

South Korea: Wary of Another Financial Crisis

By Choong Yong Ahn

South Korea has been particularly hard hit by the current financial crisis. Ironically, the country was among the most ardent in reforming its economy after the 1997–1998 Asian crisis. So why, Koreans are rightly asking, is Korea being treated so harshly now? Global Asia Editorial Board Member Choong Yong Ahn examines the issues behind this paradox.

WE'VE BEEN HERE BEFORE. Beaten once eleven years ago by the Asian financial crisis, until recently almost no one in South Korea would have thought that the far-away US subprime mortgage mess would have undermined Korea. But now leaders and ordinary people look warily at the unfolding global financial crisis. Despite Korea's seemingly strong fundamentals, the relentless crisis has begun affecting the real economy and a great many Koreans are deeply worried. By mid-November 2008, Korea saw the won's value against the US dollar fall to 1,500, a drop of more than 30 percent in just a few months. Korea's benchmark KOSPI stock index has lost half its value, falling below the symbolic 1,000-point mark.

In 1997, when the domino effect of the Asian financial crisis began to spread from Thailand in July to Indonesia, Malaysia, Hong Kong, and finally to Korea in December of the same year, Korea was faced with the near depletion of its foreign exchange reserves. As a result, Korea had no choice but to seek an International Monetary Fund bailout to cope with the liquidity shortage. Under the stringent conditionality of the \$57 billion IMF financial package — at the time, the largest ever — Koreans had little choice but to implement a painful restructuring of the country's entire economic system. As a result of the IMF reform program, Korea was given a second chance at life, if you will, and over the past ten years has seen its economic system mature on the back of the reforms.

As the current global financial "tsunami" unfolded, many Koreans, including the author, were both dismayed and appalled by its origins. Koreans have been repeatedly lectured by many Wall Street

financial “gurus” to adopt US best practices, such as early warning systems, prompt corrective actions, prudent regulations, respect for minority shareholders’ rights, and the adoption of outside board members to enhance managerial transparency and corporate governance.

Despite its robust fundamentals, including holding the sixth largest foreign exchange reserves in the world as of September 2008 and low debt-to-equity ratios in its corporations, Korea is now one of the hardest hit economies in the world, even though growth rate predictions on the year remain in the mid-4 percent range. On a daily basis, Koreans have suffered the worst exchange rate volatility in years. Inevitably, Koreans have also grown fearful as their financial assets evaporate into thin air. A serious credit crunch has now spread to Korea’s real economy, which has seen a chain of company bankruptcies starting in the construction sector and even reaching some smaller shipbuilders. Why has Korea been so hard hit by the global financial crisis and subsequent recession? How are Korea’s economic woes different from those experienced during the Asian financial crisis? What are the major tasks that lie ahead?

IMF REFORM MODELS DURING AND AFTER THE ASIAN FINANCIAL CRISIS

In the wake of the Asian financial crisis of 1997–1998, Korea surprised the world not once but twice. First, this symbol of the “East Asian Miracle” faced nearly depleted foreign exchange reserves. It was a great humiliation for Korea to seek an IMF assistance package in order to avoid a moratorium on its foreign debt. Second, and more surprisingly, the Korean economy bounced back to positive 10.7 percent GDP growth in 1999, a tremendous recovery from a contraction of 6.7 percent one year earlier. Korea’s rebound included a trade surplus of US\$41.7 billion — a single year record — after four decades of following an outward-looking development regime.

As a follow up to the IMF conditionality and reform program, Korea carried out comprehensive restructuring in four major sectors: banking, corporate, public enterprise and labor. While serving as Chairman of the Board of Choheung

Bank, the oldest and leading commercial bank at the time, from 1998 to 2002, the author and the entire board were continuously reminded of the need for global best practices from Wall Street experts. These days, such reminders are more appropriate for the ears of those on Wall Street now that their complex repackaged mortgages-cum-financial-securities have come back to bite them. Many economists are asking themselves why such greedy behavior by Western investment banks was permitted without any alarms going off?

At the core of Korea’s financial crisis ten years ago were difficulties in both the financial and corporate sectors. Although triggered by contagion and currency speculation, the Korean crisis was fundamentally rooted in a vicious cycle between a banking crisis and a corporate one. Accordingly, both the breadth and depth of corporate and financial distress in Korea were unprecedented. The level and structure of corporate debt, the number of debtors and creditors involved and the weak legal environment made the restructuring of both the corporate and financial sectors an enormous challenge.

From early 1999, however, Korea’s economy began recovering much faster than expected, due to both comprehensive economic reforms and robust external economic conditions in non-Asian economies. Efforts to enlarge both the trade surplus and foreign exchange reserves paid off in a bullish stock market and rapidly rising market confidence at home and abroad. Above all, the country’s foreign exchange reserves jumped from US\$8.87 billion at the end of 1997 to over US\$90 billion by October 2000. The won-dollar exchange rate stabilized at about 1,100 won in 1999, from an average of 1,700 won in December 1997. The sovereign ratings given Korea by international agencies improved and Korea’s benchmark KOSPI index recovered to pre-crisis levels within 3 years.

Why had Korea become engulfed in the Asian financial crisis? During the high growth period, Korea’s large enterprises, the family-owned *chaebol* conglomerates, had undergone ambitious expansion and diversification, including numerous overseas investment projects. These were funded mainly through aggressive borrowing, often short-term, from Korean commercial and

¹ For details, see Choong Yong Ahn, "Financial and Corporate Sector Restructuring in South Korea: Accomplishment and Unfinished Agenda", *The Japanese Economic Review*, Vol. 52, No. 4, December 2001.

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merchant banks, and frequently from foreign financial institutions for overseas projects. Banks relied primarily on collateral in the allocation of credit, and relatively little attention was paid to earnings performance, cash flow generation or the corporations' ability to repay. In addition, the *chaebol* generally supplied guarantees from their affiliates and subsidiaries in order to secure loans. Under the high growth push, the Korean government supported this expansion and often directed *chaebol* into specific lines of business.

Korean corporations' aggressively leveraged expansion worked well as long as the economy and exports expanded vigorously and returns on new investment exceeded the cost of capital. Within this environment, high debt-to-equity ratios were a risky but winning strategy. Borrowing heavily allowed Korean firms to grow more rapidly than if they had relied on retained earnings. However, rapid wage increases and a highly unionized labor force in the wake of the democratization movement in the late 1980s began to often outstrip productivity growth. Declining demand and falling prices abroad for Korea's major export items such as semiconductors, chemicals, shipbuilding and steel further weakened profitability.

The first policy priority after the Asian crisis was to stabilize the financial market and restore external confidence. For this reason, financial institutions that were no longer viable were closed down. Those that could be saved were turned around quickly through recapitalization with public funds and the purchase of their non-performing loans by the government on the condition of intense and painful internal reforms including mergers, management shake ups and downsizing. By the end of 1998, a total of 139 financial institutions had been

closed down, and another 20 non-viable financial institutions were merged with viable ones.¹

As for banking sector reform, the Financial Supervisory Commission (FSC) inspected the assets and liabilities of 12 banks that failed to meet the Bank for International Settlements' (BIS) 8 percent capital adequacy ratio by the end of 1997, and required them to present management rehabilitation plans. Upon examination of these, the FSC ordered five non-viable banks to close or merge with others. This was done through a "purchase and assumption" formula, whereby the acquiring banks were chosen because their capital adequacy ratios, a measure of a bank's risk exposure relative to its capital reserves, were more than 8 percent at the end of 1997.

The other aspect of Korea's restructuring was related to insolvency in the corporate sector. Corporate sector reform was carried out under five principles: a) Ensuring the transparency of corporate management, b) Dismantling cross-debt guarantees, c) Significantly improving capital structure, d) Identifying core businesses and strengthening cooperative relationships with small and medium-sized companies, and e) Enhancing the accountability of the controlling shareholders and of management. As a result, Korea's corporate debt-to-equity ratios improved steadily. Comprehensive reform in the banking and corporate sectors along with labor market flexibility, massive privatization of public enterprises and a subsequent quick economic recovery, made Korea a success story for the IMF reform model.

FUNDAMENTALS: ROBUST UNTIL RECENTLY

Under new conservative President Lee Myung-bak the government has been very attentive to

the present global financial crisis, but responded rather slowly at the onset of the crisis, repeatedly endorsing the economy's strong fundamentals. Korea's macro-economic indicators were, in fact, sound although rates of economic growth were slowing. The potential growth rate of any economy is normally affected by three factors: labor, capital stock and total factor productivity. In previous administrations after the Asian financial crisis, the Korean economy had lost its growth momentum, as government policies focused more on income distribution than growth. Nevertheless, Korea's macro-fundamentals were still regarded as robust. Several indicators justify this claim.

Above all, Korea had its huge foreign exchange reserves as a result of consistent trade surpluses over the past decade. At the start of the recent crisis, Korea was in a better position than it was a decade ago to deal with external financial shocks and defend its currency. Many thought that Korea had enough foreign reserves — \$240 billion — to cope with external shocks. However, controversy quickly arose over whether Korea was in possession of enough dollars to meet its external liabilities amid rising short-term debt, current account deficits for the first time in 10 years and massive capital outflow by foreign portfolio investors due to the global credit debacle.

Secondly, Korea's banking sector has continued to enhance its balance sheet and profitability over the past decade. Even though some banks have engaged in excessive lending to expand their reach over the past few years by increasing foreign borrowing to take advantage of low interest bearing US dollar carry trade as well as the yen carry trade, the ratio of the banks' non-performing loans to assets were on the average below 1 percent. Until recently, the capital adequacy ratio of most Korean banks stood at 11.5 percent, well above the international average of 8 percent.

Thirdly, Korean businesses have also significantly improved their balance sheets over the years, making themselves more immune to business cycles. Domestic companies, particularly those in Korea's six major export sectors — petrochemicals, steel, machinery, IT, automobiles and shipbuilding — have increased profitability. The return on as-

sets of the six industries averaged 8.1 percent in 2007, a substantial improvement from negative 2.3 percent 11 years ago. Additionally, their respective debt-to-equity ratios have also dropped sharply. The average debt-to-equity ratios of domestic manufacturing firms stood at less than 100 percent in recent years compared to higher than 400 percent 10 years ago; the debt-to-equity ratio of Korean carmakers stood at 112.2 percent last year, compared with 717 percent 10 years ago.

Even earlier this year, despite sluggish domestic demand and falling exports, major Korean firms were posting better-than-expected results. Samsung Electronics recorded 1.2 trillion won in operating income in the third quarter, larger than the market expectation of less than one trillion won. Steel giant POSCO posted nearly two trillion won in operating income.

Perhaps, the strongest point for the Korean economy might be found in Korea's active globalization policy. As a result, the Confederation of Danish Industries recently identified Korea as one of the most globalized countries in the OECD.

While joining the multilateral trade and investment liberalization movement within the WTO, Korea also has been pushing through multi-track free trade agreements (FTAs) with major economies. In addition to Korea's already ratified FTAs with Chile, Singapore, and ASEAN, the Korea-US FTA is awaiting ratification by the National Assembly and the US Congress. The Korea-EU FTA is also near conclusion, while Korea-India's Comprehensive Economic Partnership Agreement is set to be signed soon. Negotiations with Canada and Mexico are also underway.

EXISTING CAVEATS

If a cyclical economic downturn in some major economies had occurred, Korea's present macro fundamentals might have remained robust. However, the current global recession is the worst since the Great Depression in the 1930s and Korea's economy still contains several caveats even after the reforms of the past decade.

DECLINING GROWTH

The Korean economy has been growing at a much

slower pace. Obviously, the restructuring itself after the Asian financial crisis tended to slow growth at least in the short- to mid-term. Especially during the previous liberal governments, economic policy focused more on distribution issues than on addressing growth and productivity. In the past several years, Korea's potential growth rate has fallen from the typical 8 percent of previous decades to the mid 4 percent level mainly due to a sharp decline in the growth rates of labor, capital stock and total productivity. At the moment, Korea also has one of the lowest birth rates in the world combined with a rapidly aging population.

Needless to say, the present global recession has aggravated Korea's growth potential even further. Gross domestic product grew 3.9 percent year-on-year in the third quarter this year, the slowest since the second quarter of 2005, as the fallout from the global crisis eroded exports.

EXTERNAL DEPENDENCE

Exports have been Korea's main growth engine, and they still account for about 40 percent of GDP, making Korea one of the world's most export-dependent economies. This makes Korea susceptible to external shocks from business downturns in the United States and other major export destinations. However, it should be noted that Korea's aggressive export drive has enabled Korea to accumulate a trade surplus every year for the past 10 years, thus contributing to healthy foreign exchange reserves.

Korea's outward looking orientation is inevitable due to the country's small domestic market — roughly 48 million people — and lack of natural resources. For example, Korea spent US\$60.3 billion in 2007 just to import oil. Record high oil prices resulted in a sizable trade deficit beginning in December 2007, the first in 10 years. Now with the world recession digging in, Korea's outbound shipments dipped 18.3 percent in November from a

year ago, the largest monthly decline in seven years. The sharp drop in exports has shriveled Korea's corporate sector; particularly hard hit are small and medium industries and the self-employed.

WEAK SERVICE INDUSTRY

Korea's flawed services industry is one of the main culprits behind the nation's worsening current account in recent years, substantially offsetting strong export growth. A growing number of Koreans are spending large sums abroad for leisure, medical, educational and other services that Korea has failed to provide at affordable prices. Korea's service industry consists basically of small businesses such as restaurants and shops. In recent years, many self-employed service providers have been forced to close due to sluggish domestic consumption.

FOREIGN STOCK HOLDINGS

Under the IMF reform program, Korea was told to remove existing barriers to foreign investment in the local stock market. Foreign traders were at one time restricted by a daily transaction limit, which was just 2 percent of the total trade volume on the market. As a result of the IMF program, Korea opened up its stock market to foreign investors in the immediate post-crisis period to help relieve the depleted supply of foreign exchange. The exchange, one of the largest bourses in Asia, saw the foreign share of total market capitalization jump from a mere 13.7 percent at the end of 1997 to a high of 44 percent in April 2004.

During the reform period, Korean stocks were believed to be undervalued compared to their price-to-earnings ratios and other indicators. Until recently, the foreign share of Korea's total domestic stock market capitalization was one of the highest in the world. In Japan, the foreign-owned share of the domestic market peaked at 26.7 percent. The complete opening of Korea's portfolio market to foreign investors helped the benchmark

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KOSPI index rise rather quickly in the late 1990s. However, in the current crisis, foreign investors' rapid exit from Korea was one of the causes of the sharp drop in the value of the won as it caused extreme volatility in the currency market due to the sudden demand for dollars.

Compared to its relatively large stock market, Korea's foreign exchange market has remained rather small, making it vulnerable to small-scale sell offs. This is also keeping the won-dollar rate volatile. According to the Samsung Economic Research Institute, an average of US\$33 billion in currency exchanges are made per day, accounting for only 0.8 percent of foreign exchange transactions worldwide. It is generally agreed that the recent instability in the won-dollar rate has not been because of deteriorating economic fundamentals, but because of the underdeveloped currency market in Korea.

FALLING FOREIGN INVESTMENT

In the past decade, rapidly rising wages and activist labor unions have caused Korean companies to search overseas for new production sites. Despite Korean government efforts to attract foreign direct investment (FDI) into Korea, the volume of notified (as opposed to arrived) inbound FDI has been tapering off for three years. Net foreign direct investment into Korea reached US\$2.63 billion in 2007, down 46 percent from the US\$4.88 billion recorded in 2006. Korea's global ranking as an FDI destination also dropped by 13 notches to 60th in just one year. Global FDI flows are likely to decrease this year compared to those in 2007, weighed down by the credit crunch. Inbound FDI could help the country a great deal with GDP growth, job creation and international liquidity, but the prospects are not good.

CAN KOREA WEATHER THE STORM?

Given that the immediate impact of the global financial turbulence on the Korean economy ap-

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peared simultaneously in the currency market and the stock market, Koreans are asking when stability will return.

In order to satisfy the capital adequacy ratio requirements in place since September, Korean banks have embarked on extensive de-leveraging activities by lending on a minimal scale and collecting as much outstanding debt as possible. Thus, financial intermediation by banks that are not functioning properly has now resulted in a serious credit crunch. Because of the on-going breakdown in financial intermediation, even healthy companies are at risk of default.

With an excessive upward fluctuation in the exchange rate, Korea has started to show serious symptoms of contraction in the real economy. The export growth rate in November dropped 18 percent compared to a year ago. In response to the downturn, the top priority of government policy is to address chain bankruptcies of construction companies, which are particularly susceptible to the slumping world economy. A project-financing scheme for railways, nuclear power plants, toll roads and the construction of large bridges, costing approximately 80 trillion won, is also in serious trouble, with half of the burden obliged to banks. This means that banks risk encountering additional non-performing loans. Since the onset of the crisis, 251 construction companies have entered bankruptcy, a 47.6 percent rise from the same period in 2007. Household debt remains tolerable, but will become problematic if home prices keep plunging and owners have no alter-

native but to sell. Thus, many households may have no choice but to default if the government does not come up with some effective counter measures. Unless such changes are put into effect immediately, Korea is likely to encounter the "Three D" phenomenon, namely de-leveraging, default and deflation.

WHEN CAN THE CURRENCY MARKET BE STABILIZED?

Compared with other major Asian currencies, the Korean won depreciated the most against the dollar. The value of won with an exchange rate of about 1,500 won is far lower than the equilibrium exchange rate measured by the "real effective exchange rate" of 1,002 to the dollar. Foreign investors who sold stocks in massive amounts to secure liquidity, and who then exited the Korean market as their home companies experienced severe liquidity difficulties, mainly created the prevailing shock in the foreign exchange market.

From early 2008 to October 17, net sales by foreign investors in Korea's stock markets amounted to US\$34.84 billion, exceeding the US\$29.26 billion sold in all of 2007. As of October 14, 2008, the foreign stake in the KOSPI, which had once hovered over 40 percent, plummeted to 27.4 percent. A surge in short selling by foreign investors, including hedge funds, has also contributed to the volatility of the exchange rate.

The structure of the Korean foreign exchange market, where the dollar takes the lion's share, has contributed to the won's woes. Average monthly

trading of the US dollar accounted for 97.8 percent of all foreign exchange transactions during the second half of 2008.² In addition, the won's precipitous fall has been urged on by the first current account deficit since 1998, US\$12.6 billion from January to August of this year, mainly because of previously surging prices in commodities, especially oil.

EXCESSIVE BORROWING

Korean banks and other financial institutions rely heavily on foreign borrowing, often short-term, for their financing needs. From 2006 onward, they frequently managed overseas funds invested in foreign equities and other assets in anticipation of higher yields, and even utilized the yen carry trade to buy domestic bonds. In order to hedge against the expected appreciation of the Korean won against the US dollar, Korean financial institutions have continued to borrow abroad, thus increasing their short term debt to US\$93.6 billion.

In early November, Fitch Ratings, a global credit rating agency, downgraded its outlook on Korea to "negative" from "stable," citing weaknesses in Korea's debt-ridden banking system. The rate reduction is likely to impose further constraints on the banking sector, which is already suffering from a liquidity shortage and a weakening capital base due to the downturn. A Fitch Asia specialist commented that, "Fitch's revision reflects concerns that the de-leveraging of the banking system may contribute to an erosion of the sovereign's external credit strengths, especially if it were accompanied by central bank interventions in the currency market to support the exchange rate." (However, Fitch reaffirmed its sovereign rating for Korea at "A plus," its fifth-highest grade.)

As foreign investors sell Korean stocks to rescue their own troubled companies, the supply of US dollars on Korea's currency market has dried up. Maturing bonds have also contributed to the liquidity shortage. As a consequence, the Bank of Korea funneled foreign exchange reserves to the market to such an extent that Korea's reserves shrank to US\$200 billion by the end of November 2008.

Korean banks have been left with few options but to seek de-leveraging and shore up their capi-

tal base, as many of their current loans are likely to be non-performing due to the global recession. The Bank of Korea had US\$212 billion in foreign exchange reserves in October and has been granted access to a US\$30 billion currency swap recently arranged with the US government. The IMF has also provided "no strings attached" short-term facilities of up to US\$22 billion to economies with strong fundamentals. And significantly, a rare summit in mid-December among China, Japan and Korea resulted in a landmark deal that would make nearly US\$60 billion in swap arrangements available to Korea. The fiscal and foreign exchange costs of funding a de-leveraging of the banking system against the backdrop of a sharp and prolonged downturn of the economy and deterioration in asset quality could erode Korea's external credit strengths.

MALFUNCTIONING FEEDBACK

As the global financial crisis spills into the real economy, local banks are under growing pressure by the government to keep lending to companies that have been struggling with liquidity and declining profit. Banks, however, have their hands full with their own problems as their assets threaten to turn sour. Net income of the country's 18 banks slumped 36 percent to 8.4 trillion won in the first nine months of this year. Korean banks' average capital adequacy ratio dropped to 10.79 percent at the end of September from 11.36 percent three months earlier.

Recently, the Financial Supervision Commission signed a pact with those banks that want the government to guarantee their foreign debt. The deal requires them to undertake self-help measures, including a pay freeze for employees. Chief executive officers also had to agree to give up 30 percent of their annual salary. Bank employees have the feeling that they are returning to the austere days of the late 1990s.

Due to the spread of the global financial crisis, virtually all financial variables are fluctuating to all-time highs or lows. Furthermore, the dollar liquidity of financial institutions has become seriously aggravated. As a result, conditions for foreign borrowing have worsened, with the inter-

est on the Currency Rate Swap plunging to zero percent. In addition, as more and more investors refuse to invest in risky assets, banks have found it more difficult to raise funds even within Korea. An inevitable increase in lending rates has led to financial burdens for households and small- and medium-size enterprises. Furthermore, a contraction of the domestic housing market has fueled concerns over defaults in household loans and project financing for real estate.

To make matters worse, foreign media reports, based largely on incorrect information and distorted data, have highlighted Korea's short-term debt and banks' liquidity troubles. Amplifying such media claims, international markets have pushed up credit default swap premiums, which, in turn, have exacerbated Korea's foreign currency liquidity status.

Korean banks have been finding it increasingly difficult to borrow US dollars since Lehman Brothers collapsed in September. At the end of September, the government decided to provide a three-year guarantee on the foreign debt of banks incurred through the end of June 2009, a figure estimated at US\$80-100 billion. The Bank of Korea announced that Korea and the US agreed to a currency swap of up to US\$30 billion in dollar liquidity, an arrangement which could help the Korean banking sector stabilize the foreign exchange market. Korea has also proposed to multi-lateralize the existing currency swap mechanism under the Chiang Mai Initiative by raising the swap limit up to US\$80 billion.

**THE ROAD AHEAD:
REPEAT A QUICK RECOVERY**

Despite being an economy that has been the model of reform during the past decade, Korea seems engulfed helplessly in this US-sourced economic contagion. An excessive opening of the domestic capital market without due monitoring

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on hedge fund flows and appropriate corrective mechanisms have contributed to exacerbating the current crisis. Under the G-20 process, Korea needs to propose a built-in mechanism to provide emerging economies with timely liquidity support. As many advanced economies have proposed, Korea also needs to play an important role in designing a new global architecture to monitor the nature of financial derivatives and cross-border flows with some preemptive preventive measures whenever necessary.

On the real side of the economy, Korea is following most advanced economies in responding to the crisis. The government is proposing an aggressive stimulus package to prevent the economy from sinking further. In order to deal with the current meltdown, Korea should place the highest priority on stabilizing exchange rates. There are still fears that Korea's foreign exchange reserves may not be large enough to cushion the effect of the ongoing exit of foreign investors from the Korean market. The government should work out a way to properly utilize several lines of defense to get liquidity internationally for Korea's foreign exchange reserves, which still amounted to US\$200 billion as of the end of November, from the US\$30 bil-

lion US-Korea currency swap, the US\$80 billion swap from the ASEAN + 3 Chiang Mai Initiative, the IMF short-term facility of up to US\$22 billion, and has just finally created a network of bilateral Korea-Japan and Korea-China currency swaps up to US\$60 billion.

It is clear, however, that the liquidity squeeze, domestic or foreign, will gradually ease as global financial markets stabilize and aggressive monetary measures taken by major governments increase liquidity. The Bank of Korea has already provided a temporary guarantee for commercial banks' borrowing of short-term liquidity. A historic downward adjustment in the base interest rate to 3 percent from 4 percent was made on December 11. One piece of good news is that Korea registered a trade surplus in October, amounting to US\$1.2 billion, and is likely to do so next year, mainly thanks to rapidly falling oil prices. For the first time, Korean exports have reached US\$400 billion, an accomplishment achieved in early November.

Belatedly, Korea's frequently combative National Assembly has agreed to approve the government's proposed 2009 budget as well as other legislative actions, including various tax cuts and welfare programs for those in low income brackets. The government will activate an early injection of the national budget for infrastructure projects and job creation. As agreed at the G-20 Summit Meeting in mid-November in Washington D.C., Korea will exercise a bold and swift fiscal stimulus package.

As has happened before, the expected trade surplus can send an important message to the world that the performance of Korea's economy will restore confidence and remove uncertainty about any perceived currency shortage. Although Korea's total trade deficit of US\$13.3 billion from January to November 2008 signaled emerging risk, the trade surplus in October could help Korea restore international confidence. Another positive sign is the fact that Korea's export destinations

are becoming increasingly diversified between developed and emerging markets. From January to August, 69 percent of Korea's exports went to developing economies, while 11 percent went to the US. Furthermore, Korea has substantial room for fiscal stimulus compared to other OECD economies at a time when inflation is subsiding.

Koreans also should learn that manufacturing should not be neglected for the sake of developing the financial industry. The Korean economy should be one in which more efficiently functioning financial development is promoted along with manufacturing. Korea has made clear its ambition of becoming a deregulated regional financial hub by adopting US standards and attracting foreign capital on the eve of the Capital Markets Consolidation Act, set to go into effect in February 2009. In this regard, financial development remains an important task for Korea, and the country should join in designing a new global architecture to contain "greedy Wall Street capitalism" based on slick repackaging of financial derivatives. If Korea succeeds in developing an economy driven by both finance and manufacturing, it can emerge as an advanced economy after overcoming the current global crisis, as happened following the Asian financial crisis of just over a decade ago.

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