The Long Shadow of the Asian Financial Crisis in South Korea

Seoul’s approach to pandemic relief is colored by the formative experience of the 1997-98 crisis.

By Yong Kwon
December 06, 2021

Credit: Depositphotos
In November, South Korea’s ruling Democratic Party proposed sending citizens another round of stimulus checks in response to the economic challenges created by the ongoing pandemic. However, Finance Minister Hong Nam-ki opposed this call and suggested a smaller but more-targeted assistance package. Prime Minister Kim Boo-kyum backed up this position by adding that the government could not afford another round of universal assistance despite anticipating a larger-than-expected surplus in tax revenue this year.

Curiously, public polling in the first week of November revealed that over 60 percent of Koreans agreed with the government’s objection to universal relief. Why might this be? It is certainly not because people feel that COVID-19 is no longer a major source of economic pain. The latest round of universal disaster relief moved forward as late as September of this year and public assistance packages to-date have been broadly popular.

Rather than feelings of contentment, uncertainty is the chief driver of the people’s apprehension towards another round of relief payments. Public discussions reveal fears of exposing South Korea to international volatility – an unease that stems from the country’s experience during the Asian Financial Crisis of 1997-98.

The Thai baht’s devaluation in the summer of 1997 precipitated a panic as international investors became worried that other currencies in the region might be similarly vulnerable. In particular, countries with comparable debt profiles such as Indonesia, Malaysia, and South Korea experienced a sudden outflow of U.S. dollars. Unable to finance short-term loans, several flagship companies in affected countries
collapsed, with consequences reverberating up and down the value chain.

The Asian Financial Crisis still casts a heavy shadow over South Korea because it was incredibly traumatic. Unemployment during the turmoil tripled and 80 percent of households experienced loss of income.

Structural readjustment measures that Seoul adopted as part of a rescue plan coordinated by Washington also left deep scars, leading to greater job insecurity and heightened inequality in subsequent years. For instance, the number of workers without full-time contracts increased by over 800,000 between 1997 and 2000.

The chaos also convinced South Korean policymakers and the public that the country was more vulnerable to erratic shifts in international market conditions than it had previously assumed. The failure of the International Monetary Fund (IMF) to provide effective assistance during this crisis despite its stated mission of acting as a backstop in these panics further exacerbated Seoul's angst.

The belief that South Korea must prepare for future bouts of financial instability on its own remains a significant driver of the country's macroeconomic policies, most notably its fastidious accumulation of foreign exchange reserves.

Despite preventative measures adopted since the crisis, both the public and policymakers remain deeply wary of creating any reasons for investors to lose confidence in the South Korean market again. This fear has been further sharpened in recent months by changes in U.S. monetary policy that are expected to pull investors and their capital from emerging markets to the United States. South Korean
market observers have raised alarm that these anticipated outflows will most heavily affect countries with higher debt levels.

This anxiety creates resistance to public policy that demands greater government spending and borrowing (such as relief funds), particularly as the 2022 budget is already expected to increase the country’s debt-to-GDP ratio to over 50 percent. The IMF’s expression of concern around the debt increase further adds to this unease.

But public discussions on what the country risks by not committing more resources and support at this critical moment are worryingly few and far between.

Worsening gender inequality is one consequence of inaction that is not on the forefront of policy consideration. In May, the former head of the Korea Desk at the Organization for Economic Cooperation and Development (OECD) called attention to how the growing demand and cost of caretaking tasks during the pandemic have pushed more South Korean women out of the labor force. Market surveys suggest that 476,000 female workers left the labor market in 2020, with more than four-fifths shifting to the status of homemaker. He warned that the resulting loss of productivity will have long-term ramifications on the country’s economic growth.

While this is a global trend, South Korea is starting from a pre-pandemic environment where gender inequality was far worse than in peer economies. Data from the OECD confirms that the country persistently suffers the largest gap in total income generated between genders among member states. Without further public assistance helping households overcome the
An onerous increase in the cost of caretaking, South Korea will likely suffer further loss of female workers, with deep consequences for both growth and social welfare down the road.

Another point of contention is whether it is reasonable for the South Korean government to spend more aggressively at this moment.

The IMF is correct to point out that the growth of South Korea’s debt-to-GDP ratio has been quick. From 47.9 percent in 2020, the figure is expected to rise to 55.1 percent in 2022 and 66.7 percent by 2026. This is the fastest increase among the 35 nations that the IMF classifies as advanced economies.

However, as Korea Economic Institute’s Kyle Ferrier pointed out in October 2020, South Korea’s public debt is still among the lowest in the OECD. That figure in the United States stood at 122 in the third quarter of 2021 and France is expected to hit 115.2 by the end of this year.

Credit ratings agency Moody’s also noted last year that even if Seoul were to hit its debt ceiling of 60 percent, “Korea will remain less indebted than advanced economies that share a similar rating, such as France and the UK.” George Washington University International Business Professor Danny Leipziger similarly saw greater downsides from South Korea engaging in “a tepid use of fiscal policy.”

With South Korea exhibiting both a need for public spending and fiscal capacity to increase its budget, the only remaining constraint is the public’s low tolerance for perceived risk. But built on the trauma of the Asian Financial Crisis, the people’s aversion to increased public debt is understandable.
South Korea is hardly alone in its need for greater public spending. Placing the global economic recovery at the forefront, the United States could do more to reassure countries needing to increase public spending that its monetary policy would not risk prompting sudden shifts in international capital flows. And influential commentators should probably say and do less to limit fiscal actions at this time.

AUTHORS

CONTRIBUTING AUTHOR

Yong Kwon
Yong Kwon is fellow and director of communications at the Korea Economic Institute of America (KEI). Follow him on Twitter @ykwon88.

TAGS

The Koreas Economy East Asia South Korea

1997 Asian financial crisis South Korea COVID-19 relief package

South Korea debt South Korea fiscal policy South Korea stimulus