Korea and the Global Economic Crisis

Korean policymakers constructed the global economic crisis as a purely external threat to the domestic economy. This understanding of the crisis supported a selective retreat from neo-liberalism. More problematically, the construction of the crisis as an exogenous phenomenon allowed policymakers to focus on maintaining short-term growth without seriously addressing the structural weaknesses of the economy that the crisis should have drawn attention to. Levels of household debt in Korea have risen since the crisis and are considerably higher than in the US. Equally, the economy remains over reliant on exports as a source of growth.

Keywords: Korea, Global Economic Crisis.

This paper explores how the Korean state has come to conceptualise and respond to the contemporary global economic crisis. The paper advances four key arguments. First, the crisis has come to be understood as a purely external threat to a fundamentally sound domestic economy. Global events that Korea has had no role in authoring are seen to threaten the stability of the economy. Second, this interpretation of the crisis has impacted upon the credibility of the neo-liberal theories of economic functioning that have been propagated by the Western-dominated international financial institutions (IFIs). This in turn has led to a highly uneven retreat from the neo-liberal reform policies that Korea has pursued since the 1997 Asian crisis. Third, the construction of the crisis as an external phenomenon has allowed policymakers to avoid taking serious action to address the structural economic problems that Korea faces. The global economic downturn highlighted the dangers inherent in Korea's overdependence on exports. Furthermore, levels of household debt, in relation to disposable income, are higher in contemporary Korea than in the US in 2007. [i] The state's response to the crisis has exacerbated rather than resolved these underlying structural vulnerabilities. Finally, the Korean state's interpretation of, and response to, the crisis shared certain critical similarities with that of other major East Asian political economies. The idea that the crisis was essentially an external ‘Western’ threat was influential throughout the region (Breslin 2011a). Essentially healthy East Asian economies were being undermined by the collapse of key Western export markets. Furthermore, there is evidence of a shift away from neo-liberalism in other major East Asian political economies (for example China and Taiwan). Unfortunately, Korea’s failure to address internal structural problems has also been mirrored throughout much of the region (Fang, 2010; Ho-Fung, 2012; Vithiatharan and Gomez, 2014). We make extensive use of documents produced by international organisations and national governments throughout the paper in order to evidence our key claims.

In advancing these arguments the paper draws upon and seeks to contribute to four distinct but overlapping literatures. First, we engage with the material on the impact of the global crisis on East Asia. As indicated above, the arguments that the crisis has been constructed as an external threat and that internal economic problems have been downplayed are not entirely novel (see for example Breslin, 2011a). However, by demonstrating how they apply in Korea, the third largest economy in East Asia, we strengthen these arguments. Second, scholars focused on the impact of the crisis on advanced capitalist states have, in our view convincingly, stressed how the crisis has strengthened the neo-liberal policy paradigm (Crouch, 2011; Mirowski, 2013; Lapavitsas et al, 2012). Against this context, it becomes important to analyse why the crisis led to a selective retreat from neo-liberalism in Korea. Why was the political impact of the crisis different in Korea than in other high-income economies? Third, the paper contributes to the on-going debates on the extent to which neo-liberal principles have been embedded within systems of economic governance in Korea (Shin and Chang, 2003, Weiss and Thurbon, 2006; Kim, 2012). Our analysis of

Korea’s response to the crisis highlights the extreme unevenness of the state’s commitment to neo-liberal reform. The crisis promoted a retreat from certain aspects of neo-liberal reform, as the state strengthened its role in the provision of credit and industrial planning. At the same time, however, the state remained entirely committed to the marketization of public services and the privatisation of state assets. Attempts to define Korea as either a ‘developmental’ or ‘neo-liberal’ state inevitably obscure the importance of inconsistencies and sectoral variations within systems of economic governance. Finally, in our analysis of the Korean economy’s structural vulnerabilities we draw upon post-Keynesian/ neo-Marxist analysis of income distribution, aggregate demand and household debt. Scholars working within these intellectual traditions have explored, at length, how changes in income distribution affect levels of demand and household borrowing (Brancaccio and Fontana, 2011, Tridico, 2012; Stockhammer, forthcoming). However, this research has taken Europe and North America as its primary empirical reference point. By exploring these issues within the Korean context we highlight the broader applicability of this approach.

The structure of the paper reflects the core arguments. The first section of the paper offers a descriptive account of the impact of the crisis on the Korean economy and the state’s response to the crisis. This provides the reader with the essential contextual detail without which the core arguments of the paper make little sense. The second section of the paper is focused on the Korean state’s selective retreat from neoliberalism and the construction of the crisis as an external threat. The third focuses on the key structural vulnerabilities that affect the Korean economy and the failure to address these in the wake of the crisis. In highlighting the state’s inaction regarding internal economic problems we draw back upon the arguments made in the previous section regarding the construction of the crisis as an external phenomena. The final section assesses the extent to which the key features of Korea's response to the crisis were mirrored in the response of other major East Asian political economies to the crisis.

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Writing in early 2015 it would appear that Korea has proven relatively resilient in the face of the contemporary economic crisis. The Korean economy has registered positive growth in every year since the onset of the crisis and the rise in the unemployment rate, according to the Organisation of Economic Co-operation and Development (OECD), between the first quarter of 2007 and the end of 2010 was limited to 1.1 per cent. By the end of 2013 unemployment had fallen below 2007 levels (OECD, 2014b), while unspectacular growth has exceeded 2 per cent in every year since 2009 (OECD, 2012: 13; 2014a: 14).

In late 2008 it looked far from certain that Korea would avoid a major recession. The Korean won experienced the sharpest devaluation of any major currency in 2008 and the first half of 2009 (Shin, 2014: 4). High levels of foreign ownership within the stock market created a source of volatility. Foreign ownership within the Korean stock exchange averaged over 40 per cent between 2003 and 2006 before falling to 28.8 per cent in 2008 as investors lost confidence (ibid: 54). These problems were compounded by the large-scale withdrawal of funds by foreign banks. The fall in the won did little to protect Korean exporters. In the second half of 2008 exports collapsed and in January 2009 exports registered a 34.5 per cent year on year decline (Cho, 2009: 3; Lee, 2010: 10). Durable goods dominated Korean exports and as confidence in the global economy evaporated, end users deferred the purchases of these goods (Lee, 2010: 7). Exports have played a critical role in the Korean growth model since the 1997 crisis. The export to GDP ratio for Korea increased from 28 per cent in 1996 to 53 per cent in 2008 (World Bank, 2014a). The decline in exports represented an existential threat to the regime of accumulation. Korean GDP shrank by 4.5 per cent in the final quarter of 2008 (Lee, 2010:10).

The Korean government came under limited pressure in the bond markets in the second half of 2008 as confidence in the economy declined. Yields on 10-year government gilts exceeded 6 per cent on several occasions. To put this in context, yields were just over 5 per cent in April 2008 (Trading Economics, 2014).

While the increases in the costs of financing government debt were limited, the costs of corporate borrowing rose sharply. The spread between AA-rated three-month corporate bonds and government bonds increased from under 1 per cent in 2007 to 3 per cent in mid 2008 (OECD, 2010: 71). Firms with weaker credit ratings faced prohibitive borrowing costs as the spread between BBB-rated bonds and government paper remained at over 6 per cent between mid 2008 and mid 2010 (ibid). At the same time, surveys of senior loan officers at Korean banks between late 2007 and early 2009 revealed the application of increasingly restrictive criteria to corporate borrowing (ibid). The volume of lending to SMEs decreased from 5.9 trillion won in July 2008 to 2.4 trillion in January 2008 (Shin, 2014: 85)

The corporate sector was highly polarised going into the 2008/9 crisis. In 2007 the return on assets employed for the sector as a whole stood at 7.3 per cent and the interest coverage ratio at 469.8 per cent. However, the same figures for SMEs were

3.5 per cent and 267.9 per cent (OECD, 2010: 46) Korea also faced considerable potential vulnerabilities relating to the weak financial position of the household sector. Household debt increased from 80 per cent of net disposable income in 1998 to 146 per cent in 2007 (ibid: 27).

Despite the vulnerabilities and problems outlined above, Korea avoided a full-scale recession as the overall performance of the economy improved in the spring of 2009. The Korean won recovered, GDP and export growth both turned positive, and credit conditions for domestic firms eased. In part this recovery can be attributed to the relatively robust rebound in demand for exports in China, Korea's primary export market. At the same time, it is important not to ignore the role that government policy played in averting a full-scale recession. The Korean state acted aggressively to boost aggregate demand and improve credit conditions for private firms. The Bank Of Korea (BOK) reduced interest rates from 5.25 per cent to 2 per cent between October 2008 and February 2009 (OECD, 2010: 62). Korea's relatively high inflation rate, 6 per cent at the point of the first interest rate cut, could be seen as positive as it allowed the Central Bank to set a strongly negative base rate (ibid). The BOK injected 28 trillion won (approximately $25-26 billion) into the financial system in 2008 and early 2009 to support the banking system and bond markets (ibid: 75). Perhaps most fundamentally, Korea undertook the largest fiscal stimulus, as a proportion of GDP, in the OECD area between 2008 and 2010. The first stimulus measures were implemented in September 2008 when the Korean government was under pressure in the bond markets. The Korean government's response to the contemporary economic crisis was the polar opposite of its response to the 1997 Asian crisis. The state did not adopt conservative fiscal and monetary policies in an attempt to reassure global markets. Instead, policymakers made the (quite reasonable) judgment that the confidence of global markets could only be secured by engineering a return to growth. Korea has shown a willingness to consistently revise fiscal plans and delay consolidation to secure growth. The relative success of these policies in promoting growth has prevented them from leading to significant fiscal deficits.

The maintenance of growth was essential to the system of political legitimation in Korea. Rajan (2010) has argued that the absence of comprehensive welfare structures in the US increases the social costs of unemployment and the pressures to reflate, in comparison to the EU. Korea faced the same pressures as the US but in a more acute form. In 2008 levels of public social spending in Korea were the lowest in the OECD area in relation to GDP (OECD, 2008: 32). Furthermore, there was substantial public support for a large-scale expansion of welfare spending (Korean Herald, 2012). Against this context, the maintenance of high levels of employment is vital for conservative politicians opposed to the creation of a comprehensive welfare state. Chang (2012) has argued that the initial popular appeal of conservative Lee Myung-bak, who won the 2008 Presidential election, lay in his stated ambition to achieve 7 per cent growth, his capacity to generate an nostalgia for the developmental state (high growth) era and the concept of developmental citizenship. The citizenship 'regime' during the age of 'high developmentalism' is seen as being based on high employment and increasing market opportunities. The state did not take responsibility for meeting individuals' social needs but rather for ensuring rapid growth that would allow individuals the opportunity to secure the resources to ensure their wellbeing through market exchange. The Korean state needed to intervene to support the maintenance of growth and high levels of employment to limit political pressures for higher social spending, to protect the claims of the developmental citizenship regime against the threat posed by welfare citizenship.

As part of the fiscal stimulus package introduced between September 2008 and April 2009, 1 per cent of GDP was allocated to direct transfers to business (primarily SMEs) and public financial institutions that served the SME sector (OECD, 2010: 51). The volume of government guaranteed loans to SMEs increased from 40.8 trillion won in 2006 to 59.4 trillion won (6 per cent of GDP) in 2009 (OECD, 2010: 78). According to the Korea Technology Finance Cooperation (2013: 28) and the Korean Credit Guarantee Fund (2014: 19) the volume of officially guaranteed loans increased by a further 8.5 billion won between 2009 and 2012. Support for SMEs fulfilled an important social function. Wages in the SME sector are much lower than in major firms and older, less qualified workers are overrepresented among SME employees (Korean Labour Institute, 2004). Within the context of the crisis, support for SMEs became a means of sustaining employment levels among potentially vulnerable workers. Additionally, insofar as the *chabeol* use the SME sector as a source of supply, subsidies for this sector support the continuation of a set of highly uneven relationships.

In addition to direct support for firms, an additional 1.2 per cent of GDP was allocated for public investment (OECD, 2010: 51). The spending commitments made in 2008 and early 2009 became subsumed within a broader five-year plan to promote green growth ('The Green New Deal') to which funds equal to 10 per cent of GDP were committed (OECD, 2012: 88). Superficially the 'Green New Deal' (GND) may appear to represent a return to the policies of the past, with the state designating key strategic industries and committing substantial financial resources to their development. The truth is somewhat more complex. The GND has been criticized for being both environmentally destructive and simply representing a means of channelling funds to the *chaebol*, the large family owned conglomerates that dominate the economy, due to their political contacts. Both of these criticisms clearly have substance. A large proportion (55 per cent) of total spending has been allocated towards improving capacity to adapt to climate change (OECD, 2012: 89). The majority of these funds have, in turn, been devoted to large-scale construction schemes focused on river management. The 'four rivers project' alone accounted for 34 per cent of total GND spending. Prominent environmental scientists have been highly critical of this scheme. These scholars argue that this scheme has damaged rather than enhanced the environment (Normile 2010, Reif 2011). Kalinowski argues that a relatively limited proportion of funds are being committed to genuinely infant industries with the potential to drive future growth. Rather, the majority is being devoted to conventional manufacturing, construction and the nuclear industry that the *chaebol* already dominate and have weaker long-term growth potential. For example, 54 per cent of all orders (by value) of the Four Rivers Project, which accounted for 35 per cent of total spending, were awarded to 10 firms (Kim et al, 2012: 17). Kalinowski sees this allocation as reflecting the political influence of the *chaebol* and as being both socially and economically damaging.

Kalinowski criticisms of the GND are not without merit. Nevertheless, the GND has played a key role in supporting the contemporary Korean growth regime. The *chaebol* dominate Korea's export profile. In 2010, according to the federation of Korean industry, the largest thirty *chaebo*l accounted for 84 per cent of total exports (Bloomburg, 2012). Given the centrality of exports to the entire growth regime it was logical to support the *chaebol* during the economic slowdown to ensure that investment plans were maintained and that there was no erosion of capacity to export.

Given that the majority of these firms had substantial cash reserves, what was more important than the actual financial support they received was the confidence that state support gave them. There are serious long-term issues related to Korea's overdependence on both the *chaebol* and exports, to which we return later in the paper. However, support for the *chaebol* provided a mechanism through which a return to growth could be engineered. The scale of the *chaebol's* dominance makes support for these firms simultaneously highly problematic and deeply logical.

Key elements of the GND can be said to contribute to the structural competitiveness of the economy. The Korean economy is incredibly dependent on imported fossil fuels, particularly oil. Imported fossil fuel accounted for 80.8 per cent of total energy consumption in 2007 (World Bank, 2014b). Fluctuations in the price of oil are an important source of instability in the Korean economy. Understood against this context there is logic underpinning support for nuclear power (although this effectively exchanges dependence on imported natural gas/coal for imported uranium), large-scale investment in railways and support for existing industries to improve energy efficiency. In any case the *chaebol* also dominate investment in many of the key new alternative energy technologies. Large firms account for 21 per cent of total green R&D spending, as opposed to 17 per cent for SMEs (Kim et al, 2012: 17). Investment in key technologies (solar cell and fuel cell) is dominated by the *chaebol*. A bolder strategy that focused on 'infant industries' would have been equally amenable to the *chaebol*. The extent to which the GND neglects support for the development of new technologies can be exaggerated. 12 per cent of total spending is devoted to supporting R&D (OECD, 2012: 89). The green new deal has created the largest public R&D budget, as a proportion of GDP, for environmental and energy technologies in the OECD area (ibid: 102). The extent to which SMEs have been marginalized within the green new deal can also be exaggerated. The government has through the use of state-owned banks, credit guarantees and the establishment of public venture capital funds committed 18.9 billion won (approximately $17.5 billion) to fund the development of SMEs in ‘green industries’ – although it remains to be seen how carefully targeted towards ‘green’ firms these funds will in fact be (ibid: 100).

Public subsidies for private R&D can be justified without departing from the framework of neo-classical economics. Private R&D generates positive economic and social spill over effects, the total social value of innovation exceeds its value to any individual firm. It is legitimate, therefore, for the state to subsidize these activities. Even ‘model’ neo-liberal states, such as US, spend a considerable amount on directly supporting R&D. In the US, non-defense federal R&D accounts for approximately 0.4 per cent of GDP, with defense spending just exceeding this figure (American Association for the Advancement of Science, 2014). In addition indirect tax breaks for R&D account for over 0.3 of GDP in the US (OECD 2013: 51). Nevertheless, the forms of support Korea has put in place in relation to its ‘Green Growth Strategy’ have come under criticism for compromising market disciplines. For example, the OECD notes that 80 per cent of total lending to green industries in Korea carries a government guarantee of some form (OECD, 2012: 100). For the OECD, moderate subsidies for R&D are a legitimate means of promoting private investment in innovation. However, the Korean state’s program is seen as compromising the proper role of the market in allocating capital and assessing risk by directly guaranteeing such a high proportion of loans. Additionally, only 379 billion won of the 1.9 trillion won of public R&D spending is committed to basic research (ibid: 103). The remainder is committed to directly producing new products- with approximately half going to the SME sector and the remainder large firms (ibid). This balance is seen as inappropriate because the state effectively picks winners, in terms of firms and technologies, by funding the development of particular products.

The significance and the forces underpinning the state's retreat from neo-liberalism will be considered in the next section of the paper.

The Economic Crisis and the Selective Retreat from Neo-liberalism

It may be logical to expect a crisis of deregulated global finance to lead to a questioning of neo-liberalism and a shift in the policy agenda. However, a number of scholars have convincingly argued that in Europe and North America the intensification of neo-liberalism has come to be seen as critical to the resolution of the contemporary crisis (Crouch, 2011; Lapavitsas et al, 2012; Mirowski, 2013). There was nothing inevitable about the policy impact of the contemporary crisis on Korea. At the same time, however, the politico-economic project of President Lee Myung Bak, the institutional and economic legacies of the development state, and the way in which the crisis was constructed as an external threat made a retreat from certain aspects of neo-liberalism logical.

In 2008 Lee Myung Bak became Korea's first conservative president since 1998. Many of the initial statements of the government regarding economic policy can be seen as contradictory. For example, the administration initially stressed that economic policy would be guided by the principle of 'big markets and small government' (Jwa 2008, p. 83). On the other hand, prior to the development of a full-scale global financial crisis the government committed itself to massive increases in public infrastructure spending (Mitchell, 2009).

The key to understanding the Lee Myung Bak administration is its lack of autonomy from leading domestic firms. Any Korean government is structurally dependent on the chaebol. The success of any governing project relies upon these firms' capacity to generate growth and employment. As such any government is obliged to act to secure these firms long-term interests. However, the direct personal connections between previous liberal presidents and the chaebol were much weaker. These administrations did not act at the behest of the *chaebol* in the same manner as the Lee Myung Bak administration. Rather, they attempted to implement a more or less coherent policy of expanding market disciplines (neo-liberalism) while simultaneously seeking to strengthen systems of social protection for those unable to compete in this new environment (Doucette, 2010). The *chabeol* was clearly in favour of much of the neo-liberal agenda. The *chaebol* were enthusiastic supporters of privatization, increased labour market flexibility and the tightening of market disciplines over small farmers (Lee et al, 2010). However, the *chaebol* were less enthusiastic about the opening of key domestic markets, which they dominated, to foreign competition and the weakening of systems of industrial support from which they benefited.

As detailed in the previous section of the paper the GND in part represented a mechanism through which the government could create captive markets for the *chaebol* and effectively extend large-scale subsidies to these firms. The crisis presented Lee Myung Bak with an opportunity to retreat from those aspects of neo-liberal reform that the *chaebol* found problematic while strengthening those elements major firms favoured (tightening control over labour, accelerated marketization of public services), in the name of strengthening national competitiveness (ibid). The situation is further complicated by the demands of political legitimation and electoral politics. The hostility of the majority of Koreans towards the chaebol means that even conservative politicians need to at least make gestures towards curbing *chaebol* excesses and promoting more balanced development (Financial Times, 2013). Furthermore, as we have already made clear, the need to manage levels of unemployment demanded that SMEs be supported. So at the same time as supporting politically-connected large firms, the government came under pressure to extend supports for uncompetitive small firms, to shield them from market disciplines, in a manner inimical to neo-liberalism.

The extension of the state's role in industrial finance in the wake of the global financial crisis cannot simply be understood as a product of the political project of a particular president. Rather, the legacies of the developmental state created a conducive environment for such an outcome and ensured that forms of financing would take an illiberal form. Korea is far from alone in seeking to support lending to business as a means of maintaining employment and promoting recovery. What is distinctive about Korea is the form that this support took. A critical difference between support schemes introduced by liberal states, such as the UK, and the Korean scheme is the level these schemes operate at. The UK's funding for lending scheme constitutes a general subsidy for lending to SMEs. The Korean scheme involves public agencies making decisions on whether or not to guarantee borrowing by particular firms (Bank of England, 2012).

Korea's use of credit guarantee schemes to support lending during the crisis reflected its particular history. Prior to the crisis, only the Japanese government among the OECD states guaranteed a similar proportion of corporate borrowing to Korea (OECD, 2014). The well-established nature of these schemes made it inevitable that they form the primary mechanism through which the state would seek to extend funding to SME during the crisis. In the years preceding the crisis the volume of loans to SMEs carrying some form of official guarantee had slowly been failing

(Korea Credit Guarantee Agency, 2008: 13; Korean Technology Finance Corporation, 2012: 28). The crisis served to reverse this trend and secure the position of these programs within the Korean financial system. The scale of public agencies involvement in the allocation of credit in Korea is clearly antipathetic to neo-liberalism.

The single most important factor in accounting for the retreat from neo-liberalism was the construction of the contemporary crisis as a failure of a global, Western-dominated, financial system. The construction of the 2008 crisis in Korea cannot be understood outside out of Korea's previous experience of crisis in 1997-8. After the 1997 Asian crisis the Western-dominated international financial institutions (IFIs) advanced a strong set of claims regarding the universal desirability of open market systems (Shin and Chang, 2003). The primary economic role of the state was to maintain regulatory systems that strengthened market disciplines. While there was considerable domestic support for this agenda within Korea, the manner in which it was advanced by the IFIs still represented a potential source of resentment. Korea's need for financial support during the 1997 crisis was clearly used by the International Monetary Fund to advance its own policy agenda.

Whatever the underlying causes of the global financial crisis, its initial visible manifestations were in the US and the Eurozone. The reforms that the IMF required Korea to adopt in 1997/8 were based on a conscious emulation of Western European and US systems of regulation (ibid). The crisis could, therefore, not unreasonably be seen to discredit the reforms the IMF had previously advanced. This narrative was strengthened by the Korean governments own publications that stressed the external/foreign nature of the 2008 crisis (Republic of Korea, 2012). Critically, in 2008 Korea was not dependent on IFIs for support. Korea's relative financial strength opened up a political space for challenging components of the neo-liberal project that the IFIs had promoted.

While real, the extent of Korea's retreat from neo-liberalism during the contemporary crisis should not be exaggerated. The crisis has not led to a systematic attempt to reverse key neo-liberal reforms enacted since 1997. There has been no attempt to challenge foreign dominance of the domestic banking system. The major shareholders in the majority of Korean nationwide banks are foreign financial institutions (PricewaterhouseCooper, 2008). Equally, the new systems of financial regulation, cooperate governance and labour market regulation that were created after the 1997 crisis have been left untouched.

The increases in the use of credit guarantees, the R&D policies adopted as part of the green new deal and the creation of soft domestic markets for the leading *chaebol* through various programs to enhance 'Korea's capacity to adapt to environmental change' run contrary to neo-liberal principles. They soften market disciplines and compromise market allocation of funds. However, their significance should not be overestimated. The state did not use the crisis, and the large-scale government interventions in the financial system it necessitated, to challenge the dominant position of foreign investors within the financial system (see below). Over 90 per cent of total loans to business in Korea do not carry government guarantees (OECD, 2014: 193). The soft markets the state created for the *chaebol* through the green new deal are relatively small in relation to their overall sales. Total spending on the GND was less than Samsung electronics' annual sales (Samsung Electronics, 2014). The Korean economic policy regime since 1997 has defied any neat definition. Different policy logics have co-existed. Aspects of economic policy, such as the promotion of foreign investment in the financial sector, have reflected the influence of neo-liberal reformers. On the other hand, illiberal dirigiste systems of industrial promotion remain important in certain sectors (Kim, 2012). Other policies have simply reflected the need to support employment for vulnerable groups in order to maintain social stability (support for SMEs). The crisis altered the balance of these differing logics, weakening the position of neo-liberal reformers. It has not led to fundamental change in the basic system of economic governance.

The construction of the crisis as a external phenomena did not simply facilitate a re-examination of certain aspects of the neo-liberal project. More worryingly, allied to the prioritisation of the maintenance of growth, this construction made it easier for policymakers to avoid addressing the fundamental structural weaknesses of the Korean economy. The global economic crisis clearly highlighted the vulnerabilities that Korea's overdependence on exports as a source of growth creates and the potentially disastrous consequences of excessive household debt. Levels of net household saving were lower and levels of net household debt considerably higher in Korea than in the US in 2007. Given the role that household debt played in destabilising the US financial system it is difficult to be sanguine about these statistics. The financial performance of much of the SME sector creates an additional source of vulnerability. It is to these problems we now turn.

Household Debt, Export Dependence and the SME sector

We would argue that the three major structural issues that threaten the stability of the Korean economy are high levels of household debt, an excessive reliance on exports and the financial weaknesses of many SMEs. The issues of household debt and overdependence on exports can both be linked to the chronic deficiencies in domestic demand that Korea has faced since the 1997 crisis. In part these deficiencies can be attributed to a fall in rates of investment. Between 1990 and 1997 gross capital formation in Korea averaged 33.25 per cent of GDP. Between 1998 and 2013, on the other hand, gross capital formation averaged 29.65 per cent. If we discount the immediate post 1997 crisis period, between 2001 and 2013 the average is still under 30 per cent (World Bank, 2014c). The issues caused by the fall in investment have been compounded by the redistribution of income from labour to capital since the 1997 crisis. Between 1996 and 2008 the labour income share fell from 65 to 58 per cent.[ii] Given the fall in the level of investment within the economy, it would be desirable for domestic consumption to increase. However, the decline in the wages share would suggest the working and middle class, who largely derive their income from wages rather than investments, would have a limited capacity to support this consumption. Increased consumer debt and dependence on exports represented a partial solution to the issue of inadequate domestic demand.

As we have already said, household debt in Korea increased from 80 per cent of net disposable income in 1998 to 146 per cent in 2007 (OECD, 2010: 27). The OECD makes the argument that the rise in debt in Korea has been mirrored by a similar build up of household financial assets that limits the vulnerabilities that this debt creates (ibid). There are two issues with this argument. First, household financial assets are tied to equity and property prices. In a serious recession in which distressed households seek to liquidise assets, they are likely to find that the value of assets has been reduced as a result of the general economic situation and the rush to liquidity. Second, the BOK itself has expressed concerns over how the saving rate in

Korea has collapsed since the 1997 crisis and has been negative for the poorest 20 per cent of Koreans since the late 1990s (Chung, 2009: 89). Household net saving declined from 16.4 per cent in 1996 to 2.7 per cent in 2008.[iii] Korea also presents a paradox in that gross national savings are among the highest in the OECD area whereas household saving is amongst the lowest.[iv] While low government borrowing plays a role in supporting the high rate of gross national saving, it is primarily a product of high levels of corporate saving.

The problem of low household saving becomes more apparent when we breakdown saving behaviour by income group. The savings rate of the richest 20 per cent of Korean household remains very high at well over 30 per cent of disposable income whereas the poorest 20 per cent of household have negative net saving rates of over 15 per cent (Chung, 2009: 89). Increases in borrowing by poorer households can be linked to increased income inequality and represented an attempt to cope with relatively stagnant real incomes. The Gini co-efficient in Korea increased from 0.26 in 1996 to 0.3 in 2007.[v]

The redistribution of income from labour to capital has largely been achieved by increasing levels of low-paid insecure employment. While significant prior to the 1997 crisis, rates of temporary employment have further increased since this point and by 2008 Korean had the second highest rate of temporary employment in the OECD area (OECD, 2010: 36). Over 90 per cent of jobs created between 1998 and 2002 were temporary (International Monetary Fund, 2004: 34). The trend towards casualisation has continued and the proportion of temporary workers increased from 18.1% in 2002 to 28% in 2007 (OECD, 2008: 37). Temporary employees on average earn approximately 30% to 40% less than their permanent counterparts (Ha and Lee, 20012). Through the use of subcontracting, large firms have been able to shift work to the low-wage largely non-unionised SME sector were causal employment is the norm. In 2007 Korea had the highest rate, 25.6 per cent, of full time workers earning less than two thirds of medium earnings in the OECD (OECD, 2009: 295).

Financial reforms that made it easier for banks to focus on consumer lending together with stagnant wage growth for large sections of the working class perhaps made a large increase in household debt inevitable. Household debt increased further during the crisis from 154.1 per cent of disposable income in 2009 to 163.8 per cent in 2012.[vi].

The initial recovery from the 2008/9 crisis was supported by not only increases in household debt but phenomenal rates of export growth. Exports rose, in dollar terms, by 28.3 per cent in 2010 and 19 per cent in 2011 (OECD, 2012: 13). The flatlining of exports in 2012 and 2013 prompted the government to introduce stimulus packages of approximately $6.5 billion and $15.4 billion respectively (BBC, 2012; The New York Times, 2013). Between 2008 and 2013 Korea's export to GDP ratio increased further from 50 to 54 per cent (World Bank, 2014e). [vii] A significant decline in exports represents an existential threat to the growth regime that requires immediate action.

Shin and Chang (2003) argue that neo-liberal reform is responsible for the decline in rates of investment in Korea since 1997, that has left the economy over dependent on consumer borrowing and exports as sources of growth. The blame is seen to lie with new systems of corporate governance that pressure firms to reduce debt and focus on shareholder value together with financial reforms that make it more difficult for institutions to support viable but highly indebted firms. We do not dispute this reading of financial reform - although it is worth noting that the high rate of corporate saving in Korea means that many firms could increase investment without seeking external funding. However, we would also stress the importance of a lack of opportunity for profitable investment in accounting for the decline in investment levels. According to Jeong (2007: 58) the rate of profit of non-farm business in Korea fell from over 16 per cent in the late 1970s to less than 6 per cent prior to the 1997 crisis. Although, there has been a recovery in profitability since this point the output-capital ratio has not improved. Rather, the rise in profitability since the 1997 crisis is entirely due to capital's capacity to capture an increasing share of output not any increase in value produced relative to capital employed. By reducing the wages share Korean capital may have improved profitability but it has also undermined its own domestic market and in so doing placed further constraints on the expansion of investment. If Korea had not undertaken the neo-liberal reforms that Shin and Chang criticise, business investment might have been higher but there were secular forces that made a substantial decline in rates of investment inevitable.

While the financial position of leading firms in Korea is strong, the corporate sector is bi-fractured and the position of many SMEs is much weaker. The IMF has argued that the Korean government keeps many unviable SMEs alive through publicly guaranteed loans (IMF, 2010). The wage disparity between small and large firms in Korea is among the highest in the world and low wages are critical to the survival of many marginal small businesses (Korean Times, 2014). For many Koreans, including those not overly inclined towards radicalism, the roots of these problems lies in the nature of the uneven relationship between the SME and the *chaebol* (Financial Times, 2013).

The Korean government, at least rhetorically, accepts that the economy suffers from certain structural issues. Levels of household debt are understood to be problematic (The Economist, 2014). However, a close examination of government publications reveals a continued focus on external threats and contradictory statements regarding the domestic economy (Republic of Korea, 2012; 2014). The primary issues that Korea faces are seen still to relate to the unstable global environment. In terms of domestic policy the government simultaneously discusses the need to increase domestic consumption and reduce consumer debt. The simultaneous achievement of these objectives would require a major redistribution of income from capital to labour- particularly heavily indebted low and middle-income households. In the absence of substantial increases in income for low and middle earners these objectives are contradictory – households cannot increase both debt repayments and consumption. Ultimately the Korean government's growth strategy relies on a never ending drive to improve national competitiveness and running ever-increasing current account surpluses – despite the obvious vulnerabilities associated with this strategy.

The failure of Korea to address the need for redistribution is neither surprising nor unusual. Policymakers have ignored Lapavitsas et al (2012) analysis of the role that German wage stagnation has played in the development of the Eurozone crisis (European Commission, 2010). Analysis highlighting the linkages between inequality, household debt and financial instability in Europe and the US has carried little policy traction (Brancaccio and Fontana, 2011; Tridico, 2012 Stockhammer, forthcoming). The issues that Korea faces in terms of capital surplus and the rise of household debt are the same as those faced by other relatively advanced capitalist states in East Asia, Europe and North America - although Korea faces these issues in a particularly severe form. The relationship between debt, income inequality and aggregate demand is well established theoretically by both Marxist and left-Keynesian economists. However, the need for redistribution has rarely been addressed in national policy responses across the OECD area. Redistribution threatens the position of those with the greatest social and political power. It is always likely to be politically difficult. Nevertheless, the contemporary global crisis has thrown the instabilities that the build up of household debt can create into sharp relief and highlighted the vulnerability that Korea's overdependence on exports creates. In other words, it made clear the potential costs of inaction on these issues.

Having considered how the crisis has come to be politically constructed in Korea and the state's failure to address the internal economic weaknesses the crisis ought to have highlighted we are now in a position to consider how far the Korean case can be said to conform to a wider East Asian crisis paradigm.

Korea in a Regional Context

The sheer diversity of states within the East Asian region makes it difficult to discuss an East Asian response to the crisis.[viii] For example, it was inevitable that the response of established market high-income economies (Taiwan, Korea, Singapore, Japan) would be different from low-income post-communist states (Vietnam, Laos, Cambodia). Equally, the vast differences in the size and economic openness of the region's economies render comparison of macroeconomic responses to the crisis difficult. Malaysia had a trade to GDP ratio approximately three times that of China (World Bank, 2014d). The impact of stimulus is likely to be very different given the contrasting levels of openness. Furthermore, in developing an analysis of the impact of the global economic crisis on individual East Asian political economies we are constrained by the unevenness of the literature. Analysis of the political economy of the crisis, how the crisis has served to consolidate or challenge particular aspects of national economic governance, in East Asia is uneven. We focus on Malaysia, China and Taiwan because of the relatively developed nature of the literature on these political economies have been effected by the crisis. Nevertheless, we would suggest that Korea's response to the crisis conformed to a broader regional logic in a number of significant ways.

First, the size of the stimulus packages in East Asia stands out from the rest of the world. According to the International Labour Organisation (ILO), excluding the OECD economies of Japan and Korea, the average size of stimulus package in East Asia was 9.1 per cent of GDP (ILO, 2011: 4). This compares with an average of 3.4 per cent across the high-income economies and 2.6 per cent in Latin America (ibid). In part this reflects the weakness of automatic stabilisers in the region given the underdeveloped nature of welfare systems. However, it can also be seen to reflect the political necessity of growth. The absence of developed welfare systems intensifies the social and political impact of prolonged recession. We would argue that in Korea it threatened the viability of the relatively minimalist welfare model and the electoral prospects of the centre-right. In China there is a sense in which a prolonged period of slow growth is perceived (correctly or otherwise) to threaten the stability of the entire political system (The Atlantic, 2013).

The detailed national case studies that exist indicate that the crisis has ushered in a selective retreat from neo-liberalism. The most obvious example of this is China. The Chinese response to the crisis involved using the statecontrolled banking system to finance large-scale infrastructural programs through the establishment of Local Government Financial Vehicles (LGFV). The overall volume of bank lending in China doubled between 2008 and 2009 (Breslin, forthcoming a). A 2010 survey revealed that 70 per cent of LGFV were not generating the funds necessary to service their debts (Breslin, forthcoming b). The solvency of many local governments and the value of the loans made to these governments is highly questionable. The Chinese government's response to the crisis has created substantial bad debt problems in the banking system that would render any form of substantive liberalisation/ financial opening suicidal. The crisis has therefore reinforced the system of state capitalism in China in which local and central government continues to play a key role in shaping the flow of credit. The response of the Taiwanese government to the crisis served to strengthen the position of state-owned banks within its financial system as these institutions were afforded a lead role in maintaining the flow of funds to corporations (much of it government guaranteed loans to SMEs) and homebuyers (Hu, 2011). At the same time through the six flagship industries program the Taiwanese government has reaffirmed its commitment to interventionist industrial policies (Wang and Lin, 2011). Obviously, it would be possible to read too much into the experience of three 'states' in developing an analysis of a regional crisis narrative. On the other hand, the experiences of the largest (China), third largest (Korea) and fifth largest (Taiwan) economies in the region cannot be easily discounted when we consider the regions response to the crisis.

The conceptualisation of the crisis as essentially an external (Western) threat served to legitimate illiberal statist economic policies. The 2008 crisis is essentially understood as a consequence of the way in which Western states have organized their financial systems. East Asian governments have had no role in authoring the crisis but are threatened by Western instabilities and excesses through a collapse in export demand (see for example Ministry of Finance Malaysia, 2010; Republic of Korea, 2012). In the case of China this discourse is more aggressive with the crisis being seen as evidence of the superiority of a distinctly Chinese more *dirigiste* model of capitalist development (Breslin, 2011). Of course a focus on the role that East Asia's large current account surpluses played in the formation of asset price bubbles, and the overexpansion of consumer lending in the US, presents a powerful challenge to the idea of a purely external crisis (Hart-Landsberg, 2010). More seriously, not just in Korea but elsewhere in East Asia, the idea of a external crisis and the focus on maintaining short term growth has led to a neglect of the internal vulnerabilities that the crisis should have highlighted. In Taiwan, for example, household debt to disposable income increased from 111 per cent at the end of 2007 to 122 per cent in 2013 (Fang, 2010 128, Fitch Rating, 2013). One does not have to be an uncritical supporter of the credit rating agencies to understand their decision to mark down the Taiwanese banking system because of the threat that household debt pose to the financial system. Equally, Taiwan's current account surplus increased from 8.9 per cent in 2007 to 11.73 per cent in 2013 (see http://www.tradingeconomics.com/taiwan/current-account-to-gdp). Taiwan, just as Korea, is now more dependent on consumer borrowing and exports as sources of growth than when the crisis began. Against this context, the wisdom of Taiwanese government initiatives to further expand exports must be questioned (Wang and Lin, 2011). Similar problems relating to an overdependence on exports as a source for growth have been raised in relation to the economies of Thailand and Malaysia

(Jitsuchon and Sussangkarn, 2012 Nambiar, 2012). Malaysia's overdependence on exports is, like that of Taiwan and Korea, compounded by household debt problems.. While Malaysia's household debt to GDP ratio is lower than Korea's, at just over 80 per cent, it could be argued that the problem is more serious given that debtors are substantially poorer overall (Rethel, 2013). In addition to the problems in the household sector, Vithiatharan and Gomez (2014) argue that the volatility Malaysian markets experienced in 2008 and early 2009 was not simply a consequence of global conditions but a well founded lack of investor confidence in systems of domestic corporate/financial regulation and concerns about opaque corrupt relationships between regulators and the regulated. Vithiatharian and Gomez see little commitment on the part of the government to addressing these issues. Most concerning for anyone interested in global economic stability, the largest economy in the region has some of the most serious structural problems. Given China's issues with domestic under consumption and overreliance on capital investment and exports as sources of growth, it is difficult to see how the longer-term impact of an investment led stimulus package can be favourable (Ho-Fung, 2012).

Asian governments largely succeeded in avoiding serious long-term recessions in the wake of the global financial crisis. This constitutes no minor achievement. However, this has largely been achieved by failing to address serious structural problems, the dangers of which the global financial crisis ought to have highlighted. In a sense the Asian response represents the polar opposite of the European. For the European Commission (2010) a return to sustained growth has been predicated on a successful resolution of the structural problems it, possibly incorrectly, diagnosed particular national economies as facing. In Asia everything has been subordinated to the maintenance of growth. The construction of the crisis as a purely external threat, which East Asia has played no role in the formation of, has opened up space for a challenge to certain aspects of neo-liberalism in the region. However, it has made it easier to indefinitely postpone taking serious action to address the internal problems that the region faces.

Conclusion

The impact of the contemporary economic crisis on Korea has clearly not been as great as the 1997 Asian crisis. However, it has not been insignificant. The crisis has led to a consolidation of the more *dirigiste* aspects of the economic governance regime. The state's role in corporate financing has increased since 2008. Furthermore, while the limitations of the GND are clearly apparent it still represents a significant commitment to the largest scale, as a proportion of GDP, public support for the development of environmental technologies in the world. These monies are not focused upon basic research or general tax subsidies for R&D but rather are being used to pick (or create) winners in terms of particular firms and technologies. It is important not to overstate the significance of these changes. We are not arguing that the old developmental state is being resurrected. Rather, that crisis altered the balance between *digiriste* and neo-liberal forces/ideas within the Korean political economy.

In Korea, as elsewhere in Asia, the global economic crisis was understood as an external (Western) threat. This reading of the crisis has led to a failure to treat the internal structural issues that the crisis exposed with due seriousness. The crisis clearly exposed the vulnerabilities created by Korea's overdependence on exports as a source of growth. Equally, the US experience highlighted the dangers posed by the growth of household indebtedness and the particular problems associated with the growth of low-income household indebtedness. In Korea, and in East Asia in general, we have seen a relatively successful focus on maintaining short-term growth. The success of Korea, and the other major East Asian economies, in maintaining positive rates of growth should, however, not be allowed to obscure their failure to address deeper structural problems that threaten to create serious social, political and economic instability.

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[i] Figures available from the OECD's statistical database http://www.oecd.org/general/searchresults/?q=household%20debt%20as%20a%20percentage%20of%20income

[ii] See OECD statistical database (http://stats.oecd.org/Index.aspx?queryname=345&querytype=view).

[iv] Figures for both household saving and gross national saving are taken from the OECD's statistical database (http://stats.oecd.org/Index.aspx?QueryId=51648# www.oecd.org/eco/outlook/Saving.xls+&cd=4&hl=en&ct=clnk&gl=uk).

[v] This information was obtained through a request for information to Statistics Korea (www.kostat.go.kr).

[vi] Figures taken from OCED online national accounts (http://stats.oecd.org/).

[vii] These figures were ascertained from 'http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS'.

[viii] We use the UN definition of the East Asia sub region (see http://unstats.un.org/unsd/methods/m49/m49regin.htm)

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