

Chapter 8

The South Korean Economy: Problems and Prospects

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Introduction

The South Korean economy continues to undergo an economic restructuring based on neoliberal, free-market principles. Mainstream analysts both inside and outside of South Korea (hereafter Korea) have viewed this restructuring as a necessary response to the country's devastating 1997-98 crisis that, according to the conventional wisdom, was caused by a legacy of state-generated "cronyism" and resulting economic inefficiencies. Ordinary South Koreans are said to support the restructuring and to be enjoying the benefits of the transformation so far completed.

Unfortunately this understanding of the crisis and, by extension, the benefits of neoliberalism is seriously flawed. While it is true that "crony capitalism" played an important role in the crisis, other domestic factors such as shifting state-*chaebol* relations of power and exploding class struggle were more important. The mainstream focus on Korean dynamics also masks other, possibly greater causes of the crisis, namely US government actions and international capitalist instabilities. In particular, US policy was instrumental in both enabling South Korea's past growth and causing its recent crisis. US policy also played a critical though often overlooked role in shaping Korea's post-crisis policy response. Tragically, this neoliberal restructuring is significantly worsening living and working conditions for growing numbers of Koreans and undermining the long-term stability and development prospects of the Korean economy.

To this point, worker opposition to the restructuring process remains largely focused on resisting state policies designed to promote labor flexibility, privatization, deregulation, and foreign ownership. So far, this defensive position has produced few and limited victories. In large part this is because many Koreans believe that their country's economic history of rapid growth and industrialization demonstrates that international capitalism provides a supportive environment for national development. In line with this understanding, current economic problems are generally blamed on misguided state efforts to override market forces and direct economic activity. Thus, many Koreans support policies designed to make domestic economic activity even more responsive to international market forces. As a result, working class resistance appears to many Koreans as contrary to the national interest, slowing down if not actually complicating the needed economic restructuring.

Company (Kim So-young, 2005b). The Korean economy is, as a result, now more closely integrated into transnational production networks and, thus, international market dynamics.

The Korean government has embarked on a major campaign to reverse the decline in foreign investment.³ In August 2003, it established three free economic zones in Incheon, Pusan, and Kwangyan in an effort to make Korea the "business hub of East Asia." Foreign businesses that operate within these zones will enjoy tax breaks as well as exemptions from various environmental and labor regulations. Foreign enterprises will also have the sole authority to build and operate educational and health institutions. In addition, the government is prepared to offer foreign high-tech investors a cash grant equal to 20 percent of the value of their total investment.

This policy appears unlikely to achieve its goal; as of mid-2005, the government has succeeded in attracting only one foreign investor to the Incheon zone. A major reason is that other countries, especially China, are offering even more attractive investment packages. In fact, the Korean government now finds itself on a slippery slope. Foreign companies, seeking guarantees that the benefits offered to them will be permanent, are asking that the investment-friendly regulations be extended to the entire country and include all firms, domestic as well as foreign (Lowe-Lee, 2004b; Alvis, 2005). The president of the European Union Chamber of Commerce in Korea made clear what was at stake: "The EUCCK thinks the peace meal opening of several localized free economic zones within Korea is far from sufficient to make foreign direct investment here an alternative option to foreign direct investment in China" (Yoo Soh-jung, 2005).

Meanwhile, as foreign direct investment inflows have slowed, outflows of South Korean foreign direct investment have grown. Over 4000 factories have moved their production out of Korea since 1998, and the numbers have been growing dramatically each year. According to a Korea Customs Service official, "about 70.7 percent of those production facilities have moved to China" (Kim Mi-hui, 2003). A study by the Korea Chamber of Commerce and Industry found that "about nine out of ten companies manufacturing products in Korea have plans to invest in China in the future, as the country's low production cost and the eager-to-please regulations make the market more attractive than Korea" (Kim Mi-hui, 2003). As a result of this trend, Korea's net foreign direct investment actually turned negative in 2002, and was close to zero in 2003 and 2005 (Asian Development Bank, 2006).

As government deficits and foreign investment declined and as significant sectors of Korean industry set up shop in China and elsewhere, Korea's economic growth

³ Foreign investment did rebound in 2004 and remain substantial in 2005, although at levels significantly below those in 1999 and 2000. The 2004 gain was largely attributable to one significant acquisition, Citigroup's purchase of KorAm Bank, South Korea's seventh largest lender. The 2005 total was also influenced by one major acquisition, Standard Chartered's purchase of Korea First Bank. This focus on finance is underscored by the fact that 2005 FDI in manufacturing fell by more than 50 percent from the previous year. See Stangarone (2006, 1).

became increasingly dependent on domestic consumption. Strong private domestic consumption often reflects sound economic fundamentals. However, this was not the case for Korea. Korean private consumption spending, with the encouragement of the government, was largely based on debt, especially credit card debt. The government began pushing credit card use in 1999 by, among other things, raising the limits on cash advances and introducing tax deductions for purchases made by credit card. The result was a major consumption boom and corresponding credit card debt explosion. The total amount of credit card spending rose from \$53 billion in 1998 to \$519 billion in 2002 (Lowe-Lee, 2004a, 1).

This credit card spending enabled Korea to limit the negative consequences of the US economic downturn in 2001 and avoid its own recession, but at great cost. The country had the world's fast growing household debt, which soared from 18 percent of GDP in 1999 to 62 percent in 2001, "a rise which even in the profligate US took a decade" (*Economic Intelligence Unit*, 2002). With cash advances and credit card loans accounting for approximately two-thirds of all consumer transactions, it was not long before many households faced unsustainable debt levels. Delinquency rates began rising sharply in 2002. According to the US-based Korea Economic Institute, "The credit card excesses . . . created spiraling social problems. Local newspapers and TV report continuously on increasing number of suicides, violent crime, kidnappings, and prostitution, all due to over-borrowing on credit cards" (Lowe-Lee, 2004a, 1).

Frightened by the prospect of a wave of personal bankruptcies and the danger such bankruptcies could cause the country's financial system, the government belatedly took steps to limit credit card use in the spring of 2003. While it appears the government has succeeded in avoiding a major banking crisis, it will be a long time before a new wave of consumption will drive the economy forward. Household debt has reached 70 percent of GDP. Approximately 40 percent of all households carry debts that outweigh their assets and many face risk of default (Choi, 2003). In fact, the government's success at limiting credit card use led to a sharp decline in private consumption, which in turn had a negative effect on business investment. The top five *chaebol* slashed their investment spending by 30.5 percent in 2003; the top 18 reduced their investment by an even greater 33.5 percent (Kim Ji-ho, 2004b). Not surprisingly, South Korea suffered a recession in the first half of 2003 (Lister, 2003, 1).

As a result of the above trends, Korea is now more dependent than ever on exports to power growth. Korea's post-crisis restructuring had already increased the export orientation of the economy. The export share of the manufacturing sector rose from 35.9 percent in 1997 to 45.9 percent in 2001 (*Business Korea*, 2002, 13). In 2003, with domestic consumption and investment down, exports accounted for 98.2 percent of the country's growth (Kim Ji-ho, 2004a). The situation did not change in 2004 as exports continued to carry the economy, consumer spending declined for much of the year, and investment stagnated.

This greater external orientation represents more than just a deepening of pre-crisis trends, however. As a result of changes in the international economy, Korea's

export (and investment) orientation has shifted from the United States to China. In 2001, China became South Korea's number one investment location. In 2002, China became South Korea's number one export market. In 2003, China became South Korea's number one trading partner. In short, China has now become the anchor for Korea's economic future (see Table 8.3).

Table 8.3 South Korea's Trade Orientation, in percent

Year	Share of exports to China	Share of exports to China and Hong Kong	Share of exports to the United States
1992	3.5	11.2	23.6
1993	6.3	14.1	22.1
1994	6.6	14.8	21.4
1995	7.3	15.9	19.3
1996	8.8	17.4	16.7
1997	10.0	18.6	15.9
1998	9.0	16.0	17.2
1999	9.5	15.8	20.5
2000	10.7	16.9	21.8
2001	12.1	18.4	20.8
2002	14.6	20.9	20.2
2003	18.1	25.7	17.7
2004	19.6	26.7	16.9
2005	21.8	27.3	14.5

Source: *Korea Trade Statistics, Korea International Trade Association*

As a result of this new orientation, many Korean analysts claim that the Korean economy has greatly reduced its vulnerability to instabilities in the US market and threats of trade sanctions from the United States (Lister, 2004, 1). This is wishful thinking because China now largely functions as a major production platform for multinational corporations that export to the United States (Hart-Landsberg and Burkett, 2005, Chapter 4). Most exports from South Korea to China are intermediate goods used in the production of other goods. Studies by the Korea International Trade Association and the Korea Institute for International Economic Policy have shown that "a large portion of the final products are reshipped to third countries, with about 40 percent re-exported to the United States" (Brown, 2004, 1).

More problematic perhaps, South Korea's new China orientation is likely to promote a narrowing and premature hollowing out of the country's industrial base. South Korea is currently running a trade surplus with China. However, China is quickly becoming a major competitor to Korean exports in other markets. According to the Korea Economic Institute, "Within the next decade, Chinese firms are expected

to out-compete Korean producers of low-end electronics equipment at home and abroad. Institutes and business organizations already report drops in domestic sales of Korean home appliance products" (Cooper, 2003, 54). Studies by private and state research institutes in Korea raise the same warning, concluding that "China's export competitiveness was in some cases greater than that of Korea in sectors such as machinery, electronics/home appliances, textiles, and some information products" (Cooper, 2002, 1).

Moreover, this competition is not limited to low-end manufacturing, as developments in the Chinese auto industry make clear. In 1997, when South Korea was the fourth largest automobile-producing nation, China was not in the top ten. Now, China has passed Korea to become the fourth largest producer, out-producing South Korea every year since 2002. According to an official of the Korea Automobile Manufacturers Association, "China has been accelerating its auto output because major global carmakers have been scrambling to produce vehicles in that country to tap the world's fastest-growing auto market" (Kim Hyun-chul, 2004). Even more threatening to Korean economic interests, given that cars account for nearly 30 percent of Korea's exports, is the fact that foreign producers are now beginning to use China as a production base for their own automobile exports (Bradsher, 2005).

In sum, Korea's economic future has become increasingly dependent on a narrowing range of exports within a framework shaped by a foreign-dominated, China-based, US-centered system of export production. This development greatly increases the country's vulnerability to another major crisis. For example, the Chinese economy has its own instabilities that threaten its continued high-speed growth. Problems in China, whether economic or political, will have serious consequences for the Korean economy (Hart-Landsberg and Burkett, Chapters 3 and 4; Kim Ji-ho, 2004a).

In addition, both South Korean and Chinese prospects for export growth continue to depend on the stability and import capacity of the United States. The post-2001 economic recovery in the United States has been weak. The United States has been running bigger and bigger trade deficits: \$261 billion in 1999, \$363 billion in 2001, \$618 billion in 2004, and \$726 billion in 2005. These deficits are not sustainable. The US dollar is now falling and interest rates are beginning to rise, which will likely have a negative effect on US growth and imports. It is unlikely that the Korean economy will be able to escape the negative consequences.

South Korea's Social Conditions

Sadly, most Koreans are already paying a high price for their country's neoliberal restructuring. According to a study by the Korea Development Institute, the country's middle class is shrinking: 70.2 percent of all households were classified as middle income in 1994, 68.5 percent in 1997, and only 65.3 percent in 2000 (Sim, 2003, 10). Even though the country's poverty rate has fallen from its 1999 high, it remains considerably higher than before the crisis (Soh, 2003). Inequality actually continues

to grow. For example, Korea's Gini coefficient rose from 0.283 in 1997, to 0.316 in 1998, 0.341 in 2003, and 0.344 in 2004 (Lowe-Lee, 2006, 2). The other major measure of inequality, the ratio of top-to-bottom income quintiles, shows a similar trend. In the first quarter of 2005, "the ratio of the top group's [monthly] income to that of the bottom group widened to 5.87, the highest figure since 1982 when this ratio began to be compiled" (Editorial, 2005a, 6).

One reason for these trends is that Korea's post-crisis growth has not produced any significant improvement in labor market conditions. Before the crisis, approximately 58 percent of Korean workers had permanent labor status, which meant that they had employment contracts lasting for at least one year. Following the crisis, many corporations took advantage of new labor laws to fire their permanent workers and rehire them as temporary or even daily workers—part of the "flexibilization" of the workforce. The percentage of permanent workers fell to approximately 48 percent in 1999 and has generally remained at that level. Contingent or non-permanent workers are paid, on average, only 52.9 percent of the wages paid to permanent workers (Crotty and Lee, 2001; Korea Herald, 2003a). Not surprisingly, then, disposable income in Korea currently accounts for only 65.4 percent of GDP, compared with 82.2 percent in the United States and 82.5 percent in Japan (Kim Jung-min, 2005, 1).

A 2004 Korea Broadcasting System survey on the economic state of the nation provides perhaps the clearest evidence of the failure of neoliberalism to satisfy majority needs. As reported by the *Korea Times*, the survey found that:

More than half of South Koreans feel that the current economic situation is worse than it was in late 1997 when the financial crisis shook the nation. . . . In particular, 52.6 percent of the respondents said that their current living standards are worse than six years ago, while only 9.9 percent felt their living conditions would improve. The survey also showed that polarization between rich and poor has been accelerating, with more people in low-income brackets believing the living conditions have deteriorated. (Kim Jaekyoung, 2004)

Workers, not surprisingly, are fighting to defend their working and living conditions. According to the *Korea Herald*, the year 2003 "is likely to be remembered as a time marred by the worst labor discontent since 1990, with labor disputes occurring almost every day" (Kim Sung-mi, 2003). As of November 2003, "labor conflicts involved a record number of 131,563 workers, up 43.8 percent from 91,630 a year earlier" (Kim Sung-mi, 2003). The Korean government claims that in 2003 labor unrest at the six largest manufacturers cut overall output \$19.2 billion and exports by \$1.5 billion (Kim Ji-hyun, 2004a). Worker demonstrations and strikes continued throughout 2004 and 2005, in protest against deteriorating working conditions and government initiatives designed to encourage greater labor "flexibility" and limit unionization, especially among public sector, irregular, and migrant workers.

President Roh Moo-hyun, although thought to be "pro-labor," appears to be continuing the hard-line anti-worker policies of previous administrations. A case

in point: 190 workers were arrested for their labor activism during his first eight months in office (Kim Sung-mi, 2003). Even more harmful, his administration has allowed the large *chaebol* to use civil rather than labor laws to crush labor resistance. This has enabled companies to put union funds and worker salaries under temporary attachment while they wait for final court rulings about the legality of labor actions. Many families of labor activists have been forced into bankruptcy leading, in a number of cases, to worker suicides (Jang, 2004).

As Korea's economic reliance on foreign direct investment and exports has grown, the government apparently believes that it has little choice but to view labor solely as a cost of production that must be reduced or more effectively exploited. Thus, even if the government succeeds in attracting new foreign investment and boosting exports, the likely outcome will be only immiserizing growth, not a reversal of current negative social trends.

The Dynamics of Growth

How did Korea get into this situation? This is not a simple question to answer. After all, South Korea enjoyed one of the fastest growing economies in the world until its 1997-98 economic crisis. As one indicator of its economic success, South Korea became a member of the Organization of Economic Cooperation and Development (OECD) in 1996.

Mainstream economists are generally content to answer this question by blaming "crony capitalism" for leading the country into crisis. While the crisis is indeed central to understanding the contemporary Korean situation, this explanation of its cause is seriously flawed. The focus on cozy and corrupt relations between state and business leaders draws attention away from other more critical domestic developments such as shifting state-capitalist relations of power and intensified class struggle. And it totally ignores the unstable nature of international capitalist dynamics and the dominance of US power, factors which were at least as, if not more important than, the above mentioned national ones in triggering the crisis and shaping the later restructuring process.

Although supporters of neoliberal policies initially denied it, state policy was far more important than market forces in helping Korea achieve an annual average increase in real GDP of 9 percent during the 1960s, 9.3 percent during the 1970s, and nearly 10 percent during the 1980s and first half of the 1990s (Hart-Landsberg, 1993, Part I). Control over the country's financial system was perhaps the single most important factor enabling the state to successfully direct the economy. Government planners were able to use their power over both the allocation and cost of capital to promote exports as the priority activity for all firms.

At the same time, the government regularly targeted new areas for development by encouraging the establishment of domestic firms, protecting them with both trade restrictions and limits on foreign direct investment and then, when judged capable, requiring them to export as well as meet domestic needs. The government was

also not hesitant about undertaking key investment activities itself through public enterprises, as in the case of petroleum, chemicals, and iron and steel. However, for political reasons, the government eventually decided to allow a small group of *chaebol* to dominate production of the new industries. By 1988, the combined revenues of the top four *chaebol* equaled approximately 47 percent of Korea's total GNP (Hart-Landsberg, 1993, 38).

Although Korea was widely celebrated as an economic model, working people paid a high price for their country's economic growth. Military dictatorship kept workers disorganized and on the defensive for most of the 1960s and 1970s through control of the only legal labor federation, a maze of ever more restrictive labor laws, and increasingly violent interventions into labor disputes by the Korean Central Intelligence Agency and special labor police. Government efforts to contain growing labor militancy in the 1980s and 1990s included frequent mass arrests and several major military assaults against workers.

Generally overlooked in most discussions of the Korean experience was the dependency of Korea's rapid economic growth and industrial transformation on favorable international conditions, most importantly substantial support from the United States as well as Japan. Korea's initial economic strategy called for building a "self-reliant economy" through import substitution. Given the country's low level of development, this strategy was expected to produce a large trade deficit requiring significant foreign exchange support. The US, unwilling to finance this strategy, used its influence to press the Korean government to adopt instead an export-oriented growth strategy. The Japanese government, fearful that a self-reliant Korea might become a fierce competitor, also supported this change in strategy.

Korea's mid-1960s shift to an export-led growth strategy did not solve the country's balance of payments problems. However, its willingness to comply with US and Japanese demands did ensure ample financial assistance, thereby enabling the government to sustain the country's rapid industrial development. For example, as part of their 1965 normalization treaty, Japan gave Korea \$200 million in public loans, \$300 million in grants, and at least \$300 million in commercial credits. Hundreds of millions of dollars of additional loans and grants followed over the rest of the decade (Hart-Landsberg, 1993, 145).

The US government provided even greater financial assistance, in large measure in exchange for Korea's participation in the US-led war against Vietnam. The US paid secret dollar bonuses to Korean soldiers, which generated \$185 million in remittances over the period 1965-73. The Korean government and business community earned almost \$1 billion dollars more, over the same period, for military and civilian activities in Vietnam and increased exports to Vietnam. The country earned an additional \$1.1 billion from US military activities in Korea itself, including local spending, provision of goods, and construction. During the key transition years of 1966 to 1969, approximately 30 percent of Korea's foreign exchange earnings came from Vietnam-related activities (Hart-Landsberg, 1993, 147-8).

In the early 1980s, after Korea suffered a major economic collapse and was in political chaos, the US and Japanese governments again offered critical financial

assistance. Two weeks after the Kwangju Uprising had been brutally crushed, the US Export-Import Bank finalized terms to extend more than \$600 million in import credits to the new military dictatorship headed by Chun Doo Hwan. The heads of Chase Manhattan Bank and First National Bank also traveled to South Korea to pledge their financial support. Not long after, the Japanese government extended a massive \$4 billion loan under exceptionally generous terms (Hart-Landsberg, 1993, 148, 223).

US and Japanese support for Korea was not limited to financial assistance. Japanese corporations provided critical technology and components to the large *chaebol*, enabling them to rapidly upgrade production and boost exports. For example, during the 1980s, Korean firms depended on Japanese corporations for between 40-60 percent of their machines, 60 percent of their parts, and 50 percent of their licensed technology. The level of dependence was far greater for those firms producing critical higher value-added exports, like cars, ships, and electronics (Bello and Rosenfeld, 1990, 114). The additional US economic contribution included a willingness to provide open markets for South Korean exports. Thus, in 1986, Korea's first ever trade surplus of \$4.2 billion was made possible because of the country's bilateral surplus of \$7.3 billion with the US.

However, the international conditions that encouraged US and Japanese support for Korean growth were not sustainable. More specifically, capitalist dynamics eventually generated instabilities and tensions that reached a boiling point in the mid-1980s. US and Japanese government and corporate responses to these instabilities and tensions led to the creation of a new international environment hostile to Korea's growth strategy, thereby helping to set the stage for the country's 1997-98 economic crisis.

The Dynamics of Crisis

The post-World War 2 (WW2) political successes of the US government in shaping an international capitalist world system favorable to American economic interests set in motion dynamics that eventually threatened those same interests. For example, as a result of the successful rebuilding of Japan and Europe, US corporations began facing growing competition within their home market. The US trade balance finally slipped into deficit in 1971, and with the US government continuing its war efforts in Vietnam, the sustained outflow of dollars finally led to the collapse of the dollar standard in 1973 and a rapid decline in the value of the dollar in 1977-78. Beginning in the 1980s, the US government started to take aggressive actions, especially against Japan, to stop the deterioration in the US trade balance and the hollowing out of the US manufacturing sector. In September 1985, it pressured the Japanese government into supporting a rise in the yen relative to the dollar as part of the Plaza Accord. The yen appreciated by almost 50 percent over the period 1985-88, creating serious economic problems for Japanese corporations.

The severity of US economic problems led the US government to object to Korea's export drive as well. In 1983, it began pressing Korea to drop its tariffs, end its quantitative restrictions on imports, liberalize its service sector, and improve its protection of intellectual property rights. That same year it initiated anti-dumping suits against Korean color TV exports and forced Korea to agree to so-called voluntary restrictions on its steel exports. By the middle of the decade it was forcefully demanding that the Korean government open the country's beef, rice, and cigarette markets to US goods. In 1988, with Korea's bilateral trade surplus growing rapidly, the US government demanded that Korea revalue its currency. That same year the US Congress passed the Omnibus Trade and Competitiveness Act, which required the US trade representative to take action against countries deemed to be "unfair traders". In 1989, the US trade representative threatened Korea with trade penalties if it continued to use special taxes and tariffs to block imports of US goods and placed the country on the special trade watch list each of the next three years.

Fearful of angering the US government and losing access to the American market, the Korean government began opening its markets. It also allowed the won to rise by 16 percent relative to the dollar in 1988 and by another 3 percent over the first half of 1989. The Japanese, upset at losing US market share to Korea in the years following the Plaza Accord, also took action to blunt Korea's economic challenge. For example, in 1990, the Japanese government banned the export of 200 advanced technologies to Korea until 1995 (Bello, 1992, p. 88). These developments proved disastrous for the Korean economy. Export growth fell from 36.2 percent in 1987 to 28.4 percent in 1988, 5.7 percent in 1989, and 3 percent in 1990. Corporate profits also fell. In 1988, VCRs surpassed color TVs to become Korea's leading electronics export. Yet, Korean producers lost money on every single VCR sold that year in the US (Hart-Landsberg, 1993, 161). Overall manufacturing profit rates fell each year from 1989-1992 (Brenner, 2002, 162).

As noted above, Korea's economic problems were not solely caused by changes in the external economic environment. Internal contradictions were also at work. Korean export growth had benefited greatly from a highly exploitative labor regime. Over time, however, industrialization created large working class-dominated cities and massive industrial enterprises that eventually encouraged labor solidarity and an explosion of labor organizing. Massive strike waves swept the country in 1987 and 1988, resulting in significant wage increases in most manufacturing industries.

The higher labor costs no doubt contributed to the economic difficulties of Korean manufacturers, especially exporters. At the same time, it was the changing international conditions that made this development so threatening. Given that the Korean state could not force a change in US or Japanese policies, it had little choice but to concentrate its economic recovery efforts on actions designed to reverse the labor movement's victories.

These international and national developments also contributed to a weakening of Korea's system of state planning. As the state found it increasingly difficult to protect the domestic market from imports and ensure the competitiveness of Korean exports, the *chaebol* became increasingly unwilling to accept continued state

direction and control over their activities. Because the county's growth dynamic had concentrated production and wealth in their hands, the *chaebol* had grown powerful enough to resist state mandates that threatened their profitability. They therefore demanded and won, over the first half of the 1990s, new borrowing and investment freedoms. One of the most important was the freedom to borrow internationally without government approval. Another was the freedom to invest abroad. From 1968 to 1980, cumulative Korean foreign direct investment totaled less than \$250 million. In 1990 alone it was \$1 billion. It rose to \$3 billion in 1993. Between 1993 and 1996, it grew at an annual rate of 53 percent. In 1996, reported overseas direct investment totaled \$6.22 billion (Burkett and Hart-Landsberg, 2000, 158).

The government did not make these changes in economic policy, along with others that allowed greater foreign investment in Korean stock and bond markets, solely in response to domestic pressures. US demands also played a critical role. A case in point: the US threatened to block Korea's entrance into the OECD unless it opened its financial markets for the benefit of US banks and brokerages (Kristof, 1999).

There was one final international development that may have been the most serious in terms of undermining Korean growth. In response to US pressure for a higher yen, Japanese corporations, with the encouragement of the Japanese government, initiated a massive process of foreign direct investment designed to regionalize their production. Southeast Asia was one of the key locations for this investment. This investment transformed Malaysia and Thailand into significant exporters of relatively advanced manufactured goods and thus competitors of Korea (Hart-Landsberg and Burkett, 1998). By the late 1980s, Malaysia's exports of electronics were replacing those from South Korea in the Japanese market (Burkett and Hart-Landsberg, 2000, 159).

Driven by competitive pressures, Japanese and other foreign investors were on the move again in the early 1990s, this time to China. And, as it did with many Southeast Asian nations, this investment helped to transform China into an increasingly successful exporter of manufactures. The share of foreign-produced exports in China's total exports rose from 17 percent in 1991 to 41 percent in 1996, leading to a rapid growth in China's exports of electronics and electrical goods (Tham, 2001, 3). Thanks to its integration in international production networks, low wages, and a 1994 currency devaluation, China quickly captured market share in both the US and Japan at the expense of Thailand and Malaysia as well as South Korea (Grilli, 2002, 184, 186).

Eventually, contradictions generated by this continuing expansion of regional export centers became unmanageable. Too many countries were producing the same goods for sale in the same markets. The resulting regional overproduction led to a decline in unit export prices and then to a sharp fall in export earnings (Grilli, 2002, 182). For example, the unit export prices of Korea's heavy and chemical products, which were the country's main exports, fell by more than 46.3 percent over the years 1996-98. As a result, South Korea's export growth rate fell from 30.2 percent in 1995 to 3.8 percent in 1996 (Grilli, 2002, 182).

Korea began running ever-larger current account deficits and accumulating greater foreign debt. The current account deficit rose from \$4.5 billion in 1992 to \$8.9 billion in 1995, and to a record \$23.7 billion in 1996. *Chaebol* profits were also forced downward: the forty-nine largest business groups recorded total profits of just \$32 million on combined sales of \$274 billion in 1996, for a rate of profit of 0.1 percent (Moon, 1997, 57). The *chaebol* sustained their operations only by going deeper into debt. And, thanks to the liberalization of foreign borrowing, an increasing percentage of funds came from foreign lenders. By 1997, Korea's foreign debt totaled over \$160 billion dollars, with approximately \$70 billion due for repayment in less than a year.

Relatively powerless to reverse these trends, the Korean state again focused its efforts on labor. It blamed the country's increasingly well organized labor movement for the growing economic problems and attempted to crush it with new, more restrictive labor laws passed in a secret December 1996 National Assembly meeting. This attempt was met with a massive general strike, which only further reduced the country's export earnings. A number of major Korean firms were forced to declare bankruptcy in the first half of 1997. These bankruptcies, in turn, threatened to destabilize the country's banking system.

As massive capital outflows triggered crises in Thailand, Malaysia, Indonesia, and to a lesser extent the Philippines, caused in large part by investor fears of growing balance-of-payments problems, foreign investors also found reason to worry about the stability of Korea. Many therefore sold their stocks and bonds, cut back their investment, and refused to rollover existing loans. With insufficient reserves, the Korean government was forced to respond to this flight of capital by raising interest rates and cutting spending. However, its efforts to halt the run on the won failed; by mid-November 1997 the currency was rapidly losing value, and the economy headed into crisis.⁴

The Dynamics of Restructuring

The severity of Korea's crisis and the nature and extent of the restructuring that followed were also critically influenced by the changed international environment. For example, South Korea's foreign minister traveled to Japan on an emergency mission to arrange an official loan and the rollover of Japanese commercial bank loans. The foreign minister refused to help (Blustein, 2001, 128). The US government

4 Two World Bank economists summed up the severity of the crisis as follows: "As a result of this crisis, Korea experienced the harshest economic recession of its entire post-war history. Industrial production dropped by 12 per cent between August 1997 and August 1998, while business investment decreased by 28.3 per cent in the third quarter of 1998 when compared to the same period of the previous year. Corporate bankruptcies reached an unrecorded high of 3,197 firms during December of 1997 [compared with a monthly average of 965 during 1996]. Layoffs were extensive, leading to 7.4 percent unemployment in August 1998." See Ferri and Kang (1999, 198-199).

was no more helpful. In fact, the US government sought to take advantage of the crisis to pursue its own restructuring agenda (Crotty and Lee, 2004, 8-10, 31-32).

In response to a Korean request for assistance, the IMF sent Hubert Neiss to Seoul in late November 1997. However, as business journalist Paul Blustein relates, "It soon became apparent that the deal Neiss was negotiating would fail to satisfy one interested party – the US Treasury. As one IMF economist recalled, 'Treasury thought Neiss was giving the shop away'" (Blustein, 2001, 141). Therefore, the United States sent Treasury Undersecretary David Lipton to Seoul to monitor the negotiations. Lipton became a constant, although indirect, participant in the negotiations, and he successfully stalled a final agreement, with the result that the crisis deepened. An agreement only became possible when it included conditions that the US government wanted. After the IMF agreement was finally signed in early December, a Treasury official boasted to reporters in Washington D.C. that the agreement "will bring about substantial changes in the Korean financial sector, which in turn have the potential to open up the Korean economy and move it toward one that is much more dependent on the operation of market forces" (Blustein, 2001, 149).

Responding to IMF/US pressure, the Korean government agreed to further open the country's money, stock, and bond markets to foreign investors and new sectors to foreign direct investment. It also agreed to foreign buyouts of strategic firms (even if hostile), the deregulation of the foreign exchange market, the removal of tariff and non-tariff barriers on imports, a massive privatization program, and significant changes in the country's labor laws giving firms greater freedom to fire workers and employ temporary workers in their place (Crotty and Lee, 2001). In essence, the government agreed to abandon the strategies and tools that had previously defined its once-celebrated state-directed growth strategy.

The Korean government implemented this full reform package in large part because its already weak negotiating position was made weaker still by the terms of the initial IMF agreement and US policy. As some analysts pointed out at the time, initial IMF demands for higher interest rates and cuts in government spending, far beyond what the Korean government had proposed, sharply raised business costs and slashed domestic demand. As a result, many healthy firms were pushed into bankruptcy, thereby worsening the crisis.⁵

At the same time, the IMF agreement failed to reassure foreign investors that South Korea would have sufficient foreign exchange to meet its international obligations. In part this was because the US government was reluctant to support it with promised funds (Blustein, 2001, pp. 178-182). Thus, the Korean currency continued to fall throughout December, further intensifying the crisis. As Korea approached financial collapse, a new agreement was finally reached in late December. The IMF agreed to speed up its contribution, the US government agreed to provide additional financial

5 For example, the IMF forced the South Korean government to raise interest rates from 13 percent in early December 1997 to 34 percent one month later. See Crotty and Lee (2004, p. 4; 2001, 6-7).

support, and major commercial banks agreed to rollover or extend existing inter-bank loans. This new agreement was reached, however, only after the South Korean government accepted an "IMF-Plus" plan that committed it to an accelerated and deeper reform program than the one agreed to in early December (Blustein, 2001, 199). While external pressures largely drove the reform process, the support of powerful national interests also pushed the government to accept IMF/US dictates. The large *chaebol* were eager to gain their freedom from state directives and restrictive labor laws. Some of the mandated structural changes, especially those dealing with labor, were just what they wanted.

What Lies Ahead?

The US government appears generally content with Korea's more free-market orientation. As the US Congressional Research Service explains, "The intensity of the disputes [between the two countries] has diminished considerably since the late 1980s and early 1990s, in part because South Korea has enacted a set of sweeping market-oriented reforms as a quid pro quo for receiving a \$58 billion package from the International Monetary Fund following the near collapse of the Korean economy in 1997" (Manyin, 2004, 2).

Even so, the US continues to pressure the Korean state into new market openings and a further retreat from industrial policy. A case in point: the Korean government wants to establish mobile communications as a strategic growth industry for the country. To encourage rapid investment, it announced its intention to establish mandatory technological standards for wireless telecommunications services. However, US technology firms do not support the chosen standards and fear that this will shut them out of the Korean market. The US trade representative responded by declaring Korea a "key country of concern," raising the specter of possible trade sanctions. As a result, the Korean government appears to have abandoned its plans for standardization (Manyin, 2004, 10-11).

US multinational corporations and many Korean *chaebol* also appear supportive of Korea's neoliberal restructuring, largely because it has opened up new private profit-making opportunities for them. At the same time, they also continue to press for even more deregulation, liberalization, and privatization, which the government cannot easily resist. Korea is now trapped in a self-reinforcing downward spiral. The post-crisis neoliberal restructuring has increased the economy's dependence on foreign investment and exports. Thus, foreign firms and *chaebol* exporters are in an excellent position to demand further concessions that, if granted, will only reinforce this same dependency.

Business analysts continue to claim that neoliberal reforms will improve the performance of the Korean economy and the well-being of its citizens. But, as highlighted above, neither has proven true. Changed international capitalist dynamics undermined Korea's past growth strategy and continue to limit the country's economic options. Neoliberal policies, which only increase Korea's dependence

on these dynamics, can hardly be expected to help promote a broad-based national development agenda. This conclusion is strengthened by the nature of current US and Korean business demands. In 2004, the head of the American Chamber of Commerce in Korea explicitly laid out expectations for the South Korean government: "Korea's competition is Shanghai, Hong Kong and China. Realize what your competition is, because investors can choose where to go" (Kim Ji-hyun, 2004b).

The *chaebol* share this perspective. Above all, they, like their US counterparts, seek more "flexible" labor conditions, which ultimately means government initiatives designed to weaken the labor movement. They have made clear that if the government does not meet their demands they will continue to move their production "across the Yellow Sea to China, where wages are lower and the demands of workers rarely result in headaches for managers" (Kirk, 2003, W1). This is no empty threat. As reported by the *Korea Herald*,

Korean industries are moving overseas faster than firms in other advanced economies, and the so-called industrial "hollowing out" will likely become a serious problem by 2007, Korea's leading business organization argued . . . Industrial migration, which in the past took place mostly in light industries such as shoe-making and apparel industries, is rapidly spreading to other sectors, including the electronics, telecommunications, metal and machinery industries, it noted. (Kim Hyun-chul, 2003)

In fact, signs of industrial hollowing-out are already visible. For example, Korean firms have largely stopped buying new equipment for their domestic operations. Before the crisis, the yearly growth rate of investment in machinery in the manufacturing sector was regularly over 20 percent. It fell to 0 percent in 1999, 0.5 percent in 2000, and then -5.9 percent in 2001 and -4.9 percent in 2002. While the rate of investment turned positive in 2003 and 2004, the recovery has been quite modest, 0.6 percent and 3.2 percent respectively. To put this trend in perspective, South Korean manufacturing companies spent a total of 74.4 trillion won in new equipment and plants in 2004, 4.3 percent less than the 77.7 trillion won spent in 1996 (Editorial, 2005b). As a consequence, employment in manufacturing is now declining (Kim So-young, 2005a, 1).

The administration of President Roh Moo-hyun has been doing all it can to satisfy business demands. In addition to the creation of special economic zones, it has also been pursuing bilateral investment agreements and free trade agreements with many countries, including Japan and the US. It has been one of the strongest advocates for a maximum WTO agenda, which includes full implementation of the Singapore issues. It remains committed to a program of privatization. And, it continues, despite its initial promise to remain neutral in labor disputes, to break strikes through compulsory arbitration, police interventions, and the encouragement of corporate use of civil suits. Such policies are unlikely to improve either the stability of the Korean economy or living and working conditions for most Koreans. Rather they can be expected to reinforce existing trends that promote inequality, poverty, and national industrial disarticulation.

Korea's economic fortunes are now ever more tightly tied to the dynamics of international capitalism. As a result, Korea's current growth strategy has placed workers on a treadmill, requiring them to accept worsening living and working conditions in a self-defeating attempt to attract higher levels of foreign investment and boost exports. To this point, working class activism appears focused on building militant trade unions and defending labor rights broadly defined. While these are important goals, workers will likely find their efforts frustrated and marginalized as long as overall government policy remains within the limits set by contemporary capitalist dynamics. Unless these dynamics are themselves rejected by large numbers of people, even liberal governments that identify with worker demands will end up taking the path of least resistance, which means bowing to capitalist imperatives and opposing these demands.

Thus, resistance to government policies must be tied to efforts to build new working class-based social movements capable of articulating and advancing new economic visions. This is no simple task.⁶ It is also not one faced by Korean workers alone. Unfortunately, despite the fact that capitalist globalization has proven destructive of development possibilities throughout the world, and growing numbers of people are demonstrating in opposition to neoliberal policies, no movements have yet been able to successfully place alternative social visions on their respective national political agendas and win large scale support for them. As a result, Korean activists continue to find themselves forced to break new ground under difficult conditions, with few national experiences to inspire or inform their efforts.

That said, the arguments advanced in this paper do provide insights into the kind of organizing that must inform movement building efforts. Most importantly, they make clear that opposition to government policies must be built in ways that promote popular understanding of the fact that contemporary capitalist dynamics structurally undermine development possibilities in Korea (as well as in other countries). This will encourage South Koreans to see worker resistance as a step towards, rather than an obstacle to, the needed transformation of the country's political economy.

Finally, given the nature of contemporary capitalist dynamics, organizing efforts must also encourage awareness that new social visions and the institutional structures necessary to realize them are most likely to emerge out of a process of social change that strengthens regional working class solidarity and, on that basis, encourages new forms of regional planning and regulation over economic activity. In sum, without recognizing and confronting the shifting and contradictory nature of international capitalism, Korea will likely be dragged further down a path that leads away from the future desired by most Koreans.

⁶ For a discussion of some of the challenges facing the Korean Confederation of Trade Unions and the Democratic Labor Party see Hart-Landsberg (2005).