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Korea's Neoliberal Restructuring: Miracle or Disaster?

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Over the last two years, South Korea's economy has recovered from the 1997 East Asian economic crisis faster than anyone expected. Indeed, Korea has become the new poster child for the "free-market" or "neoliberal" economic restructuring the International Monetary Fund (IMF) is peddling to a suspicious public in the developing world. In early 2000 the IMF touted Korea's "dramatic turnaround" after the crisis. Not only was Korea's output above what it had been before the crisis but, the IMF gleefully proclaimed, "over the past two years bold policies and a commitment to reform have made Korea a more open, competitive, and market driven economy."

There is a more pessimistic interpretation of Korea's experience under IMF and U.S.-sponsored economic restructuring since late 1997. The harsh policies the IMF imposed on Korea immediately after the start of the Asian crisis actually caused the Korean economy's 1998 collapse. Now, three years later, Korea faces an unbalanced recovery of questionable durability and a labor movement badly, perhaps fatally, wounded by neoliberalism, while the majority of its people suffer rising insecurity and falling incomes. If the IMF and the U.S. government succeed in their drive to transform Korea from an East Asian-style state-guided economy to a market-driven, "globalized" economy, future progressive political movements will find it exceedingly difficult to create an efficient, egalitarian economic system designed to meet the needs of the majority of its people.

The Rise and Fall of Korea's "East Asian" Economic Model

Following a 1961 coup, Korea's new military dictatorship adopted the economic development program pioneered by Japan that came to be known as the "East Asian Model." The government took control over the broad contours of economic life, guiding and regulating markets to achieve state-set national development goals. It decided what new industries and technologies would receive priority, allocated financial capital to support these decisions, and regulated investment spending by powerful Korean conglomerates known as *chaebol*. Most important, the government tightly controlled the movement of money into and out of Korea.

Under state guidance, Korea became one of East Asia's "miracle" economies. Though the authoritarian government severely repressed the labor movement, Korea's economic performance was outstanding. From 1961 through 1996, real GDP growth averaged 8% a year. And the fruits of this incredible growth were widely shared. Real wages grew by 7% a year during this 35-year period. Renowned Cambridge University economist Ajit Singh called the East Asian model "the most successful economic development model in the history of the world."

About a decade ago, under intense pressure from the United States, the IMF, and large chaebol and elite families who had prospered under the old model but now wanted the freedom to use their wealth as they pleased, the Korean government began to relinquish its control over key economic processes. By the mid 1990s, it let firms invest as they pleased, reduced regulation of domestic bank activity, and let foreign banks and investors run short-term or "hot" money into and out of the country. Short-term foreign bank loans exploded between 1993 and 1996, fueling an over-heated investment boom. When it became clear in 1997 that the boom was over, these banks pulled out, demanding immediate repayment of some $60 billion in short-term loans, which pushed the Korean banking system near bankruptcy. The banks, in turn, cut loans to highly indebted domestic corporations, forcing them toward the brink of insolvency. Korea borrowed money from the IMF to pay its foreign creditors and, in return, the IMF took effective control of the Korean economy, immediately imposing high interest rates and tight budgets to help restore foreign investor "confidence." These policies pushed the weakened economy over the edge, into 1998's state of collapse.

The Korean crisis occurred because the government stopped performing its traditional economic functions, making the economy vulnerable for the first time to volatile international financial flows. Yet the IMF did not urge Korea to restore control over capital flows to protect against another crisis. Instead, it took advantage of Korea's weakness to destroy what remained of its East Asian structure and replace it with a market-driven neoliberal system. Strong laws protecting job security were replaced by fire-at-will legislation. Remaining barriers to the entry of foreign goods, money, and corporate investment were eliminated. In the neoliberal future, global markets would make all important economic decisions without interference from the government.

The Not-So-Miraculous Recovery

It is not hard to assemble evidence in support of the IMF's triumphalist view of Korea's recovery. After falling almost 7% in 1998, Korea's real gross domestic product (GDP) grew by over 10% in 1999, and about 9% in 2000. The unemployment rate, which peaked at over 8% in early 1999, dipped below 4% in 2000. Before the crisis, Korea actually faced a large trade deficit. But the collapse of 1998 drastically reduced imports. That year, in the middle of the crisis, Korea showed a trade surplus of $40 billion – a record 13% of GDP. Since then, continued trade surpluses ($25 billion in 1999 and $12 billion and 2000) have helped restore the country's production and employment levels.

A closer look at the data, however, suggests that the recent Korean "miracle" may not be all that miraculous. In 2000, three years after the crisis hit, consumption was only 5% above its pre-crisis level, while fixed capital investment was still 9% lower. What domestic growth did take place in 1999 and 2000 was only possible because the Korean government brought down interest rates and increased government spending after the initial IMF-imposed austerity. But external agencies such as the IMF and the Organization for Economic Cooperation and Development (OECD) are demanded a return to fiscal and monetary conservatism. In 2000, the Korean government actually ran a budget surplus equal to 1.1% of the country's GDP. Since Korea's public debt had risen from 17% to 39% of GDP in the last three years, the government is not in position to sustain its stimulus program much longer anyway.

The recovery appeared to have petered out by late 2000. Economic growth slowed dramatically in the year's fourth quarter. Investment in machinery and other equipment, which had been growing rapidly, declined in the last two months of the year. The unemployment rate is above 4% again, and climbing. The Korean Development Institute forecasts that GDP growth in 2001 will fall to 4%, and even less if U.S. growth slows.

The Impact of Restructuring on Labor and Social Solidarity

The United States had been trying for decades, with only limited success, to open Korea's prosperous economy to Western multinational firms and banks. The IMF takeover of Korea finally gave multinationals the opportunity they had long sought. However, these companies wanted no part of Korea's militant trade-union movement. To attract foreign investment, the Korean government and corporations would first have to drastically weaken Korean labor. One of the IMF's key demands was that the government repeal labor laws protecting workers from being fired and replaced. In February 1998, Korea, for the first time in the country's modern history, legalized mass firings and the creation of firms to lease temporary workers to other companies. Korea's *chaebol* were quick to take advantage of their new legal powers, firing about 30% of their workers. As demand picked up in 1999 and 2000, firms hired mostly part-time or temporary workers. As a result, the percentage of Korean employees with stable permanent or regular jobs, already by far the lowest in the industrialized world before the crisis, fell dramatically, from 58% in 1995 to 48% in 2000.

In January 1998, President-elect Kim Dae Jung promised workers a "U.S. style" social welfare system to compensate them for the rising economic insecurity that his policies were bound to create. Given the enormous cost of such a system and the ever-tighter constraint on government spending, this promise will never be kept. Social welfare spending did rise after the crisis – from less than 3% of GDP in 1997 to over 7% in 1999 – as unemployment, poverty, and homelessness increased and the government broadened coverage. Even under these dire circumstances, however, Korea's social welfare spending came nowhere near the Western European levels of 15 to 20% of GDP.

The militant and democratic Korean Confederation of Trade Unions (KCTU) made valiant efforts to slow the pace of neoliberal restructuring. Strike activity in 1998 and 1999, measured in number of work days lost to strikes, stood at almost three times the 1997 level, and militant labor actions continue to this day. The KCTU even tried to organize nationwide general strikes to break neoliberal momentum in 1998 and 1999. Unfortunately, resistance has thus far been unsuccessful.

President Kim turned against the labor movement immediately upon taking office, responding to worker activism with fierce repression, including the arrest of virtually all union leaders involved in strike activity (see James Crotty and Gary Dymski, "Can the Korean Labor Movement Defeat the IMF?" *Dollars & Sense*, Nov/Dec 1998). In February 2001, the government crushed a large strike triggered by the firing of 1,700 Daewoo Motor workers, and issued arrest warrants for the strike's leaders. In April, police attacked union members demanding access to their office at a Daewoo Motor factory. Even the conservative *Korea Times* deplored the scenes of "bloodied unionists being viciously attacked by riot police," and the conservative opposition political party called for the resignation of the government's Prime Minister.

The labor movement, however, is divided: the more conservative Federation of Korean Trade Unions has refused to join forces with the KCTU in its fight against restructuring, and the widening split in the workforce between permanent and temporary workers makes it difficult to maintain labor unity. The media is universally anti-labor, the middle class fears that labor activism will destabilize the fragile recovery, and the once-powerful progressive student movement no longer exists. While it would be premature to rule out a new outbreak of effective labor militancy, prospects for labor do not look good. In June 2000, in an interview with one of the authors, KCTU President Dan Byung-Do observed that while resistance to neoliberal restructuring was on the rise, continued government, *chaebol*, and IMF-U.S. offensives against Korean workers were inevitable.

Korea is a country fiercely proud of its tradition of social solidarity. This is reflected in its long-term commitment to mass education and relative income equality. But Koreans have discovered that there are no exceptions to the rule that neoliberalism generates rising inequality wherever it is imposed. The real income of the top fifth of households rose right through the collapse of 1998, the recovery of 1999 and beyond, while the rest of Korea lost income in both 1998 and 1999. The income of the poorest fifth dropped by 18% over these two years. Not surprisingly, poverty has also worsened since the crisis. The household poverty rate, which stood at 5% in 1996, more than tripled by 1999.

Restructuring and Rising Foreign Economic Domination

Outgoing President Kim Young Sam signed the first restructuring agreement between the IMF and Korea in December 1997. According to the *New York Times*, President Clinton telephoned the wavering Korean president and told him "Korea would be 'severely punished' if the deal was not quickly reached." Incoming President Kim Dae Jung did not need outside pressure to cooperate with the IMF. Perhaps because he had been harshly treated by the military regime and the *chaebol*, Kim was a fervent neoliberal. In a 1985 book, written at Harvard under the influence of his U.S. mentors, he strongly criticized government interference with markets: "Maximum reliance on the market is the operating principle of my program." Resource allocation, he stressed, should be determined solely through unrestricted, globally open financial markets.

Kim believes that foreign investment is the key to future Korean prosperity. "What we need now, more that anything else, are foreign investors," he stated in an address to the U.S. Congress in 1999. "Market reforms and foreign investment are the only solution" to Korea's problems," he said. Kim predicted that "the crisis will be remembered as a blessing," because it would force Korea's economy open to foreign capital. Kim wants Korea to dance to the tune played by foreign stockholders and banks, a group shown by the Asian crisis to be astoundingly fickle.

The most pressing problem facing the incoming Kim government in late 1997 was the imminent collapse of the nation's banks. To deal with this threat, the government injected massive public funds into the banking system, effectively nationalizing most banks. Standard and Poor estimate the ultimate cost at $125 billion, or about 30% of the country's 1999 GDP. President Kim used state control of the banks to dictate structural change to the heavily indebted *chaebol*. He threatened to cut off their credit unless they slashed their indebtedness by 60% within just two years. In near-depression conditions, firms could meet this demand only by the extensive sale of real assets and the large-scale issue of new stock. Since domestic firms were broke, this policy was guaranteed to dramatically increase foreign control of Korea's economy.

Just as President Kim intended, foreign investment poured in. After running between $1 billion and $2 billion for most of the 1990s, foreign direct investment (FDI) – which includes the construction or acquisition of factories or other real assets – totaled over $40 billion from 1998 through 2000. Net portfolio investment – which includes investment in stocks and other financial assets – totaled $22 billion over the same period. These figures, however, may understate the increase in foreign control, since the collapse of the Korean currency (the won) made asset purchases in foreign currency "fire sale" cheap. Most FDI took the form of acquisitions rather than the building of new facilities. Korea thus gained few additional real assets in return for this unprecedented transfer of corporate control to outsiders.

Opening the Korean stock market to global investors dramatically increased both foreign ownership (which almost tripled between 1997 and 2000, to over 30% of the value of Korean stocks) and stock-price volatility. The main Korean stock price index (equivalent to the United States' Dow Jones) went on a roller-coaster ride: tripling between late 1997 and mid 1999, then falling by half by the end of 2000, before rebounding in early 2001. Yet President Kim continues his effort to impose shareholder-guided capitalism in Korea, a system that forces managers to adapt investment strategies to hyperactive stock-price fluctuations – a far cry from the days when they adapted their strategies to long-term government development plans.

These capital inflows have added to Korea's holdings of foreign currencies, but they have a longer-run downside. Korea is losing control of its economic destiny. Major Korean financial institutions, previously used by Korean governments to guide credit in accordance with development plans, have been sold at bargain prices to foreign owners, who have no obligation to cooperate with the government. With the proposed sale of Seoul Bank to foreign interests this summer, control of six of Korea's nine commercial banks will be in the hands of outsiders. The *Korea Times* reports that foreign owned banks are "reluctant to extend loans to Korean enterprises." Meanwhile, the industries most responsible for Korea's export performance – such as semiconductors, telecommunications, and autos – have also fallen under foreign influence. Foreigners own 44% of Korean semiconductor shares and

21% of telecommunication shares, according to the *Korea Times*, and are the dominant stockholders in such important firms as Hyundai Motors, Hyundai Electronics, LG Chemical, and Samsung Electronics.

The situation in autos is especially disastrous. In 2000, Daimler-Chrysler gained significant influence over Hyundai Motors through the purchase of over 10% of its shares. And Kim, in his lust for foreign ownership, ordered Daewoo Motors, Korea's second largest auto maker, to be sold to foreign interests, even though Daewoo has become so weak that its sale will bring little money. In April 2001, the *Korea Herald* reported that a General Motors (GM) spokesman "demanded that Daewoo Motor be immediately sold to the U.S. car maker without charge." Daewoo has lost much of its value because government-controlled creditor banks starved it of operating funds to deliberately force management to impose firings and wage cuts on its fiercely militant unions, bringing them to heel. "Mass layoffs are inevitable," Kim said in January 1998, "because without them foreign investors will not come to Korea." GM refused to make an offer for Daewoo until the unions were broken. Daewoo cut employment by 6,100 since November, firings the *New York Times* says are designed "to make a deal more desirable to GM." The influential *Financial Times* in mid 2000 raised "the possibility that the entire [Korean auto] sector, the second largest in Asia, could soon be dominated by foreigners."

Korea's Only Hope for the Future is to Defeat Neoliberal Restructuring

The widely advertised neoliberal Korean "miracle" is a fraud. The financial system remains fragile and subject to crisis even after the massive injection of public funds. Key corporations remain debt ridden. Since Korea's financial markets have been liberalized to an even greater extent than in 1997, and foreign financial investment in Korea is both more important and more unstable, a renewed outbreak of financial crisis cannot be ruled out.

The neoliberal restructuring process has dismantled or badly weakened most of the policy tools the government used so effectively to impose social control over the Korean economy in the decades before the crisis. Indeed, this is largely what neoliberal restructuring *is* – the replacement of potentially democratic political control over the economy with market processes dominated by rich individuals and powerful companies. With a "flexible" labor market and weak unions, free cross-border capital flows, unregulated stock and bond markets, corporations independent of government influence, banks guided only by short-term profits, and foreign domination of finance and industry, what policy instruments will be available to future progressive governments to guide Korean economic development so that it meets the needs of all the country's people? This is the most serious long-term problem facing Korea.

The destruction of the policy tools traditionally used to guide the economy is not an easily reversible political process. State-regulated economic systems, whether in the West during in the Golden Age of the 1950s and 1960s or in the East Asian "miracle" economies, were created in the aftermath of depression, revolution, or war. In the absence of a severe economic crisis, it will be extraordinarily difficult to put together the domestic political coalitions necessary to create such a system from scratch, even in the absence of external pressures and constraints. For a country as embedded in the global neoliberal system as Korea will be if the U.S. government, the IMF, President Kim, and their supporters have their way, it might well prove impossible. The battle for a progressive future for Korea has not yet been lost. The government has not yet lost its leverage over the economy, the union movement remains militant, and public support for neoliberal restructuring, and for President Kim himself, has declined dramatically of late. The *Far Eastern Economic* Review observed that "Kim now presides over a political disaster zone" and that opposition to the president now stands at 70%. Backing for the progressive Democratic Labor Party, though still weak, has been rising rapidly. But time is running short. To have any chance of success, a national offensive to defeat neoliberalism must begin soon.