Economic Performance in Post-Crisis Korea: A Critical Perspective on Neoliberal Restructuring

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This paper evaluates the neoliberal economic restructuring process implemented in Korea following the 1997 Asian financial crisis. We first argue that the austerity macroeconomic policy of late 1997 and early 1998 was the main cause of the economic collapse in 1998, and that the decision of the IMF and President Kim Dae Jung to impose a radical neoliberal transformation of financial markets and large industrial firms in the depressed conditions of 1998, though defensible on political grounds, made the failure of these reforms virtually inevitable. A detailed analysis of the macro economy, labor markets, financial markets, and nonfinancial firms in Korea in the past three and one-half years shows that neoliberal restructuring has created a vicious cycle in which a perpetually weak financial sector fails to provide the capital needed for real sector growth, investment and financial robustness, while real sector financial fragility continuously weakens financial firms. Neoliberal policies may have pushed Korea onto a low-investment, low-growth, development path, one with rising insecurity and inequality. Meanwhile, the removal of virtually all restrictions on cross-border capital flows has led to a dramatic increase in the influence of foreign capital in Korea's economy. The paper concludes by arguing that Korea should reject radical neoliberal restructuring and instead adopt reforms designed to democratize and modernize its traditional state-guided growth model.

Keywords: Globalization, Korean crisis, Neoliberalism, Economic restructuring, Korean economic model.

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I. The Radical Neoliberal Restructuring of Korea's Economy: Background

In the mid 1990s, a vast inflow of short-term foreign loans fueled an investment-led boom in Korea.[1] The boom created excesses of various kinds, which, exacerbated by the financial crisis that broke out in Southeast Asia in July of 1997, became apparent to foreign banks toward the end of 1997. They demanded immediate repayment of their loans, which had been used primarily to finance long-term investment projects. Already suffering the ill effects of the crisis, Korean firms were unable to repay their local banks on demand; domestic banks were thus in no position to repay foreign banks. Pushed to the verge of default, Korea accepted an International Monetary Fund (IMF) loan to repay foreign debt in return for effective IMF control of Korean economic policy. In December 1997, the IMF ordered the Korean government to impose austerity macro policy on the country in what was later explained to have been a failed attempt to restore foreign investor confidence.[2] Interest rates were boosted to 30% and fiscal policy was tightened in the first half of 1998. These policy shifts were followed by precipitous economic decline and financial collapse. Simultaneously, the IMF ordered President-elect Kim Dae Jung to drastically accelerate the transition of the Korean economy from its traditional East Asian, state-guided development model to a neoliberal model — like the US and UK. Under neoliberal restructuring, the Korean economy rebounded from its 1998 collapse faster than expected. After falling near 7% in 1998, real GDP growth was almost 11% in 1999 and near 9% in 2000. Supporters of neoliberalism declared Korea's rebound a "miracle." For example, The Asian Development Bank (2000) described Korea's "economic recovery and financial stabilization" following the crash of 1998 as "remarkable."

These facts are not in dispute, but there is an ongoing debate about the causes and consequences of the crisis. Everyone agrees that by the mid-1990s serious flaws had evolved in Korea's

[1]Foreign short-term credit, which stood at $12 billion in 1993, rose to $32 billion in 1994, $47 billion in 1995, and $67 billion in 1996.

[2]As Stanley Fischer (2001, p. 6), Managing Director of the IMF at the time, put it in his farewell speech upon leaving his position: "our initial judgment on fiscal policy was faulty."

economic system, and that these flaws caused or at least permitted the imbalances that led to the 1997 crisis. Supporters of neo-liberalism argue that these flaws are built into, or *inherent* in, every possible form of state-led growth model.[3] The ever-evolving Korean development model built an economic record that remains the envy of the developing world — though its political system was authoritarian, repressive, and brutal. Over the 35 years ending in 1996, Korea had an annual average real GDP growth rate of about 8%, while real wages grew by more than 7% a year, one of the best development records in world history. Nevertheless, when the crisis broke out, its state-led growth model was suddenly declared to be non-reformable in principle, even by Western economists who had lavishly praised it right through 1996. There was no choice, then, but to replace it with the only economic model thought to be viable in the new era, a lightly regulated, globally integrated, free market economy. This belief is often summarized by the acronym TINA — There Is No Alternative (to neoliberalism) (Korea Development Institute (KDI) 1999; Greenspan 1999; Brittain 1997; Hahm and Mishkin 2000; and Borenstein and Lee 1999). Fortunately, the sole viable model is also believed to be quite efficient, capable of bringing prosperity and stability to Korea in a reasonable period of time. In this view, the 1997 crisis was a blessing. *It created a political environment in which radical neoliberal restructuring could be forced on a Korean population who would never have accepted it in the absence of the economic and political chaos created by the crisis*. The unexpected vigor of the rebound in 1999 and 2000 is seen as proof that neoliberal restructuring is the right path for Korea and, by implication at least, that TINA encapsulates the "truth" about economic development strategy.

There is an alternative position, to which we subscribe (Crotty and Dymski 1998a; Chang 1998; Chang *et al.* 1998; UNCTAD 1998; Wade 1998; Stiglitz 1998; Radelet and Sachs 1998; and Furman and Stiglitz 1998). It acknowledges that serious economic problems arose in the 1990s, but has a different view of their roots. The 1990s saw rising *external pressure* in support of

[3]It is often acknowledged that in the earliest years of development, a state-led growth model may be effective if it is market friendly and helps compensate for immaturities in the country's market system. However, in mainstream doctrine, its inherent inefficiencies appear as soon as a medium level of development is attained.

liberalization from the IMF, G7 governments, and multinational firms and banks, who wanted their piece of the Korean "miracle," and rising *internal pressure* from the powerful enterprise groups know as chaebol and from wealthy Korean families, who wanted to pursue their self-interest free of government restraint. There was also a gradual ideological shift towards liberalism among key government bureaucrats. In the decade preceding the crisis, this coalition induced the government to abandon or weaken economic control mechanisms that were central to the efficiency of the Korea state-led growth model. Chang and Evans (1999, p. 29) argue that "the dismantling of the development state was effectively finished by … 1995."

We believe that the external crisis resulted primarily from inappropriate acts of liberalization from the late 1980s through the mid-1990s, not from flaws inherent in all state-led growth models. In this period, the state ended its control of chaebol investment decisions, substantially reduced regulation of domestic financial markets, and liberalized short-term capital flows, eliminating three major tools of state economic regulation. Ill-advised liberalization was a precondition for the rapid inflow of short-term foreign loans from 1994-7 that financed excessive investment, and for the mass capital flight of late 1997 and 1998 that brought Korea to its knees (Chang *et al.* 1998; Cho 2000; and Lee *et al.* 2000).[4] As Nobel Prize winning economist Joseph Stiglitz put it: "Many of the problems these countries face today arise not because governments did too much, but because they did too little — and because they themselves had deviated from the policies that had proved so successful over preceding decades" (*Wall Street Journal* February 4, 1998). The key difference from the neoliberal perspective then is that the mid-1990s flaws in Korea's economic model are here seen as *contingent* — and thus potentially repairable through reform. We agree with those progressive Korean economists who argue that a radical transformation of the traditional model was desperately needed — for political or democratic as well as economic reasons. But we also believe that in the absence of the destructive liberalization of the 1990s, Korea would have experienced the after effects of a serious bout of debt financed over-investment by chaebol

[4]The elimination of controls on short-term foreign bank loans was the proximate cause of the Korean crisis.

firms, but *not* a severe *external* crisis in 1997 nor a virtual foreign takeover in 1998.

TINA is an ideological slogan. *There is always more than one viable economic development path.* We believe that in late 1997 and early 1998 the Korean people could have chosen to radically modernize and democratize their traditional state-guided model, repairing the most serious of its flaws, and that the majority of Koreans would have been better off in both the short and long run if they had done so. *No country has ever undergone a successful long-term development process incorporating the majority of its people by following a neoliberal path.* As we demonstrate below, the neoliberal restructuring of the past three and one-half years has badly damaged Korea's economy, not restored it to health. A reformed state-led model could hardly have performed more poorly. Letting the state set the broad contours of development obviously does not guarantee success. Nevertheless, every post World War II development success story, whether in Latin America in the 1950s through the 1970s, or in Asia in the last several decades, has been state-led. Neoliberalism conquered in 1997-8 not because there were no alternatives, and not because it was demonstrably more likely than alternative paths to deliver prosperity to the majority of Koreans, but because its supporters were able to use the crisis to grab the reigns of political power.

The crisis put the neoliberal IMF in charge of economic policy. The core of the IMF program for Korea was the immediate implementation of severely restrictive macro policy, followed quickly by the radical transformation of Korea's traditional industrial, labor-relations, and financial structures into a neoliberal mode, a system-shaking process intended to take but a few years time. Following on the heels of the crisis of 1997, the imposition of austerity macro policy was certain to trigger an economic collapse. The rate of decline of the won accelerated as soon as these policies were announced.[5] When the crisis broke out in late 1997, the appropriate macro policy response would have been expansionary budgets, low interest rates, and the maintenance of a supply of credit adequate to maintain moderate growth in demand. Such a

[5]"The IMF programs, rather than inspiring confidence, seem to gave accelerated the flight of currency from the region" (Radelet and Sachs 1998, p. 29).

policy would have avoided an economic and financial collapse and, in so doing, reduced investor pressure to flee Korea (Radelet and Sachs 1998; and Sachs 1997). This is the typical policy response of developed country governments in such situations, as well as the approach taken by Korean governments in all previous crises.[6]

The IMF and Kim Dae Jung knew at the time of its imposition that austerity macro policy would have disastrous consequences; *they had to know because everyone else did.* Severe criticism of this policy was widespread. The *Wall Street Journal* (January 8, 1998) reported that Joseph Stiglitz and other "prominent Wall Street economists," were "wondering aloud whether the IMF is prescribing too much austerity." Jeffrey Sachs attacked the IMF program, calling it "folly" and an "indiscriminate punishment" of Korea. He argued that "the IMF's seal of approval is a seal of doom" (*New York Times* Dec. 12, 1997) and that the IMF was squeezing Korea so that foreign lenders could "leave the field of battle unscathed." "Looking back," he said, "it's hard to imagine that the Korean won could have fallen any further if the IMF had punished the lenders rather than the borrowers" (*New York Times* January 8, 1998). Paul Krugman suggested that default would have been better than the IMF program (*New York Times* Dec. 18, 1997).

The decision to implement the radical restructuring of Korea's industrial corporations and financial institutions *in the midst of an economic and financial collapse* cannot be justified on economic efficiency grounds. It is impossible to identify and eliminate weak and inefficient firms and banks when almost every firm and bank faces insolvency and the entire price-profit system is in chaos. Its rationale must have been *political*. We believe that the sharp rise in unemployment in 1998-9 was *deliberately* created by austerity macroeconomic policies in late 1997 and early 1998 to sweep away domestic political barriers to the radical restructuring efforts of the IMF and President Kim Dae Jung. If the neoliberal powers had tried to impose their free-market revolution in more normal times, they would have met determined political resistance from labor,

[6]Consider, for example, that US Fed Chairman Alan Greenspan slashed interest rates in reaction to the US recession and bank credit crunch of the early 1990s. Paul Krugman observed that "policy makers in Washington and bankers in New York often seem to prescribe for other countries the kind of root-canal economics that we would never tolerate here in the U.S.A." (*New York Times* July 18, 2001).

large segments of the Korean people, and even some sectors of the business community. This is *the paradox of neoliberal revolution*: efficient restructuring, whether defined within or outside the neoliberal paradigm, requires a semblance of economic normalcy. But neoliberal policies are so contrary to the perceived interests of the majority of the population, particularly in the years immediately following their implementation, that they are extremely politically unpopular.[7] Thus, *neoliberalism cannot be achieved through normal democratic processes in normal economic times*. Only in times of crisis and chaos, when a panicked public can be led to believe that failure to accept IMF dictates would be even more disastrous than their implementation, is it possible for neoliberalism to conquer. According to Larry Summers (2001), former Secretary of the Treasury: "Times of financial emergency are time when [outside political] leverage is greatest. Times of financial emergency are often moments when there is the greatest malleability with respect to structural change." The Brookings Institute's Barry Bosworth (1998, p. 83) agrees: The IMF "used the [Asian] crisis to force these countries to adopt its own agenda."

Sensible macro policy could have prevented the financial and economic collapse of 1998, and in so doing, created an environment in which necessary alterations in Korea's economic institutions and practices could have been implemented over an extended period of time without unnecessary transition costs. But it would also have kept radical neoliberal restructuring off the political agenda. This was not the case with reform of the traditional model however. Prior to the crisis, there was substantial agreement among Koreans that the repressive traditional model needed to be thoroughly democratized, and most Koreans understood that the state-economy nexus needed to be modernized in response to changes brought on by its previous successes — though there no consensus about the precise form such change should take. Most Koreans who cast their vote for Kim Dae Jung in the December 1997 presidential election did so in the hope that he would utilize the opportunity presented by the crisis to reduce the excessive

[7]The strength of the potential political backlash to the proposal of neoliberal restructuring in normal times will depend in part on the performance of the economy in the period leading up to the proposal. It will be weakest where economic performance was asysmal prior to the IMF takeover.

political and economic power of the chaebol and deepen democratic rights. They were later shocked to discover that Kim was an enthusiastic supporter of the whole neoliberal project, including austerity macro policy. However, the public should not have been so easily mislead. Strongly influenced by his American protectors and mentors, Kim (1985) had been a committed neoliberal for at least two decades.[8] In a 1985 book titled *Mass-Participatory Economy: A Democratic Alternative for Korea*, written while in residence in the US, he stated that "maximum reliance on the market is the operating principle of my program (p. 78)" and that "world integration is our historic mission (p. 34)." Kim believed that allowing firms and banks from the most developed nations to enter the country would modernize the Korean economy and destroy the ability of the large chaebol to block necessary economic reforms. Foreign investment, he said in 1999, was essential to the successful restructuring of Korean industry and finance, and would be maximized by the "liberalization of the foreign exchange and capital markets" (KDI 1999, p. 138). The crisis and induced economic collapse created conditions in which he could vigorously pursue these goals: "I believe that the crisis will be remembered as a blessing," Kim announced that year, "because it is forcing essential economic changes" (New York Times Feb. 18, 1999).

We will show that almost four years of restructuring have created neither a healthy financial sector nor a profitable industrial sector. Instead, it has triggered a *vicious circle* in which ongoing problems in real-sector firms keep financial institutions perpetually weak, and weak financial institutions are never able to provide industrial firms with the capital they desperately need to invest and grow. Assertions to the contrary notwithstanding, the economic recovery of 1999 and 2000 was imbalanced and unsustainable; it appears to have petered out in late 2000. The economic condition of the majority of the population has deteriorated, as has the position of organized labor. Moreover, rather than "wither away," as neoliberal doctrine prescribes, the Korean state has exercised a higher degree of direct administrative control over the private economy since 1997 than at any time in the past two decades. Foreign capital has

[8]Kim's whole-hearted adoption of neoliberalism may be explained by his desire to punish the chaebol and, perhaps, to erase his earlier 'radical' image in the minds of middle-class voters.

invaded Korea to an extent that would have been unimaginable before the crisis. Inequality has risen significantly, as it does in every country that falls under IMF control. Ominously, the rate of capital accumulation in Korea may well be experiencing a pronounced secular decline.

A complete analysis of the transformation of the Korean economy from an East Asian state-led growth model in the late 1980s to its current status would require: (1) an evaluation of the strengths and weaknesses of the Korean economy as it entered the 1990s; (2) a discussion of the ill-fated liberalization process that led Korea to the brink of crisis in 1997; (3) an analysis of the post-crisis decision-making process that chose austerity macro policy followed immediately by radical neoliberal restructuring in the midst of the ensuing economic collapse; and (4) an analysis of the economic effects of the restructuring process from December 1997 to the present. Such a complete analysis is beyond the scope of this paper. We focus primarily on (4) and, to a lesser extent, on (3). *The main purpose of this paper is to demonstrate that the radical neoliberalization of Korea has been a failure, not a "miracle."* That radical restructuring was introduced in the midst of an economic collapse might be offered by its supporters as an explanation for its failure, but we argue that without the crisis and subsequent collapse, it would not have been implemented at all, and that the IMF understood this and chose to go forward anyway. Those who accept our thesis that the neoliberal path has failed to create a foundation for the future prosperity of the majority of Koreans, as it failed to do in every other developing country where it has been imposed, can move on to the more hopeful debate over the best alternative development model for Korea in the opening phase of the new millennium. It is not possible to adequately address this crucial debate in this paper, though we do make a few pertinent comments in section VII. Interested readers are referred to the concluding section of Crotty and Lee (2001).

The rest of the paper is organized as follows. Section II provides a broad overview of general economic performance since the crisis. The next three sections discuss the impact of restructuring efforts on labor, industrial corporations, and financial institutions. Section VI looks at the rising influence of foreign capital on the Korean economy. The last section sums up our arguments.

II. An Overview of the Korean Economy Since the Crisis

Prior to the outbreak of the crisis, Korea had low inflation and its budget was in surplus. Nevertheless, upon taking control in December 1997, the IMF demanded that the government immediately implement severely restrictive macro policy, including cutbacks in government spending, an increase in taxes, and a substantial rise in interest rates. The interest rate on three-month corporate bonds, which was 12% in November 1997, rose to 30% in early January in the wake of the IMF agreement.[9] The combined effects of the crisis itself, IMF-mandated austerity macro policy, and the corporate and financial sector reforms described in sections IV and V depressed domestic demand. These initial problems triggered a Keynesian "multiplier" process that led to further decline. Initial reductions of investment and government spending, along with rising bankruptcies, created increased unemployment and fear of job loss. These developments induced falling real wages and a collapse of consumer confidence that caused a rapid decline in consumption demand. Falling demand, rising uncertainty and high interest rates further reduced investment. Collapsing business conditions led to ever-higher loan defaults, which led to a contraction of the credit supply. And so on. These depressing effects were all built into the IMF's policy.

The drop in the pace of economic activity in early 1998 was precipitous. In the first quarter of 1998, gross fixed capital formation and household consumption spending dropped 33% and 12% below their fourth quarter 1997 levels. For the year, fixed investment fell by 22% and consumption by 12%. The official

[9]The Organization for Economic Cooperation and Development (OECD) described the IMF macro policy in these terms. "On the monetary policy side, the key objective was to stabilize the exchange rate at a more normal level. This required very high money market rates, which jumped from 12 percent prior to the crisis to 27 percent at the end of 1997," after the IMF agreement. "A more restrictive monetary policy was accompanied by fiscal restraint.··· The balanced budget objective was maintained even though the growth rate projected under the initial IMF programme was more than halved" — a projection which turned out to be extraordinarily over-optimistic. "The initial stance of fiscal policy in 1998 was decidedly contractionary," according to the OECD, "thus compounding the effect on demand of high interest rates" (OECD 1998, pp. 6-7).

TABLE 1

MAJOR MACROECONOMIC INDICES

(%, Billion Dollar)

	1993-5	1996	1997	1998	1999	2000
Real GDP growth rate	7.6	6.8	5.0	-6.7	10.7	8.8
Unemployment rate	2.4	2.0	2.6	6.8	6.3	4.1
CPI growth rate	5.4	4.9	4.5	7.5	0.8	2.3
Trade balance	-1.7	-15.0	-3.2	41.6	28.3	16.6
Equipment investment growth rate	14.1	7.3	-8.7	-38.8	36.3	34.3*
Exchange rate (Won/$) (end of the year)	790	844	1,415	1,207	1,145	1,259
Government balance/GDP	0.35	0.26	-1.5	-4.2	-2.7	1.3
Foreign Reserves	233.7	163.5	8.9	48.5	74.1	96.2
Total foreign debts	896	163.5	159.2	148.7	137.1	136.6

Note: * expected value
Source: Bank of Korea, National Accounts (Various Year)

unemployment rate, which had been 2.0% in 1995 and 1996, was still only 2.1% in October 1997. It rose to 3.1% in December, then leapt to 6.5% by March 1998 on its way to over 8% by year's end as the chaebol took advantage of the IMF-imposed labor law revisions to engage in mass firings (Bank of Korea (BOK) 1998, p. 133).

Of course, with domestic demand and the exchange value of the won in free fall, the balance of trade improved dramatically. Trade in goods was in approximate balance in July through October 1997, then moved into moderate surplus in the last two months of the year as the economy slowed. In the first half of 1998, a $19 billion surplus was created by a collapse of imports. The dollar value of imported goods fell by 36%, or more than $50 billion, in 1998, creating a trade balance of $41.6 billion for the year — *a record 13 percent of GDP*. This enormous improvement in the trade balance was the only thing that kept Korean aggregate demand and employment from total collapse. Real GDP fell only 6.7% for the year, but real final domestic demand fell by 13.8% — or by 19.6% if we include the decline in inventories (OECD 2000a, p.124).

In 1999 and 2000, South Korea's economy recovered faster than anyone expected. Indeed, Korea became the new poster child for the free-market or neoliberal economic restructuring the IMF is peddling to a suspicious public in the developing world. In early 2000 the IMF touted Korea's "dramatic turnaround" after the crisis. Not only had Korea's output surpassed it pre-crisis value, but, the IMF gleefully proclaimed, "over the past two years bold policies and a commitment to reform have made Korea a more open, competitive, and market driven economy" (IMF 2001, pp. 78, 80). It is not hard to assemble evidence in support of the IMF's triumphalist view. Korea's real GDP grew by almost 11% in 1999, and near 9% in 2000. The unemployment rate dipped below 4% in 2000. Continued trade surpluses ($28 billion in 1999 and $17 billion in 2000) helped restore the country's production and employment levels.

A closer look at the data, however, suggests that the recent Korean recovery was not as impressive as neoliberals claim. In 2000, three years after the crisis hit, consumption was only 5% above its pre-crisis level. Rapid growth in Korea from 1961 through 1996 was built on high investment, yet real fixed capital investment in 2000 was still 9% lower than in 1997 largely due to the prolonged collapse of the construction industry. Real machinery and equipment spending for the economy as a whole was 41% and 19% below its 1995-7 average in 1998 and 1999, but in 2000 it rose to 8% above the pre-crisis average. However, in 2000 real equipment investment by large manufacturing firms — the core of Korea's export-led economy — was still 38% below its 1995-7 level (Korea Development Bank (KDB) 2000). Forecasts call for a sharp drop in all investment categories in 2001. This data raises the serious questions of *whether neoliberalism has permanently shifted the Korean economy from a high to a low investment regime.*

High growth in 1999 and 2000 is attributable to large trade surpluses, the rebound of investment and consumption from their collapse in 1998, and a dramatic shift from contractionary to expansionary macro policy after mid-1998 as the government budget shifted into deficit and interest rates fell. The huge trade surplus was central to the recovery. GDP minus net exports of goods and services in 2000 was still 4% below its 1997 level, and gross national income, which adjusts GDP for losses due to terms of trade and cross-border factor payments, was less than 2% higher. Moreover, the terms of trade (which depend on export and import prices and the exchange rate) have moved dramatically against Korea; by July 2001, they had fallen 36% below 1995. This is forcing the country to export ever-larger quantities of goods to pay for any given quantity of imports. The dollar value of exports rose by 41% from 1995 to 2000, but only because the quantity of exported goods rose by 117%. Even if Korea could continue to export its way to acceptable growth rates, which it cannot do, it would make no economic sense to do so in an environment of collapsing terms of trade. BOK data, based on 1995 prices in won, show that in 1993, real exports of goods and services were 25% of real GDP. By 1995 this figure rose to 30%; and in 1997 it was 36%. In the collapse in 1998, export dependence increased dramatically, to 45%. Recovery did nothing to stop this trend. In 2000, the figure rose again to 52%. If both numerator and denominator are measured in current won, the absolute values of this index are lower — for example, the value in 2000 is 38.5% compared to 25% in 1996 — but the trend remains the same. Both series show that export dependence in every year since the crisis is higher than in any year prior to the crisis.[10]

The rebound in 1999 and the first half of 2000 in Korea was stimulated in part by an export boom fueled by the great American stock market bubble that induced massive investment in US high-tech industries. But the collapse of the US boom in mid-2000 dragged down both global growth and Asian export demand, especially in electronic and telecommunication products in which area economies specialize. Korean exports for July and August 2001 were 20% below the previous year's level and in August the current account balance turned negative. By October, exports had declined for eight straight months. They are expected to continue to fall. The radical opening of its economy under neoliberalism has thus put Korea at the mercy of global economic forces completely beyond its control.

Significant fiscal stimulus is also not likely to continue. The government ran a budget surplus from 1993 through 1996, but deficits in 1998 and 1999 of 4.2% and 2.7% of GDP. However, external agencies such as the IMF and the OECD are demanding a return to fiscal and monetary conservatism. In 2000, the Korean

[10]Data used to construct the first series are taken from the Bank of Korea's *Monthly Statistical Bulletin* (2001, pp. 146-7). The difference between the two series is caused by the sharp decline in export prices relative to non-traded domestic goods prices since 1995 ad the terms of trade turned against Korea.

government actually ran a budget surplus in excess of one percent of the country's GDP, though it shifted into deficit once again in response to the slowdown in early 2001. Since Korea's broadly defined public debt rose from 17% to 39% of GDP in the three years following the crisis, the government may not in position to provide adequate fiscal stimulus program in the coming years.

The recovery appears to have ended in late 2000. GDP growth slowed dramatically in the year's fourth quarter, and was only 3.7% in the first quarter of 2001 and 2.7% in the second quarter. Total fixed investment fell by 3.7% in the opening quarter of 2001 and 7.6% in the second quarter from year-ago levels. Investment in machinery and other equipment, which had been growing rapidly, slowed in the late 2000, then fell at an 8% annual rate in the first quarter of 2001 and at an 11% rate in the second quarter. A survey of the top 400 firms taken in July forecast a decline in investment spending of 9.3% for 2001 (*Chosunilbo* July 18, 2001), reinforcing concerns about a possible permanent decline in the rate of capital accumulation. Consumption grew at an annual rate of just 0.4% in the first quarter of 2001 before rising by 2.9% in the second quarter. The unemployment rate rose well above 4% in early 2001; it then declined in the summer in response to emergency fiscal stimulus. It will rise again soon. The consensus forecast for real GDP growth in 2001 is between 1.5% and 2.5%, which would be the lowest growth rate in near two decades, 1998 excepted.

Meanwhile, Korea, a country proud of its tradition of social solidarity, is discovering that there are no exceptions to the iron rule that neoliberalism generates rising inequality everywhere. Not only was real household income in mid-2000 still below its 1997 value, but the Gini coefficient, which equaled 0.28 in 1997, reached 0.32 three years later, and the ratio of the income of the highest quintile of households to that of the lowest quintile rose by 16 percent from 1997 to 2000. Table 2 shows that real income for the top 20 percent of urban households, after standing still in 1998, increased substantially in 1999 and 2000, ending up 12.5% above its pre-crisis level. The majority of households fared worse, with the incomes of the bottom 40% declining significantly. The poorest fifth suffered income losses relative to 1997 of 17%, 13%, and 5% in 1998, 1999, and 2000. Not surprisingly, poverty has also worsened since the crisis. The household poverty rate, which stood at 5% in

TABLE 2

TRENDS IN INCOME FOR DIFFERENT INCOME GROUPS

(Won, %)

	1997	1998	1999	2000	Rate of Change (1997-2000)
Top 20%	4,254,829	4,243,950	4,475,049	4,786,279	12.5%
60-80%	2,653,761	2,440,219	2,541,984	2,704,911	1.9%
40-60%	2,028,062	1,827,226	1,885,134	2,029,242	0 %
20-40%	1,551,587	1,368,326	1,404,109	1,512,804	-2.6%
Bottom 20%	947,097	784,086	815,551	899,183	-5.1%

Note: Recalculated on the basis of KOSIS data
Source: National Statistical Office (NSO) web page

1996, more than tripled by 1999 (Park 1999).

In sum, from the perspective of Autumn 2001, Korea's post crisis economic performance appears decidedly non-miraculous.

III. Restructuring Labor

A. Policy

In January 1998, the main obstacle to the IMF-Kim plan to create a neoliberal economy in Korea was a militant labor movement whose power was sustained in part by 'rigid' labor laws and the permanent full employment achieved under the traditional model. *Breaking the strength of the labor movement thus became a central IMF-Kim policy goal.* President-elect Kim was determined to raise competitive pressure on chaebol firms through massive foreign investment. The defeat of labor was understood to be a precondition for large-scale FDI. The large chaebol believed that the biggest obstacle to their development as world-class multinationals was not intense foreign competition or weak global markets or crushing debt burdens, but the excessive power of Korean unions and their inability to fire workers as they pleased.

Capital-labor conflict over the flexibility issue was at a temporary standoff after the general strike in January 1997. This changed dramatically in early 1998 as labor received two severe blows. First, the IMF austerity policy sent an already weak economy into free-fall. The number of unemployed tripled from 1997 to mid 1998 in an economy in which permanent full employment had been taken for granted.[11] The sudden, unexpected creation of a "reserve army" of unemployed terrified most workers and disoriented union leaders. Second, with labor reeling from the explosion of job insecurity, the IMF, with the enthusiastic support of Korea's most powerful business leaders, demanded that the government immediately repeal the traditional labor laws protecting job security, as its agreement specified.[12]

The December 17, 1997 issue of the *Korea Herald* reported that the Minister of Labor predicted a doubling of unemployment from its already high level, and quotes a consensus forecast by private-sector economists that unemployment would triple to over two million. The January 17, 1998 edition of the *New York Times* predicted that Korean unemployment would reach 10%. In the first week in January, the *Korea Herald* (Jan. 7, 1998) quoted Kim Dae Jung saying that "mass redundancies should go ahead because without them, foreign investors will not come to Korea." A headline in the *Korea Herald* of January 9, 1998 reflected the position of the chaebol: "Employers Call for Expansion of Massive Layoff Plan." In February 1998, *Business* Week (Feb. 16, 1998, 54) ran a story on Korea titled "Sky-high interest rates could crush the whole economy." We stress the fact that everyone — including Kim Dae Jung and the IMF — knew in advance that the IMF's austerity macro policy would cause a dramatic rise in unemployment because it supports our thesis that mass unemployment was an essential component of the restructuring plan. *Without mass unemployment and fear of job loss, union power could not be broken, the chaebol could not be forced to restructure, and there*

[11]The rate of unemployment was 2.1% in October 1997, but rose to 8.6% by February 1999.

[12]In the election campaign, Kim Dae-Jung strongly opposed mass layoffs in response to the crisis. He promised to renegotiate a better deal with the IMF. However, he subsequently accepted the existing IMF deal. "During the campaign, Mr. Kim attacked the IMF agreement, in part because it would lead to takeovers of Korean firms... But on Dec. 19, the day after he was elected, Mr. Kim embraced the IMF plan: 'I will boldly open the market. I Will make it so that foreign investors can invest with confidence'" (*New York Times* Dec. 27, 1997, 1). In late December, 10,000 KCTU members attended a meeting in Seoul to protest President-elect Kim's rejection of his campaign pledge to ban mass layoffs.

would be no boom in foreign investment.

The Kim government took the public position that, since great sacrifice would be required all Koreans in this time of national crisis, tough decisions should be arrived at by consensus. Toward this end, it created a "tripartite committee" in January 1998. The government's stated intention was to model this committee on European corporatist institutions. However, this would have required government and business to accept labor as a genuine partner in decision making, a step they were not prepared to take. Representatives of capital, the state, and the government-allied Federation of Korean Trade Unions (FKTU) pressured delegates from the more militant and independent Korean Confederation of Trade Unions (KCTU) to agree to the labor law changes, arguing that the crisis made their passage inevitable, and that concessions (such as granting permission for union officials to run for public office, and giving teachers and government workers the right to unionize), could be extracted in the context of the tripartite committee. KCTU representatives eventually conceded. The KCTU rank and file immediately "reneged on its leaders initial approval of the pact, after a majority of member unions rejected it" (*Wall Street Journal* Feb. 11, 1998). They insisted that all aspects of restructuring, including those affecting the financial and public sectors, be included in tripartite decisions, and that labor representatives be given real, not just symbolic, influence. When the government refused their demands, the KCTU withdrew from the committee and tried to organize general strikes in the May-June period.[13]

The new capital-friendly labor laws were enacted in February 1998. For the first time in modern Korean history, firms were allowed to fire as many workers as they pleased in cases declared to be of "urgent managerial need" — which included all mergers and acquisitions. Moreover, temporary help agencies became legal after July 1998. By the end of the year, 789 such agencies had been established, employing a total of 42,000 temporary workers, who were allowed to join firms for up to 2 years and could be used in all occupations (KDI 1999).

[13]The KCTU charged that the Tripartite Commission was "never contemplated by the government as a forum empowered to set the basic framework for restructuring··· [but rather] as a convenient excuse for the government to avoid and deny direct negotiation and consultation between the government and trade unions" (KCTU 2001, p. 33).

The government acknowledged that restructuring would significantly raise unemployment and the incidence of poverty over the next few years, and indeed that workers' economic insecurity would remain high even after the new economic model was fully in place. The tradition whereby large firms offered lifetime employment to their key employees was out; from now on all workers could expect to hold a series of different jobs, with bouts of unemployment in between. In January 1998, President-elect Kim argued that, given the mass unemployment that would inevitably follow austerity macro policy, "we have no option but [to pledge] to install a US-style safety net in the form of unemployment insurance and retraining programs" (*New York Times* Jan. 18, 98). Social spending did increase substantially after the crisis. Total public spending on welfare programs including unemployment insurance was 3.7 trillion won in 1996 and 4.2 trillion won in 1997, but rose to 5.6 trillion won in 2000 (KDI 1999; and OECD 1999). Unfortunately, the level of income protection for most workers is still woefully inadequate. A 2000 OECD report on Korean labor and welfare policies reported that only one in nine unemployed workers receive unemployment benefits, such benefits amount to but 50% of the previous wage, and the maximum duration of benefits is three to eight months. Moreover, only a quarter of those of retirement age receive a pension of any kind, while the average pension is about two to three US dollars per day (Adema, Tergeist and Torres 2000).

However, the government will never be able to create a welfare system generous enough to assure economic security to all Koreans in the wake of neoliberal restructuring. Given the enormous cost of such a system and the ever-tighter constraint on government budgets, this promise cannot be kept. Total social welfare spending as a percent of GDP did rise after the crisis — from 6.8% in 1997 to over 7.5% in 1999 — as unemployment, poverty, and homelessness increased (Koh, 1999; and NSO website) Even under these dire circumstances, however, Korea's welfare spending came nowhere near the US level of 15% of GDP, never mind Western European levels well in excess of 20% of GDP (Martin and Torres 2000).

B. Results

Table 3 presents a number of important indices of labor market

TABLE 3

MAJOR LABOR MARKETS INDICES (ALL SECTORS)

(%)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Labor force participation rate	60.6	60.9	61.1	61.7	61.9	62.0	62.2	60.7	60.5	60.7
Unemployment rate	2.3	2.4	2.8	2.4	2.0	2.0	2.6	6.8	6.3	4.1
Productivity growth	13.8	11.1	8.8	9.4	10.3	12.5	14.9	11.8	15.98	10.7
Real wage growth	8.2	9.0	7.4	6.4	6.7	7.0	2.5	-10.0	11.2	5.7

Source: Ministry of Finance and Economy, National Statistical Office

performance in the period following the crisis. Unemployment soared in 1998, peaked in early 1999 at 8.6% of the workforce, then fell to under 4% in 2000, before rising above 4% again late in the year. If the increase in those unemployed is added to the number of workers who dropped out of the workforce between 1997 and 1999, we get a total more than six times the number unemployed in 1997 (KCTU 2001, p. 34). In the face of rapidly rising unemployment, real wages fell by 10% in 1998, and though they increased significantly in 1999 and modestly (by Korean standards) in 2000, their growth rate in these years was well below the rate of growth of productivity. With real wages rising more slowly than productivity, labor's share of national income fell from 62.8% in 1997 to 61.3% in 1998 and 59.8% in 1999 (BOK, National Accounts).

Even prior to the crisis, Korea was the only OECD country with near half (46%) of those who worked for a non-family member in the insecure and poorly treated status called non-regular or non-permanent. (OECD 2000a, p. 174; and Martin and Torres 2000). Thus, there was significant 'flexibility' in Korea's total workforce before the crisis, if not in the union strongholds in many large-chaebol firms. Table 4 shows the impact of the IMF-Kim policies on work status. From 1992 to 1996, between 57% and 59% of Korean workers had permanent job status. But in the context of collapsing sales in 1998, the chaebol were able to take immediate advantage of the new laws by firing large numbers of permanent workers in 1998 and early 1999, then hiring mostly

TABLE 4
LABOR MARKET STRUCTURE

(%)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Permanent workers	55.2	57.0	58.8	57.9	58.1	56.7	54.1	53.0	48.4	47.6
Temporary workers	28.7	27.7	26.6	27.8	27.7	29.5	31.6	32.8	33.4	34.3
Daily	16.1	15.3	14.6	14.4	14.2	13.8	14.3	14.2	18.3	18.1

Source: National Statistical Office, Survey on Employment Trend, Monthly Report on Economically Active Population Survey

cheaper, non-union, temporary workers when demand improved in 1999 and 2000. Their actions pushed the percent of permanent workers down to just above 48% in 1999 and just below 48% in 2000.[14] 70% of female employees had irregular status in 2000, compared to 57% in 1995.[15] Crisis and restructuring cut about nine percentage points from the permanent worker category, spreading job insecurity ever more widely.

Moreover, Koreans have traditionally worked very long hours. In 1999, the Korean manufacturing work year totaled 2760 hours, second in the OECD only to Turkey. The manufacturing workweek, at 50 hours in 1999, was seventh longest among the 75 countries covered by International Labor Organization data (ILO 1999).[16] The collapse in 1998 brought almost no reduction in hours even though the labor movement demanded that workers be allowed to share the pain of the crisis through reduced hours rather than high unemployment. And the economic rebound in 1999 and 2000 brought no relief, as hours worked met or exceeded their decade

[14]The OECD reports that in 1999 "less than 30% of [Korea] workers had a permanent (*i.e.*, open-ended) contract··· the lowest number [sic] of workers holding a permanent job in the OECD" (Adema, Tergeist and Torres 2000).

[15]Women suffer multiple forms of employment discrimination. About 70% of working women are employed at establishments with 5 or fewer workers; they receive on average about 63% of male wages (KCTU 2001, p. 38).

[16]The countries with greater work hours per week than Korea were all relatively poor: Jordan (58.3 hours in 1995), Egypt (57 hours in 1996), Sudan (56.1 hours in 1992), Sri Lanka (54.7 hours in 1998), Makau (51.8 hours in 1998), and Turkey (51.2 hours in 1998) (ILO 1999). The *New York Times* of June 10, 2001 reported that the Korean workweek, at 55.1 hours, was the longest of 31 countries surveyed. For comparison, both China and the US have workweeks of 42.4 hours.

highs.

The KCTU tried again and again to organize resistance to anti-labor restructuring policies. After 1997, several indices of strike activity rose significantly above their levels in the mid 1990s. For example, in 1997 there were 78 strikes, while in 1998, 1999 and 2000 the numbers were 129, 198 and 238 respectively. 1997 saw 445,000 workdays lost to strikes, but this jumped to 1,452,000 and 1,366,000 in 1998 and 1999. But it faced several strong road-blocks. The country was in near depression conditions in 1998 and the labor movement was split — between the militant KCTU and the conservative FKTU, and between the highly unionized permanent workforce and the ever-increasing numbers of hard-to-organize non-permanent workers. The media was solidly against them, the middle class feared that labor struggles would worsen the crisis, and the student movement was all but dead. In addition, Korea's harsh labor laws, which prohibit industrial unions, made it very difficult to organize coordinated strikes. For these reasons, the KCTU's efforts to organize effective mass resistance to neoliberal restructuring since 1998 have, to this point, been a failure.

To make matters worse, President Kim responded to serious labor activism in the same general fashion as his military predecessors, though with less physical brutality. Strikes against mass layoffs or restructuring are always declared to be illegal, immediately trigger arrest warrants for key union leaders, and often unleash brutal police repression against strikers. Whereas 35 labor leaders were arrested in 1997, 429 arrests were made in the three years that followed (KCTU web site). In April 2001, police attacked union members demanding access to their office at a Daewoo Motor factory. Even the conservative *Korea Times* (April 17, 2001) deplored the scenes of "bloodied unionists being viciously attacked by riot police," and the conservative opposition political party called for the resignation of the government's Prime Minister. When the KCTU organized a coordinated series of strikes in June 2001 that affected 50,000 workers, the government ordered the arrest of most KCTU leaders, including Chairman Dan Byong-Ho, and riot police assaulted strikers, often viciously. The *Korea Herald* (June 11, 2001) lectured President Kim: "The government should stop regarding striking workers as targets of suppression⋯; it was not pleasing to see the government mobilize the police as soon as requested by businesses to do so." As of July 12, 168 workers had been arrested in 2001, almost 50% more than in all of 2000 (KCTU web site).

On June 5, 2001, the KCTU submitted a formal complaint to the International Labor Organization charging the Kim government with serious violations of the fundamental rights of Korea's workers. "The Kim Dae Jung regime has created an ideological climate in which 'restructuring' is accepted as an "absolute good," it argues; "the struggles and efforts of workers in response to issues of restructuring are branded as sabotage of the 'national effort to overcome economic crisis'" (KCTU website). The indictment continues: "The natural extension of 'labour exclusion' inherent in the neoliberal regime is repression. In July the KCTU called for "the resignation of the Kim Dae Jung regime responsible for the destruction of people's lives, misdirected reform, and environmental degradation" (KCTU website July 1, 2001). In response to constant government harassment of unionists, Amnesty International urged "the government of President Kim Dae-Jung not to arrest trade unionists for legitimate trade union activities" (April 22, 1999 statement; KCTU website). The OECD seems in general agreement with the KCTU's assessment of government-labor relations. "Arresting and imprisoning workers for what might be considered legitimate trade union practices is back in vogue, a matter of considerable concern both at the OECD and the International Labor Organization. The arrests are… a threat to the exercise of fundamental workers' rights" (Adema, Tergeist and Torres, 2000).

From the perspective of capital and the state, labor market restructuring has been quite successful, though they will not be fully satisfied until there is unlimited labor flexibility. Large chaebol firms have cut employment, substituted non-regular, non-union workers for permanent workers, and raised productivity significantly. Labor cost as a percent of total cost in the capital-intensive manufacturing sector declined from 17.5% in 1996 to 13.4% in 1999, while as a percent of sales revenue, it dropped from 12.9% to 9.8% in the same period. The union movement has been badly weakened, though it is not yet broken — strike and protest activity increased in the spring and summer of 2001. After hesitating in 1998 to see whether the Kim government and the chaebol would make good on their promise to tame Korea's unions, foreign capital poured into Korea in 1999 and 2000. *None of these results would have been possible in the absence of the deliberately created mass* *unemployment of 1998-9.*

Conversely, labor restructuring has taken a terrible toll on Korean workers. Unions represent fewer workers and are unable to adequately protect their members' economic interests. The permanent low unemployment achieved by the traditional Korean model has been replaced by a regime of higher average unemployment with pronounced instability. Job insecurity has increased qualitatively because of higher joblessness and the ongoing shift from permanent to irregular status.

IV. Restructuring Nonfinancial Corporations

A. Policy

The Kim government announced five principles of corporate restructuring whose stated purpose was to break the traditional dominance of the large chaebol conglomerates, introduce greater competitive pressure on chaebol firms, and raise productive efficiency. They were: improved transparency; the end of cross-debt guarantees by conglomerate firms; a drastic and immediate reduction of corporate leverage; chaebol concentration on core businesses; and, in an attempt to weaken founding family control and move toward global shareholder capitalism, greater managerial accountability to minority shareholders. Other objectives added in 1999 included reduced chaebol influence on financial markets and lower cross-shareholding among chaebol firms. The chaebol were to be transformed into more specialized businesses, with efficient corporate governance, and much lower leverage, ultimately monitored and controlled by capital markets. The top chaebol had long dominated Korea's economy. In 1995, value added by the largest 30 chaebol was 16.2% of Korean GDP and 41% of manufacturing value added. They also had gained immense political power, especially in the Kim Young Sam administration. President Kim Dae Jung's attack on the chaebol was extremely popular, earning him approval ratings of 80% in the depressed conditions of 1998.

By virtue of the public monies it injected into the financial system after 1997 to prevent its collapse, the government soon controlled most large banks. It designated one or two banks as lead or main creditor banks for each large chaebol. They were to monitor chaebol activity, control their access to credit, and regulate the use to which credit was put. The government was thus in position to attempt to force structural change on the chaebol.[17] It pressured the top 5 chaebol to drastically reduce their degree of diversification by swapping lines of business. The government ordered chaebol-wide financial statements to increase transparency, and required firms to give as many as half of all seats on the Board of Directors to outsiders. Measures to increase the power of capital markets to control chaebol decision-making were introduced. Creditor banks maintained tight control over many of Korea's largest firms throughout the restructuring process, and the government kept tight control over the main banks; in each case, the mechanism of control was the threat of bankruptcy.[18] The restructuring process thus reflects a paradox. Though President Kim and the IMF espoused the general position that the state was inherently incapable of efficient economic intervention in the current era, *their actions reflect the counter thesis that restructuring is too complex and too important to be left to market forces.* Both the IMF and President Kim called upon the state to accomplish this extraordinarily difficult task.

B. Results

The government's restructuring policy had some success. The top 30 chaebol reduced their average debt-equity ratio. It was 3.9 in 1996; leapt to 5.2 in 1997 as the crisis began, then fell back to 3.8 in 1998. The leverage ratio dropped to 2.2 in 1999. Most of the decline in chaebol debt-equity ratios came about because the denominator rose, through new stock issues, asset sales, and asset

[17]From February to April 1998, 57 heavily indebted chaebol affiliates signed agreements with creditor banks in which they pledged to cut their debt-equity ratios to 200% by the end of 1999, restructure their businesses, and cede veto power over investment spending to the banks (SERI 2000, p. 58).

[18]Threats of credit cutoffs were not idle. In June 1998, creditor banks forced 55 firms into bankruptcy, including 20 firms in the top five 5 chaebol, and 23 companies in the top 6-30 chaebol. After July 1998,twenty smaller chaebol went bankrupt. In mid-1999, in a move designed to show that no chaebol was "too big to fail," Daewoo, the third largest chaebol, was forced into bankruptcy, an event that crippled the bond market. In November 2000, the government ordered the banks to close down 52 more companies.

revaluations. New issues on the Korean Stock Exchange in 1997 were only 3 trillion won, but this rose to 13.5 trillion won in 1998 and 33.5 trillion won in 1999. (SERI 2000, p. 66; and Jang 1999). Whereas the debt of the top 30 chaebol fell by 26% in the two years following the onset of crisis in December 1997, the value of equity rose by 125%. Top-30 chaebol debt stood at 219 trillion won in 1995 and 276 trillion won in 1996. In 2000, the top 30 chaebol had debts of 265 trillion won, significantly less than in 1997, but more in nominal terms than in 1995 and slightly less than in 1996. Combined financial statements for the top chaebol constructed in mid 2001 using the more rigorous accounting standards required by the Financial Supervisory Commission showed that almost all the top chaebol, with the exception of the Samsung and Lotte groups, had sharply rising debt-to-equity ratios in the fiscal year ending March 31, 2001. An examination of the broad nonfinancial corporate sector shows that total debt in 2000 was 23% higher than in 1996, and less than 4% lower than in 1997, its peak year.

Since, on average, corporate debt levels have not experienced a major decline, interest burdens remain high even as interest rates have fallen. For all manufacturing firms, net financial costs as a percent of sales, which averaged 4.2% from 1993-6, rose to 4.9% in 1997, before hitting 6.7% in 1998. The debt burden remained high at 5.4% in 1999, before dropping back to 3.8% in 2000. But all this does is restore the pre-crisis average. In 2000, 29% of manufacturing firms had interest coverage ratios less than one, an 8.1 percentage point rise from a year earlier, an indication that all was not well (*Korea Herald* July 21, 2001). Deteriorating economic conditions in 2001 have likely pushed this ratio much higher.

Contrary to conventional wisdom, which asserts that Korean firms always sacrifice growth for profits, they have always had gross or operating profit shares as high as firms in other countries. For example, from 1990 through 1995, Korean manufacturing firms' operating profit as a percent of sales averaged 7.1%. By this measure, Korean firms' profit share was higher than US firms' share in every one of these years, and higher than Taiwan's in five of the six years (BOK 1997; and Chang and Park 1999). But high leverage, essential for Korea's fast-paced investment spending, kept ordinary profitability low. Looking again at the top 30 chaebol, we find that ordinary profit as a percent of sales traditionally measured two to four percent. The collapse in key export markets in 1996 drove this ratio to 0.2%, and the onset of crisis in 1997 dropped it to minus 0.8%. In the collapse and high interest rates of 1998, net profits were minus 4.5% of sales, but in 1999 the figure rose to 2.5% if we count only the 23 conglomerates that remained in the top 30 from the previous year. If we include the seven new firms added to fill out the top 30 in 1999, the net profit figure was a negative 3.4%. In 2000, top 30 chaebol ordinary profits fell to 0.5% of sales as the economy soured late in the year (Fair Trade Commission 2001).[19]

As Table 5 indicates, ordinary profit as a percent of sales in manufacturing was satisfactory by Korean standards in 1994 and 1995. It fell to 1.0% in the global export slowdown of 1996, then fell again to minus 0.3% and minus 1.8% in 1997 and 1998. 1999 saw a slight rebound to 1.7%, and profitability rose substantially in the first half of 2000. But firms ran up against the sharp drop in the growth rate later in the year, which lowered the annual rate to 1.3%. However, if we exclude Samsung Electronics, whose profits soared with the short-lived semiconductor boom of 2000, *the rest of manufacturing posted only a 0.8% ordinary profit share of sales in 1999 and suffered a negative 0.2% share in 2000* (BOK 2001). The recent global downturn in ITC investment has now battered Samsung Electronics; it is expected to have operating losses in the third quarter of 2001.

The government encouraged a new venture capital industry in information and communications technology (ITC), in part as an alternative to the chaebol-dominated economy. Spurred by exports stimulated by the US boom in ITC investment from 1996 through mid 2000, the new Korean ITC sector grew rapidly. The number of startup ventures increased from 304 in May of 1998 to 10,398 in April of 2001 (Small and Medium Business Administration, Venture Company Statistics) and sector stock prices soared. The government estimated that the share of the venture capital sector would account for 18% of GDP in 2005, up from 4.8% in 1999. However, when massive over-investment and over valued stock market

[19]Ordinary profit is defined as operating profit plus the non-operating balance. Financial costs such as interest payments are the most important component of the non-operating balance; when leverage rates and/or interest rates are high, ordinary profit will be much lower than operating profit.

TABLE 5

PROFITABILITY AND DEBT OF MANUFACTURING SECTOR

(%)

	1994	1995	1996	1997	1998	1999	2000
Operating profit/sales	7.65	8.33	6.54	8.24	6.11	6.62	7.4
Ordinary profit/sales	2.74	3.59	0.98	-0.33	-1.84	1.68	1.3
Net financial costs/sales	-	-	4.3	4.9	6.7	5.4	3.8
Debt ratio	302.5	286.7	317.1	396.3	303.0	214.7	210.6

Source: Bank of Korea, Financial Statement Analysis

burst the US high tech bubble in the second half of 2000, it dragged Korea's venture capital sector and KOSDQ stock prices down with it. Sector firms found themselves cut off from reliable sources of finance and faced with depressed markets. Given that Korea has a highly developed ITC infrastructure and a great deal of technical and managerial talent in this area, it is still possible that ITC will play an important role in Korea's future economic development. But prospects in the short to intermediate run are dim.

Clearly, restructuring has yet to restore even normal profit levels in Korean industry, never mind create a new high-profit regime.

Whereas firms used to rely heavily on external funds to finance their ambitious investment programs, Table 6 shows that 1999 and 2000 saw a dramatic change, as about two thirds of equipment finance was supplied by internal funds. This would appear on the surface to be good news. One of the most profound weaknesses in the neoliberal plan to convert Korea from a state-guided, bank-based model to a capital-market based model as in the US was the dramatic difference between internal funds as a percent of investment spending in the two countries. Internal funds are large enough to finance the lion's share of US investment, and often exceed investment spending.[20] But in Korea, internal funds normally cover only between a third and a quarter of enterprise investment expenditures. For this reason, the proposed rapid conversion of Korea to a capital-market based system of finance seemed bizarre, if not malevolent (Shin 2000).

[20]Indeed, in the last two decades nonfinancial corporations in the US were large net *buyers* of stock, putting enormous quantities of their own funds *into* the market to finance mergers and acquisitions and support their stock price in the face of large sales by stock option holders.

TABLE 6

FINANCING OF EQUIPMENT INVESTMENT IN MANUFACTURING

(%)

	1981-5	1986-90	1991-5	1996	1997	1998	1999	2000
External financing	62.8	66.5	70.4	75.6	76.0	66.4	37.3	30.3
Internal financing	37.2	33.5	29.6	24.4	24.0	33.6	62.7	69.7

Source: Bank of Korea, Analysis on Recent Equipment Investment Behavior

Unfortunately, there has not been a pronounced rise in the net profitability of Korean firms; thus, internal funds appear to have increased in importance *only because investment spending declined substantially*. Total real fixed investment in Korea was 20%, 17%, and 8% *lower* in 1998, 1999, and 2000 than the average level in 1995-7. Real equipment investment in 1998 and 1999 was 41% and 19% lower than the 1995-7 average, but rose 8% above this level in 2000. However, equipment investment fell continuously after October 2000 (NSO web site). The Korean Development Bank's annual survey of equipment investment by large and medium size firms shows that real equipment investment in industry was 35%, 34% and 10% *below* its 1995-7 average in 1998, 1999 and 2000 respectively. For manufacturing, real equipment investment was 60%, 57%, and 38% below the 1995-7 average these same years, and investment in 2001 will be much lower than it was last year (KDB Survey of equipment investment; inflation correction using the producer price index).

Restructuring has thus achieved the goal of increased reliance on internal funds to finance investment not by raising profits but by strangling investment spending. Investment has been crippled by a lack of finance. Profit flows are meager. Credit has been cut off on the supply side by financial market restructuring and blocked on the demand side by the government's mandate that chaebol firms slash their debt-equity ratios. R*estructuring seems to be creating a substantial long-term decline in the rate of capital accumulation in Korea. If so, we can expect real GDP, real wage, and productivity growth rates to fall to a fraction of the levels achieved under the traditional model.*

The Kim government promised to wrest control over the large chaebol away from the owning families. Some progress can be claimed. For example, the forced sale of real and financial assets to outsiders, facilitated by post crisis deregulation, raised foreign ownership of the listed stock of Korea industry dramatically, as we show in section VI. Nevertheless, though some chaebol owners have been removed from power through bankruptcy or equity dilution, most knowledgeable observers believe that insiders remain in control of most of the larger chaebol, a development that has contributed significantly to the collapse in public support for President Kim. While the number of outside directors has risen, they have yet to exercise substantial independent authority.[21] FTC data show that in the top 30 chaebol "ownership concentration has deepened, rather than weakened, since the financial crisis" (*Korea Herald* August 1, 2001). Of course, the oligopolies that chaebol insiders control have been severely weakened by government policy since the crisis, so that the range of choice available to them has narrowed considerably. Few if any attractive options are left. Nevertheless, it would appear that the same insiders are in position to choose among them.

By implementing such a radical restructuring program in concert with austerity macro policy, the government caused the collapse of the economy and a crisis in both the real and financial sectors. This so weakened the chaebol that government threats to drive them into bankruptcy if they did not alter their governance structure increasingly became hollow. After mid 2000, the economy became so fragile that efforts at governance reform took a back seat to fear of a second crisis. *The dilemma for the government is this: since the chaebol still dominate Korea's economy, efforts to force them to alter their governance structure by starving them of the credit they need to survive is as likely to destroy the economy and force a change of government as it is to dislodge the owner-managers.* The severity of this problem recently led the government to relax several important anti-chaebol policies.

[21]A recent study by the Korea Stock Exchange found that "at 465 companies listed on the Korea Stock Exchange, only 66 percent of the outside directors participated in board meetings." Furthermore, "the outside directors of those firms voted affirmatively 99.3 percent of the time for company management decisions" (*Korea Herald* November 30, 2000).

V. Restructuring Financial Markets

A. Policy

In his 1985 book, President Kim stated that "financial markets must be allowed to operate completely free of government interference in credit allocation and interest rate determination" (Kim 1985, p. 44). The implementation of his philosophy would require the complete transformation of the traditional Korean state-guided, bank-based financial system into a capital-market based system — a truly radical undertaking.

The government's immediate restructuring objectives were to drive weak financial institutions from the market, clean up the large volume of non-performing loans (NPLs) generated largely by its own macro policies in early 1998, recapitalize viable financial institutions, apply much stronger prudential regulation to force banks to avoid excessive risk, assign one or two main creditor banks to monitor and control credit allocation to each important chaebol group, and induce foreign banks to take control of much of Korea's banking system in order to modernize its management techniques and raise its profitability (KDI 1999, pp. 87-104). Later, in 2000, the government decided to create huge bank holding companies it hoped would be capable of competing with the most powerful multinational banks in global financial markets.

The severe economic collapse in 1998 left only a few consumer oriented banks viable*; all institutions involved in corporate finance were in desperate shape*. The government was thus required to inject huge amounts of public money into the banking system. It established state-owned corporations called the Korea Asset Management Corporation (KAMCO) and the Korea Deposit Insurance Corporation (KDIC) to clean up the NPLs and strengthen the industry's capital base. Public funds spent on financial restructuring through September 2001 totaled over 150 trillion won — about $128 billion at an exchange rate of 1200 won per dollar — an astounding 29% of 2000 GDP. The process is ongoing: 7.1 trillion won was spent in September 2001 alone. This huge infusion of public capital gave the government control over almost all Korean banks. The de facto nationalization of the banking system in tandem with the main creditor bank policy gave the Kim government immense power over the debt-ridden chaebol: *the* *avowedly neoliberal state had put itself in control of the core of the private economy.*[22]

The government eliminated financial supervisory fragmentation by creating an all-powerful new Financial Supervisory Service (FSS). It then established stricter prudential regulations starting immediately, *in the midst of the economic collapse in 1998*. Insolvent commercial and merchant banks were required for the first time to meet the Bank for International Settlements (BIS) capital adequacy standards, which required that capital must be at least 8% of the full value of total loans. As rising NPLs and the collapse of asset values in the crisis shrank the value of capital and the criteria for classifying loans as nonperforming were tightened significantly, banks were forced to sharply reduce the supply of loans. Similar measures were applied to non-bank financial intermediaries (NBFIs). Banks and NBFIs had no choice but to refuse to renew expiring loans, end new lending, and lay off near 40% of their workers. T*he ill-timed application of the BIS standard dramatically cut credit flows to the business sector.* The FSS also selected 477 financial institutions (out of an original 2,077) to be closed down in the three years following late 1997.

Prudential regulation of Korea's financial system *was* in dire need of improvement. The liberalization process of the 1990s in particular had led to many destructive managerial practices. However, to implement such radical change in such a short period was extremely irresponsible. To do it in the midst of a severe economic and financial collapse, when most important financial institutions were already insolvent, *was clearly malevolent. IMF austerity macro policy had already created a serious contraction of the credit supply. Financial restructuring policy turned this into a severe credit crisis* (Kim 1999b). The dramatic drop in bank credit to the corporate sector, caused firms to further slash investment, wages, and employment, thereby aggravating the ongoing deficiency in aggregate demand. Falling aggregate demand pushed more firms into bankruptcy, which increased the volume of NPLs in the banking system. This forced banks to lower credit even further in

[22]Though paradoxical, this outcome is hardly unique. For example, the neoliberal Pinochet government in Chile nationalized the banking system to avert a financial collapse brought on by deregulation and liberalization of the capital account.

an attempt to raise capital adequacy to mandated levels. *This vicious cycle, in which real-sector problems cause financial-sector malfunctions that, in turn, further weaken nonfinancial firms, continues to plague Korea today.*

The disastrous results of these policies were hardly a surprise. As Stiglitz put it: "If, in the midst of a downturn, we push banks too quickly toward 'prudent' capital adequacy ratios, we risk shutting down the flow of credit entirely" (Kumar and Debroy 1999, p.16). In 1998, Crotty and Dymski made the following observation about unfolding events.

> Korean banks have always operated with lower equity/asset ratios than are permitted by the free-market oriented Basle standards. When the loan defaults of the crisis left them near insolvency, the imposition of the Basle standards forced banks to drastically cut loans, especially to small and medium businesses. The resulting credit crunch then forced more firms into default, leaving banks even further away from compliance with the Basle standards. Together, these policies [of austerity and financial restructuring] created an ever-deteriorating cycle of bankruptcies, bank failures, declining production and rising unemployment (Crotty and Dymski 1998a, p. 33).

Since a dramatic tightening of prudential regulation in the midst of an economic and financial collapse cannot be justified on economic efficiency criteria, we can only conclude that *its motivation was strategic*. The crisis and collapse were politically necessary conditions for the IMF and the Kim government to impose their neoliberal revolution on Korea's economy.

B. Results

In the almost four years since the outbreak of crisis, the Korean economy has experienced an ongoing credit crunch with two distinct phases. In 1998, financial markets were battered by the combination of an economic collapse and radical financial restructuring. This led to the first phase of the credit crunch, which lasted through early 1999 (even though interest rates fell in the second half of 1998, and remained relatively low thereafter).[23] In the first half of 1999, credit flows to the real sector began to speed up.

[23]At near 10%, the interest rate on three-year corporate bonds, while much lower than the usurious rates on early 1998, could not be considered low in any absolute sense.

However, in mid 1999 a bond market crisis erupted, drying up credit flows once again. Things improved somewhat in the first half of 2000, but in the latter half of the year credit flows plummeted yet a second time.

Bank profitability has risen since 1998, but only because of the huge injection of public funds. Nonperforming loans are still high, largely because the nonfinancial corporate sector remains weak — the vicious cycle at work. NPLs fell from 118 trillion won in mid 1998, before the main inflow of public funds, to 60.2 trillion won at the end of 1998 and 51.3 trillion won at the end of 1999; but they jumped again in phase two of the credit crunch to 76.3 trillion at the end of 2000. NPLs as a percent of all loans are listed in Table 7.

Credit flows from the financial sector to nonfinancial firms, individuals and the government collapsed in 1998. Banks, which provided at least two-thirds of total credit flows in 1996 and 1997, were forced to slash lending due to the combined effects of deep recession, bank closings, and tighter prudential regulation. NBFIs, which include the risk-loving Merchant banks created in the 1990s liberalization, were hit hard by forced exit plus tighter prudential requirements. As a result, total credit flows from commercial banks and NBFIs dropped by 108 trillion won from 1997 to 1998 — an amount equal to the total supply of funds from the sector in 1997 (BOK, Flow of Funds). A credit crunch of this magnitude might be aptly described as savage.

Table 8 traces the evolution of the credit crunch faced by nonfinancial corporations. Total funds made available to highly levered real-sector firms dropped from 117 trillion won in 1997 to just 28 trillion won in 1998. This evaporation of the credit supply was a major cause of the collapse in investment spending and the rapid deterioration in the financial health of real sector firms — *phase one of the vicious cycle.* Nonfinancial corporations, who saw their credit from banks and NBFIs fall by 29 trillion won in 1998, were forced to turn to the capital market — a shift consistent with the IMF-Kim plan to move Korea to a capital market based financial system. They issued a record 46 trillion won in bonds, 14 trillion won of which carried the super-high interest rates of the first half of the year. Most bonds were bought by investment trusts, which increased their bond holdings by 108 trillion won from late 1997 to the end of 1998 (Ministry of Finance and

TABLE 7

CHANGE OF NONPERFORMING LOANS IN THE FINANCIAL SECTOR

	1996*	End 1997	June 1998	End 1998	End 1999	Sept. 2000	End 2000
NPL share	5.2	6.7	15.8	10.5	8.7	12.3	10.4

Note: * 1996 for commercial banks
Source: Financial Supervisory Service

TABLE 8

EXTERNAL FINANCING OF THE CORPORATE SECTOR AFTER THE CRISIS

(Billion Won, %)

	1997	1998/1	1998/2	1999/1	1999/2	2000/1	2000/2
Indirect finance	44,362 (37.9)	-1,780 (-19.2)	-13,223 (-69.3)	-8,431 (-23.0)	10,484 (62.1)	11,698 (26.9)	-307 (-1.3)
Borrowing from banks	15,116 (12.9)	8,142 (-87.7)	-8,088 (-42.4)	8,606 (23.5)	6,546 (38.8)	18,601 (42.8)	4,747 (20.6)
Borrowing from NBFIs	28,339 (24.3)	-10,002 (-107.7)	-5,485 (-28.6)	-17,036 (-46.4)	3,998 (23.7)	-6,903 (15.9)	-5,094 (-22.1)
Direcr finance	43,391 (37.1)	20,388 (219.6)	29,361 (153.9)	35,232 (96.0)	-8,446 (-50.1)	8,113 (18.7)	10,883 (47.2)
Commercial paper	4,773 (4.1)	450 (4.8)	-12,128 (-63.6)	6,878 (18.7)	-23,370 (-20.0)	-200 (-0.05)	-933 (-4.0)
Corporate bonds	26,845 (22.9)	13,958 (150.4)	31,949 (167.5)	7,722 (21.0)	-5,989 (-35.5)	-1,583 (-3.6)	-525 (-2.3)
Stocks	8,974 (7.7)	4,964 (53.5)	8,551 (44.8)	19,863 (54.1)	19,116 (113.3)	9,279 (21.4)	11,527 (49.9)
Foreign borrowings	7,162 (6.1)	-9,571 (-103.1)	-625 (-3.3)	4,223 (11.5)	5,818 (34.5)	13,666 (31.5)	2,099 (9.1)
Others	22,704 (19.7)	246 (26.5)	3,564 (18.7)	5,676 (15.5)	9,015 (53.4)	9,977 (23.0)	10,403 (45.1)
Total	117,041 (100)	9,283 (100)	19,077 (100)	36,700 (100)	16,871 (100)	43,455 (100)	23,076 (100)

Note: Others include government loans and corporate credit.
Source: Bank of Korea, Flow of Funds

Economy (MOFE) 2000). Firms associated with the largest chaebol had easiest access to bond funds because chaebol-owned investment trusts attracted much of the new NBFI deposits in this period. The chaebol used these funds to purchase their own bonds and stocks. Small and medium companies, which must rely on the banking system to meet their credit needs, were crushed by the 1998 collapse of bank credit.

The first half of 1999 showed a significant improvement in financial intermediation. The total flow of money to industrial and commercial firms rose to an annual rate of 73 trillion won from January to June. Real GDP grew moderately in the first half of 1999 and the rate of unemployment began to decline: many Koreans now believed that the worst was over. Stock prices doubled between November 1998 and June 1999 even as supply rose — new equity issues jumped from 8.5 to 20 trillion won. Meanwhile, foreign credit flows shifted from negative to modestly positive. And, after withdrawing credit from nonfinancial firms in 1998, the commercial paper market made an additional 7 trillion won available to them in early 1999.

In July 1999, the government decided to force the huge, debt-ridden Daewoo chaebol into bankruptcy. As Korea's third largest chaebol at the time, Daewoo was universally believed to be too big for the government to allow it to fail. Thus, its collapse triggered panic in the commercial paper and bond markets. Since even five months later, banks held 22 trillion won worth of Daewoo bonds and investment trusts had 24 trillion in Daewoo bonds and commercial paper, Daewoo's bankruptcy badly damaged the banking sector (SERI 2000, p. 74). Korea thus entered *a second phase of the credit crunch* as the cross-sector infection process continued. Stock issues and foreign borrowing remained steady, but there was a decline of 23 trillion won in outstanding commercial paper in the second half of the year.

Worried about the safety of chaebol bonds, and aware that large quantities of the bonds issued in 1998 were up for repayment, frightened investors withdrew 100 trillion won from investment trusts in the year following Daewoo's bankruptcy, crippling the bond market. They moved these funds back to commercial banks. Hampered by new capital adequacy standards and stricter prudential regulation, banks chose to increase their holdings of government bonds (issued to finance deficit spending and purchase NPLs) and increase lending to the more secure household sector instead of lending to industrial firms.[24] Rising securities purchases

[24]Deposit monetary banks held 25 trillion won worth of such government

drove the commercial bank loan to deposit ratio, traditionally about 100%, to 71% by the end of 1999, and a rapidly shrinking percent of loans went to commercial and industrial enterprises. *Firms were once again starved for funds.* The flow of funds to nonfinancial enterprise collapsed to a 33 trillion won annual rate in the second half of 1999, a mere 29% of the 1997 figure.

The year 2000 was similar to 1999 in that corporate access to finance improved significantly in the first six months, only to collapse again in the second half of the year. The early months saw a sharp rise in bank loans counterbalanced by a sharp drop in credit from NBFIs, which were plagued by bad assets and deposit outflows. The bond market remained weak, but the commercial paper market saw balanced inflows and outflows, a great improvement over its collapse in late 1999. Stock market issues slowed, but foreign borrowing picked up. Total flows to nonfinancial corporations proceeded at an 87 trillion won annual rate, the best performance since the crisis.

But neither the industrial nor the financial sector had been restored to health. Industrial production peaked in October, and declined thereafter; in the second half of the year it fell 9% below its first half level. Real machinery and equipment investment fell in both the third and fourth quarters. Chaebol profit rates fell substantially in the second half of the year. When Hyundai, the largest chaebol, experienced a serious liquidity crisis in mid-year, lending by banks and NBFIs dropped precipitously. The commercial paper and bond markets remained moribund, and foreign borrowing declined dramatically. *Total funds to nonfinancial corporations in the second half of 2000 dropped to an annual rate of 46 trillion won — the worst performance since 1998.*

In December 2000, in response to the latest phase of the credit crunch, the government intervened again to try and stop the bond market collapse from pulling the entire financial sector down with it.[25] The state-owned Korea Development Bank was authorized to

bonds in 1996, 36 trillion won in 1997, 72 trillion won in 1998, and 98 trillion won in 1999. Holdings of securities as a percent of total assets went from 14.3% in 1997 to 25.7% in 1999.

[25]The *New York Times* (February 27, 2001) reported that South Korean banks accumulated $31 billion in nonperforming loans in 2000, "twice the figure for 1999 when the economy appeared to have rebounded from the 1997-8 crisis." In July, the *Korea Times* (July 2, 2001) noted that "Korean

use 20 trillion won to facilitate the rollover of shaky corporate bonds. The KDB was to buy 80% of the estimated 25 trillion won worth of nonperforming corporate bonds from financial institutions. Issuing firms would only be required to repay 20% of their face value; this would pull them back from the edge of bankruptcy. Some 65 trillion won in corporate bonds are due for repayment in 2001, but many of the firms who issued the bonds are too weak to repay them, and many of the NBFIs who hold the bonds might not survive their default.[26] The *Wall Street Journal* (June 4, 2001) warned that "crunch time is approaching for South Korea, threatening a liquidity shortage similar to the one that nearly brought the country's economy to a standstill late last year."

Government interventions such as these contradict the logic of radical restructuring, because they vitiate the process through which the 'strong,' — primarily foreign firms — are able to take over the 'weak.' And they bring condemnation from the citadels of global neoliberalism.[27] But the perilous condition of both financial and industrial sectors made non-intervention too dangerous a policy stance for President Kim to adopt, especially in light of the massive deteriorating in his popular support. *The Economist* (September 1, 2001, p. 38) reported that only 20% of Koreans now support Kim, "down from a high not long ago of 80%."

In spite of the massive infusion of public funds into Korea's financial system, it is clear that Korea's financial institutions never recovered from the devastation they suffered as a result of the economic collapse brought on by austerity macro policy in 1998 and the imposition of tight prudential regulation in the midst of that collapse. As of mid-2001, there is no reason to expect that the

financial institutions, including securities and financial firms, lost almost one trillion won in 2000."

[26]Morgan Stanley points out that an additional "60 trillion won of corporate bonds have been converted into bank debt in the past two years and banks are not willing holders of these loans" (*Korea Times* March 4, 2001).

[27]The OECD's Economic Survey of Korea: 2001 (August) demanded that the government "stop the Korean Development Bank's refinancing of maturing corporate bonds, citing that state rescue financing for ailing firms runs counter to market principles." It also urged the government to quickly sell its stake in commercial banks to private investors (*Chosunilbo* August 2, 2001). Since no major Korean private investors have deep pockets, this is, in effect, a call for even greater foreign bank ownership.

vicious circle strangling the Korea economy will end anytime soon.

Radical restructuring created strong market incentives that induced the large commercial banks which traditionally financed the bulk of Korea's capital accumulation to shift to a new mode of operation. *Lending to Korea's debt-ridden businesses is being de-emphasized in favor of more profitable loans to individuals, especially wealthy households*. Korean financial markets will soon be dominated by three giant conglomerates, the Shinan Holding Company, the merged Kookmin and H&CB banks, and the Woori Holding Company, presently owned by the state. Both Kookmin and Shinan have made clear their intention to concentrate on retail banking, with a main focus on wealthy households. The new Kookmin bank alone will control one-third of Korea's deposits and 54% of household lending. Goldman Sachs and ING will be its biggest shareholders, "furthering a trend which now sees foreigners as the biggest private stakeholders in five of Korea's top banks." After a heated struggle, Kim Jung-Tae won the presidency of this merged super-bank. "Crucial to Kim's selection was backing from the major foreign investor in each bank." These developments are likely to cause two serious problems for Korea's evolving financial sector. First, the only one of these three giant banks planning to concentrate on commercial loans is state-owned Woori, but this policy will presumably last only until the government sells it to private interests — which it intends to do as soon as possible. Second, new giant banks, especially those under foreign control, have no reason to cooperate with government policies they do not like. Kookmin's new president Kim Jung-Tae is a good example: "He has an un-Korean warning for the government: I want to make my [own] way even if the government doesn't like the idea" (all quotes from *Far Eastern Economic Review* August 23, 2001).

VI. Restructuring and the Rising Influence of Foreign Capital

A. Policy

President Kim Young Sam signed the first restructuring agreement between Korea and the IMF in December 1997. According to the *New York Times* (Feb. 17, 1999), President Clinton telephoned the wavering Korean President and "told him he had no choice but to accept an international bailout." Incoming President Kim Dae Jung didn't need outside pressure to cooperate with the IMF. He believed the key to successful corporate and financial restructuring in Korea was a massive infusion of foreign capital and foreign know-how. This would solve Korea's foreign exchange problem, infuse Korean industry with modern managerial methods, and provide for the first time in modern Korean history the kind of vigorous competition needed to finally break the chaebol stranglehold on the Korean economy. "What we need now, *more than anything else*, are foreign investors," Kim stated in an address to the U.S. Congress in 1998 (Address by President Kim Dae Jung of the Republic of Korea at a Joint Meeting of the United States Congress June 10, 1998. Washington, D. C, emphasis added).

As we have seen, in early 1998 the government injected massive public funds into the banking system, effectively nationalizing it. President Kim then used state control of the banks to pressure the heavily indebted chaebol to slash leverage by 60% within just two years. Given the depressed state of domestic demand brought on by austerity macro policy and the havoc caused by radical restructuring of both financial markets and the industrial sector, Korean enterprises could meet this demand only through the extensive sale of real assets and the large-scale issuance of new stock. Since domestic firms were broke, foreign firms and banks were the only possible large-scale buyers. *This forced Korean economic assets to be put up for an international auction in which all bargaining power lay with the buyers*. The policies implemented by President Kim and the IMF were therefore guaranteed to dramatically increase foreign control of Korea's economy, provided that Korea's remaining laws restricting the inflow of foreign capital and its laws protecting labor were overturned — which they were. To close the circle, the crisis-induced collapse of the won — it was 844 per dollar in 1996, 1,415 in 1997, 1,207 in 1998, 1,145 in 1999, 1,259 in 2000, and near 1,300 in mid-2001, made Korean assets extraordinarily cheap in US dollars and other dominant currencies.

The liberalization of cross-border financial flows accelerated dramatically after the IMF agreement. The remaining restrictions on capital inflows, *which were still substantial entering 1997*, were quickly disposed of by the IMF and President Kim.[28] The government raised the number of business categories open to foreign ownership in 1998, including security trading, investment companies and real estate. In a crucial move resisted by the chaebol, hostile foreign M&As were permitted for the first time. The Foreign Investment Promotion Law was enacted in November 1998 providing 10-year central government tax exemptions for high tech and related industries, and for investment projects in Foreign Investment Zones. The government also agreed to eliminate all restrictions on the foreign ownership of Korean banks and security companies. Giant US industrial and financial firms had finally gained a prize they had sought in vain for decades.

Portfolio investment was, for the first time, fully liberalized. By May 1998, the government had removed all remaining curbs on foreign participation in Korea's stock and bond markets. It abolished the Foreign Exchange Management Act in 1999, eliminating most remaining restrictions on foreign exchange transactions. Regulations on capital transactions were to be completely abolished by the end of 2001. As of January 2001, foreigners were allowed to borrow won in Korea; this will arm foreign speculators for an attack on the won should conditions warranted it. Fear of renewed capital flight caused the government to limit the amount individuals could borrow. This frenetic pace of cross border capital deregulation was much more rapid than the one demanded by the OECD as a condition for Korea's entrance to that organization in 1995, leaving Korea vulnerable to yet another foreign exchange crisis.

B. Results

Figure 1 shows the effects on equity flows of the cross-border financial liberalization process that started in the early 1990s. It does not include foreign bank loans.[29] The initial phase, from 1992

[28]A late 1997 IMF report outlined the new policy with respect to foreign capital. "The government plans to accelerate substantially its ongoing capital account liberalization program···. By end-February 1998, the present timetable for capital account liberalization will be accelerated by taking steps to liberalize other capital account transactions, including those restricting foreigners' access to domestic money market instruments and the corporate bond markets, and by further reducing restrictions on foreign direct investment···. In order to instill market discipline a timetable will be set by end-February 1998 to eliminate restrictions on foreign borrowing by corporations" (IMF 1997, p. 10).

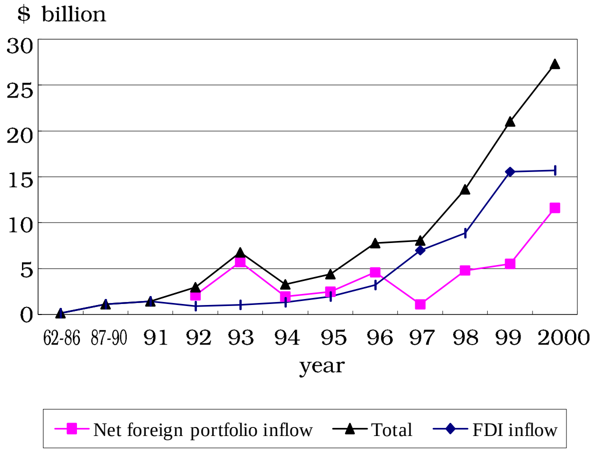
[29]The huge inflow of short-term foreign bank loans in the mid-1990s, and

through 1997, saw a significant rise in total inflows from around $1 billion to as much as $7 billion or $8 billion a year. The crisis and restructuring then accelerated total foreign equity capital inflows dramatically. A total of $62 billion entered Korea from 1998 through 2000.

The role of FDI is especially important because of its potential to make effective government guidance of the economy in the future difficult if not impossible. From the late 1980s through 1994, inward FDI averaged about $1 billion a year (Net FDI was consistently negative as the larger chaebol built up their foreign base of operations). It rose to $2 billion in 1995 and $3 billion in 1996. Post crisis liberalization let FDI jump to $7 billion and $9 billion in 1997 and 1998. The door was now wide open to outsiders, but the uncertainty caused by the collapse of late 1997 and 1998 and the tense tenor of labor relations caused potential buyers to bide their time. After 1998, both legal and economic conditions were ripe for an explosion of inward FDI. *Over the next two years FDI totaled $31 billion — a nominal sum 25% greater than total inward FDI from 1962 through 1997.* Even in the global slowdown of 2001, inward FDI is on track to reach nearly $12 billion (*Korea Times* September 7, 2001). FDI as a percent of total fixed investment had been no more than 1% until the mid 1990s; it rose to 2% in 1996 and 4% in 1997. It jumped to 9% in 1998, then increased again to about 13% in 1999 and 2000. But even this dramatic rise in FDI is not enough to satisfy President Kim's unyielding determination to give foreign firms a dominant position in Korean industry and finance. *In July 2001, the Presidential Secretary for Economic Affairs announced that the government is committed to expanding annual FDI to the astronomical figure of $120 billion by 2003 — equal to 29% of GDP in 2000 and 20% of the value of GDP in 2003 as forecast by the government* (*Korea Herald* July 7, 01).

Inward FDI of the magnitude achieved in 1999 and 2000, never mind hoped for in 2003, would have been unimaginable prior to the crisis. One tragic aspect of this great 'fire sale' is that the overwhelming majority of FDI expenditures involved foreign acquisitions of domestic firms, rather than new or "greenfield"

their subsequent outflow in 1997-8 were the proximate cause of Korea's financial crisis.



Source: Bank of Korea, Ministry of Commerce, Industry and Energy.

FIGURE 1

FOREIGN CAPITAL INFLOW IN THE 1990S

investment (United Nations 2000; and Mody and Negishi 2001).[30] President Kim thus traded vast quantities of Korea's best economic assets, built over decades with the blood and sweat of Korea's working class, for money to pay back foreign bank loans that never should have been permitted in the first place.

Net portfolio inflow varied between one and five billion dollars annually from 1992 through 1999, then leapt to almost 12 billion dollars in 2000. Gross portfolio inflows have increased phenomenally, from little more than $10 billion a year to over $60 billion in 2000. But foreign investors are simultaneously withdrawing enormous sums from the stock market as well — $48.5 billion in 2000 (BOK 2001). Gross flows of this magnitude and volatility

[30]Estimates of the percent of FDI represented by M&As are inexact, but the share was probably around 80% in post-crisis Korea. Mody and Negishi state that "the much talked about resilience of FDI during the crisis was due entirely to the rapid increase in M&A rather than to traditional foreign investment in "greenfield" projects, those designed to build new means of production" (Mody and Negishi 2001, p. 7).

create the potential for extreme instability in asset prices. The volatility of the Korean stock market rose dramatically during and after the crisis: the main Korean stock price index was 350 in late 1997, rose to near 1000 in mid-1999 just prior to the Daewoo bankruptcy, then dropped to 500 at the end of 2000. When investors jump into and out of stocks in pursuit of short- term speculative gains, stock market "turnover" — the value of trades as a percent of total market capitalization — is high. According to Standard and Poor's, "South Korea was the emerging market with the highest turnover in 1999, at 347% of market capitalization" (*The Economist* June 24, 2000, p. 122). Turnover in the second highest market was significantly lower. By comparison, turnover in the US stock market in 1999, when the stock price bubble was accelerating at record speed, was only about 120%.[31]

President Kim has proposed a form of shareholder capitalism for Korea, in which business decisions and the allocation of investment funds are to be guided by stock price movements. But the Korean stock market is now extremely unstable, and its surges up and down are increasingly correlated not with Korean business indicators, but rather with movements in American stock price indices (BOK 1999). Since the average share in the Korean stock market now changes hands three and one-half times a year, it is obvious that short-term speculators, not long-term investors, are the dominant force in Korea's equity market.[32] Shareholder capitalism is dysfunctional in the best of conditions; *it would be disastrous in present day Korea.*

The IMF-Kim strategy to dramatically increase foreign ownership of Korean industry and finance has succeeded beautifully. Table 9 shows that the percent of Korean market capitalization owned by foreigners rose from a miniscule 2.7% in 1992 to 12.3% in 1997, then leapt to 32.4% in May 2001 as the liberalization accelerated.[33]

[31]As global financial market integration increases, turnover is rising in most markets. It increased substantially in the first four months of 2001 in the US, to a 188% annual rate. David Hale, chief economist for Zurich Financial Services, observed that "we are witnessing an unprecedented institutionalization of speculation without any anchor in traditional value measures" (*Business* Week July 16, 2001, p. 26).

[32]In early 2001, 72% of listed Korean firms, and 7 of the 10 largest chaebol had market values well below their book or liquidation value, making them potential targets for foreign buyers (*Korea Times* May 23, 2001).

TABLE 9

GROWTH OF FOREIGN OWNERSHIP IN THE KOREAN STOCK MARKET

(%)

Year	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001/5
Share	2.7	7.6	8.0	10.0	10.5	12.3	16.4	21.9	30.1	32.4

Source: Korea Stock Exchange

Foreign firms have gained major influence over many of Korea's most important industries, such as semiconductors, autos, electronics, telecommunications, petrochemicals, and finance. The 1990s liberalization raised foreign ownership of the top seven Korean firms (as measured by stock market capitalization) to an average 20.6% just before the crisis broke out, but after just three years of restructuring it had more than doubled to 47% (FSS 2000). As of February of 2001, total foreign ownership exceeded that of the dominant domestic shareholder in 29 of Korea's most important firms. Foreigners owned 56% of the shares in Samsung Electronics, the number one firm, while the controlling domestic owner's share is just 11.7%. They owned 42.2% of the listed shares of the top 10 chaebol (*Korea Herald* May 25, 2001). Foreign holdings greatly exceed the shares of the dominant domestic interest in such giant firms as POSCO, the great steel producer (63% foreign owned by August 2001), and SK Telecom. Foreigners own 57% of the stock of Hyundai Motors, while Hynix Semiconductor, the world's third largest producer of semiconductors, is expected to soon fall under foreign control (*Korea Herald* June 25, 2001).

The situation in the key auto industry reveals the utter bankruptcy of the policy of pursuing foreign investment at all cost. In 2000, Daimler-Chrysler gained significant influence over Hyundai Motors through the purchase of over 10% of its shares. Worse, Kim Dae Jung ordered Daewoo Motors, Korea's second largest automaker, to be sold to foreign interests by its creditor banks. In 2000, the government rejected an offer of some $5 billion from GM in favor of Ford's $7 billion offer, which Ford eventually rescinded.

[33]This data refers only to 'listed' shares. A substantial portion of chaebol shares are privately held or 'unlisted.'

But Daewoo Motors continued to lose value as government-controlled creditor banks deliberately starved it of funds in order to force management to impose firings and wage cuts on its militant unions. They put in about $2 billion, just enough to prevent Daewoo's collapse, but not enough to allow Daewoo to maintain its share of key markets. GM refused to make another offer for Daewoo until the unions were broken. After November 2000, Daewoo cut employment by 6,100, firings the *New York Times* (April 10, 2001) says were designed "to make a deal more desirable to GM" But still GM refused to make a second offer until the government allowed it to break up the company, buying only those assets it found most attractive. In particular, GM did not want to acquire the Bupyong plant in Inchon, with its capacity to produce 500,000 cars annually, because its 8,000 workers, about half the domestic workforce, had a history of militant unionism.

By late 2001, the prolonged cash squeeze caused Daewoo's share of key markets to collapse. Whereas in 1997, Daewoo had 33% of the Korean market, by the first half of 2001 it had only 12%. While Hyundai-Kia saw its US sales grow by 37% in the first eight months of 2001, Daewoo's sales fell by 20%; in August it sold 53% fewer cars than it had a year ago.[34]

The government had thus maneuvered itself into a lose-lose position. It now was at GM's mercy. In September 2001 the government reversed itself and let GM take only those pieces of Daewoo it desired. In response, GM signed a memorandum of understanding to acquire Daewoo in the first half of 2002. According to Rick Schlais, president of GM's Asia-Pacific Division, "The major reason why GM did not acquire the [Bupyong] factory stems from its concern about the unstable labor-management relations" (*Chosunilbo* Sept. 21, 2001).[35] GM will keep only two of Daewoo's 13 foreign plants, but will take all 22 marketing

[34]The *Wall Street Journal* (Sept. 21, 2001) reported that "over the three years of on-and-off again negotiations it has taken GM to get the deal, Daewoo's position has eroded significantly. Sales are plunging in just about all Daewoo's markets."

[35]It did agree to buy cars from the plant for several years and maintained an option to purchase it in 2006. But the *Korea Times* (Sept. 21, 2001), noting GM's antagonism toward the plant's workers, said that "there is a rumor going around that it will be shut down after next year's presidential election."

subsidiaries, giving GM "a sales network that spans the globe" (*Wall Street Journal* Sept. 21, 2001).

GM paid $400 million for a two-third's share in Daewoo, which has the capacity to produce almost two million cars annually, less than it normally pays to build one new plant. It also agreed to take over just $830 million of Daewoo's $12 billion total debt. In return, GM received a guarantee that creditor banks would offer $2 billion in new long-term loans and would be responsible for any additional Daewoo loans that GM discovers prior to sale, as well as any foreign exchange losses that might take place before the sale is completed. It will also receive huge government subsidies. In April 2001, the *Korea Herald* (April 4, 2001) reported that a General Motors spokesman "demanded that Daewoo Motor be immediately sold to the U.S. car maker without charge," a demand that seemed outlandish at the time, but one that the government now appears to have accepted.

Prior to the crisis, near 100 percent of cars sold in Korea were made by Korean-owned car manufacturers. In a few years, assuming that Daewoo's market share returns to its pre-crisis level of 33%, foreign-owned firms may produce close to half of the cars made in Korea, and Daimler-Chrysler will be part owner of the firm that makes the other half, while imports are likely to grow substantially.[36] The influential *Financial Times* (June 27, 2000) raised "the possibility that the entire [Korean auto] sector, the second largest in Asia, could soon be dominated by foreigners."

The Kim government has used about 150 trillion won in public money in a yet unsuccessful attempt to create a healthy financial system. The justification for this massive investment is that a healthy financial system is a precondition for a productive and growing nonfinancial business sector. Yet in the case of Daewoo Motors and other crucial firms, the Kim government refused to provide the capital needed to sustain these companies as viable and competitive businesses.[37] It could have invested an additional

[36]In 2000, Renault Samsung had 4.5% and Ssangyong Motors 7.4% of Korea's market. the first company is foreign owned, and the second is likely to be sold to foreign interests soon. Keep in mind that as of June 2001, foreigners owned 57% of the listed shares in Hyundai Motors.

[37]In 1998, Daewoo was the second largest transnational corporation based in a developing country, with over $22 billion in assets and $30 billion in sales (UN 2000, p. 82).

several billion dollars in Daewoo Motors in a debt for equity swap, providing it with essential investment funds while eliminating much of its interest payment burden. It could have used the equity position acquired this way to carry out desired managerial reforms, and place representatives of labor and the public on the Daewoo Board of Directors so that stakeholder interests would have to be taken into consideration in corporate decision-making. Or, it could have sold its shares to domestic investors if and when the Korean economy became sound again. It could even have sold a healthy Daewoo Motors to a foreign auto giant for a price well in excess of Ford's $7 billion bid if it was determined to place it in foreign hands. Instead, it chose to bleed Daewoo Motors until both management and labor were too weak to resist foreign takeover, even though in the process it starved the company of funds needed both for capital investment and the retention of its most talented executives and scientists, driving its effective purchase price to zero. This process inevitably produced plant closings and mass layoffs, and is likely to eventuate in the end of serious domestic R&D activity. President Kim's Daewoo Motors strategy brings to mind the US General who said he had to destroy Vietnamese villages in order to save them.

The dramatic rise in foreign ownership of the listed stocks of many of the most important Korean firms raises again the question first posed in section IV as to whether insider control of the large chaebol has been broken — a key goal of the Korean people. How can the thesis that insider control has been effectively maintained during the Kim administration be sustained in the face of the jump in foreign ownership just documented? The answer turns on two characteristics of the institutions of corporate control in Korea. First, only about a quarter of chaebol firms are listed on the stock exchange; the rest are privately held. However, listed firms own about 60% of top 30 chaebol assets. Second, owner-family and sister-firms together held about 65% of shares in these unlisted firms in late 2000 and about 30% for listed chaebol firms (FTC 2001). Early in Kim's presidency the government relaxed previous constraints on cross-firm shareholding. This allowed total insider holdings to rise from about 44% of total shares in 1996-8 to 51% in 1999. In 2000, insider control fell back to 43%, partly in response to the rapid inflow of foreign capital during the second phase of the credit crunch. Latest estimates by the FTC put insider ownership at 45% and rising. At this point in time, then, insiders appear to retain effective control over chaebol policy. But this may change in the foreseeable future. Though only time will tell how much insider control will ultimately be reduced through the restructuring process, wide spread foreign domination of large Korean firms and banks in the intermediate future *is* a possibility.

The problem is that a trade of foreign control for chaebol founding family control of Korea's most important economic assets will prove to be no bargain for the Korean people. President Kim had a clear popular mandate to end chaebol founding family dominance of Korea's economy and its political process; he did not have a mandate to replace it with foreign domination. Foreign owners are likely to be as anti-labor as the chaebol, and they are even less likely to cooperate with government economic policies they don't like. Foreign control of Korea's banks is especially dangerous because the Korean economy has had a bank-based system of corporate finance for four decades, with all major commercial and industrial firms dependent on financial institutions for investment capital. *Since Korea's businesses are still heavily in debt, foreign control over key financial markets means a foreign stranglehold on Korea's future economic development.*

Three years ago, foreign-ownership of Korean financial institutions was inconsequential. Today, foreigners are major shareholders in more than half of the nation's crucial commercial banks — they will soon own six out of nine — and in many important NBFIs. By 2000, foreign financial institutions controlled 41.7%, 10.6% and 8.2% of Korea's banks, securities companies, and insurance companies respectively. The sale of Korea First bank to the "vulture capitalist" Newbridge Capital is a good example of the dangers involved in this process. The government invested about 15 trillion won in Korea First to restore it to health. The sale price to Newbridge was a paltry one-half trillion won. So desperate was the Kim government to accelerate its program of foreign bank ownership, it accepted a notorious 'put-back' provision demanded by Newbridge by which the government was required to buy all assets that turned sour in the two years following the sale. Purchased for a song, and with all short-term risk borne by the government, Korea First turned a profit in 2000. From January to May of 2001 alone, the government bought 572 billion won worth of bad loans from Korea First, allowing it again to turn a small profit.

But Newbridge showed no gratitude to President Kim. When, in late 2000, the government announced its plan to rescue the faltering bond market, Korea First was the only commercial bank that refused to roll its bond holdings over. A Korea First executive explained their position: "The Korean banking system needs a foreign player who can say no" to the government (*Business Week* January 22, 2001, p. 53). This foreshadows a serious problem for future governments. When Korea's financial institutions are predominantly foreign controlled, they may refuse to provide adequate financing for Korea's domestic economic development, and they may fail to cooperate with, and thereby block, future government economic policies. This is happening already. Though President Kim claimed that foreign owned banks would provide Korea's nonfinancial firms with adequate investment finance allocated more efficiently than under the traditional model, Korea First has fled corporate finance to focus on less risky and more profitable retail banking. Its announced policy is to quickly cut the corporate share of its loans from 60% to 20%. This policy is the wave of the future in Korea's liberalized financial system. In the aftermath of failed neoliberal policies, industrial firms are too financially fragile and insufficiently profitable to be attractive to market-oriented banks, while rising wealth at the top of Korea's income distribution makes niche consumer banking especially attractive. Market incentives will eventually pressure all banks not controlled by the state to shift from corporate to consumer banking, leaving Korea's still heavily indebted firms without the finance needed to remain competitive in the new global economy. Foreign owned financial institutions are the least likely to respond to any future government request to reverse this process.

VII. Conclusions

We have presented evidence in support of the following propositions:

- The austerity macro policy of late 1997 and the first half of 1998 caused severe damage to Korea's crisis-weakened industrial firms and banks.

- The imposition of restrictive prudential regulation and large-scale bank closings in the midst of the 1998 collapse created a vicious credit supply crunch, while the requirement to drastically reduce leverage ratios left Korean corporations unable to demand desperately needed external finance.
- The decision to adopt restrictive macro policy and then impose radical neoliberal restructuring in Korea in the midst of the subsequent economic collapse is without adequate economic justification. We conclude that the IMF and President Kim deliberately brought on the economic collapse in 1998 because they believed that neoliberal restructuring would not have been politically viable without it.
- The collapse in aggregate demand coupled with the credit crunch led to a collapse in capital investment. Neoliberal restructuring may have created a permanently lower rate of capital accumulation in Korea.
- Korea's major corporations remain debt-burdened and unprofitable, while the attempt to break insider control of chaebol decision-making has yet to succeed.
- Though the injection of massive quantities of public funds prevented the complete implosion of Korea's financial system in 1998, the profitability of banks and NBFIs remains dependent upon continued state assistance. Korea's financial institutions are currently incapable of providing adequate finance to the non-financial corporate sector, and their priorities are rapidly shifting from domestic business loans to consumer lending.
- The economic recovery in 1999 through late 2000 was unbalanced and unsustainable. Economic growth after the third quarter of 2000 slowed dramatically. The consensus forecast is that Korea's intermediate-term economic prospects are dim, and that the outbreak of another financial crisis is possible. The trigger this time could be either an external or internal financial shock; serious problems in either sector would quickly infect the other.
- Foreign commercial and industrial firms, financial institutions, and portfolio investors have entered Korea's economy at a pace that would have been unimaginable prior to 1997. These agents have no allegiance to Korea's general development and no reason to cooperate with government policies they do not like.
- If the government continues to force large numbers of

unprofitable firms and banks to close, a new financial and economic crisis is likely to occur. But if it continues to use public funds to prop up weak enterprises, restructuring will fail.

- Neoliberal restructuring has led to increased inequality and economic insecurity.
- Contrary to the neoliberal ethos, it was the state, not markets which both designed and executed the restructuring process. Almost four years into the neoliberal revolution, the state continues to exercise substantial power over market processes and outcomes.

No one should be surprised by these results. Extreme neoliberal 'reform' has failed to deliver a better life for the majority of people wherever it has been imposed, though it often does deliver benefits to national elites.[38] This record of consistent failure naturally raises the crucial question as to whether the Korean people would have been better off if the traditional model had been replaced not by neoliberalism, but with a reformed state-led growth model, one adapted to current economic and financial conditions. We believe the answer is yes. Space constraints do not allow us to discuss in detail suggested principles and guidelines for the creation of an alternative, democratized state-led development model for Korea. Interested readers can find our views on this matter in the last section of Crotty and Lee (2001).

The structures and methods of state economic intervention in Korea have shown themselves to be quite flexible. They have been changed significantly on numerous occasions over the past forty years, and they can be changed again. However, until the late 1980s control of state economic policy remained in the hands of a brutal military regime, and even after the 'revolution' of 1987, the extent of genuine democracy was quite limited. In the decade preceding 1996, the families who owned the large chaebol gained such great political influence that it might be said that the chaebol controlled the government planners rather than the other way

[38]Mexico is often touted as an example of a country that prospered as a result of IMF reforms instituted after the peso crisis of 1994. However, real wages in Mexico remained some 20% below their pre-crisis level in 2000; they will presumably fall yet further due to the impact of the current US and global recessions.

around.

What is needed now is to remove the remaining vestiges of its authoritarian shell from the rational core of the state planning apparatus — the structures that produced such high real wage growth for 35 years. The Korean people acting collectively through the government must set guidelines and priorities for economic development, so that the broad contours of future economic growth are determined by society acting through a democratic political process. State-guidance of economic development is essential for effective, progressive economic development even if markets are to be relied on to a much greater degree than in previous decades. History instructs us that state economic guidance and socially-embedded markets are necessary — though by no means sufficient — conditions for sustained development. This means that *a second democratic 'revolution' is needed* to force the state to act in the perceived interest of the majority of Koreans, rather than in response to the demands of a domestic economic oligarchy and foreign economic powers.

Herein lies the daunting challenge that confronts the Korean people. To create a viable and effective economic system capable of building widely shared prosperity, they must accomplish yet another progressive political revolution in circumstances that might be considered more difficult than the ones they faced in 1987 because of the newly-strengthened alliance between domestic and international capital. Pre-crisis liberalization plus radical post-crisis neoliberal restructuring have dismantled or badly weakened many of the policy tools the government traditionally used to impose social control over the Korean economy in the decades before the crisis. Contrary to President Kim's belief that free-market systems promote democracy, neoliberal restructuring requires the replacement of at least potentially democratic political control over the economy with market processes that dominated by rich individuals and powerful companies but controlled by no one. *If Korea completes its transition to: "flexible" labor markets and weakened unions; free cross-border capital flows; investment guided by speculative, volatile stock and bond markets; corporations and banks guided only by the pursuit of private profit and shareholder whim, and emerging foreign domination of finance and industry — what policy instruments will be available to any future progressive government to guide Korean economic development so that it meets* *the needs of all the country's people?* This may be the most serious long-term problem facing the Korean people.

The destruction of the institutions of state economic regulation is not an easily reversible political process. State-regulated economic systems, whether in the West during in the Golden Age of the 1950s and 1960s or in the East Asian "miracle" economies, were created in the aftermath of depression, revolution, military coups or war. In the absence of a severe economic crisis, it would be extraordinarily difficult to put together the domestic political coalitions necessary to create such a system from scratch, even in the absence of external pressures and constraints. For a country as embedded in the global neoliberal system as Korea will be if the U.S. government, the IMF, President Kim, and their supporters have their way, it might well prove impossible.

The battle for a progressive future for Korea has not yet been lost. The Kim government continues to face a difficult dilemma: the more it tries to withdraw from the economy in the name of neoliberalism, the worse economic conditions become, and the greater the need for and demand for strong government economic action. For example, on its forced march toward neoliberalism, President Kim found it necessary to increase state control over Korea's financial institutions, which gave the state additional tools with which to influence economic affairs. If a progressive government took office in the intermediate future, it could take advantage of this situation to reassert social control over Korea's economy. Meanwhile, the democratic union movement, though bloodied, remains militant, and public support for neoliberal restructuring, and for President Kim himself, has declined dramatically. In May 2001, the *Far Eastern Economic Review* (May 24, 2001) reported that "Kim now presides over a political disaster zone" in which "70% of the people oppose him." Just four months later the *New York Times* (September 9, 2001) reported his approval rating at just 19%. But time is running short. The further down the neoliberal path the economy is dragged, the greater the costs of transition to a reformed state-led model. To have a reasonable chance of success, a national offensive to defeat neoliberalism must begin soon.

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