
Letter from the Editor

Korea's disappointing economic performance in 1996 has triggered a long overdue reality check of the nation's economic structure. The economic trends of 1996 indicate that this is not merely a cyclical downswing. Exports have been lackluster, and the current account deficit has more than doubled, estimated to have hit a record \$22 billion in 1996. The stock market index is also at a record low, suggesting that the economy will not recover soon.

Exports will improve slightly as the yen is expected to stay weak against the dollar at least through early this year. As a result of the export slowdown and low profitability of companies, fixed investment is not expected to be strong. Overall the Korean economy will grow somewhere between 6.0% and 6.5% in 1997, significantly lower than the 6.9% expected in 1996.

Due to the slowdown in growth and the increasing openness of the domestic economy, inflation will be lower in 1997. The current account balance is projected to improve slightly because imports will grow at a decreasing rate. Interest rates will remain fairly high in 1997 because of inefficient financial channeling, but the government's efforts to gradually open the financial markets will help stabilize interest rates.

The current business downturn started in the third quarter of 1995. It has since continued its downward trend and will probably not bottom out until the third quarter of 1997. Some believe that the economic downturn may even be longer and more severe.

There are several structural reasons for the pessimistic outlook. First, the Korean economy's business cycle is determined by the yen currency trends. This is mainly caused by the fact that Korean exports are scarcely differentiated and dependent on their price competitiveness.

Second, a "premature-aging" phenomena has emerged in our society. Since 1985, nominal wages have shown double-digit increases every year, while productivity has only increased by 6% or less on average. In spite of wage increases, the private savings rate dropped from 28.3% in 1991 to 26.0% in 1995, mainly due to excessive consumption.

Third, financial liberalization has severely weakened the effectiveness of the government's macro policies. The deregulation of short-term capital movements has greatly reduced the efficacy of domestic monetary and exchange rate policies. Additionally, opening the goods

market to foreign competition has limited the government's options in terms of industrial policy.

Fourth, strained labor-management relations continue to escalate. Both sides remain intractable in the current, heated debate on new labor regulations, and labor disputes may intensify in the coming year.

In 1997 Korea's OECD membership will bring about major implications for the nation's economic structure. In the future, in order for us to develop our economy we must adjust our policies according to the principles of the global open market.

First of all, we must ensure our nation's macroeconomic stability. For example, Korea needs to foster its ability to respond to the fluctuations in interest and exchange rates caused by the complete opening of the domestic capital markets.

Second, with complete financial liberalization scheduled for 1998, it is vital that we revitalize the competitiveness of our domestic financial sector. This should include removing restrictions on financial institutions' range of activities, fostering natural mergers and specialization, and introducing a system where management is accountable for its performance.

Third, deregulation must be promptly and effectively implemented. The government is aware that intervention and regulation are no longer appropriate in this era of heightened competition. Nonetheless, many feel that deregulation is taking place too slowly and time is running out for a much-needed national restructuring.

The government is not the only one who needs to be active. Businesses need to adopt a "value-based management". This concept entails businesses' conducting their activities and decision making towards creating additional value for all stakeholders of a firm, including employees, customers, stockholders, and society. Firms, as corporate citizens, must now also adopt a sense of social responsibility in order to prosper in the future.

The year 1997 will be the turning point of the Korean economy. Being Korea's initial year as an OECD member it will be our first test in a full-scale open market economy. Corporations must strive towards recovering their competitiveness through R&D investment for new technology and products. The government also needs to play a critical role in helping firms effectively compete in the global market economy through widespread deregulation. **VIP**