Managing institutional change in an era of globalization: Foreign investment and sectoral governance in South Korea[1]

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INTRODUCTION

The paper inquires about the possibilities that countries, especially developing ones, have to manage institutional changes despite globalization forces. One of such forces is multinational firms, both industrial and financial. This work provides a critical view to the idea that globalization is an irresistible and omnipotent process which leads to institutional convergence both in economic and political arenas. The paper considers globalization not as an all-negative and destructive process; neither advocates globalization as the only way to produce worldwide sustainable and equitable development. My argument here adheres to the view that internationalization and economic liberalization may not necessarily relinquish the policy choices of societies and governments to the absolute rule of market forces. In other words, there is room for state actors and domestic capitalists to formulate institutions and policies suitable to their needs and strategic preferences. To illustrate the point empirically, the case of South Korea is examined.

Apparently, South Korea has gone through a rapid institutional change; such an observation is often referred to the period after the 1997-8 economic crisis. However, both general and sectoral analysis of the Korean political economy shows that institutional change has followed an evolutionary pattern: adaptation to the external environment with persistent internal institutional structures. To put it differently, Korea has followed a more gradual and managed pattern rather than a revolutionary and chaotic. This is clearer when the Korean political economy is analyzed from a historical perspective to account for a longer period. It is worth noting that some legacies of the developmental model are salient when reviewing the Korean case even after the economic crisis, especially the economic nationalism and the corporate structures. It is argued that such legacies can signify an advantage and not necessarily an obstacle to the kind of institutional changes that a country like Korea need to cope with the challenges of globalization. One of such challenges is to keep control of the liberalization process and retain some leverage in economic policy against predatory market forces.

The paper is divided in three parts. The first part reviews literature on globalization and domestic political economy, and builds an analytical framework bringing together three dimensions: international, domestic and institutional. Such dimensions intersect in a particular institutional factor: the foreign investment regime. It is argued that the process of change of foreign investment regime is more than just the convergence of economic institutions towards "global standards"; changing investment rules has important political implications domestically, especially regarding economic governance. Therefore, it is a concern for nationalistic governments and domestic economic actors to define the extent of penetration of international capital.

The second part analyzes the evolution of the Korean foreign investment regime building upon the framework. This section provides a brief review of Korean contemporary history of the foreign investment regime, and highlights the nationalist nature of such institutional framework. The time frame is from 1980s to 2002. During this period, some critical reforms and events are covered. It points out that the interaction between the reform process, domestic political economy and foreign direct investment (FDI) has had a differential impact within Korea.

In order to capture the diversity of effects, the third part examines three sectors –automobile, banking and telecommunications– that illustrate the role of institutions in the domestic political economy. I analyze the institutional evolution in each sector during the 1980s up to the 1997 crisis. Subsequently, I illustrate how economic interests and government reacted to the shock under particular institutional circumstances. In each case, ownership issues were critical for the immediate success or failure of adjustment. The three selected sectors are taken as sub-cases to illustrate the hypothesis that management of institutional change is possible when political and economic leadership keep a sense of purpose and planning. From this perspective, institutional change is a process of conscious adaptation to the international political economy, maintaining controlled check

[1] The paper is mostly based on my PhD dissertation concluded in 2007. It also benefited from further thoughts about the main issues and the feedback of colleagues after the final version of the thesis was submitted.

and balance systems, but providing room for domestic private capital to pursue their own initiatives. The management and gradual liberalization of foreign investment regime has been a key factor to remain competitive, at least in two of the sectors analyzed (automobile and telecommunications).

The three cases show that evolutionary change and purposefulness are not necessarily contradictory processes. When analyzing individual sectoral cases, it is quite clear how economic liberalization in the 1980s, notwithstanding some trial-and-error phases, became a purposive strategy to resist external forces. This was due to the close relationship between domestic economic groups and the government reflected in the FDI policy as a part of the property regime. Although such relationship was deteriorated as economic groups gained more financial independence from the government and industrial policy lost its directive functionality in the first half of the 1990s, much of the nationalist inertias and corporate structures and practices remained. Thus, foreign capital found difficult to penetrate into the Korean economic system. The 1997-8 economic crisis was apparently a major shock to the remaining resistance forces to give way to market forces. Foreign investment soared, but mainly to buy troubled firms. However, except for isolated cases, foreign investors did not take full control of corporations. Although Korean capitalism has developed in an internationalized fashion, government and domestic business groups still have a strong presence and clout.

FIRST PART

Globalization and domestic politics

Globalization is generally a concept about the effects that intensifying economic interactions has in several aspect of social life, including the institutional structures of the nation-state. However, the debate is polarized. On the one hand, those who see the increase of trade and investment flows and the expansion of production by multinational firms as an irreversible but positive trend (Sachs, Warner, *et al.* 1995), minimizing the relevance of national economic policies and the meaningfulness of sovereignty (Friedman 2000; Ohmae 1990). On the other hand, those who are rather pessimistic on the effects of market deregulation and the reduction of state's capabilities to tame the hostile and predatory side of economic forces (Strange 1996).

The true effect of globalization in dismantling state's capabilities of economic governance has been questioned. Empirical research has demonstrated the adaptive capabilities of the state to retain its centrality in social change (Boyer and Drache 1996; Wade 1990; Weiss 1998), which generates doubts about the all-embracing and irreversible character of globalization (Helleiner 1996; Hirst and Thompson 1996). Instead of taking radical positions in either way, a moderate position claim for the creation of an effective system of global governance (Hay and Marsch 2001; Held and Koenig-Archibugi 2003), probably utilizing the already existing –but reformed– multilateral organizations and countries' groupings (Hirst and Thompson 1996; Stiglitz 2002). These perspectives of globalization do not utterly downgrade the relevance of sovereign nation-states but it does consider a 'power shift' towards other non-state actors.

The shared concern among most of these perspectives is the issue of institutional change and whether societies and political structures worldwide are converging and, if so, who are the main forces driving the process. The controversy over the convergence of policies and rules among the varied capitalist models is far from being resolved. For example, the importance once given to the autonomy of state agents to design and coordinate industrial and commercial strategies towards global competition is sometimes in conflict with the new liberal standards and democratic check-and-balance systems. This supposes changes in external and domestic environments to which state and non-state actors are obliged to respond and modify their rules and practices in order to sustain their institutional advantages (Hall and Soskice 2001: 62-3).

An important assumption here is that FDI always implies the issue of property and hence the interests of capital owners; therefore, FDI has important implications for the political economy of institutional change. From the multinational corporations (MNCs) side, as private self-interested actors they will predominantly prefer environments that reduce uncertainties and costs to their transactions. Such firms will establish operations in economies with secure and stable legal frameworks, which also provide substantial freedom to control their own network of subsidiaries, and to reinvest or repatriate their gains as they see fit. In addition to those institutional factors, MNCs will look for places with environments in which political and economic leaders' as well as general people's attitudes towards foreign companies do not radically oppose their presence. Ultimately MNCs always exert their ‘structural power’ threatening governments to leave or simply shut down (Scholte 1997: 443, 447-9).

From the side of governments and their institutional jurisdiction, their response to development challenges and the role of private foreign capital can be observed from various fronts. One perspective is to see governments as proactively promoting and welcoming FDI. Another is to see governments competing to attract more FDI into their countries by giving MNCs numerous incentives and a favorable environment. A third way is to observe governments engaging in collective action to harmonize institutional frameworks among other states (Moran, Graham*, et al.* 2005: 378-81). In none of these views governments are indifferent to the implications of FDI, although mostly the attitudes are favorable to MNCs.

Competition among countries to attract FDI is often used as an explanation for the trend toward unilateral liberalization and the associated consequences of reducing governments' power in economic management in a ‘race-to-the-bottom’ phenomenon (Walter 2000: 51), which may produce income polarization, and reduce labor and environmental standards (Sklair 2003), and probably eschewing welfare policies and programs (Gereffi 1985). In some cases, optimists argue, liberalization may also trigger a ‘race-to-the-top’ in regulatory and policy standards (Walter 2000: 51) producing spillover effects thus raising countries' technical capabilities (Moran, Graham*, et al.* 2005: 379-81).

The institutional connection between the domestic and international dimensions

The underlying argument of this paper is that controlling changes in property regimes is crucial to face the challenges of globalization. Such an argument is shaped by the assumption that the propensity for change is contingent upon the institutional legacies that shaped the worldviews and preferences of the major economic and political actors.[2] In this sense, the formal institutional structure not only curtailed the role of MNCs in development but also shaped a nationalistic value system that affected the attitude towards foreign companies.

Around the central argument regarding the importance of property, three processes are interlinked: a) the formation and control of the economic agents by the property regime (domestic dimension); b) the economic liberalization as a process of institutional change (institutional dimension); and c) the increasing importance of international capital along the internationalization of domestic firms (international dimension). The institutional connection between these processes is the foreign investment regime.

The property system is one of the most important institutional factors in the political economy of development because it *affects the formation and control of firms by governing entry and exit mechanisms*. Property regimes comprise the formal set of rules that recognize the possession of an object (tangible or intangible) and grant the right to use it within the boundaries established by the authority and the society. This institution defines the type of productive system, promotes the economic cooperation, governs competition among economic units, stimulates or discourages the investment and capital formation, and makes economic governance possible. However, in some cases, the entitlement to property is dictated by the government in pursuit of development goals. In other words, property systems are a function of power and governance. From a political economy perspective, the property regimes determine who is entitled to participate in the market and benefit from industrial policy incentives; therefore *property regimes can be considered as political institutions.*

Property systems within the institutional structure of the state have the function to filter economic interests, select and coordinate the dominating preferences (Garrett and Lange 1995). Therefore, the change of such institution would signify the alteration of the relations between the government and the business groups. This applies to the emergence of new domestic firms as well as to the entry of foreign companies. Consequently, opening property rules may constrain the government's ability to affect economic performance.

However, the state comprises a mixture of property regimes –or ‘sectoral governance structures’ (Kitschelt 1991)– established according to the nature and technological characteristics of the industries. The institutional variance and the particular arrangement of sectoral property regimes would enable state agents to coordinate the variety of policy choices within the more general pattern of national development. Therefore, a sectoral analysis is an important part of the framework.

[2] As North (2005) points out, the path of action that societies take is based on the particular rationalisation of the learning experience. However, the interpretation of reality may differ according to what a different society made up from its own historical experiences and beliefs.

The second process refers to the connection involving *economic liberalization –including privatization– and change in political institutions*. The relationship between liberalization and political openness is that the reduction of entry barriers to new ownership leads to the emergence of new actors who are independent from government interference. This can create mixed outcomes: on the one hand, if domestic industrial actors are weak, foreign economic interests are likely to penetrate and dominate the national economy. On the other hand, if economic power is concentrated in strong business groups, economic liberalization may lead to further concentration because the new expansion opportunities will be seized by those domestic interests in the absence of significant counterbalance from foreign capital.

The third process that affects the evolution of property regime is the *opening to international forces* such as MNCs. Foreign companies may feel attracted to enter big and integrated markets; once they have gained substantial market share or have acquired controlling stakes in domestic firms they might directly or indirectly influence the business environment. The impact of the international dimension on domestic politics is relevant when external forces impinge upon value systems, thus affecting collective and/or elites' perceptions. Therefore, they are susceptible of ideological influences, which can also be employed for their political convenience or reinterpreted under their belief and value systems.

Nevertheless, policy makers and other relevant actors as lawmakers and regulators are constantly seeking alternatives to maintain the status quo or to adapt the formal institutional framework to domestic and external circumstances. Initially, reformists may liberalize the economy as a complementary disciplinary force to keep control over socioeconomic agents, including the big companies, through the so-called "global standards". Such a strategy does not necessarily seek to cede the power to external structures of governance, but to influence the popular perception that the adoption of new practices will ensure competitiveness and long-term economic survival. At issue is how existing –remaining– formal and informal institutions can provide a viable framework to keep control over the distribution of power and wealth.

The institutional linkage where domestic and international spheres intersect across the three processes – the political aspect of property regimes, economic liberalization, and the exposure to external forces– is the foreign investment regime. Since the property system implies the existence and control of economic groups, one may expect that to open it to external agents would lead to a reconfiguration of policy choices. In the following sections, I explore these issues looking at Korean experience.

SECOND PART

Evolution of the political economy of Korean development and the FDI regime

Korea is an example of a planned economy that industrialized rapidly without relying on FDI but in debt (Kim 1990: 29). The emergence from economic backwardness was either directly or indirectly controlled by the government under a particular formal institutional setting known as the developmental state (DS) (Leftwich 1995; Woo-Cumings 1999; Woo 1991). The government disciplined and directed the private sector toward expansion and greater investment and enhanced the learning capabilities of the society as a whole (Amsden 1989). Despite the inadequacy of technology, the scarcity of capital and the lack of natural resources, government intervention fostered the development of comparative advantages. The success was in part due to the construction of an institutional framework that gave autonomy and centralized power to the bureaucracy, and also due to a socio-cultural and nationalistic disposition to catch-up with advanced capitalist countries (Woo 1991: 84).

The political economy of the DS consisted on the 'tripartite alliance' between the commercial banks, a small group of family managed-and-owned companies and the government at the top of the pyramid (Hahm 2003: 96). Firms were initially specialized in the production of tradable goods and construction activities, but soon after were allowed to diversify. Fiscal and monetary policies worked in favor of the targeted industries and helped them with price incentives. Protection of internal market and selective government procurement were also important incentives for private investors (Amsden 1989). As long as firms inside a selected industry were fulfilling government's expectations, especially the export goals, it was possible to cultivate a stable and cooperative relationship (Kim 1997). These institutional conditions and the control of the banking system vested the government with entry and exit powers thus providing ample scope to influence private business decisions according to the industrial policy (Chang 1994; Woo 1991: 174-5), while the participation of foreign firms was restricted (Mardon 1990; Yun 2003: 258). These factors mark the origin of the Korean industrial conglomerates known as *chaebol*, and the conformation of the developmental coalition.

The DS model established formal and informal barriers to FDI. Korean historical experiences and observations of other developing countries might have been an important influence to shape the perception and sentiments towards foreign investment in terms of economic and technological dependence (Coolidge 1981), thus in political autonomy. Foreign capital was subject to strict legal controls and restrictions during the critical periods of industrialization (1960s-1970s) only to be relaxed but not eliminated during the 1980s and 1990s (Kim 1988). Consistently, foreign investment laws were linked to the industrial policy (Lee 1987: 36-7, 47). Industrial plans set targets for localization and government-run companies seldom opened procurement to foreigners. Much of these formal obstacles in addition to administrative procedures continued for long time (Lim 1999: 53; Yun 2003: 239).

Korean businessmen developed their own sense of nationalism and self-sufficiency too. They were probably conscious of the advantages of foreign investment, but were influenced by the family-oriented tradition of their companies which reinforced a desire for control (Steers, Shin*, et al.* 1989). Such preference was strengthened by the organizational and ownership structure (Yun 2003: 234) as well as by government's localization preferences. In such structure, property regimes and corporate structures were critical to maintain foreign interests at bay (Beck 1998: 227; Moon and Mo 2003: 129), fostering what Doner (1992: 427) called 'industrial nationalism'.

Economic crisis and sectoral governance

As Korea's internationalization and economic performance reached a more advanced status in the world economy in the 1990s, it was important for political leaders to adapt the country's institutions to the new environment. That process included a gradual change of FDI regime. As a result, multinational firms and financial organizations were able to gain access to the Korean market although they did not really operate as a benchmark for corporate practices or as a disciplinary force to improve transparency of business management. Such institutional inconsistency was one of the conditions that lay behind the economic crisis in 1997, which has been considered a watershed into the process of managed institutional change.

However, even though international organizations and foreign investors increased their presence in Korean economic affairs (see figure 1),[3] the main driving force for reform was within the government itself. Interestingly, the government considered FDI as a key factor to support the financial stability (Lim 1999: 24; Lim and Hahm 2005: 24-5). It was also thought the MNCs activities that reforms in corporate practices would come about, facilitate technology transfers, and create more jobs, all of which ultimately would benefit Korean development and national wealth (Cho 2003: 305; Kim 1999a; Lim 1999: 24-5).

The challenge faced by the government and the economic actors was to generate a new environment to attract foreign capital. In late 1997, a new foreign investment law came into force according to which, among other things, restrictions on FDI were further diminished (Kim 1999b). By the end of 1998, the new opposition government had orchestrated a range of institutional changes in the public, financial, and corporate sectors, although it was mostly the implementation of previous reform roadmaps in addition to the IMF conditionalities (Kim 2003a: 55; Lim and Hahm 2005: 27-8).

In order to solve the monitoring problem caused by the government's accelerated roll-back in the 1990s, the progressive administration established new supervisory agencies. One of the most important was the Financial Supervisory Commission (FSC) to scrutinize the activities of the financial companies and to evaluate the progress of corporate reforms. The FSC would also work as an intermediate agency between the *chaebol* and the banking system, which was again temporarily controlled by the government.

The advancement in creation of new checks and balances is undeniable. However, the participation of the foreign companies as catalysts for reforms has been normally overestimated. The issue and sell of shares from Korean companies temporarily solved the liquidity problem in which they were caught after the crisis, but it did not result in a direct participation by the foreign shareholders in all cases. The optimism of the stock market was rather due to the bargain prices of stocks (see figure 1).

[3] Nevertheless, the great majority of incoming capital bought stock-shares at bargain prices and acquired portions of troubled firms through M&As. These developments created concerns about competition as economic concentration appeared to shift from domestic to multinational players.

In sum, it can be seen that indeed many formal institutions, including FDI regime as part of the property system, were substantially transformed after the 1997 economic crisis. Most importantly, the crisis apparently triggered a shift in the mindset of Korean public opinion and suddenly foreign investment was not only welcomed but enthusiastically invited. Nonetheless, older perceptions towards foreign capital and the corporate structures have prevailed despite the shock. This presents a situation of continuity rather than of radical change. This is clearer when the analysis focuses on sectoral variations.

THIRD PART

Sectoral governance in automobile, banking and telecommunications

The process of economic liberalization did not present a uniform path because the property regimes varied according to the nature of the sector, although generally the government imposed its preference to create strong industries independent of MNCs. The institutional evolution of the three economic sectors analyzed here shows that, in general, the presence of foreign firms was marginal; the degree of penetration was contingent on the nature of the economic sector and its institutional characteristics. In each case, ownership issues were critical for the success or failure of adjustment.

Automobile Industry

The history of the Korean automobile industry is quite recent: while a few components and repair facilities existed prior to the 1960s, it was in that decade that the government launched a program to advance into vehicle assembly. Since then the industry has grown rapidly. Currently Hyundai-Kia is among the top 10 producers worldwide and the dominant domestic producer. The factors that make the automobile development a success story are the government guidance, the compromise of local capital –notably Hyundai–, and the institutional framework, which includes the industrial policy and the specific automobile promotion laws. In 1967 the government approved production licenses to Hyundai and others but it was Hyundai Motor Company (HMC) who actually followed thoroughly government's initiative to improve the localization of supplies, machinery and technology in order to develop a "national car" to gain independence from the big manufacturers (Doner 1992; Jeong 2004; Lew 1992).

Although restrictions to FDI were tightened in other sectors throughout the 1970s, foreign participation was to some extent accepted in the automobile industry. In fact, the government tried to encourage the alliances between local and foreign automakers, though some guidelines on foreign equity, technology transfer, raw materials provision, and allocation of credits were also established. However, foreign auto-manufacturers including the main two global players –GM and Ford– were neither interested to comply with localization objectives nor willing to share their key technologies and distribution channels to enhance Korea's industrial base.[4] The GM-Korea[5] alliance was funded according to the particular interests of GM. Therefore, when in 1978 Daewoo took over 50% of the Korean shares of GM-Korea, it also inherited the managerial, technological and structural constraints of its predecessors (Jeong 2004: 140; Lew 1992: 43-4).

In the early 1980s, the new military regime targeted the car industry for structural adjustment by trying to force HMC and GM-Korea to merge. The plan failed basically because the firms were unwilling to subordinate management control and because of the refusal of GM to cooperate with the government's instructions (Jeong 2004; Lew 1992). The failure to restructure the automobile industry reflected the government's limited enforcement abilities, especially with foreign firms, despite the authoritarian approach (Doner 1992: 414). Since then, the process of institutional evolution in the sector followed a mixed pattern of continuities and disruptions. On the one hand, the sector's adjustment was due to purposeful action from the government. This fact represents a salient continuity with the traditional developmental practices. On the other hand, the traditional business-government interaction through exclusion and inclusion mechanisms created by industrial policies and related laws was challenged by the changes in mentality and attitudes due to the new capacities and autonomy of economic agents, which modified the basis of the developmental model.

[4] The problem of being assemblers of foreign cars whether for local or export markets is that localization must comply with the requirements of foreign manufacturers thus reinforcing dependency (Bello and Rosenfeld 1990: 137).
[5] In 1972, Shinjin agreed a 50-50 partnership with GM, creating GM-Korea.

A major institutional change came about in early 1986: the enactment of the Industrial Development Law (IDL). The automobile industry was identified as one of the 'sunrise' or emerging industries and was subject to restructuring measures, though it was given time for adjustment (Chang 1994: 7; Lew 1999: 155). The character of IDL, although conducted by the government, marked a transition stage in the Korean political economy. The government intended to prepare the economic agents, including the automobile sector, for external competition. However, the new institutional framework left no mechanisms to tame *chaebol*'s ambitions to expand and diversify. For instance, DMC expanded by buying facilities in Eastern Europe and Samsung got its license in 1994 after several failed attempts to enter the passenger vehicle manufacturing.

The institutional context created by the government through the automobile industrial policies gave HMC and DMC chances to take advantage of protective car market and licensing conditions (Doner 1992: 418),[6] but each company took a different path. The variation was based on the management style and philosophy of owners-founders that shaped corporate strategies; both factors contributed to establish the intensity of 'industrial nationalism' (Doner 1992: 427), and thus the patterns of interaction with foreign companies. What lay at the bottom of the process was the ownership structure and the preference to keep managerial independence from outsiders. For HMC, both suppliers' diversification and technical agreements that did not compromise managerial and corporate independence were always preferred (Bello and Rosenfeld 1990: 134-5; Doner 1992: 418; Jeong 2004: 123, 178). DMC followed the opposite strategy as it was not concerned with developing its own technology. For DMC's management, it was more important to catch-up quickly regardless of its dependence upon GM. However, despite that Daewoo bought GM's 50% of the joint-venture in 1992, DMC could not shake off the technological dependency that constricted the firm. Later on, DMC was unable to confront the 1997 economic crisis as it was burdened with massive debts and unable to export freely.

The crisis highlighted two factors in the automobile sector: a) the conflicting logics between traditional mindsets and the process of liberalization and b) the importance of ownership. For the automobile industry a whole, the crisis provided suitable conditions for a major restructuring of the sector[7] –including the subcontracting system– and tested the individual strategies of auto manufacturers for coping with such circumstances and for surviving the global competition.

HMC was able to ride out the problem because of the financial support from Hyundai group affiliates, so HMC was not in such a desperate situation as to be rescued by a foreign partner. But most importantly, it succeeded because it had no export restrictions due to its independence from the big manufacturers. This could only be done by producing the key technologies and machinery, especially engines. Therefore, continuous investment in R&D to foster innovation and meet the competition in more advanced product technologies was crucial to survival.

Another lesson is that, doubtlessly, formal institutional factors such as property regimes and industrial policy had a great importance in the development of Korean automobile industry. But the informal by-products and legacies of those formal arrangements –like the preference for autonomy, self reliance and family-oriented structures– can also be regarded as having an equal relevance in fostering competitiveness.

Commercial banking

As with the automobile industry, the banking sector also experienced strong governmental intervention which had mixed consequences. On the one hand, it was beneficial for channeling scarce capital into the industrialization drive that helped Korea to modernize. On the other hand, it had harmful consequences in the long-term improvement of the sector by retarding its upgrading (Woo 1991: 159). Overall, the role of foreign financial institutions was marginal and thus their political influence remained minimal even until mid 1990s (Ruffini 1999).

Partly as a response to the necessities of the stabilization and liberalization programs in the early 1980s, the government included the banking sector in the financial system reform agenda. In consonance with the drive towards a market economy, commercial banks were privatized throughout 1982 and 1983. To prevent industrial capital from taking stakes in commercial banks, the Banking Act maintained the restriction on majority shares and voting rights. Privatization thus meant scattering ownership. Notwithstanding these modifications, the

[6] The government strongly advised local firms that foreign ownership share should not surpass 50% (Lee 1998).

[7] Major changes were the Hyundai-Kia merge (2/3rds of Korean market), and the absorption of Daewoo Motors by GM and Samsung Motors by Renault.

change of the property regime was not accompanied by significant transformation of internal governance structures. Therefore, change in formal institutions did not effectively alter the governance practices of banks and their role as instruments of government policies, even after the 1994 public sector's restructuring (Hahm 2003: 195-6; Park and Kim 1994).

Despite the fact that a civilian leadership took office in 1993 the government initially opted for gradual opening of the capital market to international investors (Lim and Hahm 2005).[8] Eventually, the government allowed financial institutions "to borrow directly from overseas without centralized coordination, leading to an explosion of their foreign borrowing" (Thurbon 2001: 245). The reforms also eliminated entry barriers to non-banking financial companies, and encouraged greater foreign participation that invested in portfolio and short-term transactions rather than in productive activities, which later became a problem (Kang 2000: 93; Thurbon 2001: 246). On top of that, the government transferred the disciplinary mechanisms to the market and kept the supervisory functions fragmented after public sector restructuring in mid-1990s. Such exposure formed the background of the 1997 crisis (Lim and Hahm 2005: 7).

Before the 1997 crisis, there were a total of 26 Korean commercial banks (16 nationwide banks, 10 regional banks). The scale of the crisis was so large that allowing the bigger and most troubled banks to collapse would surely have had severe economic, social and political impacts. Given the size, complexity, and risks of the situation, the government intervened thoroughly. As part of the Financial Sector Restructuring Program, a total of 94 financial institutions of diverse nature had their operations suspended or were closed by September 1998. Through different restructuring methods, the operations of several commercial banks were suspended and liquidated (Kim 2003b: 231-40).[9] As to be expected, the selling of troubled banks to foreign banks as a method to solve simultaneously the liquidity and managerial problems proved to be quite difficult, but the government managed the transition systematically with the newly created FSC, which played a crucial role.

Foreigners faced no restrictions to establish subsidiaries and joint-ventures or own Korean banks, whereas the limits on *chaebol*'s ownership remained (4% in national and 15% in provincial banks). Foreign banks came into Korea, although not as promptly as the government hoped given the liquidity emergency and confidence crisis. The initial reluctance of foreign capital to invest and buy Korean stocks and bonds eased once satisfactory signs of stability could be seen (after banks' and corporations health could be restored). Once the institutional change was implemented and foreign banks and foreign investors had property stakes inside the Korean financial system, the political economy environment changed substantially. It was the first time in the country's history that non-Koreans would acquire controlling shares in a domestic bank. Not surprisingly, the issue still generates controversy and rise concerns about financial sovereignty, the coordination of stabilization efforts, and the long term development by focusing on household credit instead of greater scale development projects.

Basic telecommunications

As with the sectors described above, the Korean government played a major role in the expansion of the telecommunication infrastructure and in the development of endogenous technology. In the 1980s, the sector went through important institutional changes aiming to deregulate competition and the ownership of the state-run carrier KT.[10] From the beginning, the government held total control of the deregulation process, following a gradual approach without letting market forces free at once.

However, the rapid technological changes in the late 1980s and early 1990s, the increasing sophistication of Korean industrial and services base, and the penetration of private groups in less regulated categories (i.e., mobile telecommunications and value-added services) led to the re-examination of the institutional framework. Given this early awareness, the government had time to prepare a modernization plan mostly designed by the KISDI,[11] based on competition,[12] liberalization, privatization, and deregulation. Nonetheless, reforms did not aim

[8] However, the gradual approach to financial reform was abandoned partly because of the commitments acquired prior to the OECD membership in 1996.
[9] "FSC Press Release upon Ailing Bank Resolution" June 29, 1998, http://www.fsc.go.kr/eng/ revised January 29, 2006.
[10] The government held majority ownership of Korea Telecom until its complete privatization in 2002.
[11] Korea Information Society Development Institute
[12] The government introduced a domestic competition scheme by introducing nominally-private carriers in services that did not compete simultaneously over the same services provided by KT (Kim 1993).

the removal of property restrictions to facilitate competition in basic telecommunications (Cho, Choi*, et al.* 1996). Moreover, despite domestic and external pressures and the commitment of the government towards liberalization, local competition remained largely controlled by keeping a reduced number of national operators before opening the market to foreign capital (Cho, Choi*, et al.* 1996: 361; Nam 2000: 360-5; Yoon 1999: 295).[13]

The overall telecom regime changed in the early 1990s. The government allowed competition but established a market differentiation scheme between international, long distance and local telephony.[14] It also introduced a schedule for opening the market to remove ownership ceilings for each service provider. However, the Ministry of Communications (MOC) was still reluctant to embrace full market liberalization and feared that foreign carriers and *chaebol* would eventually undermine its influence over the transformation process (Yoon 1999).

The privatization of KT was on the agenda since 1987, but the government showed no hurry to sell its stakes to the public. It was until 1991 that a new timetable to sell 49% of KT shares was set, although by 1993 the government still owned most of the issued shares of common stock.

Notwithstanding KT's ownership status, the telecommunications service market was not isolated from efficiency pressures and technological innovation, which prompted organizational and human resources reforms within the national carrier (Kwun and Cho 2002). Following government's initiative to modernize public enterprises in early 1990s, KT management attempted to modify its business structure and organization towards profit-driven system, emphasizing R&D and seeking a customer-oriented focus (Kim 1993: 126; Larson 1995: 130; Rhyu 2006: 36-7).

The economic crisis in 1997 led to particular pressure for public sector reform and privatization of state-own enterprises (SOE) was an outstanding issue. But, as mentioned above, the reform of the telecommunications industry, including KT, was already in progress before the crisis. At the time of the economic shock, KT was coming out from an internal reorganization and restructuring. In any case, the main input of the crisis was to accelerate the transformation process and encourage rationalization and downsizing to keep KT afloat.

The economic crisis imposed a new condition on the government and its telecommunications policy. The external pressure from US government, the OECD and the IMF provided a significant push for corporate and market reforms, the need to upgrade Korea's sovereign credit rating, and the improvement of the government budget deficit were strong motivations for implementing them. In that sense, the resistance to institutional change in the ownership regime of KT was rather weak (Kwun and Cho 2002), although concerns for *chaebol* and foreign interests remained.

Just before the crisis, KT was officially a publicly owned joint share company after the abolition of the Korea Telecom Act in early October 1997. Two months later, KT was no longer a SOE, although the Ministry of Information and Communication (former MOC) retained shareholding rights. Restrictions on individual shareholders continued, so ownership remained scattered, thus giving the government an upper hand for a little longer.

On the eve of full privatization, KT was subject to further changes towards private-like corporate governance, organization and shareholder's rights in order to enhance the value of the company. After the last portion of shares destined to foreign markets was sold in January 2002, the remaining 28% stake was to be distributed among domestic investors with some technical restrictions so big conglomerates could be tamed. The government attempted to remain in control of the process until the very last drop of its stockholdings. On mid-May 2002 the government disposed of all of its equity interest on KT so it became fully private, independent company.

Relaxation of ownership restrictions before and after the full privatization of KT may not be as serious as it appears, however. Although foreigners are not impeded legally to participate as CEO or outside directors, foreign stock-ownership is dispersed and no controlling stakes are in the hands of any individual. Therefore, the 49% limit to foreign ownership is not a constraint on KT's day-to-day management. In that sense, KT still is the national telecommunications flagship run by Koreans. Anyhow, foreign shareholders seemed to be satisfied with the performance of KT and its management, especially since KT embraced the government's IT projects and foreign shareholders showed no concerns about the strong government IT policy.

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[13] Including individual ownership ceilings for KT, which aimed to restrict foreigners and *chaebol* (Nam 2000: 355)

[14] The market differentiation implied that licenses were granted for each type of service but not allowing one firm to participate in the other services.

CONCLUSIONS

This paper followed the underlying argument that institutional change is not a mechanical but an evolutionary process that involves some sense of purpose (adaptation to a new environment), legacies of political institutions (power relations and habits), and also the external environment (MNCs presence). This thesis asserts that one institutional connection between domestic and international dynamics is through foreign investment regime as part of the broader property regimes.

In general, Korean institutions such as property regimes endured as the government was able to secure the rule-compliance from business groups, which also developed their own ways to maintain status quo. The issue explored here was how the Korean government managed general economic reforms with differentiated property regimes according to the development needs and the nature of each economic sector.

Through the examination of the Korean case, this paper concludes that the legacies of ownership regimes are important in the process of institutional change. The legacies I am referring to are the mental frameworks and institutional inertias of certain modes of capitalism that linked the notion of property with nationalism. The historical account showed that economic and political actors are constantly adapting their development strategies and worldviews to cope with the challenges of the external environment without loosing the grip of the process.

In using the Korean case, it was possible to observe the ways in which the emergence and evolution of institutional settings, both formal and informal, shaped the dynamics of economic and political forces that made possible the management of national development. It is now common knowledge that the DS shaped the political institutions that formed a distinctive hierarchical structure between government, business and banks. In that sense, the role of the state was crucial as an organizational structure that used property regimes as a filter and buffer of external forces, preventing the negative impacts of economic internationalization.

However, the maturity of the economic system and the technological advance made governmental controls inadequate to sustain the catch up process. The liberal technocracy, which was incorporated into Korean elite in the 1980s and 1990s, elucidated that liberalization was an inescapable condition for survival. As a response to those challenges, major institutional changes were implemented by the new regime, although it is unclear if the government was fully aware of the consequences. For instance, the government opened the property regime to outsiders (FDI regime) to foster the competitiveness of domestic firms but had to confront new distributional pressures across the different national levels and sectors. Moreover, the mechanisms to filter preferences from domestic powerful industrial and financial groups were dislocated and abandoned without substitute mechanisms to counterbalance or keep them in check.

The institutional inconsistencies brought about a model that could not provide the tools to manage the contradictions of paradigm transition, ending up in a major shock to the system as a result of adverse internal and external circumstances. That major shock was the 1997 crisis. Many people in Korea saw the 1997 crisis as the turning point for a shift in understanding the workings of the market economy and to realize that the old developmental paradigm, or what remained of it, was no longer functional. Nevertheless, some nationalistic legacies prevailed such as the eagerness to keep in control of major Korean industries.

Although I found much more continuity than radical changes in the essence of Korean political economy, it would be inadequate to say that little or nothing changed. In order to have a closer and more detailed look at the process of institutional change and the role of FDI, this research explored three sectoral case studies. After all, the process shows that institutional change followed mixed patterns and obviously entailed different consequences for each sector and firm.

The transformation of sectoral governance

In order to illustrate empirically the political economy of institutional change –i.e. opening up the property regime by inviting foreign capitalists to own Korean firms– I explored the historical process of three economic sectors: automobile, commercial banking and basic telecommunications. These cases represent a heterogeneous sample of sectors that were highly regulated in different periods because of their political significance and importance to development. The institutional and organizational changes that started in the 1980s were meant to adapt the Korean model to the external environment, while maintaining the essence of the DS in which the government still played a central role against market forces.

Nevertheless, the changes in ownership structures did not modify the political economy severely in all cases. Except for the automobile industry, foreign capital was not a relevant actor in the domestic economy. Moreover, the remaining formal restrictions in some sectors and the informal barriers demonstrate that the issue of *who* owns national assets was relevant within the nationalist mentality of political leaders, bureaucrats and some business groups.

The value of autonomy has been relevant for Korean bureaucrats and private firms despite the economic opening throughout the 1980s and 1990s. Autonomy is crucial for keeping the pace of technological development and limiting economic dependence from more advanced countries and foreign firms; competition with foreign conglomerates is indeed the driving force and it works as an incentive for both government and Korean firms to remain in control, sometimes despite the political and economic costs. The HMC and basic telecommunications industry cases corroborate the key importance of ownership. The state of commercial banks after foreigners became majority owners of many of them offer another piece of evidence that profit-oriented commercial banking does not necessarily help to boost industrial development.

The institutional change in terms of new practices and expectations has only been partially achieved in the case of Korea as a great deal of continuity was rather the predominant condition. Nationalistic attitudes remained even after the economic crisis and the quick recovery gave policymakers and economic interests the opportunity to get a grip on the process, meaning the slowdown of transformation impetus. Short-term stability as well as political and social considerations was prioritized, so the government rescued many troubled firms instead of closing them. As proof of a willingness to reform, however, the government let some financial and manufacturing companies go bankrupt, obliged others to merge, and opened the foreign investment regime almost completely. However, a paradigm change did not occur in Korea to a full extent. At the end, institutional changes came about in a proportion just enough to keep some of the mental models unaltered, allowing the society to recognize itself after the shock.

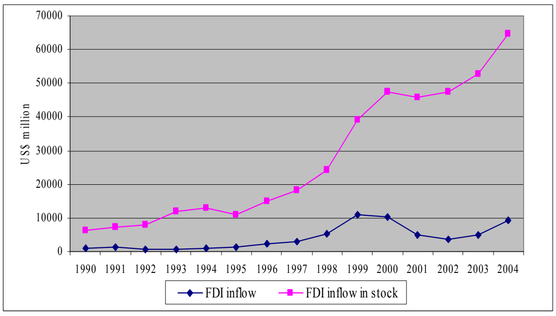

Figure 1 FDI and stock inflows 1990-2004 (US$ million)
Source: UNCTAD, *WIR*, various issues; MOFE (special info request)

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