

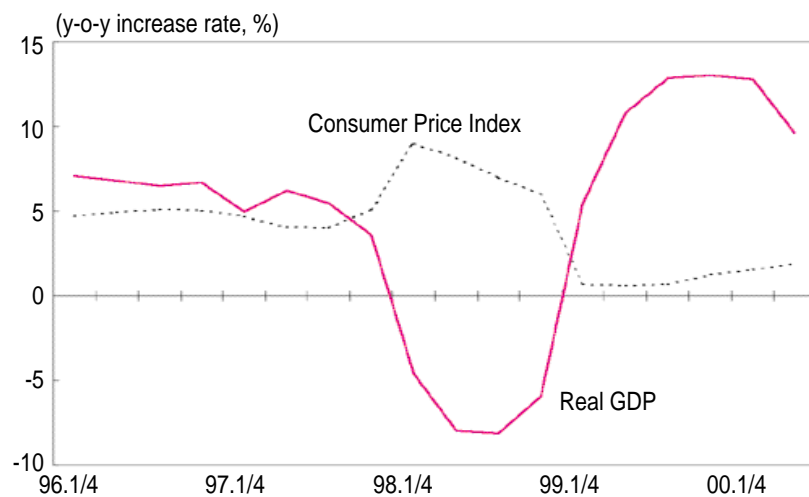
## HAS THE “NEW ECONOMY” APPEARED IN KOREA?

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*The recent phenomena of low inflation and high growth might encourage some pundits and government officials to consider that the Korean economy has transformed into a “New Economy”.*

The Korean economy has shown a high growth rate exceeding ten percent since the second quarter of 1999. Although the growth rate slowed down to 9.6% in the second quarter of 2000, it still remains in the high growth range. Inflation has recorded extremely low figures, although it jumped due to a hike in oil prices since July. In spite of its recent increase, one can say that the inflation rate is still very low compared to Korea’s past records. The recent phenomena of low inflation and high growth might encourage some pundits and government officials to consider that the Korean economy has transformed into a “New Economy”.

Figure 1. Korea’s GDP and CPI Increase Rate



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If the new economy has really appeared in Korea, the government’s economic polices could be more flexible based on the good performance of private companies. The economic restructuring program could also be pursued more vigorously. On the other hand, if the recent good features of the Korean economy are merely a coincidence, the government’s economic restructuring plan would face a lot of obstacles.

It is clear that high growth with low inflation does not necessarily signal the presence of a new economy because such a situation might come from other factors such as appreciation of the nation’s currency. That is why we need to have some idea about what have caused high growth and low inflation.

## The issues in debate on new economy in Korea

The appearance of the new economy in Korea would mainly depend on whether information technology, the new fast developing industrial sector, is causing increases in productivity of the overall economy. To check the spillover effect of the IT industry, the basic reasons for current high growth and low inflation should be investigated. Counter evidence for the new economy theory may be found if high growth and low inflation originate from reasons other than an increase in productivity.

In addition to the investigation on the background of high growth and low inflation, we should consider the possibility of US-style long-term high growth in Korea. Long-term high growth necessarily results in excess demand. It is natural that some differences exist between the Korean economy and the US economy. That means each economy responds differently to long-term excess demand.

### • The causes of Korea's high growth

Although the GDP growth rate recorded only 9.6 percent in the second quarter of 2000, a somewhat lower figure than those recorded in the previous four quarters, it still remains in the high growth range. But five quarters are not long enough when we say long-term growth. Moreover, considering that the growth rate figures were obtained by comparing GDP with that of the same period of the previous year, it cannot be denied that the deep depression of 1998 contributed to the high growth figures of 1999. Therefore, we can say that the substantial high growth period began in the first quarter of 2000, and there is insufficient evidence of a new economy one of whose characteristics is long-term high growth.

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Table 1. Growth Rates by Industries

	1999				year	2000	
	1Q	2Q	3Q	4Q		1Q	2Q
Agriculture, Forestry, and Fishing	9.3	4.7	6.7	2.7	4.7	1.6	-1.7
Mining and Quarrying	-8.1	8.9	15.0	7.9	5.2	0.7	4.5
Manufacturing	10.7	21.5	27.3	27.2	21.8	23.0	16.8
Electronics Industry	29.8	52.4	51.8	51.9	46.8	49.8	39.0
Electricity, Gas, and Water	4.5	8.5	8.5	15.4	9.1	18.0	11.9
Construction	-14.2	-7.1	-9.5	-10.5	-10.1	-8.1	-4.4
Wholesale, retail trade, restaurants, hotels	7.1	13.1	16.1	15.9	13.1	12.8	10.7
Transport, storage and communication	13.2	13.2	17.0	20.6	16.1	17.3	20.0
Communications	26.7	18.9	27.2	34.2	26.9	26.8	35.4
Finance, Insurance, real estate, business	3.1	7.5	5.6	5.5	5.4	6.0	2.3

Source : Bank of Korea, GDP: second quarter 2000, Aug 22, 2000.

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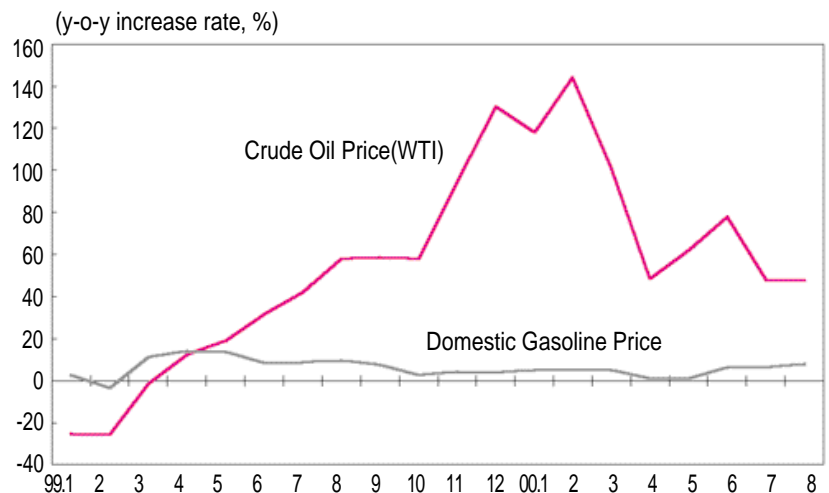
It is true that information technology related industries are one of the fastest growing sectors in the Korean economy. The electronics industry and the communications industry are growing much faster than other industries. Yet it is not easy to find evidence that an economy-wide improvement in productivity has appeared in Korea because of the IT related industries. The first stage of the new economy might be fast growth of the IT related industries and the second would be a spillover of productivity gains into other industries. In the final stage, most of the other industries would show fast growth due to the economy-wide efficiency. In this stage, the economy would show long-term steady high growth. As the growth rates of IT related industries such as the electronics or communications industry are much higher than other industries, it seems that the Korean economy is in the first stage of the new economy. And it is obvious that the current high growth is mainly due to some other reason besides an improvement in efficiency originated from the IT related industries. The main factors that are causing the current high growth seem to be a fast increase in external demand, in particular the exports of semiconductors and automobiles, and facility investment induced by an export boom.

• The causes of low prices

Since 1999, the price level has been very stable. The CPI growth rate recorded 0.8 percent in 1999 which is the lowest figure in Korea's history. The basic tone has not changed in the first half of 2000, when the y-o-y CPI growth rate recorded 1.5 percent which is a little higher than in 1999, but still lower than in the pre-crisis period.

As in the high growth rate case, however, it does not seem that the recent low prices are due to improvement in efficiency in the whole economy. More likely factors would be the domestic currency's appreciation and the government's

Figure 2. Crude Oil Price and Domestic Gasoline Price



adjustment of the flexible tax rate on domestic oil products. That is, the exchange rate and the flexible tax system have absorbed the hike in oil prices in the international market.

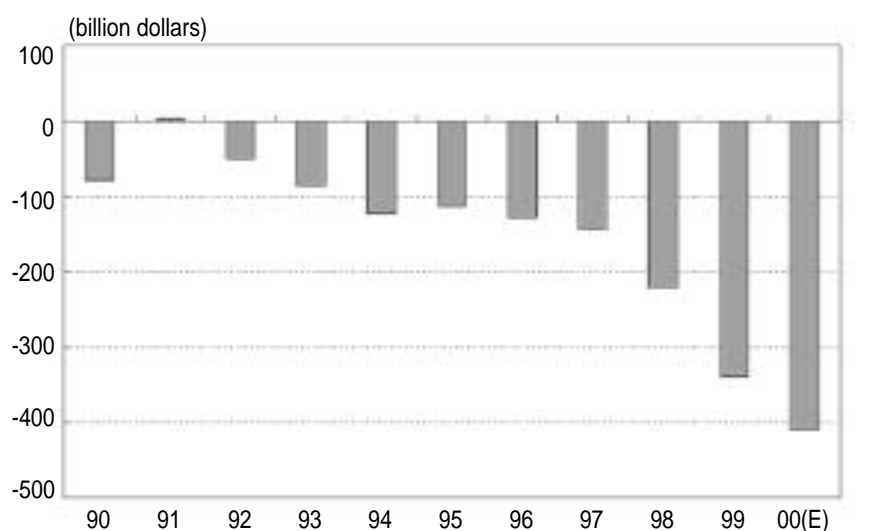
- Economic conditions for high growth and low inflation

The US economy has shown ten years of high growth and relatively low prices. But it should not be overlooked that long-term high growth is accompanied by a huge deficit in current account. In 1991, the early period of the USA's long-term economic boom, the current account deficit was merely \$4.3 billion, but it ballooned to \$338.9 billion in 1999 along with the economic boom. The deficit is mainly due to a mismatch of demand and supply. Domestic demand grows much faster than domestic supply because it takes a long time to build facilities to fulfill domestic demand. The mismatch caused excess demand in the US economy, and the excess demand in turn brought a large inflow of imports from foreign countries and a current account deficit. The deficit, however, mitigated inflationary pressure.

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Figure 3. US Current Account

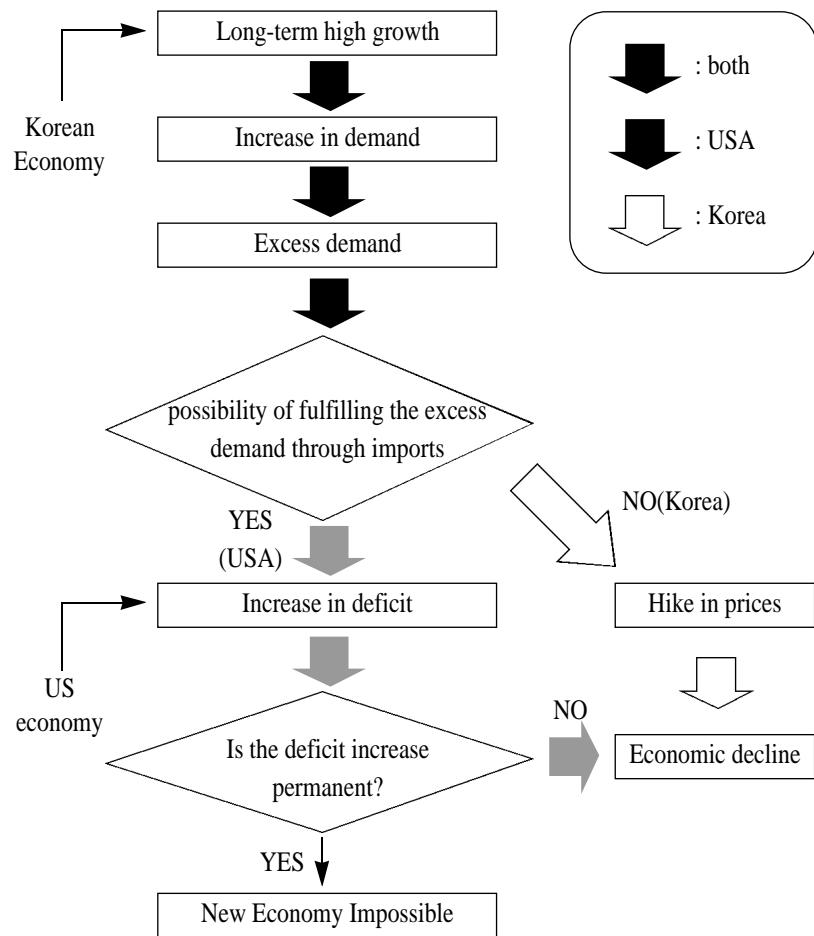


It seems impossible that Korea can enjoy long-term high growth and low inflation (with inflationary pressure mitigated by increased imports from foreign countries) like the US economy. In 1996, Korea's current account deficit amounted to \$23 billion, or 4.4 percent of the gross domestic product. Because the deficit was too huge for a small economy like Korea to sustain, it became one of the main causes of the 1997 currency crisis. Meanwhile since the United States is the supplier of the basic currency in the world economy, it could endure a long-term deficit.

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If the Korean economy suffers a long-term current account deficit like the United States, it would cause a shortage of foreign liquidity, deteriorate Korea's

Figure 4. Long-term High Growth for Korea and the US



*Long-term high growth would cause high inflation in Korea while it causes an increase in the current account deficit for the United States.*

confidence, trigger an outflow of foreign capital, and lead to another economic crisis. The difference between the two economies is that Korea’s sustainable deficit level is much smaller than that of the United States. Therefore, long-term high growth would cause high inflation in Korea while it causes an increase in the current account deficit for the United States.

### New Economy in Korea Overstated

*It is very important for the Korean economy to keep the current account surplus in order so that the new economy can appear in Korea.*

The high growth and low inflation the Korean economy is currently experiencing does not seem to be from a higher efficiency due to the development of IT-related industries, which is counter-evidence for the new economy. Moreover, the Korean economy would not be able to endure long-term high growth by satisfying excess demand through imports. This fact implies that it is very important for the Korean economy to keep the current account surplus in order so that the new economy can appear in Korea. **VIP**