

Hyun-Hoon Lee

The Korean Economy

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Reviewed by
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The economy of the Republic of Korea (hereafter Korea) has known as one of the most successful models of extensive economic development in a short period of time. It has experienced an incredible record of economic growth since the early 1960s and integrated itself into the modern high-tech world economy. The East Asian financial crisis of 1997-1998, however, exposed limitations and weaknesses of the government-led development strategy, including an undisciplined financial sector. The Korean economy had to undergo tremendous restructuring processes during and after its financial crisis and is still being reshaped towards a more competitive and opens economy. For many developing countries, the experiences of the Korean economy, whether positive or negative, are definitely worth reviewing to obtain valuable lessons on development. This book, consisting of four Parts and thirteen Chapters and written by seventeen experts in the field, provides readers with some guidelines in this regard. It covers lessons of the Korean financial crisis, post-crisis government's reform policies and several important issues the Korean economy has recently been facing, as well as prospects of the development models for the future Korean economy.

The book is edited by three economists, Charles Harvie, Hyun-Hoon Lee

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and Junggun Oh. After these three editors present a brief overview of the book in chapter 1, Professor Jong-Wha Lee at Korea University analyses the causes of the Korean financial crisis and shows how the economy recovered in its aftermath in chapter 2. He argues that the decisive factor to bring the economy into the crisis was the large outflows of short-term capital and the depletion of foreign exchange reserves, while longstanding structural weakness and vulnerability were contributing factors to the crisis. The author then discusses the various structural reform processes that the economy had to undergo and draws some key policy lessons for other developing economies. He suggests prudential regulation and supervision of the financial sector, gradual and careful approach to financial liberalization, caution over adopting a relatively fixed exchange rate, institutional development for well-functioning capital markets, government-led financial restructuring when needed, and policies for stable macroeconomic environment and sound financial system.

In chapter 3, Junggun Oh of the Bank of Korea presents the experience of Korea's financial sector reform, with discussion of the contents of financial restructuring: exit of non-viable financial institutions and the disposal of ailing financial institutions, public funds support for purchasing non-performing assets and recapitalization, improving the transparency of financial institution's management, strengthening prudential regulation and supervision and strengthening the power of main creditor banks for corporate restructuring. He argues that the main goals of financial restructuring were normalization of the financial intermediation function, enhancing the soundness of the financial system and strengthening the competitiveness of the financial industries. Despite progress made in these areas, he contends much more needs to be done: heightening the soundness and profitability of the corporate and financial sectors, and improving management transparency of financial institutions. In order to achieve these, he argues that privatization of government-owned financial institutions and further strengthening of the financial intermediation function would be of help.

Chapter 4, by Charles Harvie at the University of Wollongong, reviews the

corporate sector restructuring that occurred in the wake of Korea's financial crisis. The review is fairly comprehensive, covering the details of government measures and their outcomes. First, the author examines the pre-crisis growth and performance of the corporate sector and discusses the legacies of Korean government's interventionist industrial policies that resulted in corporate sector weakness. Then, he analyses the market liberalization measures that were aimed at solving the structural problems of the corporate sector. Despite efforts at corporate restructuring, the author argues that Korea's corporate sector remains highly leveraged by international standards and suffers from low profitability. Although cash flows have improved and the interest coverage ratio has also improved, he contends that the improvement has not come from increased earnings or the profitability of corporations but rather from lower interest payments. The author argues that ongoing operation of financially troubled enterprises will constrain the growth of the economy and hinder the establishment of a healthy financial sector. It is noted that further improvements in legal bankruptcy procedures will be needed. Regarding the effectiveness of the Big Deals, he concluded that the outcome remains unclear. The author argues that inflows of FDI, particularly in the form of mergers and acquisitions, have contributed to supplying liquidity for Korean firms and to improving corporate governance and transparency.

In chapter 5, Martin, Tergeist and Torres point out key challenges in Korea's labour market: the need for a system of industrial relations based on trust, reduction of high degree of duality, and establishment of a modern social safety network that can adapt to population ageing. They argue that the country's further convergence to the living standards of the world's leading economies depends to some extent on how well Korea addresses these key labour market and social challenges. An industrial relations system should be based on mutual trust, and basic labour standards and collective bargaining rights should be fully in line with international standards. The authors also call for a reduction in the high degree of duality that presently characterizes the Korean labour market, since the duality not

only raises job insecurity but may also hinder improved productivity performance. They argue that the social safety net needs extending and strengthening. There are concerns over the coverage of the employment insurance scheme, implementation of 'productive welfare', and adjustment of the public pension and enterprise retirement systems in face of growing ageing population.

Chapter 6, by Junsok Yang, reviews public sector reforms in Korea after the 1997-1998 financial crisis. Korea's public sector reforms focused mainly on three areas: government structural and managerial reforms, SOE reforms including privatization and managerial reforms, and regulatory reform including deregulation. The author argues that the results of these reforms are mixed since the reforms in the three areas cannot be classified as complete successes even though there were some improvements in each area. He concludes that the Korean government's privatization effort was rather successful as the government succeeded in forming and implementing a plan to privatize 11 SOEs including KEPCO and Korea Telecom. Korea also downsized the government and SOEs by reducing their number of workers, and installed more flexible management techniques that emphasize the responsibility of the individual ministries, agencies and SOEs. The Korean government also put in place a mechanism to review new regulations and instituted a major deregulation programme that eliminated over 50 per cent of existing regulations in 1998. However, the reforms mostly took place in the first half of the Kim Dae Jung administration periods, and the pace of reforms slowed down in the second half.

In chapter 7, Korea's monetary and exchange rate policies are reviewed and assessed by Junggun Oh, in the wake of the financial crisis. The contribution of those policies is examined as to whether they were helpful for the recovery and stabilization of the Korean economy. The author argues that the tight monetary policy in the wake of the crisis and the resulting high interest rates greatly exacerbated the contraction of the economy, in addition to negatively impacting the heavily indebted corporate sector and financial sector. The easing of monetary policy from the second quarter of 1998

contributed to the dramatic recovery of the Korean economy, and restored stability in financial markets thereafter. While the Bank of Korea's monetary policy has advanced in terms of its system and practices, there remain some challenges and difficulties, according to the author. The Bank of Korea will try to harmonize different policy objectives while fulfilling the task of inflation targeting, strengthen the effectiveness of the interest rate channel of monetary transmission, develop and deepen financial markets, and enhance the Bank's forecasting capacity.

In chapter 8, Dong-pyo Hong, Gae-Iyong Choi and Yongkyu Kim consider Korea's Information Technology (IT) policies as an important agenda item for the Korean government. They argue that the national development strategy based on input-driven growth had begun to reach its limit around the early 1990s. They find that the IT industry has greatly contributed to reviving the Korean economy when the 1997-1998 financial crisis hit the economy. It contributed to increasing investment, improving the trade surplus and creating jobs. The authors point out that the government appropriately provided a competitive environment and the necessary infrastructure for the IT sector through deregulation and liberalization. In response, the private sector has made the best use of new business opportunities by increasing investment in IT, with its innovative entrepreneurship. At an early stage, the Korean government actively participated in the market in order to build a firm foundation for the IT sector. Later, government policy became market-friendly as the IT industry grew into a new leading sector. At present, government policies are promoting competition and entrepreneurship to facilitate innovation and the utilization of IT.

Chapter 9, by Taekdong Yeo, Young Man Yoon and Kar-yiu Wong, focus on the trend of Korea's trade and foreign direct investment (FDI), together with its policy regime during the period from the early 1990s through to recent years. The authors analyze the development of the Korean trade policy that has contributed to the country's successful transformation into an open market-driven economy. They also discuss Korea's trade policy under

the multilateral regime of the GATT/WTO and review trade and foreign direct investment developments in the times when Korea struggled to escape from the financial crisis. The chapter examines the future economic agendas that the Korean government should consider and discuss possible policy responses to the challenges that can arise in the rapidly changing world economy.

Chapter 10, by Inkyo Cheong, reviews Korea's Free Trade Agreement (FTA) policy, and evaluates the effects of Korea-Chile and Korea-Japan FTAs. Although Korea believed FTAs were necessary for the growth of its exports and has been studying the feasibility of FTAs since the 1980s, it did not actively explore an FTA because of the anticipated difficulties that would arise from opening its markets. However, the Korean government began to seriously consider the introduction of FTAs with trading countries after the 1997-1998 East Asian financial crisis. Korea's first FTA, which was with Chile, was concluded in late 2002. Since then Korea cautiously pursued its subsequent FTAs with small and medium-sized countries. The author argues that the goal of Korea's new trade policy is to adapt promptly to the changing global economic environment, as well as resolve the nation's economic difficulties. He presents his analysis of FTA effects on welfare and GDP, and argues that Korea's policy should aim to transform Korea into an 'open trading country'.

Chapter 11, by Dongho Jo, reviews the economic situation of the Democratic People's Republic of Korea (hereafter North Korea) and analyses the causes of its stagnation. He discusses North Korea's policy reaction and suggests a development strategy for the North Korean economy. The author finds that North Korea has made bold changes in its economic policies since the second half of 2002. It introduced new measures to improve economic management, established economic and tourist zones in the Kaesong and Mt. Kumkang areas, and designated Sinuiju as a Special Administrative Region. However, the author expresses his doubt whether such policies will be able to contribute to economic growth without attracting foreign capital. He argues that North Korea's economic development is important not only for the North,

but also for the South, in order to secure peace on the Korean peninsula and stability in the North-East Asian region. The author concludes the chapter by proposing a set of strategies on how to develop the North Korean economy.

Chapter 12, by Jong Won Lee, first discusses the limitation of the traditional development models, including 'Economic Development Stage Model', 'Neo-classical Approach', 'Structural Analysis' and 'Neo-Marxian Approach'. The author, then, presents a new analytical model of economic development and assesses the Korean economic development process. He argues that Korea's 'developmental state model approach' has been a cause for both the success and failure of the Korean economy. According to him, government-led economic operations functioned effectively in the early stages of economic development, but they created low-efficiency and a high-cost economic structure during the later stages of economic development. Even though IMF policy recommendations advocated adoption of the neoclassical principle as a replacement for the country's traditional development approach, the author argues that extreme neoclassical strategies cannot be a successful substitute for the statist model approach in Korea. He suggests an 'advanced state model' as a more relevant strategy for Korea.

In chapter 13, Charles Harvie and Hyun-Hoon Lee review the 'old' Korean development model, and then construct a 'new' model emphasizing the key ingredients that can enable the Korean economy to return to its earlier path of robust and sustained growth. They discuss that the economic crisis of 1997-1998 revealed the 'old' development model to be no longer adequate in the new international environment and for the country's stage of economic development. The authors argue a new development model for Korea needs to be based upon market mechanisms of competitive discipline and a necessary institutional framework that supports competitive and open markets. The model also needs to be based on an outward-looking development strategy, while maintaining stable macroeconomic management, and emphasize the development of SMEs and an appropriate education

system to produce a creative, skilled and adaptable workforce. The chapter also suggests fostering gradual economic integration between the North and the South Korea.

Since the book contains sizable collection of papers that deal with Korea's post-crisis policies and issues, it can serve as a good reference for scholars who are interested in reviewing Korea's economic crisis in 1997-1998 and its policy measures for economic recovery. The book covers Korea's reform and policies in various areas, including the financial, corporate and public sectors as well as labour market, to provide readers with a comprehensive picture of the Korean economy before, during and after the 1997-1998 economic crisis. In addition to these four major areas of reform, it also deals with Korea's monetary and exchange rate policies, IT sector, trade and foreign investment, FTA issues and a development strategy for the North Korean economy, all of which constitute important policy agenda for Korea. If readers are already familiar with the Korean economy and are looking for some fresh insights and/or new findings in this area, they are recommended to read the last three chapters in the book. Despite the fact that most contents of the papers in the book can be found in other literature on the Korean economy without difficulty and some important issues such as contribution of education to the economy are lacking, this book will be useful for those who wish to refresh their knowledge and understand the history and structure of the Korean economy. If the book were intended to project the future course of the Korean economy as an important player in Asia and even the world economy, it would have included a variety of papers adding more chapters in the last part: Prospects.