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Yeoi Lin Lee

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Dedication

I would like to dedicate this M.A. thesis to my grandparents, who were proud farmers and merchants all their life, without whose unwavering support I would not have been able to come thus far. I would also like to thank my parents for giving me many opportunities and my two siblings. And last but not least, I would like to thank Anton for his continuous support and reassurance for the course of the thesis writing.

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1 Introduction

As today's economy becomes more specialized and technologically advanced than ever before, it also struggles to respond to the needs of certain groups of population or industry who contribute to the economy and society at large as well as newly developed and highly fashionable industries do. When we look at a country's primary sector, especially, how it has developed and advanced the initial stages of the country's economic growth, it gives not only an overview of the country's economic history but also a good insight to the present struggles and areas of possible future investment. This is true especially in developed or industrialised countries like Japan and the Republic of Korea (henceforth South Korea) agriculture has lost its economic significance. Nevertheless, it remains an important area of development in the future. There have been numerous literature on the development of agriculture in Asia as many were once agrarian societies before industrialization and some still are.

On the one hand, Japanese economy underwent an impressive economic development pattern which also cultivated an interesting attitude towards international trade: protectionism. Notably, Japanese agriculture still seeks highly protective measures on most of its agricultural products in international trade despite its intention to liberalise trade in 21st century.

As well as South Korea, among the industrialised economies, is often discussed in regard to the country's economic development model in which the power shift between sectors was notably dramatic as the economy rapidly modernised. Even though this paper does not specifically deal with economic development, background information on the economic history of the country will be essential to understanding the current structure of the economy.

Both Japan and South Korea are hardly agriculture-oriented now. Yet, their position on supporting the rice farmers, in specificity, was unchanged mainly because "without protection, the industry would collapse" (Udo, 2008). However, the face of agricultural trade is advocated for liberalisation. With the joining of international trade organisations and signing numerous bilateral trade agreements, both Japan and South Korea's agricultural trade exhibit a slightly different picture now.

Seeing the Northeast Asia region as a potential regional group for further political and economic engagement, the interactions between Japan, South Korea and China are to be noted.

Often the political interactions are hindered due to some residual business from the past and it is definitely worth looking at these as well to analyse the relationships between the nations involved. Unfortunately, the political interactions are only limitedly discussed in this thesis in order to understand some of the resistance and hindrance to more engagement in the past or present.

In this section, one aims to provide a brief yet broad understanding of Japan and South Korea's current political and economic climate in order to introduce the main aim and objectives of the thesis. The thesis is explicitly concerned with two concepts, which are international trade and agricultural sector and trade in Japan and South Korea. This encompasses the questions as to what extent international trade changed agricultural trade in respective countries. Through research, one intends to utilize the concept of international trade in Japan and South Korea in order to analyse their attitude towards international agricultural trade. Further interest is on to what extent international trade has been a regional one as well as how further international trade will affect agricultural sector in both countries.

1.1 Aim and Objectives

Are Japan and South Korea East Asia's biggest enemies or allies? Japan-ROK relations are very labyrinthine, to say the least. The tension between these two U.S. American allies in the Northeast Asian region often leave the U.S. government perplexed in trying to remain neutral on a number of contended issues such as the island in dispute[1] and comfort women during war times, to name a few. Owing to disagreements on the issues left unappeased, Japan-ROK relations are more delicate now than ever before. However, Northeast Asia is no exception to the global trend of integration and cooperation on world trade. The two governments have met a number of times on international forums and summit meetings along with China this year to discuss future political and economic relations of the region.

However, on August 14th, 2015, it sparked tension on media after Japanese Prime Minister Shinzo Abe delivered his statement on commemorating the 70th anniversary of the unconditional capitulation of the Empire of Japan to the United States, which also brought the end to the Japanese

[1] The island in the East Sea (or the Sea of Japan according to many world maps), has been claimed by both governments, is known as Dok-do in Korean and Takeshima in Japanese.

colonial rule and the beginning of an independent state government in the Korean peninsula. Abe's words were "filled with rhetorical twists and did not offer a new apology to Japan's wartime victims" (Gady, 2015). South Korean media reports on Prime Minister Abe's statement were similar in that a report by Tokyo Shimbun was quoted, it was controversial that Abe, for the past three consecutive years, has not expressed any remorse on Japan's wrongdoings on its victim countries (as cited in Newsis, 2015).

More recently, South Korean government protested Japan's Hashima Coal Mine built under Japan's Meiji Industrial Revolution: Iron and Steel, Shipbuilding and Coalmine becoming a World Heritage site because Japan failed to mention that the island had been used for forced labor of Korean workers during its occupation of Korea. Additionally, the details on the agreement of the comfort women issue are: "Prime Minister making an apology and expressing regret, South Korea setting up a foundation for the former comfort women paid for by budget allocations from the Japanese government, and both sides refraining from mutual recriminations on an international level, including at the UN" (Lee, Choi, & Kim, 2015). South Korea's progressive media reported that Prime Minister Abe did not 'sincerely' apologise as he had promised. South Korean's Park administration has further angered the people of South Korea by agreeing to "persuade the former comfort women, Jeongdaehyeop[2], and civic groups to remove or relocate the so-called peace statue of a young girl symbolizing the comfort women, which is currently located in front of the Japanese embassy in Seoul, as the Japanese government has long requested" (Ibid.). The site continues to draw protestors of all ages who are against the government's decision on the "final and irreversible settlement." (Ibid.)

This unresolved negative emotions toward the Japanese government among some Asian countries, namely China and South Korea, can be perpetuated as long as Japan continues to misinterpret their understanding of the history. The Northeast Asian region shares both similarities and differences between nations. Regardless of the issues in dispute, the two neighboring countries have led similar paths of economic development, political enrichment and social changes in recent decades.

[2] Jeongdaehyeop = the Korean Council for the Women Drafted for Military Sexual Slavery by Japan (Lee, et al., 2015)

There have been extensive literature covering the East Asian economic development phenomena i.e. Japan and South Korea's development models. Jang (2006) wrote, "During the second half of the twentieth century, the citizens of the East Asian economies experienced improvements in income and general well-being that are so far unparalleled in human history." Jang also called South Korea's "the best and the worst of the East Asian model as the most 'extreme' variety of it." (Ibid.) Japan's long-term recession is no longer news. Japan had worked its own economic miracle after the World War II, however, has been deeply in trouble since the 1990s. As Paul Krugman (1998) explained that Japan's "bubble economy left a legacy of large debts and troubled bank balance sheets which are widely regarded as the main culprits of Japan's current plight". Krugman also predicted that Japan's slump would be a long one, and evidently only in the fourth quarter of 2013, Japan was reported to have come out of recession in spite of its sluggish growth. (BBC, 2015)

Moreover, Glosserman and Snyder (2015) have stated that "South Korea's great success by following Japan's developmental path, a path that has created an economic and political partner with shared values and common interest in Northeast Asian stability." The former rapidly growing economy, the South Korean miracle, ran its course and slowed down as the annual Gross Domestic Product (GDP) growth barely reached 3% in 2014. (World Bank, 2015a) Fortunately for South Korea, an economist Matthew Circosta of Moody's Analytics in Sydney anticipated South Korea's struggle would not last as long as Japan's, which had lasted for two decades, because South Korea's growth has just begun to decline. (as cited in Einhorn and Kim, 2014) The fear that South Korea will likely repeat Japan's recent past does not only stem from the economic front. Japan is ageing faster than that of any other rich country in the world and South Korea catching up with Japan hastily. (The Economist, 2011a) The fertility rates of both countries are well below the average of OECD countries, in fact, South Korea scores lower than Japan. (OECD, 2015) These concerning social elements contribute to further stagnating the nation's economic growth and competitiveness along with increasing demand of social welfare system in place due to the change in demographics. Japan had been in recession for over two decades and its path to recovery could present what South Korea can do in the foreseeable future to prevent itself from repeating similar patterns.

Why agriculture in focus?

It seems only yesterday when both Japan and South Korea were not today's technologically or globally competitive economies but living on humble farming. In spite of relatively small percentages of arable land: only 11.7% in Japan and 15.3% in South Korea (Central Intelligence Agency, 2015a;b); as well as with limited resources that they had, "South Korea's economy was fuelled by farming and agriculture. In 1970s, farmers accounted for half the population; today, they represent only 6.2%" (Foreign Policy In Focus, Ahn, and Muller, 2013). Similarly, compared to 41% at the time of the Meiji Restoration[3], Japanese agriculture employed only 4% of its total employment in 2010. (World Bank, 2015) As mentioned in the above, this trend is nevertheless a natural consequence of their industrialisation at an unprecedented velocity, which has brought about a striking size of agriculture.

However, it seems the idea and culture of farming are deeply embedded in both societies, especially their love for rice as it is a main staple food item in both countries. In South Korea, "consumers are very conscious of the quality of their rice and now pay more for domestic rice than they would for high-quality imported rice (United States Department of Agriculture, Economics Research Service [USDA ERS], 2010" (as cited in Agriculture and Agri-Food Canada, 2011, p. 6). Harner (2011) suggested that "Japanese consumers are said (by politicians and bureaucrats, that is) to be either indifferent to how such protection reduces choice and raises prices, or to support protectionism because they fear contaminated and disease-bearing foreign products, and the vulnerability of Japan to blockages of agricultural products imports. …particularly strong with respect to rice."

Under current economic structure in which other money-making industries thrive, agricultural sector suffers tremendously. Due to the change in demographics, agriculture is taken up by the elder population. (Yashimata, 2008) For example, "In 2008, just 8.5% of those working in agriculture are aged 39 or under, and only 6.5 % are aged 40-49, compared with 14.7% aged 50-59, 9.9% aged 60-64, 13.6% aged 65-69, and 46.8% aged 70 or over." (Ibid.) Similarly, famers in South Korea are similar as in "over the four decades, farm incomes has increased *(mind the*

[3] The population of Japan at the time of the Meiji era is estimated to be about 34 million and the population of employment in agriculture at the time is estimated to be 14 million. (Yamashita, 2008) Thus, the percentage of employed farmers in Japan in the year 1875 is calculated to be 41 percent.

inflation rate) by approximately 120 times, while debt has increased more than 1,600 times." (Yoon, Song, & Lee, 2013) The significant decline in agriculture does not overthrow the "highly-protected nature of Japan's farm sector" even though "in 2012, the WTO [World Trade Organization] report noted, agriculture only contributed 1.02 percent to Japan's GDP." (Bridges, 2015)

As far as trade is concerned, no other area is more contended than agriculture even though the sector's obvious decline in production compared to the country's service and manufacturing sectors. According to Agriculture and Agri-Food Canada (2011), "The agriculture share of South Korea's gross domestic product (GDP) is small at 3%, but the sector still employs about 7% of the labour force. … Approximately two-thirds of farm income comes from subsidies or trade protection." Japan had signed the General Agreement on Tariffs and Trade (GATT) in 1955 and South Korea in 1967[4], which made them members of the WTO upon signing the new WTO agreements. Moreover, "the Agreement on Agriculture [AoA], which effectively forced the government to eliminate quotas and tariffs even while major agriculture exporting blocs like the United States and European Union still gave billions in subsidies to their own farmers" (Foreign Policy In Focus et al., 2013). However, upon signing the GATT and liberalizing its trade, "South Korea is only 20-percent self-sufficient in grain production, compared with the 1970s when it was at 70 percent" (Ibid.). On the other hand, Japan has continuously shown reluctance to agricultural trade reform which is not in accordance with the WTO rule. (Udo, 2008) The 2015 report by WTO acknowledged some changes were implemented in agricultural programmes, however, "support and protection given to agriculture in Japan remains high compared to other countries and is provided by a comprehensive set of policies" (WTO, 2015).

This thesis does not aim to evaluate advantages and disadvantages of their trade liberalisation policies however, it does attempt to analyse the association between the protectionist attitudes of Japan and South Korea's agricultural trade and trade liberalisation. The Northeast Asian market is known to have protectionist policies as a tactic fearing foreign competition and influence in their domestic market, particularly in Japan and South Korea. In the past several years, both countries have signed more and more trade agreements to deregulate their policies as well as in agricultural policies and the results of such decisions are available to be observed, for instance,

[4] GATT members, World Trade Orgnization. Available from https://www.wto.org/english/thewto_e/gattmem_e.htm

numerous bilateral trade agreements as well as joining of the Trans-Pacific Partnership (TPP) in Japan's case. South Korea has recently showed an interest in joining TPP as well.

The main objective of this thesis is to develop a thorough understanding of the two major economies in the East Asian region in a comparative analysis with a particular emphasis on the notion of international trade and trade policies in the agricultural sector by comparing and contrasting the two countries' stances as well as practices on the subject. The aim and objectives of this Master of Arts (M.A.) thesis do not only meet the requirement of the East Asian Economy and Society M.A. program at the University of Vienna which includes two or more East Asian countries and their economy, politics, or society as the focused topic area but also provides a detailed understanding of the similarities and differences between trade and agricultural sector policies of Japan and South Korea for one's personal and professional interest.

1.2 Research Question

So far both Japan and South Korea have successfully engaged in international trade since the turn of the 20th century, albeit an imperfect one. The thesis presents several notions of international trade that are specific to Japan and South Korea in order to answer the following questions: first, **does the theory of Strategic Trade Policy explain the protectionist agricultural trade policies/government intervention in Japan and South Korea, controlling the effects of the agricultural trade in domestic market?**; and second, **to what extent the agricultural sector and its trade have been compromised in the realm of trade liberalisation?**

Based on the theory of Strategic Trade Theory as the main theoretical framework, it is to be found out if the government interventions can explain their agricultural trade. The hypotheses of this thesis are that both economies' agricultural trade policies have the tendency to be protectionist on the basis of the theory of the Strategic Trade Policy in order to give the domestic market a competitive edge over foreign markets especially when the domestic market is at a disadvantage. The analysis will focus on agriculture, specifically on the product of rice. Additionally, one can hypothesize in another light that the agricultural sector and its trade both in Japan and in South Korea have been largely compromised due to trade liberalisation however, there have been domestic efforts to boost the sector's production and efficiency.

These research questions further inquire about international trade liberalisation and its impact on agricultural trade in the East Asian region. The concept of international trade liberalisation has been effectively taken place in the region through bilateral Free Trade Agreements (FTAs), international trade organisations or partnerships of various kinds, however, each economy took on the liberalisation process individually, not regionally like the European Union (EU). The aforementioned research questions as well as further research areas show Japan and South Korea's similarities as well as differences in the aforementioned areas of interest.

1.3 Outline

The thesis is structured into five sections, reflecting the historical development of Japan's and South Korea's economy since the beginning of trade until the globalization of trade, while combining a review of theoretical foundations and related literature. An analytical framework with methodology follows the theoretical framework and finally the analysis and discussion in accordance with the criteria defined in the analytical framework.

In the following section 2, I discuss the basic overview of the recent Japanese and South Korean history of trade economy in chronology with emphases on significant events. In section 3, I discuss the theorization towards the approach, primarily grounded in New Trade Theory and the theory of Strategic Trade Policy. I provide a literature review of a number of theories leading up to the theory of Strategic Trade Policy as well as highlighted theories in international trade liberalization focusing on the concept origins, definitions, elements, and applications. In section 4, I describe the methodology to conducting this analysis. In particular, I discuss the rationale for selecting a comparative analysis research methodology, as well as the Brander-Spencer model for analysis. In section 5, I describe the analysis and discuss the findings, in the order of agricultural trade policies of Japan and agricultural trade policies of South Korea. Finally, in section 6, I draw conclusions of this thesis and raise propositions for future research.

2 Basic Overview of History of Trade Economy of Japan and South Korea

This section aims to review Japan and South Korea's trade history of trade economy in accordance with a number of significant events throughout recent history so as to provide a historical foundation as well as theoretical approach to the discussion ahead. Japan and South

Korea share a number of similar characteristics in their economic events and most notably their developmental model and pattern. This section provides a comparison and contrast between important characteristics of their economy. This section is explained in five subsections: 1) beginning of trade; 2) postwar; 3) take-off; 4) globalization; and 5) agricultural trade.

2.1 Beginning of Trade

Since Commodore Matthew Perry of the United States Navy on July 8th, 1853 forcibly opened the Japanese harbors to trade with them, Japanese trading economy had been initiated hastily but soon transformed into an advanced economy. The Tokugawa leaders were not pleased with foreign influence over Japan "but in 1854 a treaty was signed between the United States and Japan which allowed trade at two ports. In 1858 another treaty was signed which opened more ports and designated cities in which foreigners could reside. The trade brought much foreign currency into Japan disrupting the Japanese monetary system" (Asia for Educators, 2009a). Combined with domestic troubles, "the weakness of the Tokugawa shogunate before the Western demand for trade, and the disruption this trade brought, eventually led to the downfall of the Shogunate and the creation of a new centralized government with the emperor as its symbolic head" (Ibid.). This eventually led Japan to the Meiji Restoration in 1868. The Meiji Restoration (1868-1912) was the beginning of Japan's political, social, and economic modernization. Imagawa (1992) discussed the role of government during the process of Japan's economic development in which the government heavily influenced its economic growth by using governmental investment and other types of assistance to establish and to develop many of the leading industrial sectors since the Meiji Restoration.

If the United States forced Japan to trade with them, it was Japan that approached the Korean harbors to open for trade. On February 27 1876, a treaty was forcibly signed between Japan and Korea which are called *the Japan-Korea Treaty of Amity* in Japanese and *Treaty of Ganghwa Island* in Korean. Korea's last dynasty Joseon at the end of its age was nicknamed as the Hermit Kingdom because of its isolationist policy which is the name the modern day North Korea bears, which is to describe its closed tendency to the outside world. Japan had planned to claim its power on the Korean peninsula before any other country had their chance to which they succeeded starting with the signing of the treaties. Japan was superior to Korea in terms of weaponry and

machinery and it "used gunboat diplomacy as a way of forcing the Koreans to accept trade and diplomatic relations" (Duus, 1995). As a result of that, the unfair treaty was signed.

Duus (1995) explained that even among the Japanese leaders there were different interpretations of "subduing Korea (sei-Kan ron)" whether Korea would be Japan's tributary state or a "fraternal alliance" to show a solidarity between the two Asian countries against emerging western influence in the Asian region. What is clear about it is that this treaty was the first of many treaties between Japan and Korea and it was soon inevitable for imperial Japanese influence to take over Korea. Consequently, Korea was annexed by Japan from 1910 to 1945. For better or for worse, economic interaction with the outside world for both Japan and Korea was initiated by external powers.

Japanese politics, society, and economy underwent significant changes during the Meiji era. Japan had successfully "regained complete control of its foreign trade and legal system, and, by fighting and winning two wars (one of them against major European power, Russia), it had established full independence and equality in international affairs" (Asia for Educators, 2009b).

The government introduced a number of new strategies for building Japan's infrastructure such as "building railway and shipping lines, telegraph and telephone systems, three shipyards, ten mines, five munitions works, and fifty-three consumer industries (making sugar, glass, textiles, cement, chemicals, and other important products)" (Ibid.). The government quickly ran out of finance so it privatized most of these industries and provided support such as subsidies and other incentives to private investors. (Ibid.) Japan's industrialization gave birth to the *Zaibatsu* (財閥: business conglomerate) which means "samurai or merchants who controlled much of Japan's modern industrial sector" (Ibid.). Namkoong (2006) asserted that Zaibatsu refers to the elite group of businessmen who mainly acquired their wealth during the Meiji Restoration era and played a significant role in developing Japanese economy. The famous four enterprises are Mitsui, Mitsubishi, Sumitomo and Yasuda.

Whereas Korea remained Japan's main supplier of agricultural goods since annexation in 1905. Below is an excerpt about Korean agriculture under the Japanese colonial rule from *South Korea: A Country Study* for the Library of Congress, 1992. (Savada, Shaw, Library of Congress, and Federal Research Division, 1992)

> "The Korean economy also underwent significant change. Japan's initial colonial policy was to increase agricultural production in Korea to meet Japan's growing need for rice. Japan had also begun to build large-scale industries in Korea in the 1930s as part of the empire-wide program of economic self-sufficiency and war preparation. Between 1939 and 1941, the manufacturing sector represented 29 percent of Korea's total economic production. The primary industries--agriculture, fishing, and forestry--occupied only 49.6 percent of total economic production during that period, in contrast to having provided 84.6 percent of total production between 1910 and 1912.
>
> The economic development taking place under Japanese rule, however, brought little benefit to the Koreans. Virtually all industries were owned either by Japan-based corporations or by Japanese corporations in Korea. As of 1942, Korean capital constituted only 1.5 percent of the total capital invested in Korean industries. Korean entrepreneurs were charged interest rates 25 percent higher than their Japanese counterparts, so it was difficult for Korean enterprises to emerge. More and more farmland was taken over by the Japanese, and an increasing proportion of Korean farmers either became sharecroppers or migrated to Japan or Manchuria. As greater quantities of Korean rice were exported to Japan, per capita consumption of rice among the Koreans declined; between 1932 and 1936, per capita consumption of rice declined to half the level consumed between 1912 and 1916. Although the government imported coarse grains from Manchuria to augment the Korean food supply, per capita consumption of food grains in 1944 was 35 percent below that of 1912 to 1916." (p.21)

Tsakok and Gardner (2007) echoed that "after decades of Japanese occupation and their claim to have brought modernization to the Korean peninsula, Korean economy begged to differ. In fact, agriculture in colonial Korea as well as in Taiwan [also Japanese colony at the time] replaced Japan's declining agricultural sector and supplied rice and sugar to the Japanese people." Jeolla Province of South Korea, famous for rice farming, is a perfect example of (coerced) rice export to Japan. Gunsan, in particular, is known for having preserved much of the Japanese remnants around the city where one can still spot many modern architecture and industrial facilities that remained after the Japanese residents had left the Korean peninsula. The Gunsan Modern History Museum displays some statistical information on the production and export of Korean rice to Japan under Japanese rule.

<Outflow of rice under Japanese rule/unit:10,000 seok (= 1,440 tonne)>

Year	Nationwide		Gunsan harbor
	Production	Export	Export
1926	1,497	544	137
1928	1,930	742	161
1930	1,370	540	106
1932	1,590	760	163
1933	1,630	870	179

Table 1.1 (Ko, 2014)

As shown in the above table 1.1, in the year of 1926, 36% of the country's total rice production was exported to Japan. The volume steadily increased and the rice export to Japan was 53.4% of the total rice production in 1933. Moreover, in 1934, which marks the 35th anniversary since the opening of the harbor, it was recorded that 288,000 metric tonne of rice were taken away by Japan.[5] (Ko, 2014) According to the 1909 research by Governor-General of Korea, Gunsan's export-dependency on Japan was 99.9% and import-dependency 89.8%. (Ibid.) As a result of which, Gunsan became the third largest port city in Korea after Busan and Incheon.

During the Second World War, almost all important sectors of the Japanese economy have been under the control of Japanese government. Imagawa (1992) stated that "the companies regarded as important for conducting war were given the highest priority to receive materials, labor power and money by submitting their powers to manage their companies to the government." All factories were transformed into producing for military purpose. Bloch (1941) reported that "beginning in agriculture, forestry, and fishing, spreading with government help, by restrictive regulations, over all the traditional handicraft industries of Japan, the decline of production extended after 1939 into the very heart of Japanese war economy, into the armaments industries." At the same time, Japanese colonies supplied more resources including labor to support the wars.

[5] Author's calculation: 1,000 seok(Korean unit) = 1,440 tonne, therefore 2,000,000 seok = 288,000 tonne

Korea was no exception to the case. Tens of thousands of Korean men were conscripted into Japan's military. Thus, the production of agricultural products dropped and trade was limited to serve the war.

2.2 Postwar

Japanese economy had seriously been exhausted from the war. Imagawa (1992) explained that "by the order of the Allied Forces, the total system of war economy controlled by the Japanese government was destroyed completely." It was a foreseeable result from the last several years of the war that Japan ran short of all the resources it had over the course of the war. The economy underwent a number of changes such as "the leading enterprises called the Dai-Batu were to be dissolved; the landlords in rural areas were also ordered to submit their lands to peasants; and the labor population was to be restructured due to those who partook in the war" (Ibid.). This scenario was similar to the times of the Meiji Restoration where after the feudal system had been lost, the land previously owned by a few feudal lords were redistributed to the common people and a new political, social and economic order was to introduced. This corresponds with what Cypher and Dietz (1997) called "basic building blocks for the field of development economics emerging after the war."

According to the theory of the Big Push by Paul Rosenstein-Rodan (1943), Japan successfully materialized the *hidden potential* in its economic development through "large-scale planned industrialization projects that encompassed several major sectors of the economy simultaneously" (Cypher and Dietz, 1997). "A 'big push' of concurrent industrial investments could launch a chain reaction of virtuous circles and complementary investments that would then ripple in many directions through the economic system. Large-scale investments in several branches of industry would lead to a favourable synergistic interaction between these branches and across sectors" (Ibid.). Rosenstein-Rodan added that the government makes the push to shape its industry. (Ibid.) And Japan did exactly that.

Naturally, Japan had to build up new infrastructure around the country to make up for what had been totally destroyed in the war. Imagawa (1992) claimed that under the Economic Stabilization Headquarters as a new "economic control system," the government intensively invested its capitals into two industries which were iron & steel and coal. "By increasing the

production of iron & steel as well as coal, the Japanese government intended to stimulate the increased production of other economic sectors" (Ibid.). The Korean War which started in 1950 and ended in 1953 was a source of aid into Japanese economy and certainly helped Japan to kick start its economic development. (Ibid.)

Coincidentally, one of the identical characteristics of the economic development of Japan and South Korea is the role of the State whose vital role in reshaping the economy from scratch has been contributing to their economic success to date. It was necessary for the government to re-establish a structure in its economic system in order to cope with the aftermath of the wars. The State decisively planned and executed economic policies and practices through the establishments of the economic planning board in South Korea and economic planning agency in Japan.

As mentioned in the earlier subsection, the legacy of government intervention dates back to after the Meiji Restoration or in other words industrial revolution period of Japan (1868-1912). The government-led investment and other initiatives fuelled industrialization and modernization of the island such as textile, iron and steel industry. The government had also worked closely with the Zaibatsu e.g. Sumitomo, Mitsubishi, Mitsui, and Yasuda. The power of the Zaibatsu weakened as many of the enterprises were subject to dissolution after the war. This period reshaped Japan's economy in terms of tax laws, stock exchanges as well as banking system. Japanese main strategy was to import raw materials from abroad since natural resources were scare and to export back finished goods. Pre-industrialization Japan had focused solely on agricultural sector which diverged to machinery and high-technology industry.

Eventually, South Korea took a similar path under the leadership of Park Chung-hee. South Korea remained underdeveloped and poor after the Korean War had ended in 1953. Khaled (2007) described South Korea as a very poor agrarian country which was even a recipient of foreign aid. The Korean War destroyed what was left of the agrarian economy and the Rhee government had concentrated more on the inter-Korean relations than economic revitalisation which remained very tense after the signing of the armistice. In fact, North Korea was reported to have been more prosperous than South Korea from the end of the Japanese occupation era in 1945 until about the late 1960s because most of the heavy industry in Korea, built during the Japanese occupation era, was exclusively located in the North, closer to major sources of coal and other raw materials whereas the South was merely a farmland.

Soon the first government of South Korea was overthrown by a military coup d'état and the economy began to work its way up. Consequently, South Korea became no stranger to the strong influence of the State especially during the Park Chung-hee administration from 1961 to 1979. Similar to the effect the Korean War had on Japanese economy, the Vietnam War served as a springboard for the initial stages of the economic development in South Korea. President Park's main achievement that is still championed till this day is that he turned the war-torn soil into quickly industrialised under the instructions of the authoritarian leader. The president had a full autonomy of everything, in which "various governmental ministries below him closely cooperated with the Korea Central Intelligence Agency to supervise and regulate political parties, interest groups and private companies" (Kim and Shin, 2004).

President Park welcomed foreign direct investment (FDI) into his country. Park copied Japan's growth model in which the country accepted foreign aid, took out loans from foreign banks to build export industries. (Khaled, 2007) His rationale behind such moves were that "Jeffery Sachs of Columbia University argues that if public investment and foreign aid are big enough, they will boost household incomes, spurring savings and boosting local investment. They should also "crowd in" external investment improving infrastructure" (The Economist, 2011b). The major target industry was heavy chemical industry, specifically, Pohang Iron and Steel Company (today's POSCO) and a few other short-term projects to first and foremost build strong infrastructure in the country. On January 12 1973, Park declared the government's Heavy and Chemical Industrialization Policy. In the plan there were six heavy industries on focus – steel, nonferrous metal, shipbuilding, machinery, electronics, and chemicals. The heavy and chemical industries received special favours also for the Customs Act. (Khaled, 2007) Fourteen key industries, including steel, metals, petrochemical, and shipbuilding received 100 percent direct tax exemption for three years and a 50 percent tax waiver for the following two years. (Ibid.) Additionally, existing and newly developed social overheads such as roads, ports, electricity, and water were prioritized for those industries. (Ibid.)

Fletcher (2011) stated that "private interests have been subordinated to the national economic interest under a system most succinctly desirable as state capitalism. And protectionism is an innate part of that system." According to President Park, "guided capitalism was system of economic management designed to create an economic order that would guarantee the equalization of income and public benefit from the economy" (Woronoff, 1983 as cited in Khaled, 2007, p. 5).

Similar to today's China where "even today, industry is 30 percent owned by the state. Over a dozen strategic industries have been slated to remain under outright government ownership and control, including information technology, telecommunications, shipping, aviation and steel" (Fletcher, 2011). China is a contemporary example of state-guided capitalism and what is controversial is how undemocratic South Korean politics was even after some degree of democratization had been achieved.

Nevertheless, Park's envisioning of South Korea's economy was explained in the first Five-Year Plan. The plan stated that "the nation would achieve 7.2 percent annual economic growth and would secure the basis of a self-supporting economy by boosting exports, fostering industries that could substitute for imports, and improving the balance of payments by increasing the influx of foreign currency" (Khaled, 2007).

The basic targets of the Five-Year Plan were as follows:

a) Securing energy resources, including electricity and coal;
b) Expansion of social overhead capital including railroads and ports'
c) Construction of basic industries, such as cement, fertilizer, and steel plants;
d) Expansion of farm production;
e) Improvement of the balance of foreign payments, and
f) Promotion of technology. (Korean Economy About to Take Off, Ministry of Public Information, Republic of Korea, 1966 p.17) (p.6)

Savada et al. (1990) stated that "The plan called for steady growth for the next three years, low inflation, and sharply reduced foreign borrowing. Exports were to rise by 15 percent a year, inflation was projected to be held at 1.8 percent, and per capita GNP was to rise to US$2,325 by 1986. The annual growth rate was planned to average 7.5 percent though the actual performance was higher. The real GNP growth rate was 7 percent in 1985, but for the next three years 12.9 percent, 12.8 percent, and 12.2 percent, respectively." South Korean economic development was achieved at a rapid speed.

Cho (2015) wrote, "During Park's five-year plans, the government sometimes took successful subsidiaries away from the chaebols: on Park's orders, Samsung would cede a bank, a fertilizer manufacturer and a broadcaster, much to its dismay." Besides, a strong presence of the State in directing the nation's economy seems undemocratic to today's standards. However, it was

definitely easier and faster for the government to execute plans than what is within the capabilities of private-sector companies. (The Economist, 2012)

Japan's *keiretsu* and South Korean *chaebol* as well as contributing factors to 'take off' of these economies will be reviewed in the following section.

2.3 Takeoff

Japan's Zaibatsu was weakened after the war but not completely broken up as an effort to reindustrialise Japan's economy, a newly formed *Keiretsu* (系列: affiliation or series) surfaced. Windorf and Beyer (1996) stated that "Keiretsu represent forms of corporate networks that facilitate intercompany co-operation and the regulation of competition." There have been both horizontal and vertical Keiretsu; the former centred on a central bank with various industries and the latter centred on a major manufacturer and included other various subsidiary bodies. Cutts (1992) asserted "Keiretsu are evidence of Japan's basic nature, and Japanese capitalism differs greatly from typical business practice in the West." The Japanese government has been closely working with Keiretsu in revitalising the economy.

South Korea under President Park Chung-hee formed *Chaebol* which shares the same roots and meaning of the words, business conglomerate e.g. Samsung, Hyundai, Daewoo, to name a few. In fact, Khaled (2007) stated that these companies obtained their wealth from some of the Japanese firms after they had left, and maintained close ties with the government. Several other characteristics shared between Zaibatsu and Chaebol are family-owned, receiving "protection and privileges, including foreign loan guarantees, financial subsidies, protection from independent unionism and a fixed-wage system" (Ibid.). These measures allowed Chaebol to grow bigger and have access to massive industrialization programs. This was a win-win situation for both parties in the name of increasing national welfare because "even the simplest activity requires a network of other activities and that individual firms cannot organise such a large network, so the state or some other giant agency must step in" (The Economist, 2011b). The government and Chaebol groups were a fantastic team in that "Park government provided the blueprints for industrial expansion and the Chaebols realized the plans" (Khaled, 2007). The government needed the large enterprises for their economic and industrial plans and the companies needed the government's cooperation in authorizing large-scale industrial projects.

Chaebol formed the Promotional Committee for Economic Reconstruction, the forerunner of the Federation of Korean Industries (FKI) in 1961. Khaled (2007) stated that FKI had set out to execute the industry development plans in six key industries that were cement, synthetic fibre, electricity, fertilizer, oil refinery, and iron. Khaled (2007) reported that "government-Chaebol cooperation created an astonishing success in the early 1960s." As mentioned in the above, the "large-scale investments in several branches of industry led to a favourable synergistic interaction between these branches and across sectors."[6] Present day FKI as a domestic economic organization continues to work closely with the government and serves the role of an advisory body to the national economy. (The Federation of Korean Industries, 2005)

The main strategy for the South Korean economic growth was the export-oriented regime based on labour-intensive manufacturing industries which, of course, is now taken over by developing countries with cheaper labour cost such as China or some Southeast Asian countries. The Park Chung-hee administration vehemently encouraged Foreign Direct Investment (FDI) which are "international capital flows in which a firm in one country creates or expands a subsidiary in another" (Krugman & Obstfeld, 2000). The massive amount of FDI in South Korea benefited the economy with the inflow of foreign capital that supplemented the shortage of domestic savings. President Park's industrial plan which included "export orientation program, foreign capital inducement and monetary and fiscal reform, export led growth strategy" (Khaled, 2007) has been effective and the tremendous growth was almost instantly evident in the dramatic increase in exports. "During the period between 1962 and 1966, 72.2 percent of required capital was drawn from domestic sources and 27.8 percent from overseas." (Ibid.) "The government took charge of 55.6 percent and the private sector took 44.4 percent." (Ibid.)

However, there were other externalities that contributed to the rapid growth, for example, the Vietnam War for almost two decades (1955-1975). For the duration of 8 years and 6 months until March of 1973, approximately 320,000 South Korean soldiers have been to the war. (DongAIlbo, 2009) During the war 4,407 South Korean soldiers were killed 17,060 wounded. (Ibid.) From 1965 to 1973, South Korean soldiers participating in the war were paid 236 million dollars; 82.2 percent of which was sent back to South Korea. (Ibid.) Moreover, South Korean enterprises enjoyed a substantial profit through munitions supply and services. (Ibid.) Thanks to

[6] The classic reference of this big push theory is Paul Rosenstein-Rodan (1943)

the American military aid and foreign exchange remittances by the South Korean soldiers, the domestic market as well as export industry boomed. (Ibid.) In 1964 a year prior to the deployment of South Korean troops, the country's GNP per capita was only 103 dollars but in 1974 the GNP increased more than fivefold to 541 dollars. (Ibid.) South Korean economy grew thanks to the Vietnam War efforts as Japanese economy had recovered thanks to the Korean War in 1950s.

Japan, on the one hand, "began to see a favourable balance of payments after its accession to the General Agreement on Tariffs and Trade (GATT) in 1955" (Ministry of Economy, Trade and Industry, 2009). Ito (1996) stated that "from the mid-1950s until 1973, Japan grew at a rate comparable to [10 percent or more]." Moreover, "at the height of the postwar miracle, Japan's real GDP expanded four fold in fifteen years, from 1958 to 1973." (Ibid.) Japan made efforts to liberalize its economy in order to reach the goal of 90 percent of the liberalization rate. (METI, 2009) "In 1963, Japan joined the Organisation for Economic Co-operation and Development (OECD) and Japan's economy began operating under open regime." (Ibid.) In the meanwhile, Japan maintained an attitude which is later characterized as typical for an East Asian market, which has been subject to criticisms for those who are for 'free trade'.

Whereas the Keiretsu dominated Japanese economy until the late 20th century, the Chaebol remain an economic power of utmost importance in South Korea. They have also played a significant role in South Korean politics. The late Chung Ju-yung, founder of Hyundai, had also run for presidency in 1992 and continued to remain politically active, particularly, in inter-Korean relations. Chung is noted as one of the key players in realizing the first South-North summit in 2000 as he walked to North Korea passing the border after having sent 500 cows as economic assistance. This was symbolic for having provided the ground for engaging North Korea in an economic alliance with the South. In fact, what later developed as the Kaesong industrial complex, which is a cooperation between South and North Korea, was discussed in the meeting between Chung and Kim Jong-il. (Han, 2015) The Hyundai Group has worked as a bridge between the two governments both politically and economically since then. The current chairwoman of the Hyundai Group Hyun Jung-eun has visited North Korea as a representative of the South in a number of occasions and tourism on the mountain Kumkang remains an important symbol for Hyundai's engagement effort.

However, a few words of criticism on the influence of Japan's Keiretsu as well as South Korean Chaebol in Japan and in South Korea respectively are not unheard of. Khaled (2007) stated

that “the Chaebols-led industrialization accelerated the monopolistic and oligarchic economy in Korea.” Kim and Shin (2004) stated that “political networking rather than economic rationality determined the survival or extinction of a chaebol group.” The legacy of corruption in this regard continues to this day. Keiretsu are said to be too ‘cliquey’ among themselves. Cutts (1992) reported that keiretsu cemented economic structures in which if you’re not part of them, you’d better forget combating to get into the Japanese market. More importantly, what might have been the causes of economic recession in Japan and in South Korea could be owing to the structures made by these economic groups.

The inequality of income and the unequal distribution of wealth in the country are the direct results of such policies giving special favours to certain businesses. It has taken some time to see the negative impacts of such a rapidly developed economy, however, what is clear is, “state-capitalist governments can be capricious, with scant regard for minority shareholders” (The Economist, 2012). “Others may find their subsidiaries or joint ventures in emerging market pitted against state-backed favourites” (Ibid.). “A major concern is the impact of the state capitalist model on the global trading system … ensuring that trade is fair is harder when some companies enjoy the support, overt or covert, of a national government” (Ibid.).

The common criticisms along the financial crisis of 1997 and Japan’s lost decade will be reviewed in the following section.

2.4 Globalisation of Trade

The age of world economy dictates the vulnerability of economies that have opened up their markets, for instance, Japan and South Korea. They have been heavily dependent on international economic events and trade issues. As the 1973-74 oil crisis shocked the steady growth of the Japanese economy, the depreciation of the Chinese yuan will likely affect the whole Asian region and farther. A similar event pertaining to the value of currency introduced a new phase into Japanese economy. The Japanese Yen sharply appreciated: its value tripled from 1970 to 1995. Alexander (1995) wrote, “The Yen has appreciated more than 400 percent against dollar since floating exchange rates were introduced in 1973.” Ito (1996) stated that “Largely due to this currency appreciation, per capita GDP, denominated in U.S. dollars at the market exchange rate, had overtaken that of the United States by the late 1980s.” “Already by the mid-1980s, many

observers were noting that the Japanese economy had matured, with per capita income approaching that of the leading industrial economies and growth slowing to approach rates in the leading industrial economies" (Ibid.). "Market forces, especially the sharp appreciation of the yen, had forced rapid structural changes in industry" (Ibid.). "During the second half of the 1980s, the economy experienced a large speculative bubble in asset prices, which then burst in the first half of the 1990s" (Ibid.). The growth rate did not rise above 1 percent between 1992 and 1995" (Ibid.). The bubble economy brought many Japanese hardships and as economists reflect on the lessons from the era "agree the failure by the BOJ (Bank of Japan) and the Finance Ministry to act quickly in the early 1990s, when it was clear the banks were in trouble, is a major reason for the lost decade" (Johnston, 2009).

On the other hand, South Korea's export-oriented regime with the help of 'government-corporate cooperation' expanded South Korean exports and enabled the astounding growth rate to persist until the Asian financial crisis of 1997. The crisis affected countries across the Asian continent however, South Korea was one of the most harmed by the crisis. From a South Korean perspective, there are two contending paradigms to explain the causes. On the one hand, the first paradigm suggests that "the Korean economic crisis was primarily due to international shocks, external pressures, and foreign conspiracies over which Korea had little, if any, control" (Kim and Shin, 2004). On the other hand, the second paradigm purports that the causes may be found within the financial structure of the country. (Ibid.) Be it either the government or the chaebols. Or both. The paradigm places blame on the Kim Young Sam administration for its "inconsistency, inefficiency, and near-sightedness" of his economic policies. At the same time, the chaebols are blamed for "overspending, borrowing heavily, and overexpanding" that "undermined the confidence of international investors in the Korean economy" (Ibid.). The latter paradigm was proven to be a more relevant one as the 1999 official report produced from a National Assembly hearing confirmed the direct involvement of the internal economic institutions including the government and the chaebol in the crisis. (Ibid.)

The partner-in-crime – government and the chaebol groups – and "the destructive interaction, the devastating interplay between business and politics ultimately led to the economic crisis" (Ibid.). "Those companies that survived and thrived, thanks chiefly to the government's preferential treatment, became the underpinning for a great proportion of the whole economy" (Ibid.). "As a result, the economy became overly dependent on the performance of the chaebol

groups" (Ibid.). To put into perspective, "in 1995, the 30 biggest chaebol groups accounted for 44.9 percent of the Korean economy in terms of sales share and 18.5 percent in terms of employment. (Ibid.) In 2011, the 30 biggest chaebol groups' annual sales accounted for 96.7 percent of Korea's GDP. (Kim, 2012) "Between 1980 and 2011, the assets of these 30 chaebol grew by a factor of 70, while their sales increased 48-fold" (Ibid.). The humungous power of the chaebols groups evidently continue to this very day.

Park Chung-hee was assassinated in 1979 but his guided capitalism lived on. Kim Young Sam, the first civilian president elected since the early 1960s, pledged to achieve an 'economic democracy'. (Kim & Shin, 2004) The first two years of the regime was a continuation of political and economic reforms one after another. (Ibid.) Kim's economic reforms focused on putting an end to the tradition of 'government-chaebol' collaboration as well as 'chaebol reform' in response to 'economic democratization'. (Ibid.) The reforms unfortunately failed noting the obviously enormous share of chaebol in Korean market today. Nonetheless, Kim's further efforts on ecnomy included globalizing the chaebol groups and increasing their international competitiveness. Kim and Shin (2004) echoed that "the Kim Young Sam government miserably failed to democratize both internal structure of the chaebols' and the market structure, but 'succeeded' in strengthening and reinforcing the status of the chaebols in the Korean economy by increasing global competitiveness."

The chaebols became bigger and bigger and they were no longer "a tame and powerless partner to the development state during the 1970s and 1980s" (Kim and Shin, 2004). The government then further implemented financial deregulation and capital market opening in order to facilitate the chaebol's globalization. Short-term borrowing for the firms required no strict regulation thus, "in the banking sector, short-term external debts accounted for 61% of total external debts in 1996" (Kim, 2006). A number of businesses could not deliver returns and profitability and started to lose foreign investors' confidence. A chain reaction of companies' bankruptcy had had a negative effect on foreign reserves and the government decided to request for '58.4 billion dollars'[7]. On January 23, 1997, The Hanbo Steel Co. went bankrupt. On 15 July

[7] The total amount of money that the IMF together with other international financial institutions offered to bail out Korea was $58.4 billion. Out of this, $23.4 billion was reserved as a second line of defense that would be made available to Korea by G-7 countries only if the initial amount of $35 billion contributed by the IMF and other multilateral institutions proved inadequate. The disbursement of the $35 billion was to be spread over more than two years until the year 2000, with each installment conditioned upon the progress Korea was to make in structural reforms

1997, the Kia Group requested for emergency loan. In 1998, the Hyundai motors took over the Kia motors; Daewoo was bought out by American General Motors. The government officially requested financial assistance from the IMF on November 21, 1997.

The International Monetary Fund (IMF) diagnosed South Korea of having "the loss of market confidence, deep currency depreciation, weak financial systems, and excessive unhedged foreign borrowing by the domestic private sector" (Fisher, 1998). Another contributing factor to the crisis was "a lack of transparency about the ties between government, business, and banks" (Ibid.). In dealing with the crisis, on December 3, South Korean government accepted the IMF reform package. Kim (2006) stated that the reforms have set out "to strengthen the legal and regulatory infrastructure, to rehabilitate the financial sector, to aim at strengthening prudential regulation, to reduce moral hazard, to promote capital account liberalization, and to strengthen the corporate governance of financial institutions." Kim (2006) also asserted that the reforms have restructured the balance sheets of financial institutions to avoid the likelihood of a similar crisis in the future, however it is unclear as to if the reforms can further ensure economic growth with stability post-crisis.

In the case of Japan, Asia's biggest economy was not as badly affected as South Korea, Thailand, or Indonesia. Yet, Japan experienced devaluation to a degree, which quickly bounced back thanks to its large reserves. The annual GDP growth fell from 1.6 percent in 1997 to negative (-) 2.0 percent in 1998[8]. Kim and Shin (2004) stated for Japan, the case could be explained as an "intrusion of international factors including the protracted trade conflict with the U.S. and the resultant pressure from the U.S." (Okimoto 1999, as cited in Kim & Shin, 2004, p.14). This period coincided with the period after the Japanese asset price bubble collapsed in the late 1980s, also known as the 'lost decade'. Fisher (1998) explained that "the bad loan problem inherited from the bubble years has continued to fester, contributing to unprecedented bank failures in late 1997, a sharp loss in confidence, and a tightening in credit availability despite record low interest rates." The crisis further stagnated Japan's growth and delayed recovery largely due to the regional

and 11 the further tightening of its monetary and fiscal policies. It is worth noting that the amount Korea was allowed to withdraw immediately after reaching the agreement with the IMF on December 3 was $5.6 billion. Korea was allowed to withdraw an additional $3.5 billion on December 18. Thus, the total amount Korea was able to withdraw during this 15-day period was only $9.1 billion. (Kim, 2006)

[8] GDP growth (annual %) World Bank Data

economic climate. The IMF called Japan on fiscal expansion and structural reform in Japan's financial sector in order to cope with the economic crisis and to Japan's ongoing recession. (Ibid.)

On the note of a lack of transparency which has been pointed out as one of Japanese financial sector's flaws, Fisher (1998) asserted that "the need for transparency in both the banking and financial areas – which contributed to the miscalculation of the impacts of the tax increase in 1997 was great."

Nevertheless, South Korea undertook major structural reforms immediately following the IMF bailout package. South Korea recovered relatively fast from the crisis not only thanks to the IMF bailout package which contained aggressive restructuring of the financial sector but also thanks to the nationwide effort from Korean people who took the matter seriously. Despite the fact that the unemployment rate quickly tripled, Koreans came together to help pay back the IMF debt by donating gold jewellery which included "heirlooms, wedding rings, or small gold figures, such as those traditionally presented in Korea on a child's first birthday" upon request of the government in January 1998. (Becker, 2015)

Unlike South Korea, Japan's 'lost decade' prevailed. The collapse of the asset price bubble had had a bigger impact on Japan's economy than the Asian financial crisis of 1997 did. However, the crisis also left more companies to declare bankruptcy and more people laid off from jobs. After mild recovery in 2000, the economy fell back to another round of 'lost decade' in which GDP fell steadily in nominal terms, real wages fell around 5%, and a stagnant stock and price levels. The workforce underwent significant changes too. As Japan lost some of its competitiveness to its Asian counterparts such as South Korea and China, many Japanese employees were then temporary workers, who had little job security and fewer benefits. It is "easier for businesses to keep using temporary staff – as long as individual workers are replaced every three years" (The Japan Times, 2015).

Another economic crisis has hit South Korea and Japan hard in 2008 just like it hit pretty much the rest of the world. Economic agenda has proven to be the most important issue during political campaigns since the last two recessions. Economic revitalisation served as the number one priority for the incumbent governments. Both administrations are focusing on bettering the economy as Japanese Prime Minister Abe Shinzo and South Korean president Park Geun-Hye ran

their election campaigns on the promise to revive the economy[9]. 'Like father like daughter,' Park Geun-hye declared that economic progress of Korea was her government's primary goal. Likewise, Abe Shinzo has pursued his famous 'Abenomics'.

3 Theoretical Framework

As mentioned in the introduction to the thesis, existing literature on new trade theory and the theory of Strategic Trade Policy discuss both Japanese and South Korean economies in length as both of them have effectively utilized the concepts in their trade and industrial policies. Although the relationship between the concepts has been investigated, the existing literature have little emphasis on the combined implications of the two as a unified analytical tool – a tool that could potentially explain the nature and practice of agricultural trade policies in Japan and South Korea.

In order to obtain a thorough understanding of the topics concerned, it is essential to develop a theoretical framework that explains the foundation. Prior research has largely been devoted to analysing agricultural protection policies and measures in Japan and in South Korea, but few of which contains a comparative research on the two economies. Additionally, in order to investigate the main and sub- research questions, the thesis aims to review, apply and merge the two big concepts 'new trade theory' and 'the theory of strategic trade policy' in the realm of 'international trade liberalisation'.

First, the chapter introduces the two concepts in a theoretical manner. Definition and functions of the concepts are mainly discussed. As background and also to provide insight into the rationale behind policy outcomes, lessons from 'New Trade Theory', 'Protectionism' and 'the theory of Strategic Trade Policy' as well as the trade liberalisation literature will be reviewed. Second, and finally, the chapter concludes on the above by proposing to merge the two concepts into a combined analytical framework tool in order to answer the research questions posed.

Most importantly, both the New Trade Theory and the Theory of Strategic Trade Policy explain the role of government in trade and their protectionist policies as a mechanism the governments use in order to protect their domestic industry from foreign competition in

[9] Known as *Abenomics*, Japanese Prime Minister Abe's signature economic strategy that includes monetary easing fiscal stimulus, and structural reforms elected him for his second term in 2012. (McBride & Xu, 2015) President Park's Creative Economy was the central theme of Park's election campaign in 2012.

international trade. In the realm of trade liberalisation, more and more economies are integrating and joining trading partnerships and organisations. Japan and South Korea have proven to have largely benefited from trade liberalisation. While some industries have benefited, others have declined in sheer number.

The notable Trans-Pacific Partnership (TPP) has a regional significance and relevance to Northeast Asia as Japan after a long deliberation and much hesitation has finally joined the club. South Korea expressed her wish to join the group as well. The mentioned theories essentially discuss their positions on trade liberalisation as new trade theory and the theory of Strategic Trade Policy have differing views on the notion: 'free trade'.

3.1 New Trade Theory

As New Trade Theory (NTT) can be explained in relation to the theory of Strategic Trade Policy which can demonstrate the interaction between government and domestic industries and firms in Japan and South Korea, a detailed look at NTT as the first element of the theoretical framework will provide the readers with a better understanding of the Theory of Strategic Trade Policy and agricultural trade policies under the notion of trade liberalisation in respective countries. The new trade theory reaffirms the advantages of international trade and identifies new gains from it. The early theories primarily provided the groundwork for the new understandings on international trade that is the New Trade Theory (NTT). In a nutshell, NTT is based on product differentiation, economies of scale, and imperfect competition. (Helpman & Krugman, 1989)

3.1.1 Concept Origins

First and foremost, the origin of trade theories dates back to the sixteenth to eighteenth century when 'mercantilism' dominated Europe. The theory supposed having a trade surplus is every country's path to prosperity. (The Economist, 2013) Having more profit to set aside was the ultimate goal of a country to show one's wealth. Naturally the role of government was important in protecting traders and ensuring gains. Then, Adam Smith, father of economics and author of *The Wealth of Nations*, suggested that a country has absolute advantage in production of a product when it is more efficient than other countries in producing it. This line of thought eventually matured to David Ricardo's comparative advantage. Ricardo's comparative advantage suggests

that “static models in which equilibrium is uniquely determined by tastes, technology and factor endowments” (Krugman, 1995 as cited in Marques, 2001). This notion of factor endowments for production which are land, labour and capital is what differed the Heckscher-Ohlin model from Ricardo’s. The two economists from Sweden, Heckscher and Ohlin, developed a theory that “emphasizes the interplay between the proportions in which different factors of production are available in different countries and the proportions in which they are used in producing different goods” (Krugman & Obstfeld, 2000). The Heckscher-Ohlin theory was built on Ricardo’s comparative advantage, which “seems to follow naturally from Ricardo - both models build on the basic idea of differences in production possibilities, with Heckscher-Ohlin simply shifting the explanation of these differences to one that stresses differences in resources rather than in technology; increasing returns stories about trade, in which differences are the result rather than the cause of trade, represent a major departure” (Krugman, 1999). Moreover, Abbott and Kalloi (1996) stated that “[t]he Heckscher-Ohlin-Samuelson framework … including the existence of and importance given by government policy to export subsidies.”

All in all, the New Trade Theory was developed by an economist Paul R. Krugman in his “Increasing Returns, Monopolistic Competition and International Trade” in the late 1970s and most prominently he has won the Nobel Prize in Economic Sciences in 2008 for his findings on the new trade theory. As the name ‘new’ trade theory suggests, the theory bases its assumption on some of the insufficiencies of the ‘old’ theories in explaining the patterns of world trade, for instance, two countries of similar conditions or resources (of factor endowments) will still trade with one another (Krugman, 2008). Marques (2001) identified several criticisms on the traditional trade theory that are:

> “first, the traditional trade theory is unable to explain the existence of different production structures in similar regions;
> second, trade should lead to conflict between factors of production;
> third, countries having complementary factor endowments were the best candidates to the formation of trading blocs, so that they will specialise in different commodities. However, these implications did not accord with post-war facts: trade among similarly endowed countries, intraindustry trade, and the formation of EEC (European Economic Community); and

last, “the traditional trade theory performs poorly when there is high mobility of production factors.”

Moreover, the traditional trade theories and models assumed constant returns to scale and homogeneous goods trade in which a country specializes. Krugman (1979) demonstrated that economies of similar scale (of technology and factor endowments) boosts trade and makes gains from it. Krugman (2008) explained that because of the enormous economies of scale, monopolistic competition occurs especially in the areas of producing highly skilled and expensive goods meaning that trade is easily dominated by a small number of large firms. The idea is to focus on the role of increasing returns to scale and the use of network effects that can occur in key industries.

It is stated that “The presence of economies of scale creates incentives for countries to specialize in the production of a small number of differentiated products and therefore naturally leads towards intra-industry trade. But economies of scale are also at the root of imperfectly competitive markets” (The World Bank, 2015). Intraindustry trade cannot be explained by the Ricardian or the Heckscher-Ohlin model. Krugman (1981) explained that intra-industry trade depends on the similarities of countries concerning factor endowments. That means economies of similar scale and factor endowments do trade with each other. Krugman (1999) asserted that “the rise of intra-industry trade among advanced countries meshed perfectly with monopolistic-competition-cum-comparative advantage models developed by Dixit and Norman, Helpman, and [him]self.” It is stated that “the growing share of intra-industry trade in world markets was calling for an explanation. The introduction of the assumptions of product differentiation and economies of scale into trade models provided an answer” (The World Bank, 2015).

Marques (2001) wrote that “Krugman was neither the first nor the only economist to defend increasing returns: Nicholas Kaldor attacked constant returns in the 1960s, Thomas Schelling talked about dynamics and multiple equilibria in the 1970s and Paul Romer applied increasing returns to economic growth in the 1980s.” Krugman (1987; 1999) himself noted that international economists before him were certainly aware of the increasing returns such as, “R.C.O. Matthews’ 1950 integration of external economies and offer-curve analysis, as well as papers by Chacoliades (1970).” However, Krugman and Helpman (1985) turn the imperfectly competitive framework into ‘new trade theory’. The World Bank (2015) explained that “The intuition is simple: by creating larger and more competitive markets, trade reduces the distortions that are associated with

imperfect competition in a closed economy. As a result, trade protection is associated with greater losses. However, in the case of imperfectly competitive international markets, the literature has identified 'strategic' gains from protection. That is, the use of sophisticated government intervention, known as 'strategic trade policy', can lead to better outcomes than free trade. These however have been quickly dismissed on empirical grounds, especially in the case of developing countries." The theory is basically for interventionist trade policies and measures in the name of raising national welfare however, "the gains from intervention are limited by uncertainty about appropriate policies, by entry that dissipates the gains, and by the general equilibrium effects that insure that promoting one sector diverts resources from others. The combination of these factors limits the potential benefits of sophisticated interventionism" (Krugman, 1987).

Krugman (1987) further stated that it is in a government's interest to intervene "in trade via import restrictions, export subsidies, and so on" which correspond to the theory of strategic trade policy, which "argues against free trade" (Ibid.).

3.1.2 Definitions

The terms 'economies of scale' and 'network effects' have come up most frequently in new trade theory. They can be explained as "in some industries, two countries may have no discernible differences in opportunity cost at a particular point in time. But, if one country specializes in a particular industry, it may gain economies of scale and other network benefits from its specialization" (Pettinger, 2013). In a nutshell, "economies of scale make it advantageous for each country to specialize in the production of only a limited range of goods and services" (Krugman & Obstfeld, 2000). Economies of scale can be either external or internal. According to Krugman and Obstfeld (2000), "external economies of scale occur when the cost per unit depends on the size of the industry whereas internal economies of scale occur when the cost per unit depends on the size of an individual firm." The distinction between the two explains different structure of industries, "[a]n industry where economies of scale are purely external (that is, where there are no advantages to large firms) will typically consist of many small firms and be perfectly competitive. Internal economies of scale, by contrast, give large firms a cost advantage over small and lead to an imperfectly competitive market structure" (Ibid.). Dixit, Norman, Helpman, and Krugman focused on the "internal scale of scale economies [which] necessarily implied imperfect

competition" in order to show that there are high fixed costs, which suggests trade be driven by as "a result of the efforts of firms to raid each other's inframarginal customers." (as cited in Krugman, 1999)

Krugman (1996) defined the idea of increasing returns as the following: "The observation that increasing returns could be a reason for trade between seemingly similar countries was by no means a well-understood proposition. … The idea that trade might reflect an overlay of increasing-returns specialization on comparative advantage was not there at all: instead, the ruling idea was that increasing returns would simply alter the pattern of comparative advantage. Indeed, as late as 1984 many trade theorists still regarded the main possible contribution of scale economies to the story as being a tendency for large countries to export scale-sensitive goods. The essential arbitrariness of scale-economy specialization, its dependence on history and accident, was hardly ever mentioned. To the extent that welfare analysis was carried out, it focused on the concern that small countries might lose out because of their scale disadvantages" (as cited in Krugman, 1999).

The other characteristic about the new trade theory is the imperfect competition. According to the World Bank (2015), "As early as 1936, Haberler noted that the theory of international trade needed further development to incorporate imperfectly competitive markets." Additionally, "In a perfectly competitive market, all firms sell identical products and services, firms cannot control prevailing market prices, market share per firm is small, firms and customers have perfect knowledge about the industry, and no barriers to entry or to exit. If any of these conditions are not met, a market is not perfectly competitive" (DePersio, n/d). Imperfectly competitive markets describe the market conditions more accurately as the market becomes more diverse and both firms and consumers have more and more information and knowledge to make their choices. Advantages of trade under imperfect competition are "in addition to the traditional gains from trade linked to a more efficient allocation of resources, four additional gains" can be identified as:

"i) pro-competitive gains;

ii) gains from economies of scale;

iii) gains from rationalization; and

iv) gains from variety" (The World Bank, 2015).

An example of imperfect competition is monopolistic competition. Krugman (1987) stated that "During the 1970s researchers in industrial organization began to develop models of imperfect

competition that, while admittedly lacking generality, were easy to use and apply." The new models supplied trade theorists with necessary framework for formal modelling of the role of increasing returns as a cause of international trade. At the same time, in a monopolistic competition model, intraindustry is simply "the exchange of manufacturers for manufacturers in two-way trade within the manufacturing sector" (Krugman and Obstfeld, 2000). Furthermore, "Monopolistic competition describes a market that has a lot of buyers and sellers, but whose firms sell vastly different products. Therefore, the condition of perfect competition that products must be identical from firm to firm is not met. … Barriers to entry and exit are lower, individual firms have less control over market prices, and consumers, for the most part, are knowledgeable about the differences between firms' products" (DePersio, n/d). The monopolistic competition or intraindustry-versus-interindustry story that has become, as Krugman (1999) called it, 'emblematic' of the new trade theory.

3.1.3 Elements

The economies of scale and network effects that can occur in key industries are the primary elements of the theory. Another element is monopolistic competition in which only a few existing firms dominate the market share and in world trade, industries in developing countries find it more difficult to enter the market which has already been taken over by developed countries with their advanced industries. Of course, it is advantageous for the few that started out early which can mark their territories more easily. Since there is a limited number of successful firms for production, the economy is met with increased productivity, which naturally results in huge economies of scale. The gap between the few successful ones and latecomers continues to enlarge. However, customers can enjoy a wide range of differentiated goods unlike homogeneous goods in the traditional model.

Krugman (1979) stated that economies of scale can explain the rise to trade and to gains from trade between economies of similar scale in "tastes, technology, or factor endowments." After that has been settled, Krugman (2008) started questioning about "what happens when some (but not all) economic resources, especially labor and capital, can move." The traditional trade theory assumed "if factories and industrial workers can move freely, they'll spread out to be close to the farmers, and neither food nor manufactured goods will have to be shipped long distances" (Ibid.). Krugman's new trade theory, however, suggests that firms would tend to favour one

specific location to produce and maximize the economies of scale rather than spread out their production line. Moreover, more and more producers would likely move their location to where a large market exists and form a home to their specialized products such as the Silicon Valley, Wall Street, etc. Later, Krugman's new trade theory developed into new economic geography in his 1991 paper "Increasing Returns and Economic Geography". Krugman (1991) stated that "if trade is largely shaped by economies of scale, as new trade theory suggests, then those economic regions with most production will be more profitable and will therefore attract even more production. That is, new trade theory implies that instead of spreading out evenly around the world, production will tend to concentrate in a few countries, regions, or cities, which will become densely populated but will also have higher levels of income." Helpman (1987) also stated that "the larger the similarity in factor composition, the larger the share of intraindustry trade." We can infer from the statement that member states of a regional organisation will likely increase trade with one another.

Therefore, new trade theory can also explain growth of globalization. The tendency and efforts to industrialize and globalize developing economies continue however, the developing economies are limited to develop only certain industries because they lag far too behind the economies of scale dominated by the developed nations. The traditional trade theory would suggest that the difference between developing and developed economies lies in their comparative advantages however, new trade theory suggests this is due to the economies of scale the developed industries already have. 'First come first serve' creates barriers for other industries to enter. The developed economies have already dominated the competition and smaller countries' economies are not strong or innovative enough to compete with the developed economies as long as their governments do not actively seek to provide favourable measures of strategies. Lancaster (1980) stated that protection might abolish intraindustry trade, but agricultural protection of a "country within a comparative disadvantage in agriculture may even increase two-way trade in manufactures."

In addition, reciprocal dumping can be explained by new trade theory. Reciprocal dumping coined by James Brander explains "the situation in which dumping leads to two-way trade in the same product" (Krugman & Obstfeld, 2000). It is further stated that "The reciprocal dumping effect probably tends to increase the volume of trade in goods that are not quite identical" (Ibid.). A further discussion on reciprocal dumping continues in the methodology section.

The other element of the theory is that governments tend to intervene in promoting new industries and supporting the growth of key industries. According to Cortright (2001), "New Growth Theory emphasizes that economic growth results from the increasing returns associated with new knowledge." Cortright (2001) asserted technological advancement is changing the face of economy. As "in the 19th century, the most important industries, like manufacturing and agriculture, were characterized by decreasing returns. As agriculture expanded, it would move on to less productive land and confront rising costs or diminishing demand for its product" (Ibid.). However, today, "many of the technologies of the twentieth century are characterized by increasing returns: huge initial costs to create knowledge needed to produce the first product, but much smaller costs for each additional unit of output" (Ibid.).

As mentioned in the above, East Asian countries as well as many developing economies in Southeast Asia are subject to perform protectionist trade policies in order to protect their domestic market. There are different kinds of government intervention such as tariff protection and domestic subsidy to encourage specific industries' growth and performance. The idea is that if the industry has had enough support from the government since infancy, it will rise above the economies of scale and thrive without further government support. As the disadvantages (demerits) of protectionism have been outlined in the above section, government intervention under new trade theory also received criticisms. The idea of any measure of protectionism or barrier to free trade is controversial in the realm of free trade and trade liberalisation. Criticisms include the likelihood of the government having 'poor information about which industry to support and how to go about it' and 'the tendency for powerful vested business interests which rely on state support which then may encourage inefficiency and corruption in the long-term.

As an explanation for some of the protectionist measures based on market imperfections which include limiting imports of foreign products in order to foster the sector serving the domestic market on such industries is infant industry protection argument. The infant industry argument is a key element in protectionism as well. However, Grossman and Horn (1988) in their infant-industry analysis identified flaws in the infant industry argument which is in favour of protecting infant producers that could attract inefficient producers and make the process of quality control a lot more expensive. Besides, "domestic firms suffer a temporary competitive disadvantage owing to their lack of reputation" (Ibid.). In short, Grossman and Horn (1988) concluded that "appropriate

policy should seek to reward firms that invest in their reputations, without encouraging entry or expansion by others."

New trade theory is a mechanism for explaining government intervention. It is not just about advocating government intervention in industry, new trade theory recognizes the economies of scale as a cause of trade. It suggests that free trade and non-intervening government may be much less desirable for developing economies who find themselves unable to compete with already established multi-nationals with a reputation. The new trade theorists asserted that "the gains from intervention are limited by uncertainty about appropriate policies, by entry that dissipates the gains, and by the general equilibrium effects that insure that promoting one sector diverts resources from others. The combination of these factors limits the potential benefits of sophisticated interventionism" (Krugman, 1987). Krugman (2008) restated the purpose of his work in new trade theory that "new trade theory does suggest a possible role for government interventions, but also suggests bigger gains from trade liberalization."

It can ultimately be dangerous for a government to intervene to protect their domestic firms or industries from foreign competition because, in the end, the protected firms or industries would profit at the expense of a foreign competitor. That is, the same can happen to other non-targeted firms or industries that are engaging in international trade if the foreign market decides to intervene which will result in a trade war. This resembles another theory which is called the Prisoner's Dilemma or Game Theory. Prisoner's Dilemma or Game Theory will be discussed in the frameworks in relation to agricultural trade. Abbott and Kallio (1996) stated that "Free trade – elimination of export subsidies" – is only achievable if all agree to cooperate.

If "the Ricardian Simplification" presumed constant returns and perfect competition, the main notion of new trade theory can be summarized to economies of scale and imperfect competition. (Marques, 2001) Krugman (1979)'s model showed that gains from trade will also occur between economies of similar scale which had not been asserted in previous theories. The notion of economic geography allows for countries to trade in proximity. Certain groups would use their political power (i.e. lobbying) to influence the decision-making of state intervention to suit their interest. For example, Japan has a strong agricultural union as well as political interest group who are concerned with opening of the domestic rice market and they will pressure the government to pass legislations that are in their favour.

Medin (2014) asserted that although new trade theory does not make clear policy recommendations, positive effects on certain targeted firms or industries have been shown. He warned that "industrial policy in one country may induce other countries to implement countermeasures, which may led to losses for everyone" (Ibid.). This reasoning is echoed by Abbott and Kallio (1996) that "McMillan shows many of the results in New Trade Theory can be derived in explicit game theoretic frameworks."

Eaton and Grossman (1986) stated an export subsidy with Cournot[10] competition is advantages for the home company at the expense of the foreign firm. Brander and Spencer (1984) asserted the same that an export subsidy with Cournot raises domestic welfare by transferring profit to the home company. Abbott and Kallio (1996) further stated that "Trade interventions may be rational welfare-enhancing policy. Subsidies, rather than taxes and tariffs, may be optimal under certain market structures. A classic example is the debate between Brander and Spencer, and Eaton and Grossman, who show that simply changing a market structure assumption from Cournot to Bertrand[11] can shift the optimal intervention from a subsidy to a tax."

A few points of danger, though, stated by Medin (2014), are that "subsidies are often assumed to be financed through lump-sum taxes, but in real life … tax collection leads to efficiency losses." Additionally, "promoting export in some industries may lead to increased factor prices which can harm other industries" (Ibid.).

However, Krugman (1987) asserted that the new trade theory suggests government intervention such as import barriers, export subsidies, etc. is in a national interest of a government rather than focusing on comparative advantage. Fine and Deraniyagala (2001) concluded that "New trade models incorporate four innovations within neoclassical economics: market imperfections, strategic behavior, and the new industrial economies, new growth theory and political economy arguments." Moreover, "many of the models based on market imperfections and strategic behavior justify interventionist trade policy" (Ibid.). However, it is often rejected on the "political economy arguments" (Ibid.)

[10] Cournot analysis: "A firm determines its sales while price is determined by some unspecified agent so that market demand equals the total amount offered" (Judd, Hoover Institution, & National Bureau of Economic Research, ,1989).

[11] Bertrand analysis: "A firm determines the price at which it sells its output with firms being absolutely obligated to immediately meet the resulting customer demand" (Ibid.).

Even within government interventions, some industries benefit and others lost out. Krugman (1987) stated "the gained excess returns in the subsidized sector must therefore offset the lost returns in the other home sector." Dixit and Grossman (1984) stated that "the general equilibrium principle that promotion of one industry is implicitly taxation of another."

To sum up, whereas traditional trade theories focused on trade between dissimilar countries with different width of technologies, factor endowments, and so on, Krugman and other new trade theorists focused on large amount of trade among similar economies. Moreover, trade models on comparative advantage focused on inter-industry trade in different commodities, New Trade Theory purported considerable intra-industry in similar commodities. Krugman showed that trade is possible and mutually beneficial in the case of two completely identical countries.

3.1.4 Applications

There are arguments for and against interventionist trade policies however, how does new trade theory apply to agricultural sector policies? Prehn and Brümmer (2010) stressed the importance of looking at both farm productivity and agricultural trade using the findings on 'new' new trade theory. The 'new' new trade theory framework based on the so-called Melitz model "makes two important adjustments to the earlier literature" (Medin, 2014). The adjustments are 'fixed export costs' and elimination of 'the assumption of homogeneous firms' which mean that "only the most productive firms will likely export". (Ibid.) This contradicts the findings of the original new trade theory which purports that "either all or no firms will export." (Ibid.) Medin (2014) added that "mutual trade liberalisation will induce more firms to start exporting, and a few large, highly productive exporters will replace many small, less productive non-exporters." However, Dixit (1984) stated that protection can be used for wrong groups.

One sector that has been consistent with government intervention may be agriculture. Balakrishnan (2012) asserted that given the crucial time of food security, government intervention in agricultural markets gains supporters. However, the issue still remains controversial: "… there are those who feel that since the initial economic conditions for government intervention have ceased to exist, governments should withdraw from the food grain market. On the other hand, the current price volatility in the international market has meant that a case for government intervention still exists" (Ibid.). It is argued that "Government intervention in the agriculture sector

is thus predicted on the belief that uncertainty in markets is undesirable from the viewpoint of producer welfare and national food security" (Ibid.).

Even though the share of agricultural contribution may vary between developed and developing economies given the structure of economy, government intervention in some form or the other in agricultural markets is commonplace. (Balakrishnan, 2012) The reason why most governments intervene is "to ensure remunerative prices for producers and affordable prices for consumers" (Ibid.). Governments intervene by "set[ting] prices directly or offer subsidies to farmers. They may also use tariffs and export taxes to raise revenue and/or to manage domestic prices. Subsidized food prices for poor consumers are fairly common. Intervention in the markets for agricultural inputs is also widespread: It is common to find subsidies for agricultural uses of diesel or fuel, electricity, fertilizer, and credit, not to mention government services such as extension and education." (Ibid.)

Krugman (1987) stated that "The economic cautions about the difficulty of formulating useful interventions and the political economy concerns that interventionism may go astray combine into a new case for free trade. This is not the old argument that free trade is optimal because markets are efficient. Instead, it is a sadder but wiser argument for free trade as a rule of thumb in a world whose politics are as imperfect as its markets."

A further discussion on the theoretical background of new trade theory and strategic trade policy continue in the following section.

3.2 Theory of Strategic Trade Policy

To reiterate an important part of new trade theory is that government interventions can advance market results. Governments, according to new trade theory, in the name of maximizing national welfare, "can tax (or subsidize) the output of domestic firms, tax (or subsidize) the exports of these firms, and tax (or subsidize) the imports from the foreign rivals of domestic firms" (Eaton & Grossman, 1986). The theory of strategic trade policy is concerned with raising national welfare by supporting home companies in international competition and stems from this view that interventionist policies by a government can reallocate excess returns from foreign to home enterprises. (Krugman, 1987) In other words, "a "strategic" trade policy of demanding trade barriers for the home market if foreign markets are protected" (Milner & Yoffie, 1989).

Within the realm of international trade, free trade is still championed by new trade theorists. Protectionism is said to be the exact opposite of free trade, however, the theory of strategic trade policy, aligned with new trade theory, is competing with the notion of free trade. Practical implementation of strategic trade policies may result in retaliation and political disadvantage at international market as the strategic trade policies produce gains for a domestic firm often at the expense of a foreign competitor. However, Reimer and Stiegert (2006) concluded that there may also be positive analyses of strategic trade policies in international market. As for the agricultural sector, there is even a greater need for protection, especially rice as "rice plays a central role in Japanese culture, and without protection, the industry would collapse" (Udo, 2008). The same case can be applied to South Korea.

3.2.1 Concept Origins

Before starting with the concept origins of strategic trade policy, one must mention protectionism. Protectionism is an economic policy naturally against free trade for the following reason: "since the emergence of modern nation-states in the sixteenth century, governments have worried about the effect of international competition on the prosperity of domestic industries and have tried either to shield industries from foreign competition by placing limits on imports or to help them in world competition by subsidizing exports" (Krugman & Obstfeld, 2000). The most famous argument for protectionism is the infant industry argument. The argument has been used by many developing countries who lack in what it takes to compete with their counterparts in world market. The first thinker who coined the term in the late eighteenth century was Alexander Hamilton who cleverly used the logic to defend United States' heavy tariffs at the time. Friedrich List is another name who fully developed Hamilton's idea in his 1841 work *The National System of Political Economy*. List (1841) asserted that the infant industry protection is necessary for developing countries as not all countries have the equal status in competitiveness. List also suggested different trade policies be set for different industry branches, it is not necessary to protect all branches of industry equally.

The impacts of protectionist policies are debatable. International organizations such as OECD and WTO make the case against protectionism. OECD (2015) wrote that "In the fact of concerns over unemployment and recession, governments are coming under pressure to implement

protectionist policies and measures – including tariffs, quotas and various forms of subsidies – as a way of 'saving' domestic jobs and enterprises. However, such measures would be counter-productive. Direct trade-restricting measures have the most negative impacts on growth and employment." OECD further suggests that "governments should resist calls for protectionism and instead pursue further trade liberalisation" (Ibid.).

To all the criticisms directed at protectionism, Ha-Joon Chang (2002), economist and professor of Cambridge University, wrote "almost all of today's rich countries used tariff protection and subsidies to develop their industries." Thanks to such policies protecting the domestic market from being crippled by foreign, more competitive and powerful industries and firms, some economies developed faster than others.

Protectionism has been widely used in international trade. The WTO member countries' agricultural protection measures must conform to the guidelines. Japan's agricultural protection policies have technical trade measures, tariff and nontariff measures, which reflects a tendency of strong protectionism. Japan's long-term implementation of protectionist policies for agricultural trade, including factors that are natural conditions, industrial protection, and import controls reaffirm Japan's will to protect agriculture. In practice, the strong protection measures reflect Japan's advantages in economy and technology.

The theory of strategic trade policy, which was developed in the early 1980s, "offers a way of conceptualizing and testing for strategic government interventions in imperfectly competitive international markets" (Reimer & Stiegert, 2006). As the theory introduced oligopoly[12] which presents a barrier in the market for the later entry competitors, the aforementioned government interventions of large-scale investments i.e. domestic firms that were strategically favored by government prompted Japan to be "the most visible strategic trade policy of the industrial countries" (Krugman & Obstfeld, 2000). They also pointed out there are two phases in Japan's trade strategy. The first is the aforementioned government interventions of large-scale investments by government agencies and the latter is the shift to high-technology industries. (Ibid.) In terms of food and agricultural markets, Reimer and Stiegert (2006)'s findings are critical in a sense that "while many international markets are characterized by oligopoly, price-cost markups tend to be

[12] Oligopoly describes a market in which control over the supply of a commodity is in the hands of a small number of producers and each one can influence prices and affect competitors. (Advanced English Dictionary)

small, and the potential gains from intervention are modest at best. In turn, empirical work has turned up few examples in which government intervention has been optimal in a strategic trade sense. Nonetheless, governments are found to frequently intervene on behalf of domestic firms and play a major role in shaping the nature of international competition."

Moreover, how does the theory of strategic trade theory differ from protectionism? Contrary to the infant industry argument, which was the case for the developing nations, strategic trade policy was used to explain the protection of certain high-tech industries in the developed nations. (Cherunilam, 2006) The examples Krugman and Obstfeld used in their book International Economics fifth ed. are Japan, U.S. and western European countries like France. Accomplishments as well as the level of success of their respective strategic trade policies are contested. (Ibid.)

Reimer and Stiegert (2006) warn against stretching the theory of strategic trade policy to make a case for protectionism as "strategic trade theory has shed light on many aspects of international competition, and offers an explanation for the evolution of certain industries for which competitive trade models have little to say. Government intervention in imperfectly competitive international markets is persistent and strategic trade theory offers a way of conceptualizing and testing for these interventions. The empirical strategic trade literature has helped settle some of the debates from the theoretical literature and is addressing positive questions such as whether strategic trade behaviour does occur, despite the normative prescriptions of economists."

3.2.2 Definitions

The definition Spencer and Brander (2008) give to strategic trade policy is the policy that "affects the outcome of strategic interactions between firms in an actual or potential international oligopoly." The interaction between firms are described as strategic in the name of this theory and the "strategic interaction requires that firms recognize that their payoffs in terms of profit or other objectives are directly affected by the decisions of rivals or potential rivals. As a result, firms recognize that their own choices concerning such variables as output, price and investment depend on the decisions of other firms. The existence of strategic interaction is the defining characteristic of oligopoly" (as cited in Durlauf & Blume, 2008).

Strategic trade policy is operated in oligopolistic competition whereas new trade policy in monopolistic competition. Collins (2012) explains the difference between the two kinds lies in the number of sellers in the competition that "Under monopolistic competition, many sellers offer differentiated products – products that differ slightly but serve similar purposes. By making consumers aware of product differences, sellers exert some control over price." However, "in an oligopoly, a few sellers supply a sizable portion of products in the market. They exert some control over price, but because their products are similar, when one company lowers prices, the others follow" (Ibid.).

Krugman and Obstfeld (2000) explain strategic trade policy is one possible answer to improving a country's economic performance. Mainly, "the policies that promote exports or discourage imports in particular sectors" have been extensively practiced by some successful economies including Japan and South Korea. (Ibid.) In the agricultural market, the theory of strategic trade policy, even though some argue it is difficult to carry it out, "shows that in certain circumstances a government can take actions to increase a country's share of … rents." (Reimer & Stiegert, 2006)

Protectionism is an economic policy closely aligned with anti-globalization and anti-free trade. It blocks trade between states, through means of imposing tariffs on imported goods, restrictive quotas, and other government regulations to discourage imports, and limit foreign influence on its domestic market. The term is almost interchangeably used with strategic trade policy in that the policy emphasizes the protection of domestic economy and the interests of the government, regardless of the natural flow of the international market. One can state that strategic trade policy has elements of policies or doctrines which shield businesses and workers within a country by restricting or regulating trade with foreign nations that are similar to protectionism and further improved on the variables. Dixit and Grossman (1984) asserted that "subsidies that assist domestic firms in their competition with foreign rivals are being viewed with increasing favour, both in theoretical analyses and in practical applications."

Reimer and Stiegert (2006) stated that "WTO rules allow for a variety of government interventions in international markets, and many of these – including export subsidies, state-trading operations, subsidized R&D, product standards, and tax and investment policies – are potentially strategic in nature."

Krugman and Obstfeld (2000)'s definitions of these popular means of strategic trade policy (or protectionist policy) are given in the following (some that are not given in their book have been taken from elsewhere):

- "Tariffs are the simplest trade policies, but in modern world most government intervention in international trade takes other forms, such as export subsidies, import quotas, voluntary export restraints and local content requirements" (p.197-8). Domestic economy can gain by increasing its import tariff. The tariff shifts profits from the foreign to the domestic firm.
- "Quotas are limitations on the quantity of imports" (p.188). "The restriction is usually enforced by issuing licenses to some group of individuals or firms" (p.201).
- "Nontariff barriers have become more popular as tariffs and quotas were lowered by the WTO and many bilateral trade agreements" (p.188). Examples include "import quotas (limitations on the quantity of imports) and export restraints (limitations on the quantity of exports – usually imposed by the exporting country at the importing country's request)" (p.188).
- "Export subsidy is a payment to a firm or individual that ships a good abroad. Like a tariff, an export subsidy can be either specific (a fixed sum per unit) or ad valorem (a proportion of the value exported). When the government offers an export subsidy, shippers will export the good up to the point where the domestic price exceeds the foreign price by the amount of the subsidy" (p.198).
- State trading enterprise is "A governmental and non-governmental enterprise, including marketing boards, which have been granted exclusive or special rights or privilege, including statutory or constitutional powers, in the exercise of which they influence through their purchase or sales the level or direction of imports or exports" (Understanding on the Interpretation of Article XVII of the General Agreement on Tariff and Trade, 1994, article 1).
- Subsidized Research and Development (R&D): payments given to firms for research and development including "promotion, and some agricultural and rural infrastructure" (Sumner, 2008).

Abbott and Kallio (1996) stated that especially export subsidies are provided to support domestic producer. Therefore, "Trade interventions are used, however, partly because of market

power in trade, and since that power resides in a few public agencies, strategic interactions in policy setting arise" (Ibid.). "Free trade – elimination of export subsidies – is that solution only if al trading countries cooperate" (Ibid.). Krugman and Obstfeld (2000) wrote that "Economists often argue that trade policies in practice are dominated by special-interest politics rather than consideration of national costs and benefits." They further stated that even if the government aims to raise national welfare by intervening, the harsh reality suggests wealth ends up in the hands of few that are politically strong. (Ibid.) In which case, free trade should give better prospects. (Ibid.)

The retaliatory nature of international market may provide a reason against employing strategic trade policy. This has also been mentioned as the demerits of protectionism. The main argument against such policies to protect domestic market is that these economic gains of an economy is often at the expense of another which has a possibility to create a trade war if the foreign government also decides to employ their strategic trade policy. Therefore, the governments find themselves in a situation called a Prisoner's dilemma. (Krugman & Obstfeld, 2000) Prisoner's dilemma will be further discussed in the following section.

3.2.3 Elements

Krugman and Obstfeld (2000) wrote that "the theory of strategic trade policy is a special case of the domestic market failure analysis." Governments can use protectionist trade policies and measures to shift profits from foreign to domestic firms, thereby raising national economic welfare at the expense of other countries. In practice, however, the will for government intervention is likely to come from a narrowly focused interest group that has a stake in a specific industry and is likely to be politically sought after.

Two household names in this theory of Strategic Trade Policy are James Brander and Barbara Spencer. Spencer and Brander (2008) stated that "the analysis of strategic trade policy provides a helpful framework for understanding the incentives facing governments in trade policy negotiations. In particular, strategic trade policy provides a rationale for the Prisoner's Dilemma mentality that pervades real-world trade policy negotiations" (as cited in Durlauf & Blume, 2008). Their collaborative work on "an international duopoly in which a domestic and a foreign firm compete based on Cournot oligopoly in a third-country market" is noted as pioneering

contributions of strategic-trade policy. In their first paper *International R&D rivalry and industrial strategy*, Brander and Spencer (1983) developed a three-stage game: in the first stage, a subsidy to R&D (or combination of R&D tax and an export subsidy) can increase domestic welfare by shifting profits from the foreign to the domestic firm; in the second stage, the R&D subsidy makes it credible for the domestic firm to commit to a higher level of R&D; finally, the foreign firm is motivated to reduce its R&D and exports.

In their second paper, Brander and Spencer (1985) "envision[ed] two exporting countries selling to a third country that does not produce the product. If the government of one of the exporters makes an aggressive commitment to subsidize sales abroad, and the foreign government does not retaliate, the foreign competitor has to reduce its output and the home firm obtains a larger share of sales and profits. In effect, the export subsidies are 'rent-shifting' policies: they shift oligopoly profits from the foreign firm to the domestic firm. The intervening country sees a national welfare gain despite its subsidization of the foreign importer" (as cited in Reimer and Stiegert, 2006). Reimer and Stiegert's findings are relevant to the purpose of this thesis as the paper "is a survey of recent developments in the empirical literature, with special attention to international food and agricultural markets. These markets are of particular relevance to strategic trade since international market power is often concentrated among a few firms and since GATT/WTO agreements allow for a wide variety of interventions that may be strategic in nature" (Ibid.).

In his earlier work, Brander (1981) came up with "a model in which the rivalry of oligopolistic firms serves as an independent cause of international trade and leads to two-way trade in identical products" (Brander & Krugman, 1983). In their combined work, Brander and Krugman (1983) proceeded further to assert that "the oligopolistic rivalry between firms naturally gives rise to 'reciprocal dumping': each firm dumps into other firms' home markets." Brander and Spencer (1983) stated that "'strategic' moves such as investment in excess capacity or research and development serve in many models of oligopolistic competition – here by the term 'strategic trade policy'." Brander (1981) used a Cournot competition, in which both firms produce identical products. In his model, trade arises from a "dumping or price discrimination motive." Domestic welfare is being raised by competition and therefore lower prices exist for consumers.

Krugman (1987) stated that "the emphasis on external economies suggested by new trade theory is similar to the strategic trade policy argument in offering a reason for the government

targeting particular sectors. However, the external economies argument differs in one important respect; policies to promote sectors yielding external economies need not affect other countries adversely. Whether the effect of one country's targeting of high externality sectors on other countries is positive or negative depends on whether the scope of the externalities is national or international. There is a conflict of interest if knowledge spills over within a country but not between countries."

Krugman and Obstfeld (2000) stated that reasons for domestic market failures "include the possibility that the labor used in a sector would otherwise be unemployed or underemployed, the existence of defects in the capital or labor markets that prevent resources from being transferred as rapidly as they should be to sectors that yield high returns, and the possibility of technological spillovers from industries that are new or particularly innovative." Three criteria have been noted by advocates of the theory: "Industries are desirable if they have *high value added per worker*, if they *high wages*, or if they make use of *high technology*" (Krugman & Obstfeld, 2000)

Krugman and Obstfeld (2000) offered a definition of strategic trade policies that "are those that promote exports or discourage imports in particular sectors. Advanced countries use strategic trade policies in order to improve their economic performance. The proper use of strategic trade policies involves the identification of market failures that justify active intervention of government policy. The two market failures that justify strategic trade policy in advanced countries are technology and externalities and imperfect competition" (p. 275). Colacicco (2013) stated that "Firms face resource constraints and wages are simultaneously determined. Relative to free trade, cross-sector protectionism generates a reduction in the foreign wage without affecting the domestic wage. Domestic countrywide profits benefit from small import tariffs, whereas the foreign counterpart is hit, but when sectors share the same technology. Domestic welfare is unambiguously penalized. Hence, the general-equilibrium cross-sector perspective goes against the textbook version theory of the optimal tariff in partial equilibrium. Rationalization of these effects suggests a political economy view on tariff formation in general equilibrium." Moreover, "The standard literature on STP focuses on single markets, without taking into account factor markets and how they are affected by these policies. Governments ought to look at general equilibrium scenarios to better understand trade policy effects on the economy as a whole, as firms in many markets are likely to compete strategically" (Ibid.).

Both Japan and South Korea have highly technologically oriented markets and these days even in primary sectors like agriculture has adopted new technology and skills to further improve the sector. In order to see if this criterion is satisfied, we have to examine if high-technology industries are subsidized or otherwise protected and supported by government policies. According to Spencer and Brander (1985), the theory of Strategic Trade Policy "locates the market failure that justifies government intervention in the lack of perfect competition" (as cited in Krugman & Obstfeld, 2000, p. 281).

The nature of strategic trade policy is also said to resemble the classical Prisoner's Dilemma game in Game Theory in which "each government, the best decision for itself, will choose to protect" (Krugman and Obstfeld, 2000). Such theory suggests "each government will be better off if it limits its own freedom of action, provided the other country limits its freedom of action as well" (Ibid.). Game theory explains why agriculture lagged behind or was 'unfavored' and suggests that it would increase agricultural productivity globally however, domestic farmers and consumers especially the lower class of the socio-economic stratification of the society will negatively be affected once the domestic market has been exposed to the ever fluctuating world market price for grains i.e. rice. Therefore, highlighting the advantage of both parties agreeing to a trade agreement. The core of the argument in this theory is that trade policy measures including strategic use of export subsidies, import tariffs and subsidies to R&D or investment for firms facing global competition can have strategic effects to their development in the international market.

On the one hand, Salvatore (2007) pointed to a number of serious difficulties when it comes to executing strategic trade policy that are:

1. It is difficult to determine which sector of the economy or economic sector should be favoured.
2. The appropriate policy for the situations is hard to choose.
3. As most nations are making use of strategic trade policies, the benefits for each country are mostly neutralized.
4. The benefits for one country come at the expense of another.

On the other hand, Reimer and Stiegert (2006) provided two rationale behind the theory of Strategic Trade Theory:

> "One rationale is the 'terms of trade' argument, wherein a trade restriction can benefit an individual nation that is large enough to influence world prices. Another rationale is the theory of the second best, which suggests that free trade may not be efficiency-enhancing in the presence of other distortions in the economy."

Dixit and Grossman (1986) analysed the effects of export subsidies in their third-country framework. (as cited in Colacicco, 2013, p.3-4) Brander and Spencer (1984) purported that "The terms of trade will move against subsidizing country but price still exceeds the marginal resource cost of exports so that the resulting expansion of exports can actually raise domestic welfare."

3.2.4 Applications

As for the section 'Applications' to the theory of Strategic Trade Policy, a more detailed explanation will be provided in the methodology section of the thesis and the following will be a preview to the methodology used in this thesis.

According to Spencer and Brander (2008), "Most applications of strategic trade policy assume that firms differ by ownership as well as country of location. This assumption focuses attention on the importance of the policy in shifting profits from foreign to domestic firms. Indeed, strategic profit-shifting is often viewed as the hallmark of strategic trade policy. According to our definition, however, strategic trade policy can apply even if all firms in the industry are owned by residents of just one country. For example, a country might be interested in fostering exports by foreign multinationals that compete with firms located abroad. Potential sources of domestic gain would include rents such as above-normal wages, captured by domestic employees of the multinational, and taxes on the multinational's profits" (as cited in Durlauf & Blume, 2008).

Reimer and Stiegert (2006) stated that "The standard model is set up as a two-stage game. In the initial stage the home government is able to enact an export subsidy for the home firm's output of the homogenous product. In the second stage the firm of each country chooses the quantity to produce and sell to the third country (they are Cournot competitors). Each firm takes the other's output as given when maximizing profit. The domestic government's first-mover advantage is transmitted to the domestic firm such that the latter becomes a Stackelberg leader."

Brander and Krugman (1982) further explained that between two identical countries, “one 'domestic' and one 'foreign', and that each country has one firm producing commodity Z. There are transport costs incurred in exporting goods from one country to the other. The main idea is that each firm regards each country as a separate market and therefore chooses the profit-maximizing quantity for each country separately. Each firm has a Cournot perception: it assumes the other firm will hold output fixed in each country.”

The example of strategic trade policy in action put forward by Reimer and Stiegert (2006) suggests since “world trade agreements for agriculture make allowances for state trading enterprises and certain types of subsidies, this sector has proven to be a fruitful area of investigation.” “For example, evidence of strategic trade policy is found in the international durum wheat market, which has characteristics that closely mimic the strategic trade setting envisioned by Brander and Spencer” (Ibid.). The Brander-Spencer model “locates the market failure that justifies government intervention in the lack of perfect competition” (Krugman & Obstfeld, 2000). Since “some sectors of the food industry lack one or more characteristics of perfect competition and this offers those businesses an opportunity to earn economic profits” (Saxowsky, 2010).

Agriculture as an industry “generally lacks mobile resources; that is, it can be difficult to find an alternative use for farmland or for a tractor that is no longer needed to produce agricultural commodities” (Saxowsky, 2010). Brander and Spencer (1984) stated that “producing countries have cooperative incentives to get together to agree not to use such subsidies, but they also have an incentive to cheat on any resulting agreements, suggesting that international regulations which attempt to discourage subsidization, such as GATT regulations, are likely to require regular reinforcement if they are to survive.” In a nutshell, Brander and Spencer (1984) concluded that when both economies engage in strategic trade policy, both will be worse off.

Aligned with Europe’s Common Agricultural Policy (CAP), Agriculture is one of the most protected areas of trade, for example, the European Union (EU) has a guideline – CAP for its member states to ensure a good standard of produces despite the global challenges. Among the global challenges outlined in the report, foreign competition and food security are major concerns. (European Commission, 2014) Reimer and Stiegert (2006) concluded that through performing strategic government intervention no real gain has been attained.

3.3 Trade Liberalisation

Trade liberalisation and the last two theories in section 3.1 & 3.2 are interconnected. Both theories recognise the importance of trade liberalisation. Trade liberalisation describes the current trend at international trade, simultaneously it provides an answer to why both Japan and South Korea have been so protectionist in this realm. This section provides a literature review on trade liberalisation in global, regional and domestic dynamics specific to Japan and South Korea.

Trade liberalisation and economic growth have proven to correlate that "by liberalising trade and capitalising on areas of comparative advantage, countries can benefit economically" (OECD, 2015). The research questions of this thesis stem from both economic and political theories. The aforementioned David Ricardo's Labor Productivity and Comparative Advantage in "Principles of Political Economy and Taxation" (1817) in the realm of free trade serves as the ground for countries producing the goods which they do most efficiently and trade freely for which they lack in. Ricardo supplied the pillars for today's international organizations such as WTO and OECD, of which Japan and South Korea are member states. It further advocates that "consumers ultimately benefit because liberalised trade can help to lower prices and broaden the range of quality goods and services available" (OECD, 2015). Moreover, "companies can benefit because liberalised trade diversifies risks and channels resources to where returns are highest" (Ibid.).

Lastly, "when accompanied by appropriate domestic policies, trade openness also facilitates competition, investment and increases in productivity" (Ibid.). Also frequent in the U.S. President Obama's State of the Union addresses each year, the trade relations between South Korea and the United States among other trading partner countries have been notable. President Obama stressed the importance of international trade deals and the milestone achieved with South Korea in which resulted in "at least 70,000 American jobs" (The White House, 2011). Therefore, more trade brings nations closer as they 'seal the deal' to deliver their goods and services.

Thus, countries seek to liberalise their economies in hopes of boosting economic growth, especially the developing countries. According to the IMF staff in the report issued in November 2001, "developing countries can ill-afford the large implicit subsidies, often channeled to narrow privileged interests, that trade protection provides." East Asia achieved the level of economic prosperity largely due to the opening of their economies. (Ibid.) Evidence have been demonstrated in the sections of 2 of this thesis. However, amid the positive outcomes of international trade, there are also criticisms. OECD does not discount the fact that in the process of liberalising an economy disadvantaged industries might occur. Krugman and Obstfeld (2000) explained this is due to

"relative power of different interest groups within countries, rather than some measure of overall national interest, is often the main determining factor in government policies toward international trade." However, rather than restricting trade, OECD adamantly encourages other measures to be adopted such as "labour, education and environmental policies" (Ibid.).

Why is there such a push for trade liberalisation? Krugman and Obstfeld (2000) explained that "For the last 45 years of international trade policies have been governed by an international treaty known as the General Agreement on Tariffs and Trade (GATT), and massive international negotiations involving dozens of countries at a time have been held."

Brander and Spencer (1985) stated that most trade liberalisation has been multilateral because countries require reimbursement in the form of freer access to foreign markets for reducing their own tariffs or quotas. They argue imperfect competition attempts to explain the phenomenon that "If imperfect competition is an important characteristic of some international markets, then firms in these markets may earn pure profits. Protection can shift some of these profits from foreign to domestic firms, and in addition, tariffs can transfer foreign rents to the domestic treasury in the form of tariff revenue. There is some cost in that markets are further distorted, but it is clear that, from a purely domestic point of view, protection is likely to be an attractive policy."

Porter (1990) suggested that "among governments, there is a growing tendency to experiment with various policies intended to promote national competitiveness – from efforts to manage exchange rates to new measures to manage trade to policies to relax antitrust – which usually end up only undermining it." According to Krugman and Obstfeld (2000), the "Ricardian model is this approach, in which trade is solely due to international differences in the productivity of labour." Ricardo's comparative advantage suggests that "no nation can or will be competitive in every or even most industries" (Porter, 1990). Therefore, a country is better off investing its resources in industries in which they have 'comparative' competitiveness and trade with other countries for other goods and services which they lack in competitiveness. In short, Ricardo was in favour of industry specialisation and free trade. As explained in the earlier theories, new trade theory distinguishes itself from comparative advantage and acknowledges trade between economies with similar economies of scale still do trade. On the other hand, practical implementation of strategic trade policies may result in retaliation and political disadvantage at international market as the strategic trade policies produce gains for a domestic firm often at the expense of a foreign competitor. However, free trade is not the optimal choice under market

imperfections, which agricultural markets are. (Prehn & Brümmer, 2012) Prehn and Brümmer (2012) advocated for a further agricultural trade libearlisation upon the implementation of 'New New Trade Theory' "because expected gains from trade are much higher than originally expected."

The three major Northeast Asian countries have been very active in signing of bilateral agreements linking to the Americas as well as Australia and New Zealand in the past years. Evidently, the average import tariff in East Asia has fallen from 30 percent to 10 percent over the past 20 years. (IMF staff, 2001) In addition, Scollay (2004) asserted that "the proliferation of preferential trading arrangements (PTAs) has been the most notable development in the trading environment of the Asia Pacific region in recent years." Moreover, since the early 1990s, regional trade agreements (RTAs) have prevailed across the globe. (WTO, 2015) Both Japan and South Korea became member state of Asia-Pacific Economic Cooperation (APEC) in November 1989, which has served as another channel of economic and diplomatic relations between the two countries. Freund and Ornelas (2010) distinguish RTAs from both multilateral liberalization and unilateral liberalization in that tariffs under an RTA fall exclusively for member economies.

Trade liberalisation in Northeast Asia can be highly economically beneficial. As the goal of agricultural trade is to redistribute income, these so-called benefits could undermine the very noble notion of agricultural trade. As it has previously been discussed in new trade theory, trade liberalisation benefits developed countries more than developing countries of which the trend perpetuates.

Adversely, challenging the mainstream view that liberalizing agricultural trade will be beneficial for the world overall, this article contends that agriculture is incompatible with free trade because of its innate role in managing ecological/-natural resources at both national and global levels and the uneven playing field that was created by the way that agriculture has been treated (protected/taxed) differently across countries in the past. (Moon, 2011)

Kim, Lim, and Park (2009) using a Granger causality test found evidence that "imports have significant positive effects on Total Factor Productivity (TFP) while exports do not," which means "the results suggest that TFP growth has been driven, in the main, by the increasingly open market." Based on the quarterly data from 1980Q1 – 2003Q3, Kim et al. (2009) studied the relationship between trade and TFP growth for the Korean economy. Their "findings imply that the salutary impact of imports generally stems not only from competitive pressures and the acquisition of new knowledge from foreign rivals that occurs with increased imports of final goods,

but also from technological transfers embodied in imports from developed countries." Kim et al. (2009) argued that their study is distinctive from previous ones, "which suggested that exports enhance productivity growth because firms exposed to international competition tend to absorb best-practice technology." This point of view, therefore, advocates for trade protection. However, their findings suggest that "at least when it comes to TFP growth, by showing that higher imports would have been particularly beneficial for Korea during the period 1980-2003" (Ibid.). This view challenges the espoused notion of import substitution as well as export-led growth of the South Korean economic development.

Kim et al. (2009) concluded that their findings suggest that "East Asia should be more receptive to foreign imports in order to accelerate growth because imports enhance productivity growth." In other words, they advocate for more trade liberalisation because "import growth brings institutional and technological change into a country." (Ibid.)

Agricultural trade liberalisation takes up only a small amount of overall international trade for Japan and South Korea because their specialisation has lain on service industry however, it is always the case in negotiations for trade agreements that the bottleneck is on agriculture.

In the current trend of trade liberalisation of agricultural production, agricultural trade protectionists and relevant interest groups can find theoretical basis not only from international trade theories, but also from agricultural production itself, for example, the fragility of agriculture: firstly, the agricultural production is an industry with high input and high risk due to the effect of natural conditions and market volatility, therefore, the production and price are not stable; secondly, the inelastic supply and demand of agricultural produce will affect agricultural production, farmers' income, further affect other economic sectors. (Zhang & Jiang, 2008)

In addition to fragility, it is also argued that agricultural products not only supply food which maintain human existence and social stability, but also provide raw materials for the industrial sector, furthermore, the price of domestic agricultural products and trade condition will be adjusted through international trade of agricultural products. (Norton, Alwang & Masters, 2006)

Trade liberalisation would eventually lead discussion to regionalisation of trade in East Asia. We observe that there are already a number of regional trade organizations in the East Asian region i.e. the Association of Southeast Asian Nations (ASEAN), the Asia-Pacific Economic Cooperation (APEC), the Asia Cooperation Dialogue (ACD), to name a few. Nevertheless, it is difficult to conclude that a regionalisation process has begun in East Asia because regionalisation

is a more complicated issue. Nevertheless, on the economic front, there are definitely more integration and cooperation from the countries concerned.

4 Methodology and Analytical Framework

In order to answer the research questions posed in the initial stages of the thesis, an analytical framework comprised of elements from the mentioned theories is chosen to discuss the findings. The applied methodology is a comparative and analytical approach.

4.1 Applied Methodology

In order to answer the two research questions posed in the beginning: first, **does the theory of Strategic Trade Policy explain the protectionist agricultural trade policies/government intervention in Japan and South Korea, controlling the effects of the agricultural trade in domestic market?**; and second, **to what extent the agricultural sector and its trade have been compromised in the realm of trade liberalisation?,** I put forward a quantitative research question in order to answer with a comparative, analytical framework which include a list of government intervention tools in an industry in order to "promote particular exports or discourage particular imports" (Krugman & Obstfeld, 2000).

The analytical framework specifically stems from the theory of Strategic Trade Policy, protectionism as well as new trade theory. On the one hand, since Japan's strategic trade policies throughout the course of its economic development are popular examples, Japan has shown their targeted sectors (i.e. steel and semi-conductors) and their success stories convince us that the country has effectively utilized the policies and produced positive results under such framework. In addition, South Korea has likewise demonstrated their capabilities to the extent that their targeted sectors (i.e. steel and shipbuilding industry) have continuously strived and thrived in the international market. Krugman and Obstfeld (2000) stated that "such policies have been extensively practiced by … Japan and South Korea."

On the other hand, "Agricultural trade research has for a long time recognized the importance of imperfect competition" (Lee, 2002). MacDonald et al. (2015) studied the relationships between trading partners of agricultural products. A distinction is drawn between importing country and exporting country of various agricultural products and the use of natural

resources such as cropland, water, and son on varies according to production. According to MacDonald et al. (2015), Japan and South Korea "were large embodied pasture importers." Fader et al. (2013) explained that they are basically hugely "reliant on imports because of resource constraints; however, South Korea … could theoretically reduce their import reliance if more of their domestic resources were devoted to domestic crop production" (as cited in MacDonald et al. (2015), pp. 285). According to Beghin, Bureau, and Park (2003), "despite partial trade liberalization under the URAA [Uruguay Round Agreement on Agriculture], South Korea has been pursuing a policy of food self-sufficiency using trade restrictions and administrative prices in key agricultural and food markets, while following production targets with partial trade opening in lesser markets."

According to Jelić, Durović, Radojćić, and Anićić (2014), there are four main reasons for government intervention in agriculture that are:

1) Efficiency increase of agricultural production;
2) Protection of farmers' income;
3) National food safety and security; and
4) External effects and public goods in agriculture.

Beghin et al. (2003) found that South Korea's policies actually "result[ed] in considerable welfare losses" and its state objective of self-sufficiency and food security has been met through different means rather than through the policies used. Even though Beghin et al. (2003) generally propose the WTO member states to liberalize their agricultural trade, they also acknowledge there are better means of protection or government intervention than some that are used in practice.

In order to assess the level of protectionist attitude and government intervention in their agricultural policies, the current agricultural policies as well as recent agricultural trade agreements of Japan and South Korea must be examined in accordance with the criteria of the theory of Strategic Trade Theory. As both countries have been effectively engaging the theory of Strategic Trade Policy and protectionism in agricultural trade, the elements of the theory which are **tariffs on imported goods, restrictive quotas, and a range of other government regulations** will be discussed. The list of defined criteria are determined within the realm of protectionism, new trade theory and the theory of Strategic Trade Policy in order to measure the amount of protection in

their respective agricultural policies in Japan and South Korea prior to; as well as in the realm of trade liberalisation in recent years. The list includes ways a government intervenes or subsidizes an industry or a firm according to the Brander-Spencer model.

Reimer and Stiegert (2006), in identifying the categories of government intervention in agricultural and food markets, came up with two strands: the general use of **export subsidies** and **state-trading enterprises**. "GATT Article XVI allows for export subsidies for primary products such as agricultural goods, provided the subsidy received does not displace the exports of another member. Farmers, landholders, and agribusiness are among the direct beneficiaries of these subsidies" (Ibid.) In addition, "the literature on state-trading enterprises (STEs) is growing since they have become quite common in international agricultural markets and are a potential vehicle for strategic interactions. GATT Article XVII is the main body discussing the conditions under which STEs are allowed to operate." (Ibid.) According to the OECD report (2001), "all of the main exporters and importers of agricultural goods use state trading enterprises to manage their agricultural goods."

According to Food Agriculture Organization (FAO) of the United Nations (2002), "About 75 percent of the STEs notified to WTO under GATT Article XVII are involved in *agriculture*." The state trading enterprise in Japan (the Japanese Food Agency) functions as "only the instrument of government policy for administering imports and not necessarily the main cause of the world market distortions" (OECD, 2001). The Japanese central government determines domestic prices and policy instruments which have more of an effect on the agricultural sector than the state trading enterprise. More extremely, "South Korea lists eight state trading enterprises responsible for around 18 commodities" (Ibid.).

Japan's firm stance on protecting its agriculture has been sufficiently explained in the name of increasing its national welfare, whereas the effort to push for multilateral negotiation and trade liberalisation on the rest of the world can also be explained through the beggar-thy-neighbor policies in which other countries that trade with Japan do not benefit or increase their national welfare. It is natural domestic companies as well as labour, no matter what type of industry, tend to favour protection because of profit-shifting motives. (Brander & Spencer, 1985)

In order to answer the latter part of the research questions which is to what extent has trade liberalisation change the course of respective agricultural trade policies and its sector, elements of

new trade theory have been included in the list of criteria. By means of trade liberalisation 1) reducing tariffs; 2) reducing or eliminating quotas; and 3) reducing non-tariff barriers.

A number of characteristics of interventionist policies include export policies/subsidies, import policy barriers, R&D tax and subsidies. Among these, "R&D tax and export subsidy are optimal policy" (Eaton, 1986).

The analytical tool for answering the research questions comparing and contrasting the cases of Japan and South Korea is the Brander-Spencer model as the definition given by the authors of the model in the abstract of their article 'Strategic Trade Policy'.

> Strategic trade policy refers to trade policy that affects the outcome of strategic interactions between firms in an actual or potential international oligopoly. A main idea is that trade policies can raise domestic welfare by shifting profits from foreign to domestic firms. A well-known application is the strategic use of **export subsidies**, but **import tariffs** as well as **subsidies to R&D or investment** for firms facing global competition can also have strategic effects. Since intervention by more than one government can lead to a Prisoner's Dilemma, the theory emphasizes the importance of **trade agreements** that restrict such interventions. (as cited in Durlauf & Blume, 2008, pp. 1)

Hence, the list of defined criteria under Japan and South Korea's agricultural policies are:

- Nontariff barriers
- Export subsidy
- Import tariff
- R&D or investment subsidy (Combination of R&D tax and export subsidy)
- State-trading enterprises

Although most of these criteria have previously been discussed in the theoretical framework section of the thesis, each of them should briefly be defined once more in order to properly compare and contrast Japan's and South Korea's agricultural trade policies. Basic facts or definitions about the criteria are below:

- **Nontariff barriers**: Import quota (limitations on the quantity of imports) and export restraints (limitations on the quantity of exports) (Krugman & Obstfeld, 2000, p.188)
- **Export subsidy**: Payments given to domestic producers who sell a good abroad (Krugman & Obstfeld, 2000, pp. 108)
- **Import tariff**: Taxes levied on imports (Krugman & Obstfeld, 2000, pp. 108)
- **R&D subsidies** (Combination of R&D tax and export subsidy): An export subsidy is a payment to a firm or individual that ships a good abroad. (Krugman & Obstfeld 2000, pp.198)
- **State-trading enterprises (STEs)**: "A governmental and non-governmental enterprise, including marketing boards, which have been granted exclusive or special rights or privilege, including statutory or constitutional powers, in the exercise of which they influence through their purchase or sales the level or direction of imports or exports" (Understanding on the Interpretation of Article XVII of the General Agreement on Tariff and Trade, 1994, article 1, WTO).

The thesis aims to compare and contrast Japan and South Korea in their strategic government interventions using the theory of Strategic Trade Policy as well as other protectionist tools in agricultural trade and in addition, also to access how trade liberalisation has altered the face of agricultural trade policies and its sector. The list of criteria is defined in accordance with popular measures or tools of government intervening in trade. In the following section, I attempt to explain the relevance of the analytical framework in answering the research questions posed.

4.2 Brander-Spencer Analysis as Guiding Analytical Framework

First and foremost, economies of scale in comparison must be identified. The overall trade portfolio is given in the beginning of the analysis of each economy.

Krugman and Obstfeld (2000) stated, "Economies of scale (or increasing returns) make it advantageous for each country to specialize in the production of only a limited range of goods and services." The Brander-Spencer (1985)'s duopoly model displayed "effects of a subsidy [given] to an industry or a firm". A country would justify a government intervention in the name of raising a country's welfare because their own firm would benefit at the expense of the foreign firm,

otherwise known as "beggar-thy-neighbor policies" (Ibid.). Krugman and Obstfeld (2000) pointed to another criticism of the theory of Strategic Trade Theory which is the lack of information to effectively engage the theory into practice. Therefore, for some countries which lag behind in terms of capabilities will be at a strategic disadvantage engaging in such trade relations. Additionally, the successful outcome of the theory depends on individual situations mainly due to the fact that governments often lack sufficient information to make optimal decisions. (Ibid.)

The Brander-Spencer analysis supposes "there are only two firms competing, each from a different country" (Krugman & Obstfeld, 2000). The target industry or firm in our case is agriculture. Thus, for our sake, let us suppose there are two rice producers, and the countries Japan and South Korea. Both can produce 150 tons of short grain rice. "For simplicity, assume each producer can make only a yes/no decision: either to produce or not" (Ibid.).

Table 2.1[13] Two-Firm Competition

Japan / South Korea	Produce	Don't produce
Produce	-5 / -5	100 / 0
Don't produce	0 / 100	0 / 0

Table 2.1 displays a number of scenarios depending upon the decisions of the rice producer in Japan and South Korea. "Either [producer] alone could earn profits making 150 tons of short grain rice, but if both [producers] try to produce them, both will make losses" (Krugman & Obstfeld, 2000). An upper hand is taken by the one who starts producing 150 tons of short grain rice first. The theory goes that if a producer is ahead of the game by the time the other wants to get started, the latecomer "will find that it has no incentive to enter" (Ibid.). Thus, "The outcome will be in the upper right of the table, with [Japan] earning profits" (Ibid.).

Table 2.2 Effects of a Subsidy to South Korea

Japan / South Korea	Produce	Don't produce
Produce	-5 / 20	100 / 0
Don't produce	0 / 125	0 / 0

[13] Table 2.1 and 2.2 were adopted from Krugman and Obstfeld (2000:pp.282-283).

Table 2.2 reflects the Brander-Spencer analysis: South Korea decides to subsidize her rice producer by 25 tons upon entry. Essentially, South Korea government "removed the advantaged of a head start" (Krugman & Obstfeld, 2000). Therefore, South Korean rice producer profits 125 and 25 of subsidy supported by the government. Krugman and Obstfeld (2000) stated that "the subsidy raises profits by more than the amount of the subsidy itself, because of its deterrent effect on foreign competition. The subsidy has this effect because it creates an advantage for [South Korean rice producer] comparable with the strategic advantage it would have had if it, not [Japanese rice producer], had had a head start in the industry."

To reiterate the main points illustrated in the tables above, the decision on profits is first determined by each firm "either to produce … or not" (Ibid.). The illustration provided by Krugman and Obstfeld (2000) shows that the basic idea of the theory of Strategic Trade theory is that the government intervenes in the decision making of the firm 'either to produce … or not' by offering an incentive to the firm to do it no matter if the other firm from a different country decides to do or not. (Ibid.) That is the power of subsidization by the government. Therefore, the single most important element of the theory of Strategic Trade Theory is a subsidy. Brander and Spencer (1984) state that a domestic subsidy lowers the world prices of a given product, which is beneficial for foreign consumers, but it also raises domestic and decreases foreign profit. "Because "some sectors of the food industry lack one or more characteristics of perfect competition and this offers those businesses an opportunity to earn economic profits" (Saxowsky, 2010). Agriculture as an industry "generally lacks mobile resources; that is, it can be difficult to find an alternative use for farmland or for a tractor that is no longer needed to produce agricultural commodities" (Ibid.).

It can be assumed that each criterion of strategic government intervention has some kind of effect on the outcome on the firms or industries in competition. Strategic trade policy states that interventionist policies by government can reallocate excess returns from foreign to home enterprises. (Krugman, 1987) Since the goal of agriculture trade is to redistribute income across the national economy, this criterion is met.

Corden (1997) stated that "direct correction of domestic market failure is desirable; protection is always second-best." How do Japan and South Korea do that raises another question. It is a bit tricky because "government should [always] favour industries that yield positive externalities" (Krugman & Obstfeld, 2000).

However, agriculture, as mentioned in the above, has been shrinking in size and thus significance both in Japan and South Korea whose main industries are technologically advanced ones. In the analysis and discussion, in addition to if the Brander-Spencer analysis be used for sectoral analysis and trade portfolio for Japan and South Korea, one attempts to analyse the rationale for protecting agriculture in the respective countries.

Reimer and Stiegert (2006) stated that "WTO rules allow for a variety of government interventions in international markets, and many of these – including export subsidies, statetrading operations, subsidized R&D, product standards, and tax and investment policies – are potentially strategic in nature."

5 Analysis and Discussion

This section aims to analyse the research findings based on the applied analytical framework and methodology which include a number of criteria for the comparative analysis. The organization for the comparison and contrast analysis is the point-by-point method.

Japan and South Korea's economies share a number of characteristics in agricultural trade, namely protectionist or interventionist attitude. In the overview of the two countries' trade economic history was demonstrated that the two have led a similar path to achieving economic development and are currently faced with a few economic and societal challenges.

Agriculture is one of the most protected areas of trade, for example, the European Union (EU) has a common agricultural policy (CAP) for its member states to adhere to a good standard of produces despite the global challenges. Among the global challenges outlined in the report, foreign competition and food security are major concerns. (European Commission, 2014) Food security (FS) is South Korean government's motivation behind aggressively protecting its agricultural sector. (Beghin et al., 2003) "In particular, it stresses the need for ensuring an adequate supply of food in all market conditions. It motivates its resistance to eliminating farm subsidies by the fact that food security goes beyond a multilateral trade issue" (Ibid.). However, food security is not the only driving force in pursuing high protection. "High agricultural prices are partly motivated by political economy concerns" (Ibid.), The reasons for Japan and South Korea in protecting trade of rice are alike; both countries regard very highly of the staple food: rice. The

Economist (2013) echoes the previous statement by quoting a JA representative that "rice is a spiritual cornerstone." Thus, they do that by the defined criteria and more.

According to Fletcher (2011), the notion of protectionism to Japan is almost something special. It "… runs very deep in its political and economic system. The Japanese themselves certainly believe their economic success has been due to protectionism. No one in Japan of any standing in business, government or academe believes that Japan's success has been due to free trade."

Agriculture, in every sense of the word, is a much needed sector for our sustenance. Countries such as Japan, South Korea, and China are no exception to the rules and have had protectionist policies to help the agricultural sector. The protection of the domestic economy and the interests of the State are at the core of this policy. The policy represents an antonym for free trade. John Maynard Keynes of Keynesianism proposed the operation of protective tariff and pointed out the advantages of tariff protection: first, domestic consumption can be fostered and employment can be increased; second, the pressure on the unfavorable balance of payments deficit can be relieved. (Keynes, 1935) This is opposed to trade liberalisation as well. Because agriculture is regarded 'weak', the trade is also being protected.

Nonetheless, there has recently been an increasing amount of trade across the globe. East Asia is not an exception to the rule. Japan, beginning with its first bilateral trade relations with Singapore, has signed on an FTA with many neighbouring economies in Asia, Europe, the Americas; and joined a number of trade organisations which advocate for more liberalisation and economic integration. South Korea, too, has been keeping up with the trend almost religiously. In the discussion of trade liberalisation, the level of current trade libearlisation in both countries will be discussed as well as prospects of further integration in the region will also be discussed.

In the following section, the agricultural trade is reviewed in order to give background information to the relevant theories in discussion of the research questions.

5.1 Agricultural Trade

There is no doubt that agriculture in the past played an essential role in our everyday life and for most of us today agriculture can only be an indirect experience or almost something one would have to make an extra effort to experience at first hand. In recent decades, the economic,

social and environmental dimensions of farming and agriculture-food sector have been the subject of wide-ranging consultation, revitalization, integration into the greater international economy due to a number of changing and altering conditions of the world. Agriculture as a "politically sensitive sector" yet "uncompetitive" in today's global economy is well-reflected on economic policies of a country. (Park & Koo, 2007)

Regardless of how it has been in recent decades, agriculture has every potential to find its place once again in the international market. Subjects such as food security raise concerns for not only developing countries but also developed countries in the areas of "food availability, food access, and food use" (WHO, 2015). It does not only highlight the importance of food and other agricultural products in our daily lives but also sustainability of those food and other agricultural products in the generations to come. The World Health Organization (WHO) addressed how agricultural trade directly affects concerns for food security in the below paragraph.

> Agriculture remains the largest employment sector in most developing countries and international agriculture agreements are crucial to a country's food security. Some critics argue that trade liberalization may reduce a country's food security by reducing agricultural employment levels. Concern about this has led a group of World Trade Organization (WTO) member states to recommend that current negotiations on agricultural agreements allow developing countries to re-evaluate and raise tariffs on key products to protect national food security and employment. They argue that WTO agreements, by pushing for the liberalization of crucial markets, are threatening the food security of whole communities. (WHO, 2015)

Even though both economies the thesis is concerned with, Japan and South Korea, have matured to be developed countries, their trade policies in regard to agriculture have been criticized as particularly 'protectionist'. The reason why the thesis is centred round the agricultural sector is because even though the role of the agricultural sector in both countries has steadfastly diminished since the introduction of international trade where Japan and South Korea have more competitive commodities than their agricultural products, their agricultural trade policies have stayed notably protectionist. Trade policies that are protectionist simply means their policies tend to either protect

domestic industries from foreign competition by restricting imports or to help their domestic industries in world competition by subsidizing exports. (Krugman & Obstfeld, 2000) Whether these protectionist policies on agricultural trade, in particular, have been successful in the cases of Japan and South Korea or not is to be investigated but seems evident in their fairly consistent behaviour in maintaining protectionist measures. The real question is how protectionist have these policies been? Additionally, why have they been so stubborn about keeping these measures in the agricultural sector?

As mentioned in the above sections, both Japan and South Korea once have been agrarian societies. As the two countries industrialized one after another, the interest shifted to more lucrative industries which naturally were developed as their competitive edge in the global market as the governments had planned i.e. shipbuilding, automobiles, electronics, and so on. However, agricultural sector did not just fade. Japan's agricultural sector has always been politically active to secure its position even though it had long been replaced by foreign imports starting with rice and sugar in the colonial times from Taiwan and Korea (Tsakok & Gardner, 2007) and declining ever since then. Agriculture is one of the sectors which get protected from import competition. Krugman and Obstfeld (2000) stated that "in Japan, the government has traditionally banned imports of rice, thus driving up internal prices of the country's staple food to more than five times as high as the world price. This ban was slightly relaxed in the face of bad harvests in the mid-1990s, but in late 1998 – over the protests of other nations including the United States – Japan imposed a 1000-percent tariff on rice imports." The unionized rice farmers in Japan are a strong group which can influence political decision making and are strongly against agriculture market liberalization even though after years of government support and protection measures, the result has only been disappointment with "low productivity, low profitability, and subsidy dependence" (Araki, 2012). The reality in agriculture market is that "Japan's imports of agricultural products have significantly expanded due to the diversification/advancement of consumer needs under the restricted land conditions, the effect of the long-term yen appreciation, improvement of market accesses, etc. Japan's share of the world's import of agricultural products is also high, ranking first in the world for wheat, corn and meat, and ranking second following the EU for soybeans" (MAFF, 1999). "Japan's agricultural trade balance has constantly been in considerable deficit, indicating \4.4 trillion in 1998.Japan has been the world's top net importer of agricultural products since 1984" (Ibid.). "Japan depends on more than 80% of the amount of import of major agricultural products

such as grains from two countries including the US" (Ibid.). Thus, it implements measures to secure stable import by, for example, setting the target annual transaction quantity between major exporting countries" (Ibid.). "Also, in international conferences etc., Japan claims the importance of stable food supply to exporting countries from the standpoint of a food-importing country" (Ibid.).

South Korea does not have that politically powerful of a farmers' unionization and a quite liberalized agriculture market contributed to a declining domestic agricultural production by small farmers. Some agricultural groups have voiced their opposition to the government's signing of Free Trade Agreements (FTAs) with the U.S. and the EU. (Yoon, et al., 2013) South Korean agriculture can be divided into three different stages: first, the U.S. aid program after the Korean War (1950~1953); second, the Saemaul (New Community) Movement in early 1970s; and third, neoliberal free trade regime since the early 1980s. (Ibid.) Since the shift from agriculture to manufacturing industry, the sector which used to employ most of the country's population lost all its workers to factories at very cheap cost. Unlike the farmers' union movement in Japan, even the factory laborers were very much suppressed by the government. "South Korea's agricultural problems were hence not just agricultural or farmers' problems; they were connected with social problems such as those related to labor" (Ibid.). "The low wage-based export policy developed into the free trade policy for agricultural products, while small farmers rapidly disappeared" (Ibid.).

However, the South Korean government has developed plans to "develop an overseas grain production base and secure a stable channel to import grains, with no intention of increasing domestic agricultural production by protecting small farmers" (Yoon et al., 2011). According to Lee (Arirang, 2013), the South Korean government has promulgated the sixth industrialisation plan – production, distribution, processing including various other sectors - comprehensive revamp of the agriculture industry not only for food production but also including rural tourism, restaurants for commercialization for farmers' income, consumption of local foods. The latest is the opening of the 12th innovation centre in the country's southwestern province of Jeollanam-do. The centre plans to "apply the latest biotechnology and food processing techniques to Korea's traditional agriculture and fisheries industries to increase productivity and encourage young entrepreneurs to launch startups in the field. A dozen agricultural and fisheries industries will also come together to provide mentoring services and funding to would-be entrepreneurs. The center will also

collaborate with GS Group to turn the culturally rich southwestern region into an international tourist destination" (Arirang, 2015).

When Japan and South Korea agreed to be part of the international trade regime which is by the rules and regulations of the World Trade Organization (WTO), they have set their own priorities in terms of exporting and importing goods and services. Krugman and Obstfeld (2000) wrote that the mainstream international economists usually analyse the effects of protectionist policies and often criticize protectionism and show the advantages of freer international trade.

"Demerits of 'maintaining expansive, protectionist international trade strategies' are (Kish, 2001):

- Protection is against the interest of consumers as it increases price and reduces variety and choice
- Protection makes producers and sellers less quality conscious
- It encourages domestic monopolies
- Even inefficient firms may feel secure under protection and it discourages innovation
- Protection leaves the arena open to corruption
- It reduces the volume of foreign trade
- Protection leads to uneconomic utilisation of world's resources" (Cherunilam, 2008)

OECD seconds the above list of disadvantages of adopting protectionist policies and measures; has outlined some facts about protectionism:

- **"Protectionism makes domestic firms less competitive in the export market**
  Import barriers raise domestic prices through higher costs for intermediate inputs – and so export products also become more expensive and lose market share in the face of international competition. Also, protectionism leads to retaliation by trading partners.
- **Protectionism has costs for a country's overall domestic production**
  Each dollar of increased protection leads to a drop of 66 cents in gross domestic product (GDP).
- **Protectionism has a negative impact on the global economy**
  An increase of $1 in tariff revenues can result in a $2.16 fall in world exports and a $0.73 drop in world income.

- **Protectionism holds back economic growth for all countries**

  Full liberalisation of trade in goods and services would help increase average real incomes in developing countries by 1.3%, and by 0.76% in high-income countries. Newly-emerging economies, including Egypt, Thailand and Nigeria, would gain 3% to 6% of GDP."
  (OECD policy note, May 2010; Joint repot by OECD, ILO, World Bank and WTO, November 2010 as cited in "Protectionism – the case against", OECD, 2015c)

In defense of protectionism, on the other hand, Kish (2001) called on "instead of attacking international multilateral trade arrangements, countries should protect and promote their economic interests and culture within smaller bilateral and regional trade agreements." The first argument of protectionism of their agricultural sector in Japan and South Korea is "when countries' domestic industries are unable to compete with foreign import products" because of the decline in production due to transfer of labor force and the increase of foreign competition from developing countries which specialize in agricultural products at cheaper cost. (Ibid.) Fletcher (2011) added "Japan's withdrawal from labor-intensive goods in the 1970s opened space for Taiwan, South Korea, Singapore, and Hong Kong, and their ongoing withdrawal from these goods is opening up space for China."

Furthermore, their protectionist agricultural trade policies can be further justified that agriculture is incompatible with free trade regime because it is too important a sector for our sustenance at both national and international scope and the playing field in which agriculture trade is conducted is inherently unequal due to practices (protection/taxation) by all the countries across the world. (Moon, 2011) This serves as a rationale for safeguarding farming and agricultural food sector in Japan and South Korea.

5.2 Agricultural Trade Policies of Japan and Government Intervention

Before analysing Japan's agricultural trade policies in detail, a general outlook on the Japanese trade portfolio as of 2014, according to the World Factbook by the Central Intelligence Agency, US (2014), lists the following: "exports – commodities: motor vehicles 14.9%; iron and steel products 5.4%; semiconductors 5%; auto parts 4.8%; power generating machinery 3.5%; plastic materials 3.3% … imports – commodities: petroleum 16.1%; liquid in natural gas 9.1%;

clothing 3.8%; semiconductors 3.3%; coal 2.4%; audio and visual apparatus 1.4%." Japan's exports experienced a decline: $624 billion in 2015 compared to the previous year $699.5 billion. Japan's imports also declined from $798.6 billion in 2014 to $625.4 billion in 2015. Therefore, a trade deficit of $1.4 billion was resulted in 2015. (Ibid.)

As discussed in the previous sections, Japan's main strategy in trade was to import raw materials from abroad since natural resources are scare and to export finished goods. Japan, up to its industrialisation, focused on agricultural sector which later diverged to machinery and high-technology industry.

According to Ito (1996), leading up to 1990s Japan continued its success in economic growth and ran a large amount of trade surpluses. The areas of Japanese exports "has changed quite rapidly during the postwar period, shifting from textiles and toys to other light manufactured goods in the 1950s; to consumer electronics, steel, and ships in the 1960s and 1970s; to sophisticated optical products in the 1970s; and to automobiles and semiconductors in the 1980s" (Ibid.).

In fact, Krugman and Obstfeld (2000) used Japan's practices of the Strategic Trade Policy and there have been two notable ones. The earlier one was between 1950 and 1970; the nation sprang up from the ruins of World War II whose economic and industrial policies were mostly dictated by the government, for example, "the famous Ministry of International Trade and Industry (MITI) [whose] control over vital resources gave these ministries great power over the direction of the economy's growth" (Ibid.). The more recent example is Japan's high-tech industries. "The tools of strategic policy have been a combination of modest subsidies for research and development [R&D subsidy] and encouragement of joint government-industry research projects aimed at developing promising new technologies" (Ibid.). In short, both strategic trade policies have had positive effects on Japan's economy even though some areas remain more successful than others.

Japan's top products of export and import do not include agricultural products. Agriculture is one of the sectors which get protected from import competition. According to the World Bank data (2010), agriculture employs only about 4 percent of the work force in Japan. Even that, "Of Japan's 1.5m farmers, only 420,000 are engaged in farming full-time" (The Economist, 2013). However, the small number of Japanese farmers are known for their active participation and influence in politics. (Ibid) For example, "through the national network of local farm co-operatives

called Japanese Agriculture (JA). With its tight links to the Liberal Democratic Party (LDP) and the agriculture ministry, and employing an astonishing 240,000 staff in Tokyo and around the country," JA exercises its power to the fullest. Their main goals are to "keep high import tariffs on farm goods: the tariff on rice is 777.7%" (Ibid.).

JA-ZENCHU (Central Union of Agricultural Co-operatives) mainly works to represent Japanese farmers' interests and promote further agricultural development in the country and in the world at large. (JA-ZENCHU, n/d) The group provides a number of services to the members such as farm guidance, better living guidance, credit business, mutual insurance business, marketing business, supplying business, and other activities which include "processing business of agricultural products, promotion of members' house-renting business, and travel agency business" (Ibid.). These services provide an insight to the level of government support for farmers in Japan.

Krugman and Obstfeld (2000) in International Economics Theory and Policy 5th Edition stated that "in Japan, the government has traditionally banned imports of rice, thus driving up internal prices of the country's staple food to more than five times as high as the world price. This ban was slightly relaxed in the face of bad harvests in the mid-1990s, but in late 1998 – over the protests of other nations including the United States – Japan imposed a 1000-percent tariff on rice imports." They also asserted that "governments do not necessarily do what the cost-benefit analysis of economists tell them they should. The cost-benefit analysis that they meant is the analytical framework for determining the effects of government policies that affect international trade. The framework not only predicts the effects of trade policies, it also allows cost-benefit analysis and defines criteria for determining when government intervention is good for the economy" (Ibid.).

Fletcher (2011) claimed that postwar Japan, compared with the United States, "had comparative advantage only in low-value industries." During the signing of their first post-occupation trade agreement, the U.S. demanded Japan cut their tariff on imported cars because the controlled Japanese market limited their access and moreover, trading with the U.S. would also benefit Japan in the areas in which it has the comparative advantage. (Ibid.) However, the Japanese trade negotiator at the time, Kenichi Otabe, asserted that Japan wopuld "encourage and protect those industries which it believes important for reasons of national policy" (Ibid.). Mr. Otabe, also an economic historian, offers his definition of protectionism (as quoted in Fletcher, 2011):

> Protection from foreign competition was probably the most important incentive to domestic development that the Japanese government provided. The stronger the home market cushion … the smaller the risk and the more likely the Japanese competitor was to increase capacity boldly in anticipation of demand growth. This can give the firm a strategic as well as a cost advantage over a foreign competitor operating in a different environment who must be more cautious.

Protectionism in Japan has been quoted as "the most important incentive to domestic development that the Japanese government provided" by the economic historian Kozo Yamamura. (Fletcher, 2011) As we know, Japan has protected its automobile industry and as a result, Japan currently has one of the world-leading automobile industries. As Japan protected its automobile industry from foreign domination, it also protected its agricultural sector. According to Van der Meer and Yamada (2005), "agricultural protection in the early post-war period was not high in Japan … the Japanese protection level in 1970 was about twice the EC (European Common) level and the level increase even more later." Moreover, "The increasing trend in agricultural protection is reflected in terms of trade between agriculture and industry. The government has supported agriculture not only by **import quota** and **product price support**, but also by heavy **investment subsidies**" (Ibid.).

5.2.1 Nontariff barriers

Nontariff measures are said to be "especially prevalent in agriculture" (World Trade Report, 2012). Most of Japan's forms of market price support has been abolished and the government's agriculture policy has been generally moved to direct income support for farmers in recent years, but price support still applied to a limited number of products. In addition, wheat, barley, and rice are the most heavily supported goods, for which subsidies totalled 176 billion Japanese yen (US$1.48 billion) in 2006 and separate amounts for these goods were not made available to the WTO Secretariat. (WTO 2011) "Food prices in Japan are extremely high by international standards, and its agricultural sector is beset by low productivity." (Van der Meer & Yamada, 2005) As a possible solution to reliving the burden of the high price of rice, "In 2010, a direct payment called 'individual household income support' was introduced by the DPJ" and this

policy was mainly used so as to avoid being part of subsidies which as a result did not influence the lowering of the high price of rice but rather stalled the price at the high level. (Yamashita, 2015) This further reports that compared to the United States and the European Union, Japan's PSE shows they have not reformed their agricultural policy toward liberalisation. McLannahan (2013) wrote that "Direct payments to hundreds of thousands of farmers have been at the heart of agricultural policy in Japan since 1970, when the government began to prop up prices by subsidizing production of table rice according to annual estimates of demand, while encouraging shifts to other crops such as wheat, soybeans or rice for animal feed."

According to Yamashita (2015), "In order to maintain high domestic prices, Japan has had to rely on tariffs and non-tariff measures so as to isolate its domestic market from the international market."

Though tariffs still remain Japan's main protectionist tool, Japan also uses non-tariff barriers such as import prohibitions, import quotas on fish and state trading for "leaf tobacco, opium, rice, wheat, barley, and milk products." (WTO, 2011)

According to Yamashita (2015), "The Producer Support Estimate (PSE) was developed by the OECD as an indicator of agricultural protection and evolved into the Aggregate Measurement of Support (AMS) in the WTO Agreement on Agriculture in a legally binding form. The PSE is the sum of the taxpayer burden in the form of subsidies and payments made to farmers and the consumer burden in the form of price support higher than an international price brought about by border and domestic measures (calculated as the different between domestic and international prices multiplied by domestic production volume)." OECD (1999) reported "In 1997, the OECD average PSE for rice, which is dominated by the Japanese PSE, was 80 per cent."

In order to stabilise domestic price and raise the food self-sufficiency ratio, the Japanese government implemented "supply-demand adjustment" tool for rice, through which the diversion payments are paid to farmers, the program encourages the farmers reuse their rice paddies for planting other crops when rice output reaches a certain volume. (WTO, 2011) The adjustment is participated voluntarily by farmers and farmers' organizations and is based on the government's annual demand estimate, and the payments vary according to the crop actually sown or how farmers use the land. (Ibid.) Accordingly, the estimate producer price of rice in Japan would be US$ 1,704 per tonne without the adjustment policy compared with the current price of US$15,067 per tonne. (Ibid.)

Japan actively uses green box measures to support its agriculture sector. For capping and reducing trade-distorting domestic agricultural support, the WTO divides domestic support measures into three boxes - amber, blue, and green-depending on the effects on production and trade: all domestic support measures considered to distort production and trade fall into the amber box; the blue box covers any support linked to supply control programmes which are exempt from reduction commitments; and the green box support involves all non-trade-distorting measures and is exempt from reduction commitments, including public services, income guarantee, security programmes, programmes to adjust structures and environmental protection programmes. (Massot, 2015) The Japanese government implemented various green box measures in ten categories, such as subsidies for general services, Japan allocated high levels of green box subsidies in this category which includes agricultural production materials and machinery, production facilities, general research, construction of drainage facilities and rural roads, land consolidation, extension and infrastructural services for technological improvement of agricultural production, and so on. Other categories are food security, agricultural insurance for relief from natural disasters, farmers' pension, agricultural loans provided by the government, support program for reduction of environmental burden due to dairy farming, in addition, due to natural factors, agricultural development in hilly and mountainous areas lags behind plain regions and hence, the Japanese government introduced in 2000 a direct payment programme to encourage farmers to continue production, and in 2011 the scheme for direct payments to farmers in the hilly and mountainous areas was extended to cover flat areas on isolated islands and other disadvantaged regions as well. (Li, Wang, & Shen, 2014)

5.2.2 Export subsidy

"An export subsidy is a payment to a firm or individual that ships a good abroad" (Krugman & Obstfeld, 2000:p.198). "Export subsidies, which capture a large share of foreign markets, are attractive policies for domestic companies. In general the welfare effect would be higher if subsidies were reduced; nevertheless, this puts countries into the situation of a 'Prisoner's Dilemma' because the country which does not use subsidies is worse off. (Brander & Spencer, 1984)"

Prior to the current so-called "Uruguay Round reform programme", the General Agreement on Tariffs and Trade (henceforth GATT) 1947 provisions stated that export subsidies for industrial products have been prohibited and exceptions were made only for agricultural products.

(i) Export subsidies subject to product-specific reduction commitments within the limits specified in the scheduled of the WTO member concerned;

(ii) Any excess of budgetary outlays for export subsidies or subsidized export volume over the limits specified in the schedule which is covered by the 'downstream flexibility' provision of Article 9.2 (b) of the Agreement of Agriculture;

(iii) Export subsidies consistent with the special and differentiated treatment provision for developing country members (Article 9.4 of the Agreement); and

(iv) Export subsidies other than those subject to reduction commitments provided that they are in conformity with the anti-circumvention disciplines of Article 10 of the Agreement on Agriculture. (GATT)

According to USDA (2012), agricultural export subsidies were first asserted at the Uruguay Round Agreement on Agriculture (AoA). The change that took place was the "countries that employed export subsidies for agricultural commodities agreed to lower the volume and value of their subsidies during a multiyear phase-in period. New subsidies cannot be introduced. Bona fide food aid and export market promotion and advisory services are exempt" (Ibid.).

The future development in the Doha Ministerial Declaration was that the ultimate goal of export subsidies would be near a complete elimination of them. As well as to include "other export competition policies including export credits, food aid, and export state trading enterprises (STEs)" (Ibid.). Furthermore, "WTO members have agreed to ensure the parallel elimination of direct export subsidies and imposition of disciplines on export credits, food aid policies, and STEs" (Ibid.).

Besides, "The only conditions were that agricultural export subsidies should not be used to capture more than an "equitable share" of world exports of the product concerned (Article XVI:3). The GATT rules also allowed countries to resort to import restrictions (e.g. import quotas) under certain conditions, notably when these restrictions were necessary to enforce measures to effectively limit domestic production (Article XI:2(c))" (WTO, 2011).

According to WTO Trade Policy Review (2015), "Japan notified the Committee on Agriculture that it had not provided any export subsidies for FY1995-2013."

5.2.3 Import tariff

One common restrictive measure is to impose tariffs, which raise the price of imported good, making it less competitive against the price of protected home-produced good. There is also import quota, which limits the quantity of trade and that the amount of imports allowed in a given period of time is controlled by the hosting economy. Yamashita (2015) stated that "Japan is criticised abroad for being protective of its farming sector by its rigid opposition to tariff reductions, while at home the government is blasted for damaging the nation's interests because its position on agricultural issues stalls any trade negotiations." Japan uses tariff escalation to protect its agricultural sector. According to Yin, Liao, and Zhou (2007), Tariffs escalate from semi-processed to final products in Japan, which shows the features of high labor cost and dependency on advantages of high technology and processing. According to Udo (2008), "Japan also protects its domestic rice industry by erecting substantial barriers for imported rice contrary to AoA's stated objectives."

Japanese agricultural tariffs have been subject to criticisms among partner countries. According to the WTO trade policy review (2015), Japan has 18 tariff quotas covering 196 tariff lines, mainly for cereals (including rice) and dairy products. According to Udo (2008), Japan has kept very high tariff on rice that "remain around five times the overall price of rice."

Under the Tariff Rate Quota (TRQ) of AoA, "Japan is required to import a certain amount of foreign rice each year."

Tariff Rate Quota (TRQ) is defined by the OECD Glossary of statistical terms (2003) as follows:

> The tariff rate quota resulted from the Uruguay Round Agreement on Agriculture. Certain countries agreed to provide minimum import opportunities for products previously protected by non-tariff barriers. This import system established a quota and a two-tier tariff regime for affected commodities. Imports within the quota enter at a lower (in-quota) tariff rate while a higher (out- of-quota) tariff rate is used for imports above the concessionary access level.

For instance, "In 2001, Japan's import quota for rice and rice products was 682,000 tons. Within this quota, rice imports are not subject to tariffs. Any amount outside of the quota was accessed a tariff of $2819/ton in 2001. This prohibitively high amount essentially eliminated the

possibly that foreign rice would enter the Japanese market. Furthermore, a large percentage of imported rice within the TRQ is not sold within Japan's domestic market, as the AoA intended, but is donated as food aid. Thus, Japanese rice farmers are shielded from all foreign competition." (Udo, 2008) TRQ "increased market access for agricultural exports, but also left many high tariffs in place" (USDA, 2012). "Agricultural trade would benefit from reducing high tariffs, expanding and reforming TRQs, and improving the predictability of tariff protection" (Ibid.).

Entering the Trans-Pacific Partnership promises Japanese agriculture a different future.

5.2.4 R&D subsidy

Government subsidies to research and development (R&D) and investment in Japan provide Japanese farmers with many advantages.

Japanese Agriculture (JA-ZENCHU) whose aim is to "protect farming and living of its individual members" provides a number of services to the members such as farm guidance, better living guidance, credit business, mutual insurance business, marketing business, supplying business, and other activities which include "processing business of agricultural products, promotion of members' house-renting business, and travel agency business" (JA-ZENCHU, n/d). These services provide an insight to the level of government support for farmers in Japan. Japan has a hierarchical agricultural financial system that provides financial support for the Japanese farmers.

In Japan, in order to enable agricultural producers gain more low-interest loans, preferential loans are offered by the government through the financial support from the government's rural financial system – JA – the largest farmer based organization in the world, which has a hierarchical structure: the primary agricultural cooperatives are the basic unit operating at the local levels such as city and village, and provide a wide range of financial services to the member farmers and organizations; the prefectural credit federations of agricultural cooperatives are at the second level with function of transferring fund for other cooperatives, so that farmers can get financial support from those cooperatives; the upper level of the prefectural federations is the central cooperative bank also known as the *Norinchukin* bank which is responsible for providing guidance and support to the prefectural credit federations, handling credit services. (Wang & Li, 2009)

5.2.5 State trading enterprises

According to Food Agriculture Organization (FAO) of the United Nations (2002), "About 75 percent of the STEs notified to WTO under GATT Article XVII are involved in *agriculture*." The state trading enterprise in Japan (the Japanese Food Agency) functions as "only the instrument of government policy for administering imports and not necessarily the main cause of the world market distortions" (OECD, 2001). The Japanese central government determines domestic prices and policy instruments which have more of an effect on the agricultural sector than the state trading enterprise.

"The government has begun to move from tariff protection against imports – which acts as a floor keeping market prices high – to paying a direct subsidy to farmers and allowing more market competition. However, the WTO report points to "remarkably lower productivity" in agriculture compared with other sectors of the economy." (Harner, 2011)

As the economies move toward trade liberalisation at a fast speed, agricultural trade is faced with eliminating most of the restrictions, however, certain products still remain heavily protected such as "rice, barley, dairy products, and leaf tobacco farming operates under high tariff and non-tariff barrier protection." (Harner, 2011)

According to the criteria defined in the analytical framework in the previous section, Japanese agricultural policies satisfied many elements of the protectionist or interventionist government offering a number of protection measures to the rice producers.

Japan, as Asia's main regional economic power for many decades, is said to have had an influence on South Korea's protectionist policies. (Fletcher, 2011) This attitude has a lot to do with their culture in "see[ing] the economy not as an end itself, but as an instrument of national power." (Ibid.) There is a whole lot more of nationalistic sentiment in East Asian economies including China and Singapore compared to their western counterparts.

As seen in the examples of Japan's strategic trade policies, agriculture has been neglected as it has constantly been shrinking in size. Nevertheless, the government employs a number of strategic interventions through nontariff barriers, import tariff, R&D subsidy as well as state-trading enterprises. Most recently, Japan's membership to the Trans-Pacific Partnership (TPP) trade agreement raised concerns for rice farmers in Japan as agriculture is likely to be affected most. Harner (2011) stated that "The TPP framework does not allow a country to pick and choose sectors; it is all or nothing" targeting Japan's agriculture.

5.3 Agricultural Trade Policies of South Korea and Government Intervention

Before analysing South Korea's agricultural trade policies in detail, a general outlook on the Japanese trade portfolio as of 2014, according to the World Factbook by the Central Intelligence Agency, US (2014), lists the following: "exports – commodities: semiconductors, petrochemicals, automobile/auto parts, ships, wireless communication equipment, flat display displays, steel, electronics, plastics, computers. … imports – commodities: crude oil/petroleum products, semiconductors, natural gas, coal, steel, wireless communication equipment, automobiles, fine chemical, [and] textiles." (Ibid.) South Korea's exports experienced a sharp decline: $535.5 billion in 2015 compared to the previous year, $621.3 billion. South Korea's imports also declined from $528.6 billion in 2014 to $430.8 billion in 2015. Therefore, a trade surplus of $104.7 billion was resulted in 2015. (Ibid.) Similar to Japan, South Korea's top products of export and import do not include agricultural products.

South Korea's trade policy is largely open, but farmers receive a lot of government support and protection. (WTO, 2008) Although South Korean government has consistently intervened in agriculture trade, the share of overall GDP has steadily fallen. Self-sufficiency has been achieved for products such as rice, but in general more agriculture import occurs now than before. South Korea most recently finally concluded an FTA with Canada and under negotiations with countries such as Indonesia, China, Vietnam and more.

South Korea's agriculture industry has many inherent challenges. It is a mountainous country with only about 17% arable land and less rainfall than most other neighbouring rice-growing countries. Nonetheless, "today's South Korean consumers are very conscious of the quality of their rice and now pay more for domestic rice than they would for high-quality imported rice (United States Department of Agriculture, Economic Research Service [USDA ERS], 2010)" (Agriculture and Agri-Food Canada, 2011). According to the World Bank data (2010), agriculture employs only about 7 percent in South Korea.

In fact, South Korea's agriculture disintegrated rapidly in the process of industrialization, and under the influence of the global agri-food system. Since processes from the seed to the supermarket are controlled by the corporate food system, South Korea's grain self-sufficiency, which was over 70 percent during the mid–1970s, is now approximately 20 percent. (Yoon et al., 2013)

According to the criteria defined in the analytical framework in the previous section, South Korean agricultural policies satisfied many elements of the protectionist or interventionist government offering a number of protection measures to the rice producers.

5.3.1 Nontariff barriers

"Through the implementation of the Uruguay Round agreement, import prohibitions on major agricultural products except rice were transformed into a tariff system." (Jeong, 2008)

USDA (2015) stated that "another measure to deal with surplus rice production is the direct payment for adjustment of rice production. Currently, the payment is 3 million won per hectare ($3,000 per hectare) for fields that are not used for any commercial production for 3 years." It further wrote that "the unit market support granted to producers is the main source of the implicit tax on consumers measured by the CSE. "The percentage CSE is slightly lower than the PSE and the gap has tended to widen over time, on the one hand because transfers from taxpayers to producers increased more quickly than transfers from consumers to producers, and on the other hand because consumer subsidies have been significantly higher at the end of the period."

Beghin et al. (2003) state that South Korea has protected its agricultural sector much more compared to other economies around the world through the means of "[p]ublic intervention mainly consists of high production prices supported by government purchases, together with high tariffs that protect domestic producers from foreign competition and, implicitly tax consumers." (Ibid.)

Jeong (2008) purported that "Support through direct payments has increased significantly in recent years, especially after the introduction of the direct payments system for paddy fields in 2005 following the rice negotiation which permitted the suspension of tariffication for rice for another ten years from 2005 to 2014."

Tariff Rate Quota (TRQ) "Under the current WTO agreement, South Korea must buy exactly 408,700 tonnes of foreign rice this year, or 9 percent of its demand. The amount that must be purchased from abroad has gradually increased from 51,000 tonnnes in 1995." (Cho, 2014) From 2015, "Seoul would still be required to import at least 408,700 tonnes a year, with the higher tariff rate charged on any imports beyond that" (Agricultural ministry officials, as cited in Cho 2014)

5.3.2 Export subsidy

South Korea heavily depends on export. Export subsidies, prior to URAA, are said to have distorted international trade. Export subsidies lead to trade disputes between trading partners.

Under Uruguay Round Commitments it states:

> Like other signatories of the WTO, South Korea committed to policy reforms under the URAA. In general, the agreement has resulted in improved market access (in the form of tariff reductions, quota growth, and elimination of import bans), restrictions on **export subsidies** and trade-distorting domestic support, and provision of some recourse against the use of safety and health standards as disguised barriers. **South Korea notified the WTO that it does not provide export subsidies for agriculture.** … (USDA, 2015)

WTO (2012) reported the following:

> "Export prohibitions are aimed at protecting animal rights and endangered species, and conserving natural resources. Direct export subsidies are maintained to reduce marketing costs for certain agricultural products (e.g. fruit, vegetables, flowers, kimchi, ginseng, and livestock); they totalled ₩ 32.68 billion in 2008, according to the most recent data available. In addition to the tariff drawback scheme, excises and VAT are rebated at the border, while income tax relief is accorded to enterprises located in free-trade zones. Exporters benefit from export credit insurance, finance, and the promotional activities provided by state-owned institutions.

5.3.3 Import tariff

In his article, Lee (1997) divided present and future of South Korean agricultural trade policies before and after the Uruguay Round Agreement on agriculture in 1994. The Uruguay Round Agreement on agriculture in 1994 allowed all items that had previously been banned from imports through various kinds of tariffs. Beghin et al. (2003) stated that Korea did not fully embrace the provisions of the Uruguay Round Agreement on Agriculture. For example, "It has kept very high tariffs in the rice, meat, and dairy sectors; high production subsidies in most other sectors; … ." (Ibid.) Lee (1997) confirmed that "the [South] Korean government is operating state

trading systems to collect rents that might accrue to importers of products subject to tariff rate quotas and to return the rents to the agricultural sector." Rice, among other grains and agricultural products, belong to the Office of Supply Agricultural and Fishery Marketing Corporation Livestock Products Marketing Organization with Simultaneous Buying and Selling (SBS) system. (Ibid.) Lee (1997) also pointed out the different kinds of tariffs which are "1) normal tariffs imposed on the products which had been already liberalized before the Uruguay Round, 2) tariff equivalents of tariffied products, 3) tariffs applied to MMA and CMA, and 4) additional tariffs based on Special Safeguard.

South Korea has tight controls on rice imports. Import quotas have been nearly completely abolished, only the importation of rice requires quotas.

South Korea took a dramatic turn of policy reforms including "trade liberalisation involving cuts in tariffs and the abolition of most quantitative restrictions". (Jang, 2007) As a result, it provided a more competitive environment for domestic producers so that the efficiency as well as quality improved. (Ibid.) However, on the trade front, the level of trade liberalisation has not fully reached the level that of other markets. Jang (2007) asserted that "[f]irstly, tariffs were still quite high after the 'liberalisation' and the bureaucracy retained the power to impose 'emergency tariffs' (for items with 'excessively' fast import growth) without changing the relevant laws. ... quantitative restrictions, usually under the name of various 'special laws' and import area diversification regulations, were still pervasive after the 'liberalisation'." Moreover, "there was extensive state support for import substitution, for example, subsidised credits to the import-substitutors and to the purchasers of some domestic products (especially machinery), which in effect acted as import restrictions." (Ibid.) Therefore, Jang (2007) insisted South Korean development cannot be explained by it moving to 'free market'. On the other hand, Jang (2007) suggested that "some neoclassical economists, including Bhagwati, tried to reconcile the existence of an interventionist state with the rapid growth of the economy."

A high rate of tariffs are applied on agricultural and fishery products. In 2007 South Korea adopted HS Tariff Classification. In 2008 the simple average MFN tariff was 12.8%, for agricultural goods 53.5%, for industrial goods 6.5%; showing different tariff protection goals. WTO (2012) wrote that "Rice remains the only item subject to import quotas (until 2014)." "Korea periodically restricts or monitors exports of certain products (e.g. rice and steel) to ensure adequate domestic supplies, and thereby possibly assist downstream processing of these products." (Ibid.).

5.3.4 R&D subsidy

Brander and Spencer (1983)'s three stage model describes: in the first stage, a subsidy to R&D (or combination of R&D tax and an export subsidy) can increase domestic welfare by shifting profits from the foreign to the domestic firm; in the second stage, the R&D subsidy makes it credible for the domestic firm to commit to a higher level of R&D; finally, the foreign firm is motivated to reduce its R&D and exports.

OECD (1999) reported that "research and extension seem to have been quite efficient at developing technically productive methods and inputs adapted to Korean natural conditions and at transmitted them to farmers." More recently, Jeong (2008) reported that "Several comprehensive agricultural investment plans have been put in place to improve the infrastructure for production, processing, and distribution and have contributed to efficiency gains."

According to Lee (Arirang, 2013), the South Korean government has promulgated the sixth industrialisation plan – production, distribution, processing including various other sectors - comprehensive revamp of the agriculture industry not only for food production but also including rural tourism, restaurants for commercialization for farmers' income, consumption of local foods. The latest is the opening of the 12th innovation centre in the country's southwestern province of Jeollanam-do. The centre plans to "apply the latest biotechnology and food processing techniques to Korea's traditional agriculture and fisheries industries to increase productivity and encourage young entrepreneurs to launch startups in the field. A dozen agricultural and fisheries industries will also come together to provide mentoring services and funding to would-be entrepreneurs. The center will also collaborate with GS Group to turn the culturally rich southwestern region into an international tourist destination" (Arirang, 2015).

5.3.5 State trading enterprises

More extremely, "South Korea lists eight state trading enterprises responsible for around 18 commodities" (FAO, 2002). The possibility of which the agricultural state trading enterprises might distort trade and discriminate among trading partners cannot be disregarded.

Lee (1997) asserted that "through the state trading systems, the imports of major agricultural products are closely managed for the minimization of the adverse impacts on domestic agriculture." Even though the domestic agricultural sector was not hit as big as some had feared

thanks to the protection measures, problems still arose. Lee (1997) identified the problems that lessen the effect of market liberalization as the lack of quality control, dumping, global impact of price instability. Lee (1997) further advised that stabilizing the price of agricultural products would be important. Additionally, "tariff and tariff equivalents should be adjusted in line with the directions of the agricultural development plans of the government" (Ibid.).

Jung (2008) explained the interventionist nature of South Korean government that even though the government appeared to have embraced "neoliberal ideals and slogans for deregulation" in accordance with the global trend of liberalisation, was not enough to really reform 'the Korean interventionist state'. Jang (2007) stated that the popular belief that South Korean economic development was possible due to "the transition from an inward-looking, or import-substituting industrialisation, strategy to an outward-looking or export-led growth, strategy" which are the elements of 'free market'.

Agriculture ministry's roles include not only stabilizing production but also helping provide food at low cost for the country's people (A farmer, as cited in Cho, 2014)

Cho (2014) stated that Korean Advanced Farmers Federation has said, "The switch to the tariff scheme for rice unavoidable" and "tariffs should be at least 400 percent and that the level should not be amended as part of any free trade deals with other nations."

The signing of the free trade agreement appears to benefit North Korea as well mainly due to the joint cooperative operations South Korea had set up in North Korea's Kaesong industrial complex. (DW) In the free trade agreement, the items such as clothing and electrical parts that were made by North Koreans in North Korea were included. (Ibid) The more trade it generates, the more South Korea have to invest in the operations in North Korea forecasting possibly an expansion which may lead to maintaining a more peaceful and friendlier inter-Korean relations. (Ibid.)

South Korea shipped its first batch of 30 tons of rice to China for the first time in history. Jang (2016) reported that Chinese officials' monitoring system for the import of South Korean rice was very meticulous and cautious because rice import is categorized as food not an agricultural good. On 29th January the day marked exactly 150 days since South Korean president Park Geun-hye requested a speedy process of South Korean rice import to China in the South Korea-China summit meeting last year. (Ibid.) It was also a historically significant moment for South Korea as the first rice export to China took place in the very Gunsan port which adds more momentum to

the day because Gunsan is remembered as the place for forced export of South Korean rice to feed the Japanese during the occupation era. South Korean rice is higher quality and three to five times more expensive than Vietnamese rice or rice harvested in northeast China and it will be sold in department stores, online shopping malls such as Lotte Mart or Alibaba as well as televised home shopping mainly targeting higher or equal to middle-income Chinese households. (Ibid.)

Whereas in South Korea, "according to government data released Friday, South Korea's per capita rice consumption fell 3.4 percent on-year to a record low of 62.9 kilograms last year as people added other types of grain products to their diet." (Yonhap, 2016)

As a result of the current government to allow more rice imports "in accordance with the WTO agreement on import quotas" from 2015, many farmers took the streets of Seoul to protest against the decision. (Cho, 2014) Protesting farmers are afraid that tariff rate would eventually fall via other free trade deals, allowing more imports and affecting domestic rice farmers negatively. Talks of signing bilateral trade deals and joining of international organizations are worrisome to domestic producers however, it seems inevitable given the trend of international trade liberalisation.

It can often be witnessed that some interest groups take to the streets to protest against certain decisions of the government. If the governments of Japan and South Korea have been protecting agricultural sector like none other, why are farmers' groups and civic groups out protesting?

6 Conclusion

The world of trade began with "an international treaty known as the General Agreement on Tariffs and Trade (GATT), and massive international negotiations involving dozens of countries at a time have been held" (Krugman and Obstfeld, 2000). International trade plays an important role in our lives as no country on this earth truly remains an autarky. Countries started to trade with one another for many beneficial reasons and the world as we know it today becomes much smaller and closer day by day.

In the previous sections, the thesis has argued that both Japan and South Korea have had an interventionist and protectionist regime when it comes to international trade, especially agricultural trade. Among many theories explaining patterns and practices of international trade,

New Trade Theory and the theory of Strategic Trade Policy were chosen to explain agricultural trade in Japan and South Korea. Krugman and Obstfeld (2000) state that "Strategic trade policies have been extensively practice by some successful economies, such as Japan and South Korea." And the examples included were based on their industrial policy which they have mostly maintained until today. On the other hand, the objectives of the thesis were to find out if such policies have been part of agricultural policies. The analytical framework adopted was the *Brander-Spencer analysis*, "which shows how activist government policies can in principle help national firms increase their profits at the expense of foreign rivals" (Ibid.). Even though both governments steadfastly maintained their firm stances on protecting domestic agriculture, findings suggest that in the realm of global trend in liberalising trade, they are under pressure to adopt the changes as well.

Upon comparing and contrasting the agricultural trade policies and protection measures between Japan and South Korea, a number of similarities as well as differences were located. Both protect their agriculture strongly. Japan has moved into a direction of trade liberalisation by reducing the use of nontariff barriers and export subsidies but supported the domestic producers with import tariffs, quota, state-trading enterprise as well as R&D and investment subsidy.

South Korea has heavily protected its agricultural trade and still manages to do so by various nontariff barriers, high import tariffs, quota, state-trading enterprises as well as R&D and investment subsidy to the agricultural sector. Thus, government's strategic intervention in agriculture in Japan and South Korea have been analysed in accordance with the given criteria.

A direction to Free Trade Agreements (FTAs) and complying with international trade organizations for rice trade will be inevitable. It is reported that there has been a discussion of a trilateral trade agreement between Japan, South Korea, and China which began in 2012. Kish (2001) writes that "The advantages of less protectionist regionalism with a case study of Japan and South Korea's recent joint effort to promote their economies."

Kühnhardt (2010) writes that "regions are social realities that produce memory, meaning, and communication. Regionalism is the theory of the process of region-building." Regionalism in East Asia is a recently developed phenomenon and it serves as an important economic development of the region during the first decade of the 21st century. As Pomfret (2011) also acknowledges, since 2000 the region has seen an explosion of trade agreements. The reality is that the massive proliferation of free trade agreements (FTAs) of various kinds present challenges

today for regional policy makers on how to effectively create and manage them. Expansion and deepening of "the vertically integrated production chains" is another reality with which the contemporary FTAs need to cope as they are the principal driving force behind regional integration in Asia. One prospect of East Asian regionalism Pomfret (2011) states is that it will continue to deepen because trade facilitation addressed issues beyond trade. There is much political will at each institution and organization in the region. East Asian regionalization and integration is an on-going process.

These research questions further inquire about international trade liberalisation and its impact on agricultural trade in the East Asian region. The concept of international trade liberalisation has been effectively taken place in the region through bilateral Free Trade Agreements (FTAs), international trade organisations or partnerships of various kinds, however, each economy took on the liberalisation process individually, not regionally like the European Union (EU). The aforementioned research questions as well as further research areas show Japan and South Korea's similarities as well as differences in the aforementioned areas of interest.

However, seeing the Northeast Asia region as a potential regional group for further political and economic engagement, the interactions between Japan, South Korea and China are to be noted. Often the political interactions are hindered due to some residual business from the past and it is definitely worth looking at these as well to analyse the relationships between the nations involved. Unfortunately, the political interactions are only limitedly discussed in this thesis in order to understand some of the resistance and hindrance to more engagement in the past or present.

Limitations on the research account for mainly a lack of readily available models or frameworks that are specific to Japan and South Korea or East Asia as a region since most of the literature concentrated on the region of North America or the EU nations under the notion of agricultural markets in 21st century. A future direction of the study may delve into the future of regional trade area of East Asia or behavioural analysis of trading partners in a given trade agreement or sustainable farming and agriculture in East Asia.

Food is of utmost importance in a person's life and "[w]ith a projected global population of eight billion by 2025, feeding these massive numbers should be our number one priority. This can only be achieve if we bring back attention to the agriculture sector and envision ways of creating high-yielding, vibrant and bumper harvests on a sustained basis." (Balakrishnan, 2012)

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Appendix A

Abstract

This thesis deals with Japan and South Korea and their agricultural trade policies in terms of government intervention in protecting the agriculture industry. As agriculture is one of the most protected areas of trade, the two governments have heavily protected their agriculture, especially rice, even when its share of the overall economy has constantly declined.

Agriculture, in every sense of the word, is a much needed sector for our sustenance. Developed nations such as Japan and South Korea are no exception to the rules and have had protectionist policies to help the shrinking agricultural sector mainly for self-sufficiency and food security reasons.

However, in recent years, there are efforts to liberalise trade in both countries to meet the international standard which means some of these policies in place to protect domestic production, market, and labour are to be reformed. Both Japan and South Korea are member states of various international trade organizations and have signed numerous bilateral trade agreements as well as been engaged in bilateral and trilateral negotiations with neighbouring countries.

Agriculture sector remains highly important in a country's economy however, ways to maintain production, market price, and consumer as well as producer satisfaction will face changes as further trade liberalisation demands compromises from each trading partner. Different trade theories across the spectrum have been dealt throughout the thesis for explaining the current situation of international trade as well as for developing a specific framework for argument for the sake of the research questions in this thesis.

Key words: international trade, trade agreement, agricultural trade, trade liberalisation, strategic trade theory, state intervention

Appendix B

Academic Curriculum Vitae (CV)

Personal Data

Date of Birth	19.07.1990
Place of Birth	Suwon, Republic of Korea
Nationality	Republic of Korea

Education

03/2013 – Present	East Asian Economy and Society (M.A.) at University of Vienna, Austria
01/2009 – 05/2012	Political Science (BA) at University of Wisconsin-Eau Claire, USA
06/2010 – 07/2010	International Summer Campus at Korea University, Republic of Korea
04/2005 – 04/2008	GCE O'Levels at Maz International School, Malaysia

Language

Korean, English	Native Proficiency (C2)
German, Mandarin Chinese	Effective Proficiency (B2)

Work Experience

05/2015	Interpreter on behalf of Rep. Korean Embassy, Ljubliana, Slovenia
2008 – Present	English Tutor (Private)
05/2014 – 01/2015	Content Manager at BBI International a.s., Bratislava, Slovakia
01/2012 – 05/2012	Leadership Circles Student Fellow, University of Wisconsin-Eau Claire, USA
09/2011 – 05/2012	Commission Director at Student Senate, University of Wisconsin-Eau Claire, USA
03/2010 – 05/2012	Marketing Manager at Open.Eau Claire, University of Wisconsin-Eau Claire, USA

Appendix C

Eidesstattliche Erklärung

Ich versichere an Eides statt, dass ich diese schriftliche Arbeit in allen Teilen selbstständig verfasst und keine anderen Hilfsmittel als die angegebenen verwendet habe. Die Stellen der Arbeit, die anderen Werken dem Wortlaut oder dem Sinn nach entnommen sind, habe ich in jedem einzelnen Fall unter Angabe der Quelle als Entlehnung kenntlich gemacht.
Ich versichere weiterhin, dass ich die vorliegende Arbeit oder Teile davon noch nicht als Prüfungsleistung in diesem oder einem anderen Studiengang eingereicht habe.

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Yeoi Lin Lee

Wien, den 2. Februar 2016