argued that had it not been for massive investment in the early 1980s, Hyundai would not have become an internationally recognized automaker by the end of the 1980s. This argument can be supported when we compare Hyundai with another automaker in Korea. Daewoo, the other firm allowed to produce passenger cars in 1981, had come to rely on producing foreign models supplied by its foreign partner GM by the mid-1990s. With modest production capacity and little knowledge of manufacturing key auto components, Daewoo became a minor producer in Korea and could not export its originally designed autos by the mid-1990s. Only after it bought off all equity share of GM in 1994 was Daewoo able to export its autos with its own brand name to the U.S.

4. Conclusion

In this chapter, I have tried to explain the causes underlying the increase in the performance of the Korean auto industry, particularly during the latter half of the 1980s.

In the early 1980s, the main agenda of industrial policy was private autonomy strengthened by the state's deliberate attempt at liberalization. The main proponents of such a policy change were a group of liberal-minded technocrats in the EPB and MOF, international financial organizations, and entrepreneurs engaged in light industries. They also promoted the institutional reforms, particularly concerning the finance sector and the process of industrial policymaking.

However, after the disappearance of key reformers from the center of power, the long-standing tradition of statism and developmentalism once again took center stage in industrial policymaking in Korea. The MCI's status among economic ministries was also strengthened as a political figure was appointed as the minister. Hence, it tried to recapture the hegemony of industrial policymaking from the EPB by initiating its own version of new industrial law, which resulted in the formulation of the IDL in 1986.

As we will see later, the big chaebol were in favor of liberalization and deregulation in the 1990s. However, during the most of the 1980s, they were very cautious about the impact of liberalization on existing state-business relations. Although, they grew bigger and stronger throughout the periods of the 1970s and 1980s, they still relied on the government for financial support, import protection, and labor control. Hence, when the MCI regained power and began to redress the side-effects caused by liberalization, most of the chaebol took side with the MCI and so strengthened their collaborative relations. This was illustrated by the massive investment drive of Hyundai in the early 1980s and the approval of Kia Motor Company to restart the manufacturing of passenger cars as early as 1984. Kia was excluded in the business of passenger car manufacturing by the rationalization measure in 1981. However, Kia planned to reenter the industry as early as 1982 and contracted with Mazda to receive models and technological assistance in 1983. Nevertheless, it should be remembered that the relationships between the state and chaebol became more remote and cautious than those in the 1970s. This reflected the enhanced power of business during the big-push of HCI.

CHAPTER IX

THE 1990: FADING AWAY OF A DEVELOPMENTAL STATE

1. Performance of the Korean Auto Industry in the 1990s

On November 30, 1995, the U.S.-Korea automobile trade negotiation was concluded; the Korean government promised to abolish most of the non-tariff trade barriers that were thought by U.S. delegates to have hampered the penetration of imported cars into the Korean market. In the same year, Korea exported more than one million unit cars, including KD parts, and thus became one of the seven advanced auto manufacturing countries that had ever exported over one million units in a year. Residing in the country that ranked 5th in the world in the volume of auto production, Korea n auto firms also began to make subsidiaries in several developing and previously communist countries, aiming at becoming an internationally competitive industry within the context of increasing globalization of the auto industry.

In this process of advancing into a world-class auto industry by expanding production capability, developing technological autonomy, and increasing exports, the domestic market structure also began to change. Throughout the 1970s and 1980s, three firms (Hyundai, Kia, and Daewoo) dominated the auto industry, though Kia was excluded from passenger car production from 1981 to1986. As the special treatment of the auto industry occasioned by the IDL ceased, coupled with the lifting of entry control in 1989, a few chaebol groups tried to enter the auto industry. Thus Ssangyong, a minor chaebol in Korea, began to produce passenger cars with a technological alliance with Mercedes

Benz, while a member firm of the Daewoo chaebol, Daewoo Heavy Industry, and a member firm of the Hyundai chaebol, Hyundai Precision Industry, began the production of mini-cars and jeep-style SUVs, respectively, in the early 1990s. The existing three firms did not voice intense opposition to the entries of these three firms into the market, in part because, given scale economies, the long period of technology acquisition, and Ssangyong's relatively low status in Korea's big businesses, they thought Ssangyong would not be able to catch up with them, and in part because the other two firms were members of the chaebol groups already producing autos. When Samsung expressed its intention to enter the passenger car industry, however, the responses from the industry, government, academics, and the general public diverged, ranging from the intense opposition of Kia, Daewoo, MCI and the general public, to the relative indifference of Hyundai, to the active support of the EPB, some research institutes, the citizens in Busan area, and a number of politicians. Specifically, the existing firms felt greatly threatened by Samsung's entry because, as the largest chaebol in Korea, Samsung had the potential to take away the advantages retained by the existing firms, primarily by using its advanced technology in electronics and shipbuilding as well as its abundant capital resources. In any case, the government approved Samsung's production of passenger cars in December 1994. This decision had an indelible impact on the development of the Korean auto industry, particularly with respect to investment competition among firms and the subsequent domino of business failures, beginning with the bankruptcy of Kia in 1997 and culminating in that of Daewoo in 1999. This subject will be examined in detail in the latter part of this chapter.

Accordingly, the development of the Korean auto industry had revealed both positive and negative facets before the financial crisis of 1997. In the realms of production capacity, the so-called Korean big three (Hyundai, Kia, and Daewoo) had the combined capacity of 2.6 million units in 1995, about a 70 percent increase from the figure of 1989 (see Table 9.1). The production volumes of automobiles had also shown steady increase in the first half of the 1990s, recording 15.0 percent of the average annual increase from 1991 to 1995 (KDB 1997).

Table 9.1
Production Capacity of the Korean Big Three (unit: 1000/year)

YEAR	1989	1992	1995
Hyundai	820	1,150	1,300
Kia	550	650	830
Daewoo	435	520	508
Total	1,850	2,320	2,638

Source: KDB (1996) 548.

One of the most critical issues determining the export success of Korean auto firms in the world market has been the development and acquisition of technologies. To develop technologies, Korean auto firms had spent almost equal ratio of R&D investments against total sales to those in the U.S. and Japan. As table 9.2 shows, the Korean firms' R&D (B/A) ratio was a little higher than that of Japanese firms and a little lower than that of US firms in the early 1990s.

Table 9.2
Comparison of R&D Investments among Selected Countries

	UNIT	TOTAL SALES	R&D INVESTMENT	B/A (%)
Korea (1994)	100 million won	292,755	10,534	3.6
Japan (1994)	100 million yen	316,106	10,213	3.2
The U.S. (1990)	100 million dollar	2,530	98	3.9

Source: MOST (1995) 12.

The Korean firms' attempt to upgrade their technological foundation can be observed in data that indicate how many defects have been reported by consumers. Using J.D. Power and Associates' data on the quality of automobiles sold in the U.S., we can conclude that the quality of Korean made cars was still behind the industry average, but the gap, particularly with that of U.S. made cars, was incrementally reduced during the period between 1988 and 1996 (see table 9.3). Given the price advantage, largely because of the high yen and a relatively low level of labor costs, then, the Korean-made cars could successfully compete in the foreign markets by the mid-1990s.

Table 9.3
Comparison of Quality among Selected Auto Brands

	HYUNDAI(KOREA)	FORD (U.S.)	TOYOTA (JAPAN)	INDUSTRY AVERAGE
1988	229	172	121	174
1992	193	129	83	125
1996	146	130	80	100

Note: The figures are the number of defects per 100 vehicles, occurring within 90 days of purchase.
Source: J.D. Power & Associates (Various years).

The increase in production capacity and in production volumes for domestic and foreign markets and the deepening of technological acquisition generally constitute the positive facet of the development of the Korean auto industry in the 1990s. However, investment competition among the firms to gain the upper hand in the domestic market might have ruined the industry as a whole. As discussed later in this chapter, Korean auto firms ran into internecine investment competition just before the onset of financial crisis. In the years of 1991 and 1993, total investments in the auto sector were 1,510 billion *won* and 1,674 billion *won*, respectively. However, the amount sharply increased to 2,937 billion *won* in 1995 and reached 3,884 billion *won* in 1996, an increase of 32.4 percent. This rapid increase in investments was closely related to Samsung's entry into the market.

Each firm attempted to increase its production capacity to the point of realizing maximum scale economies, thus frustrating Samsung's ambition to be the number one automaker in Korea even before it constructed the plant. Unfortunately for Korean automakers, however, demand conditions in both the domestic and foreign markets were not favorable to such a surge of investments.

In sum, the performance of the Korean auto industry increased in the first half of the 1990s, although not as rapidly as during the latter 1980s, largely because of the increase in domestic sales and exports, a deepening technological sophistication, and a stable market structure. However, the growth potential of the Korean auto industry began to erode as the existing firms expanded production capacity rapidly in anticipation of Samsung's entry into the market. Therefore, in the remainder of this chapter, I will examine the issue of Samsung's entry in detail, particularly in the context of the change in industrial policymaking structure and the subsequent power transition between different coalitions in the government's auto policymaking process.

2. Searching for New Institutions of Industrial Policymaking

Korean political economy in the 1990s sequentially followed the familiar steps of the formation of economic bubbles and their tragic burst. Korea achieved a $10,000 per capita GNP in 1995 while the country gained the accession to the OECD as its twenty-ninth member in December 1996, becoming one of Asia's two representatives, including Japan. Political development accompanied economic success. In the 1992 presidential election, the Korean people ended the era of direct and indirect military rule by electing the civilian Kim Young-Sam as President. President Kim initiated several drastic reforms in both politics and economy. The indictment of former presidents Chun Doo-Hwan and Rho Tae-Woo, because of their illegal raising of slush funds, represented the political reform aimed at breaking the links of corruption between political leaders and big businesses. On the economic front, Kim brought about the long-waited Real Name Reform in financial transactions in 1993 while formulating several anti-chaebol measures in order to lessen business concentration. These political and economic reforms were carried out in the name of *Segyehwa*, which can be interpreted as "globalization."[1] Throughout the era of Kim's presidency, this term was used to represent the completion of economic liberalization, deregulation, and political democratization.

The euphoria of joining advanced nations within the foreseeable future, however, soon evaporated. The reforms proved unsuccessful not only because of their incomplete and inconsistent nature but also because of resistance from conservative forces. The spate of chaebol bankruptcies and the corruption cases involving high-ranking bureaucrats and politicians were signs of the failure. Finally, Korea came under the sway of IMF conditionalities in December 1997. Per capital GNP in 1998 dipped to $6,500.

Against such a backdrop, I will examine the Korean state's effort to reform the existing institutional arrangements of industrial policymaking, particularly focusing on the issues of financial liberalization and deregulation in the 1990s. The main arguments in this section consist of (1) democratization within the context of economic liberalization charged contradictory tasks to the government, that is, the task of weakening the power of big businesses while at the same time promoting their international competitiveness; (2)

[1] Although *Saegewha* is formally traslated into "globalization," its meaning is closer to economic liberalization. Therefore, I use both globalization and economic liberalization interchangeably, depending on the context.

the state's efforts to liberalize finance and trade and to deregulate business activities could not be pursued completely since they would result in decreasing business confidence, thereby reducing the growth rate; (3) the concurrent development of democratization and economic liberalization reduced the autonomy of the industrial policymaking agency (MCI) while reinforcing the power of regulatory agencies such as the MOF(later MOFE) and FTC (Fair Trade Council); (4) the collaborative relations between the state and business on the basis of information-sharing, reciprocity, credibility, and trust rapidly deteriorated, largely as a consequence of the state's repressive measures of chaebol bashing and the chaebol's increased capacity of capital mobilization in both domestic and international financial markets; and (5) as a result of these institutional decays, the coalition between the segments of state managers and big business was unable to maintain its internal cohesion, thereby paving the ground for its complete erosion in the late 1990s.

2.1 The Dilemma of Economic Reform in the Early 1990s

As long as an economy is on the rise, the relation between the state and big businesses is likely to maintain its existing shape, even if there is increasing need for change before the boom period gives way to recession. Meanwhile, the demand for economic reform is likely to intensify as soon as the economy slides into recession, but with a slim chance of its realization, primarily because economic recovery presupposes invigorating big businesses, which are also the target of economic reform. This is true of the situation in Korea during the late 1980s and early 1990s. The booming economy showed signs of slow-down in 1989 as the trade surplus turned again to deficits. One authoritative research institute commented on this matter as follows: "The illusion that Korea was becoming an advanced country also began to loosen the work ethic of entrepreneurs and workers, alike, causing rapid wage hikes, the degradation of product quality, and a slowdown in the development of technology" (KIEP 1993, 2-3).

The Rho regime (1988-1993) strengthened the measures for controlling big businesses as a consequence of the popular pressure that pointed to the chaebol as the cause of economic slowdown.[2] The state ordered the chaebol to sell off their non-industrial land and reinforced regulation on chaebol's business activities by amending the Monopoly Regulation and Fair Trade Act in 1990. However, all these measures failed to bring about the anticipated result because of the intransigence of the chaebol and the state's ultimate dependence on it for economic recovery (Chung 1992).

As soon as he became President, Kim Young Sam launched the New Economy Plan, replacing the ongoing Seventh Five-Year Economic Plan (1992-6) in July 1993.[3] The main objective of this plan was to get rid of the institutional and ideological remnants of developmentalism. The Plan emphasized private initiative as the new engine

[2] There was widespread consensus among the general public that the chaebol even with increased profits during the latter half of the 1980s did not engage in productive activities, such as investing in technological development, but concentrated their efforts on buying real estate and diversifying into unrelated business areas, thus becoming bigger though still lacking in international competitiveness.

[3] Before launching the New Economy Plan, Kim first introduced a 100-Day Plan to ameliorate the short-term problems of the economy. In essence, a 100-Day plan was a measure to promote the sluggish economy by clinging to the traditional way of pump-priming. There were intense debates among high-level policymakers regarding the sequence of the economy policies. On the one side were the reformers who stressed the priority of reform even under the circumstance of economic recession. On the other side were the realist policymakers who argued for the priority of economic recovery and reform afterwards. In the end, the latter group's argument was taken. (KIEP 1993; Kim ed. 1999)

of economic growth and structural economic reforms, including intensifying efforts for liberalization and deregulation. In the area of industrial policy, the plan stressed that the injection of foreign competition (trade and financial liberalization) combined with properly policed regulatory measures (e.g. restrictions on diversification, the enforcement of transparency, and internal accountability to outside shareholders) would promote efficiency.

The formulation of the reform plan was above all a political choice of the new regime (Chung 1995, 23). As the first civilian President since 1961, Kim was sensitive to how the people felt about the chaebol and the unbalanced economic structure. Personally, he also had a somewhat hostile attitude toward chaebol owners. This is easily expected when we consider the one of his opponents in the presidential election was Chung Ju-Yung, the owner of the Hyundai chaebol. In the election campaign, Kim vehemently criticized the illegal business practices in which big businesses engaged and targeted Chung as the leader of corrupted chaebol owners. This personal enmity toward Chung later developed into severe retaliation against the Hyundai Group, sentencing Chung to prison and imposing a large sum of fines on the Hyundai chaebol for tax evasion.

While democratization prompted the formulation of a reform plan, its implementation was constrained by many non-political factors. The problem was that the reform formulated with the aim of lessening business concentration, abolishing trade barriers, and liberalizing the financial market was easily manipulated and distorted by big businesses. As noted in chapter eight, the chaebol opposed the EPB's liberalization proposal in the early 1980s. During that time, the chaebol's main concern was to get as much government support as was available within the context of a strong and developmental state. Having become financially more self-sufficient with the boom of 1986-1988, the confidence and political leverage of the chaebol were strengthened. As the potential gains were recognized, the fear of liberalization gave way to demands for faster reform. What they demanded was, according to Kong (2000, 154), to "relocate production overseas to utilize lower cost labor and improve proximity to target markets; reorganize local labor to improve its productivity; and branch out into new areas of activity while exiting from the declining ones." Accordingly, the state faced the dilemma that the more intensively it pursued a chaebol reform, the more likely chaebol's economic power to be strengthened. The chaebol tend to strengthen their business power by diversifying into other, often unrelated, areas. As we can see in table 9.4, the chaebol had persistently increased their member companies even during the era of globalization.[4]

In the end, it can be argued that President Kim's reform plan, be it called the New Economy Plan or *Segyehwa* (globalization), did mean different things to both the state and big businesses. While both the state and the chaebol sought enhanced international competitiveness via accelerated liberalization and deregulation reforms, the two also differed in the preferred pace and scope of the reforms. For the state, the danger of monopolization was the foremost important matter to be addressed by the reforms while the chaebol supported the dismantling of the barriers of entry and exit, a measure that would allow them to discard or relocate their loss-making sectors and to facilitate their movement into promising fields (see Mo and Moon 1999). In the next section, I will

[4] Another indicator that shows the staying power of the chaebol in the mid-1990s was that the sales of the top thirty chaebol were estimated at around 82.2 percent of GNP in 1994, while they accounted for 30 percent of bank credit in 1995 (Kim 1996, 54).

examine how the state's institutions of industrial policymaking changed in response to the demands of economic reforms, particularly focusing on the issue of deregulation.

Table 9.4
The Change in the Number of Member Companies of the Five Largest Chaebol (ranked by sales), 1972-93

1972		1983		1987		1993	
Samsung	16	Hyundai	35	Samsung	34	Samsung	50
Lucky	18	Samsung	31	Hyundai	40	Hyundai	48
Hanjin	8	LG	42	LG	50	LG	54
Shinjin	8	Sunkyung	14	Daewoo	26	Daewoo	24
Ssangyong	6	Daewoo	27	Sunkyung	13	Sunkyung	33
Average	11.2	Average	29.8	Average	32.6	Average	41.8

Source: Lee (1997), 66.

2.2 The Change in the Institutions of Industrial Policy-Making

The kernel of the industrial policymaking process in Korea, particularly during the 1970s, was the selection of strategic industries by the MCI or the Planning office of the HCIPC and the channeling of financial resources by the MOF into the selected industries. In this process, financial concerns were subordinate to the demands of industrial policy. Such a system of planning and financing resulted in many problems. Massive loans (many of them non-performing) to the targeted industries (mainly to the chaebol groups) had left the banks financially vulnerable and dependent on support from the central bank.[5] Along with the underdevelopment of the banking sector, largely due to strict supervision by the state, another problem was the extremely high debt-equity ratio

[5] The debt-equity ratio of the fifty largest chaebol was extremely high in 1980 when, the big-push of HCI was terminated: 524.0 percent. It began to be slightly improved in the 1980s and early 1990s: 410.6 percent in 1987 and 368.9 percent in 1991. But these figures indicate that the Korean big businesses were still highly debt-ridden as of the mid-1990s (Lee 1997, 69).

of most Korean firms, which made the firms vulnerable to the fluctuation of interest rates and the vicissitudes of general economic condition.

As I examined in chapter eight, liberal-minded policy reformers in the EPB attempted to make industrial policy subordinate to financial policy by carrying through financial liberalization in the early 1980s, with mixed results. Although they succeeded in privatizing commercial banks, it was not as complete as initially intended, since the state still had authority over the designation of high ranking executives in the now privatized banks and over the setting of interest rates, which is the core of financial liberalization. In chapter eight, such mixed results of financial liberalization in the early 1980s were explained by the enduring power of a neo-mercantilist coalition between the sections of the state managers and big businesses.

The current accounts surpluses and the stock market boom that accompanied the rapid growth of 1986-89 led to an improvement in the financial structures of the chaebol and their supporting banks. At the same time, in 1985, the government began the gradual reduction of policy loans as a share of commercial bank lending. This means that financial liberalization was still the major agenda of the state in the latter half of the 1990s. However, the state hardly relinquished its control over the financial sector even under the favorable economic conditions. To effect an orderly restructuring of the declining sectors and to provide the emerging industries with needed funds, the state continued to make use of the policy loan. It also made use of administrative or "window" guidance through the banks to achieve its industrial policy (Lee 1992; Cho and Kim 1997).

However, upon entering the 1990s, the need for more complete financial liberalization was deeply felt not only by the government but also by the businesses. While the measure of financial liberalization was the instrument for taming big businesses in the 1980s, its role was reversed, as the chaebol groups were more vociferous about its complete implementation. The ability to borrow chiefly from foreign sources without the state intervening led to a shift in the attitude of big businesses to financial reform (FKI 1992, 61-6). External pressures such as the abundant funds available from the international capital market, the necessity of strategic alliances with foreign TNCs, and the opportunities of overseas investment also played a significant role in accelerating financial liberalization. As a result of these internal and external pressures, a four-stage interest rate deregulation and a Five-Year Foreign Direct Liberalization Plan were announced in 1991 and 1993, respectively, as the central measures of financial liberalization.

Accelerated financial liberalization in the first half of the 1990s had a serious repercussion on the institutions of the Korean state's industrial policymaking. First, in the liberated economic environment, the usefulness of sector-specific industrial policy significantly decreased. Accordingly, the objective of the Korean state's industrial policy shifted towards functional intervention such as supporting R&D in both the public and private sectors and strengthening economic infrastructure. The formulation of the IDL in 1986, as we have seen, can be interpreted as the state's deliberate efforts to shift to another type of industrial policy while maintaining policy instruments for traditional sector-specific intervention. However, the policy instruments available to the state for the purpose of sector-specific intervention were reduced in the wake of liberalization and deregulation. When Samsung expressed its intention to enter the auto industry, the MCI did not have any other instruments for blocking Samsung's effort than its authority over the introduction of foreign technology. Its market-shaping power executed by means of the controlling of entry and exit of the firms in the auto industry vanished when the auto industry dropped out of the industries that required special treatment from the government in accordance with the IDL.

The relative significance of the EPB in national economic management was also reduced throughout the 1980s and 1990s, primarily because its main function, national economic planning, lost its initial *raison d'être* of directing the national economy in a certain direction and changed into an "indicative" one. However, as the ministry that controlled the budget process and carried out fiscal policy, the EPB retained its power during the early 1990s. For instance, when President Kim secretly prepared the institution of the real-name financial transaction system, he ordered the minister of the EPB to select a handful of researchers and technocrats from the Korea Development Institute (a research arm of the EPB) and the MOF. This was in sharp contrast to the decision made by President Park in the early 1970s, when he considered an extraordinary measure of business recuperation (8.3. Decree), according to which he ordered that EPB technocrats be excluded from policy deliberation, processes (see chapter 5).

Along with the decline of the MCI and its mercantilist policymakers in the overall policymaking process of industrial policy, on the one hand, and the stagnating power of the EPB over the management of the national economy, on the other, financial liberation gave birth to a new powerful economic ministry. This was the Ministry of Finance and Economy (MOFE), which was born of the merger between the EPB and

MOF in December 1994. The initial purpose of the merger was the reduction of government agencies and the enhancement of administrative efficiency. By monopolizing finance, budget planning, and taxation, however, its ability to control the economy and business practice magnified. The EPB was once regarded as a pioneer agency in liberalizing the Korean economy, but after the merger, businesspersons had to look to the MOFE as the chief instigator of government regulations.

The emergence of the MOFE as the center of Korean economic ministries had another significant implication for industrial policymaking. The days of promotional industrial policy seemed to retreat behind history, and the days of regulatory industrial policy seemed to replace its vacancy. One example illustrates this shift in industrial policy. In 1995, when Samsung and Hyundai announced plans to build factories overseas using 100 percent foreign financing, the ministry quickly declared that it would not permit them to do so unless they financed 10 percent of the investment with their own funds. The ministry tried to prevent them from expanding by depending on foreign loans. In the end, both chaebol had no choice but to accept the government's decision.

Another development that expedited the demise of traditional industrial policy in Korea was the strengthening of the Fair Trade Commission (FTC). It was made independent of the EPB in December 1994. In March 1996, its chairperson was elevated from vice-ministerial to full ministerial status (FTC 1996, 2). The organizational upgrading of the FTC was the result of President Kim's political decision to weaken the power of the chaebol. The FTC's main role was to regulate not only internal relations between chaebol group affiliates but also diversification, with the aim of business de-concentration. This issue of regulating big business by "prohibiting abuses of marketdominating positions, excessive concentration of economic power, unreasonable collaborative activities and unfair trade practices" (FTC 1996, 10) resulted in the estrangement of big businesses from the state as well as bureaucratic infightings among state economic agencies. This will be examined in the next section.

2.3 The Decline of Collaborative Relations between the State and Business

It is true that chaebol groups have developed mainly because of their privileged access to the state's policy loans and bank lending. In addition, such abnormal business practices as mutual debt guarantees and cross-holdings between group affiliates have made business concentration and aggressive diversification easy (Cho 1994; Jwa 1999). President Kim attempted to fix such abnormal business practices by introducing strong anti-monopoly measures. The Third Amendment to the Monopoly Regulation and Fair Trade Act was passed in order to limit the size of cross-holdings and mutual debt guarantees between chaebol affiliates in December 1992. The Fourth Amendment was also made in order to reduce an affiliate's equity ceiling in a non-affiliated company from 40 to 25 percent in December 1994 (FTC 1996, 12-14). The aim of such anti-monopoly measures, particularly by obliterating abnormal intra-group support, was to facilitate the transition of the chaebol into more profit-oriented smaller groups or independent firms. This aim was also clearly indicated in another anti-chaebol measure: a main-line business system.[6]

[6] This system was introduced to reduce the number of business areas of the chaebol to three to five, depending on their overall turnovers.

Against the intensified pressure on them through anti-monopoly policies, the chaebol reacted with great discontent, arguing instead for the rapid implementation of de-regulation measures. The chaebol insisted that a de-regulated free market would resolve the most harmful side-effects of business concentration. Under a completely free market, argued the chaebol, the formation of a monopoly would be the result of the firm's superior competitiveness, thus optimizing the efficiency of resource allocation rather than wasting social welfare. The abolition of government-imposed entry and exit barriers was also claimed to be necessary in order for the firms to make strategically rational investment choices. The Korean Economic Research Institute (KERI), the research arm of the Federation of Korean Industries (FKI) that was the umbrella organization of the Korean chaebol, was on the forefront in its attack on government anti-chaebol policies. The KERI argued that the problem of government-business collusion was rooted in the state's power to meddle in business affairs, in response to which it advocated sweeping deregulation. Anti-monopoly measures did nothing else but perpetuate government over-regulation. Anti-monopoly measures would only work for the protection of inefficient firms. Sweeping deregulation would therefore remove much of the necessity for anti-monopoly measures by exposing the firms to competition (Lee 1997, 256).

In fact, the FTC's anti-chaebol policies were rooted in political appeal to a balanced and equitable economic structure, which intensified after the onset of the democratization process. Therefore, these policies were to a significant extent at odds with the demands for enhancing international competitiveness of the firms within the context of increasing globalization. In this matter, the EPB and later the MOFE took the side of the chaebol. Two distinguished researchers in the EPB's research arm, the Korea

Development Institute (KDI), argued that "the Korean government should lift all entry barriers, domestic as well as at border, and deregulate the Korean economy. Moreover, a search for or a discovery of a new optimal industrial organization should be the responsibility of the private sector, given the undistorted market incentive structure provided by a rational government" (Lee and Lim 1999, 36-51). Such a positive approach towards deregulation played a significant role in allowing Samsung to enter the auto industry, as will be discussed.

The MOFE also argued that the government should further reduce economic regulations, criticizing the FTC's attempt to decrease drastically the "ratio of mutual share-holding among chaebol group's affiliates." The MOFE took the view that either excessive support or regulation by the government would eventually erode the international competitiveness of the chaebol, thereby disposing itself to the side of the chaebol in debates over the issue of deregulation.

Up to this point, we have examined the disarray of institutions of industrial policymaking in Korea during the first half of the 1990s, first by pointing out the difficulty of taming big businesses through measures of liberalization, second by examining the shift in the power center of economic ministries in industrial policymaking, specifically to the regulatory MOFE from the promotional MCI, and finally by tracking down the decline of state-business collaboration with the focus on the state's anti-monopoly measures and business's counter-attacks.

Looking at three key institutional variables that are presumed to play a critical role in determining the power balance of competing coalitions, we could have predicted the decline of a neomercantilist coalition during the first half of the 1990s. First, the insulation of the MCI was greatly reduced, coupled with its declining power vis-à-vis other economic ministries. Stripped of major policy instruments that had made possible industry-specific policy during the 1970s and 1980s, the MCI in the 1990s could do little but appeal to industry-wide functional measures such as the assistance of private R&D activities and manpower training to promote specific industries.

Second, the power of business, particularly that of the large chaebol, increased to the extent that it could threaten the power of the state. In the 1970s, the business structure of a multisectoral conglomerate and financing through the state-administered banking system were to a great extent encouraged by the state and in turn helped local firms gain technology and capital resources that were required to initiate heavy industrialization. However, the state in the 1990s focused its reform effort on the abolition of these two institutional pillars of the Korean chaebol, largely by the measures for anti-monopoly deconcentration and financial liberalization. Facing a new state policy against the chaebol, the latter tried to maintain their business structure and monopolistic position while diversifying their means of financing.

Finally, as anticipated from the above argument, the nexus between the state and business in the 1990s weakened, to the extent that both looked at each other not as a business partner but as a competitor to gain the power of the state. The specific policy networks formed between some state agencies and private firms were often even more deteriorated. The close relations between the MCI and Hyundai as seen in the middle of the 1970s, for instance, were bygone history in the early 1990s, mainly because the owner of the Hyundai chaebol challenged the power of the state in the 1992 presidential election.

With such a background of the Korean political economy during the 1990s, I will explore the development of the Korean auto industry, particularly focusing on the issue of Samsung's entry into the industry. All of the theoretical arguments examined in this and previous sections, particularly the contradictory nature of democratization and economic liberalization and its consequences for the institutions of auto policymaking, will be the focus of the next section.

3. Samsung's Trial of Entering the Auto Industry

3.1 The Conditions of the Auto Industry

Encouraged and protected by the government, the Korean auto industry had expanded rapidly since the mid-1980s. This development was to a large extent due to the revitalization of a growth-oriented neomercantilist coalition between local auto firms and the nationalistic segment of state managers. The shift of power toward a new coalition was indicated by the incorporation of the auto industry as a strategic sunrise industry by the IDL of 1986.[7] According to the rationalization plan stipulated in the IDL, the government would try to (1) optimize the production system and scale (by restricting new entry into the industry, seeking efficient facility expansion, and maintaining a specialized production system according to the types of automobiles), (2) expand the base of auto parts supply (by encouraging parts firms to specialize in only a single item), and (3) provide measures for promoting motorization among the general public.

[7] The inclusion of the auto industry as one needing the state's conscious effort of rationalization was confined to the period between July 1986 and June 1989. In 1989, the auto industry was excluded from the group of rationalization industries, although there were some who wanted to prolong the rationalization period.

By the end of 1995, Korea's automobile manufacturing sector was the sixth largest in the world, with production of more than 2.5 million vehicles a year. Much of this growth came from the development of the domestic auto market, providing the industry with a largely captive outlet for its products and creating a firm basis for growing export activities. In 1995, auto exports rose above one million units for the first time, including a surge in exports of knocked-down (KD) kits as Korean auto firms began to put down industrial roots in overseas markets and start a long march towards globalization.

When the Samsung chaebol tried to enter the passenger car market, particularly during the first half of the 1990s, the production capacity of the Korean auto industry had tremendously increased. In 1993, the manufacturers' combined capacity was estimated to be 2.8 million units, but by the end of 1995, the time when Samsung had finally received the government's permission, it was over 3.6 million units (see table 9.5), an increase of around 30 percent. As a result, in 1995, capacity utilization was under 75 percent, a figure that was well below a satisfactory level. Hyundai was the only manufacturer to have achieved a satisfactory level of capacity utilization, producing at around 86 percent of its capability in 1995. Other manufacturers had installed a substantial amount of spare capacity. To make matters worse, as of 1995, some manufacturers had even been planning further increases in capacity, which provided an ample demonstration of the confidence that they had in their future.

Table 9.5
Korean Auto Manufacturers' Domestic Production Capacity, 1995

MANUFACTURER	PRODUCTION CAPACITY
Hyundai Motor	1,350,000
Kia Motors	1,040,000
Daewoo Motor	522,000
Asia Motors	255,000
Ssangyong Motor	140,000
Hyundai Precision & Industry	88,000
Daewoo Shipbuilding & Machinery	240,000
Total	3,635,000

Source: KDB (2000)

There appeared to be no relaxation of the investment programs being implemented by the major manufacturers. According to the Korean Automobile Manufacturers Association (KAMA), the country's seven automakers planned to invest 4.12 trillion *won* in 1996, an increase of 32 percent over the previous year. This level of spending was making them increasingly conscious of the need to reduce costs, all the more so when the weakening of the yen and the saturation of the domestic auto market were considered.

As if ridiculing the ambitious investments of manufacturers, the Korean auto vehicle market finally reached a plateau in 1995. Passenger car sales increased by a mere 0.8 percent to 1.15 million units, while sales of commercial vehicles dropped by 2.1 percent to 406,000 units (see table 9.6). The market slowdown in demand for vehicles seems to have been inevitable, following a huge 82 percent expansion in the market between 1990 and 1994.

One comfort for Korean auto manufacturers was the consistently increasing trend of auto exports during the first half of the 1990s. Korean auto exports trebled between 1990 and 1995. Passenger car exports rose by 181 percent to 955,000 units, while shipments of commercial vehicles rose 17-fold to 128,000 units. In contrast with the evolution of sales in the domestic market as seen above, the rate of export growth accelerated markedly in 1995, shipments rising by 47 percent over the previous year's level to exceed the symbolically important barrier of one million units.

Table 9.6
Domestic Sales of Motor Vehicles in Korea, 1990-95

YEAR	1990	1991	1992	1993	1994	1995
Passenger Vehicles	626,126	772,548	876,262	1,037,488	1,140,393	1,149,409
Commercial Vehicles	328,151	331,636	392,112	398,479	415,209	406,493
Total	954,227	1,104,184	1,268,374	1,435,967	1,555,602	1,555,902

Source: KAMA (1997).

All of the above assessments of the Korean auto industry during the first half of the 1990s indicate that it would face an enormous challenge in the next few years unless contemporary plans for the expansion of production capacity scaled down. The domestic auto market would not grow at the rate that it had during the period between 1985 and 1995. Indeed, it seemed likely that before long the cyclical pattern characteristic of a developed market would set in. The only solution to excessive capacity was the accelerated growth of exports. However, it was not an easy task. Even if the Korean auto market had risen above two million units by 2000 (this was also an optimal scenario), full capacity utilization would, on the basis of contemporary plans, have required exports of around 4 million units, an increase of around 270 percent over the 1995 total. This is significantly faster than the growth that took place between 1990 and 1995.[8] The more

[8] Some comparisons between the Korean industry and its Japanese counterpart may be instructive at this point. Broadly speaking, the Japanese auto industry was in 1966-67 producing approximately the same number of vehicles as Korea did in 1995. It had a bigger domestic market than Korea, and was exporting little more than a tenth of its output. Five years later it was making around 6 million vehicles, but the domestic market had digested 4 million units. Exports, though they had climbed steeply, were only around 1.8 million units, and still accounted for under 30 percent of production.

sad news to Korean auto manufacturers was their still low level of international competitiveness. The price advantage enjoyed by Korean automakers in the international markets started to erode because of the depreciation of yen and the technological developments that could reduce production costs in advanced automakers.

Above all, we can conclude from this review of the Korean auto industry during the first half of the 1990s that the Korean auto industry should have reconsidered its investment plans as well as future growth strategy. It is true that the Korean auto industry succeeded in upgrading its development potential in the areas of production capacity, technological learning and innovation, and export penetration up to 1995. However, as the mechanism of policy coordination, which had been conducted under the leadership of the Presidential Office and the MCI, was significantly deteriorated in the wake of liberalization and democratization, there appeared a collective action problem among local manufacturers. The relationship between the state and big businesses became more hostile while the power of industrial policymaking was transferred to such regulatory organizations as the MOFE and FTC from the promotional MCI in the first half of the 1990s. In this process, the state saw investment coordination among the manufacturers as collusive act that had to be prohibited for the purpose of complete competition. The case surrounding Samsung's attempt to enter the auto industry apparently reveals the decay of institutions of industrial policymaking as well as the decline of a neomercantilist coalition, which we will examine carefully in the next section.

3.2 Background of Samsung's Attempt in the early 1990s

In the above section, I argued that the concurrent development of democratization and economic liberalization put the Korean government in a sandwiched position, neither able to tame the chaebol through anti-monopoly measures nor able to promote chaebol's autonomy through deregulation measures. The inquiry into Samsung's attempt to enter the auto industry reveals such a predicament faced by the government more obviously than any other case of industrial policymaking. When Samsung applied for the production of automobiles, the government sought to prevent the chaebol from diversifying into unrelated business areas as a means of controlling their expansionist business strategy. At the same time, the government itself proclaimed the era of globalization with the slogan of deregulation and liberalization in most fields of business activity. In accordance with such contradictory economic policies sought simultaneously by the government, industrial policymaking was also thrown into confusion. On the one hand, the state's control over entry and exit in certain industries was justified in the name of regulating chaebol's reckless diversification activities and protecting small and medium-sized business firms. On the other hand, the existence of state-imposed, discretionary entry and exit barriers was criticized as a remnant of the authoritarian state, preventing economic actors from doing what they want on their own, impeding the development of competitiveness in individual firms that would be possible only with a competitive market structure, and facilitating rent-seeking activities among both the private and public actors.

As for Samsung, this confusion of the priority of policy agenda was a second to none opportunity to pursue its long-standing wish to manufacture automobiles. To get their way through the oppositions, Samsung not only made use of contradictory industrial policies, but also engaged in strategic political activities by mobilizing the support of politicians, civil associations, and the general public of the specific region. Samsung's political maneuvering was possible because of the consolidation of democracy by the mid-1990s. In the following parts, I will examine Samsung's strategy and politics of policymaking with an aim of finding out the cause of the demise of a neomercantilist coalition in the auto industry by the mid-1990s.

3.3 The First Stage: Getting the Permission to Produce Commercial Vehicles

In fact, when the auto industry was excluded from the category of sunrise industries in 1989, there disappeared at the same time formal legal restrictions on private firms' decisions to enter the auto industry. However, according to clause 9 of the Law of Introducing Foreign Capital, when domestic firms sign a contract with foreigners for introducing foreign technology, the former should report to the relevant ministries. As for the auto industry, the relevant ministry was the MCI, and it was able to approve or reject a proposal, depending on whether the introduction of the requested technology would harm the healthy development of the national economy. Since the launch of the auto industry was more or less dependent on the alliance with foreign automakers in such realms as the design of models, production technology, and process skills, it was out of the question for domestic firms to begin auto production without some sort of contract for technology introduction with foreign automakers.

The first earnest attempt to produce automobiles was made by Samsung in 1989 (SHI 1994, 435).[9] On June 21, 1990, Samsung signed a contract of technology partnership with Nissan Diesel and presented the application for technology introduction to the MCI on July 6, 1990. When Samsung expressed its intention to manufacture commercial vehicles in 1989, the MCI's strategy was to pass on the matter to the newly formed Working Committee for the Development of the Automobile Industry (WCDA), in which government officials, academic scholars, and the auto industrial organizations (KAMA and KAICA)[10] were supposed to discuss important problems in the auto industry, to coordinate government policy and private initiatives, and to facilitate the flow of information about changes in the international auto industry.

In addition, as a way of searching for a more comprehensive measure to promote the auto industry and to deal with Samsung's application, the MCI requested the Korean Industry and Economy Institute (KIET) - a research arm of the MCI - to prepare a report. In the report entitled "The Long-Term Development Plan of the Korean Auto Industry," the KIET represented the MCI's stand on Samsung issue. In this report, the KIET argued, "There should be an accelerated effort to increase the development potential of the auto industry. In order to do this, the growth strategy must change into the policy searching for qualitative development from that focusing on quantitative growth" (KIET 1990, 355). As

[9] In fact this was Samsung's second attempt to enter the auto-industry, the first attempt was to make a joint venture with Chrysler in the mid-1980s, having been frustrated by the rationalization plan of 1986.

[10] The KAMA (Korean Auto Manufacturers Association) was formed in 1988 by the five terminal auto manufacturers - Hyundai, Kia, Daewoo, Asia, and Ssangyong. Although this organization's role was limited to information sharing and lobbying the government on matters of common interest, it had a historical meaning, for the highly mutually antagonistic auto firms had a chance of forming a unitary voice for the first time in the history of the Korean auto industry (See Kim 1992).

for the question of Samsung's entry, it took the negative stance, arguing that "the overall production capacity of domestic manufacturers needs to be reduced since a poor showing of exports is due to the stagnation of demands in the advanced countries as well as to the structural problems in the domestic auto industry" (KIET 1990, 190). This report contrasted with the one that the KIET presented in 1994 by the request of the KAMA, in which the KIET only suggested four alternatives on the question of Samsung's entry, withholding any definitive conclusion. On the basis of the KIET's report as well as the consultation with the WCDA, the MCI reached a negative conclusion for the reasons that Samsung's entry into the production of commercial vehicles would barely help the development of indigenous technology, would deepen the economic concentration by allowing diversification, and would ultimately result in the entry into the production of passenger cars (KIET 1993, 172-175).

The Blue House was in agreement with the MCI on this issue. The President's Economic Secretariat, Kim Jong-In, was reported to have exerted pressure on the MCI to reject Samsung's application on account of its breach of government policy of business specialization of the chaebol (*Seokyong Daily,* July 2, 1993). The reaction of existing auto firms to Samsung's application was never more intense. Centered in the Korean Automobile Manufacturers' Association (KAMA), they renounced with a single voice renouncing Samsung's entry into the auto industry. On July 11, 1990, they announced their formal opposition, entitled "Our Stance on Samsung Heavy Industry's Plan to Enter the Auto Industry," under the name of the KAMA.

The united opposition of the MCI, the Blue House, and the existing firms to Samsung's attempt signified the dominance of a neomercantilist coalition in the automobile policymaking process as late as 1990. Facing formidable opposition, the government could do nothing but return the application to Samsung, arguing that four or more producers would be too much for the Korean Automobile industry, considering the small size of the domestic market and uncertainty about export possibilities (*Maekyong Daily,* August 20, 1990). Samsung on its part attributed the rejection of its application to the close relationships between state managers and existing auto firms (SHI 1991, 436).

Two years later, Samsung made its second attempt to enter the auto industry, this time with success. On June 23, 1992, Samsung presented the application for technology introduction for the production of commercial vehicles. By this time, there had appeared a crack on the neomercantilist coalition, primarily because of the political aspects of democratization. First, the MCI's interpretation of whether Samsung's production of commercial vehicles would be a diversification into an unrelated business field or into a related business field supplementing Samsung Heavy Industry's production of construction equipment changed in favor of the latter view. Second, the Blue House was silent at this time, as the campaign for a presidential election was heated and the candidate for the next president in the governing party was a man who was known to have had favorable relations with Samsung.

However, the most critical factor leading to the acceptance of Samsung as an commercial vehicle producer was internal division among existing auto firms. In 1992 when Samsung made clear its intention to resubmit an application, the existing firms held several meetings and voiced their opposition by interviewing with the Minister of the MCI and submitting petitions to the Blue House, the governing Democratic Liberal Party, the MOF, the EPB and the MCI. Their argument was that Samsung's entry into the industry would give rise to excessive and redundant investments, to the deepening of oversupply, to confusion in the industrial order, and to the retreat of competitiveness that should be based on business specialization (MCI 1992, 9-16). However, their opposition was not forceful enough to deter Samsung's attempt, primarily because of Hyundai's somewhat ambiguous attitude. For instance, when the KAMA decided to announce its formal opposition in the form of a public statement, the chairperson of the KAMA, who was the CEO of Hyundai Motor Company, resisted releasing the statement under his name. He also expressed lukewarm opposition whereas the CEOs of other auto firms vehemently opposed Samsung's application at the interview with the Minister of the MCI on June 30, 1992.

The reason for Hyundai's ambivalent attitude lay in political considerations. At the time, the chairperson of the Hyundai chaebol, Chung Ju-Yung, had prepared to run for the presidency, which was supposed to take place at the end of 1992. Accordingly, Hyundai could not act as a center to unify oppositional producers, largely owing to its urgent concern with maneuvering the election campaign. In challenging political power, Chung contended that the existing state had put too many restrictions on the freedom of business activities, thus stifling the creativeness of businesspersons and bringing down the competitiveness of entire industries. Since its chairperson decided to enter the presidential race with a slogan for free market economy, there existed political restrictions on Hyundai's response to Samsung's application, even though it really wanted the MCI to reject it again. Moreover, Daewoo Motor Company was unable to lead the opposition either because its chairperson, Kim Woo-Jung, was also involved in domestic politics. Kim was reported to have been assisting another candidate (Lee Jong-Chan) in the governing party, thus being confronted with the leading political figure there, Kim Young-Sam.

In the end, the passiveness of the MCI and the Blue House and the failure of collective actions among auto firms hastened the erosion of a state-business coalition, facing another of Samsung's attempts to enter the auto industry. This obviously contrasted with the consolidated coalition between the state agencies and local firms that had been seen two years before. The MCI could not stand firm as before on this issue because of Samsung's adroit manipulation of the rhetoric of globalization and democracy.[11] In the end, on July 4, 1992, the MCI approved Samsung's application for introducing Nissan's technology, and Samsung officially established the division of commercial vehicle production in August 1992 and began to produce commercial vehicles in November 1993.

3.4 The Main Stage: Samsung's Attempt to Enter Passenger Car Production

When Samsung was given the permission to produce commercial vehicles, it promised not to attempt to enter passenger car production. However, the promise was just a cosmetic gesture to pacify the opposition. One year after setting up the division of commercial vehicle production, Samsung took a bolder step by officially announcing its entrance into the passenger vehicle industry with a technological license from Nissan

[11] Another factor that could explain Hyundai's hand-off attitude towards Samsung attempt was that Hyundai also tried to enter into a steel industry, which had been dominated by the state-owned firm, POSCO, and also needed the approval of the government. If the government approved the Samsung's application, believed Hyundai, the government would also give the permission to Hyundai to construct a comprehensive steel mill.

without consultation with the MCI. On June 9, 1993, Samsung announced that it would eliminate 14 affiliated firms from its group structure in accordance with the government's desire for business specialization. Paradoxically enough, however, Samsung officially took up its intention to start passenger car production at the time of this announcement. Right after this announcement, Samsung held a conference on June 28, 1993, in which Takahasi, the research director of Nomura Institute, claimed that the success of the Japanese auto industry had been occasioned by unhindered competition among a relatively large number of automakers, thereby providing the theoretical justification to Samsung's attempt (Huh 1994, 149-152)

Amid the policy debates concerning Samsung's new attempt, it was disclosed that Samsung had been trying to conduct a hostile takeover of Kia Motors by stealthily amassing Kia's stocks. Samsung had increased its share of Kia's stock from 5.8 percent in June 1993 to 8.34 percent by September, thus raising doubts that Samsung had planned to enter the passenger car industry by taking over the existing firm (*Hankyong Daily,* October 10, 1993). Kia's response was extremely antagonistic, demanding publicly to Samsung to reduce its share of stock to the level of May 1993. This bold step by Samsung was, however, backfired from almost all corners of society. The press, academia, and the bureaucracy everyday raised moral questions inherent in a hostile takeover and in chaebol's incessant pursuit of profits by expanding its business into almost all areas of manufacturing. In the face of opposition and resentment from all corners of the society, Samsung agreed to resell the portion of Kia stock it had acquired since June 1993 (*Hankyong Daily*, October 19, 1993). Yet Samsung seemed never to give up the idea of its entry into the passenger car industry. Faced with stronger opposition than before, it decided to put greater energy into building theoretical rationale for its entry into the industry by utilizing mass media and some research institutes. But the most important instrument for Samsung to get over the opposition was again to maneuver the opportunities opened by the state's contradictory pursuit of democratization and economic liberalization. This issue was finally settled the next year within the heated debates accompanied by intra-bureaucratic disputes, the mobilization of regional political forces, and the breakdown of a neomercantilist coalition between the state and business.

3.4.1 Samsung's Rationale to Enter the Auto Industry

Why did Samsung so tenaciously try to enter the auto industry? What was the underlying objective that was so valuable as to make Samsung endure an uphill battle against the state and other producers? To answer these questions, we need to look more carefully into the corporate structures and survival strategies of the business groups in Korea. Also important is the corporate culture that rules the mentality of high-ranking corporate officials.

The Korean business group, the chaebol, is an unavoidable outcome of the big push development strategy, for the government used big businesses as the principal agent of heavy-chemical industrialization. Facilitated by preferential access to financial resources, each chaebol pursued aggressive, octopus-type corporate expansion through cross-investment, cross-subsidization, and cross-payment guarantees. Samsung also pursued the same strategy of diversification into almost all business areas. As the company report shows (Samsung Group, 1994: 65), however, Samsung's major business activities had been conducted in such areas as finance and the information-service industry. The portion taken by machinery, electronics, and chemical industries in the gross turnouts of the group was only 37.5% in 1992. Although Samsung is now the number one producer of semi-conductors in the world, until the early 1990s Samsung's main source of profits was from the finance and service sectors, which stimulated its chairman and high-ranking officials in the early 1980 to consider structural readjustment seriously, making electronics and auto industries the two pillars of the group's business activities.

To justify its diversification into an auto industry, Samsung contended that the existing Korean auto firms had not achieved the competitiveness comparable to advanced foreign automakers because of the industry's oligopolistic market structure. Based on a report made by the Nomura Institute, Samsung argued that a completely competitive market structure was necessary for the Korean auto industry to become an internationally competitive industry (SERI 1995, 247). Samsung also tried to avail itself of the prevalent rhetoric of economic liberalization by providing opportunities for liberal-minded intellectuals to voice their opposition to state-imposed entry control. In the conferences, several notable researchers and professors argued that there was neither logical validity nor legal foundation for the state to regulate the investments of the private firms, and this would result in rent-seeking and the distortion of resource allocation.

The counter-arguments, suggested mainly by existing auto firms, can be summed up into three points. First, if Samsung began to produce automobiles through a technological alliance with Nissan, the efforts to develop indigenous models, which had been seriously made by existing firms, would end in nothing. Second, given the still low level of production capacity in individual auto firms, compared to world-class automakers, Samsung's entry would make the establishment of scale economies more difficult in each firm. Finally, the opposition argument emphasized that Samsung's attempt openly challenged the government policy of business specialization (*Dong-A Daily,* December 3, 1993). This debate concerning the economic rationality of Samsung's entry into the auto industry, mainly held in the private sector, provided the crucial background of government's deliberation and decision. Next, I will examine what happened inside the government in dealing with Samsung's application as well as the strategic actions taken by relevant policy actors.

3.4.2 The Politicization of the Industrial Policymaking Process

In the early 1990s, Korea entered the era of democratic consolidation. This meant that once justified ways of policy formulation and implementation (e.g. top-down and secretive process of policy formulation and compulsory and authoritarian manners of policy implementation) should give way to a complex process involving active participation from politicians and civil associations and the declining power of state agencies relative to the private sector. Of particular importance to our subject was the increasing politicization of the industrial policymaking process as well as the shift in power from promotion-oriented state agencies to regulatory ones. While democratization made the policymaking process more susceptible to the pressure by politicians and civil associations, economic liberalization facilitated the shift in power from the agencies specializing in industry-specific intervention to those specializing in industry-wide regulation. Coupled with the internal division among existing producers, such an institutional decay of industrial policymaking provided an invaluable opportunity to

Samsung. Below, I will examine the policy stands of major government agencies regarding Samsung's trial and their coordination within changing political and economic circumstances.

<u>The Declining Role of the MCI</u>

Although, during the latter half of the 1980s, the MCI regained the power it lost in the battle against liberal reformers in the early 1980s, it could not maintain its traditional role of industrial promotion within rapidly changing political and economic environments: that is, the role of selecting a few strategic industries and channeling resources into these sectors. To keep abreast with the shift in the state's policy agenda, the MCI began to cut down industrial subsidies and focus on functional measures such as supporting the R&D activities of the private sector and developing human resources rather than selecting winning industries on the basis of its own calculation.

When Samsung made clear its intention to enter the passenger car industry in 1993 and 1994, the MCI was in a defensive position as a result of increasing demands for deregulation and liberalization, which were the key economic agendas of the Kim Young-Sam administration's New Economic Policy. In this context, Samsung's trial was the a potato for the MCI. As the debates on Samsung's entry into the passenger car industry had spread over the society, the MCI could not maintain its "no-yes and no-no" policy and began to consider internally the pros and cons of Samsung's application. It was reported that, although not publicly expressed, the MCI made up its mind to reject Samsung's application through the process of internal deliberation among high-ranking officials. The MCI's stance was formally supported by the report prepared by the KIET.

The KIET's 1994 report, entitled "The Development Direction of the Korean Auto Industry Towards the 21st Century," was actually based on the government's policy of de-concentration of the chaebol by encouraging the chaebol to concentrate on only three or four business areas and thus to end their aggressive diversification strategy. However, just like the government's dilemma of pursuing anti-monopoly policy within the context of the accelerated phase of de-regulation, the KIET was unable to carry through its policy suggestion, only listing the advantages and disadvantages of four alternatives (table 9.7). Nevertheless, among the four alternatives, three were in opposition to Samsung's entry as scheduled by Samsung. The KIET's report also pointed out the delay of indigenous technological development, the weakening of the industry's international competitiveness, and the possibility of overproduction as possible consequences of Samsung's entry, thus adding weight to the MCI's objection.

The announcement of the KIET's 1994 report aroused in the general public negative opinions of Samsung's entry . The MCI then expressed its opposition overtly. It claimed that Samsung's launching of a new industry would have a harmful effect not only on the Korean economy, but also on the Samsung chaebol itself, which had already attained international competitiveness in the electronics and semi-conductor industries.[12]

[12] The MCI also had to take account the fact that if it granted Samsung's request, there would be a series of similar requests by other chaebol. As I noted, the Hyundai chaebol was preparing to get into a steel industry at this time (*Chosun Daily,* 10 July 1994).

Table 9.7
Advantages and Disadvantages of Samsung's Entry into the Auto Industry

	ADVANTAGES	DISADVANTAGES
First alternative: Allowing Samsung's entry	1. Corresponding to the government's policy of liberalization 2. Enhancing consumer welfare	1. Weakening of competitiveness of the auto industry 2. The possibility of double- and over-Investment 3. Discord with government's policy of business specialization
Second alternative: Rejecting Samsung's entry	Overcoming the disadvantages of the first alternative	1. Negation of the principle of free competition 2. Decrease in consumer welfare 3. Uncertainty of technological upgrading in the long-term
Third alternative: Delaying the entry for 3-4 Years	Cushioning of side-effects and spreading the risk	Same as the disadvantages of the second alternative
Fourth alternative: After delaying the decision 3-4 Years and indicating entry beforehand	1. Prevention of the disadvantages of the first alternative 2. Allowing existing firms to prepare their strategy	1. Inducing overinvestment by existing manufacturers 2. Allowing the exception to full-scale liberalization

Source: Remade from KIET (1994) 383-386.

This opposition from the MCI was affirmed by the fact that the Ministry of the MCI and the President's Economic Secretariat informed President Kim of "the disapproval plan of Samsung's Request," and this acquired President's support. This internal decision was also channeled to the high-ranking executives of Samsung (*Hangyorea 21*, December 15, 1994, P. 25).

However, the MCI's opposition was not as commanding as had been before. By the mid-1990s, the power of the MCI among the government's economic ministries had been greatly reduced. The ongoing trend of democratization and economic liberalization placed the regulatory state agencies such as the EPB, MOF (later MOFE), and FTC in a higher position than promotional agencies such as the MCI and the ministry of Construction. Moreover, the chaebol groups were able to disregard the MCI's policy stance on the basis of their increased financial and organizational autonomy. They even tried to make use of bureaucratic politics by pitting one ministry against another.

The Enhanced Role of Local Politics

Samsung's will to enter the passenger car industry was getting even stronger as the MCI took a negative stance on its application. For instance, on October 13, 1994, the chairperson of the Samsung group, Lee Gun-Hee, expressed that "unless Samsung can produce passenger cars, it will open an import agent of Nissan Motors" (*Chosun Daily,* October 14, 1994). In order to overcome tough opposition not only from existing auto firms but also from the MCI, Samsung decided to make use of an opportunity provided by the concurrent development of democratization and economic liberalization.

Since the onset of democratization in the middle of the 1980s, the power struggle in Korea have become highly personalized and regionalized. In the era of an authoritarian regime, there was an apparent demarcation between pro-democratic political forces and anti-democratic ones. In the era of political opening and democratic consolidation, the central cleavage dividing political forces became more complicated. Although there existed the possibility of the emergence of political cleavages on the basis of the differing political programs and class-bases of political parties in Korea, it was fundamentally impeded by the confrontation with communist North Korea. Instead, the main cleavage that divides the political parties has become regional.

A few political leaders who had a highly concentrated regional support base have been able to mobilize popular support in certain regions and challenge the central power. The two ex-military presidents, Chun Doo-Whan and Rho Tae-Woo, had their support bases in *Kyungbuk* (the southeast region centered around the city of Daegu), while Kim Young-Sam in *Kyungnam* (the southeast region centered around the city of *Busan*), Kim Jong-Phil in *Chungchung* (the middle region) and Kim Dae-Jung in *Chonla* (southwest region). Democratization in Korea gave rise to regional rivalries and internecine power struggles among regionally based political parties (Ahn 1994, Kim 1994). Hence, getting overwhelming support from the regions where they were brought up became the *sina qua non* for political leaders who wanted to challenge the central power.

Samsung was shrewd enough to make use of such a newly emerging political cleavage. In 1992, the city of Busan, the second largest city in Korea, announced an ambitious plan of reconstruction and revitalization, particularly aiming at upgrading its industrial base and expanding its infrastructural facilities. Busan, once the center of labor-intensive industries such as textiles and shoemaking, was in serious economic crisis as a result of declining international competitiveness of these industries in the world market. So it was not surprising the city made a revitalization plan. Curiously enough, however, the city government did not mention concretely how it could finance such a huge plan, saying only that it would try to induce private investments. Because one key project in the plan was the construction of a new harbor and an international airport that would cost a huge amount of money, the city's plan even sounded void and irrational.

When Samsung submitted its proposal to enter the passenger car industry in 1993, it designated the planned factory site in Busan, which lacked most infrastrtuctural preconditions for a machinery industry. The success of an auto industry to a great extent depends on the plentiful supply of skilled and semi-skilled workers as well as on the near-by existence of parts firms. It is needless to say that Busan couldn't satisfy both requirements even to a small extent. To be sure, Busan enthusiastically welcomed Samsung's plan since it would foster an industrial revival to reverse severe decline of the city's traditional industries. The Busan Chamber of Commerce was the most active agent arousing Busan's public opinion in favor of Samsung's trial. It took the introduction of Samsung's auto factory as its foremost important agenda in 1994, and made interviews with and sent requests to the Blue House and central agencies 14 times. In addition, it influenced public opinion through its official journal, "Busan Chamber." As a result, the 38 civil associations in Busan established the "All Citizen Committee Promoting the Introduction of Samsung Auto Factory" and urged the government to give permission to Samsung to enter the passenger car industry.

When Samsung announced that its future plant would be located in Busan, it not only considered the potential support from Busan's citizens, but more significantly aimed at mobilizing support from political leaders, including the President, who had had a political base in Busan. In 1992, Samsung constructed a commercial vehicle factory in Daegu, the hometown of then President Roh Tae-Woo. Likewise, Samsung cleverly located its production sites in the hometown of the current president, Kim Young-Sam, thus making the President vulnerable to hometown demands and pressures.

It was finally disclosed that there was a secret deal between the city of Busan and Samsung (Shin 1995). The congruence of interests between the local government and a big business made possible such a deal, which had been outright impossible a few years before. Although the final decision-maker was still the central government in such matters as permitting a new auto producer, the hegemonic status of a central bureaucracy began to erode as a consequence of the wave of grass-root democracy in the early 1990s. Samsung tried to make use of the confusion brought about by the institutional friction between central and local governments.

The Roles of Other Economic Ministries

Even though Samsung was able to mobilize the support of Busan citizens and some political leaders, its application might have been shelved again if the economic bureaucracy in Korea had revealed an internal coherence supporting the MCI's opposition. However, as the MCI itself tried to find its new role within the changed policy environment, the other economic ministries voiced their own views without close consultation with the MCI.

The EPB had consistently maintained a reserved attitude towards the development of an auto industry since the early 1980s. Together with the Bank of Korea, the Korea Development Institute (KDI), and international development organizations, the EPB argued in the early 1980s for bringing an end to auto manufacturing and instead focusing on simple assembly from imported parts and components. In case of Samsung's trial, the EPB insisted again on the principle of free market competition, thereby supporting Samsung's application indirectly.

The EPB also requested a report from the KDI - a research arm of the EPB - regarding the future of the Korean auto industry. The KDI's report, entitled "The New Entry into the Auto Industry and the Policy of Industrial Organization," represented the

EPB's stance, arguing for the abolition of artificial entry barriers in order to facilitate ongoing deregulation policy (KDI 1994). The EPB's view on Samsung's matter gained more strength as the Economic Secretariat of the President was changed to Han Yi-Hun, who had been the Vice-Minister of the EPB and graduated from the same high school as the President in Busan (Shin 1995). Although not expressing its stance overtly, the MOF sided with the EPB by asserting that the investment decision was the domain of private capital.

In December 1994, the EPB merged with the MOF, thus giving birth to the super-ministry, the Ministry of Finance and Economy (MOFE). The birth of the MOFE meant the triumph of the neo-liberal economic principle of liberalization. It also meant that the *Segyehwa* (globalization) ideology would gain institutional support from the Korean bureaucracy, replacing the old mentality based on the bureaucratic conception of the autonomous role of the state in economic development. The merger of the financially conservative MOF and the ideologically neo-liberal EPB thus provided a more fertile ground for Samsung to maneuver its offensive against the remaining stronghold of developmentalism, the MCI.

Unlike the policymaking processes before 1992, when the MCI had a quasi-monopoly in matters of industrial restructuring, the MOFE and the MCI began to compete head to head, providing breathing space for Samsung. Under an authoritarian regime, this kind of policy debate would have been impossible and the idea of Samsung's entry would have been as short-lived as its previous attempts.

The Decline of the Producers Coalition

The opening of the domestic market for passenger cars and increasing competition in the world market put existing auto producers into disarray. Particularly, the number one producer, Hyundai, was experiencing unbearable hardship in 1994 primarily because its chairperson had been defeated in the presidential election of 1993. Kim Young-Sam's government started retaliatory measures against Hyundai since the chairperson and presidential candidate, Chung Ju-Yung, had openly blamed Kim and other politicians as corrupt and inept during the election campaign. All year long, the national tax agency investigated the Hyundai group to find any evidence to justify putting Chung into jail. At the same time, the second producer, Daewoo, was also having difficulties in part because its chairperson was involved in domestic politics. Besides, as it ended its alliance with GM in 1994 through buying-out GM's share of its equity, it was searching for a partner of strategic affiliation in other countries, sensing that its weak financial status and low technology would hardly allow the firm to survive in an increasingly competitive domestic and international market. Kia alone struggled intensely against Samsung's trial. However, Kia had its own innate handicap, that is, its share was so broadly spread that there were few persons who could identify themselves with the company.[13] This lack of corporate leadership, which had been extremely critical in expanding business activities in Korea, prevented Kia from acting coherently in response to Samsung's several strategic actions. For instance, it was reported that there were some Kia high ranking officials who even welcomed Samsung's failed attempt at a hostile takeover of Kia in 1993.

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[13] The biggest owner's share of Kia stocks amounted to only 3.0 percent.

Overall, democratization and economic liberalization eroded the consensual base of existing auto producers. Democratization provided the distorted illusion that company owners could become President and manage state affairs the same way as a company. The owners of Hyundai and Daewoo were typical chaebol owners who had been able to establish and expand their business activities through close collaboration with the authoritarian state. The state had been seen by these owners as the providers of financial resources, opportunities to expand business fields through absorbing ill-managed firms, and protection from labor unrest and foreign imports. In turn, they had to provide the state with relevant information and achieve a certain level of productivity since the state's support largely in the forms of subsidies and protections had been based on the criteria of actual achievement. Within the context of such a reciprocity, there had appeared plentiful opportunities to form an intimate coalition between the state and major auto companies.

However, democratization eroded the institutional bases of the collaboration between the state and chaebol as well as of the collective action among the producers. The declining role of the MCI represented the erosion of the autonomy of the policymaking agency, which laid the foundation for collaborative state-business relationships. Besides, democratization put the chaebol in a defensive situation as people tended to attribute several economic problems such as increasing wealth concentration to the unscrupulous diversification of the chaebol and began to voice the need for reform of a chaebol-dominant economic system. The chaebol, on their part, conceived democratization as an opportunity to make their wishes come true through directly participating in politics, this time not as a partner with the state but as the manager of state affairs by themselves.

At the same time, the issue of economic liberalization functioned as another obstacle to the maintenance of collaborative relations between the state and business as well as to the facilitation of collective action among the producer groups. Deregulation and liberalization meant for existing auto firms more competition in the domestic market and the struggle to become the fittest in the international market. In game theoretical terms, the context of each firm's actions became more like that of prisoner's dilemma, as each firm gained the increasing incentive to act unilaterally in accordance with its preference structure.

The Intervention of Political Considerations in the Policymaking Process

When the neomercantilist coalition between the state and local firms prevailed during the mid 1970s and the late 1980s, its was relatively hard for political consideration to intervene in the industrial policymaking process. Democratization processes, however, made it imperative for the incumbent government to calculate every policy effect in terms of whether it helped maintain current political power. After the breakdown of the institutional structures that traditionally channeled social demands into political actions in many industrial policy fields, there opened wide space in which political consideration loomed large as the criteria of policy-choice, replacing the long-term goals of state policy with the short-term benefits of certain political coalitions.

As I briefly mentioned above, the city of Busan, which was designated as Samsung's factory site, was the hometown of President Kim Young-Sam. As late as the fall of 1994, however, President Kim scarcely showed any sign that he backed up Samsung’s cause. The years of 1994 and 1995 were also noted as years when the government attempted seriously to regulate the chaebol's ownership and their business and market concentration.[14] Although bureaucratic feuds prevented the government from reaching a final decision, President Kim's neutral position on the Samsung issue seemed to most observers to favor the MCI's position implicitly, and so the widespread speculation was that Samsung's entry might be blocked.

However, a sudden breakthrough came in November 1994, when President Kim was visiting Manila and was shown on Korean TV jogging in a pair of Nike running shoes. This small episode, however, enraged Busan citizens, many of whom suffered economic hardship caused by the decline of the footwear industry. This event then was seen as a betrayal of those citizens who had been his strongest political supporters. If the ruling Democratic Liberal Party lost in the forthcoming local elections in the Busan area, it could mean a nationwide defeat (Shin 1995: 260). The pressure from politicians upon the MCI to reconsider the Samsung matter were so intense that the vice minister of the MCI told the press in November that the Samsung matter had moved beyond the jurisdiction of the MCI. Given this change occurring around the forthcoming local elections, Samsung finally received governmental approval on December 4, 1994.

4. Conclusion

The concomitant development of democratization and economic liberalization puts enormous strains on the government. Institutional arrangements of industrial

[14] For example, on January 1, 1995, the government announced major amendments to the Fair Trade and Monopoly Regulation Act, demanding that the chaebol reduce the ratio of cross-equity ownership to below 20 percent, which was thought to be difficult for many chaebol (*Hangyerye Daily,* 25 January 1995).

policymaking became unstable while new forces hoping to ride the tide of democratization and liberalization emerged from every corner of society and state.

In my case study of Korean industrial policies, we can see that every relevant variable can change under the influence of these two macrosocial changes. Not only did the interests of major actors change, but the institutional structures governing industrial policymaking also could not function as they had. As to this theoretical problem of the absence of a constant, Peter Gourevitch has recently provided a valuable insight, despite the fact that his major concern is limited to international relations (1999: 137): "When institutions are fluid, they become part of the game itself and are not able themselves to structure the outcome of a political process. Indeed, fluidity of institutions, by changing options available to actors, may induce reevaluation of strategy. . . . This is the governance problem."

Throughout the study, I have argued that the development of the Korean auto industry has been occasioned by the ascendance and decline of a coalition between sections of state agencies and private firms, both of which have had a common interest in constructing an independent auto industry. However, the concomitant development of democratization and economic liberalization eroded the ground of common interest between the state and business. The state increasingly attempted to control the chaebol's business activities whereas the chaebol in general began to see the state as a burdensome regulator or, even worse, as a target that should be conquered. Moreover, inter-agency fighting within the government was intensified and resulted in the ascendance of regulatory agencies such as the MOFE and FTC at the center of economic policymaking. The much needed collective action against Samsung's attempt among existing firms was not successful, largely because Hyundai, a business leader heavily hit by a loss in the presidential election, was harshly treated by the government in every business transaction. Nevertheless, the most critical problem of industrial policymaking by the middle of the 1990s was the intrusion of political consideration, even replacing economic rationality in policy deliberation. So by the eve of the financial crisis in 1997, the industrial policymaking structure in Korea reached a crisis of "governance," in which institutions were fluid, actors hastily shifted strategies, political consideration preceded economic rationality, and state and business kept an eye on each other with precaution.

CHAPTER X

CONCLUSION: THE FINANCIAL CRISIS OF 1997 AND ITS AFTERMATH

1. Review of the Argument

The auto industry reflects the achievements and predicaments of Korea's economic growth. One year before the crisis, Korea had become the world's fourth largest auto producer, having outrun France and the United Kingdom. Production reached 2.85 million units in 1996. Specifically important was that such growth had been made by domestically owned firms - a significant achievement given the high entry barriers due to economies of scale and the rapidly changing product and process technologies. Most developing countries, facing these entry barriers, have depended on the subsidiaries of auto TNCs to produce automobiles or have concentrated on manufacturing auto parts and components.

In this study, I have argued that the growth of the Korean auto industry has never been a unilinear process, devoid of crisis, contradiction, and recess. It is more appropriate to describe the history of the Korean auto industry as having the character of cyclical ups and downs. To explain such a feature, I employed the conceptual framework of coalitional politics: the continuing struggles between two coalitions on issues ranging from the desirability of introducing an auto industry to liberalization and de-regulation. During the developmental period, it was argued, the Korean auto industry had been able to upgrade its transformative potential because of the so-called neo-mercantilist coalition, which consisted of the nationalist segment of state managers - largely based in the MCI -

and independent-oriented local entrepreneurs, gained the upper hand over the liberal coalition, which consisted of the liberal technocrats - largely based in the EPB - and TNC-dependent local entrepreneurs. The dynamism of coalitional politics was seen mediated through the shifting institutional arrangements of industrial policymaking, particularly focusing on the insulation of the state agencies that made industrial policy and on the nexus formed between these agencies and local auto firms.

The Automobile Industry Promotion Law, promulgated in 1962, marked the birth of the modern auto industry in Korea (Kim 1997, 107). The MCI was given discretion to determine which companies could participate in the industry. The Plan provided many typical types of industrial support to local firms. However, the Plan failed because of rent-seeking and political corruption. The government's strategy in the early 1960s was the "unitarization" of the auto industry, the creation of one producer with the objective of realizing economies of scale even in a single firm. Given the limited policy autonomy of the MCI and the absence of production-oriented local capital, the setting up of artificial entry barriers only worked to encourage rampant rent-seeking among corrupted local businesspersons and politicians (see Chapter Four).

The problem of the strategy of having a single assembler soon became obvious. The selected local firm (Shinjin) was able to earn significant rents in the market while its foreign partner, Toyota, appeared to be gaining the lion's share of these rents. To rectify this problem, the government allowed three more firms to assemble automobiles as of 1971. The Korean auto industry also failed to enhance the local content rate of auto parts in spite of its ambitious plans. Moreover, it revealed its extreme vulnerability to the influences of foreign auto TNCs as seen in the case of Toyota's withdrawal from Korea in

1971 and Ford's delaying tactics to form a joint venture with Hyundai in the early 1970s. (see Chapter Five, Section 1). By this time, the general economic condition in Korea had rapidly deteriorated, largely because of snowballing trade deficits and foreign debts. This economic crisis coincided with the political crisis, which led to the formation of the Authoritarian regime (*Yushin* Regime) in 1973. As crisis tends to bring about significant changes in institutional arrangements of industrial policymaking, so too did the combined political and economic crises in the early 1970s bring about renewed institutions in industrial policymaking in Korea (see Chapter Five, Section 2 and 3).

The government's major efforts to promote the industry came as part of the Heavy and Chemical Industries Project, announced in 1973. The auto industry, designated as strategic for the economy's future, was targeted to move from import substitution to export-led development. To realize economies of scale, producers would be required to submit plans for a "people's car," the specifications, timetable, and costs of which were to be laid down by the government. Over-optimistic MCI officials and local entrepreneurs, particularly Hyundai and Kia, set the tone of the developmental era of the 1970s, and began massive investment projects in the late 1970s. In this period, we can see the prototype of a neomercantilist coalition between nationalistic MCI officials and local business under the leadership of the authoritarian President, Park Chung-Hee (see Chapter Six).

However, the initiations of massive investment projects at the end of the 1970s met immediately with the second round of oil price rises and severe recession in the world economy. In the political realm, the authoritarian regime collapsed with the assassination of President Park in October 1979. The Korean economy became rapidly moribund, recording its first negative growth in 1980 since 1960. The domestic auto market also collapsed in 1980 as well as Hyundai's nascent export business when Japanese competitors lowered export prices in an attempt to maintain market share. Korean auto firms were producing at only one quarter of their capacity (see Chapter Seven, Section 1).

Institutions of industrial policymaking also changed in the wake of political and economic crises. Liberal-minded reformers (mostly from the technocrats of the EPB), with the help of international financial organizations such as the IMF and World Bank, appeared at the forefront of industrial policymaking. They argued that Korea should abandon the auto industry by allowing foreign TNCs' active participation. First, they thought that all the existing auto firms should be dissolved except for GM and Daewoo's joint venture company, GM-Korea. Facing intense opposition from the MCI and Hyundai, a liberal coalition rationalized the Korean auto industry by allowing Hyundai and GM-Korea to manufacture passenger cars while excluding Kia and Asia from the passenger car industry. This was a halfway triumph of the liberal coalition (see Chapter Seven, Section 2).

The ascendance of the liberal coalition in industrial policymaking continued well into the middle of the 1980s. The EPB accelerated its reform efforts by, for example, instituting the Industrial Policy Deliberation Council under its supervision (thus reducing the policy autonomy of the MCI), privatizing commercial banks, and liberalizing foreign trade. However, a neomercantilist coalition between the MCI and local firms was not completely wiped off the stage, given the strong institutional legacy of the developmental state of the 1970s. Although expelled from the auto industry by government order in

1981, Kia began to plan for a new passenger car model, in the agreement with Mazda on the development of a new model as early as 1982. In late 1984, the MCI decided to allow Kia to re-enter auto production, thereby defacing the liberals' rationalization plan. Hyundai also sought to expand its production capacity, particularly aiming at penetrating advanced markets with small, front-wheel driven passenger cars. As a result of the staying power of a neomercantilist coalition, the Korean auto industry could avoid the fate of denationalization and being incorporated into the global strategy of the auto TNCs. In the end, the formulation of the Industry Development Law in 1986 represented the recapturing of industrial policymaking power by the neomercantilist coalition, although not in the top-down and sector-specific manner that previous industrial support laws allowed (see Chapter Eight).

The decade of the 1990s can be termed a "reversal of fortune." Up to the mid-1990s, the Korean people indulged themselves in a rosy future of being a member of advanced countries. Per capita GNP exceeded the critical level of $10,000 in 1995 and Korea became a member of the OECD countries in 1996. Politically, democracy seemed to be fully stabilized after the first election of a civilian President since 1960. Economically, economic liberalization and deregulation were taken as the first goal of state policy.

The concomitant progress of democratization and economic liberalization put a great stress on the management of industrial upgrading. For instance, democratization required a strong state measure of de-concentration (anti-monopoly policy) while liberalization was seen to be successful on the condition of strong international competitiveness on the part of big businesses, which in turn presupposed deregulation in the area of industrial organization. In other words, democracy required the weakening of big businesses while liberalization strengthened chaebol power (see Chapter Nine, Section 1 and 2). Such a predicament gave rise to two significant institutional changes: 1) decline of the MCI and the advancement of the MOF (later MOFE) as the state's industrial role shifted from sector-specific intervention to functional and regulatory intervention; and 2) the weakening of producers' coordination due to their different business strategies.

Reflecting the optimistic prospect of the future held by the general public, the auto manufacturers began another round of investment rush in the 1990s. Within this context, Korea's biggest chaebol, Samsung, applied for permission to manufacture passenger cars in the early 1990s and suddenly became the hot potato among Korea's auto policymakers. In its trial to become another auto producer, Samsung made use of the divisions and confusions of industrial policymaking institutions that were occasioned by democratization and economic liberalization. The MCI announced its opposition to the proposal on the grounds that another automaker would create overcapacity and excess competition, prevent the realization of scale economies in the existing firms, and exit from the industry for any particular firms would be enormously expensive. For others, particularly policymakers in the EPB and MOF, however, three decades of government direction of the sector had produced unsatisfactory results. Their argument was that the market should be allowed to determine the viability of Samsung and its domestic competitors in the industry. Samsung was also able to avail itself of the division among existing auto firms on the issue of Samsung's entry. However, the most important factor that worked in favor of Samsung was its close relation with a few top political leaders, including the President. The Blue House (Korea's Presidential residence) eventually sided with the EPB, MOF and FTC against the MCI, the existing auto producers, and public opinion, and in November 1994 announced its authorization of Samsung's joint venture with Nissan. This decision could be heard as the death knell of a neomercantilist coalition in the auto sector (see Chapter Nine, Section 3).   .

2. Crisis of the Korea's Auto Industry amid Financial Crisis

In the winter of 1997, crisis afflicted the Korean economy. Against the background of major corporate insolvencies, corruption scandals, and heavy short-term borrowing due to mounting trade deficits, intense speculative pressures forced repeated depreciation of the Korean won. Along with the collapse of won, the stock market also collapsed. The lack of foreign confidence raised the specter of default. On November 21, 1997, the Korean government made a request to the IMF for financial assistance.[1]

In the auto industry, several firms had filed for bankruptcy, including the second largest auto firm (Kia) in Korea, before the full force of the financial crisis hit Korea in November 1997. Against such a backdrop, we are faced with another research question: could the main hypothesis of this study, that is whether the character of a dominant coalition determines the performance of an industry, be applied to the auto industry in Korea after the crisis of 1997? Although the Korean auto industry was still in flux as of the end of 2001, I will briefly examine the validity of my hypothesis within the recent crisis as part of the conclusion of this study.

[1] There are many different interpretations regarding the cause of the Korean financial crisis. For more detail on this matter, see Jomo ed. (1998), Krugman (1998), Cumings (1998), Chang et al. (1998), and Noble and Ravenhill (2000).

2.1 The Direct Cause of Business Failure of Korean Auto Corporations

During the 1990s, the global auto industry was undergoing its most fundamental consolidation since the 1920s. Former prominent auto firms such as Saab, Volvo, Jaguar, and Audi were taken over by big corporations such as GM, Ford, and Volkswagen. Daimler Benz merged with Chrysler, giving birth to another big automaker. Renault acquired a one third stake in Nissan while GM bought 20 percent of Fiat. All of these corporate shake-ups had their origin in global overcapacity - production capacity was over 70 million units when demand was under 52 million units a year. In such a bleak market situation, international auto firms did anything to realize synergies especially in components sourcing through global supply chains, through sharing production platforms, and through joint research and development ventures (cf. Kim 2000).

What did Korean auto firms do under the rapidly shifting environment of the international auto industry? As illustrated in detail in the previous chapter, most Korean auto firms had planned and executed over-ambitious investment projects by the time of economic crisis. To make matters worse, the Korean government had approved the largest chaebol in Korea to begin the production of passenger cars in December 1994. Obviously, all of these events resulted in enormous structural problems for the Korean auto industry. A massively expanded productive capacity led to the decline in the capacity utilization rate to a risky level (70 percent in 1997). As I discussed, Korean auto firms, like other big corporations in Korea, had relied on bank loans for capital mobilization and thus had an extremely high debt to equity ratio. When they became international actors and financial liberalization removed the government's interference in their financial transactions, they took advantage of the easy access to loans afforded by various international lending organizations. Accordingly, increasingly snowballed debts coupled with a low capacity utilization rate made Korean auto firms highly vulnerable to even a small shock in the economy. One example summarizes the highly abnormal condition of the Korean auto firms: at the end of 1996 the debt to equity ratio of Ssangyong Motors, a company that specializes mainly in four-wheel drive SUVs, stood at 10,496 percent (Shon 1999).

Even before the 1997 crisis, there was no doubt that most Korean auto firms were in serious financial trouble. Kia and Ssangyong were reported to have made no profits throughout the 1990s. A sign of crisis in the auto sector was revealed to the public when Samsung intentionally leaked the report that argued that Kia and Ssangyong would soon collapse because of financial difficulties (*Chosun Daily,* June 7, 1997). Within a month, Kia had to seek a bailout from creditors. The auto industry, alone responsible for around five percent of Korea's GDP, was indeed the fundamental cause of the financial crisis that developed later in the winter. The most critical blow to the Korean auto industry was the collapse of Daewoo chaebol in 1999. The bankruptcy of Daewoo Motor Company cast an enormous shadow not only over the recovery efforts of the government, but also over the future of the Korean auto industry. Once a hot potato for the government, Samsung also failed to gain a foothold in the auto industry and was finally sold to French Renault at a bargain price.

2.2 The Resurgence of a Neomercantilist Coalition and its Defeat

As economic conditions worsened during 1997-1998, first Kia, then Ssangyong, then Samsung Motors, and then finally Korea's third largest chaebol, Daewoo, went bankrupt. In searching for a way out of the crisis in the automobile industry, the Korean government had to take action. The solution would depend on who (which coalition) took the initiative and gained the upper hand in industrial policymaking.

On the one hand, there was a group of policymakers, local firms, and politicians who argued for the enhanced role of the state. This group had its roots in the neomercantilist coalition in the 1970s and 1980s. They first suggested the bailout of the firms by the state. When they understood that the state's bailout option was impossible to implement because of the collapse of the financial system (e.g. some prominent commercial banks were on the verge of bankruptcy) and the pressure exerted by international organizations, they attempted to allow the bankrupted firms to be taken over by another Korean company. This option was also untenable because of the financial problems of the only healthy company, Hyundai, and the opposition of the liberal reformers who were worried about the creation of a monopolistic auto industry.

On the other hand, the financial crisis strengthened the liberal coalition, which had already been gaining predominance since the beginning of the 1990s. The drastic measures of liberalization and de-regulation were taken as the new government was formed in 1998. The Korean *won* began to be freely floated according to market demands without any ceiling on its one-day variation, while the domestic stock market was fully liberated, thus paving the way for the hostile M&A of the Korean firms. Under such a liberated condition, the liberal coalition argued for the permission of foreign auto producers to purchase the assets of the bankrupt Korean auto producers.

The result of the battle between two coalitions concerning the future of the Korean auto industry seemed to be a halfway triumph for both parties as of the end of 2001. In fact, when Kia requested special favor from the government in 1997, the first response by the government was closer to the claims of a neomercantilist coalition. The government announced in October 1997 that it would place Kia Motors under court receivership and that the state-run Korea Development Bank's loan to Kia would be converted to equity, making the Bank, with 30 percent of its total equity, Kia's largest Shareholder (*Chosun Daily* October 23, 1997).

During the wrangle about the Kia's future, Kim Dae-Jung was elected President and soon initiated drastic liberalization reforms. The liberal coalition among the technocrats in the MOFE, international financial organizations, anti-chaebol civil movement groups, and politicians, including the President himself, suggested a different solution to Kia's problem. The government reversed its decision and opted to auction off Kia's assets. Interestingly enough, Kia was eventually sold to the highest bidder, Hyundai, the solution preferred by the neomercantilist coalition. As a result of this take-over, Hyundai-Kia could become the quasi-monopolistic auto firm in Korea, controlling 72 percent of the market in 2000.

The liberal policymakers might have been stunned by the result of the auction. They might have disregarded the fact that major foreign automakers did not have keen interests in Kia because it was so heavily debt-ridden. Then came the bankruptcy of Samsung and Daewoo. The government made it clear that it would follow the market principle in dealing with both companies. The sale of Samsung Motors to Renault was relatively non-controversial because the former was in the initial stage of producing automobiles. But, when it came to Daewoo, the liberal coalition faced strong opposition. The general public also opposed the liberals' plan as indicated by the fact that 87 percent of respondents in a public opinion poll opposed Daewoo's sale to a foreign bidder (*Korea Herald*, June 12, 2000). In this case, labor sided with the neomercantilist coalition because a foreign companies' taking over Daewoo would likely shut down some local plants and produce foreign models with foreign-made auto parts. As of the end of 2001, General Motors and the Korean government were negotiating the price and other costs that would accompany the take-over (*Chosun Daily,* December 11, 2001).

To sum up, by the end of 2001, the expectation was that foreign automakers would control three of the Korean producers (Daewoo, Samsung and Ssangyong) while Hyundai-Kia would maintain its managerial independence. In terms of market share, however, independently managed Hyundai-Kia has taken up over two thirds of total production in Korea. Therefore, on the surface, the battle between the neomercantilist and liberal coalition seems to have ended in a draw. However, the reality is somewhat more complex. The ascendance of the liberal coalition is more questionable than some accounts of the Korean auto industry suggest. In 2001, Hyundai-Kia achieved enormous success in exports to the U.S. and other advanced countries. Their new models have been praised as the best cars of the year. This success of Hyundai-Kia presents an anomaly to liberals in both private and public sectors who have consistently argued that independent Korean auto firms have no future within the increasingly concentrated international auto industry.

3. Conclusion and Suggestions for Further Research

3.1 Conclusion

The emergence of the Korean auto industry as the internationally influential actor in the 1980s and 1990s posed a theoretical challenge for scholars in comparative political economy. While giving us valuable clues and insights in explaining the long-term trend of Korea's auto industrialization, contending paradigms--including the state and market-centered approach--have failed to provide a sufficient explanation regarding the short and mid-term variations of industrial development.

To date, the Korean auto industry has been placed at a crossroads of either becoming fully incorporated into the auto TNCs' global strategy or continuing on an independent path of development. It is uncertain which way the Korean auto industry will go in the future. One interesting point that should be emphasized in this context is that both state and market-centered (product cycle) approaches predict the same result for the Korean auto industry: the end of the era of independent auto industrialization. Most scholars who have applied the state-centered approach to the explanation of Korea's economic growth are, with few exceptions, asserting the "demise of the developmental state," largely on account of the trend of liberalization and democratization that seems to weaken the foundation of a strong and autonomous state. As a result, they argue, "without a developmental state, no independent auto firms." On the other hand, scholars who have stressed market logic in the explanation of Korea's economic growth take for granted the erosion of the independent way of auto industrialization in Korea, arguing accordingly that the Korean auto industry must find its proper place in the international division of labor.

However, my argument is quite a bit different from both perspectives. The exclusive focus either on the monolithic state or on the self-regulating market cannot explain the vicissitudes in the performance of the Korean auto industry. In a similar vein, the argument that the Korean auto industry had been led by the state until a certain point in time and that the market replaced the role of the state from that time on also misses the mark since the conflicts of ideas and strategies primarily between neomercantilist and liberal coalitions have been the locomotive of Korea's auto industrialization throughout the whole development period. In addition, the argument that the prominent role of the Korean state in economic growth has been in its coercive and discretionary ways of targeting and resource allocation, even against the will of private firms, seem to go way beyond reality. The logical conclusion from this argument is that the role of the state should retreat into that of a regulatory states, as can be seen in Anglo-Saxon countries, as soon as the state faces increasing power in the private sector. In this argument, there is no space between the strong and developmental state, on the one hand, and the weak and regulatory state, on the other, in which the state could be as active and interventionist as but not as coercive or top-down as the so-called developmental state.

Focusing on the auto industry in Korea, I have found that the performance of the industry has had more to do with the shifts in the dominant coalition in the making and implementation of auto policy than with the change in either state or market power. In analyzing the process of auto industrialization, I have also found that the battle line dividing liberals and nationalists has been persistently drawn in this process and has continued well into the period of economic reforms occasioned by the financial crisis of 1997. To put it another way, the liberal coalition was strong enough to thwart the neomercantilist pursuit of indigenous auto industrialization even in the hey days of the developmental state, whereas the neomercantilist coalition could be the winner in the readjustment of the auto industry even during the hey days of liberal reforms. The first case can be seen in the confusion of auto policies in the early 1970s, whereas the latter case is highlighted by the take-over of Kia Motors by Hyundai in 1999 against the wishes of liberals to sell Kia to foreign makers.

Given the persistent battle line between neomercantilist and liberal ideas, interests, and organizations in the Korean auto industry, we can predict its future will also depend on which coalition will have the upper hand in the making and implementation of state's auto policy. By the summer of 2002, Hyundai-Kia, which is independently managed and occupies about a third of the domestic market share, had succeeded in becoming a competitive international actor as indicated by a huge increase in their corporate profits and export volumes.

In the mean time, Daewoo Motor Company has been on the market for three years and GM decided to take over some of Daewoo's manufacturing facilities around the world in 2002. In fact, Ford was more interested in buying Daewoo than GM, and so it signed a MOU (Memorandum of Understanding) with Daewoo in 1999. For unknown reasons, however, Ford withdrew the contract. It can be conjectured that Ford's withdrawal was again occasioned by the unwillingness of some government officials to sell domestic firms to a foreign giant firm as well as by the labor's resistance. Therefore, we cannot say that GM's take-over of Daewoo will be successful because the deal is currently based on the precarious balance between the neomercantilist and liberal coalitions in the Korean government.

3.2. Suggestions for Further Research

For developing countries, to be come an international actor in the industrial sectors that have been dominated by leading firms from advanced countries proved almost impossible with a few exceptions. In this sense, the Korean auto industry belongs to these exceptions. No other developing countries have ever tried to establish their auto industry as the platform of transforming their industrial structure and expanding beyond supplying for their domestic markets. Therefore, we might say that the experience of Korea's auto industrialization is nothing more than an outlier that could confirm the rule of permanent dependence of LDCs on a handful of leading firms from advanced countries in such highly growth-generating sectors as automobile, information technology and chemical industries.

However, such an argument runs the risk of ignoring the factors that existed in most developing countries and would have functioned as the catalyst for indigenous development of key mass-producing industries like auto industry. From this perspective, finding out these factors and analyzing why and how they failed to bring about the same result as we observed in Korea is a more important research question than relegating them simply as Korean "exceptionalism." The main factors that I sorted out as determining the pattern of Korea's auto industrialization are relatively easily observed in many developing countries. The conflicts of interests between different segments in both the government and private sector and resulting efforts to form a coalition to prevail over its rivalries in the policymaking process are the no less significant characteristics of the politics of developing countries.

Accordingly, there existed the need to expand and deepen my research question by comparing the Korean case with those in other developing countries, particularly focusing on the politics of coalition building and its impact on government's policymaking processes. We have no small number of comparative studies whose analytic focus is exclusively confined to the roles of either market force or government's initiative. Up to date, however, we still lack the comparative studies that highlight the political dynamism of coalition building and its impact on state's economic policy, particularly those comparing East Asian cases with other LDC's cases.

Therefore, although my study is a case study that attempted to find out the key factors of the Korea's "distinctive" pattern of auto industrialization among LDCs, I believe those factors can be generalized across other cases and this can be done by further comparative studies. In any event, "exceptionalist" problematic entails a distortion of reality that has long misguided research in the field of comparative political economy. This way of addressing the question gets us off to a bad start because it exaggerated the range of variation in the economic policies of various LDCs.

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