

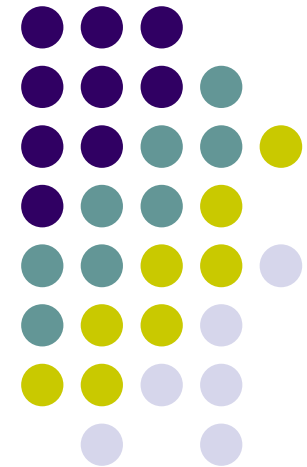
Aftermath of Asian Financial Crisis: Lessons from Korea's Experience

February 10th, 2007

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Agenda



I. Overview: Korea's Economic Development

II. Financial Crisis in 1997

III. Crisis Resolution

IV. Changes in Economy: Before and After the Crisis

V. Conclusion: Lessons from Korea's Experience

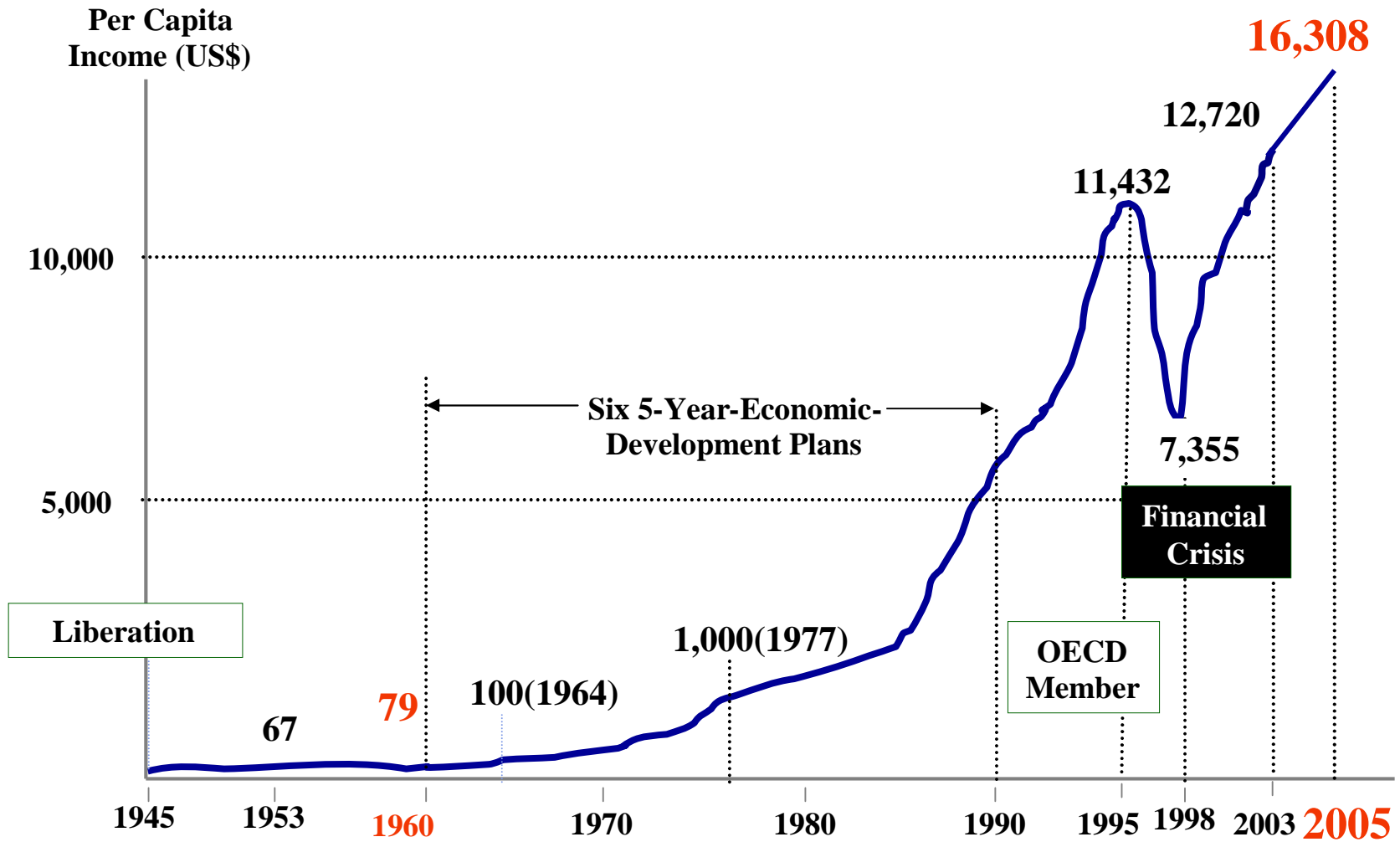
I. Overview (1)

| Korea's Socio-economic Development | |
|---|---|
| In 1950s | In 2005 |
| <ul style="list-style-type: none">• Unfavorable Environment<ul style="list-style-type: none">- Damaged from the Korean war- Rural peasant economy- The highest density of people• Per capita income of US\$ 79 (1960)• Exports accounted for 3% of GDP• Crucially dependent on foreign aid | <ul style="list-style-type: none">• Per capita income of US\$ 16,308 (2005)• One of the top ten economies in the world*• Exports grew 30% a year for more than 30 years• Dramatically improved quality of life |

* Five economies are about the same size: Korea, India, Brazil, Mexico, Russia

I. Overview (2)

Korea's Growth Performance over the Past 50 Years



I. Overview (3)

Macroeconomic Policies before the Financial Crisis of 1997-98

- ✓ **Economic Take-off with Outward-looking Strategy (1960~1980)**
 - Government-led, Export-driven
 - HCI Drive in the 1970s
- ✓ **Changes in Development Strategy (1981~1997)**
 - Stabilization policy in the early 1980s
 - Market-oriented Reform
- ✓ **Financial Crisis in 1997**
 - Some people say “blessing in disguise”
 - **What went wrong?**

II. Financial Crisis in 1997 (1)

Prior to the Crisis

- ✓ **Growth Rates** averaged more than 8 percent a year during 1987-96 and slowed to 7 percent in 1997, with low inflation
- ✓ **The Budget** was expected to be in surplus, and the sovereign debt (both domestic and external as a percentage of GDP) was low
- ✓ **The Current Account Deficit** had widened in 1996 due to a decline in high tech exports, but had narrowed again in 1997
- ✓ **The Exchange Rate** did not reflect the real value of 'Won'.

II. Financial Crisis in 1997 (2)

Macroeconomic Indicators

| | 1996 | 1997 | 1998 |
|-----------------------------------|-------|-------|--------|
| Growth Rate (%) | 7.0 | 4.7 | - 6.9 |
| Inflation Rate (%) | 5.0 | 4.4 | 7.5 |
| Unemployment Rate (%) | 2.0 | 2.6 | 7.0 |
| Interest Rate (%) | 11.9 | 13.4 | 15.1 |
| Stock Price Index (pts) | 833.4 | 645.5 | 406.1 |
| Fiscal Deficit / GDP (%) | 0.2 | - 1.4 | - 3.9 |
| Current Account Deficit (Bil. \$) | -23.0 | - 8.2 | 40.4 |
| Exchange Rate (KRW/ \$) | 804.8 | 951.1 | 1398.9 |
| FX Reserves (Bil. \$; year-end) | 33.2 | 20.4 | 52.0 |

II. Financial Crisis in 1997 (3)

Structural Weaknesses & Outbreak of the Crisis

Vulnerabilities

- ✓ Heavy corporate leverage
- ✓ Weak financial sector and inefficient resource allocation
- ✓ Vulnerable external position, with high level of short-term debt
- ✓ Delayed reform and contagion of South East Asian Crisis

Outbreak of the Crisis

- ✓ Several 'Chaebols' went bankrupt in early 1997
- ✓ With growing banking sector problems and contagion from the Thai crisis, many foreign banks chose not to renew credit lines
- ✓ Massive capital overflow and rollover of short-term debt denied

III. Crisis Resolution

- ✓ **IMF Program**, with a coordinated private sector rollover agreement with international banks
- ✓ **Corporate Sector Reform**
 - ‘Chaebols’ required to abolish cross-debt guarantees, and big deals for concentrating on core competencies, reducing excess capacity
 - Exit of 55 non-viable firms and corporate workout programs
 - Improvement of corporate governance
- ✓ **Restoring Financial Sector Soundness** through injection of public funds
- ✓ **Deregulation and Market Opening**, including elimination of foreign equity ownership ceilings and allowing hostile M&As
- ✓ **Labor Market Reforms and Expanding Social Safety Nets**

IV. Changes in Economy: Before and After the Crisis

| Pre-crisis Period of 1990-1997: | Post-crisis Period since 1998: |
|---|---|
| Chronic Overcapacity Problems | Structural Improvements |
| <ul style="list-style-type: none">• 8-year long trade deficits• Insignificant FDI inflows• Vulnerable external position• Explosive corporate debt growth• Weak financial sector | <ul style="list-style-type: none">• Continued current a/c surplus• FDI inflows jumped (not recently)• Much improved external position• Significant de-leveraging trend• Stronger financial sector |

V. Conclusion

Lessons from Korea's Experience

- ✓ Importance of **Sound Macroeconomic Policies**
- ✓ Policy Support for **Building Good Institutional Environment**
- ✓ Competition through **Deregulation and Market Opening**
- ✓ Incessant Efforts for **Checks and Balances** within the System toward Sustained Growth

Remaining Question to Asia as a Whole

- ✓ Question of **Equilibrium FX Reserves** ??
 - **A Cause of Global Imbalances**



Thank You !