

How Can South Korean Recovered Economy be Sustainable?

— Lessons from Japanese Experiences —

Yasushi Suzuki^{*}, S. M. Sohrab Uddin^{} and Chandani Persaud^{***}**

^{*} Professor, Graduate School of Management, Ritsumeikan Asia Pacific University, Japan.

^{**} PhD Student, Graduate School of Asia Pacific Studies, Ritsumeikan Asia Pacific University, Japan; and Assistant Professor, Department of Finance and Banking, University of Chittagong, Bangladesh.

^{***} PhD Student, Graduate School of Asia Pacific Studies, Ritsumeikan Asia Pacific University, Japan.

1. Introduction

The Republic of Korea, actually South Korea, has been considered as an economic powerhouse. It is also one of the Four Tigers in the East Asian region and has attained much attention for two main reasons: firstly, its miraculous economic progress achieved within a quick span of time compared to other East Asian countries; and secondly, it is a country with a smooth path of exceptionally demonstrated strong recovery from the financial turmoil that has shaken the whole region to a great extent. The average gross domestic product (GDP) growth rate of South Korea between 1970 and 1997 was 8.4 per cent (Shim and Lee, 2008); and accordingly by 1995 it was regarded as 'developed nation' with real GDP growth rate between 7 and 9 per cent per year and per capital income of US\$ 10,000 compared to 2.3 per cent and less than US\$ 100 respectively in 1960 (Jwa, 2001). South Korea faced a financial crisis in 1997 along with other South Asian countries, which has brought its way of development under question for a while. However, researchers like Bhagwati (1998), Furman and Stiglitz (1998), and Krugman (1999) opine that the crisis is the outcome of international financial liberalization and extensive flow of international capital rather than South Korea's faulty way of economic development process. Moreover, inappropriate policy prescriptions given by the International Monetary Fund (IMF) provides fuel to the crisis. Afterwards, South Korea has attained a sharp recovery from financial crisis, which can be regarded as 'V recovery', instead of accomplishing a stagnant growth period for at least three to four years as anticipated (Shin, 2004). Therefore, the case of South Korean recovery from financial crisis makes it more interesting for researchers to investigate the contributing factor towards its outstanding recovery.

Japan has been considered another economic miracle of World War II era for its remarkable economic

progress, especially after World War II. The economy of Japan can be categorized as high growth period followed by moderate growth period until bubbling of the bubble economy and period of prolonged economic and financial stagnation since the bursting of the bubble and corresponding financial crisis. During the high growth period Japan relied on the ‘catching up’ strategy of absorbing and improving engineering know-how absorbed from abroad, which contributed a lot towards its development process. In the moderate growth period, many Japanese industries reached the international technology and marketing frontier and thereby exposed to high levels of fundamental uncertainty in terms of business and investment. By the end of this period, Japan had become what we can describe as a ‘frontier economy’ in terms of technology. In parallel, it started to accommodate a paradigm shift in its industrial structure from primary to secondary industry and very recently to tertiary, i.e., service industry. The change in industrial structure along with the change in technological adoption requires for an effective functioning of the financial market through prudential screening and monitoring of financial intermediation from lenders and investors. However, in reality Japan observed the accumulation of a huge volume of non-performing loan (NPL) in the Japanese banks after the bursting of the financial bubble, which represented malfunctioning of its traditional mode of monitoring that was effective during its high growth period.

It appears that South Korea has been experiencing similar change in its industrial structure with the similar shift to frontier economy from a catching up strategy. How does this transition in South Korea affect its banking and economic system? Apparently, still it recovers from financial crisis and continues its moderate economic growth with immense success, whereas Japan fails to do so. What factors contributed to South Korea’s strong recovery from crisis? What went wrong in Japan? Is there any lesson that South Korea can learn from Japan so that it can make its development sustainable? This paper aims at identifying the reasons that contributed to South Korean strong recovery from financial crisis by evaluating industrial structure change and banks’ response towards the change. It will also assess Japan’s transition failure by reviewing the collapse of its monitoring system under the changing scenarios and thereby produce the lessons that South Korea can learn from Japan’s experiences to make its recovered economy sustainable.

The contribution of this paper is threefold. Firstly, it adopts a new way of analyzing the South Korean recovery by focusing on the industrial structure change in South Korea compared to Japan. Secondly, the findings generated by the study are useful in formulating policies so that the recovered South Korean economy can be sustainable in the long-run. Thirdly, the findings of this study also provide some guidelines for further research.

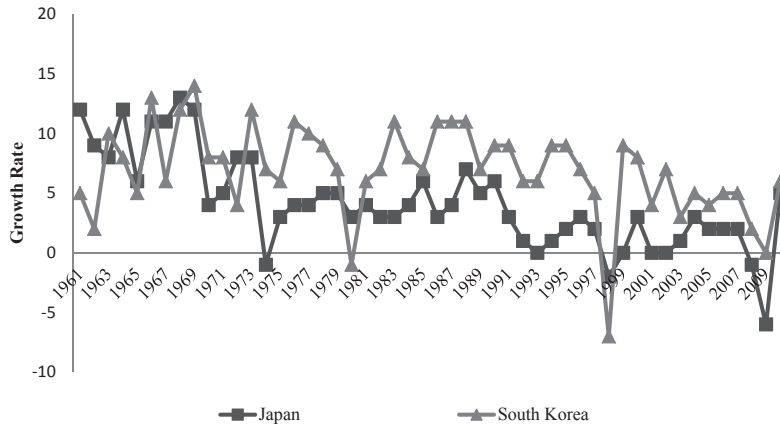
The later part of this paper is organized as follows: Section two generates a comparison between

South Korea and Japan by comparing respective countries' industrial structure change and GDP growth. Section three elaborates the background of the collapse of Japanese successful monitoring system under the transition to frontier economy. Section four evaluates the financing pattern of the South Korean financial intermediaries in line with transition in industrial and economic structural change. Section five concludes by addressing some lessons that South Korea can learn for ensuring sustainable economic growth and by creating some opportunities for further research.

2. Comparison between South Korea and Japan in respect to Structural Change

South Korea has moved to export-led industrialization policy backed by strong leadership of the President Park Chung-hee in 1961 from import substitution policy, which was promulgated in the 1950s. This shift laid down the foundation of massive economic progress of South Korea (Song, 1990; Lee, 1996; and Smith, 2000). Export-led policy was accompanied by labor intensive industries with a view to accommodating well-educated and abundant work force, state controlled and directed credit policy through assuring central bank autonomy and nationalization of commercial banks, and exchange rate reform from a unitary floating rate to a crawling peg system (Jwa, 2001). Later on during 1970s, the focus of industrialization was posted to capital-intensiveness particularly in the field of heavy and chemical industry (HCI). During these periods large corporations, commonly known as *chaebols*¹⁾, were allowed to enter into designated and protected industries. These large corporations were permitted to diversify their operations in areas directed by industrial policy and patronized by financial benefits (*ibid.*), although the concentration of *chaebols* was predominantly noticeable in the manufacturing sector (Shim and Lee, 2008). Both the two labor and capital intensive industrializations led to high economic growth until 1990, except in 1980 and in 1997 (figure 1). The socio-political unrest, the assassination of President Park Chung Hee in October 1979, the subsequent re-establishment of military rule in May 1980, the worst harvest since 1962, and the second global oil price hike collectively resulted into the decline in GDP in 1980 (Harvie and Lee, 2003). The growth rate of GDP was again badly affected by the East Asian financial crisis in 1997. In this regard, Harvie and Lee (2002) classify South Korean economy until the financial crisis into two segments: period of economic miracle from 1962 to 1989 and period of fading of the miracle from 1990 to 1997. Later, South Korea has started to recover from the financial crisis and the development process can be considered as moderate growth period compared to the high growth period as reflected in figure 1.

Figure 1: GDP Growth Rates over the Years in South Korea and Japan



Source: World Bank, 2011

Japan represents the first mover in the industrialization process among Asian countries (Memedovic and Lelio apadre, 2009) that resulted into high economic growth. According to table 1, the average real GDP growth rates during the high growth period (1966-1974) was 8.82 per cent per year. High growth period of Japan was associated with the adoption of catching-up strategy with the US economy. It was very successful in absorbing and improving engineering know-how absorbed from abroad and accordingly contributed immensely towards the high growth of Japan. From the mid-1970s, Japan rapidly changed its industrial structure by moving from low-skilled to more sophisticated production process. That is, the importance of agriculture sector gradually declined whereas the growth of non-agricultural sector, initially the manufacturing sector including large manufacturing firms and very lately the service sector, has been patronized. Researchers like Aoki *et al.* 1994; Schaberg, 1998; Patrick, 1998; Kanaya and Woo, 2000; and Hoshi and Kashyap, 2001 observe empirical evidence in favor of the internationalization and technological change in the production process of Japanese firms since the mid-1970s. This period of economic progress can be defined as the moderate growth period with an annual real GDP growth rates of 4.05 per cent per annum (table 1) and with a sharp increase of the share of tertiary industry and a decline of the primary industry (table 2, see also Suzuki, 2011). It comes to an end when Japan was experiencing a financial bubble and corresponding bubble burst. After that starting from 1992, the Japanese economy has been oscillated by a prolonged economic and financial slump with a further drop of the share of primary industry and a radical increase of the share of tertiary industry (table 2).

Table 1: Japan's Average Real GDP Growth Rates (at constant prices)

1966-1974 ^a	1975-1991 ^a	1992-2008 ^b
8.82% p.a.	4.05% p.a.	1.20% p.a.

Source: Authors based on statistics of Cabinet Office and ESRI (2008). ^aBase year = 1990, ^bbase year = 2000.

Table 2: The Changes of the Share of each Industry in Japan's GDP (at current prices)

Sector	1966-1974 ^a	1975-1991 ^a	1992-2008 ^b
Primary	7.5%	3.8%	1.8%
Secondary	40.7%	36.7%	28.5%
<i>Manufacturing</i>	33.5%	27.9%	21.3%
Tertiary	51.8%	59.5%	69.6%

Source: Authors based on statistics of Cabinet Office^a and ESRI (2008)^b

South Korea has also been experiencing structural change in its industrial composition as it moves to more sophisticated production process. Table 3 represents the value addition in percentage by different types of industries to GDP. It reflects that the share of primary industry has been reducing over time whereas the share of tertiary industry has been increasing. In 1965, the share of primary industry was 39 per cent, which reduced to only 3 percent in 2009. On the other hand, the share of tertiary industry increased to 61 percent in 2009 from 39 percent in 1965. The sharp contrast between South Korea and Japan is the contribution of secondary industry. In South Korea it has been in an increasing trend whereas in Japan it has been in the opposite direction. The reason for the increase in manufacturing sector in South Korea may as a result of the large firms still hold some competitive edge in the international market along with the shift to tertiary industry. It can be argued that the underlying fact behind South Korea's strong recovery from financial crisis is due partly to its continuing reliance on the secondary industry including the manufacturing sector.

Table 3: Value Added to GDP (in per cent) by Different Types of Industries in South Korea

Sector	1965	1970	1980	1990	1997	2000	2009
Primary	39	29	16	9	5	5	3
Secondary	21	26	37	42	41	38	36
<i>Manufacturing</i>	14	18	24	27	26	28	28
Tertiary	39	45	47	49	53	57	61

Source: World Bank, 2011

3. What went wrong in Japan after the High Growth Period?

This section will examine how the Japanese traditional monitoring system, which worked so well

until the high growth period became ineffective through a paradigm shift from catching-up to frontier economy. The analysis is going to be done by focusing on Japanese banks' financial pattern in line with the shift in industrial composition in Japan.

It has already been observed that the decline of primary and secondary industry including the manufacturing sector and the rise of tertiary industry have been continuing in Japan from catching-up to frontier economy. Table 4 indicates that the financing to manufacturing sector was dominant until 1970 and after that it started to decline tremendously. This change reflects the structural change in Japan in its industrial composition. However, Japanese banks have expanded their overall business since 1970s and accordingly the outstanding loan to the manufacturing sector has been increasing even though the share of loan to manufacturing sector has been decreasing.

Table 4: Changes in the Outstanding Loans by the Japanese Banks to Industries (in trillion yen)

In levels	FY1960	FY1970	FY1980	FY1990	FY1995	FY2000	FY2008
Manufacturing	4.0	17.5	43.0	59.0	72.6	67.1	56.4
Construction	0.2	1.8	7.3	20.0	31.1	28.8	15.4
Real Estate	0.1	1.5	7.6	42.4	57.4	57.0	58.7
Finance	0.1	0.5	4.5	37.7	49.6	39.7	36.9
Wholesale & Retail	2.3	11.3	34.4	65.6	78.1	65.8	45.9
Loans to Individuals	0.0	1.6	15.2	61.2	80.9	92.7	112.1
Others	1.4	5.0	22.6	90.1	114.8	107.2	96.1
Total	8.1	39.2	134.6	376.0	484.5	458.3	421.5
In percentage terms							
Manufacturing	49.4	44.6	31.9	15.7	15.0	14.6	13.4
Construction	2.5	4.6	5.4	5.3	6.4	6.3	3.6
Real Estate	1.2	3.8	5.6	11.3	11.8	12.4	13.9
Finance	1.2	1.3	3.3	10.0	10.2	8.7	8.8
Wholesale & Retail	28.4	28.8	25.6	17.4	16.1	14.4	10.9
Loans to Individuals	0.0	4.1	11.3	16.3	16.7	20.2	26.6
Others	17.3	12.8	16.8	24.0	23.7	23.4	22.8
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Created by the Authors upon Bank of Japan (BOJ) (1960, 1970, 1975, 1980), Japan Statistical Year Book 2010.

Table 5 gives an overview of the composition of the fund raising by the Japanese manufacturing and non-manufacturing sectors. It shows that the manufacturing sector started to use internal source for financing to a greater extent after the high-growth period. According to Hamazaki and Horiuchi (2001), most of the Japanese manufacturing firms drastically reduced their dependency on bank loan as it has reduced to less than 10 per cent from more than 30 per cent in the late-1970s. This is because these firms became financially matured after the high growth period. Thus, Japanese banks started to undertake higher credit risks through financing to small and medium enterprises (SMEs) whose financial strength was relatively weak. Apparently, the SME manufacturing firms still relied on banks to a greater extent, because they were not financially matured and needed to invest in restructuring their business to highly sophisticated manufacturing process to cope with stiff competition or shifting their production

base to overseas to reduce production cost. At the same time Japanese banks started to undertake more credit risks of non-manufacturing firms, which overlap with the SMEs to a considerable extent (Tanaka, 2002). While starting to undertake higher credit risks, the return of assets (ROA) of Japanese banks started to decline from 1970 (figure 2). This shows that the Japanese banks had started to undertake the unfamiliar risk for them without changing the traditional mode of screening and pricing, in spite that a different mode was necessary for the loan exposure towards the SMEs.

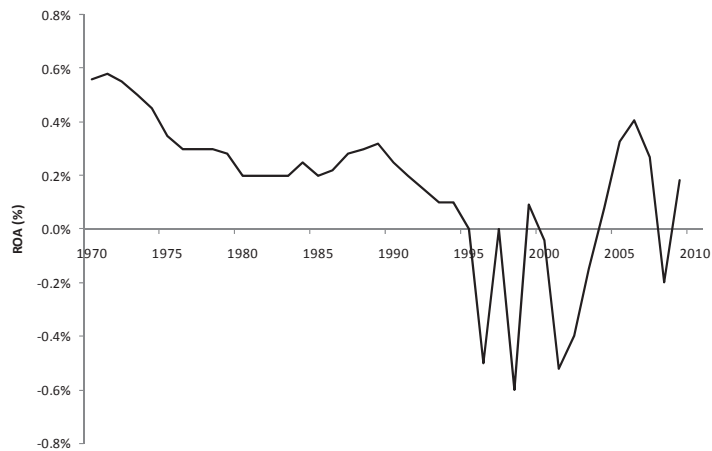
Table 5: Changes in the Composition of Fund Raising by the Japanese Major Manufacturing / Non-manufacturing Firms (in percentage)

Type of Firms	Sources of Funds	FY	FY	FY	FY	FY	FY
		1961 -1965	1966 -1970	1971 -1975	1976 -1980	1981 -1985	1986 -1990
Manufacturing	Internal Funds	27.1	33.7	35.9	54.3	68.0	53.9
	Corporate Bonds	2.8	3.0	3.9	1.0	10.3	19.9
	Borrowing	38.2	30.4	34.0	9.5	1.2	-9.5
	Stocks	10.8	3.2	2.4	7.8	12.8	19.1
	Others	21.1	29.7	23.7	27.4	7.7	16.7
Non-Manufacturing	Internal Funds	22.7	46.3	29.6	44.9	51.8	35.8
	Corporate Bonds	12.3	10.3	12.9	19.3	10.8	14.1
	Borrowing	32.7	65.9	59.0	39.1	26.1	29.1
	Stocks	7.9	6.8	7.0	8.5	9.5	11.5
	Others	24.3	-29.3	-8.5	-11.7	1.8	9.5

Source: Based on Hamazaki and Horiuchi (2001)

Notes: The major part of 'others' in the table is the trade credit. According to Hamazaki and Horiuchi (2001), the non-manufacturing industry includes public utilities such as the electric power and the railway companies, which were favored in their bond issuing compared with other industries. Therefore, the relative share of bond-issuing was larger in non-manufacturing than in manufacturing.

Figure 2: ROA in Japanese banks



Source: EPA 1999, p.245; BOJ Time Series data; etc.

It is worth noting that, though all types of manufacturing firms were successful during the high growth period with concentration of catching up strategy, there are 'winners' and 'losers' in the frontier economy period. This is because as the economy moved to frontier, firms were required to restructure its business under huge amount of fundamental uncertainty. Table 6 portrays the average real growth rate by different categories of manufacturing firms.

Table 6: Changes in the Average Real Growth Rate by each type of Manufacturing (in percentage)

Manufacturing Sector	1956 -1974 ^a (High Growth)	1975 -1984 ^a (Moderate Growth)	1985 -1991 ^a	1992 -2008 ^b
Overall manufacturing sector	17.0	7.1	5.4	-1.7
Light industry upon assembling & processing	13.5	7.2	4.5	-1.9
<i>Food and beverages</i>	10.4	10.4	2.6	-0.2
<i>Textiles</i>	12.2	1.1	-0.1	-7.5
<i>Other manufacturing</i>	18.0	6.8	6.6	-2.8
Light industry upon basic materials	18.2	4.2	5.0	-1.9
<i>Pulp, paper and paper products</i>	18.0	3.9	5.7	-2.0
<i>Non-metallic mineral products</i>	18.5	4.5	4.5	-1.9
Heavy industry upon basic materials	18.4	6.2	5.3	-1.3
<i>Chemicals</i>	16.0	7.5	4.8	-2.4
<i>Petroleum and coal products</i>	15.9	26.7	3.8	2.8
<i>Basic metal</i>	21.8	4.7	3.7	-1.3
<i>Fabricated metal products</i>	21.6	3.4	10.2	-3.2
Heavy industry upon assembling & processing	21.7	8.5	6.3	-1.0
<i>Machinery</i>	22.6	8.8	8.0	-1.3
<i>Electrical machinery and equipment</i>	23.1	11.6	6.6	-1.7
<i>Transport equipment</i>	21.2	5.8	3.9	1.0
<i>Precision instrument</i>	18.5	6.3	5.8	-1.4

Source: Authors based on statistics of Cabinet Office^a and ESRI (2008)^b

It can be argued that banks' monitoring of borrowers was not so difficult during the high growth stage of Japan since the efforts of almost all of firms were likely to be rewarded leading to success. With the shift to frontier economy from catching-up, competition was intensified and fundamental uncertainty came into action; which collectively resulted into the environmental and economic changes surrounding the traditional monitoring system. As Aoki (1994) points out, the Japanese traditional monitoring system worked as long as Japanese economy was governed by the catching-up in terms of technological capability. The traditional mode of screening and monitoring should have been overhauled or replaced with a different mode of responding to intensified uncertainties. We should also note that the overwhelming presence of the public sector in housing loans, which is one of the major profit centers for US and European banks, made it difficult for Japanese banks to diversity their profit structure (Suzuki,

2011). The ratio of real estate loans (those on residential properties) to total loans in the US reached almost 25 per cent while that in Japan remained at around 15 per cent in 1999 (Bank of Japan, 2001). The conventional housing loans to prime borrowers brought high profits to banks and their exposures were secured by mortgages on residential properties. Presumably, the reduction of the presence of public financial institutions in housing loans in Japan would have contributed to an enhancement of the profit base of Japanese banks.

4. Financing Pattern in South Korean Economy

Table 7 represents the industry wise outstanding loan in billion won and also in percentage of total industry loan in South Korea during the period 1998-2009. The primary industry includes agriculture, forestry, and fishing; the secondary industry includes mining and quarrying, manufacturing, electricity, gas, steam, & water supply, and construction; and all others, namely sewerage, waste management, materials recovery and remediation, wholesale and retail trade, transportation, accommodation and food service, information and communications, financial and insurance, real estate, renting and leasing, professional, scientific & technical activities, business facilities management and business support, education, human health and social work, public administration, and other activities are included in the tertiary industry. According to the table, the financing to the primary sector has been reducing whereas the loan to tertiary industry has been increasing, which are in line with the structural change in South Korea. However, the financing to the manufacturing sector in percentage term has been reducing although in figure it has been in an increasing trend.

Table 7: Outstanding Loan in Amount (in billion Won) and in Percentage of All Industry Loan in Different Industries in South Korea

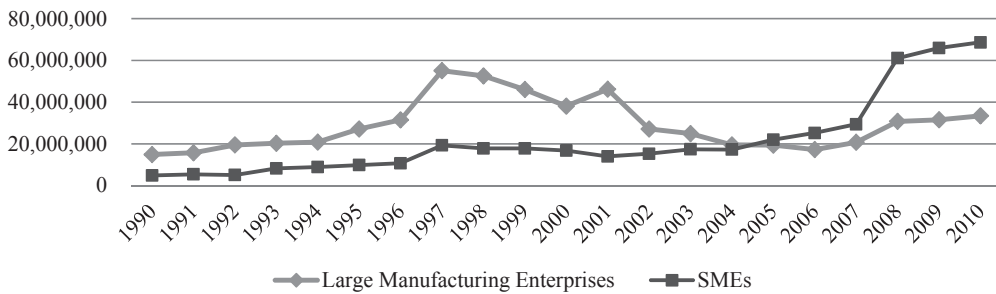
Sector	1998	2000	2003	2006	2009
Primary	19,619.10	21,640.00	17,312.30	14,462.20	15,053.40
Secondary	85,084.30	105,227.60	133,196.30	163,195.50	247,834.20
<i>Manufacturing</i>	69,200.60	87,801.10	105,590.70	127,470.80	196,556.70
Tertiary	40,063.90	74,991.50	133,995.60	175,550.30	281,113.60
In Percentage					
Sector	1998	2000	2003	2006	2009
Primary	13.55	10.72	6.09	4.09	2.77
Secondary	58.77	52.13	46.82	46.20	45.56
Manufacturing	47.80	43.50	37.11	36.09	36.13
Tertiary	27.67	37.15	47.10	49.70	51.68

Source: The Bank of Korea

The above table gives an indication about the change in the lending pattern of commercial banks in South Korea. Korean banks started to focus on lending to other sectors after the financial crisis by reducing their exposure to large firms in the manufacturing sector. According to Akama *et al.* (2003),

the financial restructuring program in South Korea brought dramatic transformation in the financing and corporate governance patterns of banks, which have reduced the lending to *chaebols* and increased the lending to households and SMEs, particularly in the service sector. Shin (2004) also reports sharp decline in indirect financing in South Korea after the financial crisis. The change in the government-*chaebol* relationship after the crisis also resulted into the decline in bank lending. Before the crisis the government favored the *chaebols*, whereas after the crisis only winners received all benefits expected from the government and losers received nothing (Lee, 1999; cited in Shim and Lee, 2008), i.e., *chaebols* seemingly received less benefit from the government after the crisis. According to Woo (1991) cited in Lee (2008), highly preferential treatment was offered to *chaebols* during the high growth period. On the other hand, Shim and Lee (2008) opine that negative public opinion and unfavorable economic situation created by the crisis led to an increasing government control with regard to *chaebols'* business. Figure 3 represents long term debt to banking institutions by large manufacturing firms and SMEs during the period 1990-2010. It reflects that in 1990 the long term debt to banking institutions by large manufacturing firms was 3.04 times higher than that by SMEs, whereas in 2010 SMEs surpass large firms with a 2.05 times higher long term debt. In response, *chaebols* have started to rely more on capital markets for financing and use stock, bonds, and commercial papers for fund raising (Akama *et al.* 2003).

Figure 3: Long Tem Debt to Banking Institutions by Large Manufacturing Enterprises and SMEs

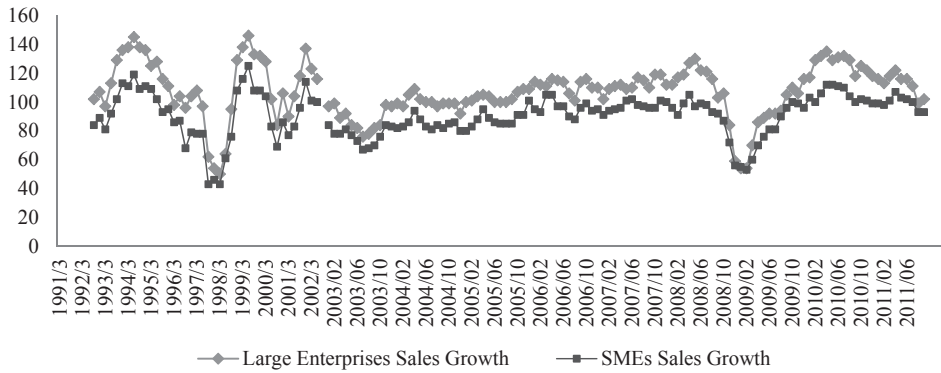


Source: The Bank of Korea

A salient feature of the breakdown of Korean household holdings, the same as that of Japanese ones, is that most holdings are "safety assets" such as currency and deposits, while the weight of "risk assets" such as shares, equities, and securities was small. According to Ko (2008), the weight of safety assets stayed at 61.9 per cent in 2001 and 60.3 per cent in 2003, respectively. This weight was higher than that held by the Japanese household sector. Presumably, Korean banks still need to transform the savings of risk-averse Korean households into long-term investments. However, Korean banks have been encouraged to reduce lending to the *chaebols* or the top 20 blue-chip companies which are still the major promoters of long-term investments, although large enterprises dominate the SMEs both before and after the financial crisis in terms of the monthly growths in sales, exports, production, and

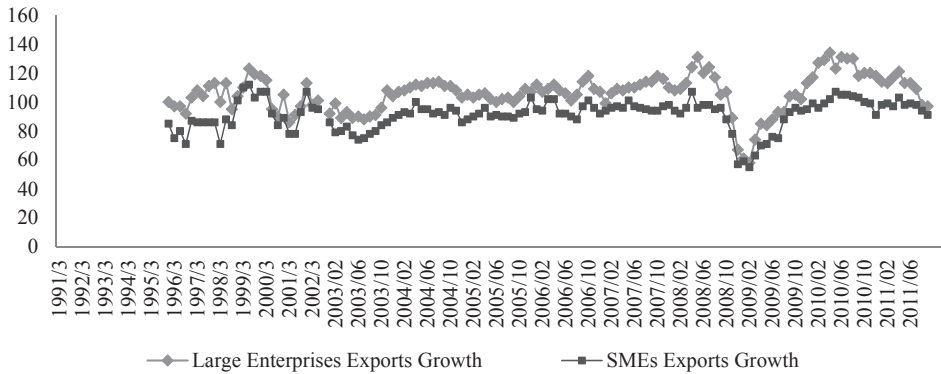
profitability; as it is depicted in figures 4, 5, 6, and 7.

Figure 4: Sales Growth of Large Enterprises and SMEs



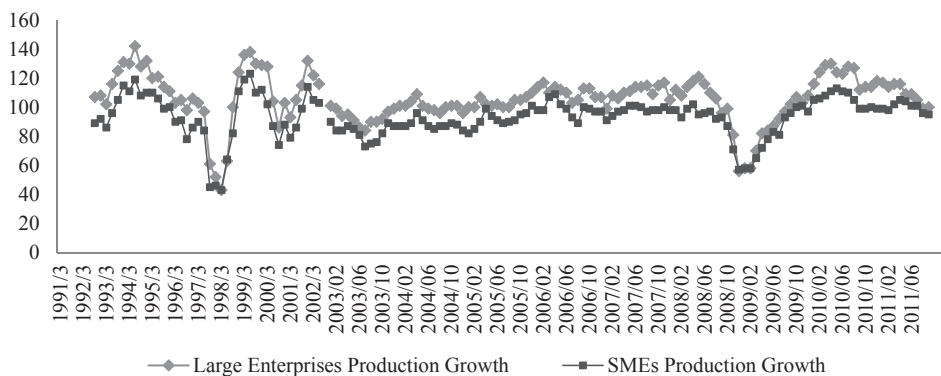
Source: The Bank of Korea

Figure 5: Exports Growth of Large Enterprises and SMEs



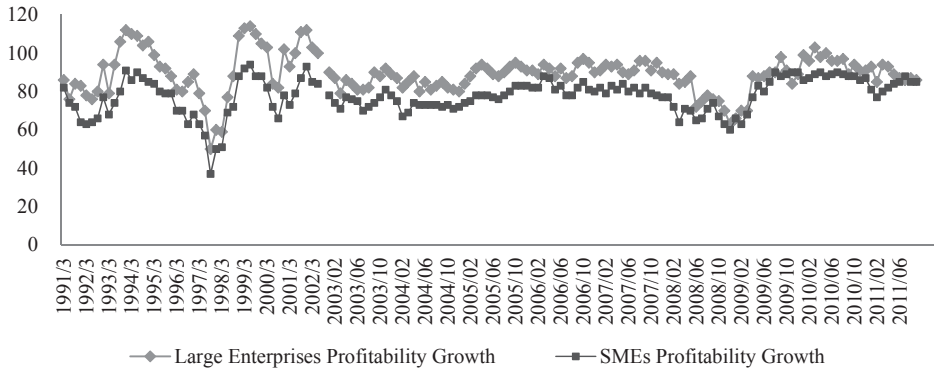
Source: The Bank of Korea

Figure 6: Production Growth of Large Enterprises and SMEs



Source: The Bank of Korea

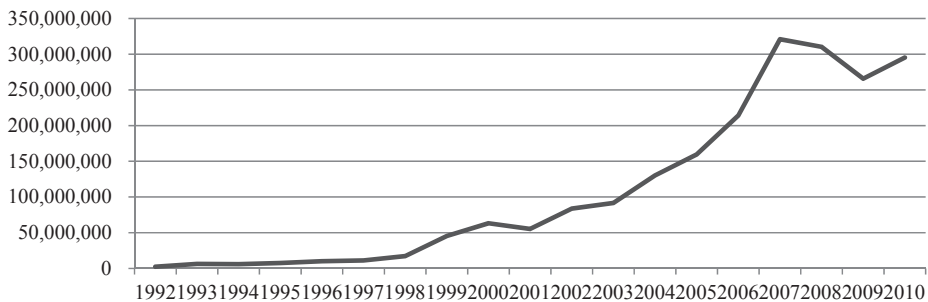
Figure 7: Profitability Growth of Large Enterprises and SMEs



Source: The Bank of Korea

The Korean Government responded to the 1997 crisis by injecting fiscal funds, equivalent to not less than 30 per cent of GDP, including capital injections, non-performing loan purchases, and depositor protections (Akama *et al.* 2003). The government also actively invited foreign capital to recapitalize banks and strengthen banks' performance (*ibid.*). Figure 8 represents the change in purchases of shares (in million Won) by foreign investors during the period 1992-2010. It reports that the shareholding is 123.83 times higher in 2010 compared to that of 1992. Thus, many Korean banks are probably still being closely monitored by the government or the foreign owners so that Korean banks may not concentrate their loan portfolio exposure to the particular *chaebols*, which concentrated portfolio might have caused the financial turmoil leading to the economic disaster.

Figure 8: Purchases of Shares by Foreigners during 1992-2010



Source: The Bank of Korea

So far, the *chaebols* or the top 20 blue-chips could tap on the corporate bond market to raise the necessary funds. Many foreign investors have shown an interest in investing in Korean blue chips (including Korean banks). However, we should note that, according to Ko (2008), the corporate bond market can afford to buy only the middle-term bonds issued by Korean firms with the final maturity of the range of 2 to 3 years at the maximum. To what extent can Korea continue to ask foreign investors

to take over the role of long-term intermediaries for channeling household savings into long-term investment in Korean economy? Even their middle-term commitment to solving the hidden structural problems in financial intermediation in South Korea cannot be relied on to any great extent.

5. Conclusion

South Korea and Japan have been considered as remarkable achievers of economic growth in the world in general and East Asian region in particular. The former has attained economic progress within a very short of period of time followed by a financial crisis and afterwards speedy recovery from the crisis. On the other hand, although Japan's development after the World War II was also outstanding indeed, its prolonged financial and economic stagnation started from the bursting of bubble and corresponding crisis is yet to be resolved. In line with this, this paper is undertaken to identify the reasons that contributed to South Korea's recovery by evaluating its industrial structure change and banks' response towards the change. It reveals that both Japan and South Korea have experienced a paradigm shift in their industrial structure by shifting the focus from primary to secondary industry and then to tertiary industry through their development process. However, the sharp contrast between these two countries is that the secondary industry, predominantly the manufacturing industry, still contributes a lot towards GDP in South Korea. This is possibly one of the fundamental reasons for the South Korean prompt recovery from the crisis. Seemingly, large manufacturing firms in South Korea still maintain a certain competitive edge in the international market even after the crisis, whereas in Japan manufacturing firms have already lost their traditional competitive edge leading to a higher focus in knowledge-based values added and an earlier response to a frontier economy paradigm shifted from the catching up period.

This paper also aims at producing some lessons for South Korea to ensure a sustainable economic growth by reviewing the collapse of the traditional monitoring system in Japan under the changing scenarios. The Japanese mode of screening and monitoring was effective during the high growth period when most of the manufacturing firms were successful and accordingly, became financially matured and started to rely less on banks. In return, banks increased the loan exposure to non-manufacturing firms and SMEs, which generally carries higher credit risks. The fundamental uncertainty brought by frontier economy and the change in loan portfolio selection of Japanese banks collectively resulted into a serious problem in financial intermediation causing an ongoing financial and economic stagnation. On the other hand, under a political pressure, South Korean banks were encouraged to decrease their lending to large manufacturing firms after the financial crisis in spite that large firms are still expected to play the role as the engine for Korean economic recovery. At this point in time, Korean large firms use capital markets for financing mainly from foreign investors. But how long large firms can rely on foreign investors is

really a difficult question to answer. Any financial turmoil in the capital market will make the situation even more difficult for the large firms in particular and the overall economy in general, since Korean banks still need to transform the savings of risk-averse Korean households into long-term investments by large firms. If Korean banks fail to play the role as prudent financial intermediaries at that moment, Korean economy may possibly fall into the same dilemma of financial intermediation which resulted in the Japanese economy being trapped into a deep and prolonged financial slump.

This paper does not focus on elaborate analysis of the changing pattern in the corporate financing strategies of large manufacturing firms in response to the restructuring process after financial crisis. Further investigation on this issue will provide a clear picture about the entire scenario. Moreover, the increasing credit risk associated with SME financing is an important issue to be dealt with through further research.

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注

- 1) *Chaebol* can be defined as large business group that run and owned by family and relatives and involved in diversified business field.

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