The Social and Political Impact of Economic Crisis in South Korea: A Comparative Note

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The five-year term of President Kim Dae Jung ended up deepening political cleavages in the wake of growing social conflicts. We find it ironic that the Kim Dae Jung regime, the first case of horizontal power transfer through election, has seen social conflicts worsening instead of weakening. Since the economic crisis of 1997, the country has undergone a profound societal and political transformation as a result of the International Monetary Fund (IMF)'s program of liberalisation, privatisation and deregulation. We investigate the structural realignment — power shift, social conflicts, and coalition change — in the wake of the economic crisis in Korea. We critically examine the impact of various reform measures on state-society relations. Our starting point is a belief that the stability of a regime depends not only on economic performance but also on social and political performance. The current Korean situation might even suggest that social and political factors are more important than economic performance in evaluating structural adjustment programs. We begin by examining the underlying nature of the Kim Dae Jung regime's reform measures. Then we address the social realignment, coalition change, and social conflicts, and assess their implications for consolidation of democracy. Finally we draw some policy implications.

Introduction

At the end of 1997, faced with unexpected national default, South Korea asked the International Monetary Fund (IMF) for emergency bailout aid. Since then, the South Korean economy has undergone a structural adjustment programme following IMF's neo-liberal prescription under its stewardship. There have been divergent assessments as to what has been the major cause of the economic crisis and as to whether South Korea has overcome the economic crisis or is still in danger.[1] According to an extremist argument, the economic crisis resulted from a conspiracy by international finance capital. A more moderate version has it that globalisation is responsible for the crisis because it made the economy increasingly vul-

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nerable to external shock. Still others attribute the economic crisis to internal problems such as *crony* capitalism based on *Asian values*. As to the prospects of economic recovery from the crisis, some believe that the country has made significant progress in consolidating financial institutions and reorganising the corporate sector. Others insist that the country may face another economic crisis without more progressive reform.

A deeper and proper understanding of the nature of the crisis requires reconsideration of the development model that South Korea has pursued during the last four decades. It was not just an economic crisis but also a crisis of the development model revealing its inherent limits to further development. Hitherto the South Korean model had been praised for its outstanding performances. However, the crisis brought attention to the dark side of the Korean model, turning the Korean *miracle* into the Korean *mirage*. Therefore the most important message of the crisis was that a new development model was needed. IMF presented the alternative model for development. The structural adjustment under IMF's trusteeship was a kind of groundwork for transition from the old model to the new model.

Despite some impressive achievements in macroeconomic indicators, the restructuring is still far from a success story. A test of the new model is not finished yet either. It is our contention that IMF-sponsored, market-oriented restructuring is basically conservative and cosmetic. The structural adjustment is conservative in that it is aimed at increasing competitiveness and productivity rather than equity and fraternity. The structural adjustment is also cosmetic in that reform measures are marked more by talk rather than by action. It can be said that the structural adjustment lacks principle, transparency and consistency. While the IMF tries to apply old-fashioned prescriptions to South Korea, the Kim Dae-Jung government lacks new attitudes and new approaches in coping with the economic crisis. One can even describe the South Korean case as "the old wine in an old bottle."

This paper is an attempt to assess economic adjustment programmes in South Korea over the last three years in terms of changing state-society relations. We propose to critically examine the social and political outcomes of restructuring with a reference to the Association of Southeast Asian Nations' (ASEAN) experience from a comparative perspective. First, we assess the basic policy lines of economic adjustment programmes in terms of achievements and failures. Next, the social and political concomitants of economic restructuring are examined with respect to employment, income distribution and class alliance. Finally we compare the Korean case with the cases of the economic crisis in ASEAN countries such as Indonesia, Thailand, and Malaysia.

Economic Crisis and Structural Adjustment

Development of Crisis

The Korean economic crisis started as a financial crisis resulting from excessive foreign and domestic borrowing by firms and financial institutions. Given the over-leveraged financial structure of the Korean corporate sector and over-exposure to short-term external debt, the profitability shock triggered by a collapse of export prices such as semi-conductors incurred a series of *chaebol* bankruptcies. In January 1997, Hanbo Steel declared bankruptcy, the first bankruptcy of a Korean conglomerate in a decade. This was followed in March 1997 by the failure of Sammi Steel, and by rumours of the imminent collapse of Kia, Korea's third largest automobile maker. In addition, the turbulence of the Asian market and unstable political situation in Korea prior to the presidential election shook further confidence among foreign investors in the Korean market. By November, the Korean won began losing value. As the crisis reached its peak, foreign exchange rates approached free fall. The Korean won depreciated by 48.1 per cent between July 1997 and February 1998. Under such severe depreciation pressures on the Korean won, the ill-advised monetary authority protected the currency, resulting in the exhaustion of foreign reserves.

A dire shortage of foreign reserves forced Korea to turn to the IMF for assistance. Offering a 57-billion dollar loan package to Korea, the IMF imposed a high interest rate policy and contractionary fiscal policy to restore foreign currency liquidity in a short period, the most urgent task at the time, and to curb inflationary pressure. As a result, interest rates rose drastically to 30 per cent from the historical range of 12–14 per cent and induced a credit crunch. The severe credit crunch in the financial market was immediately translated into a deep recession in the real sector, followed by massive bankruptcies and ensuing unemployment. The number of firms that went bankrupt increased abruptly to 3,187 in December 1997 from 1,469 of the previous month, and continued to rise until February 1998, a period during which the high interest rate policy was maintained. With widespread bankruptcies, massive unemployment was inevitable. The number of the unemployed more than doubled between the last quarter of 1997 and the first quarter of 1998, from about 561,000 to 1,179,000.

Policy Responses to Crisis

The South Korean government has vigorously undertaken a major restructuring plan under the IMF's trusteeship.[2] Both the South Korean government and IMF approached South Korea's economic crisis in a considerably different manner from the Latin American crisis in the 1980s. In the Latin American cases, many international experts recommended *quick-fix* solutions with the assumption that problems were temporary and did not reflect any structural element. In the late 1990's Asian crisis which included South Korea, however, such a quick-fix approach was neither considered nor recommended from the outset. Both domestic and international authorities concurred in attributing the crisis to chronic structural problems in the South Korean economy. In particular, the IMF and the South Korean government shared a diagnosis that *chaebol* over-expansion, mismanagement, and overall inefficiencies were chiefly responsible for the economic crisis. Based on such a critical evaluation of *chaebol*, the newly-elected Kim Dae Jung government set out unified efforts of reform in the four major areas: finance, corporations, labour, and the public sector.

In *chaebol* reform, five core issues stood out. The first was to transform *chaebol* ownership structure, separating ownership from management. The second was to reform *chaebol* corporate governance through consolidated financial statements, independent external audits, and reduction of intra-group mutual payment guarantees. The third was to streamline operations by selecting three or four core business lines and cutting unrelated subsidiaries (so-called "Big Deals"). The fourth was to decrease the debt-equity ratio. The fifth was to increase *chaebol* transparency and accountability. The Kim Dae Jung government, well before its inauguration, reached an agreement with *chaebol* leaders on all these outstanding issues and subsequently carried out various reform policies. The dissolution of Daewoo, one of the top five conglomerates, showed the Kim Dae Jung government's strong will to carry out the *chaebol's* reform despite the *chaebols*' usual efforts to delay, hamper, undermine, and sabotage reform against themselves.

In terms of financial reforms, the government closed or merged insolvent financial institutions and strengthened the capital base of viable ones, writing off non-performing loans and re-capitalising financial institutions. The government started by nationalising two commercial banks, Korea First and Seoul, and selling them to foreign investors. At the end of 1997, when the financial crisis broke out, 26 commercial banks and 30 merchant banks were operating in Korea. In two years, the government has closed five commercial banks and 21 merchant banks. Out of five banks that were nationalised, Korea First Bank was sold to foreign investors. Also there were mergers of two merchant banks and five commercial banks. By pouring in a massive amount of public funds, which is estimated to be around 50 billion dollars, the government took over the 52 per cent of non-performing assets.

Attaining flexibility in the labour market and building a social safety net were two major issues in the labour reform. As the flexibility of labour became the target of severe criticism against neo-liberal restructuring, the government tried to extract support and cooperation from the labour unions. To this end, the government formed a tripartite committee of representatives from labour unions, corporate sector, and government. This was an attempt to formally establish and develop a pact among these social actors through a form of social corporatism. The committee made a good start by producing several important agreements and compromises. However, within a year, the committee ran into trouble because the labour unions were dissatisfied with the government's pro-management tendency and withdrew from the committee. The reform in public sector has focused on the reorganisation and restructuring of the government as well as privatisation of government-owned corporations.

Evaluation of Structural Adjustment Programme

It is worthy to note that the cases of failure outnumber those of success among the developing countries having undergone the IMF's structural adjustment programmes.[3] After a critical cross-national review of various empirical studies on the outcome of these programmes, Dasgupta (1998:378) concludes: "there is no evidence that structural adjustment works." Indeed almost all the developing countries under IMF's restructuring have shown a sluggish growth even at the cost of denationalised capital accumulation, worsening income distribution, rising unemployment and underemployment, and increasing foreign indebtedness.

He goes on to say that "Dependence on structural adjustment tends to become never-ending . . . What was originally planned as an emergency surgical operation, has now become a routine treatment, irrespective of the specific conditions of the patients. Once admitted, it becomes a life-long patienthood in the [International Monetary] Fund-[World] Bank hospital. Seventeen years is a long time for testing a package of policies, there can be no doubt that structural adjustment has failed the test of time" (Dasgupta, 1998:136).

We can find a couple of general flaws in the IMF's restructuring package. First, the developing countries are forced to *adjust* their economies to the logic of the world market serving the interests of the developed countries. The IMF, controlled by developed countries, initiates structural adjustment programmes that are less beneficial for the developing countries. Second, the IMF's restructuring package is too standardised to take into consideration the social, cultural, economic, and political specificities of the developing countries. It does not allow developing countries to pursue their own development strategies based on those specificities (Dasgupta, 1998:135–36).

We can examine the process of implementing structural adjustment along three dimensions: timing, scope, and content (see Nelson, 1990:13).

In terms of timing, if South Korea had implemented restructuring earlier, it could have escaped the economic crisis. Delayed restructuring aggravated the already severe economic difficulties. The economic crisis took place in the midst of a presidential campaign, and thus all the presidential candidates hastened to accept the IMF's mandate without a thorough review. It is against this backdrop that South Korea under the Kim Dae Jung government began to launch neo-liberal structural adjustment programmes.

The scope of the restructuring in Korea is limited and can be characterised more as crisis management rather than a systematic overhaul. Short-term stabilisation has outweighed long-term structural change. The country has attempted to achieve structural adjustment in a relatively short time, with an audacious goal of achieving growth and distribution simultaneously. Thus the restructuring efforts were geared more towards revising macroeconomic coordination than introducing an overall rebuilding of the institutional basis of the inefficient economy itself. The Kim Dae Jung government favoured the technocratic political style of restructuring (see Przeworski, 1991:183) rather than the one based on participation of a broad range of social forces.

In its content, South Korea's restructuring is somewhat distinctive in two aspects. First, the neo-liberal market reform package is mixed with a neo-corporatist ideology of social partnership among labour, management and government. Second, the government has taken an unorthodox approach, pursuing investment and welfare at the same time by strengthening the social safety net. Both of these resulted from a special circumstance under which Kim Dae Jung, originally pursuing populist and pro-labour line of politics, had to follow the guideline imposed by the IMF. In implementing IMF's neo-liberal structural adjustment, the Kim Dae Jung government legitimised its reform policies with the theory of "parallel development of democracy and market economy." We can also add the element of productive welfare to this "parallelism" theory. Whether the elements comprising the Kim Dae Jung government's reform ideology fit together and provide a consistent picture of restructuring is questionable.

Recent Phase of Structural Adjustment and Its Problems

South Korea has formally entered its second phase of structural adjustment after two years of hardship in reorganising the financial, corporate, labour, and public sector. As the outcomes of the first phase of structural adjustment are questionable, there is also doubt as to whether the second phase would be implemented as intended. In fact, the second phase of structural adjustment is very sluggish. There are reasons for this. The present government has lost its willingness and ability to put spur to restructuring. In a single five-year presidential system, it is not easy to accomplish further restructuring in the latter half of the presidential tenure. Since President Kim Dae Jung has already declared that the economic crisis is over for his own political reasons, lessons from the economic crisis are fast forgotten and moral hazard is widespread among almost every corner of society. Although South Korea must guard against complacency in order to complete restructuring, the dramatic South and North summit talk in June 2000 has encouraged people to harbour the illusion that the economic crisis is over. However, time is running out for the completion of restructuring. Since the end of 2000, when the recovering economy showed signs of instability, people's interest and support for North-South talk became lukewarm and weak. On top of that, Kim Dae Jung's leadership came to be challenged by his opponents, which started earlier than the previous presidents in South Korea. These circumstances have made it all the more difficult for the Kim Dae Jung government to complete restructuring during his presidency.

The main problem involved in South Korea's structural adjustment programme is that it is nothing but patchwork. The Kim Dae Jung government attempts to put band-aids on the wounds, and not to find and get rid of the source of the crisis. The reform package lacks a long-term perspective on how to change the country's economy fundamentally to prevent recurring economic crises. Structural adjustment under the neo-liberal outlook offers one option for coping with the economic crisis, but it is unlikely to be the best one. As we can see in many Latin American cases, economic adjustment based on a neo-liberal outlook can create social unrest and political cleavages while providing only partial solutions for the economic crisis. In this regard, we would like to point out some deficiencies and problems in the South Korean experience of economic restructuring.

First, in agreement with IMF, South Korea has opened itself to the world in virtually every field. In addition to the opening of the commodity and capital markets, Korea has opened up the assets and service markets. To a certain degree, this opening is inevitable and necessary for the revival of the national economy, but a proper safeguard is also needed for controlling foreign penetration. Opening South Korean economy without any safeguards can deepen the national economy's dependence on the world economy.

Second, neo-liberal programmes can result in the weakening of state power. It is a well-known fact that the IMF uses the state to execute adjustment programmes on the one hand, but replaces the role of the state by the market on the other (*Hoogvolt*, 1997:169). The South Korean government has already accumulated excessive public debt by taking over massive amounts of debts from the private sector. At the same time, the public sector is shrinking fast due to the downsizing and privatisation of government-owned corporations following the adjustment programmes. These factors dramatically reduce the state's ability to fight against the economic cycle or to provide welfare for the people in need.

Third, structural adjustment programmes may be suitable for the US economy, but their relevance to the South Korean economy has not yet been proven. US economy led by the private sector depends on the autonomy of the market for investment, production, distribution and consumption. However, planting the US model of market economy on South Korean soil might aggravate inequality in the wealth distribution of South Korea.

Fourth, the most important goal of adjustment seems to be the strengthening of national competitiveness, especially the competitiveness of companies. Instead of reforming the political structure to break the cosy relationship between politics and business and to prevent rent-seeking behaviour, current adjustment programmes stress too much on the importance of competitiveness and productivity. This tendency is doomed to generate strong capital and weak labour.

Fifth, the adjustment programmes lack an industrial and financial policy for the future. There is no serious idea on how to fix the current problematic industrial structure. Most Korean companies export assembled products using US and Japanese components and parts; therefore, deepening dependency and low profits are inevitable. The adjustment programmes cannot upgrade the role of the Korean economy as a "subcontractor of the developed countries" in the global market.

The Impact of Crisis and Restructuring

Despite early graduation from the IMF's bailout programme due to good macroeconomic performances, South Korea integrated her economy more deeply than ever into the capitalist world economy. Two unfortunate consequences appeared from that process. One is the neo-liberal shortfall that substitutes the state for the market. The country's industrial and financial policy has been subjugated to global market forces. In such a denationalised economy, not much room remains for the government to manoeuvre its development strategy against the interests of the advanced countries at the core of world economy. The other is the social and political consequences of restructuring such as deepening class division and shifting power balance. The Kim Dae Jung government exploited the people's hope for reform and democracy as its power base for implementing the structural adjustment programme. However the consequences of the restructuring programme have dislocated Kim Dae Jung's power base, because the massive layoffs and emphasis on flexibility have put the burden of restructuring disproportionately on people.

Economic Recovery from Crisis

In order to look carefully at the outcomes of the restructuring package in South Korea, we need to put the country's recent macroeconomic recovery in the broader context. Table 1 summarises the major macroeconomic indicators of South Korea between 1995 and 2000.

Table 1: Macroeconomic Indicators of South Korea: 1995–2000

		1995	1996	1997	1998	1999	2000
National Account	GNI (billion $)	488.1	518.3	474.0	313.0	402.1	455.2
	Annual GDP growth rate	8.9	6.8	5.0	–6.7	10.7	8.9
Trade	Exports (billion $)	125,058	129,715	136,164	132,313	143,686	172,268
	Imports (billion $)	135,119	150,339	144,616	93,282	119,752	160,481
	Trade Balance (million $)	–10,061	–20,624	–8,452	39,031	23,933	11,786
Foreign Debt	Foreign Debt (million $)	127,500	163,500	159,200	148,700	137,100	136,300
	Foreign Reserve (million $)	29,390	29,420	8,870	48,510	74,050	96,200
Public Finance	Balance (million $)	1,242	1,099	–6,959	–18,757	–13,120	5,577
	Debt (million $)	22,518	25,644	28,542	41,572	61,168	71,226
Corporate Finance*	Equity to Total Assets (%)	27.2	24.9	20.4	25.3	31.4	35.6
	Debt Ratio (%)	347.5	386.5	512.8	379.8	218.7	171.2
Employment	Unemployed (thousands)	420	426	556	1,461	1,353	889
	Unemployment Rate (%)	2	2	2.6	6.8	6.3	4.0

* The top 30 *chaebol* groups

Sources: National Statistical Office (2001), *KOSIS Database*; IMF (1999) *International Financial Statistics*; Bank of Korea (2001), *Economic Statistics Database*; Korea Development Institute (2001) *KDI Economic Outlook*

In 1999, the country ranked top among the 29 members of the Organisation for Economic Cooperation and Development (OECD) in terms of economic growth. An annual growth rate of 10.3 per cent is remarkable by any international standards. South Korea has now become the 13th largest trading country in the world with the total volume of exports and imports valued at 332.7 billion dollars. As of now its foreign reserves exceeds 90 billion dollars, jumping from 4 billion dollars at the peak of the economic crisis in 1997. External liabilities have decreased to 136.3 billion dollars at the end of 2000 from 148.7 billion dollars three years ago.

Nevertheless, South Korea's public debt has radically increased from 68 billion dollars in 1998 to 95 billion dollars in 2000. If we include loans guaranteed by the government, the number increases to 154.5 billion dollars. Since financial institutions still suffer from the remaining non-performing debt, the government is required to invest a large amount of public funds to expedite restructuring. In 2000, commercial banks were liable for the repayment of 18.4 billion dollars, twice the previous year's total, and South

Korea will face the increased problem of a debt service payment due to the growing short-term debt among external liabilities.

The top 30 *chaebol* groups are reported to have achieved the debt-to-equity ratio of 171.2 per cent at the end of the 2000, less than half of 378.8 per cent in 1998. However, the number could be much higher — estimated around 300 per cent — if we count overlapping investments among subsidiaries. The *chaebol* groups continue to subsidise their sister companies by cross-loan payments. While the top 30 *chaebols*' total debts have decreased, their total assets have increased. Of particular importance, the big four — Samsung, Hyundai, LG, and SK — account for 50.9 per cent of the top 30 *chaebol* groups' total assets and 65 per cent of their total sales. This implies that the "big deal" programme of the government has helped expansion of the big four while the "workout" programme has not succeeded in removing malignant bank loans for the rest of the *chaebol* groups.

South Korea's trade balance was 39 billion dollars in 1998, 23.9 billion dollars in 1999, and 11.8 billion dollars in 2000. The trade surplus in 1998 was mainly due to decreased imports rather than increased exports. As the growth of exports is slow compared to that of imports, the current account surplus is likely to decrease in the future.

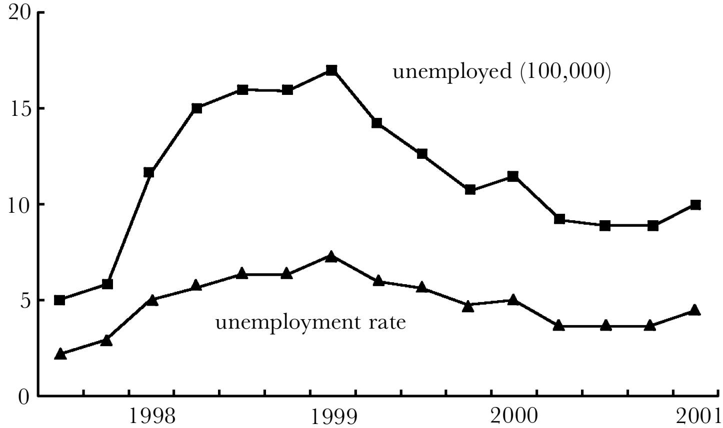
Growing Hardship and Deepening Class Division

South Korea is in the throes of deepening class division generated by the economic crisis and subsequent neo-liberal structural adjustment. The economic crisis has brought substantial change to social disparities. Before the crisis, both the middle class and the working class were growing together. After the crisis, structural adjustment resulted in the shrinkage of both classes. This is mainly due to massive layoffs and resulting unemployment in the process of restructuring.

Figure 1 shows the general trend of unemployment after the economic crisis. We can see a significant increase in unemployment from 2.5 per cent in 1997 to 6.8 per cent in mid-1998, and the peak of 8.4 per cent at the beginning of 1999. Company insolvency, shutdowns, and downsizing have contributed to the increased unemployment. However these unemployment rates tend to underreport the severity of unemployment. They tend to reflect more of the dominant added workers effect and less of the discouraged workers effect. The economically inactive population increased by 5.5 per cent, while the economically active population decreased by 0.9 per cent in 1998. Furthermore, the average unemployment period became longer. The proportion of the unemployed for six months or longer sharply increased from 7.8 per cent in the first quarter of 1998 to 31.2 per cent in the same period of 1999.

The impact of unemployment differed across industries, occupations,

Figure 1. Number of Unemployed and Unemployment Rate, 1998–2001



gender, and ages. While manufacturing and construction sectors revealed a sharp decline in employment of 13.3 per cent and 21.3 per cent respectively, employment in the agricultural/forestry/fishing sector increased 4.3 per cent. The number of employed in all occupations except professional, technical, administrative, managerial, agricultural, and fishing decreased in 1998. The female unemployment rate was 3.3 per cent in 1998 in contrast to the male unemployment rate of 4.9 per cent. This should not be interpreted as implying that women were less severely hit by the crisis. Females are more likely to exit the labour market than their male counterparts after the loss of a job, and become economically inactive rather than unemployed. In terms of age and education, it was the younger and less educated who were first and most severely affected by the crisis. The decline in employment for the younger groups has been higher than 14 per cent in contrast to the average decline of 5.3 per cent in 1998.

The South Korean government responded to the upsurge in unemployment with a comprehensive unemployment package including expansion of the unemployment insurance, the Wage Claim Guarantee fund, public work programmes and temporary livelihood protection, and loan programmes for the unemployed starting new ventures. The government assigned a budget of 2.8 billion dollars for the social safety net and unemployment-related expenditures, which accounted for 1.3 per cent of GDP. The budget increased by 34.3 per cent in the next year.

Thanks to the government programmes and general economic recovery in 1999, the number of unemployed has decreased considerably. However, intense restructuring in the corporate sector has put tight constraints on the recovery of employment. The number of unemployed and the unemployment rate were the lowest in mid-2000 with 0.8 million and

3.6 per cent respectively. However, it,began to rise sharply again in 2001. One should also bear in mind that the neo-liberal restructuring has deepened the division between winners and losers in the labour market characterised by increasing flexibility and specialisation. Increase in employment concentrated in contingent works rather than regular works. In 1999, less than 30 per cent of workers had a permanent (i.e. open-ended) contract. In fact, Korea has the lowest number of workers holding a regular job in the OECD, followed by Turkey. As a result, job tenure in Korea is lower compared to other economies — on average, workers stay with the same employer for about six years, compared with over 11 years in Japan and seven and half years in the United States (*OECD Observer*, October 2000).

Real wage recorded a 9.3 per cent reduction in 1998 due to a nominal wage decrease of 2.5 per cent and inflation of 7.5 per cent. This was the first nominal wage decrease since the wage statistics were collected. The monthly average real income per urban household recorded 20.0 per cent decrease in the third quarter of 1998 compared to a year ago. Not only did the overall level of income decline, but the disparity between the haves and the have-nots widened during the economic crisis. Increase in income inequality is evident in Table 2 and Figure 2, showing the trend in income distribution before and after the economic crisis.

The highest 20 per cent income group climbed up from 37.5 per cent in 1995 to 40.1 per cent in 2000, while that of 20 per cent of the lowest income group declined from 8.5 per cent to 7.5 per cent during the same period. It is not only the lowest income group that has experienced decline in the income share. Earnings among the middle income have also declined. While those who rely on wages for their living have suffered shrinking income, the wealthy have benefited thanks to the high interest rate imposed by the IMF. This provides empirical support for the argument that the conditions of both the working and middle classes have deteriorated after the economic crisis.

Table 2: Changes in Income Distribution: 1995–2000

Year	Distribution of Income by Quintile (%)				
	Lowest 20%	Second Quintile	Third Quintile	Fourth Quintile	Highest 20%
1995	8.5	13.5	17.5	23.0	37.5
1996	8.2	13.3	17.5	23.1	37.2
1997	8.3	13.6	17.7	23.2	37.2
1998	7.4	12.8	17.1	22.9	39.8
1999	7.3	12.6	16.9	22.9	40.2
2000	7.5	12.7	17.0	22.7	40.1

Source: National Statistical Office, *KOSIS Database*, each year

Figure 2. Gini Index and Ratio of High and Low Income Quintile

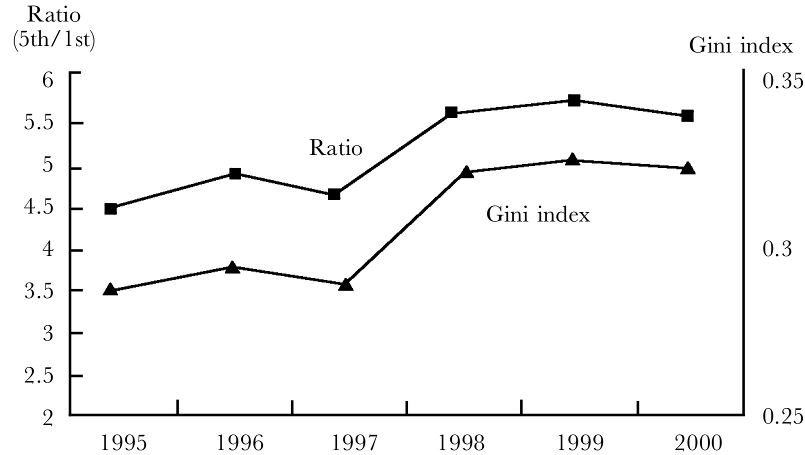


Table 3: Class Composition in Terms of Income (percentage)

		1997		1998		1999 1st half	
High Income		21.8		22.9		22.9	
Middle Income	*Upper*	68.5	54.8	65.4	51.6	65.1	51.4
	Lower		13.7		13.8		13.7
Low Income		9.7		11.7			12.0

Source: Kyung-Joon Yoo, "Changes in Income Distribution and Poverty in South Korea After IMF Bail-out," Korean Development Institute, Working Paper 2000–1, 2000:3

We can find a crude picture of the changing class composition in Table 3. Both upper and lower classes have increased in size, while the middle class has diminished. As a consequence of structural adjustment, a three-tier society is emerging, in which the bottom 15 per cent are economically inactive, unemployed, or marginalized,[4] the middle-lower 15 per cent are insecure in their jobs, the middle-upper 50 per cent are workers with secure jobs, and the upper 20 per cent hold tenured jobs. The neo-liberal logic and policy have a tendency to deepen social fragmentation: a new small entrepreneurial class engaged in fast growing information technology (IT) industry prosper at the expense of a large group of underclass who are either unemployed or underemployed. According to a systematic study of earning inequality after the economic crisis (Park, 2000), the widening gap in earning came from the increasing returns to skill and knowledge. It implies that increasing inequality not only reflect the situational effect of the economic cycle, but also the long-lasting effect of structural change in the labour market.

Changing Coalition

The Kim Dae Jung government is the first government that attained power through a horizontal transfer of power unprecedented in the nation's history. As the second civilian government it was charged with the economic and political project of carrying out economic restructuring and democratic consolidation.

South Korea used to be characterised as a strong state and weak civil society where political parties were incapable of functioning as a mediator of diverse interests among classes, groups, and sectors. Political parties are yet to become mass parties. Rather they are created by and remain at the disposal of individual political leaders such as the so-called "three Kims". These leaders are virtual *owners* of the region-based elite parties. After transition to democracy, no tutelage power such as the military or business exerted substantial influence behind the scenes. But the possibility of establishing procedures consonant with democratic governance is limited in that the electoral system does not work in terms of policy lines (see Valenzuela, 1992:71–73). Linkages between parties and citizens are not stable, and the majority of citizens question the legitimacy of parties and elections.[5] Democratic consolidation has a long way to go, as neither the "horizontal accountability" on the basis of separation of power nor the state's "vertical accountability" over civil society is fully established (see O'Donnell, 1996:34–51). In South Korea, democracy is "stalled", "delayed", or only "partially institutionalized."

The dominant view on restructuring is that the market economy is wholly compatible with democracy (Haggard and Kaufman, 1992:341). However, this has not always been the case. While the emergence of market relations contributed to the destruction of a traditional status hierarchy and arbitrary state power in western countries, market-oriented restructuring creates tension between capitalism and democracy in developing countries (Patnaik, 1999). This is mainly due to the fact that restructuring tends to deepen existing social disparities by polarisation and dislocation. Structural adjustment brings about unrest and political instability.

Alternation between economic boom and crisis over the past few decades has been a consequence of the dependent development process in which both "factors of success" and "factors of failure" are intermixed. Dependent development in South Korea has relied on the double alliance of the state and local capitalist (Lim, 1985). This differs strikingly from the experiences of Latin American countries, where the state, local capitalists, and transnational capital constituted a triple alliance.[6] In South Korea, the state's nationalist logic of capital accumulation has blocked the transnational capital from participating in the process of dependent development. Thus, the dependent development has proceeded with class confrontation between local capitalists, workers and farmers.

In neo-liberal logic of structural adjustment, good governance can be encapsulated as "bad state" and "good market". Here the market stands for not only the domestic market as the main stage of local capitalists but also the global market dominated by transnational capital. Therefore, we expect change in the nature of alliance for dependent development as a consequence of structural adjustment.

The status and role of state change with structural adjustment. The state puts itself increasingly under the influence of capital. At the start of the economic crisis, the national accounts of South Korea were quite sound. In order to re-capitalise the financial and corporate sectors, however, the state poured an enormous amount of public funds into those sectors, resulting in increased national debt. As shown in Table 4, the state liabilities of the central and local governments have jumped up from 54.6 billion dollars in 1997 to 95 billion dollars in 2000, and the payment guarantees by the government have climbed from 10.8 billion dollars to 59.1 billion dollars during the same period. By the end of 2000, the government has poured the sum total of 160 billion dollars into the financial sector. One big concern is that most of the huge public funds are not retrievable. The privately incurred debts have been nationalised under the responsibility of the state.

Table 4: National Accounts and Public Debts: 1996–2000 (billion dollars)

	1996	1997	1998	1999	2000
Balance of national accounts	0.9	–5.8	–15.7	–11.5	4.4
% GDP	(0.3)	(–1.5)	(–4.2)	(–2.9)	(1.0)
Central Government Debt (1)	30.7	42.0	59.5	74.7	80.0
% GDP	(8.8)	(11.1)	(3.6)	(18.5)	(19.5)
Local Government Debt (2)	10.8	12.6	13.5	14.6	14.9
% GDP	(3.1)	(3.3)	(3.6)	(3.6)	(3.6)
National Debt (1+2)	41.4	54.6	73.0	89.4	95.0
% GDP	(12.0)	(14.4)	(19.5)	(22.1)	(23.1)
Government Guaranteed Debt	6.3	10.8	60.0	69.1	59.1
% GDP	(1.8)	(2.9)	(16.0)	(17.1)	(14.4)

Source: Ministry of Economy and Finance (2000), *Economic Statistics Database*

It is capital rather than labour that benefit most from neo-liberal restructuring of the economy. The political economy of South Korea is well known for its strong and solid partnership between the state and capital at the exclusion of labour. Moreover, capital has unified under centralised leadership, while labour is divided into diverse organisations that differ in their political ideology. Under these circumstances, the state tends to bargain more with capital than labour on an unequal basis (see Hall, 1986:269–70). Restructuring is mainly for increasing productivity and competitiveness rather than for achieving equality. With the state's upper hand, structural adjustment will likely reinvent capital of more autonomous bourgeoisie and labour of less organised workers.

Behind the visible economic recovery exist increasing inflows of foreign capital. Figure 3 indicates that foreign investment funds and financial institutions own more than 30 per cent of the South Korean stock market.[7] The trend of foreign direct investment (FDI) is shown in Figure 4. In 1998 and 1999, FDI in South Korea amounted to 8.9 billion dollars respectively. If we add up the two years' amount of FDI, it comes close to the cumulative sum of FDI of 35 years from 1962 to 1997. As a consequence of such a massive inflow of FDI, the number of firms with more than 10 per cent foreign-share increased from 3,877 in 1996 to 9,423 at the end of 2000. Transnational companies and investors have gradually emerged as key economic actors. It is not likely in the foreseeable future that the state's role will be eroded by transnational activities. However, restructuring in the midst of growing globalisation will limit the state's capability of managing and coordinating industrial and financial policy.

Figure 3. Rising Share of Foreign Investors in Local Security Market

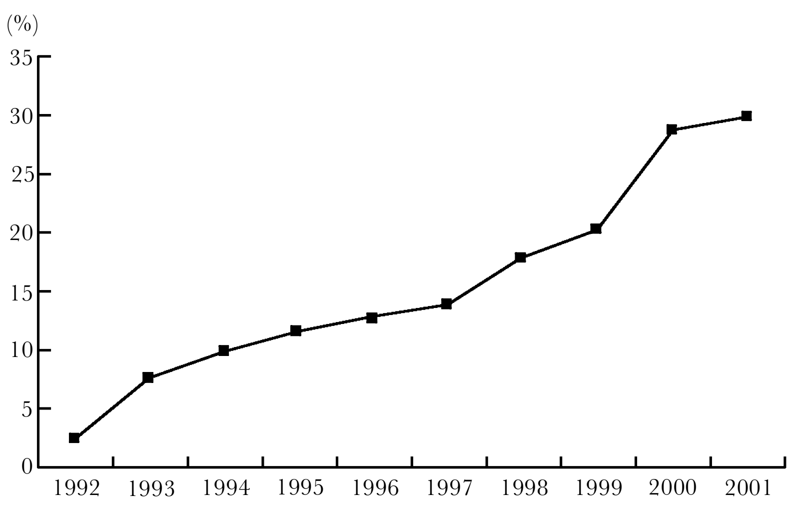
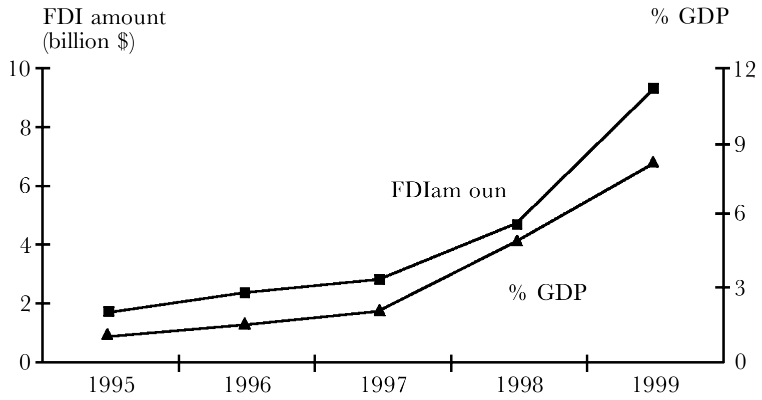


Figure 4. Trend of Foreign Direct Investment and Its GDP in Percent



Structural adjustment is double-edged in that it is a process of social fragmentation leading to loosening social ties and diminishing social capital and at the same time a process of mobilisation leading social movement based on solidarity. These paradoxical consequences of neo-liberal restructuring can be exemplified by the growth of civil society. In contrast to western societies, where new social movement diverged from traditional class-based movement, both movements are developing hand-in-hand with each other to articulate the voices of the people in South Korea. Non-Governmental Organisations (NGOs) now stand as another key actor in channeling traditional and new social demands.

Restructuring is a very complicated process in which a traditional form of development alliance is transforming into a new one. The traditional development alliance between the state and local capital will change into a new development alliance between the transnational capital and the state, with local capital in a weak position, thus excluding the working class and the farmers even more. In response to such change in development alliance, new opportunities for popular participation are emerging, which will challenge the newly formed development alliance.

Comparison with ASEAN Countries

The South Korean economic crisis did not develop in isolation from the other economies. At the same time when the Korean economy faced a deteriorating exchange rate, shrinking foreign reserve, and severe recession, ASEAN countries that experienced economic growth and boomed during the 1990s, such as Thailand, Indonesia, Malaysia, and the Philippines, also faced similar problems. In other words, economic crisis developed in par-

Table 5: Percentage Movement in Equity Markets and Exchange Rates for Selected Countries (1 July 1997–18 February 1998)

Country	Equity Markets (against US$)	Exchange Rate
South Korea	–32.3	–48.1
Indonesia	–81.2	–73.5
Malaysia	–59.0	–33.3
Thailand	–47.9	–43.2

Source: Lowell Dittmer (1999), "Globalization and the Asian Financial Crisis," *Asian Perspective* 23(4):51

allel among Asian countries having experienced recent economic growth and opening. Here we try to compare the development, outcome, and recovery from the crisis in these countries with a particular focus on South Korea. Theoretically informed systematic comparison is beyond the limit of this paper. Our goal here is a modest one of discovering the similarities and differences in the context of the economic crisis among Asian countries.

First, we examine the parallel development of crisis in these countries. Just as the Korean conglomerates were collapsing, Samprasong Land, a Thai finance company burdened by large, bad real estate loans, missed its deadline for the payment of its foreign debt. The Thai government's failure to step in with a rescue programme led to the collapse of Samprasong and thence to the bankruptcy of Finance One, Thailand's largest finance company. Immediately after the Bank of Thailand's announcement allowing the baht to float in early July 1997, the baht lost a third of its value. At the same time, the Malaysian ringgit followed the baht and, finally in mid-August, the Indonesian rupiah collapsed, losing 80 per cent of its value by January 1998. Table 5 summarises the movement of currency in each of these countries. We can see from the table that while Indonesia was most severely hit by the crisis, Malaysia and South Korea were relatively better off than other countries in terms of exchange rate and equity market respectively.

Table 6 shows the macroeconomic indicators of recovery from the crisis. All the countries hit by the economic crisis except Malaysia went to the IMF for an emergency bailout loan, and received the loan on the condition that they implement a structural adjustment programme similar to South Korea. At the end of 1999, the relative amount of public funds for financial re-capitalisation was highest for Indonesia with 60 per cent of GDP. For South Korea and Thailand, it was 12.9 per cent and 31 per cent respectively. Although Indonesia poured in public funds amounting to more than half her GDP, only 36 per cent of non-performing loans

Table 6: Macroeconomic Indicators After the Economic Crisis for Selected Countries

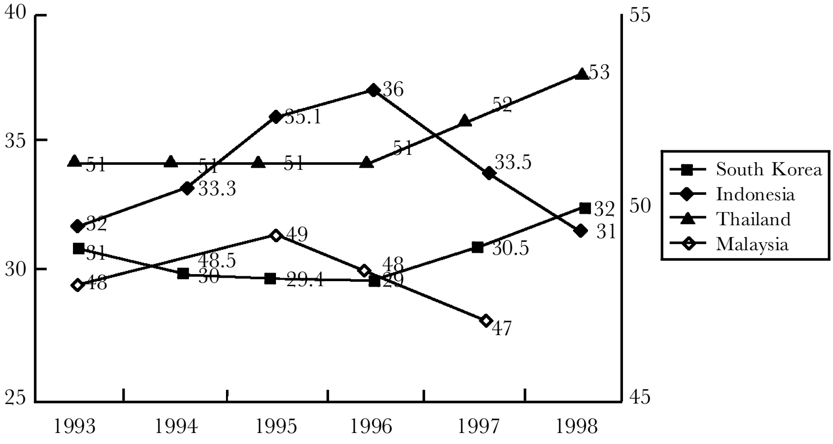
		South Korea	Indonesia	Malaysia	Thailand
Growth Rate	1997	5.0	7.5	7.5	–1.7
	1998	–6.7	–7.5	–7.5	–9.4
	1999	10.7	0.2	4.3	4.2
Foreign Reserves	1997	203.7	165.9	207.9	261.8
	1998	519.7	227.1	255.6	288.3
	1999	739.9	264.5	305.9	340.6
Non-performing Loans (% Total Loans)	1997	5.8	5.0	4.1	27.0
	1998	10.4	50.0	13.4	–
	1999	8.7	37.0	11.7	38.5
Foreign Debt (% GDP)	1996	31.4	56.7	39.4	49.1
	1999	32.9	100.2	53.3	71.6

Source: Asian Development Bank (ADB) (2000), *Asia Recovery Report*

were taken care of. Overall South Korea and Malaysia, both of whom were less severely hit by the currency devaluation, recovered fast as compared to Indonesia and Thailand. In 1999, South Korea and Malaysia had economic growth of 10.7 per cent and 4.3 per cent. The proportion of non-performing loans is also much smaller for these two while Indonesia and Thailand still suffer from non-performing loans close to 40 per cent. Between 1996 and 1999, foreign debt of Indonesia and Thailand drastically increased creating another potential source of problem.

Figure 5 shows the change in income inequality for South Korea and ASEAN countries after the economic crisis. Among the countries with high-inequality, Thailand showed a slight increase in income inequality while Malaysia showed moderate downturn in inequality after the economic crisis. Among the low-inequality countries, Indonesia experienced a steep reduction in inequality while inequality in South Korea grew worse as a result of the economic crisis. Which factors caused this difference among countries is a question to be answered by further research. It is not only the social outcome of the crisis but also the mechanism generating inequality that differs among countries. According to a study comparing the social consequences of economic crisis in these countries, over 80 per cent of the crisis-induced increase in poverty can be attributed to unemployment in Thailand and South Korea, while nearly 70 per cent of the increase in poverty was due to inflation and only 30 per cent was explained by unemployment in Indonesia (Park, 2000).

Figure 5. Comparison of Gini Coefficient of Income Inequality Before and After Economic Crisis



Sources: Sanantha Natenuj (2000) "Poverty and Inequality during Crisis Period in Thailand," ADB Country Report; Ali Said and Wenefrida D. Widyant (2001) "The Impact of Economic Crisis on Poverty and Inequality in Indonesia," paper presented at the Symposium on Poverty Analysis and Data Initiative (PADI) in Manila; Branko Milanovic. 2001; "Inequality and Determinants of Earnings in Malaysia," Asia and Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction, ADB, Manila

Concluding Remarks

Despite flourishing studies on the economic aspects of restructuring in South Korea, there has been a dearth of researches on the socio-political correlates and consequences of restructuring. We have tried here to fill this gap by assessing, in a balance sheet, neo-liberal, market-oriented structural adjustment programmes implemented in South Korea after the economic crisis. Most studies on this topic have been dominated by exclusive focus and emphasis on the issues of competitiveness and global standards. Our intention is not to deny or downplay their importance, but rather to give due weight to the issues that have not hitherto attracted much attention.

Our basic contention is that the structural adjustment and restructuring programmes based on neo-liberalism and implemented by the Kim Dae Jung government are flawed despite their contribution to the quick recovery of the Korean economy. Many Koreans enjoy a favourite saying that "there is either nothing done or nothing undone." This is readily applicable to the case of South Korea's current restructuring. Institutional reforms imposed by IMF have failed to bring forth a systematic overhaul of the long-overdue development model. What happened is a mere replacement of a defective model with an equally problematic model, which can result in increasing dependency externally and growing social disparity internally.

Although we have argued that neo-liberalism is not the best choice for South Korea, we cannot deny the fact that there are no other better alternatives available at the present moment. Considering the past experience of the state-initiated capitalist development modeled after Japan and the social-democratic development based on the Scandinavian model, it has now turned out that the former is neither more adequate nor the latter more effective. Thus one option left for East Asian and ASEAN newly industrialising countries is to design the future based on the past: where we stand should tell us which direction we should head for. It is apparent that the current restructuring would eventually bring in a market-driven economy in place of the existing state-centred economy. International development experiences over the past century have shown that numerous variants of capitalism exist in terms of state role, production system, market function, industrial relations, corporate governance, innovation system, welfare service, and so forth (Hollingsworth and Boyer, 1997; Storper and Salais, 1997; Zysman, 1986).

In the world characterised by connectedness (Mulgan, 1997), it is becoming ever more difficult for a single economy to cope with external shock by itself as the shock comes in the form of a chain reaction. In other words, there is no local economic crisis in the current global economy. This puts severe constraints on a single country designing its own development model. Here we find a reason for taking into account the efforts of regional cooperation, especially those initiated by the non-governmental organisations to build a body for economic coordination in East and Southeast Asia, to build an alternative development model.

Notes

1. It is interesting to note that as a main consultation body the IMF has offered South Korea a cautious mix of optimism and warning. Their point is that while the country's economic situation is relatively stable, without further restructuring in financial and corporate sectors, its economy may face a drastic economic downturn. *Korean Times*, 17 June 2000.
2. In implementing adjustment programmes, the South Korean case is close to *social learning* in that the IMF has had a strong influence in shaping the process of policy choice (see Kahler, 199:123–25).
3. Following Nelson (1990:3–4), we distinguish structural adjustment programmes of short-term stabilisation that is between one or two years (involving reduction of aggregate demand through macroeconomic management such as devaluing currency, slowing down inflation, reducing balance-of-payment deficit); of medium-term structural change that is from three to five years (encouraging foreign exchange earning such as trade liberalisation, price deregulation, and tax reforms).

4. This group can be called *underclass* as in the United States.
5. This is well evidenced by the low voting rates shown in the recent general and local elections. In the general election of 2000, voter turnout was 57.2 per cent. Only 19.2 million out of the 33.5 million electorates voted in this election, and this rate was the lowest in Korean election history. When interviewed, most people who did not vote said they were fed up with politics (*Korea Herald*, 15 April 2000).
6. Please refer to the seminal case study of Brazilian dependent development by Evans (1979).
7. Most of the foreign investment is private, short-term, liquid and volatile. This is one background of talks about the possibility of another economic crisis.

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