

THE KOREAN ECONOMY: FROM MIRACLE TO CRISIS

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Asian Growth in Decline

For some time, many have been viewing East Asia as a major force which will lead the world's economic growth in the coming years. For instance, the IMD's world competitiveness report for 1996 calls East Asia as the engine of the world economy. However, these rosy views of Asian success are fading out these days. Over the last several months, the Southeast Asian economies have been gripped by a severe financial crisis, as witnessed by the sharp devaluation of the Thai baht, the Malay ringgit, and other regional currencies. And in October, the world financial markets were shaken by the huge plunge of the Hang Seng index in Hong Kong. As the year 1997 closes out, the Asian economies are no longer a leading force, but rather a powder magazine.

financial situation worse. The current recession is known to have started from the last quarter of 1995 and has been going on for about two years. If this business cycle does not bottom out by the end of 1997, this recession will be the longest one since the 1970s. Furthermore, one might conclude that the Korean economy is not just in a recession but even a depression.

The Lone Bright Spot

While it is true that economy may be in crisis, there has been a recent bright sign in addition to the dark. That is exports, which have been making a recovery since the second quarter. In October, exports reached \$12.5 billion, the biggest amount ever recorded in a month, and almost equalled the amount of imports so that the trade balance is almost even. The export growth rate of semiconductors was more than 25%, while those of automobiles and steel products were 6.4% and 8.8% respectively. As a result of this boost in exports, industrial production has also been expanding.

The Korean economy in 1997 can therefore be characterized as a "production recovery during a financial depression." However, the question is whether production can continue to recover under an unstable financial market. The answer is very doubtful. The bad situation of the financial market will make the business environment more difficult and will keep corporations from investing in new facilities. The lack of investment will weaken the base of production in the long run. The past miracle of the Korean economy was based on huge investment and a sufficient, well-trained labor supply. These two

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Korea Just Like Its Neighbors

The Korean economy is also in bad shape just like its neighbors. The won has sharply devaluated, with the won/dollar exchange rate rising up to ₩960 per dollar, a record high. Foreign investors have quickly started to withdraw their financial assets from the domestic market. Their movements have shaken the Korean stock market, which has already been slumping because of the bankruptcies of several major business groups this year. The KOSPI stock index dived under 500 points, which is the lowest level since 1992. And on top of this, the political turmoil related to the presidential election is making the

major factors are basically made possible by a high savings rate and a high propensity for education. However, the financial crisis will make one of these major forces, huge investment, powerless even with a high savings rate.

Underlying Problems

What are the problems of our economy? First, our economic environment is not stable enough to support sustainable growth. This "instability" is caused by the structural current account deficit, the inefficiency of the financial system and the on-going inflationary pressure. Since 1990, the current balance has continuously been a deficit except for one year, 1993. The competitiveness of the financial sector is below average compared to other industrial countries. The inflation rate, which is around 4-5%, is also higher than those of the advanced countries, which are around 2%. Furthermore, there is accumulated inflationary pressure, especially in public service.

Second, economic policies and institutions are uncertain or shifting so that economic agencies are not able to have vision for their future.

Related to this "uncertainty", the lack of a coherent economic philosophy and the inconsistency of policy are often cited as major problems. During the more than 30 years of Korea's development history, policy targets have usually been numerical economic indicators such as GDP growth rate, export growth rate, and inflation rate, for example. Institutional issues like competition rules and the efficiency of the market structure have not been major concerns of government policy. This means that the institutional environment is being changed inconsistently to achieve short-run numerical goals. It is for this reason that the Korean economy cannot resolve difficulties by itself under the rules of free market competition.

What Lies Ahead

To overcome this "unstability" and "uncertainty", we must burst the bubbles and set a clear vision for national development. The current account deficit and high inflationary pressure are based on the fact that Korean people spend more than they should. The excess

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〈Figure-1〉 The Won/\$ Exchange Rate and the KOSPI Index

