

# Exogenous Pressures and Endogenous Ideas: A Constructivist Approach to Korea's Economic Institutional Change

Jaehwan Jung<sup>1</sup>

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**Abstract** This article seeks to explain Korea's economic institutional change from a developmental regime to a more liberal order from the perspective of constructivist political economy. While external pressures make institutional change necessary or desirable, ideas make it possible to establish an institutional resolution by enabling actors to perceive what is to be done as well as what constitutes the external environments. Without these ideas, it is cognitively impossible to construct a new institutional order. In this regard, this article explains Korea's institutional change in terms of interactions between exogenous pressures and endogenous ideas. Korea's economic institutional change can be conceptualized as a three-stage process from a developmental regime to a deregulatory liberal order and then to a regulatory liberal one. This three-stage process of Korea's economic institutional change has largely resulted from interactions between external or structural pressures and internal ideational change.

**Keywords** Korean political economy · constructivist political economy · policy paradigm · economic institutional change

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Jaehwan Jung is a visiting professor at Incheon National University. He received a Ph.D. in Politics and International Studies from the University of Cambridge in 2014. His research interests include the Korean political economy, the politics of international finance, and constructivist political economy.

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✉ Jaehwan Jung  
jaehwan21@gmail.com

<sup>1</sup> Visiting Professor, Incheon National University 119 Academy-ro, Yeonsu-gu, Incheon, South Korea

## Introduction

This article seeks to explain Korea's economic institutional change from a developmental regime to a more liberal order, from the perspective of constructivist political economy. Constructivist perspectives stress the limitations of a rationalist and materialist understanding of a political economy because "economies might vary substantially for nonmaterial reasons" (Abdelal et al., 2010, p. 2). More specifically, constructivist political economy assumes that ideational or paradigmatic change is a prerequisite of institutional change. While external pressures have provided a window of opportunity for institutional change, as Blyth (2002, p. 10) shrewdly notes, "structures do not come with an instruction sheet." While external pressures make institutional change necessary or desirable, ideas make it possible to establish an institutional resolution by enabling actors to perceive what is to be done as well as what constitutes the external environments. Without these ideas, it is cognitively impossible to construct a new institutional order.

Korea's economic institutional change can be conceptualized as a three-stage process from a developmental regime to a deregulatory liberal order and then to a regulatory liberal one. During the 1990s there had been a general change toward a liberal order that replaced government guidance and controls with market mechanisms as an organizing principle to govern the economy. Before the Asian financial crisis of 1997, however, this liberal change was centered mainly on deregulation and liberalization, whereas after the crisis the focus was changed to establishing liberal regulatory institutions. This three-stage process of Korea's economic institutional change has resulted from interactions between exogenous pressures and endogenous ideational change.

First, when the Korean developmental regime was established, a structural condition that combined severe security threats, natural resource limitations, and a lack of political legitimacy made economic development the priority of policy goals. Facing these external pressures, the Park Chung Hee government (1961-1979) relied on developmental paradigms in devising an institutional solution for economic development. Second, the deregulatory institutional change of the Korean political economy in the 1990s was the result of interaction between economic globalization and laissez-faire liberalism. In a more globalized world economy, the Kim Young Sam government (1993-1998) relied on liberal paradigms and implemented deregulation and liberalization. Lastly, the Asian financial crisis gave more momentum to Korea's economic institutional change. The Kim Dae Jung government (1998-2003) interpreted the crisis from the perspective of ordo-liberalism and sought to impose "order" on the liberalized economy by establishing liberal regulatory institutions.

This paper is organized as follows. The next section addresses theoretical issues by discussing the role of ideas in institutional change and policy paradigms. The following section discusses the three-stage process of Korea's economic institutional change in terms of interactions between exogenous pressures and endogenous ideational change. The conclusions drawn from the study are in the final section.

## Institutional change and policy paradigms

An exogenous approach to institutional change emphasizes the impact of catalytic external events on institutional change, while an endogenous approach focuses on the internal process of institutional change. In particular, constructivist political economy puts emphasis on the role of ideas in the internal process. Catalytic external events such as economic crises and globalization might open the window of change, but they do not determine the concrete direction of institutional change. External events have to be understood or interpreted first in order for political actors to respond to them. Political actors rely on a set of ideas to understand external events, and based on their understanding they redefine their interests and choose a set of policies to solve the problems caused by external pressures. In this respect, external pressures are not a sufficient condition to induce institutional change. The emergence of a new idea is required to make institutional change possible (Hall, 2013). The role of ideas in institutional change can be conceived of as a “theoretical compass” that acts as an interpretive framework through which political actors construct their understanding of the external environments surrounding them and a direction for institutional change.<sup>1</sup>

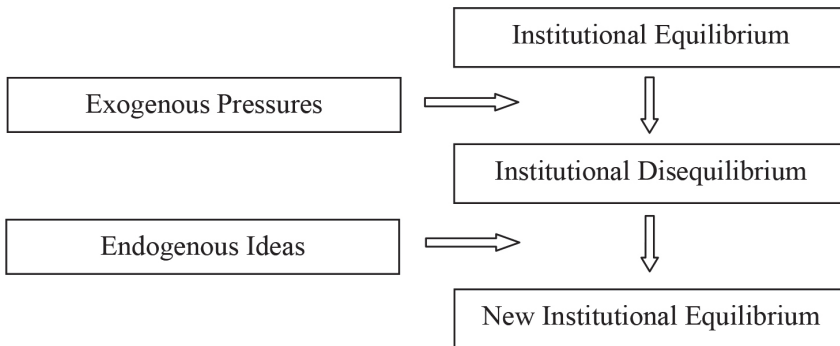
According to the “punctuated equilibrium model,” the development of institutions can be characterized as a long period of continuity punctuated by “critical junctures,” during which a substantial change occurs and institutional development takes a new path (Krasner, 1984). These critical junctures are usually brought about by a “catalytic external event” (Krasner, 1976). External pressures, such as an economic crisis or global structural change, are thus a necessary condition for “path-shaping” institutional change. Catalytic external events dramatically heighten the perception of the failure of existing institutions, which opens a political window of change. External events, however, would not be a sufficient condition to bring about institutional change, because institutional change is necessarily involved in the process of creation (Hall, 1989). Even though external pressures caused by catalytic events can explain why an institution becomes unstable, they cannot explain, in the words of Blyth (2002, p. 8), “the specific forms that institutional change takes” because external pressures, however severe or visible, do not spawn an automatic response. In this regard, by concentrating solely on external events, it is difficult to explain why institutional disequilibrium caused by external pressures results in a particular form of new institutional order.

A constructivist approach considers an endogenous process as a key part of institutional change, giving theoretical importance to the role of ideas in the creation of a new institutional order. Since, as Blyth (2002, p. 10) shrewdly notes, “structures do not come with an instruction sheet,” an institutional solution has to be found. Therefore, as Goldstein (1989, p. 32) puts it, “the demand for change must be met by a supply of ideas.” While external pressures make institutional change necessary and desirable, ideas make it possible to establish an institutional resolution by enabling actors to perceive what is to be done as well as what constitutes the external environments. Without these ideas, it is cognitively impossible to construct a new institutional order. This constructivist approach considers path-shaping institutional change as

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<sup>1</sup> Although following Blyth’s work (2002), ideas as “institutional blueprints” are more widely used, this article thinks of ideas as “theoretical compasses” because the main role of ideas is to indicate a direction for institutional change rather than a plan for building a new institutional order.

the result of interactions between strategic contexts influenced by external pressures and the ideas that political actors employ to interpret such pressures.<sup>2</sup> The constructivist process of institutional change can be schematically represented in Figure 1.



**Fig. 1** Constructivist process of institutional change

Constructivist political economy focuses on the role of ideas in the endogenous process of economic institutional change. When catalytic external factors make existing institutional arrangements unstable or inefficient, political actors diagnose the defects of institutional orders and conceive a solution to the defects with a reliance on ideas. A set of ideas for institutional change can be called a policy paradigm that is “a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them but also the very nature of problems they are meant to be addressing” (Hall, 1993, p. 279). By and large, policy paradigms contain two different types of ideas: normative ideas indicating “what one ought to do” and cognitive or causal ideas elucidating “what is and what to do” (Schmidt, 2008). According to these two elements of policy paradigms, we can identify four ideal types of policy paradigms for how the market economy ought to be organized and managed.

The normative element of policy paradigms for the market economy is concerned with the priority of policy goals. In general, there are two distinguished policy goals in organizing and managing the market economy. One is to give priority to the efficient use of economic resources by enhancing market mechanisms. The other is to prioritize stability over efficiency with a focus on preventing the volatile movements of market prices from causing damage to the stability of the entire society. In terms of cognitive elements, there are also two contrary ideas on how the market works. One is based on the “efficient market hypothesis,” according to which deregulated and competitive markets always create a stable “equilibrium” by reflecting all available information on economic transactions. The other kind of cognitive idea puts an emphasis on factors that could cause “disequilibrium,” such as imperfect information, uncertainty, and herd behavior. According to this idea, the market economy tends to bring about periodic inefficiency and instability. With these distinct normative and cognitive elements, we can categorize four ideal types of policy paradigms in the market economy.

<sup>2</sup> In this regard, constructivist approaches see political actors as “situated agents” that are constrained by structural environments but have a degree of “bounded discretion” within external constraints (Bell, 2012).

**Table 1** Policy paradigms in the market economy

		Normative Elements	
		Efficiency	Stability
Cognitive Elements	Equilibrium	Laissez-faire liberalism	Ordo-liberalism
	Disequilibrium	Developmentalism	Keynesianism

In general, economic liberalism can be defined as a set of doctrines or principles stressing, in the words of Gilpin (1987, p. 27), “the market and the price mechanism as the most efficacious means for organizing domestic and international economic relations.” Although all forms of economic liberalism are committed to such principles, it is of particular importance to distinguish two distinct strands of economic liberalism: laissez-faire liberalism and ordo-liberalism (Gamble, 2009). Laissez-faire liberalism gives priority to enhancing allocative efficiency and supposes that a free market creates a single price that brings demand and supply into equilibrium. Therefore, it stresses leaving markets free to function and allowing markets to reach equilibrium in order to ensure maximum efficiency. In contrast, according to ordo-liberalism, the critical issue is not state intervention in the market economy but the purpose of state intervention. It contends that the state should intervene in the economy for the establishment and maintenance of competitive market relations (Bonefeld, 2012). Ordo-liberals oppose “market-inhibiting policy” that interferes with the functioning of market mechanisms, since they believe that market mechanisms bring about equilibrium in prices. According to them, however, states should implement “market-enabling policy” that aims to ensure the proper functioning of market mechanisms, because the stability of the market economy could not be maintained without state intervention.

In contrast to both laissez-faire liberalism and ordo-liberalism, developmentalism and Keynesianism suppose that market mechanisms could cause inefficiency and disequilibrium. Developmentalism argues that for a developing country to achieve economic development, the state needs to control and distribute economic resources rather than letting the market decide. Since a developing country usually suffers from a lack of economic resources, especially financial resources, the efficient use of resources could be ensured by state intervention that aims to deliberately “get relative prices wrong” (Amsden, 1989). Keynesianism focuses more on the stability of the market economy. It supposes that the market clearing mechanism is not perfect, and thus, the market mechanism could result in disequilibrium and jeopardize the stability of the market economy. According to Keynesianism, therefore, in order to maintain the stability of the market economy, it is insufficient to ensure the proper functioning of the market mechanism. States should sometimes directly intervene in the market mechanism in order to rectify disequilibrium created by the market mechanism (Skidelsky, 2011).

These four policy paradigms of the market economy play the role of “theoretical compasses” in institutional change. They act as interpretive frameworks through which political actors construct their understanding of the external environments surrounding them and a direction for institutional change. Without these ideas acting as interpretive frameworks, it would be hard, if not impossible, even for those who have enough material resources to change institutions, to determine what to do with the resources (Blyth, 2001). In this respect, paradigm change is a necessary condition for institutional change.

### Three stages of economic institutional change in Korea

Korea's economic institutional change can be conceptualized as a three-stage process from a developmental regime to a deregulatory liberal order and then to a regulatory liberal one. It is misleading to conceptualize Korea's institutional change in such binary terms as a change from a developmental model into a neoliberal one, since this binary conceptualization tends to discount the importance of the economic change from a deregulatory into a regulatory order under the umbrella of liberalism. In this regard, Korea's economic institutional change can be described in terms of two different levels: the general transformation of a developmental regime into a liberal economic order during the 1990s, and the more bounded change within the boundary of the liberal economic order from a deregulatory liberal order into a regulatory one after the Asian financial crisis of 1997. During the 1990s, there was a general change toward a liberal order that replaced government guidance and controls with market mechanisms as an organizing principle to govern the Korean economy. Before the crisis, however, this liberal change was centered mainly on deregulation and liberalization, whereas after the crisis, the focus was changed to establishing a liberal regulatory regime for the purpose of imposing market discipline on the financial and corporate sectors. This three-stage process of Korea's economic institutional change has largely resulted from interactions between external or structural pressures and internal ideational change, as can be seen in Table 2.

**Table 2** Exogenous pressures and endogenous ideas in Korea's economic institutional change

	Exogenous Pressures	Endogenous Ideas
Developmental Regime	Systemic vulnerability	Developmentalism
Deregulatory Liberal Order	Economic globalization	Laissez-faire liberalism
Regulatory Liberal Orders	The Asian financial crisis	Ordo-liberalism

#### *Systemic vulnerability and developmentalism*

From 1962-1981, the Korean economy grew at an average annual rate of 8.4 percent, with a high level of investment that accounted for 25.4 percent of GDP per year, on average. Such rapid economic development was led by remarkable growth in the manufacturing sector, which, in turn, was facilitated by an increase in exports. More important than economic growth in quantitative terms was the qualitative upgrading of industrial capacity, especially with the pursuit of heavy and chemical industrialization (HCI) in the 1970s, from lower value-added, labor-intensive to higher value-added, capital-intensive industries. In other words, Korea succeeded in combining economic growth with industrial deepening. The economic development of the Korean economy during the 1960s and 1970s was based on a peculiar economic institutional order that can be called a "developmental regime," which was different from both the socialist commanding economy and the free market economy.

The Korean developmental regime was established mainly by Park Chung Hee, who came to power through the 1961 military coup and dominated the Korean political economy until his assassination in 1979. The Park Chung Hee government chose economic development as its top priority largely because it was faced with a structural pressure of "systemic vulnerability" that

combined severe security threats, natural resource limitations, and a lack of political legitimacy (Doner et al., 2005). Because of natural resource limitations and severe security threats from communist North Korea that required a substantial amount of resources to be put into the defense sector, it sought to develop national industrial bases to improve the living standards of the populace, thereby legitimating its military coup and ensuring its survival.

The Park government had little choice but to make economic development the priority of policy goals in responding to external pressures imposed by systemic vulnerability. However, external or structural conditions such as systemic vulnerability did not indicate an institutional solution for economic development. Therefore, in order to explain why the Park government established the developmental regime to respond to an imperative imposed by systemic vulnerability, we need to examine an endogenous process in which economic ideas play a key role. In establishing the developmental regime, the Park government was able to use Japanese economic development as a theoretical compass not only because of the legacy of Japanese colonialism but also because of Park Chung Hee's sympathy with, and sufficient awareness of, Japan's development model (Kohli, 1994).<sup>3</sup> Taking Japan's economic development as its basis, the Park government relied on "developmentalism," the cornerstone of which was that the state, rather than markets, should play a leading role in economic development, in order to respond to external pressures imposed by systemic vulnerability.

Committed to economic development and learning from Japan's development, the Park government strengthened state capacity mainly by revamping state bureaucracy and tightening government control over finance. First, it reorganized the state bureaucracy to centralize economic decision-making power in the hands of the president and a small number of bureaucrats, especially by creating a pilot agency headed by a deputy prime minister—the Economic Planning Board (EPB) (Chang, 1993). The Park government also secured almost complete control over finance. It not only nationalized all the banks and set up new state-owned banks such as the Korean Development Bank, but also secured control over the inflow of foreign capital by authorizing the EPB to screen foreign loans and investment applications (Chang, 1993; Mardon, 1999). Its control over both domestic and foreign financial resources enabled the government to discipline private business groups. The government used its control over finance both as a carrot to make private businesses conform to its directives and as a stick to punish them when they did not follow the directives (Kim, 1997).

When the Korean developmental regime was established, "systemic vulnerability" was a structural environment that put external pressure on Korea's economic institutional change. Facing systemic vulnerability, the Park Chung Hee government made economic development the priority of policy goals. Although systemic vulnerability made economic development a necessary thing to do, it did not provide an institutional solution for economic development. In establishing the developmental regime, the Park government relied on developmentalism that was based on the experience of Japanese economic development as a theoretical compass in devising an institutional solution for economic development in the context of systemic vulnerability.

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<sup>3</sup> Trained in the Japanese military academy in Manchuria, Park Chung Hee was fascinated by the Meiji model and strove to follow the Japanese path to modernization. In addition, many of the economic experts on whom he relied to solve economic problems also "had been educated in Japanese schools, worked in Japanese banks, and looked at Japan as a model for rapid economic development" (Kim and Lee, 2010, p. 6).

*Globalization and laissez-faire liberalism*

The deregulatory institutional change of the Korean political economy in the 1990s was the result of interaction between economic globalization and laissez-faire liberalism. Facing external pressures imposed by globalization, the Kim Young Sam government (1993-1998) relied on liberal paradigms in interpreting external environments and devising an institutional solution to external pressures. Economic liberalism was first introduced by some liberal bureaucrats into the Korean political economy as a new policy paradigm in the early 1980s. When the Korean developmental regime was in serious jeopardy in 1979, several liberal-oriented economic bureaucrats, many of whom were trained in American universities, blamed the economic predicament on the state-led industrialization of the Park Chung Hee government and proposed economic stabilization and liberalization programs as a way to solve the problems facing the Chun Doo Hwan government (Chang, 2001; Haggard & Cheng, 1987).<sup>4</sup>

Although these ideas of liberal bureaucrats foreshadowed the subsequent institutional change in the Korean economy, they were not fulfilled in the 1980s. It was not until 1993 that comprehensive liberalization and the consequent dismantling of the developmental regime began to be pursued. Changing political and economic environments gave momentum to economic institutional change toward a more liberal order. Economic globalization posed a serious threat to the Korean economy in general and the continuing growth of the *chaebol* (large family-owned business conglomerates) in particular. In a more globalized world economy, the Korean economy was caught in the so-called “sandwich effect,” competing with both lower-wage countries and more technically advanced countries (Smith, 1997). As a result, the *chaebol* were, in the words of Zhang (2002, p. 425), “desperate for low-cost financing to counteract the deterioration of industrial performance that resulted from rising wages and diminishing profitability.”

Facing the external pressures of economic globalization, the Kim Young Sam government attempted to change the economic system in a more liberal way. Three weeks after his inauguration, the president declared that Korea needed “a new leap toward a new economy” by changing the economic principle from regulation to competition, saying that “the mobilization of the available resources into the sectors by means of the direction and control of the authoritarian government ... [had] begun to reveal its limits” (quoted in Jeong, 1997, p. 107). The Kim government interpreted globalization “as a matter of survival for the nation” (Kim, 1995, p. 17). It stressed that Korea could not survive intensified competition in the globalized world unless there were major changes in the Korean economy. While globalization was presented as a new challenge facing Korea that could have impacts on national survival, economic deregulation was described as a new national development strategy to increase national competitiveness and thus ensure national survival. Proposing a “new economy initiative to revive the national economy” and calling for “a different approach from the one we have had in the past,” President Kim contended that “under the new economy, government directives and

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<sup>4</sup> It is noteworthy that, although, as Chwioroth (2007) points out, not all American economic departments are dominated by neoclassical or neoliberal ideas, the increasing Americanization of the economics profession in Korea has been one of the important factors contributing to the rise of economic liberalism since the 1980s (Choi, 1996).

controls will largely give way to open participation and creativity; a large part of the numerous restrictions on business activities will be removed; and such activities will be made free” (Kim, 1995, p. 18).

To facilitate the implementation of economic liberalization, the Kim government conducted a reorganization of the state bureaucracy that aimed to show its commitment to ending the era of state intervention by dismantling a pilot planning agency—one of the core features of the developmental regime. The abolishment of the EPB symbolically heralded both the government’s commitment to liberal economic reforms and the end of the Korean developmentalism era (Jung, 2011). In addition, pushing for the Organization for Economic Cooperation and Development (OECD) accession that was predicated on the full liberalization of financial markets, the government used international commitments as an excuse for liberalization (Lee, 2000).

In particular, embracing *laissez-faire* liberalism that focused on deregulation and liberalization, the government sought to change the focus of *chaebol* policy from regulation to alleviate the concentration of economic power in the *chaebol* into deregulation and support for the expansion of the *chaebol* (Lee, 1999). It comprehensively abolished government regulations on the *chaebol*, especially their access to international financial markets, and thus made them freely utilize international loans to increase their investment and market share. In 1993, the government announced a blueprint of financial liberalization which, in the words of Dalla and Khatkhate (1995, pp. 19-20), “embarked on a full throttle liberalization of the financial system.” This blueprint included most of the important measures to eliminate government control over finance, such as the deregulation of interest rates, the abolition of policy loans, the introduction of market principles for monetary and credit policy, and, most importantly, the liberalization of the external capital account, which, in the words of Chang et al. (1998b, p. 736), “Korea’s previous plans for financial liberalization had characteristically failed to include.”

The economic globalization gave momentum to deregulatory institutional change in the Korean economy. The Kim Young Sam government interpreted challenges posed by globalization through the lens of economic liberalism, changing the developmental regime into a deregulatory liberal order. In this respect, the dismantling of the developmental regime in the 1990s resulted from the interaction between economic globalization as an external pressure and economic liberalism as an internal interpretive framework.

### *The Asian financial crisis and ordo-liberalism*

The Asian financial crisis gave more momentum to Korea’s economic institutional change. With the help of the International Monetary Fund (IMF), the Kim Dae Jung government interpreted the crisis from the perspective of ordo-liberalism. The main purpose of institutional change implemented by the Kim government was not only to liberalize the Korean economy but also to impose an “order” on the liberalized economy by establishing liberal regulatory institutions.

By and large, the debate on the cause of the Korean financial crisis was the battle of ideas between economic liberalism and developmentalism. Underlying it was whether deregulated financial markets were working efficiently and rationally, in general, and the crisis was caused by financial liberalization per se or the ill-perceived or incomplete implementation of liberalization,

in particular (Chang et al., 1998a; Gill, 1999). Those who favored economic liberalism argued that although financial liberalization was an appropriate policy response to globalization, it was not accompanied by the necessary reforms of the corporate and financial sectors that would eradicate “Korea’s own longstanding structural problems which were incompatible with the liberalized and globalized market environment” (Cho, 1999, pp. 18-19). In contrast, those who supported developmentalism accused liberal analysts and commentators of ignoring the strengths and merits of the Korean developmental model. According to them, since the developmental model was “a relatively high-risk-taking system,” the government should play a role as “the ultimate system manager” to maintain its stability. However, financial liberalization weakened such a risk management system (Wade & Veneroso, 1998; Shin & Chang, 2005).

The liberal interpretation of the crisis tended to focus on exogenous factors of financial markets, such as government policy, as the instigator of the crisis, assuming that financial markets fundamentally would work as efficient, self-regulating markets. In contrast, the developmental interpretation was more likely to support the endogenous approach to financial crises, assuming that financial liberalization would inevitably increase financial instability, since factors intrinsic to the financial markets, such as the herd behavior of financial investors, persistently could jeopardize financial stability (Sinclair, 2010). The battle of ideas between these distinct interpretations of the crisis was as important as the material effects of the crisis on the processes of economic institutional change following the crisis.

Adopting the exogenous approach to financial crises, the IMF and the Kim Dae Jung government regarded Asian crony capitalism as a main cause of the crisis, assuming that the efficiency of liberalized financial markets was disturbed by the cronyistic features of the Asian style of capitalism. They stressed that, despite economic liberalization before the crisis, “the routines and practices, organizational forms, and social ties” that had been established under the developmental regime lingered and institutional inertia persisted (Chang, 2003, pp. 32-37). According to them, since liberalization occurred “under the old rules of the game,” the cronyistic characteristics of the Korean developmental regime were not completely dismantled, so that the government implicitly controlled the financial sector, guaranteed domestic and foreign loans, and prevented the *chaebol* from going bankrupt (Cho, 1999).

More specifically, the IMF took a position that could be called “transparency advocate,” attributing the crisis to the domestic institutional defects and inappropriate policies of the crisis-stricken countries and recommending improvements in regulation and transparency in domestic financial institutions as a solution to financial instability (Armijo, 2001). The IMF argued that capital flow volatility was not a cause of the crisis but a symptom of policy errors and institutional defects of Asian economies, stressing that massive capital flows in and out of Asian countries resulted from their defective banking systems and moral hazards caused largely by government guarantees (Chweroth, 2010, pp. 206-208). In particular, according to the IMF, some intrinsic features of the financial markets had nothing to do with a sudden reverse in capital flows. It was a lack of transparency in Asian economies that hindered the financial markets from working properly and thus induced massive capital flight from Asia. This emphasis on transparency enhancement derived from the assumption that information asymmetry, rather than some intrinsic factors of liberalized financial markets, was the primary cause of the financial market instability (Blyth, 2003).

Moreover, the IMF stressed the importance of “orderly liberalization” by employing

ordo-liberal ideas. It did not ignore the fact that the crisis-stricken Asian economies had undertaken financial liberalization before the crisis, admitting that in certain conditions, financial liberalization could cause economic problems (Widmaier, 2003). However, the IMF made a distinction between orderly and disorderly financial liberalization. It argued that the problem of Asian economies was not their financial liberalization but “extremely bad liberalization,” and thus the Asian crisis underscored “the need for an orderly liberalization of capital flows,” which meant “properly sequenced and cautious liberalization” (Moschella, 2009). Disorderly capital account liberalization resulted largely from the faults of domestic authorities, such as their inadequate efforts to reform domestic financial institutions and their attempt to unevenly liberalize financial markets in terms of long-term and short-term capital flows. In this way, the IMF’s emphasis on orderly financial liberalization also contributed to focusing reform efforts on domestic institutions and defending international capital mobility regimes.

Relying on the IMF, the Kim Dae Jung government also interpreted the crisis as caused by the defects of crony capitalism, such as a collusive link between politics and business and government-directed banking practices (Hall, 2003). Based on this diagnosis of the crisis, the main purpose of institutional change implemented by the government was not only to liberalize the Korean economy but also to impose “order” on liberalization, thereby rectifying both cronyistic and disorderly aspects of the Korean economy. For this purpose, the government attempted to establish new independent financial authorities in order to create a financial system that would work on the basis of market mechanisms without being impeded by political pressures and interests. It was an attempt to re-strengthen, rather than weaken, government regulation based not on state guidance but on market mechanisms through the de-politicization of financial regulations. The central feature of this regulatory liberal institutional order was the creation of financial authorities that, in the words of Walter (2008, pp. 20-21), “should be insulated from politics via agency independence ... [and] impartially enforce arms-length, transparent rules within a limited zone of discretion.” A new financial regulatory body and an independent central bank were created for this purpose (Pirie, 2008, p. 105).

On December 29, 1997, the National Assembly passed the Act for the Establishment of Financial Supervisory Organizations, to provide a legal basis for the creation of a new financial regulatory body. By unifying the four existing financial supervisory agencies, the Financial Supervisory Commission (FSC) was created on April 1, 1998, and the Financial Supervisory Service (FSS) was established as an executive arm of the FSC on January 1, 1999. The FSC and FSS were empowered to exert regulatory power over financial institutions and markets. They were authorized to devise and revise rules regarding the supervision of financial institutions, to issue and revoke the licenses of financial institutions, to investigate financial institutions and impose legal enforcement, and to oversee the economic restructuring after the crisis (Choi, 2002). The FSC and FSS were principally composed of independent members, appointed for a fixed term in order to release the operational independence of the FSC and FSS from political influence, and thus enable the organizations to pursue more rule-based regulations (Jung, 2009; Pirie, 2008).

In addition, the government also considered the influence of foreign investors as part of the new regulatory regime. Foreign investors were expected to play a leading role in adopting and maintaining the global standards of best practices, especially in the banking sector, since the Korean financial institutions tended to follow the old routines and customs inherited from the

development regime. In this respect, foreign investors were understood as part of the new regulatory regime, playing a role in ensuring that liberal rules would be abided by, along with the newly created regulatory authorities. In other words, along with a *de jure* financial regulatory body, foreign investors were expected to play a role as *de facto* enforcers of liberal standards, not by laws but through their financial resources in the markets.

Although it was the intervention of the IMF that catalyzed institutional change with regard to the opening of the financial markets to foreign investors, the Kim Dae Jung government also considered the role of foreign investors in the Korean economy a permanent feature of a new liberal economic order that could facilitate the convergence of Korean business and financial management practices with global standards (Pirie, 2008). In the past, government restrictions on inward foreign investment were seen as one of the important institutional measures to promote national industry and economic development. Despite the promotion of globalization as the new economic framework of the Korean economy, the Kim Young Sam government had also maintained relatively strict regulations on inward foreign investment, while strongly promoting the outward foreign investment of Korean firms. In contrast, the Kim Dae Jung government changed the main purpose of the regulatory framework on foreign investment from “control and regulation” to “promotion and support” (Thurbon & Weiss, 2006, pp. 7-9). For this purpose, the government introduced the Foreign Investment and Foreign Capital Inducement Act, which took effect on November 17, 1998. The Act allowed all types of foreign investment, including hostile mergers and acquisitions, and expanded the range of sectors in which foreigners could invest.

After the Asian financial crisis, the Kim Dae Jung government continued to pursue the liberal change of the Korean economy. However, it employed a different kind of liberalism from that of the Kim Young Sam government. After the crisis, *ordo-liberalism* became an overarching paradigm for changing the Korean economy. Based on the *ordo-liberal* understanding of the Korean economy, the Kim Dae Jung government sought to establish liberal regulatory institutions to enhance the proper working of the market economy. In this respect, a bounded paradigm change from *laissez-faire* liberalism to *ordo-liberalism* in the condition of severe economic crisis led to a bounded change of the Korean economy with the establishment of liberal regulatory institutions.

## Conclusion

This article seeks to explain Korea’s economic institutional change from a developmental regime to a more liberal order, from the perspective of constructivist political economy. External pressures have been important factors that have opened a window of opportunity for Korea’s institutional change. However, it is ideational change that has determined a concrete path to institutional change, because what enables political actors to perceive what is to be done is policy paradigms. In this regard, Korea’s economic institutional change can be seen as resulting from interactions between exogenous pressures and endogenous ideational change.

At the heart of Korea’s economic change has been the rise of economic liberalism. As early as the early 1980s, the Korean developmental regime that had enabled the rapid economic development began to change into a liberal model. In particular, during the 1990s, globalization

and the Asian financial crisis created a critical moment for paradigm change from developmentalism to liberalism. In the first half of the 1990s, the Kim Young Sam government embraced *laissez-faire* liberalism and liberalized the Korean economy. Economic liberalization allowed the *chaebol* to gain relatively unrestricted access to international financial markets, which facilitated their global expansion. However, this deregulatory liberal institutional change created an institutional vacuum for controlling the *chaebol*, inducing them to expand their business recklessly with borrowed money from abroad. The imprudent expansion of the *chaebol* with foreign debts eventually resulted in the financial crisis of 1997, which opened another window of opportunity for paradigm change. Based on the ordo-liberal understanding of the crisis, the Kim Dae Jung government focused on establishing liberal regulatory institutions, rather than deregulation, without abandoning the liberalized economic order. As a result, the institutional vacuum produced by deregulatory change before the crisis was filled to some extent by the newly established regulatory institutions.

The battle of ideas on how the Korean political economy ought to be organized and managed is still an ongoing important issue that could have a critical impact on the future of the Korean economy. For instance, the current Moon Jae In government seeks to introduce Keynesianism into its policy paradigm, stressing the importance of economic fairness and equality. In this regard, the battle of ideas among developmentalism, *laissez-faire* liberalism, ordo-liberalism, and Keynesianism should be regarded as one of the important research subjects for understanding the Korean political economy. In the way that the political contests between developmentalism and economic liberalism played a key part in Korea's economic institutional change in the 1990s, the current battle of ideas between liberalism and Keynesianism could result in an important change in the Korean political economy of the 2020s.

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