

LIBERALIZATION AT ANY COST? IMPLICATIONS OF IMF POLICY FOR SOVEREIGNTY AND STABILITY IN EAST ASIA

Michael Spaulding*

Abstract: Globalization pits pressures for liberalization against state claims to political and economic sovereignty. Less powerful states in particular face strong pressure from the international trade regime to liberalize their economies irrespective of the impact on domestic stability and national goals. East Asia has been a hold-out against the global trend toward liberalization. This paper shows that the bail-out package demanded by the IMF in 1997 during the East Asian financial crisis imposed unprecedented restrictions on state governance without regard for long-term implications. The paper argues that the IMF's motivation was to harmonize financial governance of the affected economies with Western practices. However, the cost of this initiative to the stability of the region has been overlooked. The East Asian region has carved out for itself a unique niche in the international political economy by resisting penetration of Western finance capital. Already governments have fallen and deep resentments have been sewn over the reversal. More seriously for the future, assumptions that free-market liberalism can be imposed top-down ignore the extent to which economic institutions and preferences are embedded in culture.

INTRODUCTION

Globalization¹⁾ pits pressures for liberalization against state claims to political and economic sovereignty. Less powerful states face strong pressures from the international trade regime to liberalize their economies irrespective of the impact on domestic stability and national goals. Some commentators claim that globalization compels weaker states to adjust their political economy to the Western model. The East Asian²⁾ financial crisis of 1997 provides a useful case study of these

issues.

The unique mix of public and private economic leadership which characterizes the development state³⁾ of East Asia has been credited with notable successes in rapid and balanced growth.⁴⁾ The countries of the East Asia region have sought relatively autonomous development in a region which has been generally cool towards globalization. However, the financial crisis compelled South Korea ("Korea"), Thailand and Indonesia to seek assistance from the IMF.⁵⁾ The IMF, with the support of the U.S., held the political economies of the

* Political Science Department of Dalhousie University, Halifax, NS.

- 1) There is, of course, no generally accepted definition of globalization. I use it to refer to the process of liberalization carried out to further global finance and global production and thereby lead to increased global economic integration.
- 2) By East Asia is meant the nations of Korea, Taiwan, Singapore, Japan, Indonesia, Malaysia and Thailand.

- 3) I recognize there is no single regional model and use development state to refer to the institutions, structures and policies which have generally characterized the political economies of the East Asian states.
- 4) The growth was commended by, and detailed in the World Bank's *The Asian Miracle* (NY: OUP, 1993).
- 5) The IMF coordinated the international response which was assisted by the World Bank and the Asian Developmental Bank.

countries primarily responsible for the crisis on the ground that they were unsuited to the needs of the global economy. The IMF's structural reforms sought to harmonize the financial governance of the affected economies with 'international', viz. Western, practices. They imposed unprecedented restrictions on state governance. The IMF has been widely criticized for exceeding its institutional mandate and going beyond what the crisis justified.⁶⁾

An investigation into why Korea's economic governance and infrastructure were judged unsound and ordered dismantled by the IFIs offers the potential for useful insights into globalization.⁷⁾ I raise four questions for consideration about the structural reforms in Korea. First, why did the U.S. and the international financial organizations ("IFIs") conclude so readily that the Korean development state had failed? I argue the reasons for this were two-fold. First, the restructuring of Korea's economy furthered a variety of American interests in the region. Second, the analysis of Korea's financial architecture, based on Western norms, presumed that a viable capitalist economy must contain certain essential elements.⁸⁾

The second question is whether the presump-

6) Notably by Martin Feldstein. 1999. "Reforming the IMF", *Foreign Affairs*, 77(2): 20~33 (March-April).

7) Korea has the eleventh largest economy in the world and is a member of the OECD. It had the strongest institutions and longest history of economic stability of the countries which obtained assistance. Korea's high level of development, its prowess as a competitor with Western nations in export markets, and the nature of its political economy, places it in the same category as neighbouring Japan and Taiwan. This is in contrast to the less developed economies and 'softer' states which characterize Thailand and Indonesia.

8) By Western, I refer to the set of institutions and arrangements which roughly characterize Anglo-American political economy in contrast with the Western European stakeholder-social corporatist model.

tion that only the Western economic model is viable prevented an objective analysis of the Korean political economy. I conclude that Western officials were predisposed to find that surface variations between the Korean development state and the Western model indicated systemic failures instead of differences in underlying national goals.

Third, the paper asks what costs will likely result from the structural reforms. The costs of these drastic changes will result largely from the unfounded assumption that neo-liberalism can be successfully imposed top-down. They include diminution of economic and political sovereignty, loss of stability, and threats to the long term economic prospects of Korea and the East Asian region.

Fourth, I inquire into the meaning for globalization of the IMF's actions. The conclusion is that the processes of globalization include forced harmonization where the interests of the international economic order and regional powers collide. This will hold true absent global financial architecture which respects domestic goals at variance with the norms of the strongest states and IFIs.

The first section of the paper describes the framework of the Korean development state in the context of the country's path to development. Next, the paper explores the reasons the structural reforms were so fundamental in light of U.S. interests and the prescriptive power of the Western economic model. The final section details the probable costs of the IMF's intervention and its implications for globalization.

THE COURSE OF INDUSTRIALIZATION IN KOREA

Korea enjoyed advantageous preconditions for industrialization. As a colony of Japan from

1910 to 1945, it experienced significant modernization. Japan had immediately sought to industrialize the largely agricultural economy of Korea. The colonial administration undertook significant development in transportation, power production and education. Crucially for the post-war period, the administration of the colony was highly centralized within the colonial government and this precluded creation of a comprador class.

From 1945 to 1950, Korea undertook extensive land reform under the auspices of American occupation authorities. This weakened the power of the large landowners. Hence, the state had no rival from business or civil society in the period of Korea's formative industrial growth. Japanese state-led development provided a model for state elites. The government created an autonomous, capable bureaucracy, owned key sectors of the economy, including steel, energy, and fertilizer, and nationalized the banks to control investment in other major sectors. The government exploited nationalist and anti-communist sentiment to stimulate public support for its efforts.

Industrialization efforts intensified following the coup led by General Park Chung Hee in 1961. A pilot agency, the Economic Planning Board, was created to coordinate development. Successive five year plans pursued policies first of import substitution and then of export-led industrialization. In the late 1960's, Korea, like Japan and Taiwan before it, successfully switched its comparative advantage from labour-intensive, standardized manufacturing to value-added manufacturing.⁹⁾ It sponsored the creation of the chaebols¹⁰⁾ in the 1970's to compete with foreign multinationals,

in imitation of the Japanese keiretsu.¹¹⁾

The rationale of the Korean development state was to direct investment surplus into stimulating economic expansion within the country in order to spread the benefits of growth widely throughout society. This served the interests of political elites who sought to maintain domestic stability and enhance the legitimacy of the regime by producing economic growth while reducing income inequality.¹²⁾

State power was used to increase the surplus, direct it into industries needed to sustain higher wages in the future, and expose industries to direct and indirect competition.¹³⁾ To boost the percentage of national output available for investment, disincentives and limits were placed on consumption.¹⁴⁾ As well, the government exerted strong influence over prices. High levels of investment were maintained which averaged 26.5% of GDP. The state owned the banks until the early 1980's when it privatized some outright and retained partial ownership in others but continued to direct all.¹⁵⁾

The key to the state's role in coordinating the entry into and exit out of industries was two-fold. The first was the network of formal and informal contacts among political, bureaucratic and business elites. This was grounded in the kwan-kei culture which emphasizes personal and primary group relations.¹⁶⁾ These "delib-

9) Robert Wade. 1990. *Governing the Market*, Princeton: Princeton UP, p. 47.

10) Which are large, narrowly-held conglomerates, often controlled by families.

11) Wade, p. 309.

12) Francois Godement. 1999. *The Downsizing of Asia*, NY: Routledge, p. 16.

13) Wade, 1990, p. 342.

14) Through the end of the 1980's Korea had strikingly low levels of personal car ownership and foreign holidays were banned outright, Ha-Joon Chang. 1993. "Political Economy of Ind U.S. Policy in Korea." *Cambridge Journal of Economics*, 17: 131-157, 139.

15) Wade, 1990, p. 308.

16) Ku-Hyun Jung, "Changing Business-Government Relations in Korea", Robert Fitzgerald, *The State and Economic Development*, (London: Frank

eration councils”, a hallmark of East Asian political economies, often gave state leaders information which enabled them to respond more quickly to changing markets than other economies.¹⁷⁾ Second, rewards such as loans and entry into desired industries were allocated on the basis of performance among competing chaebols. Outside investment was restricted in favour of state guaranteed foreign loans. A variety of protectionist measures, including local content regulations, were employed to control the timing and extent of exposure to foreign competition.

The government of Kim Young Sam was strongly influenced by neo-liberalism. It carried out some financial liberalization was carried out in the 1990's. This was done in the absence of adequate regulation, however, and this presaged the crisis.¹⁸⁾ After the capital account was opened up, foreign debt increased dramatically from insignificance in the beginning of the decade to \$160 billion by 1997.¹⁹⁾ Meantime, the government had loosened its control over investment and overall coordination and permitted the chaebols a measure of autonomy. This led some executives to break ranks and attempt to influence political leaders directly on behalf of their chaebols. A number of cases of outright corruption emerged in the dispensing of loans and funds. These were widely publicized as signifying the dangers of 'crony capitalism'.²⁰⁾

Cass, 1995), p. 167.

17) World Bank, p. 11.

18) Ha-Joon Chang. 1998. "South Korea: the Misunderstood Crisis", in Jomo K.S., (ed.). *Tigers in Trouble*. Zed: London. pp. 222 ~ 231.

19) Frank Veneroso and Robert Wade, "The Asian Crisis: the High Debt Model vs the Wall Street-Treasury-IMF complex", *New Left Review*, (228) 1998, pp. 4 ~ 22, p. 8.

20) Chang, 1998, p. 229.

WHY WERE THE STRUCTURAL REFORMS SO FUNDAMENTAL?

There is general agreement among IFIs, U.S. officials and commentators over the proximate cause of the crisis in Korea,²¹⁾ but not over its fundamental origin.

The U.S. and the IFIs took the position that the nature of the Korean development state itself was implicated. The IMF and the U.S. claimed that "weak financial institutions, inadequate bank regulation and supervision, and the complicated and non-transparent relations among governments, banks, and corporations, [lay] at the heart of the economic crisis".²²⁾ The U.S. pushed for drastic structural and institutional reform, both publically and through its Executive Board members within the IMF.²³⁾

Leaving aside the debate over whether the structures of the Korean development state were causal in the outbreak of the crisis,²⁴⁾ two main reasons have been given by IMF and U.S. officials. They contended that the emerging global economy requires a common 'level playing field' and that the East Asian development

21) The crisis is widely understood to have been precipitated by the flood of short-term foreign capital which burst in when domestic firms were suddenly able to borrow abroad without oversight and before adequate regulation was in place. Hence, issues of the capital account, which regulates the inflow and outflow of foreign investment capital, and currency controls were central. See for example, Wade 1998 and Devesh Kapur, "Handmaiden, Scapegoat or Bungler", Unpublished paper delivered at the ISA conference in Los Angeles, March 2000.

22) Fisher <http://www.imf.org/external/np/speeches/1998/032098.HTM>.

23) Selected reforms are listed in the Appendix.

24) It must be noted that the 'fundamentals' of the economy were sound. It had low inflation, a budget surplus and generous foreign currency reserves and had received the praise of the IMF, World Bank and OECD. Veneroso and Wade, p. 8.

model had proved to be a failure. U.S. officials also pushed for the structural reforms because they enabled the U.S. to 'advance' its trade agenda with Korea.

In explaining the need for structural changes in Korea, Shigemitsu Sugisaki, the Deputy Managing Director of the International Monetary Fund, argued that "in a globalized world with integrated trade and capital flows, market participants...fear government interference."²⁵⁾ Hence, what was needed, according to the Asian Development Bank, was a "more market-based economy."²⁶⁾ In the formulation of Larry Summers, Deputy Secretary of the U.S. Treasury Department, Korea needed a "new system of governance [that was] better attuned to the demands of an integrated modern market economy."²⁷⁾

Structural reform was also justified on the basis that, as a U.S. Trade representative pointed out, East Asia had "clung too long to failed models for economic development and growth."²⁸⁾ The crisis had helped to demonstrate, according to Alan Greenspan, Chairman of the Board of Governors of the U.S. Federal Reserve Bank, that "market capitalism, as practiced in the West, especially in the U.S.", is the superior model over the "competing capitalist-type system in Asia."²⁹⁾

To American audiences, U.S. officials additionally pointed out the tremendous benefits the changes would bring to U.S. exporters and

investors.³⁰⁾ Korean firms had provided stiff competition to U.S. firms in both the U.S. and Korean markets and abroad. In the U.S. view, the problem stemmed from the unfair advantages which resulted from a "salient characteristic[c] of the Korean economy",³¹⁾ namely, the "close relationship between the government, the banks and the chaebol conglomerates".³²⁾ Yet, as Treasury Secretary Robert Rubin admitted, the U.S. had been handicapped because "before a crisis occurs, it has the capacity to advocate but not to force sovereign countries to take actions they do not believe to be in their interest."³³⁾

Not only would the U.S. stand to benefit from the dismantling of Korea's economic structures but, in addition, the IMF initiatives removed a "stumbling block", as Deputy Treasury Secretary Summers termed it, in the form of Korean opposition to further trade or financial liberalization.³⁴⁾ Through the IMF, the U.S. was even able to link Korea's obligations to liberalize financial services in the OECD to its IMF commitments. Significant concessions were

25) <http://www.imf.org/external/np/speeches/1997/120897.HTM>.

26) <http://www.adb.org/News/1997/nr142-97.asp>.

27) <http://www.treas.gov/press/releases/pr2309.htm>.

28) http://www.U.S.tr.gov/speeches/fisher/fisher_13.html.

29) <http://www.federalreserve.gov/BOARDDOCS/TE S TIMONY/1998/199803032.htm>. Secretary Greenspan admitted that prior to the crisis this could not be demonstrated "given a record of real growth rates of close to 10 percent per annum".

30) The U.S. clearly had substantial influence on the design of the structural reforms. This was acknowledged by Stanley Fischer, the First Managing Director of the IMF. <http://www.imf.org/external/np/speeches/1998/032098.HTM>. Administration officials told Congress that the design of the IMF package had been "led" by the U.S.. <http://www.treas.gov/press/releases/pr2195.htm> Moreover, they pointed out that they had been successful in getting the IMF to include commitments by the recipient nations to reform their governance and trade policies. Congress had been pushing for this as a condition of the disbursement of IMF funds. It made this a requirement of all future bail-outs in the IMF funding legislation it passed in 1998. <http://www.treas.gov/press/releases/pr2195.htm>.

31) <http://www.treas.gov/press/releases/pr2242.htm>.

32) <http://www.treas.gov/press/releases/pr2242.htm>.

33) <http://www.treas.gov/press/releases/pr2168.htm>.

34) <http://www.treas.gov/press/re:leases/pr2978.htm>.

achieved in specific sectors such as agriculture.³⁵⁾ President Clinton reported that officials of no less than six agencies of his administration, including himself and the vice president, had lobbied the Korean government to ensure compliance with IMF requirements regarding the steel and semiconductor industries.³⁶⁾

After listing the American benefits from the IMF requirements, Deputy Treasury Secretary Summers pronounced himself satisfied with IMF policy: "In some ways the IMF has done more in these past few months to liberalize these economies and to open up their markets to U.S. goods and services than has been achieved in rounds of trade negotiations in the region."³⁷⁾

There were additional advantages of the IMF initiative that were not publically acknowledged by U.S. officials. Most of these impact the status of the U.S. as a major trading nation. As such, the U.S. regards rival capitalist economies as competitors in an anarchical global economy. Thus, the U.S. position was that a 'level playing field' for Korea meant operating its economy by rules, institutions, and structures which reflect those of the domestic American economy. This system, after all, has enabled U.S.-based transnational corporations to flourish. Its transmittal abroad served U.S. private and state interests in at least four areas.³⁸⁾

First, the structural reform process enabled the U.S. to impose virtually all of its trade agenda on Korea. It scored victories on long standing issues respecting both governance and market access.

Second, in doing so, the U.S. was able to weaken and discredit a rival capitalist/development model. The East Asian development state model had proved a formidable competitor. Its disparagement promised to make it easier for the U.S. to persuade both industrialized and developing states that there is no viable alternative to neo-liberalism. In addition, bringing to Asia the 'level playing field' of Western rules and institutional arrangements better serves the interest of Western corporations and states in the region. Western transnationals can increase market share and profits more easily if the advantages of their East Asian competitors are removed. The power of East Asian states can be weakened by removing central control over their economies.

Third, the pressure to open capital accounts was linked to the nature of domestic economies. East Asian savings represent about half of the world total.³⁹⁾ The United States and United Kingdom economies are characterized by low rates of savings and high levels of consumption. Therefore, the argument goes, it is vital for them that global investment funds be free-flowing. Robert Wade has argued the

35) Secretary Rubin reported to the House Agricultural Committee that Korea had been forced to end subsidies and weaken protection of agricultural products. He went on to announce that a total of \$6 billion had been made available to assist American agricultural producers for sales to Korea "and the other countries in crisis".

<http://www.treas.gov/press/releases/pr2469.htm>.

36) <http://www.pub.whitehouse.gov/uri-res/12R?urn:pdi://oma.eop.gov.us/1999/1/8/4.text.1>.

37) <http://www.treas.gov/press/releases/pr2241.htm>.

38) There is a parallel with the early 1990s debate over the direction of the post-communist European

economies. West Germany sought to build institutions and structures in Eastern Europe via a long term 'Marshall Plan' which would lay the foundation for a stakeholder-corporatist economy. In successfully opposing this, the United States and the United Kingdom favoured 'shock therapy' to put assets into private hands as quickly as possible through 'shareholder capitalism'. The implication was that this had to be done before the new states could assert any control or national plan for their economies.

39) Wade, 1998, p. 370.

United States has no choice but to oppose capital controls and restrictions on the international mobility of capital and contends that for the American government “there is no more important foreign economic policy issue than this.”⁴⁰⁾

Lastly, a further interest of the U.S. relates to the future leadership of the region. Any concern to reduce the power and autonomy of East Asia is connected with concern over Japan. Japanese domination of East Asian politics and economics threatens the hegemonic security and economic role of the United States. Hence, the United States blocked an early proposal of an Asian monetary fund led by Japan to respond to the debt crisis. This initiative would have involved a milder readjustment for the affected nations and increased Japanese political control over the region. ‘Open’ economies on the Western model mean greater freedom for financial capital and direct investment in Asia. With access to the tantalizing Chinese economy at stake, the risk was too great that the ‘closed’ Asian model might have been institutionalized under Japanese authority. Stephen Gill argues that these events constitute “intense interstate conflict over the forms and direction of the regional and global patterns of development”.⁴¹⁾

Thus, we can observe that the U.S. was clearly motivated to advance its own interests. But both U.S. and IFI officials concurred that the Korean development state had failed and was no longer sustainable. The reason, in my view, was that Western officials shared the same conceptual economic framework. They assumed that there are certain essential properties of a capitalist economy and derived such properties from the Western model. Korea was

found to lack certain components of the model — as the U.S. Treasury secretary proclaimed, the “essential underpinnings of a modern financial system were weak or did not exist.”⁴²⁾ Therefore, it became easy to conclude that blame for the crisis lay primarily with the economy itself and not, say, aggressive foreign investors or unbounded global financial flows. Naturally, then, structural reforms were essential. We shall investigate the basis for the pre-conception, why it is useful to the IFIs, and its attendant costs.

The Western economic model

The economic understanding of American and American-educated officials derive principally, if not exclusively, from neo-classical economics with its tenet of a minimal role for the state in the economy. American-based officials reside in a nation famous for extolling individual over collective pursuits. The rhetoric of the U.S. and IFI officials shows they have internalized American norms of the components and purpose of an economy and of a parsimonious role for the state. The Western model, then, is best viewed as an ideal type of the American economy.

The Western model, as we have seen, functioned for both U.S. and IFI officials as a “useful international standard” to benchmark other economies. Its adoption for this purpose relates in part to the bureaucratic need for simplicity. Its standardized use simplifies the task of analyzing a multitude of variations in domestic economies. It enables quick comparisons to be made based on objective and quantitative analyses of readily available data. Qualitative analysis, by contrast, takes longer

40) Wade, 1998, p. 371.

41) Gill, 1998, p. 9.

42) I assume Secretary Rubin did not confine his remarks to the capital account. www.treas.gov/press/releases/pr2168.htm.

to gather, requires time in the field, and is open to ambiguity.

It is a short logical leap from using the Western model to analyze novel economies to asserting that it is the only 'viable' model which can function properly in a global context. Since liberalization conceptually is about making economies more 'free', 'open', 'transparent', and 'modern', economies which are less liberal, it follows, are substantially deficient, if not inferior and even (as was concluded about Korea) unworkable in the global economy. With this preconception, it is not surprising that officials failed to comprehend novel economies on their own terms. Few of the IMF staff who developed the structural requirements were Asian specialists. None spent much time in country before the requirements were decreed.⁴³⁾

There are a number of costs in assuming the Western model is the standard by which other economies are evaluated. First, no critical examination takes place of the particularities of the Western model or its shortcomings. Second, economies that do not match the model are regarded as defective, if not illegitimate. Mere incongruence can serve as a lazy explanation for a state's lack of development or trade advantage. A novel state-business nexus is regarded as *prima facie* corrupt. More importantly, the presumption that only the Western model is tenable in a global context precluded an objective analysis of the Korean political economy. Comparison of the Western model with components of the Korean development state in context shows that its key differences were interpreted as failings. A review of conventional wisdom about the American economy is instructive. It includes such core precepts as:

43) Joseph Stiglitz, "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus", <http://www.worldbank.org/html/extdr/extme/js-010798/wider.htm>.

The role of private actors in the economy is held to be primary.

The paramount goal of corporations is to maximize shareholder value.

The stock market serves as the focal point of the economy.

The state's task is to enhance the freedom and flexibility of entrepreneurs and their ability to produce and preserve wealth by holding regulation and taxation to a minimum.

This arrangement is considered to provide the optimum (utilitarian) outcome.

Individuals are regarded as capable of providing for their own welfare.

Comparisons

From this account, we can see that proponents of an economic system designed to maximize shareholder value and corporate power will have difficulty understanding or empathizing with the Korean system which was built to seek harmonious shared and balanced growth

In Korea, state collaboration with private actors has sought to strengthen the national economy through an industrial strategy in priority over the interests of individual sectors or firms. Moreover, economic benefits traditionally have not gone chiefly to owners and managers of capital but rather have been apportioned among labour, entrepreneurs, and investments to "provide public goods that contribute to a good life".⁴⁴⁾

A comparison of the two banking systems is revealing. Unlike the high consumption economy of the U.S., Korea, like the other East Asian states, has featured among the highest rates of domestic savings in the world. East Asian households invest little in equities and

44) Wade, 1998, p. 371.

eschew borrowing.⁴⁵⁾ This has had two important consequences. The banks made mostly commercial loans and firms obtained most of their financing from credit. East Asian lenders typically lent far more - up to debt-equity ratios of two to one - than Western banking practice considered safe or prudent. Such high ratios meant that the debtors were highly leveraged and thus vulnerable to a weakening of the economy, interest rate fluctuations or liquidity 'crunches'. Manifestly, cooperation among borrowers, the state and the banks is required to cope with economic downturns and liquidity crises and this had been the traditional relationship in the region.⁴⁶⁾

The crisis served to reveal the differences in banking practices between the "credit based" economies of East Asia and the "equity based" economies of the West.⁴⁷⁾

In sum, the North Asian states of Korea, Taiwan and Japan can be characterized as neo-mercantilist in seeking to maximize and capture economic gains to benefit their populations and autonomy. Needless to say, this motivation is decidedly unfashionable in the era of globalization.⁴⁸⁾

45) The East Asian states have averaged savings rates of 1/3 of GDP, compared with the West at 15 to 20%, Southeast Asia at 20%, and Central America at 21%. Robert Wade. 1998. "From Miracle to Crony", *Cambridge Journal of Economics*, 22: 694-706, 700 (July). The most recent figures put Korea's savings rate at 34% compared with the U.S. at 16%. UNDP. 1999. *Human Development Report*, NY: OUP. p. 184.

46) Wade, 1998, p. 363.

47) Stephen Gill. 1998. "The Geopolitics of the Asian Crisis." *Monthly Review*. 50: 1-9, 6 (June).

48) American hostility to this sort of neo-mercantilism is demonstrated by the cool reception given to the ideas of Robert Reich, former Secretary of Labor, who has argued that American 'competitiveness' can best be achieved through state policies to improve human capital and encourage greater production in the United States, whether under-

COSTS OF THE IMPOSITION OF THE STRUCTURAL REFORMS

At least three kinds of interrelated costs can be expected from the structural reforms. They are: sovereignty, loss of stability, and threats to the economic well being of Korea and the East Asian region. The IMF assumed that neo-liberalism can be successfully imposed top down. This, in turn, rests on the complementary and equally questionable assumption that the new governance and financial architecture will meet Korea's needs. A major problem is that Korea has suffered a major compromise of its autonomy as a sovereign state. Reforms forced on Korea by the IMF saddled it with an economic framework not of its making or choosing. Moreover, the IMF acted to the barely concealed delight of the U.S., a rival and trading partner which had long sought increased market access and demanded such Western-style reforms.

Significant doubts have been raised in Korea over the legitimacy of the new economic arrangements and the wisdom of the constraints on state capacity and policy. Already there have been mass protests against the changes, particularly by labour, which must bear the immediate costs of restructuring and making the labour market more 'flexible'.⁴⁹⁾

Nonetheless, the breach of sovereignty might be an acceptable cost provided that, as the IMF

taken by domestic or foreign capital. Robert B. Reich. 1996. "Who is U.S.", in Robert J. Art and Robert Jervis, eds, *International Politics*, (4th ed.). New York: Harper Collins. pp. 352-366, 354. For example, Ethan B. Kapstein rejects the neo-mercantilist implications of Reich's position and instead argues that transnationals should be allowed to act solely in their own interests. "We are U.S." in Art and Jervis, pp. 367-375, 369.

49) Shim Jae Hoon. 1999. "Now the Harder Part." *Far Eastern Economic Review*, 25: 2.

expected, Korea's economic future is secure now that it has a suitable infrastructure and enjoys the resultant confidence from investors. However, there are five reasons to question these premises and, instead, to support the position that the reforms will engender instability and economic difficulty.

The first concerns the pace of the structural reforms. Although Korea had taken significant steps toward liberalization, they were still tentative. Now that extensive liberalization is a fait accompli, other options have been foregone. Moreover, the changes were prescribed before a domestic consensus in favour of more extensive liberalization had been built. Thus, irrespective of the technical merits of the reforms, their scale and depth lack widespread legitimacy and support.

Second, the unilateral nature of the reforms prevented the government from seeking to maximize the benefits accruing to Korea by opening its markets gradually in return for concessions from trading partners. It has liberalized significantly and, arguably, on the terms of its adversaries. This has disadvantaged Korea and provided a further stimulus to those opposed to the reforms, especially if the economy falters.

Third, the economic future of Korea is now more difficult to predict. Stitching together individual parts without regard for the whole can constitute quite a different creature than expected, as Dr. Frankenstein discovered too late. It remains uncertain over the long term which of the various reforms Korea will retain, revise or replace and, in general, how it will respond to them.

Fourth, and more fundamentally, Korea has been burdened with a mismatch between key economic institutions and its culture. This is because the institutions and philosophies that have been brought to Korea are grounded in the

particular history and societies - in this case Western- which created them. To be precise, the IMF failed to appreciate that markets require a whole panoply of rules, norms, and state and social institutions, for their construction and maintenance.⁵⁰⁾

Much of the infrastructure that the Koreans undertook to remove was established by them in order to shape the market economy to fit their values and goals. A vital part of that structure was intended to shield society from market influences at odds with societal values. This is especially evident in the field of labour 'reform' where nearly every Korean is affected daily by the IMF dictates. There, marketization will mean the citizen is to be transformed from a tenured partner in national development into a factor of production now at the behest, in many cases, of an American subsidiary.

Fifth, and most seriously, if public authorities can no longer direct the economy, then Korea will have lost its ability to alter its comparative advantage, the key to its remarkable growth. This will threaten its ability to pursue growth with equity which is given major credit for Korea's stability.⁵¹⁾

Any one of these factors could bring about economic decline and civil unrest which would engender instability and threaten the interests of domestic and foreign investors alike.

Korea offers multiple flashpoints for strife, from decreased economic growth and increased inequality, to unrest by labour, domestic and foreign capital or the population at large over the performance of politicians who must learn on the job how to manipulate the controls of the new economic machinery.

Instability in Korea would hold serious consequences for the East Asia region and

50) Karl Polanyi. 1994. *The Great Transformation*. NY: Rinehart. p. 130.

51) Godement, p. 10.

beyond. Fully half of East Asian trade is within the region.⁵²⁾ Economic woes in Korea would quickly spread as the crisis itself demonstrated.

IMPLICATIONS FOR GLOBALIZATION

Korea, despite the size and robustness of its economy, its long-standing stability, and its status as role model for developing countries, was required by the leading IFIs to carry out reforms intended to achieve a "fundamental change in what [its] government is expected to do".⁵³⁾ This event provides support for the proposition that globalization entails harmonization with Western notions and standards of political economy.⁵⁴⁾

We can also conclude that in this case the U.S. used its influence with key IFIs to advance its own economic interests and urge its conception of globalization.⁵⁵⁾ For their part, the IFIs showed little interest in investigating whether regional models might potentially serve national goals and complement social values under conditions of full financial liberalization. They did not ask whether any components of the Korean development state could have been salvaged if the pace of financial liberalization were slowed. Instead, the international community acted to exploit Korea's momentary distress to serve thinly veiled national and bureaucratic interests. Certainly, the

strength and efficacy of the partnership between the IMF and U.S. to extend the hegemony of neo-liberal ideology cannot be underestimated.

The reforms have important ramifications for the region. First, no nation will wish to compromise its autonomy in the manner of Korea. To avoid the both the crisis and the Korean solution, states of the region can be expected to back off large-scale liberalization projects certainly those involving speedy financial liberalization.

Second, a greater push toward regionalism is likely. If Western-led harmonization is to be avoided, then the states of the region must configure liberalization so it facilitates foreign access while retaining some measure of national control over the process. Third, it can be expected the region to support Japan and China as strategic counterweights to the U.S. The role of the U.S. in the crisis made it clear that in a clash of capitalisms in the region, it expects to win.

CONCLUSION

The sudden and comprehensive nature of the reforms forced on Korea brought about fundamental changes in financial governance. Placing them in the context of modern Korean political economy helps to reveal how exotic they are. The Korean development state presided over an economic system which reflected a philosophy and underlying goals distinct from the Western model. Time will show if Korea will prefer its new economic attire, shed them in favour of its traditional style, or fashion a hybrid. Since all economies are social phenomena which are rooted in underlying values and institutions, the durability of the new garb is suspect.

As for globalization, it is clear that in this instance it was made to serve the interests of

52) Robert Wade. 1998. "The Asian Crisis and the Global Economy: Causes, Consequences, and Cure." *Current History*. 97(622): 361~391 (November).

53) <http://www.treas.gov/press/releases/pr2309.htm>.

54) See for example Dani Rodrik, *Has Globalization Gone Too Far?* (Washington: Institute for International Economics, 1997).

55) I recognize that not all agencies of the U.S. government supported its official position on the structural reforms.

the U.S. and central IFIs, some of globalization's most enthusiastic proponents. Since the crisis in Asia, much work has been done to develop international financial architecture to prevent future crises. To the extent that such architecture excludes or undervalues the interests of smaller states, globalization will be eyed even more suspiciously by those disturbed by the IMF's actions in Korea.

APPENDIX

Selected Structural Reforms To Be Undertaken by the Government of Korea as Outlined in Various Letters of Understanding to the IMF⁵⁶⁾

Role of the state

Eliminate export subsidies
End subsidies to domestic firms
Ban government-directed lending
Eliminate ability of government to bail out corporations
Restructure selected government ministries to improve efficiency and cost-effectiveness
Develop a proposal for rationalizing existing subsidy programs
Adhere to guidelines on government procurement
Operate public enterprises on market principles
Deregulate domestic industry to promote competition

Finance and investment

Adopt 'international' accounting and auditing

56) Sources

<http://www.imf.org/external/np/loi/122497.HTM>

<http://www.imf.org/external/np/loi/020798.HTM#1>

<http://www.imf.org/external/np/loi/050298.HTM>

<http://www.worldbank.org/html/extdr/offrep/eap/krsalii/matcorps.html>

<http://www.imf.org/external/np/loi/120397.HTM#memo>

standards

Labour Policy

Reduce regulation of labour markets

Legalize layoffs

Access to Korean market by foreign capital

Make central bank independent from government with price stability as its main mandate⁵⁷⁾

Eliminate blanket guarantees in favour of deposit insurance scheme

Increase capital requirement ratio

Eliminate restrictions on foreign borrowing by corporations

Establish a bankruptcy court

Create a national registry of security on personal property

Shift corporate finance from debt to equity

Reduce the number of affiliates of biggest chaebols by 50%

Modernize the life insurance industry

Open up capital account

Lessen protectionist measures

Permit the foreign ownership of financial institutions, including banks, of up to 100 percent

Increase limits on foreign ownership of listed Korean shares to 50%

Reduce restrictions on foreign access to money, bond, and equity markets

Abolish restrictions on foreign ownership of land

Increase the permitted equity ownership by foreigners in telecommunications, power and gas sectors

Eliminate restrictions on foreign involvement in securities, insurance, leasing and other property-related businesses

57) As opposed to a mandate of, say, inter alia, national development, or stable employment.

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