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Déjà Vu: Is Korea the Next Japan?

By Yoon-shik Park

Abstract

The Asian economic resurgence was first initiated by Japan after the end of World War II. Japan's economy grew rapidly during the three decades from 1950 at the rate of almost 10 percent per year, with its GDP growing to be twice as big as that of Britain and almost half of the U.S. economy by 1980, becoming the second largest economy of the world after the United States. Similarly, Korea was able to replicate comparable economic successes as in Japan, even though the Korean economic drive started more than a decade later than in Japan. In recent years, however, the Korean economy has notably slowed down, with huge youth unemployment and even more serious underemployment. The recent drastic slowdown of the Korean economy has raised the possibility that it might face similar "lost decades" as in Japan during the past two decades. When President Park Geun-hye took office in early 2013, she called for a second Miracle on the Han River and launched a 3-Year Plan for Economic Innovation. However, the 3-Year Plan relies too heavily on the government to take the initiative and play the leading role. If anything, the government is expected to play an even more important role than before, in taking major policy initiatives and disbursing enormous public funds. In a truly globalized economy, there will be less room for Bureaufias to flourish in Korea. That is why the Park administration should complete FTAs with such major countries as China and Japan as soon as possible. It should also join the Trans-Pacific Partnership (TPP). In fact, completion of these FTAs should be considered as important as the government's current deregulation drive.

Key Words: *Korean economy, miracle on the Han River, new economic paradigm for Korea*

Introduction

Asia's economy was far more advanced than the West until about 200 years ago. In 1700, the Asian economy was almost three times that of the United States and Europe combined, at 62 percent and 23 percent respectively. Annual revenues of India's Mogul emperor Aurangzeb (1658-1701) were estimated to be ten times those of his European contemporary, Louis XIV of France. In the early 19th century, the size of the Asian economy (58 percent) was twice as big as that of Europe and the United States combined (29 percent). However, the Asian economy experienced precipitous decline compared to the Western world, hitting its nadir in 1952, when it accounted for only 17 percent of the total world economy, compared to 58 percent for the Western economy. During the two and a half centuries from 1700 until 1952, the relative size of the Asian economy fell from three times that of the Western economy to only one-third.

The main cause of the relative Asian economic decline during the previous several centuries is its isolationistic policy. In particular, China—whose very name means the Middle Kingdom—considered itself as the center of the world and the paragon of culture and civilization, while disdaining all other countries as barbarians. Such hubris cost Asia dearly when the economy in the Western world rapidly developed through industrial revolution and global exploration and colonization. Until the 18th century, Asia had been a fertile ground for technical innovations in such products as gunpowder and the printing press. From the 16th century, however, China practiced isolationist policies, banning further construction of ocean-going vessels, for example. While Europeans were motivated by "greed and passion" in their world exploration and commercial ventures, the Confucian state of China abhorred mercantile success.[1]

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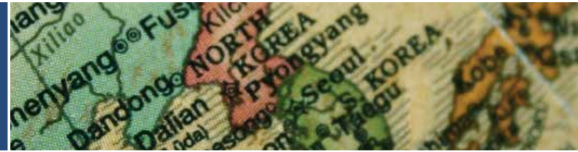


While the Western world encouraged global explorers and business entrepreneurs in the ensuing centuries, Asia's elites were mainly satisfied to be landed gentry, putting less emphasis on business ventures and profits and more on arts, poetry, literature and other scholarly pursuits. The traditional Asian value system of *sha, nong, gong, sang* (scholar mandarins, gentlemen farmers, artisans, and traders) has had persistent impact on the career choices of numerous bright young Asians. Such a value system discouraged many well-educated Asians from pursuing business careers, resulting in slower economic growth in Asia whose economy was mainly based on traditional agriculture instead of manufacturing and trade. During Korea's Choson dynasty (1392-1910), for example, those who passed the civil-service exam could gain entry to the privileged *yangban* class, a scholarly aristocracy. This tradition continues in today's education fever in South Korea.[2] The essence of the traditional Asian value system nurtured strong family cohesion, emphasis on education and social order, and pervasive influence of government officialdom. At the same time, it encouraged nepotism and cronyism, lack of transparency, pervasive corruption, less emphasis on rule of law and more on relationships, encouraging conformism and discouraging individualism.

The Asian economy embarked upon its catch-up race with the West from 1950s onward, in the midst of, or right after the Korean War of 1950-53, when Japan first blazed new trails in industrialization and robust export drive. From the 1960s, the four Asian tiger economies of Hong Kong, Taiwan, Singapore and South Korea then followed. From the 1970s, the so-called Asian tiger cubs (Thailand, Malaysia, the Philippines, and Indonesia) also imitated the four tiger economies. These eight Asian economies achieved the highest growth rate in the world. During 1965-90, their per capita income grew at the average annual rate of over 5.5 percent, while the comparable figure was less than 2 percent for the Latin American, Caribbean, Middle East and Mediterranean countries.[3] This Asian growth momentum has infected other large Asian countries: China (1980s) and India (1990s) embarked upon serious industrialization and globalization of their own economies. The 21st century is now viewed as the Pacific Century, as the global economic center seems to be pivoting from the Atlantic region to the Asia-Pacific arena.

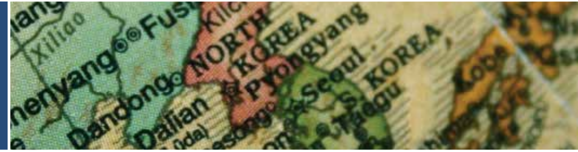
The Asian economic resurgence was first initiated by Japan after the end of World War II. In 1951, the Japanese economy measured by its GDP was less than one-twentieth of the U.S. economy and only one-third of the British economy. But it grew rapidly during the subsequent three decades at a rate of almost 10 percent per year. Its GDP grew to twice that of Britain and almost half of the U.S. economy by 1980, becoming the second largest economy of the world after the United States. Japan's post-World War II economic miracle was memorialized in such books as Ezra Vogel's *Japan as Number One in 1979 and Chalmers Johnson's MITI (Ministry of International Trade & Industry) and the Japanese Miracle in 1982.*

Miracle on the Han River

Similarly, Korea was able to replicate comparable economic successes as in Japan, even though the Korean economic drive started more than a decade later. During the Korean War, the already poor agrarian economy of South Korea was utterly devastated and its infrastructure severely degraded. As late as 1965, Korea was poorer than India, with per capita GDP of only $106 compared to $121 in India. But Korea's per capita GDP grew 313 times during the past 48 years to $33,200 (on purchasing power parity basis) in 2013,[4] while India's was only $4,000, just 33 times higher than that of 1965. Korea has achieved remarkable growth, with average annual rates of 9.2 percent in the 1970s, 9.8 percent in the 1980s, and 6.6 percent in the 1990s.

Korea's annual exports in goods and services rose from $40 million in 1961 to $718 billion in 2013, an increase of 18,000 times over 52 years. The Korean economy has achieved a truly miraculous growth since 1960s, becoming the world's 12th largest economy today. Its per capita income level of $33,200 (on PPP basis) is comparable with that of Britain ($37,300), Japan ($37,100), France ($35,700) and the OECD average of $34,500, and higher than that of Spain ($30,100) and Italy ($29,600). This so-called *Miracle on the Han River* was achieved by the deliberate government policy of export-promoting open economy accompanied by rapid development of the manufacturing sector aimed at export markets, as there was simply no domestic consumption base. Now Korea has become the 8th largest trading nation of the world, with its annual trade volume exceeding $1.1 trillion, from only $500 million in 1962.

The early years of Korea's economic development were full of trials and challenges, but the Korean people overcame those difficulties by exploiting the country's geographical and historical situations. Korean entrepreneurs initially took advantage of the advanced technical and marketing skills in neighboring Japan through joint ventures and other cooperative arrangements. After



having obtained their initial access to the Western markets with the assistance of Japanese joint venture partners, Korean businesses then chose to compete directly with their former mentors in Japan in international markets. Korea's unique brand image has also advanced and broadened from the economic and commercial field to the cultural arena, with the *Hallyu* (Korean Wave) in music, film, drama, sports and other entertainment areas.

Today, Korea is a world leader in several industries. It is number one in DRAM memory chips (66 percent global market share), LCD displays (51 percent global market share), shipbuilding (51 percent global market share) and smartphones; number five in automobiles and refinery capacity; and number six in global steel production. Symbolic of the Korean industry's global reach is Samsung Electronics, which in 2013 had an operating income of $35 billion, much higher than Toyota's $24 billion. The company accounted for 25 percent of all the combined operating income of Korea's top 100 corporations in 2013. During the past 23 years, the company's annual sales revenues rose 50 times to $220 billion, while its operating income rose 60 times.

Reasons for Korea's Past Economic Successes

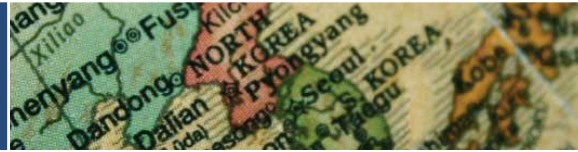
For nearly a decade after the end of the Korean War in 1953, Korea's post-war socio-political turmoil hampered any earnest attempts to jump-start economic development. However, Korea embarked upon economic development seriously from the early 1960s following the 1961 military coup led by General Park Chung-hee. In the initial stages, however, the country faced formidable challenges: it was an extremely poor agrarian economy, with a negligible domestic consumer market and weak entrepreneurial base. The country suffered from lack of capital, technology, and business management talent. The founder of today's mighty Samsung Group, the late Chairman Lee Byung-chull, started his business career as a tiny rice mill operator in his rural home village during the Japanese occupation. The founder of Hyundai Group, the late Chairman Chung Ju-yung, first started his business career as a puny car repair shop owner in Seoul.

Faced with formidable barriers to economic development, the Korean government decided to be the primary mover behind modernizing the economy by adopting a government-led industrialization policy. The military government tried to overcome the primitive and small domestic market by focusing its industrial policy on nurturing export-promoting industries to access vast foreign markets instead of a tiny and poor domestic market. In order to conserve meager foreign exchange reserves, the government also encouraged development of import-substituting industries. Thus, it is perhaps not surprising that the first modern business ventures that Samsung Group embarked upon successfully were a sugar refining business to substitute for imported sugar and a wool textile business to replace expensive imported textile products from abroad.[5] The government also encouraged inward direct investments from modern Western corporations to bring in both technology and management know-how as well as investment capital.

First-generation Korean entrepreneurs complemented their lack of modern management skills and industrial experience through foreign joint ventures or technology licenses from advanced countries. Japanese companies served as the role model for, and often joint venture partners with, new Korean business firms. Samsung Electronics Corporation benefitted initially from its early joint venture with Japan's NEC. Today's premier Korean hotel, Shilla Hotel, started initially as a joint venture with Japan's Hotel Okura. The world-renowned Korean steel company, POSCO, was initially funded by a large loan from the Export-Import Bank of Japan and it also benefitted from technical assistance from major Japanese steel companies in its early years.

Korean economic success was similar to that of the other three so-called Asian tiger economies of Taiwan, Hong Kong and Singapore, each of which faced its own existential security threats. Both Taiwan and Hong Kong, peopled with refugees from Communist China, had to face both real and imagined threats of invasion by the newly unified Communist China. Singapore, the tiny non-Muslim city-state that became independent from Malaysia in 1965, was surrounded by the largest Muslim country of Indonesia to its south and by the Islamic state of Malaysia to the north.[6] For these countries, economic development and industrialization were the primary means to secure national survival from much larger and potentially hostile neighboring countries.

Korea pursued government-led free and open market economy, relying upon international trade as the means to access advanced technology and management know-how as well as huge foreign markets for its exports. In the initial decades of Korea's industrialization in the 1960s and 1970s, the United States was the most important economic partner for Korea. While the U.S. security umbrella was essential for Korea to pursue its rapid industrialization despite constant security threats from North Korea, the U.S. market was also the most important destination for



Korean exports during those early decades. Also, Korea pursued mercantilist policy in its trade with the United States, with an aggressive export drive combined with both overt and covert restrictive measures on imports through high tariffs and non-tariff barriers. The United States acquiesced on Korea's export-oriented policies, mainly because the United States recognized Korea's frontier role during the Cold War between the Soviet bloc and the free world.

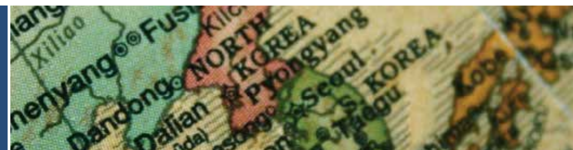
Deteriorating Performance of the Korean Economy

In recent years, however, the Korean economy has notably slowed down, with huge youth unemployment and even more serious under-employment. Korea's average annual economic growth rate was 9.2 percent in the 1970s, 9.8 percent in the 1980s, and 6.6 percent in the 1990s. But its average annual growth rate slowed down markedly to 4.2 percent in 2000s, and the economy grew only 3.7 percent in 2011, 2.0 percent in 2012 and 2.8 percent in 2013.[8] Many of the big Korean industrial giants such as Samsung and Hyundai have increasingly moved their new investments abroad to low-cost regions such as South Asia and Eastern Europe. Between 1995 and 2010, Korea's largest manufacturing firms shifted 17 percent of their production to overseas plants.[8] As a result, total employment in such companies fell by 2 percent annually. Consequently, the share of workers employed at large Korean companies fell by one-third, from 18 percent to 12 percent.

According to a review by a respectable Korean economic daily,[9] the overseas workforce of Samsung Electronics more than doubled during the past four years from 72,915 in 2009 to 190,206 in 2013, while that of Hyundai Motors also doubled from 22,500 to 41,800 during the same period. In contrast, their respective domestic workforce rose only modestly from 85,000 to 95,700 at Samsung Electronics and from 56,000 to 62,800 at Hyundai Motors. A similar trend was observed at POSCO, where the overseas workforce increased from 17,500 to 22,100 during 2009-13, while the number of their domestic employees declined from 36,000 to 32,000. This trend is likely to continue in the coming years, as large Korean firms tend to decrease their domestic investments in the face of high Korean wages and belligerent strike-prone labor unions. Hyundai Motors is reportedly planning a second car manufacturing plant in North America, with annual production capacity of 300,000 cars. Its first American plant in the right-to-work state of Alabama has been operating at capacity for 24 hours per day with three production shifts, a practice surely to be resisted violently in Korea by domestic automobile labor unions. Due to the deteriorating competitiveness of Korea, foreign direct investment (FDI) flows have worsened in recent years. Korea's FDI outflows rose from $6.1 billion in 1997 to $35.1 billion in 2013, an increase of 470 percent, while FDI inflows into Korea rose from $6.9 billion to $14.5 billion, an increase of only 108 percent.

Korean wages are relatively high compared to its competitors. Even though Taiwan's per capita income is higher than that of Korea, the starting salaries of Korean college graduates are two to three times higher than those of Taiwan. Because of the strong strike-prone labor unions in Korea, especially at large firms in banking and telecom industries, Korean wage levels are often higher than those of the United States and Europe. On the other hand, a study by the Conference Board in the United States finds that Korea's hourly labor productivity stands at 48 percent of America, which is 30th in the world, even lower than that of Greece. Reflecting the deteriorating business environment during the past couple of years, 40 percent of Korea's top 30 *chaebol* firms found their operating income falling short of covering even their interest expenses. Recently, Samsung Electronics also had to concede its number one position in smartphone market shares in China to Xiaomi and in India to Micromax. The company is also likely to find its operating income falling drastically to 3-4 trillion *won* in the 3rd quarter of 2014, compared to 10 trillion *won* a year earlier. During the same period, Hyundai Motors' operating income is likely to decline by half from 2 trillion *won* last year to 1 trillion *won* this year. Hyundai Heavy Industries, the world's number one shipbuilder, is also expected to suffer a loss in operating income of over 1 trillion *won* in both the 2nd and 3rd quarters of 2014.

According to the latest survey published by World Economic Forum in 2014, Korea's international competitiveness has also fallen to 26th, the lowest in 10 years,[10] while other Asian countries have retained much higher rankings, with Japan (6th), Hong Kong (7th), Taiwan (14th), and Malaysia (20th). The Korean banking system was ranked at 122nd and the entire Korean financial system fell to the bottom at 144th, with the return on assets of Korean banks at 0.38 percent, which is the lowest in Asia. The ranking of 144th for the Korean banking and financial system in the competitiveness index was much lower than even Kenya (24th), Ghana (62nd) and Uganda (81st).



At the same time, the quality of life in Korea shows signs of serious deterioration. With 29.1 suicides out of 100,000 each year, Korea has the highest suicide rate and the 3rd highest traffic fatality rate among the 34 OECD member countries. Even when Korea's population is fast aging, Korea's 1.2 birth rate is among the three lowest in the world along with Hong Kong and Macao. At the same time, the Korean business world is undergoing momentous generational transitions, as the founding families of many Korean *chaebol* firms are going through the handover of management from the second to third generation.

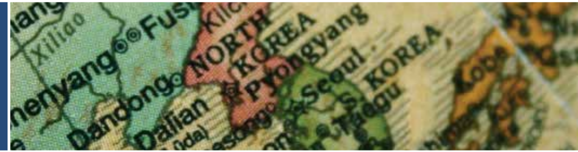
The first generation founding patriarchs of Korean *chaebols* were pioneer entrepreneurs and masters in government-business alliances, and they spectacularly succeeded in trailblazing new business frontiers ranging from consumer products to construction, heavy industries, and electronics. Their second generation successors have then globalized their businesses, turning Korean *chaebol* firms into true multinational corporations (MNCs) with globally recognized trademarks such as Samsung, Hyundai, SK, LG, etc. However, the third generation leaders are not yet tested fully, as they have labored quietly under the watchful eyes of their fathers. These third generation leaders are far better educated both inside and outside Korea at major academic institutions, thus gaining deeper insights into international issues. These new leaders, however, are more likely to exercise a finance-oriented management style instead of entrepreneurial initiatives, more eager to safeguard the existing fortune that their families have accumulated rather than risking their fortune in new ventures. The successful transition to the third generation leaders of Korean *chaebols*, and how they will perform in the coming decades, is critically important to the future of the Korean economy.

Need for a New Economic Growth Model

Recent drastic slowdown of the Korean economy has raised the possibility that it might face similar "lost decades" as in Japan during the past two decades. After miraculously achieving a real growth rate of almost 10 percent per year during the two decades of 1950s and 1960s and close to 5 percent per year during the 1970s and 1980s despite two oil crises and other economic turmoil, the Japanese economic growth rate drastically slowed down to just 0.8 percent per year during the past two decades since 1996. The "lost two decades" in Japan began with the real estate bubble burst in the early 1990s, which led to the asset price free fall and price deflation, which led to sharp income and consumption decline which encouraged further economic depression and price deflation, in a vicious cycle. The Japanese government also failed to coordinate its policy responses, adopting only the expansionary fiscal policy financed by government borrowing, without concomitant monetary policy support. Consequently, Japan's outstanding government debt grew from 68 percent of GDP in 1990 to 142 percent in 2000 and 230 percent in 2010. At the same time, the unstable political scene with 13 prime ministers over 20 years since 1993 did not help in instilling confidence in its economic policy making.

When the current prime minister Shinzo Abe took office in December 2012, he adopted "Abenomics" to combat the Japanese economic malaise, consisting of "three arrows": aggressive monetary easing (monetary policy), expansion of public spending (fiscal policy), and structural reform (growth policy). The Abe administration was convinced that insufficient monetary easing had caused the Japanese economy to sink further into chronic deflation in the past couple of decades. In response, Mr. Abe hired as his new central bank governor Haruhiko Kuroda, then president of the Asian Development Bank and a vocal proponent of aggressive monetary easing. Since 2013, in an effort to push inflation to the 2 percent target, the Bank of Japan under Governor Kuroda has energetically pursued quantitative easing (QE) thereby almost doubling its balance sheet via aggressive bond purchases. The second arrow of Abenomics consists of massive fiscal spending on key public projects like infrastructure in order to kick-start an economic recovery. As part of this drive, the Abe administration has earmarked 200 trillion *yen* for public works projects over the next 10 years to guard against earthquakes and other natural disasters. The third arrow consists of growth-enhancing structural reforms. This strategy aims to spur growth of private-sector firms through drastic deregulation and liberalization of the entire economy, especially reducing the influence of government in various sectors of the economy. This third arrow would require a fundamental paradigm change in the traditional role of government in the Japanese economy. However, even optimists concede that drastic deregulation and other growth-enhancing structural reform initiatives will take years to implement and even longer to have any effect on economic growth in Japan.

So far, Abenomics has had disappointing results. Japan's big sales tax increase in April 2014 severely impacted the economy as people rushed to spend money before the tax increase took effect, resulting in a consumer spending crash much steeper than the last time Japan raised the sales tax in 1997. More trou-



bling has been a broader economic slowdown since Abenomics was launched. Once the tax-related economic gyrations are averaged out, the Japanese economy experienced virtually zero real growth between mid-2013 and mid-2014. Despite aggressive monetary easing, wage rates have stayed depressed as the labor market dynamics have changed. In Japan, baby boomers are now retiring and taking the best paid jobs with them. Their replacements are far more likely to be part-timers, contractors and other lower-wage workers. Even though the *yen* has depreciated more than 20 percent since the beginning of Abenomics, its impact on Japan's trade balance has been not as positive as before. The reason is that Japan has become a net importer after the Fukushima nuclear accident in 2011, due to increased imports of foreign oil and gas. Yen depreciation has thus caused the real income of average Japanese to fall. There has been also a fundamental shift in Japan's manufacturing sector, as Japanese companies make more of their products abroad than they did during the past comparable period of *yen* weakness nearly a decade ago. Thus, a weaker *yen* has made the trade deficit bigger, not smaller.

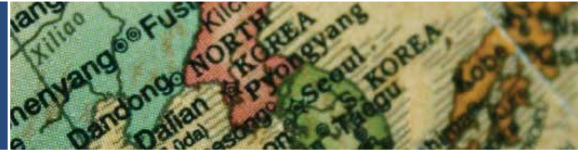
Like the Japanese economy since the 1990s, the Korean economy has also slowed down markedly in recent years, raising the specter of a Korean version of "lost decades." Faced with numerous economic structural problems mentioned earlier, it is quite clear that Korea has to reorient its economic development strategy from manufacturing and export orientation to nurturing the service sector and domestic consumption. The Korean service sector remains truly underdeveloped, accounting for only 58 percent of GDP, compared to 80 percent in the United States. The Korean economy has to be diversified from a narrow manufacturing focus to the service industries through bold deregulation and liberalization. In this way, the Korean economy can have a more balanced modern economy to create more jobs and to join the rank of truly advanced countries. Since 1970s, the world's advanced countries have embarked upon the transformation of their economy from the manufacturing sector towards the service industries.

The manufacturing sector in the United States accounted for 22 percent of total employment in 1970 but it declined to 10 percent in 2007. The Korean manufacturing sector accounted for a peak of 29 percent of total employment in 1989, but its share has steadily declined over the past two decades to 17 percent in 2008. However, the service sector's productivity in Asia, as it is in Korea, is estimated at only one-third of Switzerland and one-half of the United States. This productivity gap is due to the fact that the service industries in Korea are concentrated in *infrastructure services* such as wholesale and retail sales, transportation and warehousing, food services and lodgings, real estate agencies, and personal services.[11] These businesses account for 34 percent of total employment, compared with 29 percent in Germany and 26 percent in Finland. On the other hand, Korea's service sector is relatively underdeveloped in the high-value *knowledge service industries* such as banking, finance, insurance, telecommunication, health care, tourism, logistics, software, and research and development.

In the financial service industries in particular, Korea's competitiveness is well below that of advanced countries, even though the manufacturing sector in Korea has produced many global winners in electronics, steel, and shipbuilding. The main reason for the relative backwardness of Korea's finance industry compared to its manufacturing sector can be traced to the government's export-led growth strategy from the 1960s through 1980s. Thus, it is critically important for Korea to now nurture the high value-added knowledge service sector instead of the relatively low skilled and low value-added infrastructure service industries. Developing international financial centers in Korea's major cities such as Seoul and Busan is one way to advance the banking and financial industries in Korea to the level of globally competitive players. Successful international financial centers also nurture the development of other advanced knowledge service industries such as world-class medical and health care services and educational institutions, sophisticated telecommunications, and renowned cultural institutions.[13]

However, the greatest barrier to modernizing the Korean service sector is the suffocating regulations and bureaucratic meddling by Korea's government. The Korean service sector needs drastic deregulation and far less bureaucratic interference in order for the Korean economy to advance to the next level. The paradigm change for the Korean economy has to start with comprehensive economic deregulation and liberalization, combined with a drastic reduction in the power of government bureaucracy.

Korea's small and medium enterprises have not developed as strongly as they should, and many of them have stayed mainly as subcontractors to large *chaebol* firms. Unless Korean SMEs adopt more independent growth strategies based on solid technology and more diversified market channels, they are likely to remain overly dependent upon *chaebol* firms and their future prospects are not bright. In this sense, the government should adopt more proactive strategies to nurture Korean SMEs, including special-



ized financing channels and promotion of internationalization drives. The tax system, including inheritance taxes, should be streamlined so that management of SMEs can be smoothly transitioned from generation to generation, as practiced in Japan and other advanced countries.

The Creative Economy: 3-Year Plan for Economic Innovation

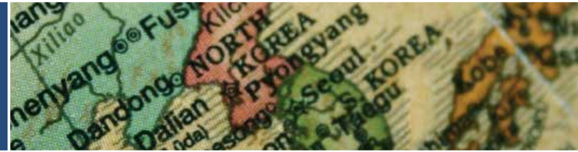
When President Park Geun-hye took office in early 2013, she called for a second *Miracle on the Han River*. On February 25, 2014, the first anniversary of her inauguration, President Park announced the details of a 3-Year Plan for Economic Innovation. It called for revitalization of the Korean economy with the goal of 4 percent potential growth, 70 percent employment rate and $40,000 per capita GDP (at market exchange rate, compared to $26,000 in 2013).[14] The new Park administration has made the development of a "creative economy" the core of its strategy to achieve the 474 goal. As the Korean economy has reached the rank of many advanced economies in products and technology, the new plan reflects increasing recognition that Korea has reached the limits of its previous "fast follower" economic strategies and that it has to become a creative "first mover" economy. It is clear that Korea's economic future critically depends upon becoming a global leader in developing and commercializing innovative techniques, products, services and business methods.

The 3-Year Plan includes three strategies to achieve this creative economy. The first one is to develop strong fundamentals for achieving the goal by reforming the public sector, developing the rule-based market economy, and building a strong social safety net. The government will reform the public sector, which has been plagued by inappropriate practices and low productivity, due to the moral hazard pervasive in that sector such as lax management, high debt ratios and various types of rent-seeking behavior. By introducing competition between public institutions, as well as with the private sector, the productivity of public institutions is to be enhanced. State-owned enterprises (SOEs) will also be required to reduce their debt-to-equity ratios from an average of 239 percent in 2013 to no more than 200 percent in 2017. Public-sector efficiency is to be enhanced by eliminating 600 overlapping government programs during the next three years. The social safety net will also be strengthened through expanded earned income tax credit and increased unemployment insurance coverage.

> "Furthermore, a creative economy in this fiercely competitive and globalized business environment cannot be incubated and nurtured successfully with the public sector playing the leadership role as before."

The second strategy is to develop a dynamic economy based on innovation, by promoting venture businesses and vibrant SMEs. For this purpose, the government intends to invest 4 trillion *won* ($3.9 billion) public funds to seed the start-up funds for young entrepreneurs and angel investments. In addition, the government will launch a new fund in cooperation with global venture capital companies to invest in Korean start-ups. To encourage foreign investor participation, they will be allowed to buy the government's share at a low price and the government will be the first to bear losses. The government will also establish 17 "Creative Economy Innovation Centers" in major cities by 2015. The centers are to become the focal point of regional development by supporting start-ups through a range of services including education, technology development, and financing. R&D investment, which was the highest in the OECD at 4.4 percent of GDP in 2012, is to be increased to 5 percent by 2017. The government plans to invite 300 world-class scientists and researchers by 2017 by providing competitive financial support and guaranteeing a sufficiently long stay in Korea. The government will introduce policies to promote exports by smaller firms. At present, only 2.7 percent of Korean SMEs export, and the goal is to raise the ratio significantly in part by completing a FTA with China.

The third strategy is aimed at an economy balanced between domestic demand and exports, reflecting a more mature market economy. By improving the domestic investment environment, the plan focuses on raising the employment rate to 70 percent from the current 65 percent level. Structural weaknesses constraining domestic demand will be addressed. Household debt, which rose to 164 percent of household disposable income in 2012, one of the highest in the OECD, is to be lowered by 5 percent by 2017 through enhanced financial supervision and regulation. The government will promote ambitious regulatory reform to promote business investment. For this purpose, the



government will reduce the regulatory burden by introducing a "one-in, one-out" system and by strengthening the sunset clause for existing regulations. The government will boost the employment ratio of the working-age population by creating more jobs for women and youth through flexible childcare services and strengthening financial and legal support for part-time jobs.

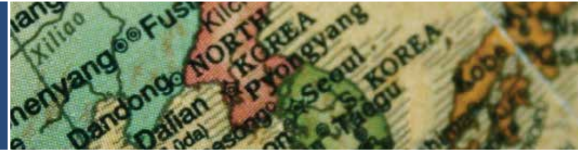
Recommendations to Strengthen the 3-Year Plan

President Park has defined "creative economy" as the concept of creating new industries and employment through the convergence of science and technology with industry, the fusion of culture and industry, and the blossoming of creativity. The success of this noble goal depends on how effectively the government can catalyze development of vibrant innovation ecosystems. It also requires that the government and the private sector cooperate seamlessly to promote creative energy in technology, business ventures and new product development. It further calls for a deft balance between public nurturing and private initiatives, a task not easily achieved in practice.

Furthermore, a creative economy in this fiercely competitive and globalized business environment cannot be incubated and nurtured successfully with the public sector playing the leadership role as before. With the globalized economy and fast-changing technology and market environment, private sector initiatives are critically important as the main engine of progress—with the government playing an auxiliary role. This is quite different from the start of Korean industrialization in the 1960s and 1970s. Nevertheless, the 3-Year Plan relies too heavily on the government with its major policy initiatives and disbursement of public funds. For example, under its second strategy, the government intends to inject $3.9 billion by 2017 to help venture businesses and SMEs. The government is also to launch a new venture fund to invest in Korean start-ups, and R&D investment is to be increased from 4.4 percent in 2012 to 5 percent by 2017. The government also plans to provide more childcare services and more financial support for part-time jobs. Even though some of these plans would be carried out in partnership with the private sector, these initiatives would further increase the central role of government in the economy.

However, the main challenge facing the Korean economy now is the pervasive influence of the government in every nook and cranny of the economy, which is the undesirable legacy of the government-led economic development drive of 1960s through 1980s. Even though the active government role in the initial years of Korean economic development was generally positive, its beneficial impact is now far outweighed by its negative side effects. Both Korea's economy and its society have been suffering from the pervasive influence peddling and outright corruption of the present and former government bureaucrats, formerly known in Korea as "Mofias" (combining the words of former and present Ministry of Finance officials and mafia). The Mofias occupy plum jobs at major Korean financial institutions after their retirement and have been blamed for the backward status of the entire Korean banking and financial system, as indicated in the recent *Global Competitiveness Index*. However, a recent series of major accidents such as the sinking of Korean ferry *Sewol* resulting in more than 300 deaths, unscheduled power outages due to defective parts from subcontractors at critical nuclear power plants, and frequent accidents involving high-speed railcars have exposed the pervasive corruption and collusion between current and retired government bureaucrats. Thus, the entire Korean economy is found to suffer not just from Mofias but from Bureaufias (former and present bureaucrats and mafia) at the Ministries of Transportation, Fishery and Maritime Affairs, Education, Commerce and Industry, Health and Human Services, for example.

Therefore, the Korean economy needs to drastically reduce both the number and power of bureaucrats in order to regain its former dynamism. One of the most effective ways to reduce the influence of Bureaufias is to globalize the Korean economy, as the open economy will force every sector of the Korean society to stay more efficient and productive in order to survive and prosper. Their survival and prosperity will no longer depend upon how effectively they lobby the various government bureaucracies through hiring of Bureaufias but upon efficient management and improved productivity. That is why the Park administration should complete FTAs with such major countries as China and Japan, and join the Trans-Pacific Partnership (TPP) as soon as possible. In fact, completion of these FTAs should be considered as important as the government's current deregulation drive. In order to facilitate these FTAs, President Park should not rely on senior bureaucrats. Instead, she should hire retired senior business executives to negotiate and push through these FTAs, not just for increasing Korea's trade volumes but also to enhance Korea's economic efficiency through opening up to fierce international competition.



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5 The Samsung Group founder, the late Chairman B.C. Lee, had special attachment to both Cheil Sugar and Cheil Wool Textile Company during his lifetime, even though Samsung Group has since ventured into other and even more successful business fields through such companies as Samsung Electronics and Samsung Heavy Industries, etc.

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13 This so-called 474 Plan is strangely reminiscent of the previous Lee Myung-bak Administration's failed 747 Plan, which called for achieving 7 percent real annual economic growth rate to realize $40,000 per capita GDP and entering the rank of G-7 largest economies of the world.

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