

In the medium-term, investments in domestic research and development and in skills-upgrading will help in diversifying away from those industries where Korea no longer has a labour-cost advantage. The appreciation of the yen may enable Korea to increase its exports and market share in such important geographic markets as the U.S. and Europe. In particular, this development is likely to help establish two major product lines for Korea, namely, automobiles and electronic products.

The particular combination of domestic policies and external developments that exists at present leads to considerable optimism regarding Korea's medium term prospects. The external environment presently features positive configurations of oil prices, interest rates and exchange rates. Should these continue through the medium run, they will assist Korea in expanding exports and sustaining a reasonable surplus on the current account, thereby raising the growth rate while simultaneously reducing reliance on external debt. The domestic policy environment features trade, financial and industrial policy initiatives that should reduce distortions and make the economy more productive, efficient and flexible. Should these incentives be sustained, the prospects for growth and stability will become all the brighter.

4.2 Monetary and Fiscal Policies

The government, through the central bank and by directly owning or controlling (through equity participation) nearly all the financial institutions, has exerted enormous influence in determining interest rates, underwriting private loans from abroad, and channelling resources to private activities and firms - South Korea's first step in export expansion was greatly encouraged by the government's new foreign exchange rate policy (adopted in 1964), whereby the currency was devalued by about 50 per cent (from 130 to 255 won per US dollar) and a unitary floating rate system was introduced.

Technically, the monetary policy resides in the Bank of Korea (BOK) as the country's central bank, but the real source of policy power has remained in the Ministry of Finance. The bank's monetary board, for instance, is chaired by the Minister of Finance. The board is empowered to set the maximum interest rate on each type of loan and deposit of banks, as well as the discount rate of the BOK. At present, the maximum interest rates of deposits are set by the board, but those for loans are determined freely by individual banks within BOK guidelines. Owing to the persistent excess demand for funds, however, the maximum interest rates have tended to be, in practice, considerably below the prevailing market rates, causing the actual rates on loans and deposits to be set at the maximum rates. A series of measures, aimed at decentralizing monetary control, have been introduced since the early 1980's, including the government divestiture of most of its holdings in banks. In 1982 direct credit control through the credit ceiling for individual banks