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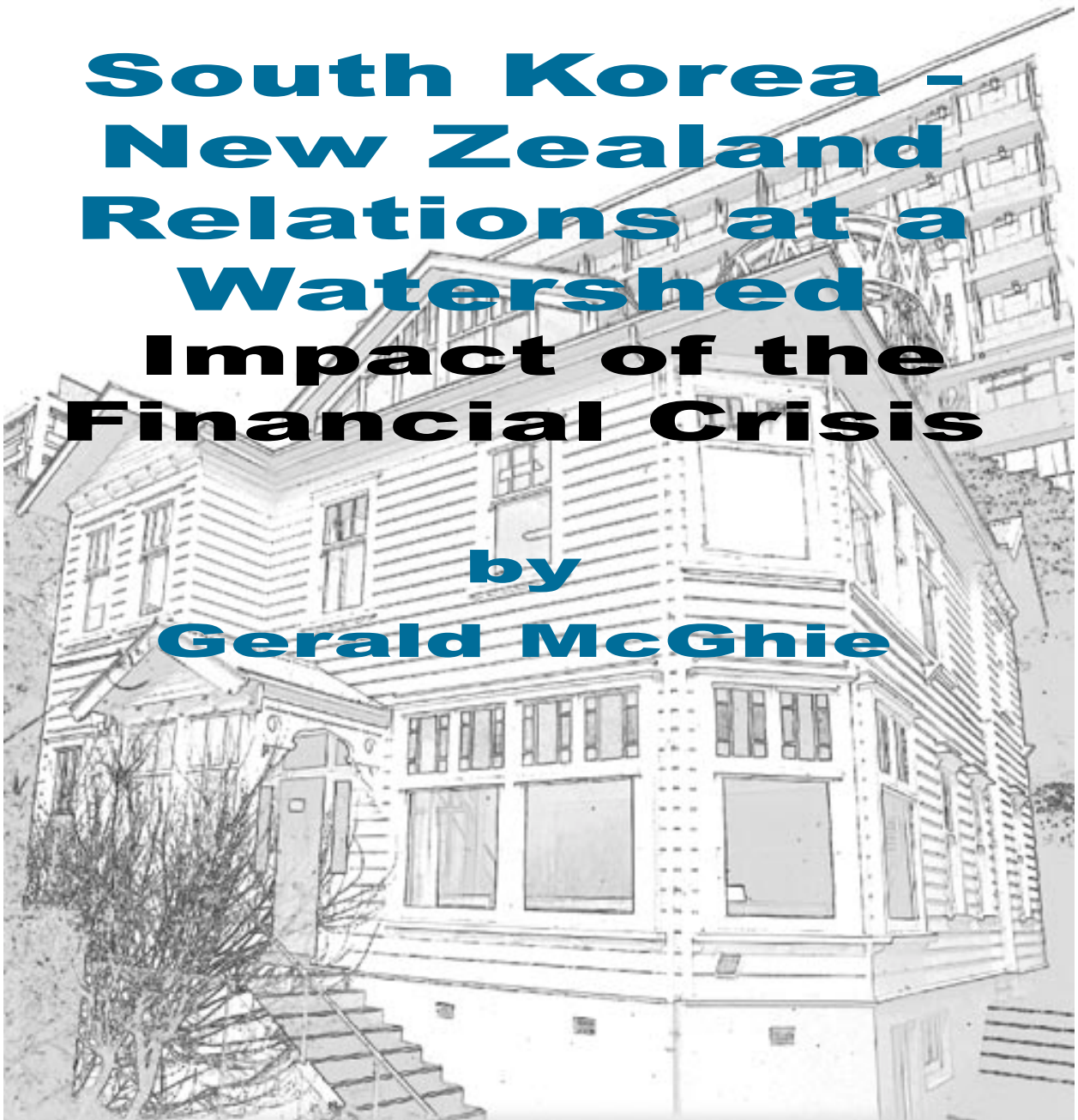
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**South Korea -  
New Zealand  
Relations at a  
Watershed  
Impact of the  
Financial Crisis**

by  
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# south korea - new zealand relations at a watershed: the financial crisis

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## Abstract

The financial crisis which hit east Asia at the end of 1997 had a severe effect on South Korea.<sup>1</sup> For three decades Korea had experienced high growth underpinned in the early period by a high level of foreign assistance<sup>2</sup> and by strong government intervention. The economy concentrated on export growth with significant import restrictions, a structure which consolidated the position of incumbent firms, produced industry concentration and promoted the emergence of conglomerate monopoly.

Immediately prior to the crisis it became clear that the earlier economic policies were failing to produce high returns. This was demonstrated by Korea's large current account deficit, overvalued currency, economic

mismanagement (particularly in the financial sector) and accumulating foreign debt. The financial crisis reduced the overvalued Korean currency and raised unemployment levels. The crisis also brought in the IMF.

This paper shows that, under the IMF reforms, Korea has made progress in financial sector restructuring, some macroeconomic indicators are nearing pre-1997 levels and international confidence is returning to the Korean economy. The paper comments, however, that deeper problems remain. Reference is made to the need to enhance the quality of financial governance and the fact that restructuring has yet to be undertaken among the conglomerates (*chaebol*) which occupy positions of privilege and dominance in the economy. The paper takes the position that Korea is now at a watershed. No longer a low-wage economy, Korea stands to lose its competitive manufacturing edge to China's and southeast Asia's lower cost producers. The paper comments that the leadership is aware of Korea's unique situation – an unpredictable Stalinist neighbour to the North and a rather more predictable and highly competitive neighbour across the East Sea.

Korea has been characterised as a low-trust society but the paper refers to the emphasis Koreans have traditionally placed on the value of education, loyalty to the family and government leadership. These values could help promote the flexibility and stability necessary for Korea to embrace the development not only of participatory democracy within but also of the global community without. In the past Korea has drawn on the resources of its people. The key to the future again lies with the adaptation and mobilisation of those resources to the challenges of the 21<sup>st</sup> century.

The Annex comments on New Zealand's relations with Korea and considers that, as Korea adjusts to the needs of the globalised trading system, New Zealand must increase the depth and range of its involvement with this vital market

## Introduction

It is two years since the financial crisis hit Korea. There is still no confirmed agreement on what led to the upheaval, but a certain consensus is emerging. This paper looks at the background to the crisis, reviews current trends and considers where they are likely to lead.

## The Pre-Crisis Background

The state or ruler has always played a central role in Korean society. The complexities of Korean economic and social development do not easily lend themselves to brief comment, but for the purposes of this paper and a consideration of Korea's adaptability to change, it is important to note the salient features of Korea's post-WWII development.

The period of greatest change in Korea is usually ascribed to the policies of Park Chung Hee (1961 to 1979). In fact, the Syngman Rhee presidency (1946 to 1960) saw revolutionary shifts in the fields of education and land reform.<sup>3</sup> The Korean War 1950 to 1953 acted as a catalyst. Large groups in the society became dispossessed and, as they moved up and down the Peninsula in the midst of war, a great deal of social intermingling took place in what had been a class-structured society. Further, young men from rural areas were exposed in the army to technology and a different world view. The officer corps developed into an important social group.

Economically, the average rise in GNP from 1954 to 1958 was 5.5% per annum. Industrial growth led the way with a 14% increase. The key contributors to the economic advance were the United Nations Korean Reconstruction Agency and members of the UN, mainly the US.<sup>4</sup> Foreign aid constituted a third of the total government budget in 1954, increased to 58.4% in 1956 falling to 38% in 1960.

Korea experienced a democratic interlude between Rhee and Park (from 1960 to 1961).<sup>5</sup>

Park Chung Hee's military coup on 16 May 1961 was responsible for a major acceleration in Korea's economic performance. President Park's achievements are acknowledged but his methods remain controversial. His formative experience had been in Manchuria where as an officer in the Japanese occupation force<sup>6</sup> he had seen at first hand the work of the military in developing the economy. He turned this experience to Korea and in his early period as dictator established the Supreme Council for National Reconstruction (SNCR) and shortly thereafter (June 1961) the feared KCIA was formed to prevent a counter-coup and suppress potential enemies.

In May 1961, Park pledged an all-out effort to build a self-reliant economy. The National Assembly was dissolved and high-level civilian officials were replaced by military officers. In this early stage Park imposed some restrictions on the press, opposition politicians and

intellectuals but they were also allowed considerable latitude to criticise the Government. In 1972, however, Park proclaimed martial law, dissolved the National Assembly as well as all universities and colleges, and introduced strict censorship. Student demonstrations continued but, by and large, Park's strongest defence remained Korea's high economic growth.

In essence, Park's developmental policies encouraged private entrepreneurs within the framework of a state-directed plan. Selected businessmen gained privileged access to low-interest, government-backed credit, while exports were encouraged by direct subsidies. Success was demonstrated by manufacturing sector growth of 15% and 21% during the first two five-year plans. As a later commentator said:

It took South Korea only eleven years (from 1966) to double its real income per person; it took Japan 34 years (1885-1919). The United States took 47 years (1839-86) and Britain took 58 years (1780 to 1838).<sup>7</sup>

Korea continued to experience dictatorship (under Chun Do Hwan and Roh Tae Woo) until 1992 when Kim Young Sam was elected. It was in Kim's presidency that Korea began to experiment with a more democratic society. As in most societies, the process of change and – particularly – democratisation has not been straightforward or uniform in its application. The levelling processes involved in the wider franchise and participatory democracy do not fit comfortably with Korea's extensive history of – and basic disposition to – a hierarchical, top-down society where the bureaucracy and legislature await direction from the President and his advisors. Until the 1997 financial crisis, the private sector operated in an environment of privileged access to state-subsidised credit. The banks acted as a conduit for this credit and, with the government acting as ultimate guarantor, paid little attention to international standards of prudential management.

## The 1997 Financial Crisis

The actual events leading up to the 1997 financial crisis are by now well established but the debate on the causes may continue in Korea for some time.<sup>8</sup>

The Korean Government's interventionist model of development had, from the early 1960s to the mid-

1990s, achieved a high level of economic success. In that period the per capita income grew from \$US80 to \$US10,000, life expectancy rose from 47 to 72 years and adult literacy rose to 98%. By 1997 South Korea was the third largest economy in Asia and the eleventh largest in the world. South Korea's government-led economic model developed vulnerabilities, however, and by the mid-1980s the interventionist matrix was breaking down. Heavy official oversight of the banking and corporate sector, inadequate allowance for competition as well as prudential policies in the financial sector created 'moral hazard' as lenders and borrowers believed that the government would, as it had for the past 30 years, continue to provide financial support through periods of economic adversity. Thus the financial sector failed to institute normal prudential facilities and was characterised by a high level of mismanagement. As they grew larger and achieved a position of dominance in the economy, the conglomerates undertook substantial and highly leveraged long-term borrowing in short-term external loan markets. After 1988, when the military dictatorships ended, the newly-elected civilian administration eased labour market restrictions and wage increases in excess of productivity followed. The underlying structural weaknesses rendered South Korea vulnerable to external economic pressure. In 1995, the depreciation of the Yen and overproduction in the semiconductor industry buffeted the economy. As one commentary said, these events –

... precipitated a substantial slowdown in exports and industrial output, and an unprecedented wave of *chaebol* (corporate) bankruptcies, undermining financial institution balance sheets. Korea's long period of sustained economic growth, low inflation, strong investment and balanced budgets, had lulled policy makers into complacency; they failed to act decisively to counter the looming threats.<sup>9</sup>

Other factors contributed. For instance, (a) South Korea's following an economic course that allowed for unregulated financial liberalisation without putting in place an adequate national or international framework of financial regulations; and (b) weak official management of foreign debt exposure added to the underlying problems. But by and large the causes of the financial

crisis in South Korea can be summed up in the words of Dongchul Cho when he wrote:

... the fundamental cause of the ... crisis was lack of market discipline, particularly in the financial sector.<sup>10</sup>

## The Crisis

In the early stages, Korea appeared relatively unaffected by the financial crisis that had hit Thailand, Malaysia and Indonesia. The exchange rate remained largely stable through October 1997.<sup>11</sup> With high-level, short-term debt,<sup>12</sup> and only moderate international reserves, the economy was, however, vulnerable to a shift in market sentiment. While macroeconomic fundamentals were regarded as relatively favourable, concerns about the soundness of financial institutions and conglomerates had increased following several large corporate bankruptcies earlier in the year.<sup>13</sup> As Korean banks began to face difficulties, the Government announced a guarantee of foreign borrowing by Korean banks.

External financing conditions deteriorated significantly in late October 1997. The *won* fell sharply while usable foreign reserves declined rapidly. The International Monetary Fund states that monetary policy was tightened briefly but was relaxed again because of concerns about the impact of higher interest rates on the highly leveraged corporate sector.<sup>14</sup> By early December 1997, the *won* had depreciated by over 20% against the US dollar and usable foreign exchange reserves had declined to \$US6 billion (from \$US22.5 billion at the end of October).

A review of the salient economic facts cannot provide a sense of the drama – at times suspended drama – that pervaded the Korean economy and society in the months before December 1997. The decline of the semiconductor market, the collapse of two large *chaebol* (Hanbo and Kia, which led to the technical insolvency of two major banks – Korea First and Seoul Bank) and the overstrained economy provided a somber counterpoint to a Presidential election campaign that for the first time in Korea's history was to put a civilian *opposition* figure in office. The indictment of the President's son at the time (on the charge of illegal handling of campaign finance etc.<sup>15</sup>), the nationalistic sloganising of Korea Inc. as the highly protected Korean market came under increasing pressure from the United States (and to a lesser degree from

Japan<sup>16</sup>) to remove what were seen as barriers to trade, all added to the context of economic tension and provided a somewhat cacophonous counterpoint. The restive student population expressed themselves in the usual barrage of ritualistic street riots, but one at Yonsei involved the burning of major campus buildings and impinged on relations with North Korea – a deeply sensitive topic in Korean society.<sup>17</sup> The labour unions were also active in demonstrating for their cause.

## IMF Policies

On 4 December 1997, the IMF approved a three-year stand-by arrangement with Korea, of \$US21 billion. The Fund noted<sup>18</sup> that financing amounting to \$14 billion had been committed by the World Bank and the Asian Development Bank, which also provided technical assistance. In addition, interested countries had pledged \$US22 billion as a second line of defence for a total package of \$US58.4 billion. The IMF programme ‘objectives’ sought to –

... narrow the external current account deficit to below 1% of GDP in 1998 and 1999, contain inflation at or below 5% , and if confidence is restored quickly, limit the deceleration of real GDP to about 3% in 1998, so recovery can occur in 1999.<sup>19</sup>

In addition, the Fund sought a number of structural reforms in the financial and corporate sectors to address what were seen as the root causes of the crisis. Upon approval of the package, Korea drew \$US5.5 billion from the Fund.

The macroeconomic policies that the Fund targeted included:

- a tighter monetary policy (the call rate was raised from 12.5% to 21%);
- a flexible exchange rate and tight fiscal policy;
- legislation being passed to supervise the activities of all banks. The central bank (The Bank of Korea or BOK) was made independent;<sup>20</sup>
- provision to close ‘troubled’ financial institutions.

The above provisions met with broad acceptance by the Korean authorities. The section of the IMF report entitled ‘Other Structural Measures’ which targeted

Korea’s tightly controlled import regime met, however, with a high level of resistance in the negotiations. The terms included:

- Trade liberalisation (aimed at timetables complying with WTO commitments to review the elimination of trade-related subsidies, restrictive import licencing as well as an import diversification programme).
- Capital account liberalisation (including liberalising foreign investment in the Korean equity market and increasing the ceiling on aggregate ownership from 26% to 55%).
- Permission for foreign banks to purchase equity in Korean banks. (Further restrictions on foreign investment in Korea were permitted.)

The Fund’s ‘Letter of Intent’ referred also to improving the quality of corporate governance and structure as well as labour market reform.

In the period immediately prior to the IMF intervention, Korea had sought, but failed, to secure other sources of finance (particularly from the Japanese). Thus the leadership was left no choice but to seek IMF assistance and comply with its terms. In discussion with the author, the Finance Minister at the time said that the package seemed to be unnecessarily restrictive in some areas and perhaps better targeted to countries with high inflation. Many of Korea’s macroeconomic indicators, he said, were in reasonable shape. The Minister was particularly critical of the Fund’s high interest regime.<sup>21</sup>

The package aimed to boost Korea’s foreign reserves through a surplus on the current account and an inflow of Foreign Direct Investment (FDI) and thus to provide adequate fiscal reserves to fund the reform process. These factors were also seen as a measure to stabilise the unemployment situation.

## Initial Impact

The IMF notes<sup>22</sup> that the positive impact of the announcement of the restructuring package on exchange rates and stock markets was small and short-lived. In the two weeks to the first review, the Korean currency (the *won*) dropped sharply. Confidence was undermined by the apparent lack of commitment to the programme by some presidential candidates (particularly Kim Dae Jung, the eventual winner, who said during the campaign

that he would seek to renegotiate the terms of the IMF package). As the debate went on, the financial conditions were becoming more critical. As the Fund said:

... with new information coming available about the level of usable reserves, and short term obligations falling due, markets became concerned about the widening financing gap.<sup>23</sup>

As the short-term debt, decline of the *won* and level of the international reserves reached crisis proportions, an agreement was reached with private bank creditors on 24 December 1997 to maintain their operations in Korea. Discussions were also held with bankers on the rollover of short-term debt.

Exports did increase in the period *immediately* after the implementation of the crisis package, but they were fuelled mainly by the depreciation of the *won*.<sup>24</sup> The increasing export trend continued for roughly the first half of 1998. From May 1998 exports by value gradually declined, recording a 2.6% decrease for the year ending in November 1998. The reduction was driven by declining demand in Asian markets, falling export unit prices and a shortage of trade finance provided by the banks.<sup>25</sup> Declining imports by China, Japan and the countries of southeast Asia reduced Korea's exports to Asia by more than 20% by value.<sup>26</sup> The reduction in export activity can be seen in the level of the outstanding balance of bills of exchange purchased by commercial banks from exporters declining to 74% of the pre-currency crisis level.

At the same time Korea experienced a sharp decline in imports due to a reduction of consumption and investment (as well as a deterioration in production facilities due to large-scale corporate restructuring). In November 1998, imports registered a decline in value of \$US84.7 billion – representing a fall of 37% over the previous year. This more than offset the decline in exports. Thus the trade balance from January to November 1998 recorded an historic high of \$US35.9 billion which amounted to an increase of \$US44.4 billion from the previous year.<sup>27</sup>

## Government Role

The Korean Government has been diligent in implementing the *financial* and *some corporate* reform aspects of the IMF package. One institution, the newly established Financial Supervisory Commission (FSC),

played a key role in the restructuring process by conducting an early review of financial institutions. Those that did not meet the capital adequacy ratios were either closed down, absorbed or merged with those that met the criteria. Thus the Commercial Bank of Korea and the Hanil Bank, two major institutions with long histories in Korea, were merged to form a new bank called Hanvit. Chan Huh<sup>28</sup> states that the Korea Asset Management Corporation purchased bad loans from the Commercial and Hanil Banks to clear their balance sheets. The Government then recapitalised the new bank which, in effect, nationalised it in the hope of a return to viability. At the end of 1998, 8 of 26 commercial banks were either closed or absorbed by other banks and 91 of the 377 Non Bank Investment Funds (NBIFs) had been closed down, suspended from operations or put under corrective action programmes.<sup>29</sup>

The Government has earmarked about 74 trillion *won* for the purposes of recapitalisation, purchases of Non Performing Loans (NPLs) and deposit insurance payments. Estimates of the total number of troubled loans held by Korean banks and other financial institutions vary. The official estimate as of May 1998 was about 120 trillion *won*; unofficial estimates range from 130-150 trillion *won*. These estimates add up to about 30% of Korea's 1997 GDP. The Government aims to dispose of 100 trillion through the Korea Asset Management Corporation (KAMCO) at about half the book value. It had already purchased 44.1 billion *won* in book value from financial institutions such as banks, merchant banks, insurance companies and securities firms as at December 1998.

Financial sector restructuring contributed to a severe reduction of credit during 1998 thus producing a shrinkage in economic activity and a 5.6% fall in real output in the same year. As Chan Huh says,<sup>30</sup> the credit crunch might have to be included as part of the costs of reform. During the first half of 1998, for instance, tight monetary policy raised the average interest rate to above 19%. The rate fell in the later part of the year but liquidity shortages in the industrial sector and in households continued. It was estimated that private consumption shrank by 10%, a much larger figure than the decline in income. Facilities investment declined by 41% due to depressed demand and difficulty in raising new capital. Corporate strategies focused not on growth but on survival.

The substantial pain brought about by the Fund's

corrective measures stabilised the economy. Credit rating upgrades as well as greater foreign interest in equity participation in Korean banks are an indication of increasing international optimism while the work of the FSC demonstrates the Korean Government's wish to reform the financial sector. But the main priority for reform remains the *chaebol*.

## The Banks

One of the main targets of criticism has been the role of the banks. Since the Park reforms, banks in Korea have long been an integral part of the government's economic development strategy. As such they have dominated the financial sector but their activities were not undertaken within the norms of international banking practice. As Chan Huh<sup>31</sup> says:

Banks were not really banks in the sense of conventional economic definitions and their operation was not dictated by profit considerations since their *de facto* owner was not particularly concerned by profits *per se*.

The chief executives of major banks were (and still are) appointed by the government while lending policies and interest rates were established by non-commercial criteria reflecting government priorities. At the top sat the President, his financial advisors and the key financial departments including the central bank, the Bank of Korea (BOK). Control over the BOK effectively meant control of credit, which in effect became the regime's most powerful economic tool and it was exercised with vigour.<sup>32</sup> Such a system was bound to produce idiosyncrasies. The huge series of NPLs incurred by all banks in Korea were indicative. In the run up to the IMF intervention, the Korean banking system sought to hide information about these. Chan Huh<sup>33</sup> noted:

... official estimates [of NPLs] in the pre crisis period were so low that they were not taken seriously and hence the guessing game about the scope of the problem had been an interesting intellectual exercise.

Information that finally emerged on the extent of these loans added to the low credibility of the financial sector<sup>34</sup> among international bankers.

## The Management Factor

In considering the general management context, it has to be recognised that businesses in Korea tend traditionally to observe obligations to the wider community. A business concentrating only on self-interest (in the Western sense) would be a target for intense criticism. Businessmen might be very strict with employees, but if inadequate working conditions can be seen as promoting the national interest and not simply aimed at personal gain many Koreans would accept those conditions.

Clifford<sup>35</sup> sees the concept of profit as not well understood in Korea. Those with resources are expected to donate generously to those with less, even if this is done at the expense of corporate investment for future activity. The *chaebol* regularly provide broad assistance to their employees. At Ulsan the author has toured the comprehensive educational institutions, and medical and sports facilities provided for Hyundai employees. He also had personal involvement with Samsung's humanitarian assistance programmes for the people of Seoul. Such activities fall within the *cheong*<sup>36</sup> concept of Confucianism – the factor involved in being sensitive to the well-being of humanity generally and indeed of all things.

In the post-crisis period, an important factor in the basic stability of the economy will be whether Korean banks can gain sufficient autonomy to develop a credit culture and management skills equal to those of international institutions. This will be difficult. In discussions with the author, the manager of an international bank in Seoul said that the main request he received from Korean banks was for overseas-based directors to sit on their boards. Their role would be to introduce a degree of objectivity into loans policy. The endemic problem was the extensive and characteristic networking relations in the Korean community. Relationships formed at high school (more), university (less) and during compulsory military training laid the foundations for life-long networks in Korea. Turning down a loan request for assistance from a class-mate or military associate would be fraught with ancillary social problems.

The reform stakes are high. If an objective prudential regime is not established, banks could remain locked into the old systems acting as passive conduits of funds for government-designated projects.

## The *Chaebol*

The *chaebol* have achieved a position of dominance in the Korean economy, and on present performance will remain so for many years to come. The input of the top five *chaebol* – Hyundai, Samsung, LG, Daewoo and SK – to the Korean economy is calculated variously. Conservatively, they represent directly about 9% of GDP but indirectly (i.e. in terms of value added by suppliers not part of the groups) at least double that amount. The concentration is more evident in the manufacturing sector where the top 5 account for about 25% of manufactured exports and the top 30 for about 40% of these shipments. At the end of 1997, the *chaebol* were estimated to encompass some 800 firms.<sup>37</sup>

Because of their dominant position, the *chaebol* will be the focus of current and future tension within the economy. President Kim Dae Jung has sought, by asset swaps, to break up the conglomerates into core interests.<sup>38</sup> This has been called the ‘Big Deals’ initiative. In spite of a degree of talking up of the issue by the President and the media, the *chaebol* have been less than willing to restructure and thus reduce the scope of their operations. In late July 1999, however, Daewoo fell into serious financial trouble<sup>39</sup> and, under FSC supervision, a reform plan was drawn up aimed at reducing the empire from 25 companies to 5 centred on the automotive sector. But the restructuring undertaken at Daewoo relates to a specific, localised financial disaster. It does not form part of an overall restructuring plan.

A general upturn in the mid-1999 economic indicators – particularly in the semiconductor industry – has, moreover, deflated pressure for reform and the President’s ‘Big Deals’ initiative. Semiconductors are not the only industry to do well. Manufacturing increased production by 12.8% in the first quarter of 1999. This in turn helped boost wholesale and retail sales with some carry-over into the depressed construction industry.<sup>40</sup> In August 1999, the value of cross-loan guarantees of the top five *chaebol* amounted to 3% of their total capitalisation. This represented a reduction from 23.8% a year earlier. The Government’s aim was to eliminate the cross loan facility by March 2000,<sup>41</sup> thus promoting confidence in M&A activity as well as internal restructuring. Some progress has already been made by foreign firms acquiring interests in Korean companies. FDI has been estimated by the Bank of Korea in 1998 to be at around \$US5 billion – a record level for Korea.

If the *chaebol* have not yet succumbed to the reformers’ zeal,<sup>42</sup> some successes have been recorded in other areas – particularly the 55 so-called non-viable big companies. These were chosen by the major banks out of 313 firms screened on their ability to repay debt. The ‘55’ included 20 companies belonging to the five largest *chaebol* and 32 companies belonging to *chaebol* ranked from 6<sup>th</sup> to 64<sup>th</sup>, as well as 3 from outside the largest conglomerates. One of the most powerful forces behind the naming of the ‘55’ was the Financial Supervisory Commission.

Since the ‘55’ exercise, the Government has changed direction on the restructuring process to help turn around big companies which it judged to have temporary cash flow problems and the potential to revive. The companies<sup>43</sup> in this category were placed under the control of a ‘workout’ programme. This meant they were given a grace period of three months where the creditor banks would ensure that the firms did not go bankrupt. The ‘workout’ programme was not without its critics. Some characterised the terms more as a ‘walkout’ deal for existing managements. Thus they were reluctant to use its provisions. The Government duly acknowledged complaints from major companies and tended to retreat in the face of the threat of mounting unemployment. Some economists referred to the programme as little more than a new version of the old bankruptcy accord. The provisions of this legislation, they considered, were directed at the Kia Motor Company which had gone bankrupt anyway.

Attacking the *chaebol* is not new. In the early period of his Presidency, Kim Young Sam targeted the major conglomerates for reform but his efforts brought little result. The *chaebol* are, after all, contributors to political campaign chests as well as being deeply entrenched in the economy. Given that Daewoo was involved and its head, Kim Woo-choong, had gained an even higher profile as President of the Federation of Korean Industry, a *chaebol* pressure group, negotiations were always going to be difficult.

*Chaebol* reform remains an elusive target. In a recent analysis the New Industry Management Academy stated that the top five conglomerates’ proportion of the top 30 *chaebol* turnovers rose from 71.2% to 76.1% in 1998.<sup>44</sup> This increase took place in spite of *chaebol* pledges to narrow their operations to core activities.<sup>45</sup>

## The Trade Unions

Labour-management relations in Korea have never been easy. The 1997 economic crisis with its attendant steep rise in unemployment<sup>46</sup> hit labour hard. In 1996 the number of labour disputes was 85, in 1997 it was 78 and in 1998 it was 129. The Trade Union leadership is not unaware of the need for Korea to return to economic viability and has stated its wish to cooperate. As Ahn Pong-suhl says,<sup>47</sup> labour joined President Kim's Tripartite Commission with Government and management "in the spirit of pain sharing and social harmony". The Commission has failed to gel. Ahn points to "the unilateral restructuring of the Government without the prior consultation of worker's representatives" as underlying the "discontent and objection of labour". The view that they were being excluded from equal participation led to the withdrawal of labour last April from the work of the Commission. A further current trade union concern is the renewed recourse by the Korean authorities to the imprisonment of trade unionists for what Ahn has characterised as "legitimate trade union activities".<sup>48</sup>

Positive labour-government-management relations are essential if Korea is to undertake the restructuring necessary to bring the economy into line with the needs of the 'knowledge economy'. President Kim Dae Jung, who in his years in opposition was closely identified with and received support from the trade union movement, is seen as an ally of labour. But the President is treading a difficult path. Management also walked out of the Tripartite Commission in April because of the Government's alleged compromise with hard-line unionists. Management is wary of what they see as the Government's 'secret' agreements with the militant Korean Confederation of Trade Unions. But Ahn, who is also Director of the International Relations Bureau, Federation of Korean Trade Unions, is reasonably optimistic when he says –

... reform of the chaebol system and industrial restructuring should be strongly implemented. Adjustment programmes should be ... implemented on the basis of the principle of burden sharing among labour, management and the government. The functioning and role of the Tripartite Commission is ... important to build a social consensus for ... success of [the] reforms.<sup>49</sup>

Labour and management remain at some distance on the major issues – particularly labour flexibility. As of July 1999, both sides have again agreed to rejoin the Commission's work. Perhaps some encouragement can be gained from the resolution of the very bitter July 1999 Hyundai strike. That is –

- The Government (especially a Kim Dae Jung Government) would be reluctant to use police when women and children were involved in the picket lines.
- Force would have damaged the Kim administration's image of rebuilding the Korean economy (particularly the market led/democratic involvement model he sought) at a time of deep economic stress.

But, significantly, the trade unions also compromised. As Ahn says,<sup>50</sup> the Hyundai trade union, where lifetime employment and collectivism were deeply rooted, accepted lay-offs. This importantly and explicitly means a change of policy for the Korean labour movement.

## Employment

Increasing unemployment has brought changing perceptions if not disillusionment among the Korean middle classes. Twenty percent perceived their economic status to have fallen since the crisis. Specifically, among those who saw themselves as middle class in 1997, only half considered that, at the end of 1998, they were still middle class. More important was the widening gap between rich and poor. The top 20% earners experienced a drop of income of 0.03% while the decline experienced by the bottom 20% was 17.2% of their income.<sup>51</sup> A recent study<sup>52</sup> put the actual number of Koreans who fell into a lower income group at 750,000.

Unemployment was the most important factor in declining income, but analysts consider that a further factor behind the disparity was the priority government policies placed on boosting the economy. These policies, perhaps unintentionally, seemed adversely to affect the middle and lower classes. The decision to raise interest rates in 1998 assisted those with sufficient cash. The decision to lower the rate in 1999 contributed to a record run on the stock market which, again, benefited mostly the rich. Various indirect taxes also placed a burden on the lower income groups.

A related issue concerns the *level* of unemployment. Korea's structural jobless rate, which excludes unemployment resulting from business cycles, stood at 4.8% in 1998, but the rate was estimated to have risen to 6.6% in the first quarter of 1999.<sup>53</sup> For a country that had averaged 2.3% unemployment over the past seven years,<sup>54</sup> a jump of 4.3% in unemployment has severe social effects. By age, job seekers in their thirties and forties increased significantly: housewives in their thirties and forties, whose husbands had lost their jobs, then sought to enter the job market for the first time.<sup>55</sup> Household income in the second quarter of 1998 was 2,094,500 *won*, a decrease of 5.2% on the year before. Real income declined 12.5%, the largest decrease in 17 years (after a 13.4% fall in 1980 when the second oil shock hit the Korean economy<sup>56</sup>).

Economic problems are producing social effects. The number of households leaving the cities to work the land increased from 1,429 in 1997 to 4,914 in 1998. Former company employees are the largest group (40%) to make this shift. Criminal activities increased. Those arrested during labour disputes were the fastest growing group. Up till August 1998, 8,508 cases were recorded which represented an increase of 40.4% compared to the previous year. At the same time fraud crimes increased 6.2%. Cases involving the murder of either parent or violence towards close relatives increased 65.2% and 46.3% respectively.

An increase of household violence, homelessness and fraud may not concern those used to the daily Western media diet. But in Korea where cultural unity and the Confucian ethic play a large role in underpinning the stability of the community and family, unemployment – especially the male head of the household not being able to support the family – compounds deep psychological strain within the community.

Koreans are aware that in spite of the inbuilt rigidities, theirs is a volatile society. The leadership knows the potential for social upheaval involved in trade union and student riots. They and the trade unions know that volatility tends to scare off international investment capital.

## Present Trends and Likely Future Prospects

The Bank of Korea, Ministry of Finance and Economy and the Korea Development Institute recently increased

their economic forecasts (the BOK estimate of GDP growth for 1999 is 6.9%). Investment and consumption have increased and the Stock Market has shown positive activity. It is not yet certain how substantial the upturn will be. For example, the Samsung Economic Research Institute (SERI)<sup>57</sup> states that the apparently good economic performance tends to exaggerate the true state of the economy. Inventory makes a disproportionate input in GDP calculations, and exports are dependent on a limited number of high selling items such as semiconductors, automobiles and electronic products for industrial use. These products make up 31.5% of Korea's total exports. Further, financial markets are showing signs of instability.

On specifics, GDP growth in the first half of 1999 was 7.3%. This figure is exaggerated by the low rate (due to the currency crisis) of the GDP scale in 1998 (which is the denominator of the GDP figure for 1999). SERI states that the GDP scale during the first half of 1999, which amounted to 204 trillion *won*, remained at a level slightly higher than that of the first half of 1997. On the role of inventory, SERI says that a change in this factor usually occurs within 1% of GDP. In 1998, inventory reduction amounted to 7% of GDP due to unusual factors such as the export of large amounts of gold and the sale of idle facilities. If the effect of decreased inventory investment is excluded, the rate of total demand during the first half of 1999 was no more than 2.2%. SERI points out that inventory decreased from 18 trillion *won* in the first half of 1998 to 7 trillion *won* during the first half of 1999. Of the recorded economic growth rate of 7.3% in the first half of 1999, 5.1% points were therefore overestimated due to the inventory effect.

There is also the colossal Daewoo problem. *The Financial Times*,<sup>58</sup> characterising the Daewoo collapse as possibly the largest corporate failure in history, has stated that the financial fallout has had a serious effect on Korea's financial institutions. Banks are expected to post combined losses of 9000 billion *won* due to provision for Daewoo loans.

The steps necessary to achieve long-term recovery are complex and, to a degree, go beyond those measurable factors included in the traditional mix of macroeconomic indicators. The role of the state in the economy, the privileged place of the *chaebol*, the lack of a credit culture and internationally recognised standards of business management, and the continuing tension

between trade unions and employers remain factors to be addressed if recovery is to be sustained. Added to these factors is the traditional Korean wariness of foreign involvement in the economy. The attitudes involved could act as a brake on Korea's assimilation of international business standards. The changes that are taking place must also be monitored. For instance, as they reduce in number, the average business project is likely to be larger in relation to banks' capital bases. Banks' reduction of exposure to these businesses will be a key factor for future financial stability. If they cannot meet their financing needs within Korea, businesses may move in a more determined way to secure off-shore financing. Such moves could lead to a reduction in asset quality of Korean banks.

Exports are currently increasing but the categories are tending to become polarised by product. Those that are based on price are suffering; those based on design or technological competitiveness are selling. Computers, petrochemicals, steel plates and textiles, which rely on price competitiveness, have shown negative growth due to devaluations by southeast Asian countries and Japan. On the other hand, exports of automobiles, semiconductors, wireless communication equipment and clothing, whose competitiveness relies on non-price factors such as marketing, technology and design have maintained a higher growth rate. By region, exports to industrialised countries are increasing (if slightly) while exports to developing countries are decreasing.<sup>59</sup>

The relative strengthening of the *won*<sup>60</sup> has adversely affected Korea's export profitability as well as the price competitiveness of domestic companies. The *won*'s appreciation is based mainly on the 1998 current account surplus, but a number of internal cost factors are also involved relating to commission on forex purchases, and shipping freight rates to Europe and North America have increased by between 80% to 115%. These costs are severe on small and medium enterprises (SMEs). Seoul must also be concerned about renewed talk of Yuan devaluation perhaps early in 2000.<sup>61</sup> But these issues as yet are not major features on the economic horizon.

## International Competition

Competition has become serious even among domestic companies as export orders are reduced and the local market remains depressed. Consequent reductions in unit price of export products have reduced profits for export

companies.<sup>62</sup> Korea responded by moving off-shore to lower cost countries and began to concentrate on the more demanding knowledge-based products and services. The Korean Labour movement is concerned at the resulting loss of job opportunities.

Korea's attempt to enter the era of the knowledge-based economy and establish a place for the industries associated with it has met stiff competition from Japan (in particular). Given the fact, that from the Park Chung Hee period, Korea chose to promote those industries in which Japan was also a major player, this is hardly surprising.

Of greater concern to Korea is the serious competition now being mounted by southeast Asian countries and China at the lower end of the export market.<sup>63</sup> No longer a low-wage society, Korea is caught in an economic crunch and must now look to the upper end of the export market to generate the high income necessary to sustain the expectations of its population. Korean R&D has not over the years been a strength, entrepreneurs preferring instead to purchase internationally the necessary intellectual property for which high, profit-reducing royalties have to be paid. The high end of the market means competition with R&D developments that have long been associated with the United States, Japan and the EU. The economic crunch will not easily be resolved but it turns on whether Korea will continue its government-dominated structure and thus risk becoming a lesser Japan. But as Clifford says,<sup>64</sup> if Korea makes the leap to a flexible, entrepreneurial economy it will take an unprecedented risk. Koreans will find it difficult to relax their obsessive, highly personalised control of the economy and companies.

Paternalism and authoritarianism do not on their own provide the essentials of Korea's economic growth. Korea's success drew on a range of factors – particularly that Park Chung Hee and his advisors got the development programme fundamentals right. The trick for the new millennium will be to repeat the same act while facing different fundamentals. Ultimately, success will again rest in large measure on Korea's sense of itself and the values that motivate its people.

## Korean Values

Korea remains a highly stratified and authoritarian society operating within a complex framework of personal linkages and a sense of ethics underpinned by

Confucian and Shaman influences. Having existed for centuries in a climate of physical and political isolation and repression, Koreans have developed a finely tuned sense of their own personal identity and culture. The historical experience, involving internal strife and external invasion, has deeply influenced Korean attitudes to foreigners. Few who have contact with Koreans would doubt their deep belief in Korean culture, their sense of purpose and tenacity.

Whether these factors are, on their own, sufficient to produce the high growth rates of the past 30 years is subject to debate. For instance, as Ezra Vogel<sup>65</sup> has pointed out, many countries achieved industrial success without drawing on a Confucian heritage,<sup>66</sup> while in east Asia industrialisation was fostered in centres far from traditional orthodoxy – in fact, where trade and commerce were already highly developed. Their historical and social experience contributed to a sense of repressed energy (particularly that of *hahn* or, loosely, the ‘unrequited yearnings’ felt by Koreans at various levels of society) which, when released, underpinned much of the dynamic with which Koreans embraced industrialisation. Vogel points also to the existence of “situational factors”. These included:

- External aid, particularly from the United Nations and the United States. US advisors also provided economic guidance.
- The Japanese conquests of the Second World War. These effectively destroyed the old order in east Asia and Korea in particular. The dominance of a conservative and rural-based mindset would have impeded the introduction of newer ways of thinking.
- The importance of the Japanese model of economic development. As an officer in the Japanese Army in his early career, President Park Chung Hee had absorbed the lessons of Japanese organisation in Manchuria.
- The presence of an eager work force (Koreans drew on the self-cultivation aspect of Confucianism in strengthening their personal drive for achievement). The Korean War also uprooted large numbers of Koreans and led to enforced mixing of the many strata of society. Further, the War gave many young Koreans experience of technology as well as a sense of organisation beyond their immediate group.
- An awareness among the Korean leadership and

people of a sense of political and economic urgency which was a compound of immediate military threat (the unpredictable neighbour to the North), Cold War imperatives, an expanding population and an entirely predictable and competitive neighbour across the East Sea.<sup>67</sup>

Vogel<sup>68</sup> adds that industrialisation requires high levels of coordination, precise timing and predictability as well as an understanding of science and technology, management skills and a deep knowledge of world markets. Koreans made the commitment necessary to achieve this.

Korea’s economic achievement drew little from the imperatives of market forces. Strong central government direction provided privileged access to credit for selected entrepreneurs (many of whom were Park’s former army colleagues) and focused on the export market. Many of the early favoured entrepreneurs evolved into today’s *chaebol*. ‘Crony capitalism’ also played an important role in Korea’s success. The Korean tradition of sharing has been referred to above. *Chaebol* largesse goes part of the way to meet the ideal, but the instinctive desire to share has a pervasive influence throughout the culture. In the management context, the concept of sharing motivates Korean resistance to performance-based pay and promotion on merit rather than on seniority.<sup>69</sup> Many international analysts consider that rewarding individual performance is an essential part of the new management ethos necessary to push Korea towards a more competitive economy. To be accepted, a new management structure will have to adapt to and possibly compete with the Confucian attitude to social rank and hierarchical ordering that has characterised Korean management style.<sup>70</sup> Typically, the president sits at the top of the management conning tower in a tightly controlled holding company. He (as the CEO almost invariably is) tends to make all the final or critical decisions by himself. There is some evidence that in the post-IMF economy some private sector companies are looking at flatter and more effective management structures. It remains to be seen whether the new operating procedures can translate into higher productivity.

## Trust

In 1997 the international financial consultants Booz, Allen<sup>71</sup> said:

Korea's international manners were seen as poor – i.e. that it could not be relied on to live up to its commitments – for example by keeping its markets closed and by making changes that it had agreed to long before only under significant pressure.

Booz, Allen was commenting before the financial crisis and it is clear that with the recent legislation aimed at improving the business climate, Korea is concerned now to address the problem. Nevertheless, at the time of the crisis and the granting of the IMF loan, Korea was pained to learn (yet again) that a number of countries – including the US and Germany – were critical of Korea's systems and attitudes. The influential Korean language daily *Chosun Ilbo* in an editorial headed 'Why We Are Disliked',<sup>72</sup> addressed the problem thus:

The most important reason may lie in our Government's unsophisticated foreign policy. We cannot deny that we are guilty of showing off our wealth without realising the bubble in our economy. We struck the nerves of our traditional allies for no valid reason, and we lacked any official public relations policy with our most important partners ... .

The *Chosun Ilbo* stated that overseas posts had failed to coordinate diplomatic activities under the head of mission and that various social campaigns stressing "nationalist sentiments" were "also to blame". But there are wider dimensions. Francis Fukuyama<sup>73</sup> has categorised Korea as a "low trust" society. He notes that Korea lacks systems allowing for the easy adoption of non-kin personnel into the society, thus promoting the inward-looking attitude with which Korea has tended to view the rest of the world. Fukuyama notes that there are areas of potential movement in the society<sup>74</sup> but his picture of Korea is not an optimistic one.

## Corruption

As an editorial in the *Korea Herald* put it, "corruption has taken root in every nook and cranny of Korean society".<sup>75</sup> Since 15 February 1999, when the OECD Convention Against Corruption came into force, Koreans have become aware that corrupt practices are no longer acceptable in the more lucrative markets

(particularly the US and EU) of the globalised economy. Koreans have traditionally evolved their own adaptive mechanisms to problems,<sup>76</sup> but if serious moves are to be taken, the following basic measures must be included:

- a focus on business strategies emphasising the value of price competition and technology;
- the establishment of cooperative or strategic alliances with foreign companies which can provide Koreans with guidance on appropriate business practices in foreign markets;
- the inclusion, within Korean companies, of a systematic plan of countermeasures against corruption; and
- the drawing up of internal audit measures within Korean companies to run checks against corruption.<sup>77</sup>

In mid-August 1999, the Kim Administration announced a package of measures against corruption. For the first time, corruption was recognised not as an individual aberration but as a socio-cultural phenomenon. The Administration viewed the causes of corruption as a combination of business-politics collusion, non-transparent corporate accounting, excessive red tape and low pay for government employees.<sup>78</sup>

## Remaining Steps

Economic reform measures taken to date have achieved some success. The consolidation of oversight agencies into the Financial Supervisory Commission has produced effective regulation in some areas of the financial sector. By cleaning up bank balance sheets, dealing with non-performing loans and uncertainty on fair valuation of Korean financial institutions, Korea is again attracting foreign investment. Bank staff numbers have been reduced. The reforms achieved (and outlined above) tend, however, to be focused on overcoming the immediate crisis, and are not necessarily directed at harmonising Korea's economy with international standards. Restoring the overall *soundness* of the financial system appears not yet to be a priority.

The key now lies with the additional changes required to improve the quality of financial governance as well as the input and guidance made by outside stakeholders. Efforts will also need to be made to ensure that financial information is full, transparent and accurate.

The unprecedented initiative of reducing the number of banks could have the unforeseen consequence of promoting ‘regulatory forbearance’ due to the remaining banks’ attaining a proportionately larger share of the financial stake. Bank restructuring will, moreover, need to be comprehensive. Measures undertaken to date give little encouragement to the belief that there has been a reduction in the practice of bank presidents (who are appointed by the government) meeting with key government ministers. Paradoxically, it seems that the public who apparently favours a reduction in *chaebol* welcomes the ‘assurance’ this government supervision or involvement imparts.

A further question relates to the promotion of international standards among bank employees. Currently employees are hired after completing their education then trained and promoted at the same time each year. Adopting a more flexible hiring policy by seeking to enhance expertise and productivity may prove difficult against the wishes of strong bank unions and an improving economy.

Banks remain the main source of credit for large businesses. At the time of the ‘Big Deals’ initiative, suggestions were made that *chaebol* not cooperating with the Administration’s proposals would have their credit lines reduced. This option seems to have been quietly dropped, lending credence to a continuing soft government-business collusion. Effective reform will depend on the government convincing the *chaebol* that reforms will be carried out.

There are wider problems. Whereas the Korean economy has in the past relied on the ‘three lows’ (the falling dollar, low commodity prices [especially oil] and low dollar interest rates), Korea is threatened now by ‘three highs’ (the *rise* in interest rates, oil prices and Korea’s currency value against the US dollar). Of these, the rise in oil prices (especially for those exports based on oil, e.g. petrochemicals) and the value of the *won* will be the most worrying.

## **Korea at a Watershed**

The Korean economy has rightly been presented as an example of economic success, producing over an extended period a significant improvement in the standard of living of its 45 million people. The system with its high degree of government direction, financial intervention and import protection provided a substantial

level of insulation for a population whose standard of living increased, almost yearly, at a spectacular rate for approximately 30 years. There were muted references to flaws in the economy, but with the government traditionally adopting the role of ultimate guarantor few considered that risk management, as understood in the West, was needed. December 1997 and the IMF intervention thus produced substantial pain for an uncomprehending population.

Korea is now at a watershed. The physical battles that have underpinned its survival in the past must be translated to Korea’s economic front. But since it has never really experienced true capitalism (the Government ultimately took the risk), Korea will be tested severely. The IMF involvement internally and the APEC and WTO negotiating processes externally may educate Korea to work through the necessary structures, understandings and trade-offs involved in making the necessary changes.

As already stated, Francis Fukuyama categorises Korea as a low-trust society. This did not inhibit Korea’s economic development in the past and need not do so in the future. It is the author’s experience that while not exhibiting the same level of ‘trust’ as some other societies, Korea has developed a high sense of values. The strengths of these – loyalty to the family and leadership and the need for education – have a highly stabilising effect on the society and could well be adapted to the imperatives of the globalisation process. For instance:

- The leadership could draw on the experience of its extensive overseas communities – particularly in the United States – to provide guidance on the functioning of market economies, particularly the role of venture capital in developing high tech industries.
- The key understandings in the economy must reflect certain hard truths. That is, that the free market functions on genuine competitiveness in which government acts as facilitator and impartial arbitrator. The building of a civil society, with its established structures, will be part of the social context within the leadership, promoting among Koreans the confidence to function outside the family and kin structure.
- The education system, which has always occupied a central place in the Korean world view, could be

harnessed to emphasise *quality* learning. Given the traditional Korean sense of inner drive and focus, a new stress on analysis and evaluation could usefully be directed at Korea's positioning itself at the forefront of economies seeking a place in the 'knowledge economy'. A shift of emphasis to analysis and evaluation would also embrace the need to make fundamental changes in the teaching profession – a group in Korea not known for its flexibility of views or sense of challenge.

As they look to the post-1997 *economic* vision, Koreans must also adapt to the needs of the *political* process. Acceptance of the principles of participatory democracy requires a sense of responsibility to the wider community, commitment and a sense of give and take. The absolutist positions taken by the key players – trade unions, employers and government – do little to promote the sense of pragmatic accommodation required for Korea's economic development as it prepares for future challenges. The hierarchical structure of society may act as a further inhibition to the free exchange of views.

To restore competitiveness, Korea must embrace not only corporate Korea but also the concatenation of attitudes or mindsets that have till now characterised the business environment. It is beyond the scope of this study to look at the issues in depth, but comment within Korea has referred to the need for:

- smaller companies to develop mobility and capability in specialised areas;
- 'environmental sensitivity' as an important factor in corporate survival;
- a less hierarchical management structure and freer communication within the organisation;
- a culture seeking ideas and creativity – for example, developing internet-style trading;
- companies maintaining their own 'vision and identity' as well as sense of direction as they adapt to the new business climate; and
- legislators adopting a less personal approach to legislative activity and becoming better informed on the issues.

Given the top-down nature of Korean society, the reform agenda is daunting. Normally, education would occupy a central position in inculcating new attitudes.

Till now, however, the education system, with its stress on memorisation and information cramming, has itself been part of the problem.<sup>79</sup> Given the tight organisation and innate conservatism of the teaching profession, careful thought will have to be given to how the demands of the 'knowledge economy'<sup>80</sup> for creativity and analysis can be met by the education system.

Discussion through this paper has tended to emphasise the rigidities and hierarchical nature of Korean society. The current structures would not, on the face of it, be particularly encouraging to the evolution of participatory democracy or flexible management procedures. Tracing the extensive philosophical roots (especially of the Chinese philosopher Meng-tzu) of Asian thought on the subject, President Kim Dae Jung takes another view.<sup>81</sup> He considers that democracy could function very well in Asia. The people came first, Meng-tzu said, the country second, the king third. Kim stated that the ancient Chinese philosophy of *Minben Zhengchi*, or 'people-based politics', teaches that the will of the people is the will of heaven and that one should "respect the people as heaven" itself. There is an increasing awareness, he says, of the "importance of democracy and human rights among Asians themselves and their willingness to make the necessary efforts to realise these goals".<sup>82</sup> He considers that the traditional strengths of Asian society can provide for a better society and that democracy can encourage greater self-reliance while respecting cultural values. He also said that:

Asian authoritarians misunderstand the relationship between the rules of effective governance and the concept of legitimacy. Policies that try to protect people from the bad elements of economic and social change will never be effective if imposed without consent; the same policies, arrived at through public debate, will have the strength of Asia's proud and self-reliant people.<sup>83</sup>

Kim identifies a less authoritarian style of governance and one which runs counter to the model popularly supported by many Asian leaders. A key landmark for Korea's economic well being will be how effectively the administration of Kim Dae Jung deals with the top *chaebol*. Till now these conglomerates have tended to operate in a quasi extraterritorial capacity. Effectively

restructuring the system to redistribute the owners' accumulated personal wealth would be a start<sup>84</sup> and provide Koreans with the sense that another of their cherished beliefs—egalitarianism—still has the possibility of achieving reality.

Looking at the wider context, Choi Sang-yong<sup>85</sup> states that Asians will promote the economy and then political democratisation in a way that reflects specific circumstances. He endorses Kim Dae Jung's view that in Korean thought there exists a tradition of human dignity and respect for those ruled. But he adds "the concept of human rights in terms of basic rights of an *individual* is an alien principle introduced from the West."

Korea has sufficient resources to provide the necessary financial backing for its own development, but the expertise and infrastructural support mechanisms in the electronic and globalised age require a different and perhaps even revolutionary input.

This paper has referred to two broad aims underpinning Korea's drive for industrialisation:

- (a) to develop an economic base that would adequately protect them from their militaristic neighbour to the north; and
- (b) to compete with Japan, their former colonial master.

Thus, intertwining concepts of security and national identity played a key role in the economic development plans which, for a period of 30 years, produced a winning formula. 'Fortress Korea' and the ability to challenge Japan are, however, coming under threat from other competitors as well as the concept of globalisation. Korea faces a complex dichotomy. While the international market is changing, Korea's external perception seems slow to adjust.<sup>86</sup> This is not wholly due to a change resistant attitude in Korea. Changes – some quite revolutionary – have been made in the past. The land reforms of Syngman Rhee and the industrialisation achievements of Park Chung Hee are examples. Since the early 1980s and the more market-orientated reforms of President Chun Doo Hwan, moreover, the frontiers of state control in Korea have retreated from the high tide of the Park Chung Hee period but, as the IMF programme revealed, much remains to be done in liberalising the economy if Korea is to allow the market a more determining role in the economy of Korea.

Korea is not unaware of the problems<sup>87</sup> but, international analysts and others notwithstanding, a certain Korean reticence about radical restructuring reflects, in large measure, Korea's historical and cultural context. The fact is that Korea remains at war<sup>88</sup> with the determinedly Stalinist regime to the North. Koreans are aware that globalisation presents the promise of expanded markets and greater wealth, but they retain a somewhat paradoxical reticence on such issues as breaking up the *chaebol* and lowering tariffs.<sup>89</sup> On the one hand, the *chaebol* have, to Koreans, come not only to symbolise their country's emergence as a world economic power, but they have also been a contributing factor in their own increasing living standards over the past 30 years. But the *chaebol* also symbolise the accumulation of wealth and power in the hands of a few. On tariffs the agricultural lobbies (particularly in rice and forestry) pursue the chimera of 'food security' and continue to maintain a resolute defence against external competition.

But there is a larger context. Koreans are cautious about the globalisation agenda. For them the sorts of issues raised by Dani Rodrik<sup>90</sup> remain to be answered. Rodrik notes that globalisation threatens social cohesion by widening the rift between people with skills and mobility in global markets and those without. Rodrik also asks whether the move towards the market will be permanent, or whether there will be a recalibration of the factors involving the government's role and those areas that will be left to market forces.<sup>91</sup> There is, of course, no clear answer to these questions which are themselves interwoven with a range of other issues. For instance, Koreans are concerned about the continuing failure of the Japanese economy to emerge from its lengthy recession. Korea continues to study Japan's economic performance not only because of Japan's importance as a market for Korea but also because of the importance of the Japanese economic model for Korean planners.

At a basic level Korea's caution reflects, moreover, traditional concerns about foreign intervention.

It will take time for Korea to work through answers to these questions. As noted, Korea is at a watershed but in resolving the range of problems presented by the globalised agenda, Korea will, as it always has, act within the confines of a resolute sense of its own destiny. Change will come but future miracles in the Korean polity and economy will not happen as quickly as the industrialisation miracle.

# Annex I

The foregoing discussion has focused on the Korean economy, the attitudes of the Korean people and their response to the financial crisis which began in 1997. The following comments are directed primarily to New Zealand's relations with Korea and concentrate on trade and economic perspectives.<sup>92</sup>

## New Zealand and Korea

New Zealand's linkages with Korea have been and remain trade driven largely in non-value added products. Unless New Zealand exporters are prepared to become more involved with the market, the basic New Zealand-Korea trade profile will not change in any significant way. Increased access for a limited range of specialised agricultural products will continue to involve government-to-government negotiation, but it is difficult to see the end result as producing anything more than useful niche markets producing useful but low cash returns.<sup>93</sup>

Except for a resolute few, the Korean market is too often regarded by New Zealand exporters as 'too hard'. Given the complexities of the distribution and regulatory frameworks as well as the clear cultural differences, the Korean market will always retain a high level of difficulty for foreign entrepreneurs. But many foreign operators have achieved considerable success cultivating areas of potential growth – particularly in high-tech products relevant to the knowledge economy.

In essence, success in the Korean market requires continuing personal engagement and the achievement of an understanding of Korean attitudes *and* culture. The ground rules involve:

- Achieving a full knowledge of the product and service being sold.
- Taking time to study the Korean market. This means gaining knowledge not only of the legal requirements but also of the idiosyncrasies of the distribution system and the bureaucratic labyrinth.
- An awareness that Western lineal-style thinking does not fit comfortably with Koreans. Successful exporters tend to work through a number of reliable Korean contacts or with a strategic partner. Some

of these may not appear to be directly relevant to the product or service being promoted. Given the pattern of contacts within the wider Korean community through family, school or region, contextual linkages can be useful for consolidating introductions. Diplomatic and Trade representatives can facilitate contacts, but ultimately Koreans want to deal directly with those they will be doing business with. Exporters must therefore become engaged with Korea and its economy.

- Effective communication. Exporters must be prepared to pay for clear interpretation when required.
- Developing patience and perseverance. Although they can be quite volatile, Koreans do not generally respond well to a confrontational or quick-fix style of doing business.
- Observing the correct formalities. While they will want to see the proper procedures observed, Koreans place little faith in what they call 'white paper'. Key relationships form around personal contacts.
- Taking an interest in Korean culture as well as its history. Koreans are concerned about personal aspects of 'face' as well as having their company held in high regard, particularly in the eyes of foreigners. Acknowledging the sacrifices made during and after the end of Japanese domination is appreciated.

A number of foreign firms have shown willingness to invest time and resources in Korea and they have generally been rewarded by achieving effective personal and trade relations. There are, of course, no easy solutions to developing the Korean market. Exporters will be aware that sales depend on a range of variables, especially whether, ultimately, their product or service is wanted.

There is a wider perspective. Few New Zealand exporters are 'Asia literate'. To a degree this is quite understandable. They and New Zealanders as a whole have not had the same exposure to Asian cultures as they have had to their United States or European counterparts particularly through the highly potent power of the pop culture. Lack of Asian background can be remedied, for instance, by undertaking structured study, particularly university business courses orientated to providing a basic understanding of Asia, the market *and* culture. Formal study of, say, Korea would enable New Zealand

exporters to understand the need for more effective business alliances with Korean companies which can provide guidance on proper trade practices. Annex II provides a suggested Course Outline for a tertiary level 'Asian Business Culture' programme.

The government is playing a role in developing collateral in the relationship.

A framework of intergovernmental agreements exists in such areas as science and technology, defence and forestry. New Zealand has much to offer Korea in applied science and technology research. Ministerial and official visits should continue to build on the established frameworks, but especially S&T, the private sector and Non-Governmental Organisations (NGOs) must develop the drive to develop linkages with the resources already available. Koreans are ready to engage in cooperative relationships, but under current structures the New Zealand private sector must be prepared to work at undertaking initiatives.

The way ahead will not be easy. As Korea develops its economy and expands its regional as well as international interests, New Zealand will need to work hard to retain its relative position with Korea as an important trade – and wider – partner. The 1999 Ministerial initiative directed at coordinating government immigration, education and trade resources<sup>94</sup> represents a useful start. The net could be extended to include services in tourism and education (and possibly also in government consultancies where foreign public relations firms are proliferating in Korea). Tourism produced huge returns for New Zealand before the 1997 downturn and will achieve renewed growth in the future. But Koreans would want to see a more consistent input if New Zealand is to persuade them that it has a long-term interest in tourism.<sup>95</sup>

What is important for a small country with limited resources to spend on foreign relations is to narrow and focus its priorities. When policy is determined, it is equally important that it is then sustained with pragmatic rigour. In practical terms it is legitimate to ask whether New Zealand would benefit from reallocating some priorities to areas of higher return. For instance, the resources spent on seeking access for minor (peaches, cherries and nectarines) agricultural products could be shifted to promoting New Zealand as a centre for educational excellence. Indeed, it is probably fair to say that if the government were to invest in a more pro-active

policy on education, earnings from that area alone would double in three years.<sup>96</sup> Niche agricultural products make their own contribution but the Australian figures demonstrate the value of investment in education. The add-on benefits would result from Koreans experiencing New Zealand as well as exploiting the potential for developing future network relationships.

Investment in Korea is a further area of potential for New Zealand. Again, the context is not an easy one but other countries are increasing their export margins by controlling some aspects of the local distribution system. Game industry products are potential areas for New Zealand investment as well as beef, the latter especially from 2001 when the Korean import tariff regime will change.

## The Korean and New Zealand Economies

It is beyond the scope of this paper to provide detailed proposals for developing the Korea-New Zealand relationship. Such proposals are probably best produced in a pragmatic environment involving the range of interests at stake in Korea. The following represents a short list of areas to be pursued if New Zealand is, through all sectors, to raise its game:

- Developing a consolidated strategic knowledge of the market. (Information on Korea is contained in a variety of sources in New Zealand but not in any consolidated form. A database requires resource allocations. Perhaps either TRADENZ or the Ministry of Foreign Affairs and Trade could be established as repositories of information where the private sector would be encouraged to draw on a data base.)
- Building networks between interested trade parties. (Developments in information technology have made it possible to establish websites of interest to New Zealand exporters/importers and investors. The Korea-New Zealand Business Council could play a role in drawing together such sites.)
- Investigating the conclusion of a Free Trade Agreement (FTA). (The Korean and New Zealand economies have strong complementarities involving alternatively the agriculturally-based New Zealand economy and the industrial Korean economy. Korea's *bona fides* on free trade agreements have

yet to be tested but officials are in active discussions with Chile. If the Korea-Chile FTA becomes a reality, New Zealand could find itself at a competitive disadvantage in a range of products, particularly in timber and kiwifruit.)

- Involving Koreans, in a non-doctrinaire way, to a greater extent in New Zealand's experience in financial and public sector restructuring. (Opportunities should be taken to promote exchanges of experienced officials. The value is not only in the exchanges of information and experience but also in achieving an understanding of – and engaging in – each other's systems, attitudes and cultures. Koreans would benefit from a realisation that New Zealand is more than a tourist destination on [as they put it] the other side of paradise and that New Zealand's high-tech industries should be taken seriously. Working with the appropriate Korean governmental agencies, Korea could also be encouraged to see New Zealand as a repository of expertise on environmental protection systems as well as food technology).
- Getting to grips with Korea's initiative in developing the knowledge economy.<sup>97</sup> (New Zealand too has expressed similar aspirations on a knowledge-based future. The changes involved will impinge on the political, technological and cultural life as well as the economy of both countries. A general disposition to restructure is now well entrenched in the New Zealand psyche, but an effective desire for fundamental change has yet to be seen to any significant extent in Korea. For Korea the key to achieving a relatively painless transition to a knowledge-based economy will lie in its ability to manage the adaptation of its education systems to retain a level of dynamism while inculcating a sense of freedom in producing the graduates needed to enable the new Korea to compete in the electronic global market place. In education, New Zealand's experience in producing creative and disciplined students could find a niche in Korea).
- Seeking a firmly-based foundation for education and research cooperation. (It is important that research exchanges be undertaken in *both* directions. Academic standards in Korea are rising and it is likely that within the next ten years some Korean universities will be among the best in the world. Is

New Zealand prepared to take advantage of this transformation? Or will the tendency to a Eurocentric mindset among its academic institutions continue? In the short time of its existence, the Asia 2000 Foundation has done much to re-orientate the focus of New Zealand's attention to Asia, but more has yet to be done by academic institutions to develop the potential for two-way exchange in areas relevant to both countries.<sup>98</sup>

- Using the networking capacity of Non-Governmental Organisations and churches which have considerable contact with Korea. (Given their role in the 1999 WTO meeting in Seattle, it may be worth developing contacts between New Zealand and Korean NGOs.)

# Annex II

## Asian Business Cultures

The following notes provide an outline for a suggested tertiary level course on Asian business cultures as mentioned in Annex 1.

Twelve sessions of two hours each over one trimester broken up as follows:

- 1) Introduction  
Course outline
- 2) Historical Context I  
(Southeast) Asia before 1500 as a trading network.
- 3) Historical Context II  
Treaty Ports and European contact (with comment on the way of life of the areas of early contact)
- 4) New Zealand and Asia  
An historical perspective on New Zealand's contact with and disposition towards Asia
- 5) Doing Business in China-Taiwan  
Historical-cultural-social developments focusing on the specific characteristics relevant to foreign contact – particularly in the trade/economic context.
- 6) Doing Business in Japan  
Content prescription: same as for China-Taiwan above
- 7) Doing Business in South Korea  
Content prescription: same as for China-Taiwan
- 8) Doing business in Southeast Asia  
Content prescription: same as for China-Taiwan
- 9) - 10) - 11) Case Studies  
Case studies should cover three countries chosen from Thailand, the Philippines, Malaysia, Singapore, China, South Korea and Taiwan. There could also be a *generalised* topic covering 'business communication'.  
Lecturers will look at specific instances of trade negotiations with relevant countries, emphasising (for example) access for specific products. Access issues will generally involve

a high level of government to government contact (possibly using the APEC model as an example), but the Tourism Board might provide discussion on (possibly) the construction of its strategy for attracting tourists from Asia. Other areas where tariff issues are not significant may require a higher level of private sector input.

### 12) Assessment

## Course Requirements

The course could conveniently be structured around the following

- A two-hour lecture each week.
- A one-hour tutorial each week in which lectures and reading will be assessed and analysed. Students could be asked to make a presentation on a topic of their choice. The tutorial presentation could represent 10% of the total course requirement.
- A journal could be compiled by participants. Students will collect articles, cuttings and other materials from newspapers, magazines and other sources about the course topics. In the journals, students will give written comments on (and criticisms of) the contents of their journals. The journal could represent 20% of the total course requirement.
- An essay on a selected topic could represent 35% of the course requirement.
- A two-hour test at the conclusion of the course could represent 35% of the course requirement. Students will be given a recommended reading list. Students should purchase a folder for filing course materials.
- A tutor would attend the lectures and would be available for consultation on course work.



## Endnotes

- <sup>1</sup> Throughout this paper, the Republic of Korea will be referred to as either South Korea or simply Korea.
- <sup>2</sup> Mainly from the US and Japan.
- <sup>3</sup> Under the land reform measures of 1959, approximately one million sharecroppers became landowners.
- <sup>4</sup> The first annual US economic aid bill after the Armistice was \$200 million; aid peaked at \$365 million in 1956 and was then maintained at \$200 million annually till the mid-1960s (US Department of State [1990] *Area Handbook, Korea*).
- <sup>5</sup> The reasons for Syngman Rhee's demise are attributed mainly to a decline in the effectiveness of his policies as rapid changes in the wider economy and society affected Korea. These included a rising political consciousness among the urban masses, the exposure in the press of the Government's ineptitude and corrupt practices, and attacks on Rhee's authoritarian rule. Events came to a head in March 1960 when the presidential elections returned Rhee to power. Rhee had relied on the blatant use of power in a vote that was widely seen as fraudulent. The results touched off civil disorders culminating in what came to be known as the 'April 19 Student Revolution'. Rhee resigned on 26 April 1960. His departure was followed by a further period of unrest. The economy suffered from mismanagement and corruption while the army and police continued to be controlled by political appointees who had supported the dictatorship. Law and order declined. The factional wrangling of the political environment eventually provided (as one commentator put it) "fertile ground for a military coup" (US Department of State [1990], op. cit.).
- <sup>6</sup> The Japanese as the colonial power in Korea took a number of able young Koreans into its service in Manchuria
- <sup>7</sup> Cited in Mark Clifford (1994) *Troubled Tiger*, London: M E Sharpe.
- <sup>8</sup> A useful outline of the events leading to the financial crisis in Korea is contained in International Monetary Fund (IMF) (January 1999) *IMF Supported Programmes in Indonesia, Korea and Thailand: A Preliminary Assessment*.
- <sup>9</sup> East Asia Analytical Unit (May 1999) *Korea Rebuilds: From Crisis to Opportunity*, Canberra: Department of Foreign Affairs and Trade (DFAT), p 2.
- <sup>10</sup> Dongchul Cho (March 1999) 'South Korea in 1998', Korea Economic Institute of America.
- <sup>11</sup> In December 1996, the exchange rate of the Korean won to the US dollar was W839.0, in October 1997 W921.9 but in November 1997 it declined to W1025.6 and in December was W1484.1.
- <sup>12</sup> Korea's total foreign debt at December 1997 was \$US158.1 billion, of which short-term liabilities were \$US63.2 billion.
- <sup>13</sup> The two most notable were Hanbo (steel) and Kia (automobiles). The extent of Hanbo's debt was calculated at \$US5.8 billion (or 21 times its equity) and was regarded as a significant factor in the slide in confidence in the Korean economy. The Hanbo incident opens up the question of the role of corruption in the Korean economy.
- <sup>14</sup> IMF (January 1999), op. cit. The comments made in page 13 of the *Assessment* provide useful background comment on the Korean sector of the crisis.
- <sup>15</sup> The son of former President Kim Young Sam, Kim Hyun-chul, was released on bail in November 1997, one month after he was found guilty of receiving W6.6 billion from six businessmen between 1993 and 1996. This was during Kim senior's presidency. Kim junior was also indicted for evading W1.2 billion in taxes. The indictment of the junior Kim threw into sharp relief Kim senior's claim that he never received any illegal funds while in office.
- <sup>16</sup> But during the negotiations with the IMF for the loan in 1997, Japan specifically requested that Korea eliminate IDMs (Import Diversification Measures). In the negotiations Korea agreed to eliminate IDMs by June 1999 ahead of the scheduled abolition in December 1999 (see Bark Tae Ho [July 1999] 'Trade and Foreign Investment Trends and Policy Reforms in Korea', paper delivered to an international conference on 'Experiences of Economic Reform Within APEC', Wellington: Institute of Policy Studies). IDMs were eliminated on 30 June 1999. The major items prohibited entry to Korea under the IDM scheme included automobiles, cameras, machines and consumer electronic goods such as colour TVs. All but automobiles seemed to be freely available at Seoul's electronic market at competitive rates.
- <sup>17</sup> Korea still operates under the national security law which prohibits contact with North Korea and which is still used as an instrument of repression. It should be noted that North and South Korea are still technically at war.
- <sup>18</sup> IMF (January 1999), op. cit.
- <sup>19</sup> Quoted from IMF (1997) 'Republic of Korea – Standby Arrangement, Letter of Intent', in chapter 7, East Asia Analytical Unit (May 1999), op. cit. It can be said that exports are indeed growing again – up strongly in the second half of 1999 with a forecast calendar growth of 3.8% to \$US137.3bn. Imports also rose sharply in 1999 by 24.2% to total \$US115.9bn. Import and export figures are contained in 'VIP Economic Report', LG Economic Research Institute, November 1999, p 12.
- <sup>20</sup> Korea's central banking system consists of the Monetary Board and the Bank of Korea (BOK). The Monetary Board is Korea's top decision-making committee on monetary policy. Under the Bank of Korea Act 29 December 1997, the Governor of the Bank of Korea became Chair of the Monetary Board. All seven members of the Board now operate full time. The administration appoints only one member (from a previous position of appointing 5 of 9). The reforms are expected to increase BOK independence.
- <sup>21</sup> Unemployment and bankruptcies were most severely felt among the SMEs which were hard hit

by the high interest rate policy.

<sup>22</sup> IMF (January 1999), op. cit., p 13.

<sup>23</sup> Ibid.

<sup>24</sup> Bark Tae Ho (12-14 July 1999), op. cit.

<sup>25</sup> Exports of electronic products, semiconductors, automobiles, petrochemicals and ships account for 49.3% of total exports. At the same time these items compete most closely with Japanese exports in the international market.

<sup>26</sup> Samsung Economic Research Institute (SERI) (17 December 1998) 'Korea One Year After the IMF Bailout', p 7. SERI has continued to provide valuable comment on the Korean economy from the time of the IMF intervention.

<sup>27</sup> SERI (17 December 1998), op. cit., p 7.

<sup>28</sup> Chan Huh (12-14 July 1999) 'A Critical Overview of Financial Sector Reform in Korea: Experience and Remaining Challenges', paper delivered at 'Experiences of Economic Reform Within APEC', Wellington: Institute of Policy Studies, p 15.

<sup>29</sup> East Asia Analytical Unit (1999), op. cit.

<sup>30</sup> Chan Huh (12-14 July 1999), op. cit., p 15. Contributing factors included the conditions established by the IMF package, particularly those relating to Basle standard deposit ratios.

<sup>31</sup> Chan Huh (12-14 July 1999), op. cit.

<sup>32</sup> Under the IMF formula, the Bank of Korea became independent. Since the economy is still under the control of the IMF, it is yet to be seen whether the Bank can exercise this independence.

<sup>33</sup> Chan Huh (12-14 July 1999), op. cit., p 4.

<sup>34</sup> Figures on NPLs remain elusive but chapter 7 of the Australian DFAT East Asia Analytical Unit publication cited above provided the following data: NPLs purchased Nov 97 to Aug 98 totalled W16 trillion, thence through first half of 1999, W86 trillion.

<sup>35</sup> Clifford (1994), op. cit. The presumption here is that Clifford is referring to the concept of personal profit.

<sup>36</sup> The Chinese language equivalent is *jen*. The concepts involved are complex. I am indebted to Dr Stephen Epstein for his comment that *cheong* conveys a sense of warmth that frequently develops over time in relationships. Koreans regard themselves as a group as having a lot of *cheong*.

<sup>37</sup> The President of a major foreign bank in Korea informed the author that the *chaebol* represented, broadly, 50% of the economy. He said that he was using anecdotal evidence but his assessment was based on many years in Korea.

<sup>38</sup> The main assets involved were the semiconductor and automotive industries.

<sup>39</sup> At the end of July 1999, Daewoo's debts totalled around \$US50 billion. It is estimated that Daewoo accounts for more than 5% of the Korean GDP. It accounts for 150,000 jobs and influences the fate of many more through its 6000 suppliers.

<sup>40</sup> SERI (17 December 1998), op. cit., p 13.

<sup>41</sup> *Korea Herald*, 6 August 1999. The article is quoting a Fair Trade Commission report of 5 August 1999.

<sup>42</sup> It should be noted that one of the responses to the

President's reform initiative was that some of the larger *chaebol* simply wrote up the value of their assets and then borrowed more on the back of the 'collateral'. Thus while their debt ratio fell, the valuation of the assets was a major contrivance which did little to add to the credibility of those involved and indeed the structure as a whole. But as Gareth Morgan, Chief Executive of Infometrics, penetratingly asked in discussion with the author, "what is the appropriate debt ratio of a *chaebol*?"

As Morgan says, it has little meaning in a structure where the government plays such a coercive role in allocating debt and deals across the business groups. It does not really matter what it is, if at the end of the day the government is going to defend government /*chaebol* practice. So, as Gareth Morgan says, the transition from that world to the version of capitalism practised in the (broadly) Western context is about far more than changing debt ratios. It is the practices that matter.

<sup>43</sup> There were 28 companies belonging to ten conglomerates ranked in size between 6<sup>th</sup> and 64<sup>th</sup>. Among them was the internationally known firm of Jindo.

<sup>44</sup> The report is contained in the *Korea Herald* of 11 August 1999.

<sup>45</sup> Samsung has been one of the most conservatively run *chaebol* and is currently cash rich due to the up-turn in the semiconductor industry. Samsung should therefore be able to withstand any move made by creditors to implement sanctions. These can of course involve tax probes. In Korea the complexity of the taxation system means that it is almost impossible to avoid some sort of tax evasion in the process of completing returns.

<sup>46</sup> The unemployment rate at the end of 1997 was 2.6%. It rose to 7.6% at the end of July 1998 then fell to 6.5% in April 1999. The main areas were the construction and financial sectors, as well as public and personal services. Wages in all industries fell 2.5% in 1999, with the construction industry declining 20%. At the end of 1999 unemployment registered at 4.8% in the statistics (*Korea Herald*, 24 November 1999). The decline in unemployment no doubt reflected the upturn in the export economy (the growth forecasts for 1999 were all over 8% with the BOK projection at 8.2%). Unless significant restructuring is undertaken in the economy, long-term prospects for employment may again show a downturn.

<sup>47</sup> Pong-sul Ahn (12 to 14 July 1999) 'The Impacts of the Economic Crisis and Reform on Labour in Korea', paper delivered at 'Experiences of Economic Reform Within APEC', Wellington: Institute of Policy Studies, p 1.

<sup>48</sup> Ahn (12 to 14 July 1999), op. cit., p 19.

<sup>49</sup> Ahn (12 to 14 July 1999), op. cit., p 23.

<sup>50</sup> Ahn (12 to 14 July 1999), op. cit., p 15.

<sup>51</sup> SERI (17 December 1998), op. cit., p 26.

<sup>52</sup> *Korea Herald*, 23 July 1999. A survey published by the National Statistical Office on 10 October 1999 (published in the *Korea Herald* of 11 October 1999)

- stated that the gap between middle income and high-income brackets continues to widen. The NSO said that the combined income of the middle income bracket was 48.7% of that of the high income bracket in the first half of 1999. This figure is the lowest since 1985 when it was 48%.
- <sup>53</sup> *Korea Herald*, 30 July 1999, quoting an OECD/Bank of Korea report.
- <sup>54</sup> Korea Economic Institute (1999) *Review*.
- <sup>55</sup> SERI (17 December 1998), op. cit., p 25.
- <sup>56</sup> SERI (17 December 1998), op. cit., p 26.
- <sup>57</sup> SERI (9 October 1999) 'Economic Trends', p 13.
- <sup>58</sup> *Financial Times*, 5 November 1999.
- <sup>59</sup> Exports to industrialised countries increased by 0.9% year on year to April 1999. Exports to the developing countries declined by 4.9%. Exports to the US, EU and Japan increased by 14.7%, 1.3% and 18.9% respectively due in the main to strong performances in home electronic goods, electronic parts, semiconductors, computers and automobiles. But exports to China decreased by 11.4% due to declines in petrochemicals, steel and general machinery. Exports to ASEAN countries such as Philippines, Indonesia and Singapore also increased.
- <sup>60</sup> *Won* rates to the \$US are as follows: Dec 96 (839.0), Oct 97 (921.9), Nov 97 (1025.6), Dec 97 (1484.1), Oct 98 (1336.7), Nov 98 (1294), Sept 99 (1192).
- <sup>61</sup> The Economist Intelligence Unit expects China to move to a current account deficit in 2001, after some years in surplus. It predicts a 13% devaluation in 2000.
- <sup>62</sup> SERI (12 June 1999) 'Korean Economic Trends'.
- <sup>63</sup> In the US market, China increased its share of imports from 1.4% in 1986 to 6.5% in 1996. It is not China alone that threatens Korea's export markets. Over the same period, Indonesia, Malaysia and Thailand increased their share of imports from 2.1% to 4.7%. Korea's share of the US market dropped from 3.6% in 1986 to 2.8% in 1996. In the EU and Japan, a similar phenomenon developed. See Booz, Allen and Hamilton (October 1997) 'Revitalising the Korean Economy Toward the 21<sup>st</sup> Century', Seoul, pp 33-34.
- <sup>64</sup> Clifford (1994), op. cit., p 5.
- <sup>65</sup> Ezra Vogel (1991) *The Four Little Dragons: The Spread of Industrialisation in East Asia*, Cambridge, Mass.: Harvard University Press, p 84.
- <sup>66</sup> For example, Malaysia, Thailand, Turkey. It was said, moreover, that Confucianism had the effect of retarding modernisation and had left East Asian nations behind the West. Vogel (1991), op. cit., p 84.
- <sup>67</sup> As Korea robustly calls it. International maps in Korean shops routinely have the 'Sea of Japan' manually deleted and the 'East Sea' inserted.
- <sup>68</sup> Vogel (1991), op. cit.
- <sup>69</sup> The author has rather more experience than he might otherwise wish of the Korean attitudes to employment and particularly the desire for equality of promotion regardless of productivity.
- <sup>70</sup> Labour-management tension tends to be generated by across-the-board collective demands. These tend to crystallise around automatic, regular pay rises.
- <sup>71</sup> Booz, Allen and Hamilton (October 1997), op. cit.
- <sup>72</sup> *Chosun Ilbo*, 16 January 1998.
- <sup>73</sup> Francis Fukuyama (1995) *Trust, The Social Virtues and the Creation of Prosperity*, New York: Free Press.
- <sup>74</sup> He refers to the fact that kinship draws from a large pool, that regionalism also plays a part in bringing people together, that university classes and the army as well as the growing impact of Christianity assist in the mobility of people. Fukuyama notes the similarity between the Confucian spirit and Protestant ethic.
- <sup>75</sup> *Korea Herald*, 18 August 1999.
- <sup>76</sup> The election in 1998 of Opposition figure Kim Dae Jung, for long a critic of the Korean Government, was hoped to usher in an era of clean government. After a year and a half, some cracks are beginning to appear in the image of 'Mr Clean'. Lim Chang Yuel, the Governor of the province of which Seoul is part, has been indicted for allegedly accepting a bribe. President Kim claims not to know about the problem. Two cabinet ministers have been dismissed over corruption problems. Guidelines have been issued by the Government forbidding senior bureaucrats from receiving any kind of favour. One rule even bans bureaucrats from announcing weddings and funerals. These latter are generally regarded as opportunities for cultivating officials with large amounts of money. Critics contend that the guidelines are not likely to have much effect.
- <sup>77</sup> The above points emerged from various discussions between the author and economists in Seoul.
- <sup>78</sup> *Korea Herald*, 18 August 1999.
- <sup>79</sup> The education system – a curious mixture of merit and dictatorial attitudes – is so inadequate that many families are forced to pay fees for extra curricula tuition for their children. Nevertheless, education is still seen as an instrument of social mobility. It could be argued, of course, that the extra coaching sought by many Korean families results from the intensely competitive nature of Korean society. From discussion with many families, the author considers that the problem lies clearly with inept teaching.
- <sup>80</sup> I am grateful to Lee Tsao Yuan, Director of Policy Studies, Singapore, for the following definition of a knowledge-based economy:
- ... a knowledge-based economy is one that is directly based on the production, distribution and use of knowledge and information. It is characterised by strong technological capability and a vibrant entrepreneurial culture. Knowledge and skills will be the key drivers of the new hardware, software and services and will be the basis of job and wealth creation.
- Lee Tsao Yuan's comment appears in 'The Political Economy of Economic Reform and Restructuring in Singapore', a paper delivered at 'Experiences of Economic Reform within APEC', Wellington: Institute of Policy Studies, 12-14 July 1999.

- <sup>81</sup> Kim Dae Jung (November/December 1994) *Foreign Affairs*, 73 (6), p 191.
- <sup>82</sup> Kim Dae Jung (November/December 1994), op. cit., p 193.
- <sup>83</sup> Ibid.
- <sup>84</sup> Some encouraging moves have been made. President Kim has had several meetings with *chaebol* leaders and discussed measures involving outlawing of cross shareholdings among group subsidiaries, reducing *chaebol* control over financial institutions and imposing inheritance taxes on *chaebol* owners. There is also a proposal to include outside directors on the boards of financial institutions aimed at preventing the misuse of capital. The measures could have been tougher. The limit on cross shareholdings will not be introduced until 2001 while a plan to limit *chaebol* ownership of non-banking institutions has been abandoned. *Chaebol* financial credibility will remain doubtful as long as their debt-to-equity ratio remains high. The latest figures show that (apart from the troubled Daewoo) the current debt/equity ratio averages 302%, which is a marked improvement on the figure of 386% at the end of 1998. The Government is seeking a reduction to 200% by the end of 1999 (see *Financial Times*, 26 August 1999). A survey conducted by the Korea Research Co. of 500 Korean adults revealed a prevailing pessimism among respondents. 53% said that *chaebol* reform will not be successful “even by the time President Kim’s tenure expires”, *Korea Herald*, 9 September 1999.
- <sup>85</sup> Choi Sang-yong (September-October 1999) ‘Asian Democracy and South Korean Experiences’, *Korea Focus*, p 48. Reprinted from *Sasang Quarterly*, Autumn 1999.
- <sup>86</sup> Robert Felton, Head of McKinsey and Co. in Seoul, was reported as saying in the *Far Eastern Economic Review* of 28 January 1999 that while Korean companies were regaining their footing, global competition was growing even tougher. South Korean companies must move faster, he said, on corporate consolidation, research and development and deregulation *just to stay in place*. Charles Lee, the FEER correspondent, commented that the “country’s leadership seem to understand that”. On 13 January 1999, President Kim’s economic advisor Kang Bong Kyun tried to pre-empt any “incipient complacency” by making it clear that restructuring, not short-term recovery, remains a top national priority
- <sup>87</sup> In the macroeconomic sense, these include the *chaebol* preferring to invest off-shore rather than internally, the continuing high level of corporate debt, and the dominant role of the *chaebol* in the economy, thereby inhibiting the growth of the small and medium enterprises which have played such a key role in underpinning the economies of Japan and Taiwan. Koreans are also aware of the pervasive role of corruption in the economy and that Korea is no longer a low wage society. There is also an awareness in some areas of society of the points made above of the need to change the Korean mindset.
- <sup>88</sup> Hostilities in the Korean War concluded with an Armistice. A full peace agreement has yet to be signed. Military actions occur sporadically between the two sides.
- <sup>89</sup> Jwa Sung-hee, president of the Korean Research Institute, commented recently that narrowing the debt/equity ratio to around 200% would result in “massive” dumping sales of Korea’s industrial assets, creating significant after-effects in the economy. Harvard Business School professors Tarun Khanna and Krishna Palepu have argued that the top reform priority for emerging economies, like Korea, is to improve market economy infrastructures and regulations, not to dismantle the *chaebol*. Reports of Korean and international views on the break up of the *chaebol* are contained in issues of the *Korea Herald* of 10 and 12 August 1999.
- <sup>90</sup> Dani Rodrik (1997) ‘Has Globalisation Gone Too Far?’, Washington: Institute of International Economics.
- <sup>91</sup> They are aware, however, of the wider debate developing around the role of the market. They would share the questions asked by D Yergin and J Stanislaw ([1998] *The Commanding Heights*, New York: Simon and Schuster) who ask whether market economies deliver on their promise in terms of measurable economic goods, that is, on growth, higher living standards and better quality services and jobs. They wonder whether the market will deliver fairness in the distribution of economic goods and whether it will undermine the traditional values and identities of their culture. As Khilnani says in *The Idea of India*, p 205, part of the purpose of a state must be to protect not merely the physical and material security of its members but also their identities (Sunil Khilnani [1997] *The Idea of India*, Harmondsworth: Penguin).
- <sup>92</sup> There are, of course, wider perspectives. Economic and trade issues are only part of New Zealand’s foreign policy which, of necessity, has a bilateral, regional and international dimension. A discussion of these dimensions is not, however, within the scope of this paper.
- <sup>93</sup> Valuable though these may be, they will not rival the big ticket items that have characterised the spectacular growth in New Zealand exports to Korea to date.
- <sup>94</sup> It is particularly important to ensure that immigration work is placed on a structured foundation. Koreans regard immigration as an indication of a country’s interest in them as potential contributors to a foreign economy and society. Inadequate facilities for processing their papers are regarded as quite improper.
- <sup>95</sup> Koreans and a range of other states take a broad view of foreign relations. To them, all facets of government-backed foreign activity are part of that government’s foreign policy. The New Zealand Immigration Service and the New Zealand Tourism Board are expressions of the New Zealand government’s overseas presentation. Thus, the

departure or downsizing of what is *perceived* as an official operation is seen by Koreans as a reduction in our commitment to Korea. To explain to Koreans the structures and distinctions involved in the New Zealand operation only serves, in the author's view, to demonstrate the gap that can exist between the rhetoric and the reality of the two cultures. Bilaterally, Koreans look to commitment to the long term and demonstrable performance to back it.

<sup>96</sup> Take the example of Australia. In 1997 Australia became the third major destination for Koreans studying abroad after the USA and Japan, and Korea was the largest source of overseas students studying in Australia. Korean students paid \$A350 million to Australian education suppliers and "probably" a similar amount to live in Australia. There was, however, a downturn in 1998 following the 1997 financial crisis. East Asia Analytical Unit (May 1999), op. cit., p 130.

<sup>97</sup> President Kim Dae Jung's vision for Korea's future embraces the knowledge economy. This will mean investment being directed to high technology goods and services, particularly information and communication technologies. The most recent OECD survey (OECD [1996] *The Knowledge Based Economy*, OECD Document OCDE/GD(96)102, Paris: OECD, p 10) states that computers and related equipment are the fastest growing component of tangible investment. Equally important are "more tangible investments in research and development (R&D), the training of the labour force, computer software and technical expertise". Spending on research in the OECD has reached about 2.3% of GDP. The Survey says that education accounts for an average of 12% of OECD government expenditures; investments in job-related training are estimated to be as high as 2.5% of GDP in some countries.

<sup>98</sup> The fact that the bulk of research work in Korea is undertaken by private companies (i.e. the *chaebol*) should be an added incentive to New Zealand's applied research scientists.

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