



Korea requires structural reforms

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Korea's economy has enjoyed many years of gains. High, often double-digit growth rates transformed this once very poor country into the world's 13th largest economy and secured it as number 7 in the global export ranking list. Yet times have changed. Korea's development has faltered quite markedly over the last few years. More and more problems associated with the existing structures are coming to light and making reforms an increasingly pressing task. All of this is made more acute by the cooling off of the economy in China and the realignment of the country's previous growth model to a more domestically-oriented strategy, as China is by far the country's largest trade partner. Realignment is therefore also imperative in Korea.

Economy in trouble

In its assessment of developments in 2014, the Ministry of Finance in Seoul had clear words: "Chronic structural problems have beset the Korean economy: Low growth persists, new growth engines have been declining (Ministry of Strategy and Finance, 2015 Economic Policy Directions: Evaluating 2014's Economic Policies). If this trend continues, low growth will become the new norm.

One year on, it looks as though Korea must in fact prepare itself for tougher times. In the first half of 2015, the outbreak of the respiratory disease MERS counteracted the measures initiated from 2014 to stimulate the economy. Private consumption, in particular, temporarily displayed a drastic decline. Greater investment in equipment and construction was only able to partially compensate for this. In terms of foreign trade, the economic slowdown in China and other emerging economies, yet also the revaluation of the won had a negative impact on goods exports. According to information provided by the Korea International Trade Association, exports declined by 6.6% in the first nine months of 2015 over the same time period in the previous year. The prospects of a reversal of trends do not look good. However, this has failed to set alarm bells ringing in Seoul, as economic policy in Korea remains largely dominated by the traditional model of export-based growth.

Even though increased domestic demand allowed economic output to increase by 1.2% in real terms over the previous quarter between July and September 2015, and thereby register the strongest quarterly growth since 2010, the uncertain situation of the global economy leaves no room for excessive optimism. Even central bank governor Lee Ju-yeol accepts this: "Because exports take up a large portion of the economy, it is true that they limit the recovery of the domestic market." ("Central Bank is Firm on Rates Prior to Fed's Move" (Korea JoongAng Daily, 13th November 2015)). For its part, the Bank of Korea (BoK) chose not to revise its growth forecast, which had already been downwards corrected. For 2015 as a whole, the BoK is only anticipating an increase of 2.7% (Bank of Korea, Economic Outlook for 2015 and 2016, press release, 15th October 2015); in 2014, the gain was 3.3%. Private insti-



tutes are even more sceptical: The Hyundai Economic Research Institute, for example, is only forecasting +2.5% (Weekly Economic Review, 8 October 2015 (kor.)).

The outlook for 2016, however, is slightly more optimistic. The BoK is forecasting a real increase in GDP of 3.2%, although the Hyundai Institute is still somewhat more reserved with its figure of +2.8%. The bank primarily expects growth impulses to come from domestic demand. Exports are also expected to recover slightly compared with 2015.


However, the assumptions of the top monetary watchdogs are seen by many observers as too optimistic ("BOK is sanguine on growth for 2015 and 2016", Korea JoongAng Daily, 17th October 2015). Although private consumption did benefit from state support measures in 2015, stagnating real incomes leave doubts as to whether this trend will continue in 2016, according to Lee Keun-tae, economist at the LG Economic Research Institute. With regard to the upturn in exports, even Yoon Sang-jick, Minister for Trade, Industry and Energy, has remained reserved. The Korea JoongAng Daily quotes him as follows: "[...]we forecast that exports are unlikely to get better next year due to the continuation of low oil prices and slow recovery of the global economy" ("Gov't Unveils Plans to Vitalize Nation's Sluggish Exports", Korea JoongAng Daily, 12th November 2015).

Structures need reform

Yet even if the economy does improve slightly in 2016, this will not resolve Korea's problems. This is because the economy is being squeezed from all sides (OECD, Korea: Policy Priorities for a Dynamic, Inclusive and Creative Economy, October 2015, page 1): For example, China is competing very successfully with Korea in a

whole range of sectors, including shipbuilding. The dominant corporate culture at the major conglomerates (chaebols) urgently requires supplementation by small, innovative operations. The rapid ageing of society is not only leading to a situation in which labour is in short supply, but is also putting pressure on public finances. At the same time, young people have highly uncertain future prospects. This situation is compounded further by an extremely high level of private household debt and low productivity in the services sector. The solution to this and other problems requires far-reaching structural reforms, as these are the only way to establish the conditions for sustainable, stable growth, writes the OECD, thereby supporting the assessment of the Korean Ministry of Finance. However, reforms of this kind take time, especially since a great deal of resistance must also be overcome.

Korea's government under President Park Geun-hye launched several initiatives in 2013/2014 to make the economy more innovative, while at the same time creating new jobs. "Creative economy" is the magic word. The goal is to connect science, technology, industry and culture in such a way that independent Korean innovations can be developed and commercialised. Information and communication technology will play a key part in this regard (S. Connell, Korea's Creative Approach to Economic Competitiveness, Blog, Council on Foreign Relations: Asia Unbound, 24th February 2014). The main focus here is on tapping the creative potential of small and medium-sized enterprises, thereby creating a counterweight to the chaebols. The government, and here in particular a newly established "Ministry of Science, ICT and Future Planning", is to create the corresponding environment for this, for example by removing regulatory barriers or securing greater mobility for qualified workers (ebenda).



To date, 17 Creative Economy Innovation Centres (CEIC) have been created throughout the country as part of the initiatives. Their distribution is based on the respective regional characteristics. The Centres are run by chaebols. For example, Samsung Electronics operates two Centres in Daegu and Gumi (Gyeongbuk province) for new "Smart Factory" technologies, as well as machine and automotive components, while Hyundai Heavy operates a Centre in Ulsan for shipbuilding, Hyundai Motor operates a Centre in Gwangju for vehicle engineering and SK operates a Centre for IoT applications in the field of agriculture in the administrative city of Sejong to the south of Seoul. The conglomerates are to help promising start-ups, venture companies, research institutes and universities in developing and marketing their technologies and products, yet also offer them financial and legal support (list of the centres and further information: Creative economy & innovation centre, <http://koreanlii.kr>).


However, the creation of the Innovation Centres has not been warmly received by everyone. The prominent incorporation of the chaebols is one point of particular criticism, as many believe their size and corporate culture make them less than ideal partners for turning creative start-ups into genuine competitors in the global market. According to Chung Yeon-woo, Professor at the Ulsan National Institute of Science and Technology, it is more likely that the conglomerates will simply assimilate the most attractive small companies and thereby reinforce their dominance even further, which is obviously the opposite of what is actually planned ("South Korea aims for creative economy to end reliance on chaebol", Financial Times, 24th June 2015).

However, the government does not generally consider acquisitions of this kind a

problem. Indeed, Lee Je-joon, who is responsible for the zones in the Ministry of Science, ICT and Future Planning is quoted as saying "such acquisitions would 'not necessarily be a bad thing'" (Financial Times, ebenda). One general aim of the initiatives is to arouse the interest of investors in small technology companies. The state is also making financial resources available for this, clearly with success: In Seoul's Gangnam district, a range of incubators and accelerators for start-ups have been created, which in several cases compete with the Innovation Centres operated by the chaebols (ebenda).

In establishing a "creative" economy, Innovation Centres and other organisational approaches only represent one step. They require supplementary measures, for example enabling young people to use their creative and entrepreneurial skills. The same applies to the question of why young people have difficulty finding a job, despite having good training. Although it has many strengths, the Korean education system also has significant deficits (OECD Skills Strategy Diagnostic Report - Korea, 5th November 2015). Employing more women than in the past, as well as improving working conditions for older employees, is also of major significance for long-term economic development, particularly since the number of available employees is likely to decrease from 2017 onwards as a result of the ageing population (ibid.).

Regulatory reforms also need to be continued if establishment of the "creative" economy is to succeed. Administrative hurdles and complicated regulations impair the development of competition and productivity. According to the OECD (Korea: Policy Priorities, a.a.O., page 13), reforms would have a very positive effect, particularly in Korea's tertiary sector, which is lagging well behind the manufacturing industry, yet also



benefit the entire economy. This applies in particular to sectors such as transport or legal services, which play an important part in the global added value chain.

Whether the parliamentarians responsible agree on the urgency of the reforms appears doubtful, at least from the perspective of President Park Geun-hye. In November 2015, she publicly complained that important economic and labour market-related draft laws would not be passed in time for the parliamentary elections scheduled for mid-April 2016. She stated that the drafts would be automatically annulled with the lapsing of the legislative period and added: "I beg for the passage of the bills at every Cabinet meeting, but I feel lament because I'm just making an empty echo" ("Park Increases her Focus on the April Elections", Korea JoongAng Daily, 11th November 2015).

Major dependence on China: A blessing or a curse?

In 1992, Korea established diplomatic relations with China. This primarily effected the bilateral exchange of goods. In 2003, its western neighbour took over from the US as the largest purchaser of Korean goods (Korea International Trade Association, Export & Import Statistics), leaving other countries behind. In 2014, Korea supplied China with goods worth US\$ 145.3 billion, representing slightly more than one quarter of all exports. The US followed in second place at slightly over US\$ 70 billion. At the same time, imports from China came to approximately US\$ 90 billion or around 17% of the nation's total. China therefore made up 21.4% of all Korean foreign trade. By way of comparison, China was responsible for 20.5% of all goods exchanges in Japan and just 13% in Germany.

However, this major dependence is now becoming a burden. China has distanced itself from the high growth rates of the past and is heading towards a "new normality". This means lower gains and aligning economic development with private consumption, services and innovation. This is having an effect on Korea, whose exports to China are currently almost all moving in one direction – downwards. The figure for January to September 2015 was -3.8% relative to the same period in the previous year.

Korea will also have to get used to the idea of low growth or even a decline in exports in the future. Most shipments are intermediate goods, such as electrical and electronic components, plastics and chemicals, the demand for which is declining due to the weak economy, but which can also increasingly be substituted by "Made in China" products. Indeed, China's efforts to produce more technologically sophisticated products are playing an important part in this regard. This hits Korea where it hurts, as China is set to compete even more keenly with this country in the future and its market is deemed comparably "safe". Korean producers such as Samsung and LG have previously dominated the global business with LCD panels. According to press reports from Seoul, however, China is set to start up new production lines from the end of 2017 to manufacture large-format screens that will also allow cost benefits to be achieved ("Korea's LCD Industry Stalled at 8G While China Eyes 11G", Korea Economic Daily, 12th November 2015). The situation is also compounded by the fact that the RMB yuan has become significantly cheaper relative to the US dollar since its devaluation in summer 2015. At the same time, the won has become more expensive, which is putting Korean exporters under even more pressure.

Calculations made by the Korea Development Institute serve to underline the importance that China now holds for Korea's economy. Based on these figures, a decline in Chinese growth by one percentage point would reduce Korea's economic output directly by 0.2%. However, the figure increases to more than 0.6% when including indirect effects on the global market. Sectors that enjoy close export and investment relations with China in particular, such as the aerospace industry, the electrical and electronic sectors, the chemicals industry, as well as the engineering sector would also be negatively impacted ("Every 1% Fall in Chinese Economic Growth to Drag down Korean Economy by 0,62%p'...KDI", Korea Economic Daily, 10th November 2015)

It remains to be seen exactly what Seoul will do about this. A bilateral free trade agreement, which Korea and China have signed in June 2015, could certainly provide new stimulus for goods exchange. The same applies to Korea's collaboration with the Asia Infrastructure Investment Bank (AIIB). However, changing the structures of trade will be more difficult. A recommendation by the Korea Institute for Industrial Economics and Trade (KIET) is to focus more on exports of cultural or medical services in the future, as well as on consumer products such as cosmetics ("What Should Korean Firms Do to Capitalize on China's Shift toward Consumer Society?", Korea Economic Daily, 9th October 2015).

Korean cosmetics in particular are proving popular in China, as underlined by the double to triple-digit export growth rates of the past few years. The US\$ 1 billion threshold is likely to be exceeded for the first time ever in 2015. The reason for this development is that Korean TV dramas are extremely popular in China and are seen as a model of Korean consumer trends by viewers (P. Kim, "S. Korea Inc. 2.0 Comes Out

of the Shadows", Nikkei Asian Review, 11th November 2015). In this context, many are therefore now calling for more tourism services that target Chinese visitors ("Korea's Dependence on China Deepens With Exports", Korea Times, 3rd November 2015). No matter what kind of responses the many questions receive, the reforms generally targeting the establishment of a "creative" economy are also helpful in organising and raising Korean-Chinese trade to a new level.

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