

The economic performance and strengths of south korea



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The three decades of unprecedented economic growth in Korea is characterized by government enabled economic developments processes. In 1993, a massive liberalization started in S Korea, with developmental state of bank-based High Debt model becoming most fully developed [Wade, 2002]. Along with Taiwan and Japan, Korea is (again) only most successful non-city state. No other country have has achieved such big gains in the average real wage or the average real wage of the bottom 25 percent [Wade, 2002]. Korea was at 7th place in technological capacity by means of number of secure patents.

Figure : Korean Currency Exchange rate[3]

Figure : Korea's External Debt and Debt Service Payments (USD Million) [3]

Source:

WB, Global Development Finance, 2003.

OECD, External Debt Statistics, various issues and Statistical Compendium CD-ROM 2003-1.

IMF, Recent Economic Developments, various issues.

Country sources.

Capital flows, South Korea [Krugman, 1998]-

Total inflow

Outward FDI

Inward FDI

1990

2886

1056

788

1991

6714

1500

1180

1992

6969

1208

727

1993

3188

1361

588

1994

10610

2524

809

1995

17221

3529

1776

1996

24025

4424

2325

Table : Korea's Capital FLOW [Krugman, 1998]

Major Strengths of Korean Economy Priori Asian Crisis

Enabling a rapid growth, country was continuing on its of outward looking strategy adapted from 1960s, which was considered well suited due to lack of natural resources, low saving and very small domestic market. Country was perceived to be building it's economic on sound macro-economic

management, by likes of World Bank [Bird, 2010], and had S&P rating of A1, backed-up by political stability.

The lack of domestic saving was being compensated by a continuous foreign capital, thus making exports a major pillar of the economy. In this regard, the strategic intervention by government should be considered too. But economic restrictive approach started taking shape by 1980s, as the domestic market became an increasing source of economic growth.

Domestic demand for automobiles and other indigenously manufactured goods soared because South Korean consumers, whose savings had been buoyed by double-digit wage increases each year since 1987 and whose average wages in 1990 were about 50 percent above what they had been at the end of 1986, had the wherewithal to purchase luxury items for the first time. The result was a gradual reorientation of the economy from a heavy reliance on exports toward greater emphasis on meeting the needs of the country's nearly 43 million people (U. S. Library of Congress).

The shifts in demand and supply indicated (as evident in point #2) that an economic restructuring was underway, that is, domestic consumption was rising as net foreign demand was falling. On the supply side, the greater growth in services mirrored what the people wanted—more goods, especially imports, and many more services (U. S. Library of Congress).

The structural reforms taken in early 80s, like conservative monetary policy, tight fiscal measures to curb the inflation, and reduction of the government intervention, liberalizing policies on imports and firing investments to prompt competition, has helped country regain its strengths of 9.2 percent real

growth between 1982 and 1987 and 12.5 percent between 1986 and 1988, and achieved significant surplus of balance of payments of US\$11.4 billion surplus in 1987, which allowed it to reduce the foreign debt (U. S. Library of Congress).

A look at the government's economic plans in this duration indicates the pattern of the economic restructuring-

Economic Development Plan 1982-86: Shifting away from heavy and chemical industries, to technology-intensive industries, such as precision machinery, electronics (televisions, videocassette recorders, and semiconductor-related products), and information. More focus on building high-technology products in greater demand on the world market.

Economic Development Plan 1987-91: Continuing with goals of the previous plan with accelerating import liberalization and reducing restrictions and nontariff barriers on imports to mitigate adverse effects, such as monetary expansion and delays in industrial structural adjustment. It was intending to continue phasing out direct assistance to specific industries and instead to expand manpower training and research and development in all industries, and to accelerate the development of science and technology by raising the ratio of research and development investment from 2.4 percent of the GNP to over 3 percent by 1991.

Economic Development Plan 1992-96: to develop high-technology fields, such as microelectronics, new materials, fine chemicals, bioengineering, optics, and aerospace. Government and industry would work together to

build high-technology facilities in seven provincial cities to better balance the geographic distribution of industry throughout South Korea.

The strengths Korean economy inherited from 80s were given to direction by means of deliberate restructuring which aimed to build the national economy on development and technology sectors. And thus, by 1997, country was one of the biggest producers of electronic consumables and automobiles, thriving on trade surplus from 1985 to 1990, riding on major focus and orientation on exports and a roaring global growth of Korean MNCs.

It can be concluded that, control over the country's financial system was perhaps single most important factor enabling the state to successfully direct the economy. Government planners were able to use their power over both the allocation and cost of capital to promote export as the priority activity for all firms (Landsberg, 2004).

Main Challenges to South Korean Economy Faced Towards mid-1990s

It's an irony that same strengths we discussed, started churning out as challenges for Korean Economy. It is worth to be seen, how failure to concur these challenges set the fireball rolling.

For a crisis to occur, therefore, it would seem necessary for fundamental economic weakness to be combined with a 'trigger' that sets it off.

Something happened in East Asia that converted a situation that appeared sustainable into one that became unsustainable [Bird, 2010].

Though, like rest of East Asian economies, Korea too was considered a roaring economy, but by 1995, end- wages were raising faster than the productivity, and massive imports were creating big trade deficits. Though, the current growth was faster than most, early sign of slowdown were already there. At the same time, country's economy was being lauded even by World Bank for its macro-economic management, strong export orientation and political stability [Bird, 2010].

While, by mid 1990s the economy was robust, 1997 was marred by heavy fleeing of the investors due to sharp speculation aggravated by Non-performing loans of many merchant banks. Some of the key parameters impacted by this chain of events are depicted in below graphs (all prepared on the basis of data sourced from " Key Indicators of Developing Asian and Pacific Countries" 1999, Vol. 30, Asian Development Bank)-

Figure : UNEMPLOYMENT in KOREA [Key Indicators of Developing Asian and Pacific Countries 1999, Vol. 30]

Figure : OUtstanding and Disbursed DEBT [Key Indicators of Developing Asian and Pacific Countries 1999, Vol. 30]

Major Challenges can be listed as below-

Excessive leverage: The pumped-up investments in illiquid properties like plants, lands, machinery with short-term debt, which suddenly became non-performing assets, as the global interest rates rose.

Foreign Debt: Korea's foreign debt nearly tripled from \$44 billion in 1993 to \$120 billion in September 1997, though not very large debt burden for an <https://assignbuster.com/the-economic-performance-and-strengths-of-south-korea/>

economy of Korea's size, but short-term percentage high at 67.9 percent for comparison other non-OECD countries same was 20 percent at the time of debt crisis.

Structural Problems:

The claim has increased in 1990 to a substantial part of the GDP, which further become worse due to the fact of these claims having part of corporate liability.

“(The chaebols) have ratios of debt to equity in excess of 6 to 1, making some form of debt restructuring unavoidable [Bird, 2010].

Rapid growth of Bank and claim on private sector (Figure 4)-

Figure : Ratio of bank claims on private sector to GDP [Bird, 2010]

The Interventionist Politics- Bank credit allocation start turning misallocation of investment, as it was ruled by government. This fact hints at the governments support to chaebols to finance their deficits, instead of the rationally answering the increasing competition to the export industry.

...for political reasons, the government eventually decided to allow a small group of chaebol to dominate production of new industries. By 1988, the combined revenue of top four chaebols equaled approximately 47 percent of South Korea's total GNP [Landsberg, 2004].

Slowing Growth- By 1990 high growth rates of the late 1980s started slowing down. In 1989 real growth was only 6.5 percent. One reason for this development was the economic restructuring that began in the late 1980s-

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including the slower growth of major export industries that were no longer competitive on the world market (for example, footwear) and the expansion of those industries that were competitive, such as electronics [U. S. Library of Congress].

Changes in External Economic Environment:

Country was faced another challenges in terms of international hostility towards its growth strategy, which become monumental in 1990s, which was mainly due to Us and Japan's support to Korean strategy, continued from past decade.

At the other end US became increasingly concerned about " unfair trade" by Korea and threatened with trade penalties, if it continued to use special taxes and tariffs to block imports of US goods.

Japan went one step further with banning export of 200 advanced technologies to Korea [Brenner, 2002]. U. S. also threatened to block its entry to OECD, unless it opened its financial markets for the benefit of the U. S. banks and brokerages [Kristof, Sanger 1999].

Rise of China- Competitive pressure started diverting Japan and other foreign investors to China. China has become major competitor with its integration in international production networks, low-cost labor, and 1994 currency valuation. The rise of China was clearly on the expense of Korea, Malaysia and Thailand.

Overcrowded Market- At the same time the export earnings fell sharply due to over-production of the same goods in same reason by many countries.

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Country's export rate fell from 30.2 in 1995 to 3.8 percent, heavy and chemical products export prices fell more than 46.3 percent in 1996-1998 [Grilli, 2002].

Chaebols: With increasing difficulties to protect the domestic market from imports and fast losing competitiveness, State also became wary of increasing power of chaebols, (which actually state helped to be so powerful with concentration of wealth and production in their hands). Chaebols were no longer willing to take state's instruction and mandate threatening their profit and competitiveness; which ultimately led to chaebols getting freedom to borrow internationally and later to invest abroad.