SOUTH KOREA’S ECONOMIC POLICY RESPONSE TO THE GLOBAL FINANCIAL CRISIS

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ABSTRACT

For the second time in somewhat more than a decade, the Republic of Korea has been hit by a major economic crisis. While the so-called Asian financial crisis of 1997-8 is history, it is still unclear whether the global financial and economic crisis, which culminated with the collapse of Lehman Brothers in September 2008, is already over. In both cases, South Korea has done remarkably well to overcome quickly what at some stage have appeared as very severe challenges. It is tempting to conjecture whether the South Korean adjustment to the second crisis may have been influenced by memories of the first. Certain lessons may have been assimilated from the 1997-8 crisis, such as the need for speedy and decisive action to meet fiscal and economic difficulties, but also to contain social unrest. Institutional mechanisms, some established since the earlier crisis, have helped, as has the top-down system of administration in South Korea, which allows for swift decisions.

1 INTRODUCING THE ISSUES

The aim of this paper is twofold. First and straightforwardly, it will trace how the Republic of Korea (South Korea—henceforth Korea) has handled the 2008 crisis so far.1 The first year of the crisis, i.e. September 2008 to September 2009, will be taken as the principal reference period. The appropriateness of economic policy measures will be its major concern.

Second, it will search for some connection between the 1997-8 and the 2008-09 crises. A number of recent contributions to experimental

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economics have shown that individuals who face a risk and have to make a decision under risk act differently in the light of their background experiences. Those who have already been exposed to a similar situation act differently from those who have only a theoretical knowledge of different pay-outs. It seems tempting to extrapolate these findings from the methodological level of individuals to the societal level. In the confined space of this paper, this can only be on the basis of a conjecture, possibly motivating further research. Still, the Korean case of crisis adjustment is interesting, because decisions made to face the new crisis may have been influenced by memories of another severe economic crisis just a decade before. One might expect that some of the following subjective lessons have been internalised by decision-makers: swift action to regain market trust is important; involving international players can be burdensome; social consequences have to be accounted for.

The first two parts of the paper will trace Korea’s economic situation when it faced the crisis and see how Korea was affected by the global financial crisis, which was to turn into a major global economic crisis. The article will next trace policy responses and see how they resonated with the performance of the Korean economy. As a fourth step, it will look at the political boundary conditions. The paper will conclude by looking for connections between the two major crises.

2 THE SOUTH KOREAN ECONOMY ON THE EVE OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

At the outbreak of the financial crisis in September 2008 (taking the Lehman Brothers insolvency as the starting point), the new government under President Lee Myung-bak was not even one year in office. Lee had started as a pro-business president, but even in his first months in office had had to face a number of setbacks. Some of his pet project ideas, with which he wanted to strengthen economic

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2 Rakow and Newell (2010) report that decision-makers in an experiment act differently depending on whether options and their outcomes are described to them or when they experience actual draws. In experiments about buying insurance, Kusev et al. (2009) notice that participants may fear exaggerated risks, and this may be caused by the accessibility of certain events in memory. Starbuck (2009) finds that learning from rare events is important and difficult, and may have significant influence not only on individuals but on organisations as well.