South Korea: Mission Accomplished

By Shinichi Nozoe

South Koreans nowadays like to say that they have caught "three rabbits." They are not talking about hunting. The "three rabbits" are a high rate of GNP growth, a large international payments surplus and price stability.

How have those elusive rabbits been caught? In 1987, South Korea's GNP grew by 12.0%, the second-fastest pace in the world after the 13.6% recorded by Hong Kong. The solid expansion of exports, accounting for 42.5% of GNP in 1986, and a surge in investment are two of the biggest factors contributing to the nation's rapid economic expansion. In 1987 South Korea's GNP broke the $100 billion barrier.

The current account went into surplus in 1986 for the first time in many years. As a result, outstanding foreign debt shrank substantially in 1987. At home, consumer prices rose only a modest 3%, while the unemployment rate dropped to 3.1%, the lowest since the start of the decade.

All this was a remarkable achievement, considering that the country faced serious problems at home and abroad in 1987, ranging from aggravated labor disputes to political instability and mounting trade tensions. The economy, as the *Maeil Kyungje Shinmun* (Maeil Economic Daily) put it on March 25, fully demonstrated the growth potential it has accumulated over the years.

Pressing problems

Yet despite the outstanding performance of the past two years, the prospects for the South Korean economy are not necessarily reassuring. Three problems in particular are casting a shadow over the future.

The first is the accelerated revaluation of the South Korean currency against the U.S. dollar. The won was slightly revalued in November 1985 following a succession of devaluations. It was revalued by a further 3.3% in 1986 and by 8.7% in 1987, yet even this was not enough to slow the rapid expansion of the current account surplus. Moreover, the won remained undervalued against the dollar compared with the yen and the Taiwan dollar, increasing U.S. pressure for further expansion. The exchange rate at the end of April was still less than 740 won to the dollar, but it would reach 640 won to the dollar by the end of the year, up a full 23%. The growing strength of the won is a matter of grave concern to the government and export-oriented industries.

The rapid rise in the won's value is likely to blunt the cutting edge of South Korea's export offensive. A slowdown in foreign sales in turn would mean slower economic expansion. To maintain and strengthen its export competitiveness, the country must work to improve product quality and cut manufacturing costs. It will take time, though, before such efforts produce tangible results. For the moment South Korea is trying to stave off U.S. pressure for further revaluations by opening its domestic market wider to imports. So far, however, this has only been partially successful at best.

A second problem of immediate concern is inflation. While consumer prices rose only slightly in 1987, a closer look at month-to-month price movements reveals that the increase in the price index began to accelerate in August. One reason was the large wage rises resulting from widespread strikes that followed the announcement on June 29 last year of an eight-point democratization program by Roh Tae Woo, then leader of the ruling Democratic Justice Party who was elected South Korean president in December. Full-time workers in the manufacturing sector, for instance, got raises amounting to 11.6% of their average wage.

Also contributing to inflationary expectations is the sharp increase in the current account surplus, which has caused a rapid expansion in the money supply. Price stability is also threatened by the massive infusions of cash that entered circulation during the presidential election campaign last December and the parliamentary election in April this year. Given the steep rise in real-estate prices that began last autumn, the price stability that has continued since 1983 may be coming to an end.

Another pressing problem facing the South Korean economy is a slowdown in plant and equipment investment. Year-to-year growth in such investment slowed sharply to 14.7% last year, about half the 28.6% figure for 1986. A drop of this order in capital spending is bad news, even though investment remains brisk in semiconductors and other high-tech products and automated office equipment. The investment plunge seems to reflect, among other things, new restraints imposed on bank lending to big businesses and concern over the future of the economy in light of deteriorating industrial relations and the unsettled political situation.

Dominant groups

These relatively short-term problems now facing the South Korean economy

Export goods from NICs on display at a Tokyo fair

Major Economic Indicators for South Korea

	GNP			Current account balance ($ million)	Outstanding foreign debt ($ billion)	Consumer price increase (annual average) (%)	Unemployment rate (annual average) (%)
	Total ($ billion)	Real growth rate (%)	Per capita ($)				
1980	60.3	– 4.8	1,605	–5,321	27.2	28.7	5.2
1981	66.2	6.6	1,735	–4,646	32.4	21.6	4.5
1982	69.3	5.4	1,800	–2,650	37.1	7.1	4.4
1983	76.0	11.9	1,884	–1,606	40.4	3.4	4.1
1984	82.4	8.4	1,998	–1,373	43.1	2.3	3.8
1985	83.7	5.4	2,047	–887	46.8	2.5	4.0
1986	95.3	12.3	2,300	4,617	44.5	2.8	3.8
1987	118.6*	12.0*	2,826*	9,783	35.5	3.0	3.1
1988	140.0	8.0	3,300	6,000	31.5	5.0	3.7

Notes: 1. Asterisks indicate tentative figures. 2. Figures for 1988 are planned values.
Sources: "Major Economic Indicators," Bank of Korea, April 15, 1988; *Maeil Kyungje Shinmun*, March 25, 1988; and others

are challenging enough in themselves. However, South Korea also faces longer-term, structural problems, and these have a close bearing on the democratization of the South Korean economy.

The South Korean government exercised strong leadership in promoting a "grow now, distribute later" policy emphasizing the quantitative expansion of the economy. This policy resulted in the formation of export-oriented industries led by a handful of major corporate groups which dominated the national economy. This strong government guidance and cluster of industrial groups led many foreigners to call South Korea a "second Japan."

However, this policy, while successful in meeting its goals, also created imbalances and distortions in various sectors of the economy. Tensions rose in South Korean society, and popular calls for structural economic reform gained strength along with demands for political democratization. Dissent has focused on four main areas.

First is the concentration of economic power in the hands of a few giant business groups. To turn the problem around, this means small business is weak, with only an extremely limited role in the economy. As the economy has expanded, the weight of small and medium-sized enterprises in production, value-added, employment and exports has steadily fallen. The concentration of economic power has also created major disparities between the big cities and rural communities. The resulting skewed distribution of wealth has spawned a deep sense of inequality and strong antibusiness feelings among the people.

The weakness of the small-business sector is also responsible for the underdeveloped state of the parts and materials industries needed to support heavy and chemical industries. This is one reason why the economy still depends so heavily on imports from Japan.

Excessive intervention

A second issue is the rigorous regulation of the financial industry. The government's excessive intervention in financial activities can best be illustrated by the example of so-called "government-controlled financing." The government has sought to promote industrialization through the active induction of foreign capital, the regulation of new industries and other measures.

South Korea's financial institutions have completely tailored their lending activities to fit these official policies, with a corresponding loss of independence. They are so dependent on the government that they have even ceased to exercise the essential function of checking the creditworthiness of potential borrowers. Government-business collusion, the existence of so-called *pushil kiup* (enterprises not performing well) and financial scandals are only a few of the symptoms of this financial dependency.

A third problem is continuing government suppression of the labor movement. Wage increases have been restricted on the pretext of preserving the country's competitive edge in export markets. But while such restraints may have been justifiable when the country was still on the road to industrialization, wage levels should go up now that it is joining the ranks of industrialized nations. The series of strikes following the democratization plan proposed by Roh on June 29 last year suggests that South Korean workers are finally beginning to assert their rights. Their varied demands are not confined to wages but call also for discrimination between blue-collar and white-collar workers to be eliminated.

A last pressing problem is the need to improve the corporate structure. Most South Korean enterprises are still managed by their founding families. Usually, a family-owned company has a strong advantage early on, when its founder is still in a position to exercise strong leadership. However, as the company grows and diversifies, an autocratic management style becomes more of a liability than an asset. To succeed, the company must modernize by hiring specialized managers, delegating authority to lower management and boosting the loyalty and morale of its employees. This is a common challenge for all owner-managed corporations, and is one of critical importance to South Korean industry today.

These four structural problems all stem from a basic malady afflicting the South Korean economy—an entrenched authoritarian system that defies market mechanisms. The problem cannot be easily resolved because it is closely related to the South Korean system of values and the country's social system. Nevertheless, improvements will come, albeit gradually, as South Korea strives to make the structural changes it needs to strengthen its international competitiveness. The South Korean economy, still in a relatively early stage of its development, appears to have what it takes to meet the challenge.

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