

Korea's economy: Finding a new momentum

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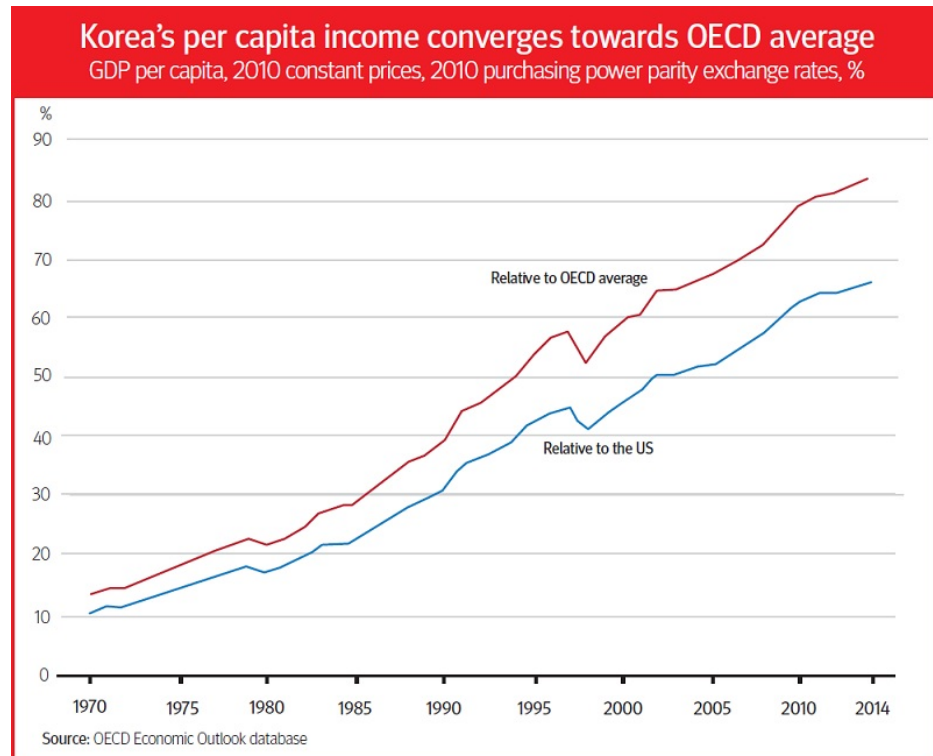


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Korea's transition from one of the poorest countries on earth in the early 1960s to the world's 11th-largest economy and sixth-largest exporter by 2015 is unprecedented.

The high-growth era that began in the early 1960s was supported by: first, an outward-oriented development policy based on the expansion of exports; second, macroeconomic stability; and third, investment in physical and human capital.

I was privileged to watch the early days of the “Miracle on the Han River” while living in Korea from 1974 to 1976; then, per capita income was less than 15% of the US level (adjusted for purchasing power parity). Life expectancy was short: my friends who saw through their 50s were honoured with “a feast at age 60” (환갑잔치). Poverty was accompanied by political repression and martial law.



Returning to Seoul in 1993 to begin preparing the first *OECD Economic Survey of Korea*, I saw a very different country. Rapid industrialisation had made it a major exporter, with per capita income at 37% of the US level, similar to Greece and Portugal at that time. Development was underpinned by education: enrolment rates reached 90% for primary school in 1964, for middle school in 1979 and high school in 1993. In addition to the economic benefits, universal access to primary and secondary education promoted social mobility and income equality. The focus on tertiary education in the 1990s laid the foundation for Korea's success in information technology and the growth of a knowledge-based economy.

Economic development was accompanied by democratisation: the election of President Roh Tae-woo in 1987 was the first democratic transition of power in Korean history. His successor, President Kim Young-sam, Korea's first president without a military background, achieved his goal of leading Korea into the OECD in 1996, a feat that represented the culmination of 35 years of extraordinary growth.

However, less than a year later, Korea was hit by the Asian financial crisis. In November 1997, Korea requested emergency assistance from the IMF to avoid a default on its foreign debt. In early December, the IMF announced a record US\$57 billion agreement with Korea. Nevertheless, the situation continued to deteriorate due to large-scale capital flight, and the Korean won lost nearly half of its value relative to the dollar during the month of December 1997. The survival of Korea's economic miracle appeared to be in jeopardy.

The financial crisis led to a sharp economic downturn. Output fell more than 5% in 1998 and around half of the country's *chaebols* disappeared, including Daewoo, the second largest conglomerate, whose 275 companies manufactured everything from ships to semiconductor chips. The unemployment rate jumped from 2% to 7%, leading to severe hardship in a country with only a rudimentary social safety net. During my visits in 1998, Seoul was covered with signs advertising “IMF” sales, also referred to as “I aM Fired” sales. I was touched by the resilience and patriotism of Koreans. Ordinary citizens lined up to turn in their personal holdings of gold—even wedding bands—to help the country overcome the financial crisis.

The 1997 crisis was a result of a number of structural weaknesses that had developed during the high-growth era. As noted in the *OECD Economic Survey of Korea* in 2000, Korea had been “deficient in developing the rules and principles of a market economy, failing to implement structural reform policies consistent with the changes in the international environment”. Two such weaknesses appear to have been fundamental: the low levels of profitability and high levels of debt in the corporate sector, reflecting the tendency of the business conglomerates to diversify across a wide range of industries; and a poorly-functioning financial system that followed government, rather than market, direction in allocating capital, as well as having poor credit analysis and internal risk control mechanisms.

Following the old saying “never waste a crisis”, the Korean authorities set out to address these weaknesses, with the OECD providing support. For instance, our annual *OECD Economic Surveys of Korea* over 1998-2001 helped by focusing on reforms to improve the corporate sector and the financial system, as well as the labour market. These policies laid the foundation for renewed growth, which averaged some 4.3% per year during 2001-11.

Since 2011, however, the annual output growth has slowed, in part reflecting a more morose global picture, to 2.8%, leaving per capita income at around 64% of the US level. Domestic problems shared the blame. The current president, Park Geun-hye, stated in 2014 that there would be “no future for us, unless we break the protracted cycle of low growth by changing the fundamentals of our economy”. Sustained output growth is necessary to further raise living standards, deal with the cost of possible rapprochement with North Korea and cope with population ageing, which is projected to be the fastest in the OECD.

Slowing growth suggests that Korea's traditional growth model, based on exports produced primarily by *chaebols*, has become less effective . The OECD is supporting the government's objective of fostering a “creative economy” by shifting Korea's economic paradigm to one based

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on innovation in which new start-ups and the service sector play a more central role.

As stressed in the 2016 OECD *Economic Survey of Korea*, converging to productivity levels in the most advanced countries requires narrowing productivity gaps between manufacturing and services, and between large and small firms. This, in turn, depends on improving framework conditions through regulatory reform, greater integration in the world economy, and enhanced labour flexibility. Changing the government's role from that of coach to referee is necessary to promote a creative economy.

Star export: K-pop icon Psy enthralled a lively crowd. The billion-dollar Korean pop music industry has been dubbed "Korea's greatest export" by Time magazine.



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An essential goal is to ensure that growth is inclusive. One of the hallmarks of Korea's high-growth era was a relatively low level of inequality, but its performance in this regard has weakened. Indeed, inequality has risen significantly and Korea's relative poverty rate is the eighth highest in the OECD area, reflecting wide wage gaps between regular and non-regular workers, who account for a third of employment and earn only 64% as much per hour as regular workers. Breaking down labour market dualism and addressing the large productivity gaps between services and manufacturing, and between large and small firms, would be sure steps to promote more social cohesion.

Quite simply, after rapid economic development, Korea now needs to focus more on well-being. Its work-life balance is undermined by working hours that are the

longest in the OECD area. In particular, Korea must reverse the environmental degradation that accompanied rapid industrialisation in order to improve the quality of life.

My 40-year experience of Korea leaves me optimistic that the country will overcome these challenges. Korea's most important resource is its people, which are outstanding in so many ways. I look forward to continued collaboration with Korea and to celebrating further progress over the next 20 years.

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References

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