



## **Korea's Political and Economic Outlook**

by Hong-choo Hyun

### **Recovery and Reform**

For Korea, the year of 1999 was indeed a year of impressive recovery. The GDP growth for 1999 is estimated at 10.2% from a 6.5% contraction in 1998. The forecast for next year is 7.2%, according to the Bank of Korea. Industrial output surged in the last quarter of the same year. With exports reaching \$144 billion, the current account surplus was recorded at \$25 billion. Foreign direct investment was a record-high \$15 billion in 1999. Together with a net inflow of \$5 billion of portfolio investment on the Korean stock market and trade surplus, the foreign currency reserve reached \$74 billion at the end of the year – another record. The stock market jumped, and the Korea Composite Stock Price Index reached 1028 at the end of December, up 75% on the year, with a total capitalization of \$392 billion. The exchange rate stabilized and the unemployment rate has dropped.

During the last year, reform and restructuring became key words for Korean businesses and the government, as the financial, corporate, labor and public sectors struggle to come out of their troubles.

In the financial sector, 265 institutions including banks and securities firms were ordered to close. One commercial bank with a nationwide franchise was sold to a foreign private equity fund. The Korea Deposit Insurance Company (KDIC) and the Korea Asset Management Company (KAMCO) began to play important roles in managing bad debts and distressed assets. New financial products like asset-backed securities and mortgage-backed securities were introduced. The Financial Supervisory Commission played a crucial role in the process as the regulator and reformer.

Corporate reform efforts were focused on the elimination of long-standing business practices such as excessive debt, over-capacity and the lack of transparency and accountability in corporate governance. Shareholders rights were strengthened. Most chaebols announced that they almost achieved the year-end goal of a 200% debt-equity ratio following up what they had committed earlier.

Programs are proceeding to privatize major state-owned corporations including POSCO, KEPCO, Hanjung, KOGAS, KT&G and Korea Telecom. Government organizations were downsized and streamlined.

To address the problems coming from the lack of transparency in financial information, the Financial Supervisory Commission announced in December of 1998 the adoption of new accounting standards closely modeled on those of the International Accounting Standards Committee and the U.S. and U.K. GAAP.

Insolvency laws were revised to simplify the proceedings and to make it easier to liquidate hopeless companies.

Market liberalization and better protection of intellectual property rights continue to be a major agenda for the government and law enforcement authorities.

### **A Work-in-Progress and Future Challenges**

While the recovery and reform of the Korean economy has been impressive, it also remains true that there are still many things left undone.

Many of the nationalized banks, as a result of a massive infusion of public funds, are heavily burdened with bad assets and will have to be restructured again. Daewoo Group debts will further weaken banks, while the problem of investment trust companies, which were papered-over temporarily, still begs for an ultimate solution. Audit by outside directors of corporations and measures to better protect shareholder rights need more improvement. Major privatization efforts are experiencing delay at the protest of interest groups. Labor seems to be stirring again after a couple of years of relative tranquility. "Moral hazard" is creeping in at the same time as banks and corporations are undergoing painful restructuring.

Many experts in and out of the government admit that the economic recovery after the shock of the financial crisis in late 1997 is not a result of reforms that improved the Korean economy's competitiveness but rather a fortunate consequence of cyclical fluctuations, including the record-breaking boom of the U.S. economy.

The Korean economy will have to face some stiff challenges in the year 2000, economists predict. Wage increases are beginning to surpass the consumer price rise and will result in further price hikes and the loss of competitiveness, which could again trigger labor tension. Pressure is increasing for the wage hikes as the parliamentary election approaches. Contraction of the investments in facilities and the R&D during the last two years could undermine this year's growth.

The outlook for a continued trade surplus is not necessarily optimistic if the present trend of the import growth rate outgrowing that of the export rate continues unabated. The strong won currency which has resulted from an influx of foreign capital into the Korean stock market, rather than by a trade surplus, has begun to hurt export growth. The Government's effort in the capital market aimed at stabilizing the currency seems to be constrained by its concern for interest rate and share prices. The budget deficit, a rise in commodity prices and wage increases will certainly fuel inflationary pressure. Income disparity has been widened during the last couple of years, posing a difficult task for the government and straining society.

All the indications point to one simple truth : Korean recovery is not a product of completed reform, but can be called a “work-in progress” at best. After praising Korea for “setting the pace” for nations hit by the Asian crisis, Michel Camdessus, managing director of the IMF, warned that “reform is far from complete” and this would be “a fitting moment for a gear shift to make sure the progress is sustained.”

### **Another Election, Another Pitfall?**

Korea is going into another election in April of this year. All of the 299 seats in the National Assembly will be up for grab and the outcome of the election will determine the fate and fortune of three political parties and their leaders for the years to come.

For the ruling party, the National Congress for New Politics (NCNP) which has changed its name to the Democratic Party for the New Millenium, the election will be an opportunity to emerge as a nationally-based political party transcending regional constraints. A poor result, particularly losing any of the 105 seats the party now holds, will make the remaining term of President Kim a difficult one to manage.

For the United Liberal Democratic (ULD), the party of J. P. Kim, the coalition partner of President Kim with 56 seats in the legislature, survival as a coalition partner and as the party with casting votes will be at stake.

For the Grand National Party (GNP), the opposing party with 130 seats in the National Assembly, the election will be a key test for its leader, Mr. H. C. Lee, who lost the presidential election in 1997, as to whether he will be able to maintain viability as the candidate for the next presidential election scheduled in December 2002.

With less than 90 days remaining before the election, the picture is not clear yet and maybe it is too early to make any forecast. Furthermore, some of the new trends in the mood of constituents add more uncertainty in the outcome. According to a recent poll by Chosun-Ilbo / Korea Gallup conducted in December 1999, certain notable features are emerging:

- Narrowing gap in voters’ support for NCNP (22.6%) and GNP (21.0%).
- Strong anti-incumbency mood; only 9.4% will re-elect current members.
- Large percentage of undecided voters (40.5%).
- Independent candidates are favored (11.4%) as the existing parties lose their appeal.

However, political analysts also agree that there will be no big surprise, and there will be even some certainty in the outcome and in the consequence. They predict:

- Not any of the parties will be able to have a majority (150 seats or more) in the new legislature, considering each parties’ strength and regionalism still as a major factor;
- The outcome will not affect the economic policy in any fundamental manner because all the parties are similarly

oriented in their platforms, and more importantly, there are not many choices left for Korean economy;

- Even with all the sound and fury, the contest will be conducted in the context of democracy, precluding whatever surprises that may have been a serious concern in the past when Korean politics were different from now.

What should be of genuine concern is not so much the results of the election but the possible negative impact on the economy during the pre-election period.

Interest groups and constituents’ issues are becoming a priority over the reform agenda as the election approaches. Delay or even backtracking in the legislation of reform measures can be found in some cases. As far as consistency and efficiency in pursuing an economic policy is concerned, politics may be a distractor at best. That is even more true during an election period. Much of the reform agenda may lose its momentum and sustaining power as the political leadership is deeply entangled in election politics. Politics-business collusion may try to re-emerge if political parties and politicians are going into a no-holds-barred campaign that will cost an enormous amount of money to finance.

With the economic crisis receding and the mood of resentment increasing against the onslaught of the globalizing economy, politicians may tempted to ride the popular sentiment for parochial protectionism and backtracking.

While there are some signs that politicians are also aware of the disasterous consequences, it may be asking too much of the politicians to turn away from such temptation. It is likely that old politics will be alive and even thrive for at least some time to come.

### **Changes Ahead**

In the last couple of years, Korea has experienced enormous changes. It is true that many of the countries of the world have undergone a tectonic paradigm shift that has come from rapid globalization and the revolution in information technology, particularly with the advent of the internet.

In Korea’s case, two additional pressures have expedited a change: the Asian financial crisis in late 1997 and the change in the government that came around the same time. To any perceptive observer, the changes can be seen not only in business and the economy, but also in the way people think and behave. No one can make a prediction with great confidence as to how these changes will lead Korea in the years to come. However, at least for the short term, some safe observations can be made.

What then, are the things one will see in Korea in the year 2000? The following are some forecasts:

- Economy will continue to grow; but vulnerability will still remain.
- Political stability will continue, whatever the outcome of the April election.
- North Korea may show some change in its behavior, but do not expect too much. It is still a dangerous force and some surprises may be up its sleeve. What will be the messages for U.S. business?

- Korea will continue to improve, but not at the speed you may want.
- Even with some glitches, Korea remains an interesting market with significant opportunities, including fast growing e-commerce and internet-related opportunities.

Therefore, don't go away. Stay tuned.

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