Korea's Economy 2009

Korea's Near-Term Economic Prospects and Challenges

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STRUCTURAL REFORM

ECONOMIC POLICY REFORMS IN THE LEE MYUNG-BAK ADMINISTRATION

By Tony Michell

Policy and Global Crisis

Between winning the election in December 2007 and taking office in February 2008, Lee Myung-bak and his administration sketched out a massive reform program that would potentially affect every aspect of Korea's economic and social life, from the organization of ministries, through macroeconomic policies, privatization, taxation, education reform, and the restructuring of policies affecting land development from zoning to massive infrastructure projects intended to jump start the Korean economy. Part of this policy was aimed at rolling back 10 years of so-called progressive government, and part was to try to change the way the Korean economy worked by opening much more of it to private enterprise and market forces.

This article, rather than providing a comprehensive overview of the structural issues, addresses a select number of issues that may be viewed as characterizing the Lee Myung-bak administration's main policy themes. The approach is largely chronological because much of the battle plan did not survive contact with the enemy, but the measure of the administration is how it has adapted to new circumstances and to opposition to its core economic policies.

Korea is exposed to the global crisis that is now engulfing the world, just as any other economy. President Lee warned Koreans early into his term in office that Korea faced a severe test coming from overseas, but there was no immediate action. Koreans, like the citizens of many countries, did not see the connection between what was still seen in February 2008 as America's subprime problem and the export-led economy of Korea. The crisis exposed in a matter of months every weakness in every company and every sector and every economy that might have been worked out over a matter of years. The questions are whether the policies adopted by the Lee Myung-bak administration during its first year in office were appropriate and whether it is fully using the experience of the past.

The first thing to state is that the global crisis has almost no resemblance to the so-called Korean IMF crisis of 1997–98. In 1997–98, the Korean domestic economy collapsed as the *chaebol* failed to pay back their bank loans, dragging down the banks as well. In the last days of 1997, foreign exchange reserves were exhausted. The exchange rate of the *won* to the dollar fell from 900 to almost 2,000, and immediately exports grew while the domestic economy continued to contract.

In 2008–09 the issue was the collapse of exports driven by the collapse of the world economy, and Korea's domestic economy declined later. Today, the domestic economy is expected to experience a fairly shallow recession, with the export economy already experiencing a massive contraction. Unlike 1997–98, many Korean companies now are cash rich with relatively low debt-equity ratios. The recovery scenario is based on exports leading, and domestic demand recovery following, with infrastructure investment coming close behind at the back end of 2009. Lagging sectors are likely to be semiconductors and construction (especially domestic and commercial building).[1]

1. For an official statistical comparison with a financial slant, see "The Korean Economy: 1997 vs. 2008," *Economic Bulletin* (Ministry of Strategy and Finance, Republic of Korea) 30, no. 12 (December 2008): 2–6, http://english.mosf.go.kr/public/direction_list.php?sect=pubs_economic.

The strengths that Korea's previous experience brings to the present situation are:

- Korea Asset Management Corporation (KAMCO) is an excellent vehicle for handling toxic assets in the financial sector;
- Seminationalization of weaker banks is still partly in place;
- Companies have kept their leverage low after a disastrous experience in 1997–98; and
- Exposure to outside toxic financial instruments and frauds has been limited.

Campaign Vision: 747 Thinking

The president was elected on a reform program that was aimed at bringing Korea a new era of growth. Koreans worried that their economic potential growth rate was slowing rapidly and that a 3–4 percent growth rate of gross domestic product (GDP) would allow Korea to neither maintain its position in the league of world economic powers nor continue the growth of the standard of living up to the level of advanced countries. President Lee had been elected as the "business president" on the "747 platform," which proposed that the country could grow at 7 percent annually, per capita income could reach $40,000, and Korea could become the seventh-largest economy in the world. Although this was admittedly a long-term vision, the president initially said that this would be achievable within his five-year term as president, but apologists stated later that this was a plan to be achieved by 2017.

The 747 concept reveals some of the flaws in the thinking of the group that surrounded President Lee Myung-bak. The group that emerged as the strongest contenders for control of the president's thinking included Kang Man-soo, who was appointed minister of strategy and finance. To achieve 7 percent growth, the economy was going to need both domestic and external drivers. Exports would need to race faster, and the domestic economy would need to positively hum. When the group of advisers reflected on what engine was big enough to accelerate a maturing economy, which all historic experience should have told them could not be done, they came up with the idea of a canal from Seoul to Busan. This would make the construction industry surge with energy, make Hyundai Construction and other construction companies in bankruptcy suddenly valuable, and bring rising land prices and economic activity to a corridor that had not seen much growth for one to two decades. Initial claims that it would reduce transport costs were largely abandoned in the face of transport experts' insistence that it would not.

At the same time, Minister Kang's thinking was that the *won,* which had been steadily strengthening for several years, should be forced to drop from its range of 920–950 to the U.S. dollar to about 1,000, where the *won*/*yen* exchange rate would be about 1 *yen* to 10 *won,* which was felt to be the optimum for Korea to compete against Japan. Although reversing the strengthening of the *won* would lower the per capita GDP short term, it would raise the GDP growth rate.

But how could Korea become the seventh-largest economy in the world? It seems that the advisers were not aware when they coined the slogan that Korea had slipped from 10th place to 13th place as Russia, India, and Brazil raced past. Even so, however you run the numbers on the back of the envelope, the only way Korea could get to seventh was to add the 24 million North Koreans to the 49 million South Koreans and also speed up the North Korean economy. This was not going to happen, in their view, unless North Korea collapsed and was absorbed by South Korea; and the group's North Korea policy was clearly tinged by this concept. In this thinking, although it was never explicitly stated, unification was to be not an abstract goal but something whose time could come within the five-year presidential term. Any North-South cooperation that delayed the collapse of the North was not really in line with this hope, and this included the Kaesong industrial estate. President Lee was to speak on the subject of unification with more assurance than his two predecessors, who had expected it to happen on a mutually negotiated basis and would not be the "acquisition" that President Lee's group nursed in their souls.

The president and his advisers also wished to create a smaller government by merging and rearranging ministries, privatizing state-owned assets, and selling the indebted companies—such as Woori, Daewoo Shipbuilding and Engineering, Hyundai Construction, and others—that had been under state bank ownership since the crisis of the 1990s. The retreat from holding assets would help reinvigorate the economy. Corporate tax cuts would stimulate the private sector, with income tax cuts following. Penal taxes on selling real estate would be removed.

High Hopes and Early Disillusionment

The year 2008 opened with expectations of a high level of economic growth. Year on year the economy was performing at its best for eight quarters in the first quarter of the year, at 5.6 percent, having sustained a rising note during the last two quarters of 2007, and confidence was high that the new president, who took office on 25 February 2008, would take the country's business to a new level. The country was thought to be immune to what was still seen as a U.S. subprime mortgage crisis, while the heights that commodity prices would reach by July were still unforeseen. Monthly exports were growing at 20–30 percent year on year.

The administration recognized that part of the stimulus to the economy could be achieved through macro policy but that much of the underwriting of growth would require a fairly massive legislative program. This could not be attempted until a new National Assembly, to be elected in April 2008, was seated in June because until then the Lee administration would not have a majority. Developing the legislation would take until at least September, and a raft of reform legislation would come into effect in January 2009.

The task of identifying and preparing this reform legislation was given to a new Council on National Competitiveness reporting directly to the president and led by the distinguished economist, SaKong Il. This council was to work on creating a business-friendly environment. In particular it was recognized that the patchwork of legislation from 45 years of rapid growth needed comprehensive reform. In July SaKong pointed to the need for comprehensive laws:

> For some regulatory reforms, more than one relevant law needs to be revised. Ideally, therefore, if we have a special comprehensive law, deregulation can be done more efficiently. However, we have to deal with legislative reality in which persuading the National Assembly to pass such a law will not be easy. Nonetheless, we will try to persuade the National Assembly to legislate a number of comprehensive laws in specific areas, so that deregulation in these areas can be expedited.[2]

Core to the 747 program was the quick implementation of the U.S.-Korea Free Trade Agreement (KORUS FTA), which was languishing in both the Korean National Assembly and U.S. Congress, because core to Lee's entire global strategy was to park Korea in the U.S. parking lot, in alliance with Japan, a political goal that implicitly clashed with the need to cooperate with China, which now took 23 percent of Korea's exports. Almost certainly in the minds of the advisers, nearly all in their late 60s, was the belief that the U.S. economy still took closer to 40 percent of Korea's exports as it had done in the 1990s, when most of them last held office, and not the 10–11 percent that flowed from Korea to the United States in 2008.

The one thing that held up the KORUS FTA, the president was advised, was the issue of admitting U.S. beef, and, in a hurry to push things along, the president agreed on his visit to the United States in April 2008 to accept the beef under a slightly lower standard of supervision than a number of other countries. No one present at the Korea-U.S. talks could have had any conception of how strong the public reaction to this would be. It is important for the U.S. side to realize that this was not an antiforeign movement but a spontaneous explosion of public discontent with the style and program of the new government, in which the majority of the Korean people felt they were treated like employees of Korea Inc. and not citizens of the Republic of Korea. The canal program, which threatened to overtake the beef issue as a matter of discontent, also disturbed

2. "SERI Interview: Presidential Council on National Competitiveness: Chairman SaKong Il," *SERI Quarterly,* July 2008, www.seriworld.org/sq/wldQArticle.html?mcd=2000&psq=20080202&ssq=&atseq=36.

every notion of what made sense for the nation. The protests finally faded after almost two months, with some backing down by the government, but it was clear that the administration had lost the confidence of the population.

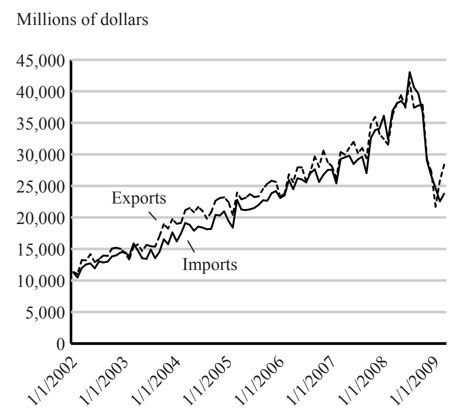
The strength of the protest, while not overthrowing the government, made an administration already nervous about answering criticism from its electorate even more inclined to be defensive and nontransparent, a bad precondition for the government and the country as they approached the worst global crisis that anyone alive in 2008 had faced. Despite a poor showing by the official opposition in the April 2008 elections, the administration has, to date, been unable to muster its full paper majority in the National Assembly, and passage of the KORUS FTA by the Korean assembly is now set for May 2009 at the earliest. Hence SaKong's cautious note in July 2008, cited above, and hence the fact that, after one year of power, almost none of the legislation that was proposed in January–February 2008 is near the statute book.

At the same time, Minister Kang's manipulation of the *won* had upset the business community, causing massive losses among many exporters who were hedged to cover rises in the value of the *won,* but actually had counterparty hedges (the so-called KIKO and other derivatives) that forced them to pay the banks if the *won* headed south. This created considerable pain among small- and medium-size exporters. The effect has been to make Koreans, always more unsure about the future of their economy than outside observers, much more prone to panics and rumors than might otherwise have been the case as Korea entered the global crisis.

Inflation and Recession, May 2008–January 2009

From May 2008 to the end of the year the Korean economy climbed a speculative mountain and then slid down the cliff of economic slowdown. This is a phenomenon illustrated in almost all data, from output to inflation, but it is well illustrated by ***Figure 1,*** which shows the long-term monthly performance of exports and imports. The reduction in the value of the *won* also came at exactly the wrong moment in terms of inflation because even at fixed exchange rates all the imported inputs into the Korean economy soared in price, but, coupled with the speculative peaks to July 2008 and a falling *won,* it meant an impending problem for every part of the Korean economy from households to banks and manufacturers. In addition, it created a current account deficit. Fortunately the collapse of world commodity prices came in time to save the Korean economy from inflationary self-destruction, and a new set of problems confronted Korea's policymakers.

Figure 1: **Performance of Exports and Imports in Korea, 2002–early 2009**



Source: Ministry of Knowledge Economy, Seoul, 2009.

The immediate legacy, which weighed heavily on the *won,* was the current account deficit run-up when oil was rising toward $150 per barrel. On a monthly basis, as prices and imports fell in parallel with exports, a current account surplus returned. Still Korea ran a negative balance of about $12 billion for the first time since 1998, and this weighed heavily on the *won.* The main problem during the last four months of 2008 and ongoing in 2009 remained building confidence in the *won.*

In each successive quarter of 2008, growth was lower, but not until October did exports cease their relentless year-on-year growth and begin to decline. Figure 1 shows that exports peaked in July 2008, but by January 2009 exports were back at the level of 2005, temporarily wiping out three years of export-led growth.

Low Expectations, Spring 2009

A summary of the achievements of the Lee administration in its first year is not very positive. In terms of macroeconomic policy, the stability of the economy had been weakened prior to the full fury of the crisis that hit Korea on the collapse of Lehman Brother on 15 September 2008, while the business-friendly legislative reform was not yet on the statute book. Inter alia, the impending sale of Daewoo Shipbuilding and Engineering and government holdings in banks had to be postponed as the Korean stock market index, KOSPI, slid from around 1800 to around 1000 and the ability of the major Korean companies to fund leveraged takeovers disappeared. At the same time, in terms of handling the domestic effects of the crisis, the steady shoveling of relatively small amounts of money by the Bank of Korea and the Ministry of Strategy and Finance through existing mechanisms was well done. Further, as described below, in August 2008, the president announced a new vision of a green and great Korea that proposed a major additional engine of economic and social policy and that could replace the ill-conceived canal.

Korea faces two economic challenges, one from internal economic players and one from external players. On the whole, Koreans are much more negative about their economy than the external players are; they are more likely to imagine forthcoming crises without adding up the numbers; and of course they are more likely to engage in foreign exchange hoarding, which has almost the same effect as capital flight in the short term but can be more easily reversed. Foreign players tend to look at the macro numbers and become nervous if there is a current account deficit; believe macro forecasts that have a limited basis in Korean reality; and look at other macro parallels—of which the most significant are the very high ratio to GDP of Korean household debt, ranking in the top five in the world alongside the United Kingdom and Australia, and the high amount of overseas foreign exchange borrowing by Korean banks—without looking at the cause and the channel.

These two debt figures are important because they have special Korean features. The level of household debt is curious given the lack of 90 percent mortgages that would explain it in the other two cases. It seems to be related to the use, which is exceptionally high, of credit cards in the economy for normal transactions and the need to borrow to pay for education. As for the amount of short-term foreign exchange borrowing, the International Monetary Fund (IMF) has demonstrated that about half is related to the shipbuilding industry and the other half to more normal business practices with some carry trade activities related to the *yen.* In addition, more than half of the debt is handled by branches of foreign banks in Korea, which means defaults by lenders become the problem of foreign banks and not domestic banks.

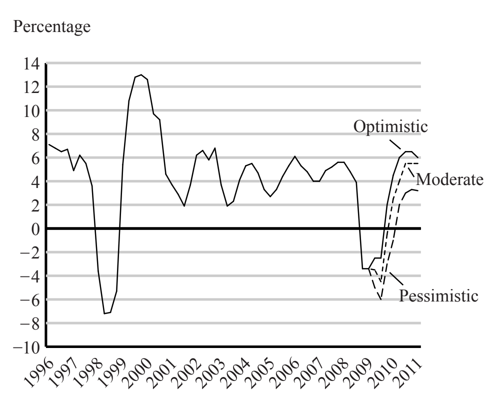
From late November 2008, when UBS predicted that Korea would experience –3 percent growth for 2009, until February 2009 when the IMF predicted –4 percent, the country's decision makers were in denial. No one in Korea realized that the global economic collapse could be so fast, least of all the group around the president, members of which were still dreaming of higher and not lower growth. Kang Man-soo used the ministry's machinery to discourage professors and journalists from making pessimistic forecasts and was menaced by an anonymous blogger, Minerva, who culturally linked the demonstrations of May to the decline in economic growth.

Only with the appointment of Yoon Jeung-hyun as minister of strategy and finance in February 2009 could a new realistic look come over the government. Yoon, unlike his predecessor, had held office under President Roh Moo-hyun and brought a new realism to macro policy, being prepared to countenance realistic estimates of short-term economic contraction. "Despite these challenges, the government will stay calm and take action as initially planned," he could say as he announced the possibility of negative growth of at least 5 percent in the first quarter (***Figure 2***). His major contribution was the proposal for a new major stimulus plan that may include radical innovations such as food stamps, while working with all actors in the economy to make progress on reform legislation.

Fears about a March 2009 crisis pushed the *won* below 1,500 in the final half of February 2009. The degree to which Korea is prone to rumors was captured during the second half of 2008 by the blogger, Minerva, whose doomsday forecasts were widely given credence. This was partly due to the parallel rumor that Minerva was a senior government or administration official and not the untrained IT specialist he apparently was. The first alleged crisis was the September 2008 crisis, where the projected failure of foreigners to roll over their *won*-denominated bond holdings would cause a foreign exchange crisis. What this September crisis rumor lacked was any quantification of numbers. The worst-case scenario that not a single bondholder would reinvest would strip only about $10 billion out of Korea's foreign exchange reserves, which at the time stood at more than $210 billion. In fact, foreigners were net buyers, and Koreans were the sellers and dollar hoarders.

The same lack of quantification drove the notion of a March 2009 crisis, which was based on Japanese banks' not rolling over loans as they closed their books. Again the total amount involved was about $10 billion, only about 5 percent of Korea's foreign exchange reserves in February 2009. In essence the *won* was being driven by Korean players who did not calculate the real probability and impact of their predictions. At the time of writing (5 March 2009) the expectation of a strengthening *won* in April, just as it strengthened again in later November, is reasonable, but we must also expect that the Korean market will continue to generate imaginary future crises that create real waves as Koreans speculate against the crisis. The sentiment grew worse in late February with concern looming over a second wave of global financial market trouble starting from eastern Europe.

Figure 2: **Growth Forecasts for Korea's Economy 1996–2010 (2009–10 est.), percentage**



Sources: Ministry of Knowledge Economy, Seoul; Euro-Asian Business Consultancy, Ltd.

Thus, most of the gloom came from doubts about the sustainability of the *won* rather than the economic fundamentals. A fierce debate was occurring over the impact of the fact that the *won* is not fully convertible: The majority of Korean financial institutions believed that the fact that the *won* was still not fully convertible and was still focused on the *won*/dollar window was restricting the global demand for *won.* Successive administrations believed that, if the *won* were freely convertible, capital flight would pull the *won* down. Foreigners thought that opening the *won* would increase the global demand for the Korean currency and deepen the market. In all this debate, typical Koreans were more pessimistic than the foreigners who were active in the market.

One of Korea's strengths is that it has an excellent mechanism—in the form of KAMCO—for handling toxic assets. KAMCO in the 1990s and early 2000 played a major role in removing bad debt from the nation's financial institutions. KAMCO's special strength is that it is an intermediary, not a long-term holder of bad assets. In the past it has packaged portfolios and resold them, unlike the Chinese asset management companies like CINTA that tend to hold the assets. KAMCO is thus able to turn over its capital relatively fast and repurchase more bad assets without government recapitalization.

Thus KAMCO swung into action on behalf of the small savings banks of Korea that had become heavily involved in project finance of projects that were suddenly unviable in the second half of 2008, and KAMCO is ready to vacuum up bad debt from the commercial banks. This means that there is never much doubt about the pricing of bad assets from the bank administrator's point of view. Further, most Korean bad assets still have a real estate base because of the conservatism of the banks where corporate lending was concerned. Consumer debt is of a different quality, and the country signally failed to handle the consumer debt crisis as well as Taiwan handled a similar crisis at about the same time.

Recovery for Korea in 2009, or for that matter in 2010, rests on the recovery of other economies. Korea is, like Germany, Japan, Taiwan, and China, a major exporter. Unlike the other four, Korea tends to run a marginal current account surplus, which is largely a reflection of the imbalance in trade with Japan rather than the need to import raw materials that is common to all the exporting economies. Is it credible that there will be enough growth in the world to allow Korea's exports to recover? During 2008, 70 percent of Korea's exports went to developing countries, including China. The assumptions are that China will continue to grow at 6–7 percent in 2009, and slightly faster in 2010, that this will pull Korean exports in, albeit not at such a fast rate, and that under most scenarios much of the developing world will grow in 2009, again modestly increasing potential exports to those destinations. In this, much hangs on the price of oil, which needs to be above $50 per barrel to ensure that oil producers continue to invest in their infrastructure plans and to subsidize their populations.

Neither 6–7 percent growth in China nor $50 per barrel oil will set the world aright, but they would set a floor under Korean exports and are likely to create a sense of a reviving economy that will underwrite Korean consumer expenditure. They will come close to offsetting declining demand in the United States, Japan, and the EC by the end of 2009.

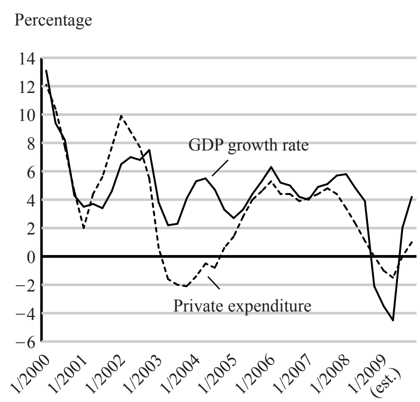
The expectation is that in the third quarter of 2009 exports will be close to their 2008 level and that in the fourth quarter exports will exceed their reduced base in the fourth quarter of 2008, bringing back growth and domestic confidence. Even consumer expenditure may be higher in the final quarter of 2009 than in the corresponding quarter of 2008. This makes the recovery "technical" as much as producing real growth, but it begins a virtuous cycle that leads to very substantial growth in 2010 (not yet factored in by forecasters in the IMF and Organization for Economic Cooperation and Development [OECD]), and that should give Korea a growth rate of 4–5 percent and a healthy balance of payments surplus, which in turn will presumably lead to a rise in value of the *won.* The worst case appears to be that the recovery will be delayed from the third quarter to the fourth quarter. Such a delay would move Korea's 2009 GDP downward from –1 percent to –2 percent. No recovery in the final quarter would result in the IMF forecast of –4 percent being close to accurate. The task of domestic policy therefore became short-term stimulus and strengthening confidence in the *won.*

Interplay of International and Domestic Sectors and an Economic Stimulus Plan

It is often said that exports represent 60 percent of the Korean economy. More accurately, during the past few years, the growth of exports has contributed 60–70 percent of Korea's growth. In terms of the actual composition, the export sector represents only about 20 percent of the composition of Korea's GDP; but, growing much faster, exports have recently contributed close to 60–70 percent of the country's growth.

During the past few years, the domestic economy and the external economy have run at very different rates, as shown in ***Figure 3,*** which compares the quarterly growth of private expenditure with GDP quarterly data. It can be seen that during the credit card crisis of 2002–03 private consumption was also negative.

Figure 3: **Comparison of Growth of Private Expenditure with Growth of Gross Domestic Product in Korea, 2000–09 (est.), percentage**



Sources: Bank of Korea; estimates by Korea Associates Business Consultancy Ltd.

The collapse of consumer expenditure in the final quarter of 2008 was faster than expected. This persuaded Minister of Finance and Strategy Yoon that a direct consumer stimulus aimed not at all segments of the population, as was done in Taiwan and Japan, but especially at lower-income groups would be most beneficial. A bill has been introduced into the National Assembly that would create both food stamps and shopping coupons. Such a bill, if it overcomes the objections that the money may not be spent but will be saved, could put additional purchasing power in the hands of consumers by the end of April 2009.

How to create a suitable stimulus for the economy remains an issue for the government. The circle around President Lee sought to reinstate the canal plan and inserted into the 2009 budget (***Table 1***) an inordinate amount of expense on river improvement, although gradually rail and other infrastructure improvements have been proposed.

Although President Lee was to claim in February that Korea had spent 2.5 percent of its GDP, about $25 billion, on economic stimulus, this clearly was no more than minimal domestic garbage disposal. This task should not be treated lightly because it has kept Korea Inc. functioning smoothly. However, if 2.5 percent of GDP is required to handle waste, another 2.5 percent to 5 percent is needed to create growth, and this is now being proposed by Minister Yoon.

Great and Green

In his independence day speech on 15 August 2008, President Lee launched his conception of a green and great Korea. This was to develop into an independent 50 trillion *won* funding initiative that would create a new engine of growth.

Although Lee Myung-bak has always been an environmental advocate, the green and great Korea concept is a major policy innovation. Moreover, Korea is one of the best bases for producing new green products. President Lee Myung-bak's administration has made a major policy innovation in recognizing that the green world can be a world of significant opportunity for Korea and that Korea can become green and great. This has begun the urgent task of preparing Korea for Kyoto II. Since the creation of the Kyoto treaty, Korea's greenhouse emissions have doubled while most OECD countries struggled to

Table 1: **Budget Expenditures by the Republic of Korea, 2008 and 2009**

	2008		2009 (proposed by government)		2009 (fixed by National Assembly)	
Budget items	***Won,*** **trillions**	**Increase (%)**	***Won,*** **Trillions**	**Increase (%)**	***Won,*** **Trillions**	**Increase (%)**
Research and development	11.1	13.0	12.3	10.8	12.4	11.5
Industry, small- and medium-size enterprises, energy	12.6	0.3	15.3	21.1	16.2	28.5
Social overhead capital	19.6	69.3	24.8	26.7	24.7	26.0
Agriculture, fisheries, food	16.0	0.3	17.1	7.1	16.7	4.8
Health and welfare	67.7	10.2	74.6	10.3	74.7	10.4
Education	35.6	15.7	38.7	8.8	38.3	7.7
Culture, sports, and tourism	3.3	11.7	3.4	3.7	3.5	6.7
Environment	4.5	10.6	4.9	10.1	5.1	14.1
Defense (normal accounting)	26.6	8.8	28.7	7.8	28.6	7.3
Union, foreign affairs	2.8	15.6	2.9	3.7	3.0	5.1
Public system and security	11.7	7.1	12.3	5.1	12.3	5.6
Normal public administration	45.9	8.6	48.9	6.5	48.7	6.1
Total expenditures	257.2	8.5	283.8	10.4	284.5	10.6

Source: Ministry of Strategy and Finance.

prevent their emissions from increasing. Korea is consequently now one of the top seven polluters in the world although its contribution to total planetary greenhouse gas emissions is not large. Under Kyoto II, Korea will need to sign emission constraints. Thus, this overcrowded country must change its ways by seizing the opportunity.

With all the distractions of a global economic crisis and oil falling from almost $150 per barrel in July 2008 to $30–$40 five months later, the dynamic of becoming green and great may seem less urgent. But in the future this two-to-three-year breathing space for the planet and for the world economy may be seen as the perfect gift to mankind's future and a chance for Korea to get ahead. During the past decade the standard of living of about 3.5 billion inhabitants out of the 6.5 billion on the planet has increased remarkably. No longer is wealth concentrated in the hands of the one billion Americans, Japanese, and Europeans. Korean exporters had been major beneficiaries of that development. But the capacity of the planet to support such a level of affluence under the brown economy is zero. What is necessary is a new era of sustainable growth that requires everyone to reconsider how they use resources.

Korea has some of the best manufacturing techniques in the world. Whatever a green planet needs, Koreans can produce it. The problem is that no one knows what the next generation of green industries will look like and what products it will use. Will cars be predominantly battery driven, hybrids, or powered by oxygen or hydrogen? Is solar power, wind power, or tidal and geothermal power going to be the major provider of household energy needs? Can we retrofit buildings to be sustainable, or must we redesign buildings and cities to be modest or minimal emitters? How can a building of 100 stories be energy efficient? How will aircraft design change to provide both mobility and low consumption of resources?

One of Korea's problems is that its research and development is spread very thinly and in-depth knowledge is concentrated in a few areas. A nationalistic pride continues to make Koreans want to invent their own technology and, therefore, ignore good existing technology.[3]

For all these reasons the need for a green dialogue between foreign companies and the Korean government and Korean businesses and educators is urgent. Korea has the opportunity to become the green foundry of new technology, producing whatever entrepreneurs or others around the world create. Or Korea may choose to try to pursue proprietary technologies that may be behind those of other leading R&D countries.

On 6 January 2009, the government announced the Green New Deal, consisting of 9 major projects and 27 affiliated projects such as improving the environment of Korea's four major rivers, developing and promoting green cars and clean energy, expanding the recycling of waste resources and waste-to-energy systems, and building more eco-friendly homes. The Green New Deal is a set of measures to promote green growth and overcome the economic slowdown at the same time.

Under the Green New Deal, the Ministry of Environment will set up a comprehensive system to collect and treat waste across the nation and expand sewage pipelines and treatment facilities to reduce pollutants flowing into rivers. The ministry will also build facilities that purify water discharged from sewage treatment sites and supply it to industrial complexes for their use. In addition, the ministry plans to develop technologies that can reduce pollutants from cars and promote eco-friendly vehicles. It remains for the Ministry of Knowledge Economy to produce effective policies that support industries that can benefit from this.

Thus far, the government has put its emphasis on the safe treatment of municipal and industrial waste,

3. In October 2007 Korea Associates Business Consultancy (KABC) organized the Green Dialogue Conference: A New Opportunity for Partnership, which was sponsored by DHL, Norske Skog, and Think UK. It was difficult to get the attention of the Korean authorities and especially to persuade major Korean companies to think there was value in such a partnership. The concern of foreign companies was that when the next round of the Kyoto Agreement is signed, Korea will have to adopt draconian measures without time for adequate consultation.

but it is shifting its policy focus to recycling waste resources and recovering energy from waste in order to address challenges from high oil prices and climate change. To this end, the government will increase investment in recycling and waste-to-energy infrastructure. These days, waste and biomass are drawing more attention as more practical alternative energy sources to replace fossil fuels.

Furthermore, the ministry will recover the health of marine habitats and create a well-preserved water environment by restoring ecosystems of streams damaged by previous river maintenance.

Foreign Enterprises and Domestic Enterprises

The fast decline of the *won* and the collapse of global demand in many industries in the final quarter of 2008 brought a rapid response from chief financial officers around the world. A quick evaluation of the relative profitability of operations worldwide showed that the Korean operation showed a remarkably good potential compared with European and U.S. plants. Chinese plants were obviously more attractive for simple operations, but Korean expertise in production engineering made Korea an attractive location for more sophisticated products. In both Korea and China plants were normally more modern, more energy efficient, and more economical than in older markets.

Korean multinational corporations (MNCs) took a different view, which was that their most modern and efficient plants are in China and India; therefore, production was increased in those locations and somewhat reduced in other locations. In this respect, Ssangyong Motors was treated more like a Korean MNC, with its Chinese owners trying to walk away from the failing enterprise. Down to mid-February there had been relatively few bankruptcies and only one major one, the C&Heavy Industry Group, a rapidly growing group that had built up a leveraged conglomerate in a short period of time.

The largest groups of Korea seem relatively secure despite the global downturn. Samsung Electronics experienced its first quarterly loss in the final quarter of 2008, and the iSamsung Group moved into an emergency mode in January. Hyundai Motors, driven by aggressive sales, continued to increase sales year on year in China in December and in the United States in January 2009. LG was less affected than Samsung because its worst problems stemmed from overproduction of memory chips at a time of falling demand that struck Taiwan even worse than Samsung. Hanwha had to withdraw its offer for Daewoo Shipbuilding and Engineering, as the leverage for purchase was just not forthcoming. In the same vein, Doosan was struck by the problems of refinancing its acquisition of Bobcat from Ingersoll Rand, which at $4.7 billion was the largest acquisition ever made by a Korean enterprise.

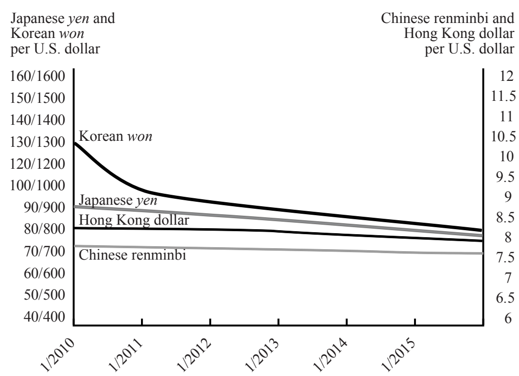
Economic Cooperation (and a Future Community?) with China and Japan

On 13 December 2008, the heads of state of China, Japan, and Korea met to discuss a common program to handle the crisis. One of Kang Man-soo’s strengths was his desire to see more economic institutional cooperation among the three countries of Northeast Asia. The December summit has to be seen as one of the most important events in shaping the future of Northeast Asia. In 1997–98 Japan had sought to create an Asian fund and had been squashed by the IMF. The idea was revived in 2000 under the more positive guidance of the Asian Development Bank (ADB), in what became known as the Chiang Mai initiative. The quiet effort of the group working primarily on creating an Asian bond market that was coordinated on the margins of the annual ADB governors meeting (and to an extent on the ASEAN Plus Three meetings) was largely ignored by economists who followed only the large print.

But, by 2008, the cumulative quiet work of the region’s central banks set the stage for the 13 December 2008 landmark agreement made by the three major countries. The countries agreed to work together to stabilize currencies and to reinvigorate their economies. From Korea’s point of view the agreement to increase the swap limits was important. These swaps were extended to Southeast Asian countries and to refunding the ADB (something to which the U.S. administration is said to be opposed). The financial engineers of the Chiang Mai initiative had put together for the politicians an alternative view of the future of Northeast Asia that would be to work hard to cement the creation of an economic bloc of the big three plus ASEAN. For now the countries agreed to make their summit an annual event.

Other issues on which agreements were reached included boosting the joint study of an FTA among the three countries; facilitating an investment agreement; holding regular meetings between foreign ministry officials; establishing a cyber bureau to review cooperative projects in 2010; and cooperating on climate change, natural disasters, and UN reform. This is likely to bring the three currencies closer together and work to raise the value of the *won,* which might bring them into a float, as shown in ***Figure 4,*** with long-term consequences for the Hong Kong dollar.

Figure 4: **Potential Evolution of Asian Regional Currencies**



Sources: Korea Associates Business Consultancy Ltd., Korea Business Forum, October 2008; Asian Expertise, Taiwan Leaders Forum, December 2008.

On 22 February 2009, the Chiang Mai group took a further step forward by increasing the mutual fund from $80 billion to $120 billion and proposing to triple the ADB's capital. The proposal to increase the capital of ADB may create the first Asia-U.S. conflict because the United States holds a 12 percent stake in the ABD and has resisted attempts to increase its funding since 2005.

It is hard to persuade Koreans about the exceptional opportunities that this development offers the Korean economy and to underestimate the degree to which this represents a changed Korea. Those who forecast the long-term development of a Northeast Asian bloc had expected this to be a gradual evolution over 10 to 15 years, not a matter of months.

Conclusion

This review of economic policy is the story of a new administration coming into office with great ambitions but having to adapt its ideals to market reality. By the beginning of March 2009 the policy of the Lee Myung-bak administration appears to have evolved into a successful package that may serve Korea well:

- Macroeconomic policy is now closely aligned with economic reality, with the administration ready to face and react to the crisis;

- In the green and great policy, the administration has a winning thrust to investment that will build future growth; and

- In the growth of economic cooperation among Japan, China, Korea, and ASEAN, the foundations of a future economic bloc have been laid, foundations that may develop rapidly if recession deepens in the West and if the Western institutions that have driven the economy for 60 years can no longer take the strain.

Finally, a degree of consensus based on this policy platform can now be found within the National Assembly. This should finally allow the patient work of the Presidential Council on National Competitiveness to be put on the statute book.

The Korean economy in 2009 therefore offers a diversity of prospects. Many are common to all exporting countries in terms of when developing countries, and especially China, will pick up the slack demand for exports. Korea is exceptionally well placed to take advantage of this when it happens, but the timing remains unclear in late February 2009. If Korea's growth is not led by its exports, then the question is whether the new economic team, appointed in January 2009, can make a difference and reinstill the Korean people's confidence that can lead toward a marginally positive growth rate.

Or can the region begin to function as a single unit with consequent extensive shifts in economic structure based on comparative economic advantage, with changes in trading patterns and a closer concentration on trade within the region that runs at about 40 percent of total trade rising toward European levels of 60 percent plus? The answers to these questions will give a growth rate in 2010 that currently must range from 1–2 percent up to 4–5 percent.

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