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THE SOUTH KOREAN ECONOMY AND U.S. POLICY

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The South Korean economy is undergoing an economic restructuring based on neoliberal, free-market principles. Mainstream economists claim that that this process was a necessary and successful response to South Korea's devastating 1997-1998 crisis. This article challenges this claim. It critically exams the economic and social consequences of South Korea's current neoliberal restructuring; highlights the ways international capitalist dynamics and U.S. policy initially promoted and then undermined South Korea's growth; describes the role played by U.S. and International Monetary Fund policymakers in shaping South Korea's post-crisis restructuring; and considers the challenges facing South Korean workers in their struggle to advance a new economic strategy.

Key words: South Korea, U.S.-South Korea relations, economic crisis, neoliberalism

Introduction

The South Korean economy continues to undergo an economic restructuring based on neoliberal, free-market principles.[1] Mainstream analysts both inside and outside of South Korea have viewed this restructuring as a necessary response to the country's devastating 1997-1998 crisis that, according to the conventional wisdom, was caused by a legacy of state-generated "cronyism" and resulting economic inefficiencies. Ordinary South Koreans are said to support the restructuring and to be enjoying the benefits of the transformation so far completed.

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

South Koreans desperately need a new economic strategy. However, given the dynamics of international capitalism and U.S. interests in structuring South Korea's economic choices, their efforts at change cannot help but generate tensions with U.S. government and corporate leaders. Overcoming U.S. political and business opposition will not be an easy task. At the same time, U.S. working people are also increasingly suffering from the implementation of neoliberal policies in their own country. Thus, the potential exists for building solidarity between South Korean and U.S. workers, thereby creating a more favorable political terrain for South Korean efforts at progressive change.

South Korea's Economic Situation

South Korea's post-crisis economic restructuring has, by design, produced an economy that is more deregulated and liberalized than in the past. According to those who applaud this outcome, it ensures that South Korean economic dynamics will be more in tune with global market forces and thus better able to generate and sustain high rates of growth. They point to the rapid recovery in GDP in the years immediately following the country's 1997-1998 economic crisis to demonstrate the correctness of their position (see Table 1).[2] However, underlying dynamics point to a far more negative assessment of South Korea's economic policies and their potential to serve majority interests.

1. The research for this article was supported by a Korea Research Foundation Grant (KRF-2003-005-B00006).

Table 1. South Korean Growth, in percent

Year	GDP growth
1998	-6.7
1999	10.9
2000	9.3
2001	3.1
2002	6.3
2003	3.1
2004	4.4 (estimate)

Source: Korea Economic Institute, *Korea Insight*.

Underlying Weaknesses of the Economic Recovery

South Korea's economic recovery has been based on four pillars: government deficit spending, foreign direct investment, consumer spending, and exports. Large and growing government deficits were the first factor helping to promote economic recovery. Central government spending as a percentage of GDP rose sharply from a surplus of 0.1 percent in 1996 to deficits of 1.3 percent in 1997, 3.8 percent in 1998, and 4.6 percent in 1999. While an appropriate response to economic crisis, deficit spending is not a long-term solution to economic problems.[3] While

2. See for example, Paul F. Gruenwald, "Korea and the IMF," in Korea Economic Institute, ed., *Korea's Economy 2003* (Washington, D.C.: Korea Economic Institute of America, 2003), pp. 8-12.
3. In fact, the South Korean government was pressured by the IMF to return to a surplus position beginning in 2000.

deficit spending could again be used to prop up the economy in an emergency, public debts have now grown quite large. For example, the ratio of government debt to GDP rose from 16.2 percent in 1997 to 39.6 percent in 2002.[4] There are additional government obligations that also weigh heavily on government finances, including a massive shortfall in public pension reserves, outstanding currency stabilization bonds, and other similar debts. Therefore, it is unlikely that the government will find it easy to repeat the massive deficit spending of the recent past.

In the years immediately following the crisis, foreign investment also played an important role in boosting growth by providing the government with critical foreign exchange. However, much of this investment was "vulture investment" that involved takeovers of South Korean assets at fire sale prices.[5] Once the most attractive assets were purchased, foreign investment began to decline rapidly (see Table 2). One outcome of this investment has been a significant denationalization of South Korean capital. By early 2003, the combined stock holdings of overseas investors in thirty-two publicly traded firms, including Samsung Electronics and Hyundai Motor Company, exceeded that of the largest Korean shareholders.[6] The South Korean economy is, as a result, now more closely integrated into transnational corporate production networks and, thus, international market dynamics.

The South Korean government has embarked on a major campaign to reverse the decline in foreign investment. It has established special free economic zones in Inchon, Kwangyan, and Pusan in an effort to make South Korea the "business hub of East Asia." Foreign businesses that operate within these zones will enjoy tax breaks as well as exemptions from various environmental and labor regulations. Foreign enterprises will also have the sole authority to build and operate educational and health institutions. In addition, the government is prepared to

4. "Korea's State Debt Tripled Over 5 Years," *Korea Herald,* September 8, 2003, online ed.
5. Martin Hart-Landsberg and Paul Burkett, "Economic Crisis and Restructuring in South Korea: Beyond the Free Market-Statist Debate," *Critical Asian Studies,* vol. 33, No. 3 (September, 2001), pp. 414-16.
6. Park Sang-soo, "32 Listed Firms Controlled by Foreigners," *Korea Herald,* February 3, 2003, online ed.

Table 2. Foreign Direct Investment into South Korea, in $US billions

Year	Foreign Direct Investment Inflows
1996	3.2
1997	7.0
1998	8.9
1999	15.5
2000	15.7
2001	11.8
2002	9.1
2003	6.5

Source: Korea Economic Institute, Korea Insight.

offer foreign high-tech investors a cash grant equal to 20 percent of the value of their total investment.[7]

This policy is unlikely to achieve its goal. Other countries, especially China, are offering even more attractive investment packages. In fact, the South Korean government now finds itself on a slippery slope. Foreign companies, seeking guarantees that the benefits offered to them will be permanent, are asking that the investment-friendly regulations be extended to the entire country and include all firms, domestic as well as foreign. The chief economist of the Asian Development Bank, while in South Korea for the Bank's 2004 annual meeting, supported this demand.[8]

Meanwhile, as foreign direct investment inflows have slowed, outflows of South Korean foreign direct investment have grown. Over 4,000 South Korean factories have moved their production out of South Korea since 1998, and the numbers have been growing dramatically each year. According to a Korea Customs Service official, "about 70.7 percent of those production facilities have moved to China."[9] A study by the Korea

7. For a more complete discussion of South Korea's post-crisis restructuring see Hart-Landsberg and Burkett, "Economic Crisis and Restructuring in South Korea."
8. Florence Lowe-Lee, "Economic Trends, Foreigners Weary About Free Economic Zones," *Korea Insight*, vol. 6, No. 6 (June, 2004), pp. 2-3.
9. Kim Mi-hui, "Factories Relocating Abroad to Cut Costs," *Korea Herald,* October 25, 2003, online ed.

Chamber of Commerce and Industry found that "about nine out of ten companies manufacturing products in Korea have plans to invest in China in the future, as the country's low production cost and the eager-to-please regulations make the market more attractive than Korea."[10] As a result of this trend, South Korea's net foreign direct investment actually turned negative in 2002.

As government deficits and foreign investment declined and as significant sectors of Korean industry set up shop in China and elsewhere, South Korea's economic growth became increasingly dependent on domestic consumption. Strong private domestic consumption often reflects sound economic fundamentals. However, this was not the case for South Korea. South Korean private consumption spending, with the encouragement of the government, was largely based on debt, especially credit-card debt. The government began pushing credit-card use in 1999 by, among other things, raising the limits on cash advances and introducing tax deductions for purchases made by credit card. The result was a major consumption boom and corresponding credit-card debt explosion. The total amount of credit-card spending rose from $53 billion in 1998 to $519 billion in 2002.[11]

This credit-card spending saved South Korea from recession in 2001, but at great cost. The country had the world's fastest growing household debt, which soared from 18 percent of GDP in 1999 to 62 percent in 2001, "a rise which even in the profligate U.S. took a decade."[12] With cash advances and credit-card loans accounting for approximately two-thirds of all consumer transactions, it was not long before many households faced unsustainable debt levels. Delinquency rates began rising sharply in 2002. According to the U.S.-based Korea Economic Institute, "The credit card excesses . . . created spiraling social problems. Local newspapers and TV report continuously on increasing number of suicides, violent crime, kidnappings, and prostitution, all due to over-borrowing on credit cards."[13]

10. Ibid.
11. Florence Lowe-Lee, "A New Financial Crisis: Credit Card Excesses," *Korea Insight*, vol. 6, No. 2 (February, 2004), p. 1.
12. *Economist Intelligence Unit*, "Drastic Plastic? The Credit Card Boom," June 3, 2002, online.
13. Lowe-Lee, "A New Financial Crisis," p. 1.

Frightened by the prospect of a wave of personal bankruptcies and the danger such bankruptcies could cause the country's financial system, the government belatedly took steps to limit credit-card use in the spring of 2003. Even if the government succeeds in avoiding a major banking crisis, however, a new wave of consumption will not likely drive the economy forward. Household debt has reached 70 percent of GDP. Approximately 40 percent of all households carry debts that outweigh their assets and face some risk of default.[14] In fact, the government's success at limiting credit-card use led to a sharp decline in private consumption, which in turn had a negative effect on business investment. The top five *chaebol* slashed their investment spending by 30.5 percent in 2003; the top eighteen reduced their investment by an even greater 33.5 percent.[15] Not surprisingly, South Korea suffered a recession in the first half of 2003.[16]

As a result of the above trends, South Korea is now more dependent then ever on exports to power growth. South Korea's post-crisis restructuring had already increased the export orientation of the economy. The export share of the manufacturing sector rose from 35.9 percent in 1997 to 45.9 percent in 2001.[17] In 2003, with domestic consumption and investment down, exports accounted for 98.2 percent of the country's growth.[18]

The Shift to China

This greater external orientation represents more than just a deepening of pre-crisis trends, however. As a result of changes in the international economy, South Korea's export (and investment) orientation has shifted from the United States to China. In 2001, China became South Korea's number-one investment loca-

14. Choi Gong-pil, "What Lies Ahead for the Korean Economy?" *Korea Herald*, January 27, 2003, online ed.
15. Kim Ji-ho, "Chaebol Investment Falls 33.5 %," *Korea Herald*, July 12, 2004, online ed.
16. James M. Lister, "Korea's Economy in Recession: Is it Technical?" *Korea Insight*, vol. 5, No. 9 (September, 2003), p. 1.
17. "Falling Exchange Rate and Profitability," *Business Korea*, July 2002, p. 13.
18. Kim Ji-ho, "Morgan Stanley Warns of Economic Slowdown in China," *Korea Herald*, March 24, 2004, online ed.

tion. In 2002, China became South Korea's number-one export market. In 2003, China became South Korea's number-one trading partner. In short, China is now seen as the anchor for South Korea's economic future (see Table 3).

Table 3. South Korea's Trade Orientation, in percent

Year	Share of exports to China	Share of exports to China and Hong Kong	Share of exports to the United States
1992	3.46	11.17	23.61
1993	6.26	14.08	22.06
1994	6.46	14.81	21.41
1995	7.31	15.85	19.31
1996	8.77	17.35	16.71
1997	9.96	18.58	15.88
1998	9.02	16.03	17.24
1999	9.52	15.82	20.51
2000	10.71	16.93	21.83
2001	12.09	18.37	20.75
2002	14.62	20.86	20.18
2003	18.11	25.68	17.66

Source: Korea International Trade Association.

As a result of this new orientation, many South Korean analysts claim that the South Korean economy has greatly reduced its vulnerability to instabilities in the U.S. market and threats of trade sanctions from the United States.[19] This is wishful thinking because China still functions as a major production platform for multinational corporations that export to the United States.[20] Most exports from South Korea to China are intermediate goods used in the production of other goods. Studies by the Korea International Trade Association and the Korea Institute for International Economic Policy have shown that "a large portion of the final products are reshipped to third countries, with about 40 percent re-exported to the United States."[21]

More problematic perhaps, South Korea's new China orientation is likely to promote a narrowing and premature hollowing out of the country's industrial base. South Korea is currently running a trade surplus with China. However, China is quickly becoming a major competitor to South Korean exports in other markets. According to the Korea Economic Institute, "Within the next decade, Chinese firms are expected to out-compete Korean producers of low-end electronics equipment at home and abroad. Institutes and business organizations already report drops in domestic sales of Korean home appliance products."[22] Studies by private and state research institutes in South Korea raise the same warning, concluding that "China's export competitiveness was in some cases greater than that of Korea in sectors such as machinery, electronics / home appliances, textiles, and some information products."[23]

In sum, South Korea's economic future has become increasingly dependent on a narrowing range of exports within a framework shaped by a foreign-dominated, China-based, U.S.-centered system of export production. This development greatly increases the country's vulnerability to another major crisis. For example, the Chinese economy has its own instabilities that threaten its continued high-speed growth. Problems in China, whether economic or political, will have serious consequences for the South Korean economy.[24]

In addition, both South Korean and Chinese prospects for export growth continue to depend on the stability and import capacity of the United States. The post-2001 economic recovery in the United States has been weak. Yet, the United States has

19. James M. Lister, "Outlook for Korea's Economy," *Korea Insight*, vol. 6, No. 1 (January, 2004), p. 1.
20. See Martin Hart-Landsberg and Paul Burkett, "China and Socialism, Market Reforms and Class Struggle," *Monthly Review*, vol. 56, No. 3 (July-August, 2004), especially chap. 4.
21. Christine P. Brown, "Trade Sector Leads Korea's Economic Growth in First Half of 2004," *Korea Insight*, vol. 6, No. 8 (August, 2004), p. 1.
22. Caroline G. Cooper, "Trade Wins Blow From West to East," in Korea Economic Institute, ed., *Korea's Economy 2003* (Washington, D.C.: Korea Economic Institute, 2003), p. 54.
23. Caroline Cooper, "Does China Pose an Economic Threat to Korea?" *Korea Insight*, vol. 4, No. 1 (January, 2002), p. 1.
24. Hart-Landsberg and Burkett, "China and Socialism," chaps. 3 and 4; Kim, "Morgan Stanley Warns of Economic Slowdown in China," online.

been running bigger and bigger trade deficits: $261.2 billion in 1999, $357.8 billion in 2001, and $489.4 billion in 2003. These deficits are not sustainable. The U.S. dollar is now falling and interest rates are beginning to rise, which will likely have a negative effect on U.S. growth and imports. It is unlikely that the South Korean economy will be able to escape the negative consequences.

South Korea's Social Conditions

Sadly, most South Koreans are already paying a high price for their country's neoliberal restructuring. Even though the country's poverty rate has fallen from its 1999 high, it remains considerably higher than before the crisis. Inequality, especially in urban areas, is also continuing to grow.[25] According to a study by the Korea Development Institute, South Korea's Gini coefficient rose from 0.332 in 1995 to 0.389 in 2000. The study also revealed that the country's middle class is shrinking: 70.2 percent of all households were classified as middle income in 1994, 68.5 percent in 1997, and only 65.3 percent in 2000.[26]

One reason for these trends is that South Korea's post-crisis growth has not produced any significant improvement in labor market conditions. Before the crisis, approximately 58 percent of South Korean workers had permanent labor status, which meant that they had employment contracts lasting for at least one year. Following the crisis, many corporations took advantage of new labor laws to fire their permanent workers and rehire them as temporary or even daily workers—part of the "flexibilization" of the workforce. The percentage of permanent workers fell to approximately 48 percent in 1999 and has remained at that level through 2002. Contingent or non-permanent workers are paid, on average, only 52.9 percent of the wages paid to permanent workers.[27]

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25. Soh Ji-young, "Gap Between Rich, Poor in Urban Areas Widens," *Korea Times*, January 7, 2003, online ed.
26. Sim Sung-tae, "Income Gap Widened Sharply," *Korea Herald*, February 17, 2003, p. 10.
27. James Crotty and Kang-Kook Lee, *Economic Performance in Post-Crisis*

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

> More than half of South Koreans feel that the current economic situation is worse than it was in late 1997 when the financial crisis shook the nation. . . . In particular, 52.6 percent of the respondents said that their current living standards are worse than six years ago, while only 9.9 percent felt their living conditions would improve. The survey also showed that polarization between rich and poor has been accelerating, with more people in low-income brackets believing the living conditions have deteriorated.[28]

Workers, not surprisingly, are fighting to defend their working and living conditions. According to the Korea Herald, 2003 "is likely to be remembered as a time marred by the worst labor discontent since 1990, with labor disputes occurring almost every day."[29] As of November 2003, "labor conflicts involved a record number of 131,563 workers, up 43.8 percent from 91,630 a year earlier."[30] The South Korean government claims that in 2003 labor unrest at the six largest manufacturers cut overall output $19.2 billion and exports by $1.5 billion.[31]

President Roh Moo Hyun, although thought to be "pro-labor," appears to be continuing the hard-line anti-worker policies of previous administrations. A case in point: 190 workers were arrested for their labor activism during his first eight months in office.[32] Even more harmful, his administration has

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Korea: A Critical Perspective on Neoliberal Restructuring, 2001, Political Economy Research Institute, University of Massachusetts Working Paper Number 23, online at www.umass.edu/peri/pdfs/WP23.pdf; "Labor Group Seeks Equality For All Workers," *Korea Herald*, January 16, 2003, online ed.

28. Kim Jae-kyoung, "Hardship More Serious Than 6 Years Ago," *Korea Times*, May 26, 2004, online ed.
29. Kim Sung-mi, "Labor Conflict May Hit 13-Year Peak," *Korea Herald*, November 13, 2003, online ed.
30. Ibid.
31. Kim Ji-hyun, "Labor Unrest Slashes Output, Exports," *Korea Herald*, February 17, 2004, online ed.
32. Kim Sung-mi, "Labor Conflict May Hit 13-Year Peak."

allowed the large *chaebol* to use civil rather than labor laws to crush labor resistance. This has enabled companies to put union funds and worker salaries under temporary attachment while they wait for final court rulings about the legality of labor actions. Many families of labor activists have been forced into bankruptcy leading, in a number of cases, to worker suicides.[33]

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

The Dynamics of Growth

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

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

33. Sang-Hwan Jang, "Korea: Protest by Suicide," *Against the Current*, No. 111 (July-August, 2004).

Although mainstream analysts initially denied it, state policy was far more important than market forces in helping South Korea achieve an annual average increase in real GDP of 9 percent during the 1960s, 9.3 percent during the 1970s, and nearly 10 percent during the 1980s and first half of the 1990s.[34] Control over the country's financial system was perhaps the single most important factor enabling the state to successfully direct the economy. Government planners were able to use their power over both the allocation and cost of capital to promote exports as the priority activity for all firms.

At the same time, the government regularly targeted new areas for development by encouraging the establishment of domestic firms, protecting them with both trade restrictions and limits on foreign direct investment and then, when judged capable, requiring them to export as well as meet domestic needs. The government was also not hesitant about undertaking key investment activities itself through public enterprises, as in the case of petroleum, chemicals, and iron and steel. However, for political reasons, the government eventually decided to allow a small group of *chaebol* to dominate production of the new industries. By 1988, the combined revenues of the top four *chaebol* equaled approximately 47 percent of South Korea's total GNP.[35]

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

Generally overlooked in most discussions of the South Korean experience was the dependence of South Korea's rapid economic growth and industrial transformation on favorable

34. See Martin Hart-Landsberg, *Rush to Development: Economic Change and Political Struggle in South Korea* (New York: Monthly Review Press, 1993), especially Part I.
35. Ibid., p. 38.

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

South Korea's mid-1960s shift to an export-led growth strategy did not solve the country's balance of payments problems. However, its willingness to comply with U.S. demands did ensure ample U.S. and Japanese financial assistance, thereby enabling the government to sustain the country's rapid industrial development. For example, as part of their 1965 normalization treaty, Japan gave South Korea $200 million in public loans, $300 million in grants, and at least $300 million in commercial credits. Hundreds of millions of dollars of additional loans and grants followed over the rest of the decade.[36]

The U.S. government provided even greater financial assistance, in large measure in exchange for South Korea's participation in the U.S.-led war against Vietnam. The United States paid secret dollar bonuses to South Korean soldiers, which generated $185 million in remittances over the period 1965-73. The South Korean government and business community earned almost $1 billion dollars more, over the same period, for military and civilian activities in Vietnam and increased exports to Vietnam. The country earned an additional $1.1 billion from U.S. military activities in South Korea itself, including local spending, provision of goods, and construction. During the key transition years of 1966 to 1969, approximately 30 percent of South Korea's foreign exchange earnings came from Vietnam-related activities.[37]

In the early 1980s, after South Korea suffered a major economic collapse and was in political chaos, the U.S. and Japanese governments again offered critical financial assistance. Two weeks after

36. Ibid., p. 145.
37. Ibid., pp. 147-8.

the Kwangju Uprising had been brutally crushed, the U.S. Export-Import Bank finalized terms to extend more than $600 million in import credits to the new military dictatorship headed by Chun Doo Hwan. The heads of Chase Manhattan Bank and First National Bank also traveled to South Korea to pledge their financial support. Not long after, the Japanese government extended a massive $4 billion loan under exceptionally generous terms.[38]

U.S. and Japanese support for South Korea was not limited to financial assistance. Japanese corporations provided critical technology and components to the large *chaebol*, enabling them to rapidly upgrade production and boost exports. For example, during the 1980s, South Korean firms depended on Japanese corporations for between 40-60 percent of their machines, 60 percent of their parts, and 50 percent of their licensed technology. The level of dependence was far greater for those firms producing critical higher value-added exports, like cars, ships, and electronics.[39] The additional U.S. economic contribution included a willingness to provide open markets for South Korean exports. Thus, in 1986, South Korea's first-ever trade surplus of $4.2 billion was made possible because of the country's bilateral surplus of $7.3 billion with the United States.

However, the international conditions that encouraged U.S. and Japanese support for South Korean growth were not sustainable. More specifically, capitalist dynamics eventually generated instabilities and tensions that reached a boiling point in the mid-1980s. U.S. and Japanese government and corporate responses to these instabilities and tensions led to the creation of a new international environment hostile to South Korea's growth strategy, thereby helping to set the stage for the country's 1997-1998 economic crisis.

38. Ibid., pp. 148, 223.
39. Walden Bello and Stephanie Rosenfeld, *Dragons in Distress: Asia's Miracle Economies in Crisis* (San Francisco, Calif.: Institute for Food and Development Policy, 1990), p. 114.

The Dynamics of Crisis

The post-World War II political successes of the U.S. government in shaping an international capitalist world system favorable to American economic interests set in motion dynamics that eventually threatened those same interests. For example, as a result of the successful rebuilding of Japan and Europe, U.S. corporations began facing growing competition within their home market. The U.S. trade balance finally slipped into deficit in 1971, and with the U.S. government continuing its war efforts in Vietnam, the sustained outflow of dollars finally led to the collapse of the dollar standard in 1973 and a rapid decline in the value of the dollar in 1977-1978. Beginning in the 1980s, the U.S. government started to take aggressive actions, especially against Japan, to stop the deterioration in the U.S. trade balance and the hollowing out of the U.S. manufacturing sector. In September 1985, it pressured the Japanese government into supporting a rise in the yen relative to the dollar as part of the Plaza Accord. The yen appreciated by almost 50 percent between 1985 and 1988, creating serious economic problems for Japanese corporations.

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

Fearful of angering the U.S. government and losing access to the American market, the South Korean government began opening its markets. It also allowed the won to rise by 16 percent relative to the dollar in 1988 and by another 3 percent over the first half of 1989. The Japanese, upset at losing U.S. market share to South Korea in the years following the Plaza Accord, also took action to blunt South Korea's economic challenge. For example, in 1990, the Japanese government banned the export of 200 advanced technologies to South Korea until 1995.[40] These developments proved disastrous for the South Korean economy. Export growth fell from 36.2 percent in 1987 to 28.4 percent in 1988, 5.7 percent in 1989, and 3 percent in 1990. Corporate profits also fell. In 1988, VCRs surpassed color TVs to become South Korea's leading electronics export. Yet, South Korean producers lost money on every single VCR sold that year in the United States.[41] Overall manufacturing profit rates fell each year from 1989 to 1992.[42]

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

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

40. Walden Bello, *People and Power in the Pacific* (London: Pluto Press, 1992), p. 88.
41. Hart-Landsberg, *Rush to Development*, p. 161.
42. Robert Brenner, *The Boom and the Bubble, The U.S. in the World Economy* (London: Verso Press, 2002), p. 162.

These international and national developments also contributed to a weakening of South Korea's system of state planning. As the state found it increasingly difficult to protect the domestic market from imports and ensure the competitiveness of South Korean exports, the *chaebol* became increasingly unwilling to accept continued state direction and control over their activities. Because the county's growth dynamic had concentrated production and wealth in their hands, the *chaebol* had grown powerful enough to resist state mandates that threatened their profitability. They therefore demanded and won, over the first half of the 1990s, new borrowing and investment freedoms. One of the most important was the freedom to borrow internationally without government approval. Another was the freedom to invest abroad. From 1968 to 1980, cumulative South Korean foreign direct investment totaled less than $250 million. In 1990 alone it was $1 billion. It rose to $3 billion in 1993. Between 1993 and 1996, it grew at an annual rate of 53 percent. In 1996, reported overseas direct investment totaled $6.22 billion.[43]

The government did not make these changes in international economic policy, along with others that allowed greater foreign investment in South Korean stock and bond markets, solely in response to domestic pressures. U.S. demands also played a critical role. A case in point: the United States threatened to block South Korea's entrance into the OECD unless it opened its financial markets for the benefit of U.S banks and brokerages.[44]

There was one final international development that may have been the most serious in terms of undermining South Korean growth. In response to U.S. pressure for a higher yen, Japanese corporations, with the encouragement of the Japanese government, initiated a massive process of foreign direct investment designed to regionalize their production. Southeast Asia was one of the key locations for this investment. This investment transformed Malaysia, Thailand, and to a lesser extent Indonesia into significant exporters of relatively advanced manufactured

43. Paul Burkett and Martin Hart-Landsberg, *Development, Crisis, and Class Struggle: Learning from Japan and East Asia* (New York: St. Martin's Press, 2000), p. 158.
44. Nicholas D. Kristof with David E. Sanger, "How U.S. Wooed Asia to Let Cash Flow In," *The New York Times*, February 16, 1999, online ed.

goods and thus competitors of South Korea.[45] By the late 1980s, Malaysia's exports of electronics were replacing those from South Korea in the Japanese market.[46]

Driven by competitive pressures, Japanese and other foreign investors were on the move again in the early 1990s, this time to China. And, as it did with many Southeast Asian nations, this investment helped to transform China into an increasingly successful exporter of manufactures. The share of foreign-produced exports in China's total exports rose from 17 percent in 1991 to 41 percent in 1996, leading to a rapid growth in China's exports of electronics and electrical goods.[47] Thanks to its integration in international production networks, low wages, and a 1994 currency devaluation, China quickly captured market share in both the United States and Japan at the expense of Thailand and Malaysia as well as South Korea.[48]

Eventually, contradictions generated by this continuing expansion of regional export centers became unmanageable. Too many countries were producing the same goods for sale in the same markets. The resulting regional overproduction led to a decline in unit export prices and then to a sharp fall in export earnings.[49] For example, the unit export prices of South Korea's heavy and chemical products, which were the country's main exports, fell by more than 46.3 percent over the years 1996-1998. South Korea's export growth rate fell from 30.2 percent in 1995 to 3.8 percent in 1996.[50] South Korea began running ever-larger current account deficits and accumulating greater foreign debt. The current account deficit rose from $4.5 billion in 1992 to $8.9 billion in 1995 and to a record $23.7 billion in 1996. *Chaebol* profits were also forced downward: The forty-nine largest business groups recorded total profits of just $32 million on combined

45. Martin Hart-Landsberg and Paul Burkett, "Contradictions of Capitalist Industrialization in East Asia: A Critique of 'Flying Geese' Theories of Development," *Economic Geography*, vol. 74, No. 2 (April, 1998), pp. 87-110.
46. Burkett and Hart-Landsberg, *Development, Crisis and Class Struggle*, p. 159.
47. Tham Siew-Yean, "Can Malaysian Manufacturing Compete with China in the WTO?" *Asia-Pacific Development Journal*, vol. 8, No. 2 (2001), p. 3.
48. Enzo Grilli, "The Asian Crisis: Trade Causes and Consequences," *The World Economy*, vol. 25, No. 2 (2002), pp. 184, 186.
49. Ibid., p. 182.
50. Ibid.

sales of $274 billion in 1996 or about .001 percent.[51] The *chaebol* sustained their operations only by going deeper into debt. And, thanks to the liberalization of foreign borrowing, an increasing percentage of funds came from foreign lenders. By 1997, South Korea's foreign debt totaled over $160 billion dollars, with approximately $70 billion due for repayment in less than a year.

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

As massive capital outflows triggered crises in Thailand, Malaysia, Indonesia, and to a lesser extent the Philippines, caused in large part by investor fears of growing balance of payments problems, foreign investors also found reason to worry about the stability of South Korea. They therefore sold their stocks and bonds, cut back their investment, and refused to rollover existing loans. With insufficient reserves, the South Korean government was forced to raise interest rates and cut spending in an effort to halt the run on the won. Its actions failed to achieve their goal; by mid-November 1997 the *won* was rapidly losing value, and the economy headed into crisis.[52]

51. Moon Ilhwan, "Seoul is Still Teetering on the Edge," *Business Week*, December 29, 1997, p. 57.
52. Two World Bank economists summed up the severity of the crisis as follows: "As a result of this crisis, Korea experienced the harshest economic recession of its entire post-war history. Industrial production dropped by 12 per cent between August 1997 and August 1998, while business investment decreased by 28.3 per cent in the third quarter of 1998 when compared to the same period of the previous year. Corporate bankruptcies reached an unrecorded high of 3,197 firms during December of 1997 [compared with a monthly average of 965 during 1996]. Layoffs were extensive, leading to 7.4 percent unemployment in August 1998." See Giovanni Ferri and Tae Soo Kang, "The Credit Channel at Work: Lessons from the Financial Crisis in Korea," *Economic Notes*, vol. 28, No. 2 (July, 1999), pp. 198-99.

The Dynamics of Restructuring

The severity of South Korea's crisis and the nature and extent of the restructuring that followed were also critically influenced by the changed international environment. For example, South Korea's foreign minister traveled to Japan on an emergency mission to arrange an official loan and the rollover of Japanese commercial bank loans. The foreign minister refused to help.[53] The U.S. government was no more helpful. In fact, the U.S. government sought to take advantage of the crisis to pursue its own restructuring agenda.[54]

In response to a South Korean request for assistance, the International Monetary Fund (IMF) sent Hubert Neiss to Seoul in late November 1997. However, as journalist Paul Blustein relates, "It soon became apparent that the deal Neiss was negotiating would fail to satisfy one interested party—the U.S. Treasury. As one IMF economist recalled, 'Treasury thought Neiss was giving the shop away.'"[55] Therefore, the United States sent Treasury Undersecretary David Lipton to Seoul to monitor the negotiations. Lipton became a constant, although indirect, participant in the negotiations, and he successfully stalled a final agreement, with the result that the crisis deepened. An agreement only became possible when it included conditions that the U.S. government wanted. After the IMF agreement was finally signed in early December, a Treasury official boasted to reporters in Washington D.C. that the agreement "will bring about substantial changes in the Korean financial sector, which in turn have the potential to open up the Korean economy and move it toward one that is much more dependent on the operation of market

53. Paul Blustein, *The Chastening: Inside the Crisis that Rocked the Global Financial System and Humbled the IMF* (New York: PublicAffairs, 2001), p. 128.
54. See James Crotty and Kang-Kook Lee, *Was the IMF's Imposition of Economic Regime Change in Korea Justified? A Critique of the IMF's Economic and Political Role in Korea During and After the Crisis*, Second Draft, June 2004, online at www.networkideas.org/featart/aug2004/Korean_Crisis.pdf, pp. 8-10, 31-32.
55. Blustein, *The Chastening*, p. 141.

forces."[56]

Responding to IMF and U.S. pressure, the South Korean government agreed to further open the country's money, stock, and bond markets to foreign investors and new sectors to foreign direct investment. It also allowed foreign buyouts of strategic firms (even if hostile), the deregulation of the foreign exchange market, the removal of tariff and non-tariff barriers on imports, a massive privatization program, and significant changes in the country's labor laws giving firms greater freedom to fire workers and employ temporary workers in their place.[57] In essence, the government agreed to abandon the strategies and tools that had previously defined its once-celebrated state-directed growth strategy.

The South Korean government implemented this full reform package in large part because its already weak negotiating position was made weaker still by the terms of the initial IMF agreement and U.S. policy. As some analysts pointed out at the time, IMF demands for higher interest rates and cuts in government spending, far beyond what the South Korean government had proposed, sharply raised business costs, slashed domestic demand, and left workers unprotected. As a result, many healthy firms were pushed into bankruptcy, thereby worsening the crisis.[58]

At the same time, the IMF agreement failed to reassure foreign investors that South Korea would have sufficient foreign exchange to meet its international obligations. In part this was because the U.S. government was reluctant to support it with promised funds.[59] Thus, the currency continued to fall throughout December, further intensifying the crisis. As South Korea approached financial collapse, a new agreement was finally reached in late December. The IMF agreed to speed up its contribution, the U.S. government agreed to provide additional financial support, and major commercial banks agreed to roll over or extend existing inter-bank loans. This new agreement was reached, however, only after the South Korean government accepted an "IMF-Plus" plan that committed it to an accelerated and deeper reform program than the one agreed to in early December.[60] While external pressures largely drove the reform process, the support of national interests also pushed the government to accept IMF/U.S. dictates. The large *chaebol* were eager to gain their freedom from state directives and restrictive labor laws. Some of the mandated structural changes, especially those dealing with labor, were just what they desired.

56. As quoted ibid., p. 149.
57. See Crotty and Lee, "Economic Performance in Post-Crisis Korea."
58. For example, the IMF forced the South Korean government to raise interest rates from 13 percent in early December 1997 to 34 percent one month later. Crotty and Lee, *Was the IMF's Imposition of Economic Regime Change in Korea Justified?* p. 4. Also see Crotty and Lee, "Economic Performance in Post-Crisis Korea," pp. 6-7.
59. Blustein, *The Chastening*, pp. 178-82.

What Lies Ahead?

The U.S. government appears generally content with South Korea's more free-market orientation. As the U.S. Congressional Research Service explains, "The intensity of the disputes [between the two countries] has diminished considerably since the late 1980s and early 1990s, in part because South Korea has enacted a set of sweeping market-oriented reforms as a quid pro quo for receiving a $58 billion package from the International Monetary Fund following the near collapse of the South Korean economy in 1997."[61]

Even so, the United States continues to pressure the South Korean state into new market openings and a further retreat from industrial policy. A case in point: The South Korean government wants to establish mobile communications as a growth center for the country. To encourage rapid investment, it announced its intention to establish mandatory technological standards for wireless telecommunications services. However, U.S. technology firms do not support the chosen standards and fear that this will shut them out of the South Korean market. The United States trade representative responded by declaring South Korea a "key country of concern," raising the specter of possible trade sanctions. As

60. Ibid., p. 199.
61. Mark E. Manyin, "South Korea-U.S. Economic Relations: Cooperation, Friction, and Future Prospects," *CRS Report for Congress*, Library of Congress, Washington D.C., updated July 1, 2004, p. 2.

a result, the South Korean government appears to have abandoned its plans for standardization.[62]

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

Business analysts continue to claim that neoliberal reforms will improve the performance of the South Korean economy and the well-being of its citizens. But, as highlighted above, neither has yet proven true. Changed international capitalist dynamics undermined South Korea's past growth strategy and continue to limit the country's economic options. Neoliberal policies, which only increase South Korea's dependence on these dynamics, can hardly be expected to help promote a broad-based national development agenda. This conclusion is strengthened by the nature of current U.S. and South Korean business demands. In 2004, the head of the American Chamber of Commerce was explicit about what was expected from the South Korean government: "Korea's competition is Shanghai, Hong Kong and China. Realize what your competition is, because investors can choose where to go."[63]

The *chaebol* share this perspective. Above all, they, like their U.S. counterparts, seek more "flexible" labor conditions, which means government initiatives designed to weaken the labor movement. They have made clear that if the government does not meet their demands they will continue to move their production "across the Yellow Sea to China, where wages are lower and the demands of workers rarely result in headaches for managers."[64] This is no empty threat. As reported by the *Korea Herald*,

> Korean industries are moving overseas faster than firms in other advanced economies, and the so-called industrial "hollowing out" will likely become a serious problem by 2007, Korea's leading business organization argued yesterday. . . . Industrial migration, which in the past took place mostly in light industries such as shoe-making and apparel industries, is rapidly spreading to other sectors, including the electronics, telecommunications, metal and machinery industries, it noted.[65]

The administration of President Roh Moo Hyun has been doing all it can to satisfy business demands. It has introduced new special economic zones that offer foreign businesses special tax and regulatory breaks as well as cash grants and special investment rights. While foreign multinationals and the large *chaebol* have been the greatest beneficiaries of state initiatives, efforts have also been made to help small and medium sized firms. One of the most politically important, because of its potential to improve South-North relations, is the government's plan to construct, with the support of North Korea, a special economic zone in Kaesong, North Korea. This zone is explicitly designed for use by South Korean small- and medium-sized firms, over a thousand of which have already expressed interest. While construction has only just begun, a small number of firms are scheduled to begin operating in the zone in 2004. The U.S. government has objected to this project on the grounds that South Korean firms will be using advanced capital equipment in the construction of the zone and the operation of the factories; it alleges that this is a violation of an international agreement not to export strategic materials to a "sponsor of terrorism." It remains unclear what effect U.S. objections will have on the project.

The Roh administration has also been pursuing bilateral investment agreements and free trade agreements with many countries, including Japan and the United States. It has been one of the strongest advocates for a maximum WTO agenda, which

62. Ibid., pp. 10-11.
63. Kim Ji-hyun, "Flexibility in Labor Top Priority," *Korea Herald*, May 22, 2004, online ed.
64. Don Kirk, "Contract at Hyundai Raises Sights of Korean Workers," *New York Times*, August 19, 2003, p. W1.
65. Kim Hyun-chul, "Chaebol Lobby Warns of Exodus," *Korea Herald*, June 27, 2003, online ed.

includes full implementation of the Singapore issues. It remains committed to a program of privatization. And, it continues, despite its initial promise to remain neutral in labor disputes, to break strikes through compulsory arbitration, police interventions, and the encouragement of corporate use of civil suits. Such policies are unlikely to improve either the stability of the South Korean economy or living and working conditions for most South Koreans. Rather they can be expected to reinforce existing trends that promote inequality, poverty, and national industrial disarticulation. In part for these reasons Roh Moo Hyun's popularity had fallen below 30 percent as of mid-2004.[66]

Working people are increasingly beginning to mobilize to resist the neoliberal agenda. One sign of their growing effectiveness is the election successes of the Korean Democratic Labor Party (KDLP). Formally launched in January 2000, the KDLP entered the National Assembly as the third largest party in April 2004. The party is calling for, among other things, a wealth tax to support the expansion of social services, a five-day work week, labor law reforms strengthening the rights of workers, and greater worker participation in management. Most importantly, the party is also calling for the creation of new forms of public regulation of economic activity to stimulate national investment and production geared to meeting domestic rather than foreign needs.

This kind of program points in the right direction. However, given that it challenges the current interests of both foreign and domestic capitalists, as well as U.S. government priorities for advancing capitalist globalization, achieving it will be difficult. At the same time, the longer the neoliberal agenda is in place, the more likely its social consequences will create a more fruitful environment for building a powerful movement for change.

One additional and important reason for optimism is that South Korean workers are not alone in their struggle. Working people in the United States are also facing and suffering from similar policies. The U.S. government has worked hard to promote the interests of U.S. multinational corporations through free trade agreements, support for outsourcing, cuts in social programs, and a weakening of environmental and labor laws. The result has

66. Sim Sung-tae, "Stimulus Policies Not Working," *Korea Herald*, July 10, 2004, online ed.

been a steady decline in the living and working conditions of growing numbers of people.[67] As Business Week explains, despite the recent boom in productivity and wealth,

> high unemployment and glacial job growth have left many workers, especially at the bottom end, suffering. The share of the economic pie going to wages and salaries has plummeted to just over 50 percent, its lowest level in at least the past 50 years, and perhaps longer. . . . Moreover, production and supervisory workers—about 80 percent of private nonfarm employees—are still seeing their real hourly earnings fall. That probably won't change until unemployment drops below 5 percent—and even at that level, pressure from cheap labor overseas may slow the revival of wage growth.[68]

Workers in the United States, as in South Korea, are finding that economic growth no longer guarantees job creation, increased earnings, or more adequate funding of social services. Moreover, growth itself is increasingly threatened by ever larger national budget and trade deficits, high levels of consumer debt, and stagnant investment. In short, U.S. workers also need a change in economic strategy.

As South Korean workers struggle to envision an economic alternative to neoliberalism and build a movement strong enough to overcome U.S. and South Korean government and corporate opposition to change, they should redouble their efforts to form bonds of solidarity with working people in the United States. The payoff is a changed international environment in which working people in both countries would enjoy far greater freedom to pursue policies capable of promoting socially responsive and sustainable growth.

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67. See, for example, Robert Pollin, *Contours of Descent: U.S. Economic Fractures and the Landscape of Global Austerity* (New York: Verso, 2003).
68. Michael J. Mandel with Richard S. Dunham, "Where Wealth Lives," *Business Week*, April 19, 2004, online ed.

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