

IV. Korea Economic Focus

Too Early To Expect a Stable Financial Market?

It has been about a year since Korea was first caught in the grips of a painful currency crisis, which eventually forced Korea to approach the IMF for a bailout. Since then, Korea's main financial indicators, such as interest rates and the exchange rate, have all stabilized, as have those of Thailand, a fellow IMF patient. However, the other major IMF aid recipient in Asia, Indonesia, is still experiencing some difficulties, although the situation may be improving.

From many aspects, Korea's situation could be viewed as being inspiring. The exchange rate, which rose as high as 2000 won/dollar at the peak of the crisis, has now stabilized in the 1300-1400 range. Interest rates, which shot up to 30 percent at one point, are now down in the single digits. The current account surplus has risen to a record level, as have the foreign exchange reserves. With much of Korea's short-term debt having been converted into medium- or long-term debt, the foreign debt picture has brightened considerably. In addition, it is generally recognized that Korea has made considerable progress in restructuring, at least in terms of setting up or introducing a new system or institutional framework for the economy.

What's the Problem?

However, at the most recent Cabinet meeting, President Kim Dae-jung expressed his displeasure with the situation. He emphasized that the government's economic policies needed to be more substantive and provide more tangible benefit. The problem is, as pointed out by the President, that the government economic policies are showing no effect in the real economy, even though the situation is apparently improving. In other words, ordinary people and companies feel no indication that the nominal indicators have been turning better.

For example, even though the government has been increasing the money supply, there has been little or no real effect. Commercial banks are trying to be more active in lending money, but only to top-notch SMEs--those least likely to need the funds. Therefore, the expansionary monetary policy has been no help at all to the majority of firms who needs the capital the most and stand on the verge of bankruptcy.

Why is this occurring? The main reason is that even though the government claims that the first stage of financial restructuring has been completed, there is still a long way to go. The issue of ownership of the banks has still not been resolved; because banks are in the process of downsizing, no one taking responsibility and extending loans to these companies in need. In other words, there are still major distortions and inefficiencies in the current lending practices.

Conceptually, one can distinguish three stages in the process of restructuring. It starts with the "introduction of a new system", followed by the "implementation of the new system" in basic practices, and ideally closing with tangible "improvements." As of now, Korea has just completed the first stage, "introducing the new system." It is now faced with the problem of implementation--having the new system manifested in the basic economic practices.

To fully accomplish the intended goals of restructuring, what is needed during the implementation phase is a mechanism which can provide economic agents with adequate incentives. In microeconomic theory, this sort of mechanism is called an "incentive-compatible" mechanism. The difficult task now lying ahead of policy-makers is designing a suitable mechanism which induces economic agents to fully adopt the new system and therefore ensure it is implemented.

(Edward Park; parked@hri.co.kr ☎724-4028)