

**Understanding Policy Responses from Economic Ideas:
Korea's Two Financial Crises**

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Abstract

The field of Economics and International Political Economy (IPE) often omits the importance of an idea that shapes an agent's interests and behaviors, which can be crucial to understanding the policy's decision-making process. This paper argues the power of economic ideas, which, formulated by internal and external affairs, have the capacity to change the institution, also providing the reasoning for certain policy choices. The paper will explore reasons to certain policy measures that happened in two financial crises in the Republic of Korea, by tracking back into the economic ideas of Neoliberalism and Pragmatism that were dominated by the policy makers during the Kim Young Sam and Lee Myung Bak administration.

1. Introduction

One of the most inspirational American authors, Earl Nightingale, once said “Everything begins with an idea”. The power of an idea has been recognized, emphasized and praised in many different fields, from the field of entrepreneurship to philosophy. This is because a single idea can motivate the interest of the people, influence their behavior, and also has the capacity to build collective goods. Therefore, ideas not only affect others on a micro-level scale, but also drive macro-consequences. However, the focus on ideas is less significantly highlighted in the academia of Economics and International Political Economy (IPE). For instance, there is ample literature on the consequences of the Asian Financial Crisis in 1997 and the Global Financial Crisis 2008 on South Korean economy, but they lack deeper explanations on the cause of these consequences. The mainstream economic and IPE literatures claim that the Asian Financial crisis heavily impacted the South Korean economy due to the government’s inadequate policies and the structural problems of the South Korean economy, whereas the South Korean economy could escape from the Global Financial Crisis by adequate policy responses and a bilateral swap arrangement with the US. However, the selected literature lacks explanation regarding why the government responded adequately during the Global Financial Crisis but not in the Asian Financial Crisis.

In order to thoroughly understand certain policy responses, the paper argues that understanding the two economic ideas that influenced the policy makers’ decisions is

necessary--neoliberalism and pragmatism. The paper suggests that that constructivist method of tracing back to the economic ideas which policy makers had during the pre-crises would be a crucial factor to fill the missing gap of pre-existing literatures by answering why certain policy choices were made during the two crises. Therefore, the paper will discuss the fundamental question of how the economic idea of neoliberalism influenced policy makers to result in inadequate government responses during the Asian Financial Crisis, whereas the idea of pragmatism resulted in adequate government policy response. In order to answer the question, the paper must analyze the domestic and international historical context of the Kim Young Sam's economic idea of neoliberalism until the Asian Financial Crisis of 1997, and LMB Myung Bak's economic idea of pragmatism until the Global Financial Crisis of 2008.

2. Literature Review

a. Existing Explanations on Crises Origins and its Limitations

This paper discusses two financial crises which erupted in 1997 and 2008 in South Korea (Hereafter Korea). They are considered to be the major economic crises which occurred during the last two decades in the Korean economy. Financial crisis in 1997 was the most severe national crisis recorded in Korean history after the Korean War as Korea faced the possibility of sovereign default. This crisis originated from the Asian Financial crisis in July 1997, which began to impact the Korean economy in November 1997. The crisis brought Korea to request a bailout from the International Monetary Fund (IMF). Certain conditions were posed for bailout from the IMF, mainly restructuring the conglomerates and fiscal austerity measures (Rodier 112). This condition led to the downfall of conglomerates and the Korean middle class. Ten years later in the Global Financial Crisis of 2008, the Korean economy was affected again. The damage originated from the fall of Lehman's Brothers, which was driven by the credit crisis and subprime mortgage market crisis in the United States (US). While previous crisis brought about a huge national crisis due to unprecedented economic shock, this crisis, despite being of a larger scale, came with a quick recovery. Its susceptibility to the global shock was profound as the Korean economy is heavily influenced by export and financial sectors (Cho 2).

How are the two divergent state responses to be explained? Mainstream economic and political economics journals provide explanations as to why these two crises had differing impacts on the Korean economy. Cho argues that the Global Financial Crisis did not affect the Korean economy as much as one would expect from its previous history as it did not occur as a twin crisis as the Financial Crisis in 1997 did (Cho 11). Cho argues that during the Korean financial crisis in 1997 the currency shock from Asian countries hit the Korean economy causing a currency crisis given that accumulated short-term debt of the conglomerates caused a foreign liquidity shock (Cho 11). However, the currency crisis led to a profound banking crisis given financial institutions were weak and the government's responses were inadequate, using up the majority of foreign reserves in very short period of time (Cho 11). The twin crises, a combination of a currency and a banking crisis, did not occur when the Global Financial Crisis hit the Korean economy. Financial institutions were stronger and the government's response was more appropriate securing currency value by currency swap with the US (Cho 12). By securing currency value the Korean government stabilized its economy by operating expansionary fiscal policies, avoiding a potential economic collapse instead of austerity measures which were active in 1997. Heo supports Cho's argument of the government's failure to manage financials of conglomerates and weak financial institution, and identifies them as the main reasons why the Korean economy was severely harmed in the Asian Crisis, whereas the Global Financial Crisis was less harmful due to Korea's reformed institutions and a higher level of transparency of the corporate sectors compared to that of decades ago (Heo 118). S.Y.Kim supports Cho's and Heo's explanations by weighing more towards the government's structural problem of having a Statist economy, leading corporations to overinvest in capitals (S.YKim 6). S.Y.Kim emphasizes that the Global Financial Crisis

was manageable due to the fact that the policy response was quick and based on expansionary fiscal policy, securing the overall economy as well as the currency swap exchange agreement which stabilized the financial economy. S.Y.Kim's comparative studies of the two crises show that the government's response to the Global Crisis resembled the post-crisis policy following the Asian Crisis. The literature agrees on the idea that the government's mismanagement of conglomerates and financial sectors developed the severe financial crisis in 1997, whereas the reformed structure of the Korean financial system and government's adequate responses to a global crisis prevented further damage to the Korean economy in 2008.

However, explanations offered in these journals comparing the crises miss further explanations of how government failure occurred in 1997, why certain policies were chosen over others, and what the motives were for those policies which led to different economic outcomes for the Korean economy. Furthermore, the discussed journals leave the question of existing weak financial institutions during 1997 although the Korean economy was categorized as a strong-statist economy. Further, it leaves the question why the government could not operate its expansionary fiscal policies at an earlier stage in the 1997 Asian Crisis but was able to during the Global Financial Crisis.

According to the mainstream-rationalist approach of IPE and the field of Economics, Rational-Choice Theory is the theory that is most widely accepted and used to explain any cause and effect in the world of economics (Abdelal, Blyth and Parsons 4; Hay and Rosamond 147). Rational choice to maximize utility is what mainstream IPE scholars see as understanding behavior in economic trends. The Rational Choice Theory has been

majorly developed by economists, sharing the notion of the self-interest optimizing human, which is hugely related and widely applicable to other mainstream theories such as Realism and Neo-realism in the field of International Relations (Dunne and Schmidt 141). Therefore, the Rational Choice Theory, which suggests that human beings make rational decisions, can be widely used. However, the Rational Choice Theory leaves the question of how one can shape the belief that the choice is actually rational. Going back to this thesis' case, the Korean government's decision to weaken control over the financial market and de-regulate it must have been a rational choice in the time frame before the Asian crisis hit the economy. Then, how did the rational belief change from regulating the market for two decades during a strong Statist era to deregulating the market? The limitation of Rational Choice Theory leaves one with the question of what elements make and made a belief rational.

Blyth demonstrates two crucial limitations of rationalist claims, namely internal change is often driven by external world events and the Rational Choice Theory is largely biased (Blyth "Structures Do Not Come with an Instruction Sheet" 695). In fact, rationalist scholars found a theoretical problem with rationalism; assuming that agents' interests are shaped by rationalist theories, the self-interested maximizing agent will encounter the problem of collective action, causing instability (Blyth "Structures Do Not Come with an Instruction Sheet" 696). As such, Blyth argues that the limitation of the rationalist theory is that the theory focuses on stability but predicts indecisiveness. However, ideas can change both an actor's and the collective interest which can lead to institutional stability as idea can influence one's self interest (Blyth "Structures Do Not Come with an Instruction Sheet" 697). Blyth's argument requires more complex

considerations and more elaborate analyses to answer agent's decision of rational choice by looking into ideas that are linked with the interest. This is related to the idea that mainstream IPE tends to omit the explanation of why it became a rational choice, for who and how it did, which can act as very significant factors in analysis. Often rationalist scholars argue that the benefit of a constructivist model is that it occasionally gives a useful explanation for the IPE and world politics. However, this can bring on Segmented Universalism, a rationalist understanding of constructivism as a 'supplementary approach' weakening its own generalizability and scope (Blyth "Structures Do Not Come with an Instruction Sheet" 702). In sum, in order to understand the action of entity, understanding its idea is pivotal.

Given these, I argue that importance of understanding how certain beliefs and the discourse of an idea impact a policy decision. This allows a deeper understanding and gives rise to understanding public policy outcomes. My approach therefore is to place the Korean case in conversation with broader IPE literature on the role of economic ideas so as to enhance the explanations on why the certain choices were made. Therefore, the constructivist approach to the IPE is necessary in order to enrich the scope of analysis possible and to enhance it as a discipline.

b. A Constructivist Approach to International Political Economy.

Blyth emphasizes the need for the constructivist approach by stating that observing and understanding economic ideas in international political economics has shown to be an influential additional factor which should be considered. Economic ideas have

influenced institutional changes much more than people assume or can even observe. This is because the power of economic ideas influences institutional change in uncertain environments rather than institutions reducing such uncertainty (Blyth “Great Transformation” 35). Based on his claim, Blyth proposes five hypotheses collectively referred to as A Theory of Institutional Change. The first hypothesis consists of the idea that it should be a priority to reduce uncertainty in the economic crisis (Blyth “Great Transformation” 35). According to the first hypothesis, economic ideas can help agents such as policy decision makers reduce uncertainty by critiquing the existing economic crisis and proposing alternatives of how to construct and structure the economy. By doing this, the economic idea can reduce the uncertainty by narrowing possible solutions (Blyth “Great Transformation” 37). The second hypothesis in the Theory of Institutional Change states that economic ideas collectively make actions. According to Blyth, economic ideas can change and reconstitute the interests of agents by providing alternative narrations to understand uncertainty in such a way that it can define political coalition (Blyth “Great Transformation” 39). The third hypothesis is that ideas are the weapon to attack unstable institutions. Blyth gives an example of the welfare state of the United States (US) during the 1970s being a targeted institution to be replaced as the economic idea identified the US as part of the economic crisis problem (Blyth “Great Transformation” 39). As existing political and economic institutions are the consequence of the economy having gone through crises, agents can change or modify existing institutions. The fourth hypothesis is that new economic ideas act as institutional blueprints. As the economic idea diagnoses problems of an existing economy the institution can be designed and changed simultaneously. Lastly, Blyth argues that economic ideas create institutional stability (Blyth “Great Transformation” 41). Economic ideas can picture a possible future outcome

through generations of conventions. Crystalizing economic ideas as the input to generate stability is the power of economic ideas which can modify institutions.

Blyth demonstrates his theory by using two case studies, the US and Sweden. His case study of the US explains its two Great Transformations, which occurred during the 1930s and the 1970s, illustrating how those hypotheses were developed. The second Great Transformation that Blyth refers to is a rather interesting case study in terms of analyzing the power of economic ideas and its relations with institutional change. Before the 1970s, Embedded Liberalism, a system in favor of both freedom of economic activities and welfare system from the state, was the ruling economic system of the US as it benefitted both steady business growth and its citizens. However, Blyth argues that in the late 1960s, business sectors faced brutal taxation burdens, inflationary pressure, and other restricted environments built by the Great Transformation based on initiatives already made in the 1930s (Blyth “Great Transformation” 152). The consumer-based economic model posed by John Maynard Keynes (Keynesian economics) limits the benefit to corporates by focusing on the demand side of economics to generate growth. In this stage of thinking, many corporate-funded think-tanks were established and started to contribute alternative theories of economic growth by supporting the supply of investment (Blyth “Great Transformation” 161). The idea of supply-side economics emphasizes the capital gain tax cuts as necessary to generate more economic growth and productivity. According to Blyth, the economic idea of supply-side economics was popularized through the Senate Finance Committee and Congressional Budget Office, as well as The Wall Street Journals, which facilitated this idea (Blyth “Great Transformation” 163-165). Criticizing the government’s failure in US economics enhanced by the US’ failure in the Vietnam War

meant supply side economics became a more effective tool to solve stagflation in the US economy and became the new economic norm. This Monetarist approach to supply side economics became a reliable alternative economic idea used to interpret the existing economic crisis during the 1970s, diagnosing problems and attacking existing welfare-institutions. After the economic paradigm had shifted, generating growth through investment and liberalization of capital was realized by placing less emphasis on labor in favor of businesses. Supply side economics became the new convention for the financial market and the Federal Reserve (Blyth “Great Transformation” 170). By analyzing case studies of the US and its shift in its economy during the 1970s, which he calls ‘the Second Great Transformation’, it becomes undeniable that economic ideas are powerful and influential, showing how agents use ideas to change institutions. Blyth notes that ideas and interests are *mutually constitutive* (Blyth “Great Transformation” 28). It is because the idea makes our desire to want something, not because of innate properties of the object desired (Blyth “Great Transformation” 28). Therefore, understanding economic ideas takes a very significant stance as one can use it to create an approach to the source of ideas which further help to clarify agent’s interests.

Similarly to Blyth, Chwieroth views the power of economic idea of neoliberalism by looking into its effect on social spending which can be understood by investigating policy making group’s interpretations of economic conditions on which they base their policy response. Chwieroth states that policy decision-making processes often involve a certain belief, developed by groups of people who think that policy implications of this belief are legitimate and appropriate given a certain situation. Also, this belief can be exercised and maintained when the shared belief is consistent with policy decision-

making agents. Chwioroth confirms his theory by analyzing Ministers of Finance and the heads of central banks from fourteen Latin American countries during the years between 1972 and 1997. His choice of those two agent categories is deliberate, as they are exclusively involved in making decisions on social spending in Latin America (Chwioroth 35). He argues that neoliberalism as an idea which governments implemented was an alternative perspective to social spending at the time because the Rational Choice Theory adapted from the neoliberal view failed in other areas such as import-substitution industrialization, an economic system that generates over-expenditure in public sectors (Chwioroth 28). He further analyzes how the idea of neoliberalism gained consistent support from agents. His finding shows that coherent neoliberal policies were supported by Ministers of Finance among Latin American states who were linked and trained with the Chicago school of Economics, known as pro-neoliberal economists (Chwioroth 42). Creating coherent policy-making teams consisting of pro-neoliberal economists-meant that the capacity of these actors to conduct their belief (i.e., neoliberalism) was increased to pursue the reduction of social spending. Interestingly, pro-neoliberal economists were well praised by military dictators in Latin America saying that neoliberal policies were compatible with the nature of dictatorships in Latin America. Given the historical context of Latin America, Chwioroth argues that military dictators preferred the way neoliberal economists handle the social problem by finding a simple solution instead of going through endless debates (Chwioroth 43). This finding shows that neoliberal economic policies were also favored in un-democratic states, opposed to neoliberalism in the US which stressed individual freedom. Chwioroth further notes that the absence of counter-arguments to neoliberalism by virtue of a homogenous policymaking team played a significant role in the implementation of policies, given that the absence of opposing ideas

facilitated the separation of policies from society (Chwieroth 43). This eventually brought policy-makers to easily implement policies and persuade the government. Therefore, Chwieroth concludes that coherence in policy-making through like-minded decision-making groups is crucial to understand the policy implications of neoliberal practices. Based on Chwieroth's work, it becomes clear that it is worth understanding how neoliberal policies were adapted both in democratic and undemocratic nations and to consider its differing interpretations in their national contexts. It is again stressed by the author that understanding economic ideas based on its historical context is crucial to comprehend various practices of economic ideas.

Ha took a similarly constructivist approach to Chwieroth, analyzing the interpretation of neoliberal policies by policy-makers in Korea and how its implications shaped their interpretation (Ha 2). He states that influence of ideas become stronger when there is uncertainty because uncertainty hinders people to predict an upcoming future. Within uncertain environments, people try to make the best result by relying on mechanism which lead Ha and other constructivist IPE scholars to place importance on these ideas. The influence of ideas within policy-making processes became important as it decreased uncertainty of the future (Ha 4). Therefore, there is a higher chance that policy decision-making is grounded in ideas as it can provide the map to an uncertain situation. However, he further states that if the scholars only emphasize the diffusion or transfer of ideas, they will tend to focus only on aspects of transferring ideas into different context (Ha 7). This will lead to thoughts related to processes of implications of ideas as a passive process which will lead to the conclusion that transferring ideas leads to convergence policy implications in every country (Ha 7). However, Ha thinks that there

are a wide variety of implications for each country given two reasons: policy-makers often select or emphasize certain aspects of ideas such that the interpretation and implication of the thought process are intertwined with the country's history and structural context. In other words, South Korean policy-makers also exercise agency by selecting which ideas to act upon rather than being passive recipient of ideas. Therefore, Ha states "...the process of spread of policy idea follows *selective isomorphism*...due to the nation's historical and structural context"¹ (Ha 7). He states that the historical context of the adaptation of neoliberalism, interpretation of globalization and the financial crisis in Korea, lead policy-makers and Korea's structural tradition of policy to the implication of Korea's neoliberal public policy. Ha further stresses aspects of policy makers' educational backgrounds-specifically that they are graduates of American universities stating that the shared belief of a group could sustain the influence of neoliberal beliefs as Chwieroth argued. Ha emphasizes the great importance of history, given the fact that a distinctive form of Korea's neoliberal policy practices and its transition from Developmental statist to a neoliberal economy, which is different to the Western transition from being welfare states towards neoliberal economics (Ha 21). Due to the democratic transition from Statist economy, neoliberal practice of economic liberalization, such as deregulation of financial sectors-, became a major policy as it implies democratic practices. The Korea's idea of neoliberal practices is different from the Western idea of neoliberal transition, as the idea originated from the issue of overspending welfare state (Ha 21). Ha further argues that a broad structural reform based on the market from the Statist economy was inevitable to create social dislocation, as the

¹ Self-Translation

Statist economy did not equip a social security net as other neoliberal welfare states (Ha 21). Therefore, Ha concludes that this is the notable difference between the Korean and Japanese neoliberal feature with the Western neoliberal states (Ha 22). Ha's analysis of the interpretation and implication of ideas with a historical and structural context of a nation shows how policy implications can differ within the same contexts of ideas.

According to this collection of literature, economic ideas and beliefs are important factors in viewing world economics given its great influence on institutions and agent's decision-making. Blyth's "Great Transformation" stresses the role of economic ideas in how institutions are formed and how institutions' characteristics are changed due to economic ideas. I argue that Blyth's focus on economic ideas and how these can bring on institutional change will be a great analytical tool to reach possible explanations of how two different policy responses in two economic crises occurred in Korea. This is because accessing economic ideas as a starting point in analysis is an appropriate step in order to understand the outcome of public policies. The literatures examined collectively argued that economic ideas can dictate agents' behavior within institutions (Blyth "Great Transformation" 34; Ha 6). Furthermore, I also agree that analyzing economic ideas can reach the point of understanding what the source of ideas can say about the interest behind such ideas. Changing economic paradigms in Keynesian economics to supply-side neoliberal economics was initiated by corporate interest to refine a business-unfriendly environment according to Blyth's "Great Transformation". Further, I also think the interpretation of economic ideas in terms of its historical and structural conditions is important, as Chwioroth and Ha showed in their research. Especially Ha's argument of selective isomorphism and the variety of Neoliberalism from different historical and

structural contexts point to the need to focus on the political history of Korea when it comes to analyzing economic ideas of neoliberalism in specific historical context. Furthermore, while historical context is of importance, tracing how ideas matter could range from being diffuse to extremely specific. Chwieroth's selection of agents could further be a great possibility to narrow down agent analysis, giving the head of the state particular consideration and-given the political history of the Statist Economy of Korea (Ha 27). In combination, the role of economic ideas in interpreting the two crises and the shaping of responses has proven to be crucial when considering the constructivist approach to the IPE. In order to understand the origins and the impact of the two crises in Korea it is crucial to understand its historical and structural background. This way the political economy will contribute a better understanding to the interpretation of neoliberal ideas which results in outcomes important to public policies during economic crises.

3. Research Design

As discussed in the Literature review, a constructivist approach is the appropriate tool to understand the causal explanation of policy responses made during the financial crises of 1997 and 2008 in Korea. The paper will explicitly focus on the notion of economic ideas, neoliberalism on Asian Financial Crisis and pragmatism for Global Financial Crisis as the main driving forces of an agent's behavior to provoke institutional change. The agent in the paper is defined as a decision maker which is the president of Korea, because the structural context of the presidential-system guarantees strong authority to the president on his or her decision making process, and given the special history of a strong head of state by the Statism legacy (Suh and Kwon 680). Therefore, the paper will analyze two presidency terms that faced financial crises, Kim Young Sam (hereafter KYS) and Lee Myung Bak (hereafter LMB), with their economic ideas of neoliberalism and pragmatism that were influenced by IPE and Korean Political Economy. Therefore, history of Korean political economy and global political economy will be the core of the paper's analysis.

4. Chapter 1:

Neoliberalism and the Asian Financial Crisis

Scholars indicate that the causes behind the financial crisis in 1997 consist of short-term debt accumulated by conglomerates due to excessive overseas overinvestment, weak financial institutions and the government's inability to ease it. In order to understand the causes of how policy choices implemented up to 1997 led to a crisis we must therefore examine the historical context before the crisis towards the end of understanding how rational economic ideas were being reasoned. Interestingly, the mismanagement of financial sectors, insufficient regulation on the international financial market and accumulated short-term debt of the conglomerates were strongly linked to core tenets of neoliberalism, economic liberalization and globalization. To trace the ways in which ideas about the market, the economy, and regulation changed, and how Korean actors actively engaged rather than passively received ideas, this chapter examines the role of KYS government, and how Korean agents acted and responded to altering international and external historical context.

4.1 The Emergence of the Multilateral Neoliberal World Order

The historical background of the world political economy has a real impact on economic ideas of the Korean government. As Blyth underscores, it is impossible to omit considerations of the influence of the real world, such as international politics and domestic politics as states do not exist in a vacuum (Blyth “Structures Do Not Come with an Instruction Sheet” 695). In the case of the Korean economy, the international community had pressured the Global South, including Korea, to join the neoliberal trend of establishing an open market economy (Ha 10). Therefore, the historical context of the global political economy acts as a significant factor in shaping the economic idea of neoliberalism during the KYS administration which led through the crisis. Internationally, at the beginning of the KYS administration there was a changing new world order. The decline of the Soviet Union and the Communist economic model demonstrated its lack of competitiveness in the world economy, leading to the perceived triumph of the Western capitalist market economy (Kwon Seo and Heo 8). Towards the end of the Cold War, a structural change within the global political economy occurred. It dismantled the mechanism of limiting trade between the Western and the Communist bloc. The dissolution of the Committee for multilateral Export Control (CoCom) led to a more reflective world trade system at the beginning of the multipolar world which brought about new norms within international trade (Park 357). Combined with active global trade, the end of the Cold War meant a new political order of multilateralism. The World Trade Organization (WTO) was introduced after the end of the Cold War, framing the world economy as ‘multilateralism’, thereby establishing the multilateral trade mechanism to

promote trade liberalization (Park 357). The WTO triggered local corporations to participate in international business and commerce and quickly increased the volume of international trade. Major corporations in the West renovated their business model from targeting local incentive base markets towards more neoliberal markets, minimizing the state's intervention on enterprise (Woll 146). Most importantly, the emergence of multilateral world economy was guided by the US' leadership of the neoliberal market economy, the economic paradigm adopted in the 1970s after the fall of the Bretton Woods System (H.Jang 18). Following the culmination of the Cold War, the economic system of neoliberalism, led by the US, emerged as the dominant global economic paradigm, with its focus on free markets and minimal state intervention providing a diametric alternative to communism. The end of communism brought about the heyday of the neoliberal economics, with its influence peaking during the early 1990s (H.Jang 18). Neoliberal hegemonic trends allowed easier access to overseas capital and international financial markets as they pressured the Global South and countries such as Korea to join the trend (Ha 10). During the mid-1990s newly industrialized countries in Asia grew rapidly, rebalancing the global economy (Golub 1001). Rapid growth of these emerging economies made them a more attractive target for international investors as high risk offered high profit. In sum, it is apparent that the world political economy during the early 1990s was driven by the interconnected ideas of 'neoliberalism' 'globalization' and 'multilateralism'. Multilateralism drove national companies to become multilateral corporates through global trade and liberalizing the financial market system. The trend of the global political economy was to liberalize national market towards being more international, giving them more freedom by allowing them to operate their businesses worldwide. By this, theories of State-led development declined significantly, and the

power and influence of corporates' increased. This is considered to be the main change that occurred within the global economy during the KYS era.

4.2 The Kim Young Sam Government and Neoliberalism

Although the rise of the neoliberal order required the Korean economy to allow market access to convert itself into a neoliberal market economy, the pressure of the world political economy wasn't the only driving force behind Korea's neoliberal transition. I argue that the president's philosophy in the early 1990s corresponded with neoliberal ideas as the president considered the existing economic system to clash with his personal political philosophy.

In November 1993, Korea finally overthrew its military dictatorship. KYS was the first Korean civilian president, with his presidency becoming a symbol of success and democratic transition in Korea (Heo, Jeon, Kim and Kim 12). The president, a political figure that fought against the military dictatorship, was praised to have created the new chapter of Korean political history. He appealed as being different to former leaders and dictators given his democratic values (H.J.Kwon 34). Because of this difference, KYS' objective during his presidency was to differentiate himself from the previous leaders. Therefore, he devised a plan for the establishment of a neoliberal Korean economy in line with trends in the global economy.

How did KYS arrive at the idea of developing neoliberal economic policies? In order to understand his decision to develop a neoliberal market economy, it is necessary

to analyze the rhetoric of his inaugural speech. During his inaugural speech, he expressed his plan for a *New Korea*, a Korea with a matured democratic society (“The Republic of Korea Cheong Wa Dae”). He acknowledges a need for change because New Korea was in danger due to the emerging threat of war,

*“ ...I dream about a New Korea, a New Korea that has a matured democratic society...but the environment that we are surrounded by is not pleasing for us, the end of the Cold War means our enemies and allies are changing. We are entering a new economy and a technology war. If we do not prepare, we will not be able to step inside the age of developed nations. If we do not reform, we will fall behind, this is a matter of our survival... we need to prepare our strength to run for the New Korea...”*² (“The Republic of Korea Cheong Wa Dae”).

In this speech, KYS is explicitly stating that the Cold War’s end brings about a new era for wars which threaten the *New Korea*. He specified that the new world order and the Cold War’s culmination brings with it a new economic and technological war in line with the major status quo economy of the world. Reflecting on this era, multilateralism and neoliberal globalization were the major trends of the global political economy. However, he saw the change of world politics and world political economy as a threat as well as an opportunity. According to his inaugural speech, he sees an opportunity in becoming a developed nation (“The Republic of Korea Cheong Wa Dae”). His notion of a developed nation implies the emergence of his *New Korea*; a country that

² Self-Translation

respects individuals' lives, a society with justice, community with prosperity, a nation that at the center of the world and a mature democratic society ("The Republic of Korea Cheong Wa Dae"). He considered becoming a developed nation an unavoidable fate because the failure of becoming a *developed nation* would imply a crisis of ethnic survival (Kwon, Seo and Heo 9). Becoming a developed nation in the changing world political economy, therefore, was a mission to the president in order to create a New Korea which he so desperately wants to create.

Following this event, KYS proposes three strategic plans for the reformation of Korea in order to realize his *New Korea*. His three points included; reformation on corruption, the economy and education, I argue that the second point deserves a thorough re-visit in order to understand his economic ideas, which guided the economic policies of his administration. KYS stated,

*"...We need to restore our economic strength. For this the government assures freedom and competitiveness instead of regulation and protection. An individual's creativity will be respected. The government will tighten our belt first...companies need to win the global competition of technological innovation, government, people and the companies can boost our economy by working hard, this is the new economy that I advocate"*³ ("The Republic of Korea Cheong Wa Dae").

The reasoning behind his second reformation outlines a direct blueprint for the

³ Self-Translation

Korean economy over the next five years. He proposed neoliberal economic projects, transforming Korea into a more competitive and Western-like state. KYS was afraid of the new economy and a technological war that would harm the Korean economy; the solution that he proposed was to join the war by engaging in the free-market system, contrary to economic systems of past regimes.

I argue that KYS' choice to follow a neoliberal market economic strategy for his *New Korea* emerged from dissatisfaction from previous Developmental-Statist regime. KYS' message of *New Korea* refers to an imminent institutional change for further development. The previous economic model operated under dictatorial regimes clashed with the democratic society which KYS valued during his political career. For the 30 years preceding KYS, Korea was a Developmental Statist economy which stressed a quick and fast-developing export-driven economy whilst exploiting labor to maximize profit (Thurbon and Weiss 639). The Statist economy is an economic model centered around the state instead of the market where state allocates resources, invests and distributes. Therefore, means of production such as labor, resources and economic institutions such as enterprises and banks were largely controlled by the state (Minns 1026). Under the auspice of the state, the free market was rejected as a method of achieving economic growth. The Developmental Statist economy was highly planned and collaborating companies were hand-picked by the state, resources were chosen and allocated by the state and banks were under the state's control. The State-Corporate-Bank triple nexus was a feature of the Korean Developmental statist model which controlled bank and corporate activity (Heo, Jeon, Kim and Kim 7). Due to this system, the state guided economic growth. Because of the immense power the state had in Korea,

individuals such as members of the workforce and civil society were hugely oppressed (Thurbon and Weiss 646). Under this Developmental-Statist model, the individual freedoms of the labor force were a secondary concern behind the state's profit-making. As KYS was a politician who resisted against military regime and its practices, labor oppression as part of the Developmental Statist economy could not be tolerated. As he expressed during his inaugural speech, undemocratic elements such as the nature of the Developmental Statist economy could not co-exist with his democratic values, which were praised and supported by the public ("The Republic of Korea Cheong Wa Dae"). Therefore, the economic system had to be replaced with something that is societally sustainable and provides economic growth.

As an alternative, Neoliberalism was seen as an ideal replacement to the Statist economy system whilst satisfying democratic values. The Neoliberal open market economy brought about a market that was not artificially created, and which opposed Statist economics which artificially blocked fair competition by selecting only the elite as beneficiaries of economic growth. A lack of a competitive economy naturally created issues of transparency which generally oppose democratic values. The corruption going on during the Statist economy favored certain groups, the Chaebols (Korean term refers to conglomerates) is an example of economic activities being excessively supported by the state. KYS' first reformation point of combatting corruption identified corruption as a legacy from the Statist system, which is anti-democratic ("The Republic of Korea Cheong Wa Dae"). A fair market economy, on the other hand brings pro-democratic values as it stresses economic liberalization which allows for the fair competition of individuals (Ha 24). The free and competitive environment resulting from the open

market economy naturally linked to democratic ideals which the Korean public pursued, alongside the pursuit of individual freedom.

A Neoliberal economy therefore became a new form of thinking that provided a new motto for the Korean economy by problematizing the undemocratic status-quo system of the Developmental Statist economy. This idea further gained legitimacy from the public as individuals preferred liberal ideas constructed by history of oppressive civil society from the Developmental Statist regime. Therefore, the neoliberal idea became a way of attacking old institutions and rules established under the Statist model. Overall, KYS' democratic philosophy framed the Statist economy as a problem for Korean socio-economics. Eventually, the Neoliberal idea started to erode previous economic ideologies and transforming their associated institutions.

4.3 Deregulation and Institutional Change

The KYS administration proposed a new economic plan aimed at facilitating the market through encouraging private sector participation. However, KYS focused mainly on deregulation (Park 358; Suh and Kwon 682), especially towards market activity of corporates and the financial sector. Further, KYS clarified the necessity of institutional change in the Saegyehwa discourse.

The reason why deregulation was the main theme of the Korean neoliberal transition is because this is closely related to the problem of excessive state control and regulation in the Statist economy (Ha 7). Unlike the Anglo-American neoliberal model

which stressed privatization resulting from its criticism of the welfare state, Korea's neoliberal transition stressed deregulation and economic liberalization resulting from its problems with a Developmental Statist economy's articulating market (Ha 7). As KYS defined corruption as a legacy of the Statist' model, the triple nexus between the state, corporates and banks was seen as a major problem from the previous economic system that created corruption and an undemocratic society (Suh and Kwon 682; Park 357). By problematizing state-managed markets and corruption arguing its inefficiency and that it is a poor strategy for survival in world politics, KYS vigorously reformed the Triple Nexus through the New Economy Plan mechanism, disrupting relations between the State, corporates and financial institutions. For instance, the state loosened regulation on corporate and financial sectors, which were hugely dependent on state commands during the Developmental Statist regime. Corporate regulation, such as restrictions on imports and exports, corporate investment, entrepreneurial activities, factory construction, trade regulation with the former communist bloc as well as regulation on real estate was eased significantly (Park 359). Concerning the financial sector, modifying fixed rates, reforming loan-management, a short-term financial market and liberalized currency exchange was introduced (Park 361). However, I argue that the theme of the New Economy Plan, economic liberalization through deregulation, was deeply related to corporate and bureaucratic interests, leading KYS to emphasize deregulation in the market economy.

a. Chaebols and Deregulation

Chaebols, the Korean word for Conglomerates, were a selected group of individuals who ran corporates through state incentives. Chaebols were a key instrument

through which the state boosted economic growth under the export-oriented Developmental Statist economy (Heo, Jeon ,Kim and Kim 6). During the Developmental Statist regime, the private sector in the Korean economy was highly dependent on the states' demands and commands. Due to the un-liberal economic environment, Chaebols could grow their wealth through state incentives, and subsidies such as policy loans made Chaebols competitive in the global market. A distinctive feature of the Chaebol system was that the system took high-risks managed by the state (Jung 51; Suh and Kwon 682). The Chaebol system was a debt-based rapid expansion system which allowed for rapid growth while accumulating debt. This debt was also taken care of by the state. Therefore, Chaebols were able to focus on innovation and growing institutions and were unbothered by the ever-growing debt which the government handled. Therefore, Chaebols opposed the neoliberal economic policy which was discussed during the 1980s, as they benefitted from the state's exclusive subsidies and support (Ha 10). However, the changing global political economy which stressed multilateral businesses triggered Chaebols to go *global* by abandoning old ways of profitmaking. Because globalization represented a chance to increase revenues through exploiting oversea resources, Chaebols saw this as an opportunity to change themselves (Jung 50). Through the benevolence of the state's subsidies and incentives, corporations grew strong enough to compete with international corporations. Resultantly, Chaebols aimed to gain independence from state control in order to increase profits. To achieve this, prioritizing the market economy was a priority for their environment through the use of a deregulation policy (Ha 2006). KYS' ambition to create a democratic society was aligned with their interest, Chaebols could gain financial liberalization (Jung 50). Unsurprisingly, financial deregulation by the KYS government was dependent on Chaebols' interest (Jung 50). For instance, KYS eased the

restriction of foreign borrowing, providing unrestricted access to the global financial markets, leading to the borrowing of international assets and overseas investments (Jung 50). The top-down relationship between the state and corporations eased through the states' minimal intervention in corporate activities. However, the affinity between the state and corporates deviated little from that observed under the Statist regime. KYS acted in favor of Chaebol's interest by allowing access to the international market and can be seen as another form of the state's benevolence towards corporations. The Ministry of Finance during the KYS era helped corporates to gain assets by allowing short-term capital market such as corporates bond market for Chaebol's interest (Weiss 31). Overall, deregulation, which is a neoliberal idea, supports corporate interests, leading the KYS' administration to inadvertently grant Chaebols tremendous freedom and allowing them to grow their businesses. Because Chaebols wanted access to international capital as the world economy shaped towards neoliberal free markets, deregulation emerged as a main tool of Korean neoliberalism (Ha 10). Furthermore, stressing the importance of deregulation to facilitate a neoliberal market economy was not only encouraged by the Chaebol, but also liberal bureaucrats emphasizing the market economy as a tool for reform.

b. Liberal Bureaucrats and Deregulation

The influence of like-minded bureaucrats in pushing economic liberalization as part of a new economic agenda could not be ignored when deregulation became a major policy in the KYS era. Ha argues that bureaucrats in late 1980s considered the Statist regime as inefficient, citing over-investments and the building of too much infrastructure (Ha 10). Bureaucrats thought that state-centric investment and a lot of infrastructure in

combination with inefficient financial assets created economic stagnation in the developing Statist economy. Therefore, bureaucrats were convinced the Statist economy created inefficiencies through excessive intervention in the Korean market (Ha 11). The lowering growth of the Developmental Statist strategy gave rise to the idea that limiting a self-regulating market was no longer an effective means to generate national profit. Based on the changing global political economy, bureaucrats wanted to separate relations between the state and Chaebols in order to activate the market, hence solving the problem of over-investment and excess infrastructure caused by the Statist regime. Also, the identification of the Developmental strategy of state-centric businesses and the incentive policy identifying corporates as a problem was not just by its relatively low growth of Developmental state but also rigorously supported by new bureaucrats. Unlike under the military regime, US-trained economists were recruited significantly in the late 1980s and early 1990s and liberal economists trained in the US developed great influence over the Korean economy (Weiss 28; Jung 49). This represented a significant change for bureaucrats given that during the Statist Regime, the majority of them were Japan-taught technocrats (Weiss 28). The neoliberal market economy was considered to be a solution to Korea's problems, a theory common amongst US-taught liberal bureaucrats. KYS accepted many of the economic policies suggested by the liberal bureaucrats as they appeared to align with his political objective, the KYS government later established a government-funded think-tank to clarify the benefits of a market economy and liberal economic policies, supported by liberal economists (Weiss 35). The establishment of this liberal, government-funded think-tank showed how liberal economics began to flourish and began to shape the Korean economy, supported by like-minded liberal bureaucrats. Therefore, the preference amongst bureaucrats towards neoliberal economics was another

crucial driver in bringing about deregulation under KYS' New Economic Plan.

c. The Saegye-hwa Discourse

In combination with the mentioned economic reforms supported by Chaebols and liberal bureaucrats, the Saegye-hwa discourse was a major driving force in legitimizing Korea's institutional shift towards neoliberalism. Saegye-hwa means 'globalization' in Korean, officially discussed by KYS when he was visiting Sydney in November 1994. The meaning behind Saegye-hwa is that in order to achieve progress within Korea (a New Korea) and to be assimilated into the new world economic order, Korea needs to conform to certain global standards through reforming traditional customs and institutions (Ha 11). Therefore, KYS created the technical body of the Saegye-hwa Committee in December 1994, to effectively assist the deregulation of institutions. Therefore, the Saegye-hwa was a KYS' project, framing the introduction of neoliberal institutionalism as a necessity in achieving a New Korea. Therefore, the discourse functioned to lend legitimacy of the idea of neoliberalism as a hegemonic discourse amongst the public. In this regard, the Saegye-hwa discourse further facilitated the rapid reformation of financial sectors and deregulatory change (H,Jang 14). Saegye-hwa discourse aimed to change of people's mindset ("MBC News Desk"). Therefore, Saegye-hwa discourse was the direct force influencing institutional change amongst Korean civilians.

However, many scholars and researchers claimed that Saegye-hwa discourse was introduced as a tool to facilitate the registration to the Organization for Economic Co-operation and Development (OECD). ("MBC News Desk"; Ha 21; H.Jang 2; Heo, Jeon,

Kim and Kim 15; Park 354). Although deregulatory policies were introduced, KYS thought it necessary to further speed up the opening of the economy. Therefore, through globalization discourse, KYS could rigorously force reform towards a neoliberal economy, another requirement for OECD membership. Therefore, the deregulation policy was further reinforced by the Saegye-hwa (H.Jang 25; Park 373). Saegye-hwa Committee reinforced liberalization of restricted area for foreign investment and financial market to the foreign investors (Heo, Jeon, Kim and Kim 15). Moreover, it is apparent that Saegye-hwa movement was very state-centric approach that aims to gain special interest. This is because a major aim of the Saegye-hwa project was acceptance as an OECD member, meaning rapid financial liberalization and a labor reform was forced upon people by the state. To reform the economy in line with global standards, the Saegye-hwa project was dominantly run by the president and the bureaucrats from the ruling party. Cooperation between the government and civil society or other political parties were lacking (H.Jang 20). Voices opposing the Saegye-hwa project, including economists' citing the danger of globalization without prevention mechanism, were ignored (H.Jang 25). Therefore, the Saegye-hwa project operated as a top-down method, as such, it is arguable that Korea's neoliberal transition can be seen as another state-centric Developmental strategy.

In sum, institutional change towards neoliberalism was enacted through deregulation policies supported by conglomerates and liberal bureaucrats, resulting in a minimal state intervention on the market and widespread deregulation. This meant the State-Conglomerates-Bank triple nexus was significantly eroded, however that did not mean relations between the state and the conglomerates were cut off; rather, the top-down

power relations of the state towards conglomerates weakened in the market economy while the nexus continued in the market. Relations between the state and corporates remained similar to the Developmental Statist regime but with different objectives, namely - facilitating a liberal market. Using this method, Chaebols could invest in overseas capital for profit, causing them to accumulate short-term debt which led to the financial crisis in 1997. Therefore, the deregulatory policies and new neoliberal institution became a status quo, functioning as the dominant economic idea until the Asian Financial Crisis hit the economy.

4.4 The Asian Financial Crisis and Korea's Response

The emergence of the financial crisis was not surprising given the Korean economic situation brought about under KYS' administration. In 1997, Chaebol's average accumulated debt reached over 400% to their debt-to-equity ratio, meaning conglomerates' accumulated short-term debt 400% higher than the value of their companies(Cho 12). Chaebols, using the international financial market, could easily access international lenders and investors to gain assets and re-invest these in manufacturing sectors (Jung 51). Also, due to open financial system, it became far easier for Chaebols to invest in overseas markets with money borrowed from overseas. In sum, accumulated short-term debt quickly increased due to lack of regulations from financial institutions due to minimal state intervention on the market - a key policy of the KYS administration. As a result, the Korean economy in 1997 was highly vulnerable to upcoming external shocks.

However, the domestic condition of the crisis was not the only culprit of the financial crisis in 1997. As analyzed earlier, the worldview also played a huge role in creating the conditions for the Korean financial crisis. Therefore, I would like to momentarily broaden the scale of this analysis from the domestic to the global level. The financial crisis in the Korean economy was a spill-over economic crisis originating from the 1997 Asian Financial Crisis which hit late-developing Asian countries. The preconditions to the Asian crisis lie in the highly open market economy's popular at the time. The Neoliberal financial market of deregulated financial systems led investors to go overseas to search for high-yielding profits in emerging economies, often found in Asian late developers, including Korea. In other words, emerging markets were accessible in deregulated international financial sectors of emerging economies such as Korea. As discussed previously, the international community pressured developing countries including Korea to open their financial sectors. Asian countries including Korea could quickly accumulate capital by opening financial markets. However, Korea's problem was that investments of the Chaebols exceeded their capacity.

The Asian Financial Crisis first happened in Thailand and as a result the currency was hugely devalued (Krugman 88) Although there are many different structural and political aspects of why the currency devalued, I would not discuss this matter in this paper as is not about the Baht currency crisis. Devalued Baht currency shocked international investors, leading to the loss of confidence in the Thai economy, leading investors to take back assets stored in the Thai economy (Krugman 89). The plunging Baht and the fear of the Thai economy collapsing created a bubble of speculative Thai economies to burst, leading to fear of spill-over within Asian late developer countries.

Krugman illustrates that when there is a loss in confidence, it creates a vicious cycle which leads to plunging currencies and the slumping of the economy, in turn, causing financial problems for companies, banks and households (Krugman 90). Therefore, the idea that losing confidence creates an economic crisis that justifies the loss of confidence (Krugman 110). This happened in many of Asian developing countries including Korea.

Hong Kong's market crashed on October 23rd 1997 marking the beginning of the financial crisis for the Korean economy. The start of the crash of Asian's biggest stock market and the collapse of Kia corporation with Hong Kong's stock market crash led international investor's losing confidence in the Korean economy. This situation quickly instigated the large-scale outflow of capital from the Korean economy (i.e., foreign liquidity shock) and led to the currency being strikingly devalued. The Dollar/Korean Won (USD/KRW) exchange rate was USD 1: KRW808.1 in 1993, and it devalued until USD 1: KRW 2,000 during the crisis (Moon and Rhyu 448). KYS' government tried to stop this outflow by dumping foreign reserves (Cho 11). The aim of using foreign reserves was to cease the foreign liquidity shock, but it triggered the devaluation of the currency, as the crisis stimulated loss of confidence in the Korean economy. Striking devaluation of the currency led to greater short-term debt borrowed from international investors. Therefore, the Korean economy lost both accumulated foreign reserves for 30 years through the Developmental Statist economy as well as foreign investment through speculative financial markets in very short term. The crisis led to the Korean economy generating tremendous debts instead. Therefore, the currency crisis created a banking crisis that led the Korean economy officially requesting a bailout from the IMF on 3rd of December 1997, the lender's last resort.

In fact, I argue that the debt was such a profound problem for the Korean economy in general. During the Developmental statist economy, debt-based growth of Chaebols was the norm for economic growth. The average debt-equity ratio was 300 percent of all industries in 1972 (Suh and Kwon 683). Growing debt for growth is what conglomerates considered to be a normal economic strategy. However, the caretaker of the debt, the state, was no longer existent due to its commitment to minimal intervention in the market economy. The state continued to assist conglomerates but in a different manner to the previous regime, whilst the conglomerates' debt-growth based strategy remained same as in the previous Statist regime. The decision makers including the bureaucrats and KYS were insufficiently informed about the danger of neoliberal market economics as they were ill-prepared for the crisis. (H.Jang 25). The trust of neoliberal globalized economy enabled the Korean economy to embrace the crisis without having developed any preventive mechanism.

4.5 Consequence of the Neoliberal Korean Economy

The consequences of the financial crisis driven by an immature neoliberal economic structure was immense. The crisis hit the Korean economy and the government faced imminent sovereign bankruptcy. The annual GDP growth dropped to -5.4% in 1998, compared to the annual growth of 8% since 1980 ("IMF World Economic Outlook"). Within the time of the crisis the interest of others became evident; at the end of November, which was the last month for the KYS administration, the Korean government asked neighboring country Japan for emergency bailout. However, the Japanese government

could not help the Korean economy for this dangerous period. In early 1990s, Japan was planning to establish an Asian Monetary Fund, an autonomous regional financial institution to combat the regional liquidity crisis (Golub 1007). However, it was denied by the US treasury to build such an autonomous mechanism as it could be the threat of the influence of the IMF in the region (Golub 1007). As the Japanese government could not bailout the Korean economy bilaterally, the Korean government had to call upon their last resort, the IMF, as it could not sustain the economy without help of international community by foreign reserve drain. Finally, the IMF offered Korea a loan of USD 58 billion, the largest bailout for an East Asian country with the condition of taking fiscal austerity measures and reforming economic sectors further towards neoliberalism (Rodier 110). The reformation on corporations, labor, trade and the imposition of fiscal austerity measures took place under the auspices of the IMF advisory board to restore the confidence of the market economy, however, it completely failed to restore market stability (Takagi 17). Although the situation started to get better after 1999 as the GDP began to increase, the crisis continuously and severely impacted the majority of Korean household to continuous restructuring and lay-offs on a national scale. The KYS' economic liberalization project for *New Korea* resulted in the collapse of the Asian miracle economy created over 30 years by the Developmental statist regime.

4.6 Chapter Summary

Chapter 1 outlined the lead up to the 1997 financial crisis by looking into the historical and structural context of the Korean economy within the world political economy. Economic ideas of neoliberalism were supported by the global political economy, the Korean civilian president, conglomerates and liberal bureaucrats as the main sources for changing the institution. Deregulation as a theme for reformation was chosen as the interests of conglomerate and liberal bureaucrats played a unique role, as they thought restriction of market economy needs to be solved although it was then reinforced by the Saegyehwa discourse supported by KYS. Due to economic liberalization, conglomerates could access international financial markets to widen their business scope, and financial institutions loosened the regulation on activities. Because the neoliberal global economy was expanding, KYS developed a strategy to establish a *New Korea*, a developed nation with a mature democratic society. When the Asian crisis hit the Korean economy in 1997 however, the Korean economy collapsed because the state could no longer secure accumulated debt of conglomerates as it did under the Developmental Statist regime. This, in turn, was due to weak financial regulations by neoliberal projects of the minimalized state's control preventing an external shock. Due to the weak reputation of their emerging economy compared to the Global North, the economic crisis stimulated fear in international investors that quickly led to a foreign liquidity shock, leading to the devaluation of currency, and shrinking bank assets in private sectors causing deterioration of bank's capital bases (Cho 12). The Korean economy faced the severest national crisis since the Korean War, exacerbated by the IMF's austerity measures, conditions of the bailout. In sum, chapter 1 concludes that a

high level of trust and optimism in the economic idea of neoliberalism built up within the Korean economy, making it susceptible to a neoliberal shock and eventually led to the danger of national bankruptcy.

5. Chapter 2:

Pragmatism and the Global Financial Crisis

The Global Financial Crisis of 2008 did not affect the Korean economy as much as the Asian crisis in 1997 did. This is a surprising consequence as scholars and analysts predicted the Global Financial Crisis would affect the Korean economy more negatively than the Asian Financial crisis did, given the scale of the crisis and the domestic conditions of the Korean economy. Nevertheless, Korea quickly recovered from the Global Financial Crisis compared to the Asian crisis. The recovery from the Global Financial Crisis is marked as a *textbook recovery* from the IMF and other international organizations (Korea Development Institute 3). Based on the literature, the expansionary fiscal and monetary policy responses and the currency swap with the US were the reasons for this quick recovery (Korea Development Institute 3; S.Y.Kim 18-20). I argue that the Korean government's decision on expansionary fiscal and monetary was highly due to the economic idea of pragmatism and distrust in neoliberalism. Furthermore, the recovery could have been quicker given the bilateral assistance from the US, which did not exist during the 1997 crisis. In order to understand the full picture, the chapter examines both the internal and the external historical background of the Lee Myung Bak (from here on referred to as LMB) government which navigated through the global financial crisis.

5.1 The Decline of the Neoliberal World Order and the Global North

The historical background of the global political economy greatly affects the Korean economy and simultaneously shapes hegemonic economic ideas within Korea. I argue that at the beginning of the LMB administration, the world economy was very different to that of the late 1990s. In the beginning of 2008, the global political economy became more diverse and complex through economic globalization, creating an inevitable economic interdependence between the Global North and the Global South. Interestingly, the position of economies in the Global North and the Global South differed. Notably, the influence of the Global North has dramatically shrank compared to one decade ago. Firstly, emerging economies became more powerful in shaping the world economy (Chey 5). For instance, the rising influence of groups such as BRICS (Brazil, Russia, India, China and South Africa) and the Group of Twenty (G20) illustrates that the fate of the world economy is no longer handled by the Group of Seven (G7); comprised solely of economies in the Global North. The possibility for growing the influence of the Global South was reinforced by the multilateral and neoliberal order, having started to spread in the late 1980s to early 1990s. Capital investment overseas and multilateral trade empowered of growth of trade and business activities in the Global South as they could provide cheap means of productions. Through the multilateral order, the Global South could attract vast amounts of international investment, leading to the redistribution of capital towards the Global South. On the other hand, the Global North suffered from a growing credit crisis escalated majorly by the falling of the US dollar and other major currencies as well as the housing crisis. In 2007, the subprime mortgage crisis erupted in the US, impacting many other countries including countries throughout the Global North.

The projection of growth for 2008 by international organizations were pessimistic because the developed world's credit crisis brought with it a crisis of confidence which instigated a decline of consumption (United Nations 3). Weaker demand impacted the real GDP growth of the Global North, leading the overall decline of international trade. Declining confidence in the western neoliberal market economy amongst the developed world was a sign that the neoliberal economic paradigm was at stake. The struggling West also questioned the hegemonic power of the US, as the neoliberal economy is no longer working for them. Therefore, crisis in the Global North and the rise of Global South shaped the idea that neoliberalism, which prevailed for three decades, is no longer the hegemonic economic idea of the world economy.

5.2 The Lee Myung Bak Government and Pragmatism

Against the backdrop of a global economy in crisis in the Global North and the declining hegemony of neoliberalism in the world economy, LMB's administration was inaugurated in February 2008. Unlike KYS, whose background was being a democratic politician who spent his life fighting for democracy against the dictatorships, LMB was the chief executive officer (CEO) of Hyundai Construction during the Developmental Statist regime. Because of LMB's background, public trust in LMB's economic credentials was immense, given the fact that the president was the former CEO of one of the biggest conglomerates in Korea (Choe 93). According to analysis, it became apparent that the economic idea that LMB had was different from the neoliberalism that KYS and his government had followed. LMB's economic idea, is rather be seen as pragmatism. How did LMB come up with pragmatism as an economic idea to execute the economic

policies?

To understand his idea of pragmatism, it is necessary to observe his inaugural speech which introduced a blueprint of his political objectives, focusing exclusively on economic growth. LMB's administration was inaugurated in February 2008. In his inaugural speech, LMB, as KYS, expressed his plan to create *Advanced Korea*. He called 2008 the year of advancement, similarly claimed by KYS a decade ago. Both presidents, shared the political objective of establishing Korea as a developed nation. However, it is important to see that LMB's way of achieving a 'developed nation' is less ideology-focused compared to KYS'. Instead, LMB stressed *pragmatism* over *ideology* as a method to becoming an advanced country, stating that ...

“...Our last 10 years, we fell down and hesitated but we will start again along with those failures which are our asset. We have to go beyond the ‘age of ideology’, move on towards the ‘age of pragmatism’. The mindset of pragmatism is a rational principle that penetrates the history of the East and the West, and it is the practical wisdom that is useful to get through the waves of globalization...” (“Hankyoreh”)

He chose advancement of the Korean nation as a political objective of his administration and he picked the idea of pragmatism as the motto to achieve his political objectives. I argue that there are two reasons for picking up pragmatism as an economic motto for his political objective of advancement of the nation. Firstly, the competition between the economic ideologies in the global political economy became much weaker, as the world became highly informative based, negating the importance of ideological

debates (Kwon Seo and Heo 45). The era of multi-polar politics and multilateralism weakened the ideological preferences, as well as innovation and technology run as a driving motto for the state to achieve its political and economic goals. In the Korean context, economic ideology was a driving force behind previous conservative regimes including the KYS administration. The trust in the economic ideology often led governments to be reluctant to react to changing domestic and international environments. For instance, Statism was an economic idea of the military dictatorship era, causing inefficiencies and over-investments. These continued to prevail when the new economic idea of neoliberalism emerged. Also, the Korean economy could not deter the Asian Financial Crisis due to blind trust in the neoliberal economy. According to the Korean political economy, an economic ideology as a basis for economic policy has resulted in unpleasant consequences throughout Korea's political economic history. Therefore, one could argue that LMB perceived governance based on a certain economic ideology as problematic, as an economy that is highly attached to an ideology is less responsive to changes in the fast-changing global economy (Kwon Seo and Heo 47). Secondly, LMB's persona could be another reason for choosing pragmatism as a driving economic idea. J.Kim defined LMB's leadership style as 'minus' (meaning rational, critical and introverted), administrative, task-centered, and his policy style is propulsion (J.Kim 119). Based on his achievements during his previous career, J.Kim argues that LMB is best described as very pushy and highly profit-driven. When in the corporate sector, LMB's nickname was Bull-dozer, given his ability to push for profit (Choe 98). Similarly, he was highly supported by citizens during his time as the mayor of the capital city Seoul because he transformed public transportation very efficiently and turned the Cheonggye River into a profitable tourist attraction (Choe 100). Due to LMB's achievements being highly

related to his outcomes, pragmatism could be also driven from his persona.

5.3 Understanding Pragmatism and Institutional Change

Then how can we understand how LMB's economic idea of pragmatism influenced institutional change? In order to analyze it, it is necessary to understand the definition of Pragmatism from LMB's perspective. According to the rhetoric of LMB in his inaugural speech, pragmatism directly refers as an idea or method to achieve national interest, to achieve advancement of Korea (Kwon Seo and Heo :46). In his inaugural speech, LMB stressed that a strong, rich and warm society is necessary conditions for the advancement of the Korean nation, and that he sees the strong market economy as a solution for achieving strong, rich and warm society. (Kwon Seo and Heo 43). To have the strong market economy, he emphasized a business and corporate-friendly environment through the deregulatory policy measures to achieve the economic growth. LMB proposed the idea of *minimal government and a big market* which is the pragmatic way to boost the active market economy for economic growth (Kwon Seo and Heo 48). Therefore, LMB declared the deregulation of existing regulations as a major institutional change (O.Kwon 211). I argue that the revival of deregulatory policy measures originates from LMB's political campaign of 7.4.7. I.Kim states that LMB's prioritization of deregulatory measures for creating minimal government is due to the fact that LMB thought the Chaebol's were necessary to boost the economy in his 7.4.7 campaign (I.Kim 82). LMB realized that the help of conglomerates was urgently needed to achieve his campaign, given the Chaebol-based economy structure. As Korean economy is heavily dependent on Chaebol's export economy, it is crucial for LMB to achieve better relations with the

Corporate sector in order to reach his political campaign. At that time, the Chaebol were dissatisfied with previous regulatory governance, which I would argue that the Chaebol's interest also reflects the LMB's deregulation policy schemes.

a. Chaebol's Demand

It is impossible to disregard the Chaebol's influence in the Korean political economy. This is mainly because the Korean economy is highly dependent on the Chaebol's export business, initially constructed under the Developmental statist regime. Deregulatory mechanisms, combined with tax exemption favoring conglomerate business activities, was opposed by the previous government of LMB, Roh Moo Hyun's government. President Roh Moo Hyun (Hereafter RMH) was focused on reforming Chaebol's custom of fraud and injustice by applying various policies, including enhancing transparency of financial institutions with regulatory mechanism, by accepting the global standard and by reconstructing the economic system to make it less dependent on Chaebols (J.Jang 49). Further, bureaucrats of RMH's administration prioritized the issue of national security and social development rather than economic development that requires Chaebol's economic power (J.Jang 52). This triggered Chaebols to come up with new defensive ideas against the inconvenient environment for Chaebol's business, created by RMH's administration. By using corporate-funded think tanks, Chaebols suggested RMH's government to support tax cuts and deregulatory policies to increase investments in Chaebols to avoid an unemployment crisis which would evoke negative domestic responses (J.Jang 55). Also, Chaebols stressed that they needed to become stronger through the process of deregulation in order to block a possible foreign purchase of

Chaebols. Chaebols heavily emphasized the necessity to *go global* for them to survive under global competition. Therefore, supply-side economies were once heavily stressed as the KYS era, and the RMH's government also had to reconsider this issue given the situation the Korean economy was in, therefore RMH's government at the end, eased the regulations for Chaebols-based economy. President LMB realized that there is still the ongoing dissatisfaction amongst the conglomerates of RMH's administration and consequently agreed on supporting the Chaebol's needs as a means of making the economy better.

Therefore, LMB problematized the structure of the previous government, called the *regulatory Developmental state* (I.Y Kim 80). Although it is an ongoing contested perception, previous governments (whereby the spectrums differ) after KYS followed *The Third Way* economics, emphasizing the productive welfare system for socio-economic improvement to take place (Kwon, Seo and Heo 21). Therefore, the state heavily intervened in wealth distribution by raising the welfare mechanism and introducing regulatory schemes. Due to this the previous governments were seen as less corporate-friendly compared to KYS and other Developmental Statist regimes. Therefore, LMB considered a minimal government through eradicating regulatory schemes to be a pragmatic way to effectively engage with the Chaebols to boost economic growth. Therefore, dissatisfaction concerning non-pragmatic regulatory policies from the previous government made LMB target the existing institutions by introducing deregulatory reform in line with the Chaebol's wishes.

Moreover, as a person who was the CEO of a conglomerate, LMB himself also

believed that the culture of the institution needs to be changed. Reflected in the Conglomerates' demands, he thought bureaucrats from the previous regime were an obstacle for economic growth (I.Y Kim 80). Evidently, problematizing bureaucrats was an idea shared with the Chaebols. The idea of needing Chaebols' empowerment for economic growth was already evident in his economic blueprint, he appointed several ministers from the private sectors. This was extraordinary because the ministers were always chosen from the civil servants (I.Y Kim 80). Ministers from outside of the government symbolized a changing paradigm within the institution, going towards a more business-focused institution, which matches with the corporates' demand. The institution transformed into being more corporate-friendly as LMB proposed, in favor of the corporates demands seems that the *minimal government and big market* strategy resembles the KYS's minimal government strategy. This shows that LMB's strong stance on creating a favorable environment to execute his economic policies with like-minded bureaucrats. Also, revival of the state-corporate nexus which were notably loosened during the previous progressive governments. However, the huge difference with the KYS administration is that it is hardly arguable that the trust of neoliberalism was the reason for LMB's preference for supply-side economies, but rather it was motivated by his pragmatism, the given Korean structural economy system and his objective of economic growth achieved through a Chaebol-based economy system.

Nevertheless, not much of the institutional change has occurred after the inauguration and before the Financial crisis 2008 besides appointing the ministers from the private sector. Most of the corporate-friendly economic policies were not implemented before when the collapse of the Lehman Brother's hit the Korean economy. The financial crisis occurred just six months after LMB's inauguration. Unlike the KYS

administration, the crisis wholly changed the LMB's economic policy blueprint.

5.4 The Global Financial Crisis and Korea's Response

Compared to the domestic conditions in 1997, when the 2008 Financial Crisis hit, the Korean economy was far better off; the debt-to-equity ratio, considered to be a main culprit of the crisis 1997, had improved tremendously compared to 1997. It fell from 400% to around 100% in 2008 (Cho 12). The financial reform executed by the two previous progressive presidents helped decrease the debt-equity ratio. Despite the fact that the Korean economy had far better balance sheets compared to a decade ago, the Korean economy was more vulnerable to external shocks. Not just only given the fact that the Korean economy is export-oriented, the Korean economy has also opened financial channels after the IMF's intervention in the Asian Crisis. The Korean economy was claimed as highly vulnerable to external shocks leading up to the financial crisis.

As the chapter emphasizes the importance of the world political economy, it is crucial to understand that the Global Financial Crisis of 2008 was also a spill-over crisis as the Asian Financial Crisis in 1997, but at a larger scale. Briefly, it was a crisis from the Global North not from the emerging economies, which caused more severe consequences to the world economy. The collapse of the US economy due to the credit crisis brought severe consequences to the both Global North and the Global South given the globalized nature of the global economy. Therefore, economies of the Global North weakened their investment and consummation due to the credit crisis, which also influenced the contraction of exports of emerging economies along with a decline in trading trust (Korea

Development Institute 1). Therefore, the Global Financial Crisis drove economies in both the Global North and the Global South to plummet. Additionally, the credit crisis was also a sign for the decline of the neoliberal paradigm as the housing market collapsed and the banking sectors were major drivers for the neoliberal economy. The collapse of the Lehman Brother's and other big investments banks in the US was a great shock for the global economy, bringing considerable uncertainty into the world economy which was heavily run by hegemonic US neoliberalism.

Within the context of the Korean and global economy, the collapse of the Lehman Brother's was projected to heavily impact the Korean economy. Capital outflow deteriorated by 6 % of the GDP which was more severe than the 1997 percentage of 5.5% (Alp, Elekdag and Lall 5). At this time Korea operated a floating exchange rate and the Korean currency was low-valued compared to other major currencies; given this fact, the Korean Won quickly devalued, from USD 1: KRW 1,100 to USD 1: KRW 1,500 (Cho 2). The market volatility was even worse than a decade before because the investors and the global market reacted quicker given the trauma of the Asian Crisis the decade before. Also, the contraction of exports from the Global North in the crisis also negatively affected the Korean economy, leaving it worse than it did in the 1997 crisis. Korean exports declined from 27.6% in September to -19.5% in November (Cho 3). The rise of oil prices added to the effect of the dropping exports during the Financial Crisis (Korea Development Institute 1). As the Korean economy hugely relied on energy imports, the combination of high oil prices and the collapse of banks from the US hurt the Korean economy harshly. The IMF quickly downgraded Korea's forecast growth from +2.5% in November 2008 to -4% in January 2009, a huge drop within two-month window (Cho 4).

Therefore, the impact of the Global Financial Crisis on the Korean economy was expected to be far worse than the Asian Financial Crisis in 1997.

LMB quickly realized that urgent action must be taken towards the restoration of confidence in the Korean market, both domestically and internationally. One month after the Lehman Brother's fall, LMB proposed expansionary measures in both fiscal and monetary policies to stabilize the domestic economy and foreign investors' confidence. His focus was to restore the confidence which can deter further crisis (Korea Development Institute 13; I.J.Kim 349). Therefore, LMB changed the economic policy from minimal-government towards the opposite direction. LMB's government quickly eased the fiscal situation by lowering interest rates from 5.25 % to 2% until February 2009 (I.J.Kim 347; Korea Development Institute 12). Combined with fiscal easing, LMB's government was also actively engaged in stabilizing the capital outflow by restoring confidence through providing positive current sheets. LMB's government achieved a positive current balance sheet during the crisis through decreasing import goods along with the contradiction of the export demands from the abroad, making up the balance of current sheets (Kim and Yoon 12). In the beginning of 2009, the LMB government declared a state of emergency and launched an expansionary-macroeconomic mechanism for economic recovery. For instance, the LMB government increased public spending to approximately 2 billion USD more in April 2009 (S.Y.Kim 18). LMB spent 5,3 million USD on self-employed citizens to support entry into markets (Korea Development Institute 2). Therefore, the welfare expenditure hugely increased under his expansionary monetary policy.

In terms of his deregulatory schemes, he quickly changed his focus from deregulation benefitting corporates towards deregulation serving small- and middle-sized enterprises (SMEs). This is quite the opposite however of the corporates' needs. According to Lee, the LMB government was actively engaged in searching for inefficient regulations that hinder the growth of the lower and middle class, such as launching institutions and policies to simplify the process for start-up creations (Lee 16). The adequate deregulatory reform and government subsidies prioritizing benefits for SMEs were key elements that helped the Korean domestic households to recover quickly from the Global Financial Crisis, which was missing during the Asian Financial Crisis (S.Y.Kim 18).

Based on the expansionary fiscal and monetary easing, it is apparent that LMB's policy response was responsive and flexible to the given situation. Compared to his slogan of creating a business-friendly and minimal government, the policy choices made by LMB during the crisis were rather the opposite, establishing huge government interventions to push through the national crisis. Expansionary policies, which are considered to be in line with Neo-Keynesian economic theory were applied to fix the market failure. It already shows that the LMB's policy response on the crisis was not subjected or grounded by the economic idea of neoliberalism which highly supports the minimal intervention of the government; but instead, LMB chose to take big policy measures to stabilize the market, demonstrating the presence of a big government on the market economy. I.Y.Kim points out that some scholars argue that LMB's governance is highly neoliberalist due to his earlier commitment to minimal government (I.Y.Kim 73). However, such rigorous expansionary policies were introduced at higher rates during the

period of the emergency government, despite being contrary to his neoliberalist minimal government plan. It is apparent that the idea of pragmatism enabled him to rigorously modify the initial economic policy as economic policies were not grounded by certain economic ideologies but were rather based in the idea of pragmatism. Therefore, the idea of pragmatism is what allowed LMB to develop an adequate policy response in a given time period.

a. The US Bilateral Currency Swap

Despite adequate responses, many of the scholars point to the bilateral currency swap as the major savior for the Korean economy in deterring the banking crisis of 2008 (Cho 12). Chey argues that the US Federal Reserve (from here on referred to as Fed) agreed on a reciprocal swap line with four emerging economies including Korea, in order to provide dollar liquidity to cease further capital outflow of those countries (Chey 1). A similar situation occurred during the Asian Financial Crisis, in which the Korean government had to request to get more dollar liquidity at the IMF because of its inadequate foreign reserve dumping, and as an exchange underwent IMF conditions. As the previous chapter argued, Korea could not receive bailout in bilateral mechanism via Japan at the first stage of the crisis, the IMF was the last resort for dollar liquidity. However, during the crisis of 2008, the Fed kindly offered a dollar swap in order to stabilize the economy. How was this possible when it was impossible during the Asian Financial Crisis?

Chey argues that the changing global economic governance and US-European

conflicts impacted the Fed's decision-making in a dollar swap with the emerging economies (Chey 2). As the beginning of Chapter Two mentioned, given the increasing influence of emerging economies within the global political economic order, cooperation with the G20 was more necessary than cooperation with the traditional global players of the G7. Therefore, the US needed to strengthened ties with emerging economies which led to the Fed, for the first time in history, agreeing to a swap line with emerging economies (Chey 6). The US' initiative can be also seen in the first G20 Summit. Although the G20 was formed right after the Asian Crisis 1997, the G7 was still a major global player in global economic governance, and G20 had never convened until the Global Financial Crisis. The first G20 summit was held on the 14th of November 2008, in the midst of the Global Financial Crisis. Holding the first G20 summit during the early period of the crisis demonstrates the importance of emerging economies to the global economy (Chey 8). Also, the US held a contradictory position with the EU as the EU criticized a dollar-based international monetary system and aimed to create a New Bretton Woods system which the US disagreed with. Also in disagreement with the EU, the US wanted to tighten relations with the emerging economies by accepting the reshaped global governances and alliances in order to protect its hegemonic influence in new global governance (Moon and Rhyu 454).

Korea was selected as one of the four emerging economies to receive Fed's dollar liquidity, receiving 30 billion USD from the US to secure the financial market and deter further banking crises similar to that which Korea experienced during the Asian Crisis in 1997 (Alp, Elekdag and Lall 7). According to Chey, Korea was selected for this bilateral swap as it was the host-country for the following G20 summit, and as such, relations with

Korea were highly significant within Washington's ultimate goal of tightening relations with the emerging economies (Chey 6). The Korean economy could restore the confidence in the financial market with the help of the dollar liquidity. Using a combination of LMB's expansionary fiscal and monetary policies, the Korean economy restored its economic growth in March 2009 whereas the major economies in the Global North were experiencing increasingly negative growth (Lee and Rhee 2012:2). To conclude, the Korean economy recovered from the Global Financial Crisis faster than all other OECD members (President Office 3). This resilience in the wake of the Global Financial Crisis could make a huge difference in Korea.

5.5 Chapter Summary

Chapter 2 outlined the buildup of the 2008 Global Financial Crisis by looking into the historical and structural context of the Korean economy within the context of the global political economy. Economic ideas of neoliberalism were declining within the global political economic setting, whereas economic ideas advocating pragmatism, as followed by president LMB, were supported. Before the Global Financial Crisis, supply-side economics (neoliberals) were supporting the president and conglomerates given the conglomerate-based Korean political economy system and that became the reason for reshaping the whole institution. However, the sudden Global Financial Crisis influenced supply-side economics into demand-side economics in order to stabilize the confidence in the Korean economy. Therefore, president LMB quickly adopted expansionist fiscal and monetary policies to normalize the Korean economy, along with the bailout from the US Fed. In sum, Chapter 2 concludes that the low level of trust in economic ideology could have triggered responsive policy decisions during the crisis, and that the rise of economic powers in the Global South and Korea's global power also contributed to overcoming the Global Financial Crisis.

6. Conclusion

Economic ideas which were shaped by both global and the Korean political economy context impacted policy responses for the Asian Financial Crisis of 1997 and the Global Financial Crisis of 2008. Despite both presidents having had a similar political objective, which was the advancement of Korea, both presidents faced totally different economic situations during the financial crises as each president had different economic ideas to execute with their policies. With the constructivist approach of tracing back to the economic ideas that were shaped by domestic and international historical backgrounds, this paper helps to further understand how the economic ideas were made and how they shaped the policy responses before and during the financial crises. KYS' deregulatory policies, grounded by neoliberalism due to dissatisfaction of the Developmental-Statist regime, incurred more accumulated short-term debt from conglomerates and the government's minimal role on debt-taker, putting the economy in a vulnerable position for external shock. Not only did the government have ill-prepared prevention mechanisms for this external shock, but also the policy response on crisis was ill-designed to defend the banking crisis, shaped by the trust in the neoliberal economy. Similarly, LMB's economic idea of pragmatism proposed that deregulatory policies and minimal government is needed for the dissatisfaction of the previous regulatory statist administration. Deregulatory policies were about to be executed to achieve economic growth as they were to stimulate the Chaebol-based economy system. However, LMB rigorously switched its policy to an expansionist way because restoration of the market from the crisis was more urgent than stimulating the economic growth through a

deregulatory scheme. Pragmatic economic policies that LMB prioritized during his inauguration speech helped Korea to stabilize its economy from the crisis.

Interestingly, the paper also observed how the fate of the Korean economy during the crises is subjected to the trend of the world political economy as well. A key difference was that the Asian Financial Crisis led to a huge reconstruction of the Korean economy due to the conditionality from the IMF bailout, which severely impacted the Korean households while the GDP was recovering. The Global Financial Crisis, on the other hand, did not bring this severity to the micro-level as in 1997 because the bilateral Swap system did not have the same conditions as the IMF had. As a bilateral swap line was offered due to the US' interest on alliance with emerging economies during the Global Financial Crisis, Korea was rather lucky to be an influential actor for the G20 group.

There are certainly more factors that played a part towards the policy responses during both financial crises. The paper also rejects the claim that only economic ideas are ones to be relied on. However, economic ideas could hugely affect institutional changes and policy decisions. Therefore, the method of tracing back to economic ideas, that were shaped by the history of domestic and international political economy, should be more credited in terms of critical analysis on any given Political Economy and Public Policy.

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