

Tigers, Hard Workers, and Online Gamers

South Korea's Political Economy Since 1980

By Joel R. Campbell

Winter Sonata Warms Up Japan

In 2003, a new Korean drama debuted on Japanese television. Called *Winter Sonata*, it was the story of a young woman whose high school boyfriend dies, and years later, she meets another man who looks exactly like her former love. The show interwove themes of love, loss, and loyalty and quickly became Japan's most popular foreign program—more watched than any American fare combined. The program's male lead, Bae Yong-joon, developed a huge following among middle-aged women. When he arrived in Japan in 2004 for a book tour, 4,000 shrieking female fans greeted him. Hordes of Japanese women toured sites in Korea connected with the show, and Bae became a spokesman for Korean tourism. *Winter Sonata* was also a hit in China and Southeast Asia. Other Korean dramas followed as the film and television industry gained increasing international attention.¹ The show's overseas success illustrates Korea's growing role as an entertainment center, its gradual shift from industrial producer to diversified economy, and its desire to be known for more than as a purveyor of technological gadgets. Once thought of as a poor country that produced cheap goods, Korea is now a complex, developed economy that produces high-quality cars and electronic goods but also boasts strong financial, service, retail, and IT sectors.

The Pre-1980 Economy

The Korean Tiger Emerges

In 1960, South Korea was still rebuilding after the calamity of the Korean War (1950-1953). One of the poorest countries in the world, its per capita GDP was on par with such newly independent states as Ghana. Its industry was dominated by production of simple consumer goods for the domestic market, and its population primarily consisted of poor farmers. The economy suffered from chronic inflation and current account deficits, and exports were limited even in the best years. All that suddenly changed following a 1961 military coup d'état. US officials urged the Korean government to change direction, and after a shaky start, the authoritarian Park Chung-hee regime (1963-1979) dedicated itself to export-oriented growth and introduced a targeted industrial policy that successively built up key input industries (such as fertilizer and cement), light industry (textiles and apparel, wigs and footwear), and heavy industries. Tight control of the financial industry allowed the government to channel long-term, low-interest loans to favored firms, mostly among the *chaeböl*, or family-run conglomerates.

Strong export-oriented industrial development propelled the macroeconomy to nearly three decades of double-digit growth, a feat only surpassed in East Asia by China. Various aid programs boosted agricultural productivity, allowing fewer farmers to fulfill most Korean food needs. As millions of former farmers streamed to the cities from the countryside, industrial peace and low wages were maintained by tough anti-union policies.

Economist Alice Amsden refers to the heavy-handed, state-led approach as “subsidies and discipline,” ie, state organs planned which industries would receive “policy loans” from commercial or state banks as long as they committed to government export and production targets. Companies that failed to meet targets or resisted government direction could be audited, heavily taxed, and even merged or closed. Overseeing state industrial policy was the Economic Planning Board (EPB), the

premier economic organ operating directly under the president's office. Economist Barry Eichengreen et al. suggest that a nearly perfect combination of rapid capital accumulation, steady growth of the workforce, and quick spurts of productivity made sustained high growth possible. Growth of total factor productivity (TFP), measuring all major factor inputs into economic production, was particularly strong.²

The Park government's push to develop heavy and chemical industries (HCI) in the 1970s created serious imbalances in the economy: Government-directed loans flowed to only selected *chaeböl*, crowding out support for light industries and raising debts to ruinous levels; Korean industry became overly dependent on international markets for heavy industrial goods; heavy use of fossil fuels built high inflation into the economy as international oil prices soared; and burgeoning urbanization created serious housing shortages and severe traffic congestion.

The Fifth Republic (1980-1988)

Reorganizing the Developmental State

By the 1980s, Korea developed a huge middle class with an appetite for new apartments, modern electrical appliances, and family cars. They also began to support demands for democratization. Seoul's hosting of the 1988 Summer Olympics symbolized Korea's coming of age as an economic power. The Korean economy became fully linked to the global economy through exports, foreign investment in Korea, and Korean overseas investments. Economic growth still outpaced most other developing economies. The Chun Doo-hwan government (1980-1988) devoted attention to welfare policies, for the first time emphasizing employment, education, health care, and housing issues.



1988 Summer Olympics Olympic Park Gate, Seoul, South Korea.

Source: Creative Commons at <http://tiny.cc/q2fq5w>.

Korea shifted from a “comprehensive” to a “limited” developmental state. The comprehensive state had put economic planning above market rationality, economic development before regulation, and industrial policy ahead of foreign policy. Its limited successor addressed policy goals besides development. Only selected industries continued to be subject to state intervention. Other areas such as foreign and welfare policy gained prominence. Chun responded to contradictory demands of the *chaeböl* and labor by implementing free market policies, ie, cutting back state investment in the HCI program of the 1970s and changing from active

intervention to regulation for most sectors. The EPB slashed the number of “policy loans” to favored companies and stressed anti-monopoly and fair trade policies. Meanwhile, the Ministry of Finance privatized state-run banks, as the Ministry of Trade and Industry lowered entry barriers for many industries and set time limits on state support for infant industries.

Economic dominance became complete as industrial firms moved from light manufacturing into automobiles and trucks, computers and peripherals, and electronics and electrical appliances. Benefiting from two decades of state support and an export boom made possible by the high yen and American-led global growth, the top five industrial groups now accounted for three-quarters of total manufacturing. Samsung and Lucky-Goldstar (LG) performed best, in part because they were not burdened with the HCI projects promoted by the state in the previous decade. Several of them entered nonbank financial services (but were prohibited from buying banks). Significantly, the conglomerates gained political clout and independence, and they flexed their muscles through increased collusion with government; greater participation in policy-making; and occasional resistance to state control, as when Hyundai and Daewoo refused to merge their automotive units and Daewoo demanded state support for its nearly bankrupt shipbuilding company.

Politics under Chun became increasingly contentious as a popular coalition of labor activists, student protesters, and church organizations grew bolder in taking on the authoritarian regime. When continuous protests in the spring of 1987 attracted significant middle-class support, Chun’s designated successor (Roh Tae-woo) suddenly promised to rewrite the constitution and hold a free presidential election. That election pitted a divided opposition against Roh, who won a plurality of the vote. Big changes were also in store for labor. Official labor suppression had ended in 1981, but state interference continued until 1988. While productivity increased, real wages rose only slightly. Labor union activity was liberalized in the waning months of the Chun regime; in 1987, strikes and other industrial actions meant seven million man-days of work lost, a roughly hundredfold increase from the year before.³

Early Sixth Republic (1988-1996)

The Old Model Wavers

The Roh Tae-woo presidency (1988-1993) was primarily a transition from the military regime to democracy. As such, Roh’s government concentrated on political reform while pursuing innovative foreign policy initiatives. Economic reforms were relatively mild and did not disrupt the overall structure of the developmental state—what foreign observers were now calling “Korea, Inc.” The new government concentrated on drastically reducing authoritarianism and expanding individual and institutional freedom. Economic policy changes centered on the inclusion of social welfare concerns in economic planning for the first time, curbing the EPB’s powers and liberalizing the financial industry. Responding to criticism that these reforms could hurt foreign trade, the government insisted that they were not aimed at restraining, but at promoting small and medium enterprises. The government talked about forcing the conglomerates to specialize, but beyond suggested realignments, little was done.⁴

The merger of Roh’s party with two major opposition parties in 1990 created a strong new ruling party that put former opposition leader Kim Young Sam in position to win the 1992 election. The economy continued to grow at nearly double-digit rates, exports still surged, and Korea became only the second Asian country to join the OECD. Like Roh, Kim talked about the need for reform, but his only significant change was a requirement of real names for bank accounts, promoted as an anti-corruption measure. Kim failed to warn the country about the dangerous

foreign debts being piled up by the conglomerates. Foreign loans soared from \$89.5 billion in 1994 to \$174.9 billion three years later. By requiring companies to reveal their long-term borrowings, companies were encouraged to borrow short-term, which raised their interest costs and created the danger of sudden liquidity shortfalls.⁵

Various factors aided the rise of the chaebol but led to their downfall. The conglomerates’ large size was intended to capture market synergies by cutting costs of allied companies, but there were no checks on group chairmen’s expansion ambitions, and ill-considered acquisitions squandered corporate synergies. Vertical integration of subsidiaries helped save production costs but built inefficiencies and large overhead into production. Chaebols’ use of debt financing allowed founder-families to maintain control over corporate groups, yet there was no mechanism to reduce corporate debt. Cross-ownership of shares merely reinforced mutual complacency and strengthened the families’ corporate control instead of cultivating professional management that could have avoided the late 1990s crash. Government encouraged banks to continue lending to the large companies, creating a kind of moral hazard that made the financial crisis possible, and there was little government oversight of corporate investments. Also, control of nonbank financial companies prevented the financial industry from reining in such investments.⁶

The Asian Financial Crisis (1997-1998)

The Old Model Crashes

The 1990s had been a period of strong albeit uneven growth. Korea’s economic fundamentals actually were fairly strong, eg, low debt, large foreign reserves, and high growth with low inflation. However, the current account deficit ballooned because a rising yen made Japanese industrial inputs more expensive. The year 1997 began ominously when Hanbo Steel declared bankruptcy after its banks turned it down for further loans. Ten more of the mighty conglomerates would fail over the next two years, most notably Kia Motor Corp. and Daewoo. The crisis in Korea was both a currency and credit problem. Initially, the Asian Financial Crisis centered on Southeast Asian economies, but as Hong Kong’s stock market fell, the contagion spread to Northeast Asia. Nervous investors began to withdraw money from Korea. This put great pressure on the Korean *won*, which the Bank of Korea futilely spent most of the nation’s foreign reserves to prop up. As the government widened the trading band and the currency weakened, it was becoming increasingly difficult to pay off short-term international debts, which had mushroomed over the previous year.

On November 21, Korea’s finance minister sought to arrange an informal bailout plan with Japan and the US—Korea’s most important trading partners—but both countries insisted that any help had to come under the umbrella of an IMF package. Korea’s request to the IMF rose from \$20 to \$50 billion. The IMF deal, agreed on December 3, gave Korea \$57 billion in loans in exchange for vast restructuring of the Korean economy and government budget cuts. Among the mandated changes were the closing or merging of failing financial companies, a more market-oriented foreign exchange system, the opening of Korean markets, and quick offloading of \$27 billion in bad loans. Amidst this panic, the Korea Development Bank failed to raise \$2 billion to service Korea’s foreign debt, and the Halla Group conglomerate declared bankruptcy after defaulting on its loans. The *won* fell to its lowest level ever, 1,891 to the dollar. US President Bill Clinton and Treasury Secretary Robert Rubin pleaded with New York banks to roll over Korea’s debt, and that seemed to buy the Korean government enough time to begin enacting reforms.

Putting an exclamation point on a bad year, Korea held its third free presidential election. Kim Dae Jung, democracy advocate and dissident under Park and Chun, was widely expected to win due to the absence of a major candidate from the politically dominant Kyongsang region in the southeast. He may have hurt himself by calling for renegotiation of

the IMF deal but managed a 40.3 percent plurality in a three-way race. As a populist unconnected to the government and with strong ties to the labor movement, Kim became the de facto president during the transition and, as the new president, was uniquely positioned to push through the most sweeping political economy reforms since the 1960s.⁷ The reforms covered corporate governance, financial market regulation, foreign investment in Korea, regulatory reform, corruption control, and privatization of state-run entities. With his death in 2009, the OECD asserted that Kim should be remembered not just as a democratic crusader but as a leader who saved Korea from economic disaster.

The government's reform mandate involved three components: restructuring businesses (in many cases by combining units from separate conglomerates), reworking corporate finances to return companies to profitability, and improving corporate governance to bring stability and accountability to corporate operations. Business restructuring was not generally successful, as it did not produce high-performing companies, but efforts to improve corporate finances did bear fruit. By 2000, companies had significantly cut debt-equity ratios and reduced cross-company debt guarantees. They did this in part by revaluing corporate holdings and boosting cross-shareholding. The government did not improve corporate governance much, though new laws strengthened the position of minority shareholders. The most important agents of change on corporate boards since the crisis have been activist investors.⁸

Recovery and Maturity (1999-2012)

Economic Diversity and Slowdown

Korea's economy has noticeably slowed since the sharp postcrisis recovery. GDP growth had averaged about 9 percent from 1963 to 1995 but barely managed 4.7 percent from 2001 to 2007. Lee Myung Bak, elected president in 2007, promised to restore growth to 7 percent, but it actually slumped in 2008-2009 before briefly bouncing back in 2010. The falloff since 2007 was generally attributed to the global financial crisis and rising competition from China. There is a strong empirical case that economies entering maturity tend to slow down. Most often this happens when per capita GDP reaches the \$10,000 level, which Korea did in the late 1990s. At that point, the "economy has caught up with the technological frontier," meaning that a country cannot just adapt foreign technology to production but has to begin indigenous innovation. Korea was able to keep its growth engine going for a few years in the 1990s only because of continuing injections of capital into production. As in other developed economies, manufacturing's share of the economy plateaued, and overall employment fell a decade before the Asian Financial Crisis.

Korea's declining growth may be irreversible. Deindustrialization has been quite rapid, nearly 1 percent per year since 1989, faster than any major economy other than Taiwan. Korea's export growth actually slowed by half in the 1980s, long before Chinese competition became serious. Merchandise exports are no longer an engine of employment, principally because parts and components are now coming from suppliers in China and other Asian countries. The service sector has not been able to absorb excess workers and has generally lower productivity than industry, while the highly productive IT industry only contributes a small part of service sector employment. Foreign direct investment (FDI) and portfolio investment have not flowed into Korea as readily as they have gone to China, in part because of past encouragement of bank lending instead of selling stock in domestic companies. Even so, Koreans have become major investors abroad. Finally, Korea's economy seems prone to economic crisis, and it has suffered one major economic downturn every decade since the 1970s. This puts Korea above roughly 60 percent of comparable economies. The latest crisis, in 2008-2009, did not originate in Korea but illustrated how maturity may subject Korea to the same kinds of economic strains as North America and Europe.⁹

Korea as a Technological Paradise

A New Model Emerges?

Korea became a leading technology powerhouse from the late 1990s onward due to several favorable factors, including insatiable demand for new technology products in the Korean market, government technology policy leadership, and the growing competitive position of Korean electronics firms such as Samsung and LG. Korean popular interest in new technology may stem from the nation's quick rise from poverty: Koreans do not take technology for granted and are still impressed with its ability to enhance their lives. Koreans took to electronic gaming very quickly, but online and PC games were the norm, unlike the game consoles commonly used in the West or Japan. With the arrival of the Internet in the early 1990s, the government took the lead in extending fiber optic cables throughout the country and, later, broadband access to every home. It also provided low-cost classes for anyone who wanted to learn how to use the Internet. The 839 Policy, unveiled in 2004, aimed to develop eight key services, three vital infrastructures, and nine futuristic products. These included updated cellphone service, wireless broadband, digital multimedia broadband, and multimedia home networking. By the early 2000s, Korean companies such as Samsung and LG were among the largest manufacturers of cellphones and tablet devices.

Samsung became Korea's standout electronics manufacturer. The company produced televisions and microwave ovens in the 1970s and early 1980s and merged all electronics units into two companies. Samsung Semiconductors concentrated on developing DRAM memory chips, entering the global market as the third-largest producer and becoming the biggest manufacturer by 1992. Meanwhile, though known as a low-end manufacturer, Samsung Electronics moved from reliance on Japanese components to making its own. Samsung Electronics took over the semiconductor unit in 1988. Its president from 1996, Yun Jong-yong, an admirer of legendary General Electric CEO Jack Welch, applied his radical reorganization ideas to remake Samsung. He slashed employees, products, and divisions while cutting costs and boosting research and development to improve product quality. Strong electronics sales helped drag the whole Samsung Group through the financial crisis, and the company avoided a government order to take over Daewoo Electronics due to bankruptcy. Yun used the crisis as an opportunity to invest even more in DRAM production. The postcrisis low won then boosted Samsung's products just as they gained notice in America, Europe, and Japan.¹⁰

Yun pushed the idea of "digital convergence," in which cellphones could perform several functions. By 2002, it was already the largest manufacturer of flat-panel monitors and DRAM chips and the third-biggest purveyor of mobile phone sets. The next year, it became the world's largest electronics maker in terms of sales. In 2005, Samsung Electronics was Korea's most profitable company, and Yun set a goal of overtaking Sony, the industry's leader. Sony's serious financial problems and flagging product line allowed Samsung to catch up—perhaps too easily. By 2007, Samsung was the second-largest handset maker, but in 2006, Samsung's overall sales leveled out and declined by 2008. Also in 2008, Yun was replaced by Lee Yoon-woo, who had been with Samsung since its first electronics divisions were founded. Lee introduced sweeping changes in corporate philosophy to emphasize a return to quality and high profitability. Sales recovered in 2009, boosted by such products as mobile phones and tablet devices.

Paralleling Korea's rise as a technology power has been its emergence as an entertainment center. The term *Hallyu*, or Korean wave, was coined by a Chinese observer to describe the growing regional sway of Korean entertainment. Since the late 1990s, Korean films have been widely admired for their quality and commercial appeal. The blockbuster thrillers

Shiri and *JSA* put Korean cinema on the map. At first funded by the chaebŏl, filmmakers found venture capital backing during the Asian Financial Crisis, leading to a flood of popular movies from 2001 to 2005; however, inflated actors' salaries and declining quality led to reduced film budgets. Korean films attract Asian audiences because of their simple stories, direct messages, and honest emotions. Meanwhile, Korean pop music (or K-Pop) overtook its Japanese and Hong Kong rivals due to the commercialization of Korean boy and girl groups by such music impresarios as SM Entertainment and YG Entertainment. Singers such as Rain and BoA are among the most popular performers on the Asian circuit, and popular singers routinely cross over to endorse products and star in television dramas.¹¹

The Future Confronting the Japan Syndrome

Korea faces numerous economic and social challenges in the coming decade. One of the most serious is demographic meltdown as the birthrate declines and the numbers of elderly soar. Korea's population in 1960 grew 3 percent, one of the highest rates in the developing world, but by 2009, it inched ahead only 0.33 percent, while the fertility rate fell to 1.2. The Korean demographic problem mirrors that of Japan and is due to many of the same reasons: expensive middle-class lifestyles, high costs of education, paucity of day care and elder care services, and limited opportunities for women who bear most household and child-rearing duties. Unlike Japan, Korea will not see the population actually dip until at least 2019, so it may have more room to adjust population and child care policies. At the same time, more elderly are living alone or being placed in nursing homes. Traditionally, parents went to live with their oldest sons, but many young people no longer have the resources to care for them. Unprecedented numbers of seniors are committing suicide, principally due to economic struggles.¹²

Other problems confronting Korea include rising energy costs; the need to reduce state economic intervention and further liberalize the economy; and the search for new ways of doing business not based on traditional insular family, regional, or school networks. The government intends to shift away from fossil fuels to nuclear energy and

renewables while building green industries, but so far, progress has been limited.¹³ Like the protagonist of *Winter Sonata*, Korea now is fashioning a new identity but remains tied in myriad ways to its fast-developing past. The question for Koreans, as it is for the show's characters, is whether the country can find happiness as something other than it once was. ■

NOTES

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JOEL R. CAMPBELL is an Associate Professor of Political Science in the Pacific Region (Japan and Korea) of the Global Campus program of Troy University. He teaches in the Masters of Science in International Relations (MSIR) program. He has taught at Tohoku University, Miyazaki International College, and Kansai Gaidai University in Japan, as well as three universities in Korea. He has published extensively on his principal research interests, the politics and political economy of Northeast Asia, along with technology policy and international security. He can be reached at jrcampbell@troy.edu.

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