
How will the Economic Policies of South Korea's New Administration Influence Economic Relations with Japan?

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Summary

1. The presidential election held in South Korea in December 2012 was essentially a two-horse race between Park Geun-hye of the incumbent conservative Saenuri Party and Moon Jae-in from the progressive Democratic United Party, which was in opposition. A feature of the election that attracted intense interest was the fact that both candidates called for economic democratization and the enhancement of the welfare system because of their concern about the failure of the traditional pattern of growth led by the *chaebol* groups to contribute sufficiently to the improvement of living standards in South Korea.
2. Characteristics of the South Korean growth model that evolved during the first decade of the 21st century include global business expansion led by the *chaebol* groups, active government support for big business, and export-led growth. However, while exports have been a growth driver, there have also been issues, such as employment problems and job insecurity for young people, and widening income disparity. In addition, deregulatory measures carried out by the Lee Myung-bak administration have had the effect of concentrating economic power in the hands of the *chaebol*, while small and medium enterprises have come under pressure from the expanding business activities of the *chaebol*.
3. Mr. Moon stated that he wanted to resurrect the equity investment ceiling system, which was abolished by the Lee Myung-bak administration, and announced a policy calling for the dissolution of cyclical investments within three years. In contrast, Ms. Park limited her policy stance to the prohibition of new cyclical investments and announced her intention to achieve economic democratization by taking steps to protect shopping precincts and small businesses and ensure that major corporations deal fairly with small and medium businesses.
4. One of the reasons for the election victory that resulted in Ms. Park becoming the next president of South Korea was the fact that her policies were seen as more realistic. Given the South Korean public's expectations toward economic democratization, the Park administration will need to make rapid progress towards this goal while maintaining a balanced approach that also includes stimulatory measures and policies to address the declining birth rate and demographic aging.
5. The new administration needs to pursue economic democratization, but the development of and support for small and medium enterprises will also be a priority. If the next stratum of businesses below major corporations can be expanded, the benefits are likely to include (1) an easing of the job-seeking environment for young people, (2) an influx of skilled people into small and medium-sized businesses, leading to improvements in their technical capabilities, (3) the prevention of the concentration of economic power into the hands of the *chaebol*, and (4) a move away from excessive dependence on the *chaebol* for growth.
6. Statements by President Myung Lee-bak have led to deterioration in the relationship between Japan and South Korea. The inauguration of new administrations in both countries is expected to provide an opportunity to move towards the normalization of relations. The past few years have also brought new developments on the economic front, and it is possible that the relationship will become even closer. If the governments of Japan and South Korea can rediscover their countries' importance to each other as mutual economic partners, the economic relationship can be expected to move to the next level.

Introduction

South Korea's presidential election on December 19, 2012 attracted interest for two reasons. First, the election became essentially a two-person race between Park Geun-hye of the conservative ruling Saenuri Party and Moon Jae-in of the progressive opposition Democratic United Party. Second, both candidates called for "economic democratization" and the improvement of welfare, albeit through different policies, on the grounds that the traditional pattern of growth led by the Chaebol conglomerates had not contributed sufficiently to the improvement of living standards for the South Korean people. The intense interest in the election was reflected in a high voter turnout of 75.8%.

Ms. Park was elected and will be inaugurated on February 25, 2013 as South Korea's next president. Her victory can be attributed to three factors. First, she was able to consolidate the conservative vote by aligning two leading politicians, Lee Hoi-chang and Lee In-Jae with the Saenuri (New Frontier) Party. Second, while distancing herself from President Lee, she worked to change the image of the ruling party, which changed its name from the Hannara-dang (Grand National Party) in February 2012. Third, her stance toward the reform of the conglomerates and her policy toward North Korea were more realistic than those of Mr. Moon.

Public expectations toward the new president are high, but South Korea also faces many economic issues. Policy management is likely to be a difficult process for the next administration. On the economic front, the government will need to take a balanced approach to stimulatory measures, economic democratization, and policies relating to a falling birthrate and demographic aging.

Currently, a transitional committee chaired by Kim Yong-joon is gathering operational reports from government ministries and agencies and making preparations for the establishment of policy guidelines for the new administration.

In this article we will examine the economic policies that the Park administration is likely to implement and examine the outlook for economic relations between Japan and South Korea. In Part 1 we will examine South Korea's economic

growth record in terms of both achievements and problems. In Part 2 we will analyze the factors that have made economic democratization such a contentious issue. In Part 3 we will consider the economic policies that the Park administration is likely to follow. In Part 4 we will look at the outlook for economic relations between Japan and South Korea.

1. Pressure for Change in the South Korean Growth Model

(1) The South Korean Growth Model

The author has previously analyzed South Korea's achievements and problems in relation to economic globalization⁽¹⁾. Discussion of this aspect here will therefore be limited to the scope required for the following analysis.

Features of the economic growth pattern that has evolved in South Korea in the 21st century, which we will refer to as the "South Korean growth model," include (1) global business expansion by the *chaebol* business groups, (2) active government support for the *chaebol*, and (3) export-led growth. Factors linked to the accelerated globalization efforts of the *chaebol* groups include a sharp decline in domestic demand after the currency crisis, the prospect of shrinking domestic markets because of a plummeting birthrate and rapid demographic aging, and the creation of business opportunities through the sustained growth of the emerging economies. Government support for the globalization efforts of the *chaebol* groups has included cuts in the corporate tax rate and the maintenance of low power prices. The government has also worked actively to sign free trade agreements (FTAs). After the Lee Myung-bak administration took office in 2008, it cut the corporate tax rate from 25% to 22%, which is one of the lowest rates in any major country (Fig. 1).

South Korea has started to function as an FTA hub, as indicated by the fact that an FTA with the European Union (EU) became provisionally effective on July 1, 2011, and an FTA with the United

Fig. 1 Effective Corporate Tax Rates

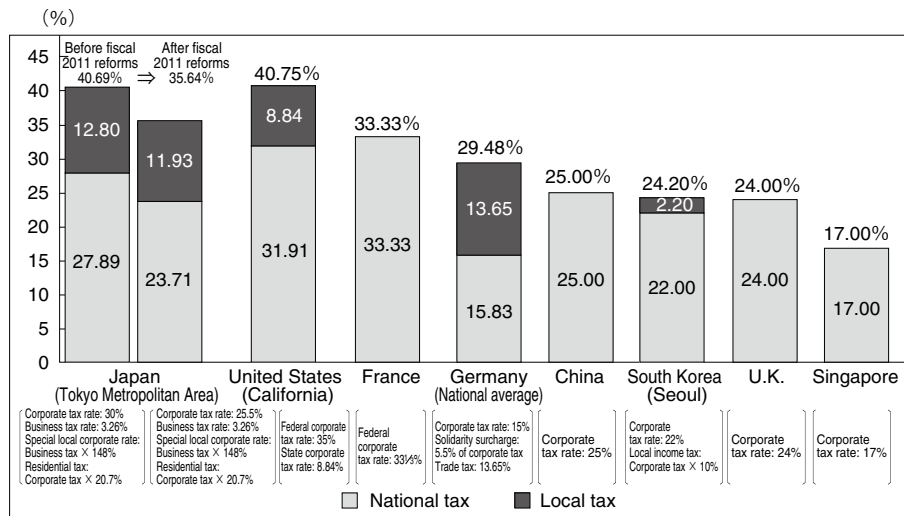


Table 1 South Korea's Moves to Establish FTAs

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Signed or agreed										
Chile		Effective April 1								
Singapore				Effective March 2						
EFTA				Effective Sept. 1						
ASEAN (goods)					Effective June 1					
ASEAN (services)							Effective May 1			
India								Effective Jan. 1		
EU									Provisionally effective July 1	
Peru									Effective Aug. 1	
U.S.A.										Effective March 15
Colombia										Agreed June 25
Turkey										Signed Aug. 1
Under negotiation										
Canada			Started in July							
Mexico				Started in Feb.						
Japan	Started in Dec.	Suspended since Nov.								
GCC						Started in July				
Australia							Started in May			
New Zealand							Started in June			
China										Started in May
Vietnam										Started in Aug.

Source: *Nippon no Keizai Renkei Kyotei (EPA) Kosho* [Japan's EPA Negotiations], Ministry of Foreign Affairs of Japan (October 2009), Ministry of Foreign Affairs and Trade, ROK, etc.

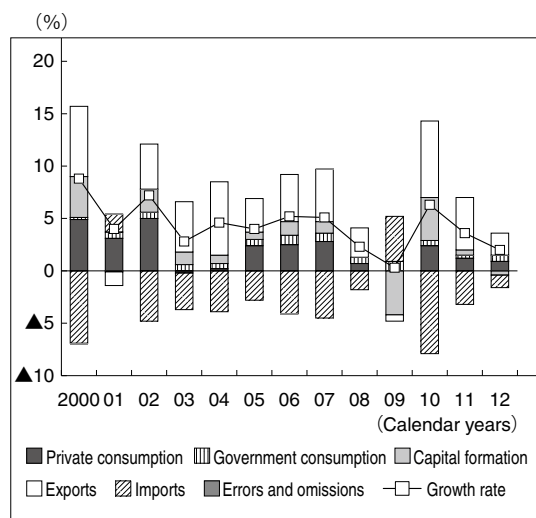
States took effect on March 15, 2012 (Table 1).

In recent years, Japan has taken a keen interest in the South Korean growth model, and there have been calls from various sectors for Japan to catch up with South Korea's lead in globalization and develop demand in new markets. This reflects the fact that while South Korean products have gained an increasing share of global markets, especially

emerging markets, the presence of Japanese companies has waned. Samsung Electronics and LG Electronics are now the leading sellers of flat-screen televisions, while the Hyundai Group is ranked fifth in terms of vehicles sold.

South Korean companies have benefited from stronger corporate fundamentals as a result of the restructuring that followed the currency crisis.

Fig. 2 Contributions of Demand Items to South Korea's Real GDP Growth Rate



Source: Bank of Korea, *Economic Statistics System*

Other positive factors include quality and design improvements, the development of products to meet local needs, the development of global human resources, rapid decision-making, and the low value of the won.

The effects of accelerating economic globalization include not only the emergence of exports as the main driver of growth (Fig. 2), but also economic development in regions with clusters of export industries, increased investment returns due to foreign direct investment, and the evolution of Pusan and Incheon International Airport as international hubs. The region with the highest per capita income is Ulsan Metropolitan Area, which has clusters of motor vehicle plants and shipyards, followed by Seoul Special City.

(2) Problems Since the 2000s

While economic globalization has produced benefits, the following problems also came to the fore in the first decade of the 21st century.

First, there is the fragility of an export-led growth pattern. As South Korea became more and more reliant on exports to drive its economic growth, it has also become extremely vulnerable to global economic slowdowns. South Korea is particularly exposed to economic trends in China,

which accounts for around 25% of its total exports. Export slowdowns, a downturn in capital investment and other factors caused the real GDP growth rate to fall from 0.9% in the January-March quarter of 2012 to 0.3% in the April-June quarter and 0.1% in the July-September quarter (quarter on quarter in all cases).

However, the export slowdown was in one sense an anticipated outcome of global economic deceleration. Like other countries with export-led economies, South Korea is fated to experience these trends.

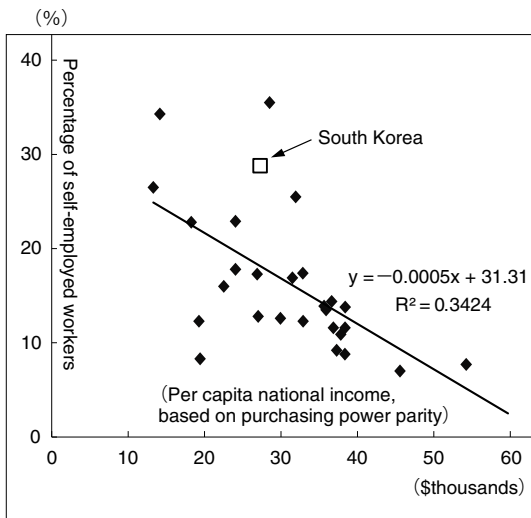
Second, progress toward the improvement of the employment and income environment has been slow. The growth rate of gross domestic income (GDI) has generally remained below the real GDP growth rate since the turn of the century, and in 2011 it increased by only 1.1% because of accelerating inflation and decelerating economic performance.

One of the reasons for slower income growth is a decline in the quality of jobs. The number of people in non-regular employment has risen over the past 10 years, while a growing number of people have moved from regular employment into self-employment. Major corporations have switched to ability-based systems since the currency crisis, with the result that it is not uncommon for workers to retire in their forties (including those who effectively dismissed under the “honorary severance” system). These early retirees frequently turn to self-employment as a way of earning a living.

South Korea has one of the highest percentages of self-employed workers of any member of the Organization for Economic Cooperation and Development (OECD) (Fig. 3). The cost of starting a new business is minimal, and the number of startups is therefore high. However, many of these businesses shut down within a few years because of fierce competition within business segments, the proliferation of mass-sales outlets over the past few years, and other factors. Because there is no unemployment insurance, these business failures can result in poverty, as will be discussed later in this article.

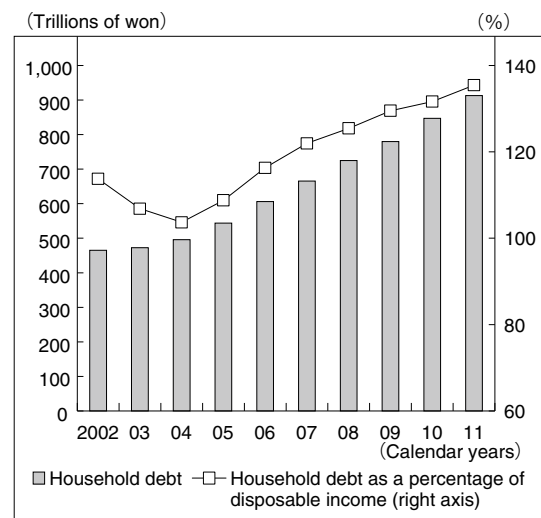
A key employment-related problem is the seri-

Fig. 3 Percentage of Self-Employed Workers



Source: OECD Statistics

Fig. 4 Ratio of Household Debt to Disposable Incomes



Notes: Disposal income includes self-employed workers.
Source: Bank of Korea, *Economic Statistics System*

ous job-seeking difficulties faced by young people. Only a small percentage, even among graduates of top universities, is able to find regular employment with major corporations. This is because major corporations limit the number of new graduates hired, preferring instead to recruit mid-career employees who can be put to work immediately. For this reason, an increasing number of people are abandoning the search for jobs and are instead attending schools to prepare themselves for the job market or public service examinations. There is also a growing population of people who have no occupations⁽²⁾. As of September 2012, 38.4% of people in the 20-29 age group were not participating in economic activities.

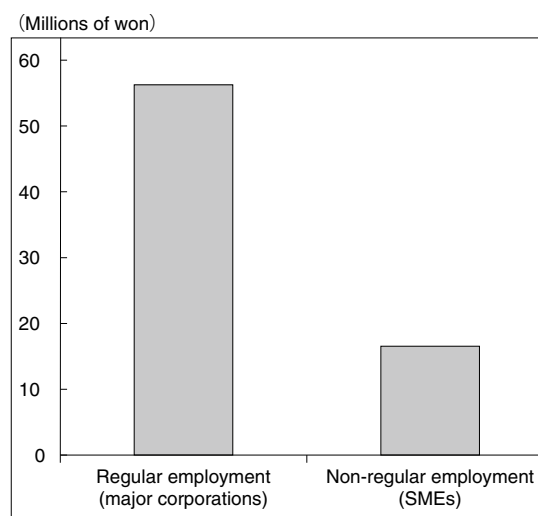
Third, household balance sheets are deteriorating. While incomes stagnate, households have been burdened with rising costs in such areas as social insurance charges, debt repayment and education. Household debt has become an especially serious issue in recent years (Fig. 4). The main reason for the increase in household debt was the housing boom, which drove an upward trend in housing loans. Apart from housing loans, household debt has also expanded because of increases in educational debt, borrowing to cover the living expenses of low- and medium-income households, and borrowing of business capital by self-employed people. Competition for places in better

universities and high-quality jobs has intensified. In addition, English skills have become extremely important as major corporations move toward globalization. For these reasons, more and more households are spending large amounts of money on courses in English schools or early overseas education for their children. South Korea's ratio of private educational expenditure to total household expenditure is the highest in the OECD. Education costs are a heavy burden for all but a small minority of wealthy households. These problems were reflected in promises made by Ms. Park during the presidential election campaign, including the establishment of a "National Happiness Fund" to ease household debt problems, and the halving of university fees.

Fourth, both disparity and poverty have expanded. On average, regular employees in major corporations earn 3.4 times more than those in non-regular employment in SMEs (Fig. 5). The determination of university graduates to find work with major corporations is understandable.

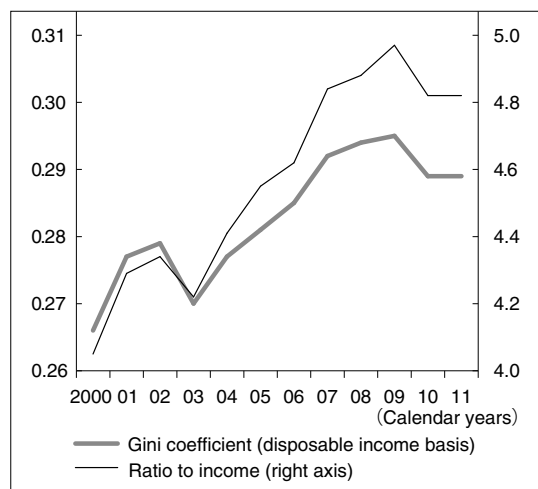
The view that the expansion of disparity occurred under the Lee Myung-bak administration is not entirely correct. The Gini Index for urban working households (based on disposable incomes, excluding single-person households) climbed from 0.266 in 2000 to 0.295 in 2009 but then showed moderate falls in two successive

Fig. 5 Average Yearly Incomes in 2011 (Manufacturing Sector)



Source: Ministry of Labor of South Korea

Fig. 6 Income Disparity (Urban working households, excluding single-person households)

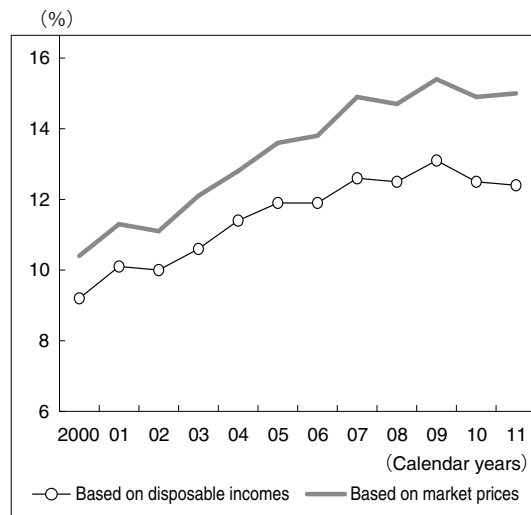


Notes 1: Gini coefficient based on disposable incomes
 Notes 2: Income ratios based on top 20% and bottom 20%
 Source: Statistics Korea, *Household Income & Expenditure Trends*

years. (As disparity increases, the index moves closer to 1.0.) A similar trend has occurred in the income ratio between the top 20% and bottom 20% of household. The reduction of disparity appears to have resulted from the share price slump and measures to help low-income households after the Lehman shocks (Fig. 6).

What is significant here is that disparity expanded in step with the accelerating trend toward

Fig. 7 Relative Poverty Ratio (Urban working households, excluding single-person households)



Source: Statistics Korea, *Korea Statistical Information Service*

economic globalization during the first decade of the 21st century. While this trend has occurred globally, in South Korea it has also been driven by such factors as the financial performance gap between the *chaebol* groups and SMEs, and the growth of non-regular employment. The *chaebol* groups have dramatically increased their sales in global markets, while most SMEs must sell their products in domestic markets and have faced chronic income stagnation. SMEs have also been prevented from sharing in the benefits of the *chaebol* groups' growth by their development of global procurement networks, and by their tendency to give preference to their group companies in their domestic dealings.

Even more serious than the expansion of disparity is the growth of poverty. The relative poverty ratio, which indicates the percentage of the total population earning less than 50% of the income distribution median (disposable income basis) rose from 9.2% in 2000 to 12.4% in 2011 (Fig. 7). Measures to assist low-income people after the Lehman shock caused the ratio to fall for two consecutive years from the 2009 level of 13.1%, but on a market price basis (before redistribution), the ratio rose between 2010 and 2011. Reasons for this increase in poverty appear to include the growth of non-regular employment, the impover-

ishment of self-employed people, and slow progress toward the development of welfare and pension systems. Poverty among the aged is an especially serious problem, as will be examined later in this article.

For these reasons, South Korea will need to find a new growth model to replace the old South Korean growth model.

2. Factors that Make Economic Democratization Essential

In this section we will look at developments relating to economic democratization, which became a focus of debate during the presidential election.

(1) Shift away from Policies Favoring Big Business under Lee Administration

After taking office in February 2008, the administration of President Lee Myung-bak initially stated that it would revitalize the economy by cutting taxes and easing regulations. The corporate tax rate for large corporations was reduced from 25% to 22% in 2008, with a further 2% cut planned for 2012. In 2009, the government also abolished the equity investment ceiling system, which was seen as a hindrance to the expansion of investment (Table 2). The equity investment ceiling system prohibited affiliated to *chaebol* groups with assets above a certain level from holding shares in other companies beyond a certain percentage of their net assets. During the recent pres-

idential election, Mr. Moon promised to reinstate this system.

Even taking into account the economic slowdown that followed the Lehman shock, deregulation brought little benefit in terms of investment expansion. In fact, the easing of restrictions had a number of effects that caused public perceptions of the *chaebol* groups to become even more negative, including the increased concentration of economic power in the hands of the *chaebol* groups, the crowding out of SMEs due to business expansion by the *chaebol* groups, and the discovery of various unlawful activities involving the *chaebol*.

Another factor that prompted the Lee administration to move away from policies favoring big business was the defeat of ruling party candidates in elections. In November 2011, the Distribution Industry Development Act was amended to prohibit the opening of major retail outlets within 500 meters of existing markets. At the end of 2011, the government established the Commission on Shared Growth and began to create structures to ensure that profits would be shared between major corporations and SMEs. In the fall of 2011, the additional tax cut scheduled for 2012 was canceled.

In 2012, President Lee Myung-bak called on the *chaebol* groups to make a number of changes, including withdrawal from activities traditionally handled by SMEs⁽³⁾, and the creation of jobs through the reduction of work on days off (not covered by restrictions on working hours). The groups adopted stances that were in line with these government policies. For example, the Samsung Group promised to withdraw from the Hotel Silla, while the Hyundai Motor Group and the Lotte Group announced that they would pull out of the bakery business⁽⁴⁾. Several groups, including Lotte, Hyundai Heavy Industries, GS (a 2005 spin-off from the LG Group), Hanjin and Hanwha, also amended their practice of channeling orders into affiliated companies and increased their use of competitive bidding in the areas of advertising, systems integration, construction and logistics.

In the retail sector, the government expanded measures designed to limit the operations of major corporations (Table 3). The law was amended

Table 2 Changes in Equity Investment Ceiling System

December 1986	40% of net assets
December 1994	Reduced to 25%
February 1998	Abolished
December 1999	Reintroduced at 25%
March 2002	Applicability level: 5 trillion won
March 2005	Applicability level: 6 trillion won
April 2007	Applicability level: 10 trillion won, ceiling raised to 40%
March 2009	Abolished

Source: Korea Fair Trade Commission, *Annual Report 2011*

Table 3 Retail Sector Regulations Introduced in 2012

March	Compulsory closure of discount stores in certain regions on second and fourth Sundays of each month
April	Prohibition on establishment of new outlets within 500 meters of existing outlets by bakery franchise chains
July	Prohibition on establishment of new outlets within 800 meters and 1,500 meters respectively of existing outlets by fried chicken and pizza franchise chains
November	Korea Fair Trade Commission order prohibiting establishment of new outlets within 500 meters of existing outlets by coffee franchise chains (Caffe Bene, Hollys Coffee, Angel-in-us Coffee, Tom N Toms, a Twosome Place)
	Announcement on November 25 that Costco, which had previously ignored the regulation introduced in March, would close its Daegu and Seoul stores on the second and fourth Sundays of each month
December	Amendment to the Distribution Industry Development Act passed by the National Assembly, requiring discount stores and SSMs to be closed between midnight and 8am and on two days each month

Source: Compiled from media reports

to allow local authorities to impose restrictions on the operations of major discount stores (known as “marts”) and corporate super-supermarkets (SSMs). This resulted in the introduction of ordinances compelling certain types of retailers, such as large discount stores, to close on the second and fourth Sundays of each month in some locations, including administrative areas in Seoul. The first mart in South Korea, E-Mart, was opened by the Shinsegae Group, which was established in 1991 as a Samsung Group spin-off. Other major marts include the Lotte Group’s Lotte Mart and the Samsung Group’s Home Plus.

In addition, the Korea Fair Trade Commission introduced a series of measures prohibiting franchise chains, such as bakeries, coffee shops and pizza restaurants (excluding companies that own and operate their own outlets), from opening outlets within specified distances of existing outlets. These measures are designed to protect the livelihoods of the many retirees who have established franchise businesses. After much debate, the government decided in December 2012 to amend the Distribution Industry Development Act to require large discount stores and SSMs to close between midnight and 8 a.m., and to close on two Sundays each month⁽⁵⁾.

With the exception of people working for *chaebol* groups, the people of South Korea have received little direct benefit from the global expansion of the groups. In fact, the *chaebol* groups have become a threat to the very existence of SMEs by expanding their business activities and taking advantage of their dominant positions to force down prices. Another factor that is fanning anti-*chaebol* sentiment is the fact that some of the groups have been able to increase their sales by expanding exports at a time when business conditions are harsh because of the worsening domestic economic situation.

It was in this environment that the achievement of coexistence between the *chaebol* groups and SMEs became a major point of debate during the presidential election.

(2) Differences in the Economic Democratization Policies of Ms. Park and Mr. Moon

The concept of economic democratization may seem to have emerged suddenly, but in fact it is stipulated in the constitution⁽⁶⁾, which says in Article 119 Paragraph (2) that “the State may regulate and coordinate economic affairs in order to maintain the balanced growth and stability of the national economy, to ensure proper distribution of income, to prevent the domination of the market and the abuse of economic power, and to democratize the economy through harmony among the economic agents.”

Not only Mr. Moon of the Democratic United Party, but also Ms. Park promised to implement measures relating to economic democratization, including the protection of local shopping precincts and micro-enterprises, improved fairness in trading between major corporations and SMEs, the rigorous enforcement of the Monopoly Regulation and Fair Trade Act, and greater independence for the Korean Fair Trade Commission. Where the policies of Mr. Moon and Ms. Park differ widely is in the way that they want to move South Korea away from a structure dominated by the *chaebol* groups (Table 4).

Mr. Moon promised that he would reinstate the equity investment ceiling system and dissolve

Table 4 Basic Policies of Ms. Park and Mr. Moon

	Mr. Moon	Ms. Park
◇Restrictions on <i>Chaebol</i> Equity investment ceiling Circular shareholding Governance	Reintroduction Dissolution within 3 years Scalpel to be taken to control structures	None Ban on new circular shareholding Ban on monopolies, rigorous enforcement of the Monopoly Regulation and Fair Trade Act
◇Other economic democratization measures	<ul style="list-style-type: none"> • Protection of SMEs and micro-enterprises • Halving of non-regular employment • Reduction of working hours (also linked to job creation) • Improvement of welfare 	<ul style="list-style-type: none"> • Protection of SMEs and micro-enterprises • Coexistence between large corporation and SMEs, pressure on large corporation to trade fairly • Conversion of public sector non-regular jobs into regular jobs • Improvement of welfare
◇Job creation	<ul style="list-style-type: none"> • Promotion of entrepreneurial spirit • Support for 4,000 SMEs • Convergence of IT and manufacturing technology • Creation of 400,000 public service jobs over 5 years 	<ul style="list-style-type: none"> • Development of knowledge creation industries based on science and technology • Strengthening of service industries • Support for renewable/clean energy • Tax incentives for companies that contribute to job creation
◇Policies toward North Korea	<ul style="list-style-type: none"> • Summit talks in 2013 • Forward-looking stance on economic cooperation 	<ul style="list-style-type: none"> • Resumption of dialog, development of relationship based on trust
◇Policies toward Japan	<ul style="list-style-type: none"> • Future-oriented • No compromise on territorial and textbook issues • Pursuit of Japanese government's responsibility concerning "comfort women" problem 	<ul style="list-style-type: none"> • Japan an important friend • Establishment of EPA to take relationship to a higher level • No room for negotiation on Dokdo Island, call for Japanese government to rethink its stance on the "comfort women" problem

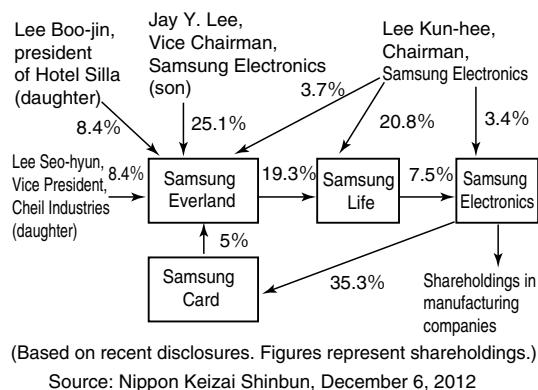
Source: Materials published by the Saenuri Party and the progressive Democratic United Party

circular shareholdings within three years. The equity investment ceiling system was introduced to prevent unbridled business expansion by major corporations. As noted above, however, the Lee administration abolished the system in 2009 on the grounds that it was curbing free economic activity and hindering the expansion of investment. Circular shareholdings allow the founding families of the *chaebol* groups to control their groups with minimal capital through linked equity investment across group companies. This situation is problematic for a number of reasons. From a corporate governance viewpoint, there are inadequate checks and balances to prevent autocratic management by owners. In addition, deterioration in the financial performance of one company can impact on the financial positions of other companies.

After the currency crisis, several *chaebol* groups, including LG and SK, dissolved their circular shareholdings and established holding companies⁽⁷⁾. Others, however, including Samsung, Hyundai Motor and Hanjin, have maintained cir-

cular shareholdings. In the case of the Samsung Group, for example, Samsung Everland, in which founding family members are the dominant shareholders, holds shares in Samsung Life, which is a shareholder in Samsung Electronics. Samsung Electronics is itself a shareholder in Samsung Card, and Samsung Card holds shares in Samsung Everland (Fig. 8). In 2005, Samsung Electronics Chairman Lee Kun-hee was charged with tax evasion and forced to resign the chairmanship temporarily after it was discovered that he had sold Everland convertible bonds to his son, Jay Y. Lee, at a discounted price. Mr. Moon wants to reform the *chaebol*-dominated economic structure by taking a scalpel to shareholding structures. However, it is questionable whether this approach would be practical. If the government unilaterally tightens restrictions on the *chaebol* groups, the relationship between the government and the business sector could deteriorate, and there could be a decline in domestic investment. A further downturn in investment would weaken the economy's capacity

**Fig. 8 Circular Shareholdings
(A Case Study of Samsung)**



now is how she will approach economic democratization.

3. Challenges for the New Administration, Future Economic Policies

In this section we will consider the challenges facing the new administration and its policy direction. The new administration is under pressure to move toward economic democratization, but it will need to take a balanced approach.

(1) Approaches to Economic Democratization

Immediately after winning the election, Ms. Park issued a message to the people of South Korea, stating that she would prevent people from falling through the cracks in society by ensuring that the benefits of economic growth would be shared. In view of public expectations toward economic democratization, the Park administration will need to take prompt action.

However, *chaebol* reform will not be a simple task because of the sheer size of the conglomerates. In 2011, the sales of the Samsung group were equivalent to 22% of South Korea's nominal GDP, while the combined sales of Samsung, Hyundai Motors, SK and LG contributed about 50%. The following factors are likely to play a key role in progress toward economic democratization.

First, cooperation with the business sector will be essential. Economic democratization does not mean "chaebol bashing." Ms. Park's stance is to acknowledge the role played by the *chaebol* groups in economic development, while also insisting that they meet their social responsibilities. The key question for the *chaebol* is whether they can establish management approaches based on partnership with the people of South Korea. If they fail to do this, public criticism of the *chaebol* could again intensify.

As soon as her administration takes office, the President is expected to announce measures to stamp out corruption among those wielding political power. She is also expected to announce a

to create jobs, leading to increased public dissatisfaction. However, if priority is given to economic recovery, resulting in a return to deregulation, the *chaebol* reform process would be delayed, and it would be necessary to start again from scratch.

In April Ms. Park indicated that she would support the reinstatement of the equity investment ceiling, but she later recanted. Her policy on circular shareholdings is to ban the creation of new links. Her reasons for toning down her position on *chaebol* reform appear to have included not only concern in the business sector that the economic democratization argument may have gone too far, but also difficulty of implementing reforms without the cooperation of the companies, and the fact that while most people saw the need for reform, they also desperately wanted improvement in the employment environment. At first glance, Ms. Park's stance may seem to be friendly toward the *chaebol*, but in fact she is demanding that the conglomerates stop abusing their power and fulfill their social responsibilities. At the same time, she has also pledged to sever the hand-in-glove relationship between political power and the *chaebol* by eradicating corruption among the president's close associates and family members, and reforming government agencies, including the Prosecution Service, the National Police Agency, the National Tax Service and the Financial Supervisory Service.

The public's verdict on economic democratization is not clear, but it appears that Ms. Park's policies were seen as more realistic. The question

number of steps relating to coexistence between the *chaebol* groups and SMEs, including a ban on *chaebol* participation in business areas that are suitable for SMEs, a shift to trading based on fair prices, and the placement of orders with non-group companies. The *chaebol* are also likely to be called upon to accept a share of social costs by increasing their regular employment levels and paying more toward social insurance costs. In addition, President Park is expected to seek the support of the *chaebol* groups for economic democratization policies, such as the sharing of profits with society. It is also possible that presidential decrees will be given legal force.

Second, President Park will need to maintain balance among policies with differing timeframes. South Korea currently faces short-term, medium-term and long-term economic challenges relating to stimulatory measures, economic democratization and measures to cope with a falling birthrate and demographic aging, and it cannot afford to give priority to economic democratization measures.

For example, if President Park were to implement all of the measures promised during the election, such as free childcare, the halving of university fees, a shift from non-regular to regular employment and the improvement of welfare, she would sacrifice fiscal soundness and put obstacles in the way of initiatives focusing on an aged society, as discussed later in this article. In addition, popular anger could erupt if the employment environment worsens because of government neglect of measures to stimulate the economy.

For these reasons, the Park administration will need to take the economic situation into account when implementing economic democratization measures. Stimulatory measures employed in the past include monetary easing, the partial relaxation of restrictions on real estate lending and tax cuts (mainly reductions in real estate acquisition taxes and special consumption tax rates for motor vehicles and major appliances). Household balance sheets will improve if lower interest rates reduce the interest burden, and if the resulting revitalization of the real estate market causes housing prices to rise. However, there is no room for

undue optimism.

A key issue will be how to deal with a burgeoning debt burden. One of Ms. Park's election promises was to establish "National Happiness Fund" to ease the burden of high interest rates and help delinquent debtors to restore their credit ratings. Other promises included the alleviation of the student loan burden. Specifically, the National Happiness Fund will buy overdue debts from financial institutions and allow applicants to restructure their debt through repayment over longer periods. Up to a limit of 10 million won per person, borrowers will be able to convert loans with interest rates over 20% to low-interest bank loans with rates of around 10%. This emphasis on measures targeting low- and medium-income people can be seen as contributing to economic democratization in a broader sense.

Third, economic democratization measures will need to be paralleled by SME development measures. In addition to a shift away from a *chaebol*-dominated economic structure through economic democratization, another priority will be the development of and support for businesses at the next level below major corporations. President Park's priorities are apparent from the fact that after her election she visited the Korea Federation of Small and Medium Business before the Federation of Korean Industries, which is organization for owners of major corporations, and also from the fact that she appointed Mr. Lee Hyun-jae, who was administrator of the Small & Medium Business Administration under the Roh Moo-Hyun administration, to the transitional committee as member of the second subcommittee for economic affairs. We will look next at the significance of SME development, including its relevance to the problems of a falling birthrate and demographic aging.

(2) Urgent Steps Needed to Cope with an Aged Society

From a longer-term perspective, too, South Korea has reached a social and economic turning point. The rapid trends toward birthrate decline and demographic aging have created a need for

measures to achieve growth while preparing for an aged society⁽⁸⁾.

South Korea's total fertility rate fell from 1.71 in 1991 to 1.47 in 2000. In 2001 it dropped to 1.30, which is below the Japanese level, and by 2005 it was 1.08 (1.23 in 2010). The reasons for this accelerating decline in the birthrate since the turn of the century include a deteriorating income and employment environment, as described above, as well as rising educational costs and a social environment in which it is difficult to achieve a proper work-life balance.

Because of this accelerating fall in the birthrate, current predictions indicate that by 2017 the productive-age population (15-64) will start to shrink, and South Korea will make the transition to an aged society, in which 14% or more of the population is aged 65 or older (Fig. 9). The process of industrialization, which took many years in the advanced industrialized countries, was compressed in South Korea. The transition to an aged society is also being compressed.

One problem that is coming to the fore as South Korea becomes an aged society is poverty among aged people (retirees)⁽⁹⁾. South Korea's relative poverty ratio for aged people is the highest of any OECD member (Fig. 10). Reasons for this include short working lives due to early retirement, low

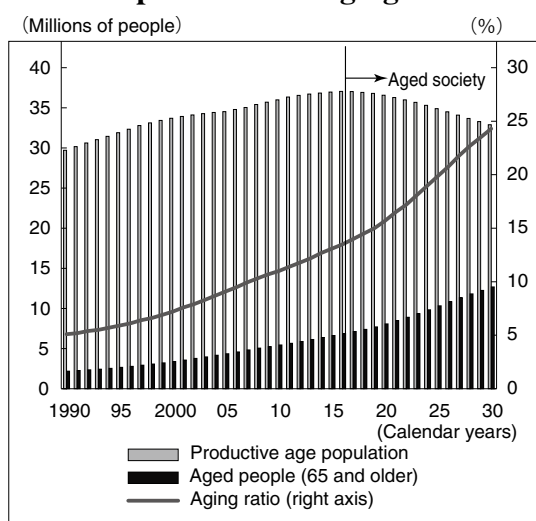
pension benefits, and failure to use government assistance schemes.

Apart from savings, continued employment and assistance from children and relatives, aged people subsist mainly on retirement benefits, national pensions and government benefit schemes for low-income people. In South Korea, support for aging parents was traditionally the role of the eldest son. However, family situations have changed dramatically in recent years because of factors that include the trend toward nuclear family living and the growing number of women in the work force. These changes have eroded the capacity of families to provide support for the aged⁽¹⁰⁾. The number of aged people living alone or as married couples is tending to increase. Unlike Japan, the percentage of aged people living with their children is lower in rural areas than in cities.

If aged people can no longer depend on support from their children, they have to rely on public pensions. Unfortunately these systems are not adequately developed in South Korea.

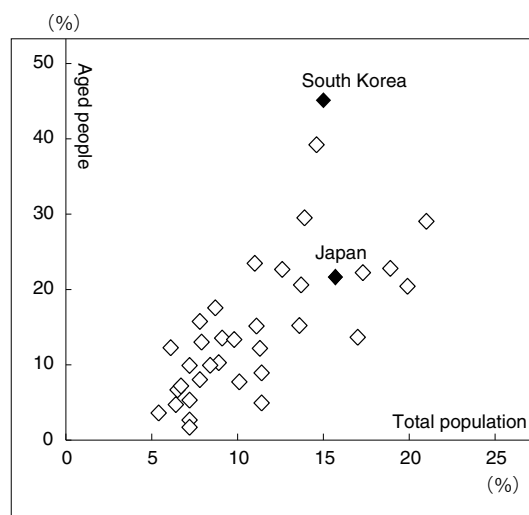
South Korea has introduced special-purpose pension schemes, including the government employee pension scheme in 1960, a pension scheme for military personnel in 1963, and a pension scheme for teachers and staff of private schools in 1975. However, it was not until 1988 that the government introduced a national pension scheme

Fig. 9 South Korea's Productive Age Population and Aging Ratio



Notes: Medium estimates
Source: Statistics Korea, Korea Statistical Information Service

Fig. 10 Relative Poverty Ratios of OECD Countries



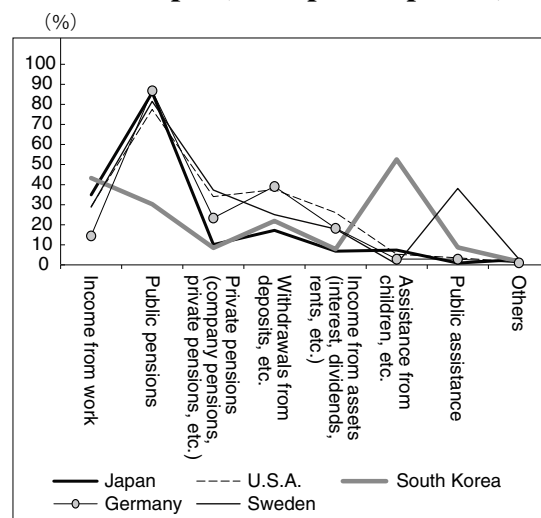
Source: OECD Statistics

covering all citizens aged 18 and older but under 60. Initially the scheme covered business establishments with 10 or more employees, but its scope was gradually expanded to include business establishments with five or more employees in 1992, people working in farming and fishing and self-employed people in farming and fishing communities in 1995, and self-employed people, micro-enterprise operators, casual workers and day laborers in urban areas in 1999. Premiums and benefits have been reviewed a number of times to reflect changes in the socioeconomic environment. At present the premium is 9%. The cost is split 50-50 between employers and employees in the case of people working business establishments, while those in other categories must pay the full amount themselves. The benefit rate is 40%. However, people must belong to the scheme for 40 years to receive the full benefit rate of 40%. The minimum membership period is 20 years, and at that stage the benefit rate is about one-half of the full rate.

The difficult situation faced by aged people in South Korea becomes apparent when we compare their income sources with those of aged people in other countries. The 7th International Comparison Survey Concerning Livelihoods and Attitudes of Elderly, which was conducted by the Prime Minister's Office in 2010, covered males and females aged 60 and over in Japan, the United States, South Korea, Germany and Sweden. The results showed that aged people in South Korea relied heavily on income from work and assistance from children, but that their reliance on public pensions was low (Fig. 11). Particularly significant is the fact that public pensions make up just 30.3% of incomes in South Korea, compared with 86.8% in Germany, 85.9% in Japan, 81.5% in Sweden and 77.5% in the United States.

When survey participants were asked if they were experiencing difficulties with day-to-day living, the percentage of negative responses in South Korea was extremely low at 11.2%, compared with 58.4% in Sweden, 55.5% in Japan and 38.4% in Germany.

Fig. 11 Income Sources of Aged People (Multiple Responses)



Source: Prime Minister's Office, 7th International Comparative Survey of Living Standards and Attitudes of Aged People

(3) The Importance of SME Development

To alleviate poverty among the aged, it is necessary to create an environment that facilitates employment for those willing to work, and to improve pension and welfare systems. Funding becomes an issue when governments try to improve pension and welfare systems⁽¹¹⁾. South Korea's consumption tax rate is already at 10%, and further increases would be difficult to implement, in part because of the risk of public anger. In the medium-term perspective, corporate income taxes could be raised back to the level before they were reduced under the Lee Myung-bak administration. A major increase would be difficult, however, because of the harsh business environment. Electricity charges are now being reviewed after being held down through government policy, and the undervalued won has started to move to a more normal level. To improve social insurance, it would be necessary for workers and employers to accept a "reasonable" share of the cost.

From this perspective, the best option would be to target sustainable growth while working to strengthen the taxation base. What is important in this context is to facilitate employment for young people by creating high-quality jobs, and

to achieve a transition from non-regular to regular employment. In this sense, South Korea's goal should be growth that generates high-quality employment.

Global expansion by large corporations has produced an employment pattern in which companies recruit talented people in South Korea and overseas for their core areas of activity, while employing large numbers of non-regular workers for their production operations. Young people are forced to compete fiercely from a young age for jobs with large corporations, but only a limited number ever achieve that goal. The remainder must either accept low incomes as non-regular workers, or remain in university or work skill training schools in the hope of future opportunities. Because many people remain in some form of study situation rather than taking up employment, there has been an increase in the number of young people who are not participating in economic activities. This situation is also reflected in a falling marriage rate and birthrate (Fig. 12).

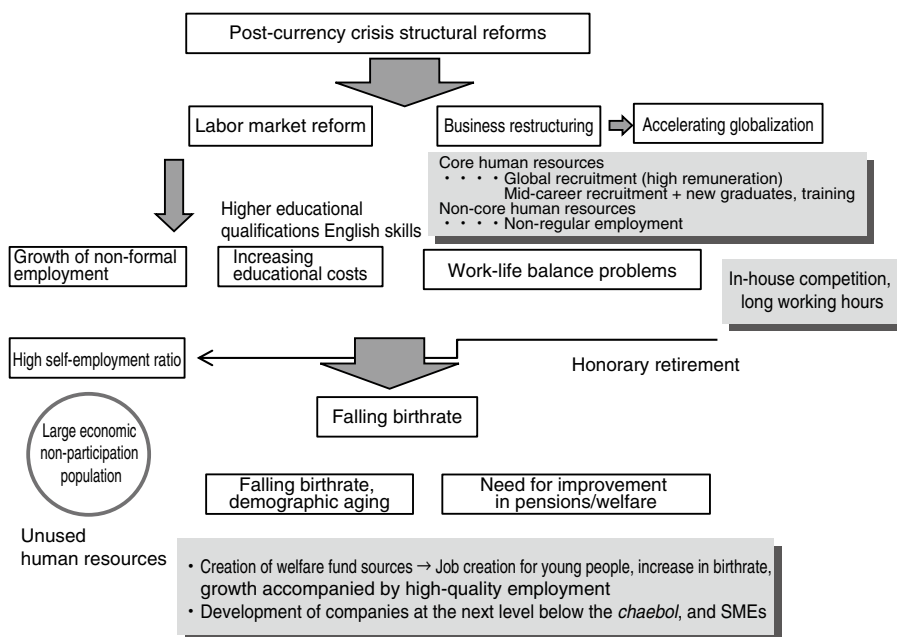
However, this situation also means that South Korea has a large pool of unutilized human resources. If this dormant resource can be mobilized to create new industries, South Korea would be

able to shift to a new growth path. Failure to do so will result in a low-growth era.

While South Korea has been able to develop large corporations, its progress toward the development of middle-ranked companies and SMEs has been slower. However, the fact that progress has been slow also means that there is room for growth. A number of benefits could be achieved by expanding the stratum of businesses at the level below major corporations. For example, it should be possible to alleviate the employment problems faced by young people, improve the technical capabilities of SMEs through an influx of skilled people, prevent the concentration of economic power in the hand of *chaebol* companies, and move away from a growth pattern that is excessively reliant on *chaebol* companies. A better employment environment for young people would also lead to a higher birthrate. To raise the birthrate, South Korea will also need to create an environment in which people can more readily achieve a good work-life balance.

While recognizing the importance of SME development, we also need to acknowledge the difficulty of this task. Because of the wide income and welfare gap between large corporations and

Fig. 12 Issues Affecting the South Korean Economy



Source: JRI

SMEs, skilled and talented people are not attracted to smaller companies. This situation prevents SMEs from improving their technical capabilities, preventing them from closing the gap with major corporations. As a result, they are unable to attract skilled and talented people. Breaking out of this vicious circle will be a major priority.

Because of the powerful influence of the *chaebol* groups, it will to some extent be necessary to restrict the participation of major corporations in business areas that are suitable for SMEs. However, mere protection could have the effect of preventing SMEs from innovating. The important thing is to develop SMEs with excellent technology and product development capabilities. Ms. Park intends to allocate a larger share of the budget for government-led research projects to SMEs.

Policies announced by Ms. Park in relation to job creation include the development of knowledge creation industries and new service industries, and support for green energy industries. These approaches are not especially novel and most have been implemented by the present administration. What is needed now is the organic linkage of these policies to SME development. For example, the construction of smart cities based on the use of renewable energy and IT would stimulate growth in various industries, including new logistics, next-generation vehicles, education and health and medicine. SMEs should be encouraged to participate in these areas as a way of providing further impetus for growth.

Support measures for SMEs are currently dispersed across multiple functional categories and industrial sectors. Ms. Park's transitional committee plans to build a more efficient support structure by realigning these policies and reviewing similar or duplicated projects.

The key question now is whether or not South Korea can build a new growth model capable of driving sustainable growth. SME development will clearly be one of the most important policy areas.

In the final section of this article, we will look at South Korea's economic relationship with Japan on the basis of the preceding analysis.

4. New Developments Anticipated in Economic Relationship with Japan

South Korea's relationship with Japan soured following a series of comments and actions by President Lee Myung-bak. However, the inauguration of new administrations in both countries is expected to lead to the normalization of relations and new developments in the economic relationship.

(1) Japan as a Vital Economic Partner

Many observers have commented that South Korea's economic relationship with China has strengthened over the past few years, while its relationship with Japan has weakened. The fact that South Korea initiated FTA negotiations with China ahead of Japan appears to support this view.

South Korea's reliance on exports to Japan fell from 11.9% in 2000 to 7.1% in 2011 (6.0% in 2010, before the earthquake), and its reliance on imports from Japan from 19.8% to 13.0% (15.1% in 2010) (Table 5). While these trends are also attributable to the expansion of relationships with emerging economies, they are indicative of a decline in Japan's importance to South Korea.

Economic relations between Japan and South

Table 5 Major Markets' Shares of South Korea's Exports and Imports

	Exports			Imports			(%)
	U.S.A.	Japan	China	U.S.A.	Japan	China	
1991	25.8	17.2	1.4	23.2	25.9	4.2	
96	16.7	12.2	8.8	22.2	20.9	5.7	
2000	21.8	11.9	10.7	18.2	19.8	8.0	
01	20.7	11.0	12.1	15.9	18.9	9.4	
02	20.2	9.3	14.6	15.1	19.6	11.4	
03	17.7	8.9	18.1	13.9	20.3	12.3	
04	16.9	8.5	19.6	12.8	20.6	13.2	
05	14.5	8.4	21.8	11.7	18.5	14.8	
06	13.3	8.2	21.3	10.9	16.8	15.7	
07	12.3	7.1	22.1	10.4	15.8	17.7	
08	11.0	6.7	21.7	8.8	14.0	17.7	
09	10.4	6.0	23.9	9.0	15.3	16.8	
10	10.7	6.0	25.1	9.5	15.1	16.8	
11	10.0	7.0	24.1	8.6	13.1	16.5	

Source: Bank of Korea, *Economic Statistics System*

Korea are likely to have been affected by the fact that the South Korean government no longer sees the establishment of an economic partnership agreement with Japan as a priority, and by the fact that President Lee Myung-bak crossed a certain line with his comments and actions. However, it would be a mistake to conclude that Japan is no longer very important to the South Korean economy.

First, while South Korea's reliance on imports from Japan has declined, it is still high. This is because core parts, high-quality materials and manufacturing equipment supplied by Japanese companies are essential to the production activities of South Korean companies.

Second, the downtrend in South Korea's reliance on exports to Japan bottomed out in 2010 and was followed by a shift to upward movement (Fig. 13). On the other hand, reliance on imports from China has declined due to the growing presence of other emerging countries, and reliance on exports to China is also expected to fall gradually.

The rise in reliance on exports to Japan is not a temporary phenomenon in the wake of the Great East Japan Earthquake. As discussed later in this article, there has been an increase in exports of motor vehicle parts, indicating that cross-border supply chains have been formed between Japan

and South Korea.

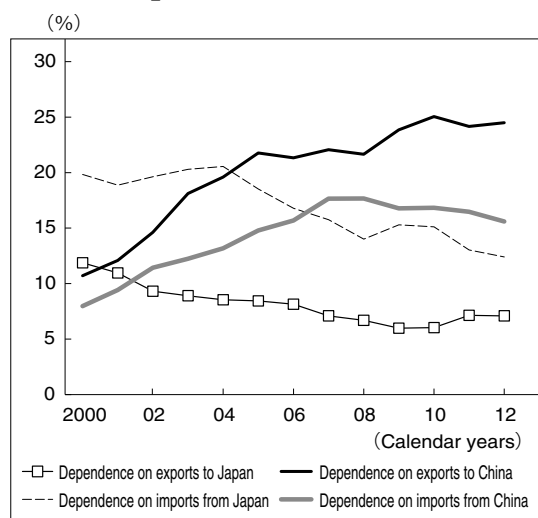
Third, investment from Japan is playing a key role in the development of an advanced industrial structure in South Korea. South Korea has worked to reduce its trade deficit with Japan by strengthening its manufacturers of parts and raw materials, which account for a large share of imports from Japan. In 2001, a special law was introduced concerning the development of companies specializing in parts and raw materials, and in 2005 the government designated 10 strategic parts and materials, including parts and materials for LCDs and organic EL devices. More recently industrial parks specializing mainly in parts and materials for the Japanese market have been established in a number of locations, including the cities of Gumi and Pohang in Gyeongsangbuk-do Province.

In addition, investment in South Korea has started to offer significant benefits to Japanese companies. As supply capacity expands, it is becoming possible to run local production operations profitably. Other advantages of local production include the ability to gather information from and communicate with customers, the facilitation of joint development, and the avoidance of exchange fluctuation risks. South Korea's attractiveness as a production base has been further enhanced by the South Korean government's enthusiasm for the signing of FTAs.

These factors are reflected in a growth trend in investment from Japan. Statistics compiled by the South Korean Ministry of Knowledge Economy show that investment (applications basis) increased by 98.4% year on year in 2012 (Fig. 14). Accounting for 27.9% of total foreign investment, Japan is the biggest investor in South Korea. There has been a steady increase in investment in the parts and raw materials industries, which are priority areas for the South Korean government⁽¹²⁾.

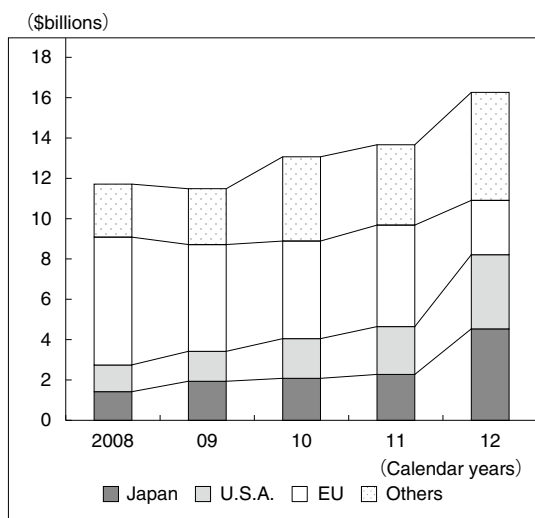
In view of this growth in investment from Japan, which is essential to the development of an advanced industrial structure in South Korea, the South Korean government has doubtless reached the conclusion that deteriorating inter-government relations must not be allowed to inflict fatal damage on the economic relationship. Although statements and actions by President Lee Myung-bak

Fig. 13 South Korea's Dependence on Exports to and Imports from Japan and China



Source: Bank of Korea, *Economic Statistics System*

Fig. 14 Foreign Direct Investment in South Korea (Application Basis)



Source: Ministry of Knowledge Economy

may have damaged inter-government relations, the impact on the economic relationship has been limited⁽¹³⁾.

Various conclusions have been drawn from the fact that the currency-swap agreement between Japan and South Korea lapsed at the end of October 2012. The Japanese government suggested that the decision not to extend the expanded swap agreement could be seen as a sanction, with the result that the decision has tended to be viewed in this light. A more likely reason is that there was a tacit agreement that since the risk of a collapse of the won has waned⁽¹⁴⁾, the two governments could save face and preserve their political stances by treating this as an economic issue.

South Korea has certainly not reviewed its relationship with Japan and decided to strengthen its ties with China. Evidence of this can be found in the resumption in November of meetings between ministers of finance, which had been suspended. The two ministers agreed that financial markets in both countries had remained stable, and that macroeconomic conditions were still sound, despite the expiration of the temporary expanded currency-swap agreement on October 31, 2012, as scheduled. Both ministers also noted that the temporary measure had limited the impact of global financial uncertainty on the South Korean and Jap-

anese economies, and that it had made a significant contribution to stability in both the South Korean foreign exchange market and regional financial markets. According to the Japanese Finance Ministry website, the ministers further agreed that economic developments in their respective countries and globally should be monitored closely, and that Japan and South Korea should continue to cooperate appropriately if necessary.

Interaction in the business community also plays a significant role in Japan-South Korea relations. The Japan-Korea Economic Association and the Korea-Japan Economic Association have maintained face-to-face contacts through their annual conferences for business leaders. These links have been strengthened most at times when government-level relations have become strained as a result of visits to Yasukuni Shrine by Japanese leaders, controversy over Japanese history textbooks, and other issues.

Ties could become even closer if the establishment of new administrations in both countries leads to the normalization of Japan-South Korea relations. Japan is likely to take steps to repair its relationship with South Korea for two reasons. First, the Abe administration places great importance on Japan's alliance with the United States, and President Obama is concerned about the faltering relationship between Japan and South Korea, which are both allies of the United States. Second, the strengthening of the relationship among Japan, the United States and South Korea is an essential part of Japan's foreign policy toward China. Evidence of Japan's commitment to the improvement of relations can be found in the decision to send a special envoy to meet President-Elect Park on January 4.

For South Korea, the improvement of relations with the United States and Japan is vital to its policy toward North Korea. South Korea also needs to cooperate with Japan in order to curb China's growing influence in East Asia. It is reasonable to assume that South Korea wants to work alongside Japan, for which democracy and market economics are fundamental principles, to play a leading role in rule-making and economic integration in Asia.

Japan-South Korea relations are also likely to become closer as a result of new economic trends. We will next look at these trends, using the motor vehicle industry as a case study.

(2) New Trends Manifested in the Motor Vehicle Industry

Trends in the motor vehicle industry point to the possibility of closer economic cooperation between Japan and South Korea. The trade in motor vehicle parts was characterized by substantial deficits on the South Korean side until the first half of the 1990s. In 2012, there was a decline in imports from Japan, coupled with a sharp increase in exports, with the result that the trade is now basically in balance (Fig. 15).

The South Korean government's determined efforts to sign FTAs appear to have played a major role in the decline in imports from Japan because of (1) the growth of imports from Europe and the United States after the removal of tariffs, and (2) the launch of American-made models onto the South Korean market by Japanese assemblers. Evidence for this can be found in the fact that while Japan's share of the total value of South Korea's imports of motor vehicle parts had been on a downward trend since the 1990s, this rapid de-

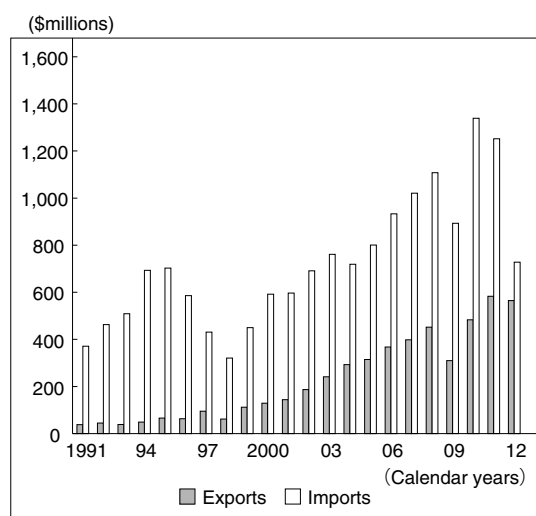
cline only occurred in the past two years (Fig. 16).

An analysis of trends in imports of motor vehicle parts over the past two years shows (1) that China overtook Japan to become the biggest source in 2012, (2) that the value of motor vehicle imports rose by 12.7% in 2011, accompanied by growth in imports from the United States and the EU, and (3) imports from some countries within the EU, notably Austria, Italy and Germany, showed particularly large increases.

While there are no detailed data concerning importers of parts from China, the total appears to include large quantities imported from South Korean companies operating in China. The increase in imports from Austria is explained by the establishment of several parts manufacturing plants by foreign companies, especially from Germany, as a result of the Austrian government's efforts to develop the motor vehicle industry through industry-academia collaboration and the formation of industry clusters.

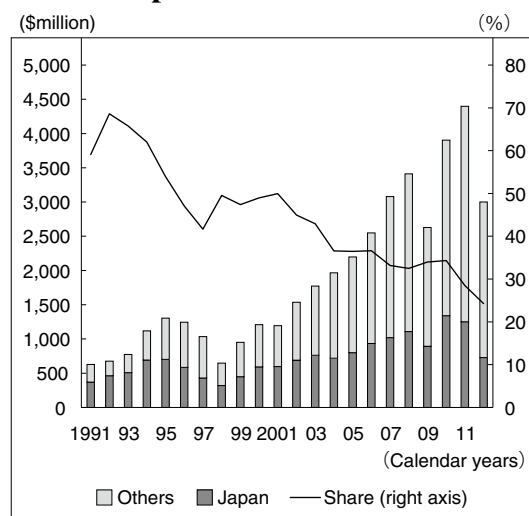
Another reason for the fall in imports of motor vehicle parts from Japan is the fact that Japanese motor vehicle assemblers have replaced some of the vehicles that were previously exported to South Korea from Japan with vehicles exported from the United States. (High-end models, such as the Lexus and Infiniti, are still exported from

Fig. 15 South Korea's Trade in Motor Vehicle Parts with Japan



Notes: 2012 up to October
Source: Korea International Trade Association data base

Fig. 16 South Korea's Imports of Motor Vehicle Parts and Japan's Share



Notes: 2012 up to October
Source: Korea International Trade Association data base

Japan.) This has led to a reduction in exports of maintenance parts from Japan.

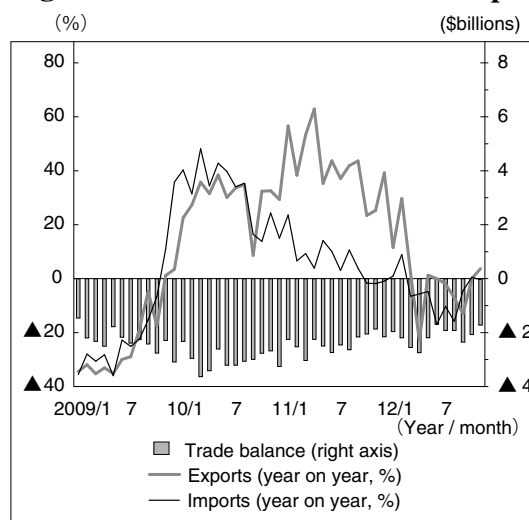
Since late 2011, more and more finished vehicles manufactured in the United States have been launched onto the South Korean market. This reflects the fact that the tariff on finished vehicles imported from the United States was reduced to 4% after the FTA between South Korea and the United States took effect and will be removed entirely in the fifth year, as well as the erosion of price competitiveness by an extremely high yen. Toyota began to export the American-made Sienna Minivans to South Korea in November 2011. In 2012 it introduced a new-model Camry, earlier models of which were exported from Japan, followed by the Venza (a sedan-SUV crossover) in November of that year. Honda exports four models, including a new-model Accord, from the United States, and a European-specified Civic from the United Kingdom. Nissan also plans to export its new-model Altima from the United States.

While imports of motor vehicle parts from Japan are declining, there has been a conspicuous increase in exports to Japan. This can be attributed to the aggressive development of the Japanese market by South Korean manufacturers of motor vehicle parts, and to the expansion of procurement in South Korea by Japanese assemblers.

In 2012, Hyundai Mobis reportedly won supply contracts worth a total of \$233 million (approximately ¥18.6 billion), including orders from Mitsubishi Motors for headlamps worth \$200 million (approximately ¥16 billion), and from Subaru for rear lamps worth \$33 million (approximately ¥2.6 billion).

As part of cost-cutting efforts, companies in Japan are also expanding their procurement of parts and materials manufactured in South Korea. This trend is especially evidence in the Renault-Nissan Group, to which Renault Samsung is affiliated. In value terms, parts manufactured in South Korea make up approximately 20% of Nissan Motor's new NV350 Caravan commercial vehicle, which Nissan Shatai Kyushu has started to produce. The parts are actually sourced from suppliers of Renault Samsung with plants in the area around Pusan.

Fig. 17 South Korea's Trade with Japan



Source: Bank of Korea, *Economic Statistics System*

Parts manufactured in South Korea are produced to a consistent quality standard, and in addition to their low prices, procurement in South Korea also results in lower logistics costs. Nissan Shatai Kyushu's plant in Kanda-machi, Fukuoka Prefecture is only about 200 kilometers from Pusan, which is less than the distance to the Kanto and Chubu regions in Japan. Under an agreement between the Japanese and South Korean governments in September 2011, it became possible to establish seamless logistics links between Japan and South Korea. These means that Japanese trailers can travel on South Korean roads and return to Japan by ferry to deliver parts to motor vehicle plants in Japan. This approach represents one vision for the future of Japan-South Korea relations.

Exports of motor vehicle parts from South Korea to Japan have thus expanded dramatically, and the trade in parts is now basically in balance. In addition, South Korea's overall trade deficit with Japan is also tending to shrink (Fig. 17).

South Korea's deficit in trade with Japan was a key issue during the now suspended negotiations over an economic partnership agreement (EPA) with Japan. The reduction of that deficit will have a positive effect on efforts to resume the negotiations.

(3) Expectations of Improvement in Relationship

The governments of Japan and South Korea need to renew their awareness of the fact that each country is an important economic partner for the other so that the economic relationship can be taken to a higher level. An EPA between Japan and South Korea would result in closer economic ties between the two countries, and it is hoped that government-level negotiations, which are currently suspended, will be resumed⁽¹⁵⁾.

Clearly it would be easier for Japan to make progress toward an EPA with South Korea than the Trans-Pacific Partnership (TPP). This is apparent from the fact that rice has been excluded from all FTA's signed by South Korea so far, and from the fact that the deadlines for the removal of tariffs have been set at 10 years for tomatoes, cucumbers and pork and other items under the FTA with Chile, which took effect in 2004, at 15 years for beef under the FTA with the United States, and at 10 years for pork under the FTA with the EU. For these reasons, we can assume that Japan will be able to approach EPA negotiations with South Korea flexibly, taking domestic factors into account.

South Korea would probably be more willing to resume negotiations if its access to Japan's farm and marine product markets could be improved. In the past South Korea viewed imports of industrial goods from Japan with a strong sense of caution, but these concerns have faded in recent times. This is because the relative positions of the two countries in relation to exports of electrical appliances has been reversed, while motor vehicles exported from the United States have partially replaced exports from Japan.

On this basis, the wisest course for Japan would be to take the initiative by offering South Korea improved access to its farm and marine product markets as a way of opening a path to the resumption of government-level negotiations. A closer relationship between Japan and South Korea is also essential to efforts to achieve regional integration and stability in Asia.

Conclusions

South Korea's president elect, Park Geun-hye, will take office on February 25, 2013. The new Park administration is expected to enforce a policy of economic democratization in an attempt to move away from an excessive dependence on *chaebol* (conglomerates).

In terms of external economic relationships, China has become the largest trading partner for both Japan and South Korea, but as discussed earlier in this article, Japan is still an important economic partner for South Korea, and vice versa. Economic relations between Japan and South Korea are expected to become closer if an economic partnership agreement (EPA) is signed. There are many areas in which Japan could contribute to the development of small and medium businesses, which is a priority for South Korea.

While China's emergence has provided many economic opportunities for East Asian countries, Pacific Rim countries are nervous about China's growing international influence in both military and economic terms. In this sense, Japan and South Korea, which both view democracy and a market economy as fundamental principles, have much to gain by working together to build a stable regional order. There is plenty of scope for political dynamics to strengthen the relationship between Japan and South Korea.

For these reasons, 2013 could be a year in which the relationship between Japan and South Korea will expand to a new level.

End Notes

1. See Mukoyama, H. [2010] and [2012b] for an analysis of this aspect.
2. According to the Korean Educational Development Institute, the number of students on leaves of absence from universities has reached 930,000 (as of April 1, 2012). Students are interrupting their university studies mainly to take courses in language schools, to prepare for public service examinations, or to earn money to pay tuition fees. The *Chosun Ilbo* featured interesting articles on the situation of these people between January 8 and 11, 2013.
3. In essence, the Commission on Shared Growth revived a system under which certain areas of business were legally reserved for SMEs. For example, the Commission has designated product categories that are suitable for SMEs, and product areas from which major corporations should withdraw.
4. Another focus of criticism was the fact that the bakery business was delegated to third-generation members of the founding families, including the granddaughter of Samsung Chairman Lee Kun-hee (the son of the founder), the daughter of Hyundai Chairman Chung Mong-Koo (the son of the founder) and the granddaughter of Lotte founder and Chairman Shin Kyuk-ho.
5. Any moves to tighten domestic regulations could cause the chain to accelerate the opening of overseas outlets. Both E-Mart and Lotte-Mart have expanded their chains in China and plan to open more outlets in Southeast Asia. (For details, see *The Korea Times*, January 7, 2013.)
6. Interestingly, the “economic democratization” concept emerged from a conservative party. The present constitution was adopted after the 1987 Democratization Declaration and Article 119 Clause 2 is also known as the Kim Jong-in clause. At the time, Mr. Kim (Saenuri Party) was chairman of the economic subcommittee of a special constitutional reform committee.
7. See Ko, Y. [2003] for an analysis of this aspect.
8. South Korea is concerned that the decline in its productive-age population and falling real estate prices will push it into a prolonged period of stagnation similar to that experienced by Japan. *The Korea Times* carried a special feature on the risk of “Japanization” in its January 8, 2013 edition.
9. According to Kim Sung-won [2011], KBS broadcast a program called “Twilight Poverty—The Elderly Who Pick up Garbage” in February 2011.
10. See Kim Sung-won [2011] and Kim, Hyang-nam [2011] for a discussion of the living standards of the aged.
11. On December 28, 2012, the threshold for the 38% top tax rate on financial income (interest and dividends) was lowered from 40 million won to 20 million.
12. See Mukoyama, H. [2012a] for an analysis of recent developments in Japan and South Korea’s economic relationship and Japan’s stance on investment in South Korea.
13. The number of Japanese visitors to South Korea in October and November declined by over 20% year on year, though current reports indicate that there has been a recovery trend since the presidential election.
14. In fact, the won shifted to an upward trend in the fall of the same year, in part because of inflows of money resulting from progress toward the stabilization of Europe’s debt problems, and the third round of quantitative monetary easing in the United States. See Mukoyama, H. [2009] for an analysis of the reasons for the won’s sharp fall after the Lehman Shock and the expansion of the swap agreement between Japan and South Korea.
15. These negotiations began in December 2003, and were suspended in November of the following year. This may have been partly a consequence of the official visit made by then Prime Minister Koizumi to Yasukuni Shrine, though the main reason was probably the refusal of the Japanese government to open up the farm and marine produce market.

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