Korea's Debt Mountain

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Seoul, the capital of the Republic of Korea, is now one of the "happening" cities of Asia. Psy's "Gangnam style" (the pop music video that has gone viral online with more than 6 billion hits) that somewhat randomly celebrates the posh modern district of Gangnam is only one of various ways in which the city is supposed to reflect the new cool. There is growing recognition that this city is both vibrant and livable, with its vertiginous high-rise buildings coexisting with clean streets, fine new museums and spots that combine the natural beauty of its forested hills with carefully preserved (or reconstructed) palaces of the Joseon dynasty.

The evident sophistication and confidence of this capital city are relatively recent, indicating the material successes brought about by the much acclaimed and analysed "Korean economic miracle" that lifted a relatively poor economy into developed country status over the course of a generation. It is now recognised that this miracle was not a result of the operation of unfettered market forces. Rather, it was based on active state involvement in shaping the way private agents behaved. This economic success also had its dark side in the brutal dictatorship of Park Chung Hee (whose daughter Park Gyeun-Hye was recently elected President). And both of these were enabled by the active support of western (specifically United States) political and economic power.

This exemplifies the extent to which Korea's turbulent and frequently tragic history has encapsulated the pulls and pushes of external forces, which outsiders frequently do not recognise. Korea's history has been significantly driven from without, from the 7th century attempts at domination by T'ang Emperors of China to the Ming takeover of the 15th century to the tug of war between Qing rulers of China and newly expansionist Japan in the 19th century. The subsequent 20th century division of the country into northern and southern sections was a reflection of the Cold War's hottest moment. The Korean War in the 1950s that split the country was less an internally generated civil war and more the result of the desire of the conflicting foreign powers to maintain their own areas of strategic domination.

For several decades thereafter, rulers in each part of the country encouraged fear of the other as a means of legitimising authoritarianism and intolerance of dissent among their own populace. This division and the associated insecurity form a continuing backdrop to the present. The potential conflict between northern and southern segments, now countries with very different political and economic systems, is routinely played up in international media, especially with the fearsome bogey of the nuclear threat emanating from the North. Visitors to the South are often surprised to find out how casually this is taken by people actually residing there, who have grown used to aggressive posturing on both sides. But the political uses of this tragic division continue.

In the Republic of Korea, this also meant that the West (and particularly the US) had an active interest in assisting its economic growth, even when the strategies used were far removed from the advice normally dispensed to developing countries. The economic powerhouse of South Korea was based on a manufacturing revolution, in which the role of the chaebol (private business conglomerates) was always subordinate to the state. Access to modern technology and loans from the US as well as open markets for exports were crucial aspects of the process. These generated a momentum that meant that even after the dictatorship of Park Chung Hee collapsed and an electoral democracy was put in place, there was a close relationship between the state and industry as well as strong government control over finance that was used as a means of favouring strategic sectors for growth.

In the early 1990s, when it was already a major industrial player, the Republic of Korea was encouraged to deregulate its relatively tightly controlled banking sector. Once again this was a combination of external and internal forces: IMF advice along with pressure from the OECD which it wished to join, and the internal emergence of a "financial class" coming out of top bureaucracy. The resulting boom, which was strongly associated with stock market and real estate bubbles as well as massive and heavily leveraged overinvestment by the chaebol, culminated in the Asian crisis of 1997-98. That crisis in turn generated a fire sale of Korean assets to foreign players, not just in manufacturing but especially in financial services.

Since then, economic processes in South Korea have come to epitomise common strategies of expansion and survival in late capitalism. On the surface this is a successful economy, with a reasonable rate of growth for its high per capita income of more than $30,000, and with some global leading companies like Samsung. But this masks a process of stagnant income growth for much of the population in the past decade, as debt-financed consumption has become the main (though now sputtering) impetus for markets.

The recovery from the Asian crisis was associated with a definite shift in the government's economic approach, towards reduced state involvement and enhanced financialisation of the economy. One of the most important changes was the opening up of the financial sector to foreign ownership and control, such that foreign owned banks and other financial institutions now dominate the sector. As a result, public direction of finance was replaced by a financial industry with very different goals: more profit-oriented than developmental, more short-term than long-term, more eager to serve consumption than production. Professor Chang Kyung-Sup of Seoul National University argues that because industry is increasingly subordinated to western finance capital, finance in the South Korean economy is no longer productive in orientation and therefore does not support wider productivity increases, but simply consumption-led growth.

This led to a boom that was essentially a credit-driven consumption bubble that is now on the verge of bursting. The low tax-low social spending model in South Korea meant that necessary expenditures on health and education have had to be met by households privately. In the past, this was associated with high rates of personal saving, which were then channeled to investment. In the post-crisis period, the incentives changed to encourage more debt-driven consumption, led by foreign banks that actively pushed loans for housing and real estate as well as consumer goods. This led to a housing boom, in which rising prices of real estate provided capital gains that apparently substituted for the lack of increase in personal incomes. This was associated with rising asset and income inequalities: between wage incomes and profits; between different types of workers; and across different industries.

If this sounds familiar, it is because it is: this is the same process that marked the pre-crisis boom in the US and UK, for example. And the outcome may well be similar as well, even if not as severe as the financial crises that swept across those countries a few years ago. The 2008 global recession had an adverse effect in South Korea, resulting in slower exports and bringing to the surface the problems that were festering in the debt-ridden domestic economy.

The most significant problem is in housing and debt related to it. House prices have been declining, creating distress among home owners faced with huge debt burdens that are becoming greater than the current value of their houses. In addition, student debt and excessive consumer debt loom as emerging concerns, because future employment possibilities do not match up to the income streams required to service all this debt. Instead of ensuring higher incomes to deal with this mess, the current government has announced a "National Happiness Fund" to deal with some excess debt on a case-by-case basis, which only scratches on the surface of the problem

So this is another bubble waiting to burst in another country, once again created by a globalised financial industry that now seems even to have run out of new growth-generating tricks.

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