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THE U.S.-ROK BILATERAL ECONOMIC RELATIONSHIP: THE 2008 CRISIS AND BEYOND

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I. INTRODUCTION

South Korea acutely felt the pain of the 2008 financial crisis, facing steep drops in the value of their KOPSI equity market and a full-scale run on the won. To combat this panic, the Federal Reserve Bank of the United States ("the Fed") agreed to create a $30 billion emergency lending facility via a currency swap agreement with South Korea. After the announcement of this swap and a fractional drawdown on this credit line, South Korean equity markets and currency stabilized, net capital inflows resumed, and investor confidence returned to the South Korean economy.

This paper answers two distinct questions. First, what role did the United States play in combating the financial market panic in the ROK throughout 2008? Second, did restored confidence in the South Korean economy after the swap reflect restored material fundamentals of the South Korean national liquidity position, or did the announcement of the swap constitute the creation of a new social equilibrium in which the South Korean won stabilized?

Answering the former question is crucial in understanding the nature of bilateral U.S.-ROK relations over the past twelve months. The latter issue contains myriad implications for the bilateral U.S.-ROK relationship going forward, in addition to several methodological implications for the broader discipline of political economy.

Ultimately, this study shows that a materialist understanding of the international financial system fails to causally account for restored confidence in the South Korean economy during the financial panic of 2008. Ideational interpretations, namely through the constructivist political economy approach of Blyth, Matthijs, McNamara, Abelal, and others, account for the marked improvement

in the health of the South Korean financial markets. Factors such as investor confidence, perceptions, and narratives—deemed materially inconsequential and exogenous to models of international capital movements—must be treated as endogenous causal factors of economic stability, as the South Korean case illustrates.

In order to analyze the way in which Korea's financial market restored its stability, this article first reviews the lessons learned from the Asian Financial Crisis of 1997 because the experience served as an immediate historical context within which the Korean market reacted to the volatility of 2008. Second, it examines market fluctuations since the crisis, arguing that the mere announcement of the currency swap helped stabilize the South Korean economy. Finally, the article concludes with consideration of the implications of this finding for the broader project of South Korean macroeconomic management in the next year and beyond.

II. LEGACIES OF THE ASIAN FINANCIAL CRISIS: LESSONS LEARNED

To understand the material composition of the South Korean economy in the run-up to and aftermath of the 2008 crisis, it is important to understand the historical context of the South Korean experience given the memory of the 1997 Asian Financial Crisis.

America has historically served an instrumental role in aiding the development of South Korea. The global economy has born witness to several episodes of global system-wide financial panic, first in the Asian Financial Crisis of 1997 and most recently during the wholesale panic of the global financial system during 2008. In both circumstances, during these crises South Korea turned to the United States and the IMF for help.

The roots of South Korea's vulnerability to financial crises grew from Korea's exposure to short-term, or "hot" international financial flows. As described by economist Joseph Stiglitz in *Globalization and its Discontents*, both the International Monetary Fund (IMF) and the Department of the Treasury urged rapid-pace capital market liberalization for South Korea in 1993. By espousing the ideological predisposition of *carte blanche* market fundamentalism that stemmed from what economist John Williamson called the "Washington Consensus," both the IMF and Treasury advised countries such as South Korea

to allow their firms to borrow from abroad. Despite initial skepticism, Western reformers prevailed in convincing the South Koreans that the benefits of open capital markets outweighed the risks associated with international borrowing.

As South Korea would later experience firsthand, this market openness is a double-edged sword. During times of buoyant liquidity and economic optimism, foreign lenders gladly lend abroad, as high foreign yields attract new capital. But during periods of perceived weakness, fickle foreign lenders withdraw credit lines, leaving domestic financial institutions without the means to roll over their liabilities. Note that these periods of speculative financial market weakness can occur without real economic stimuli. Rumors of insolvency can be self-fulfilling or recursive, as foreign lenders withdraw credit lines en masse, leading to panic and financial collapse.

Stiglitz states this pro-cyclical nature of capital flows thus: "[C]apital flows out of a country in a recession, precisely when the country needs it most, and flows in during a boom, exacerbating inflationary pressures. … [J]ust at the time [when] the countries need outside funds, the bankers ask for their money back."

This, in short, describes South Korea's experience during the Asian Financial Crisis. Although originally constraining investment, South Korea lifted controls on foreign borrowing for firms. This development, coupled with lax domestic regulation, led to the creation of a complex system of merchant banking. These lenders lacked the prudence and financial incentives for self-regulation, thus lending freely via speculation and improper due diligence for loan approvals. Poor exchange-rate management led to an overvaluation of the South Korean won. The current account surplus of $0.4 billion in 1993 became a deficit of $23.7 billion in 1996, approximately 5 percent of South Korean GDP.

Imprudent lending on behalf of South Korean industrial conglomerates, or *chaebol*s, depleted the capital bases of their lending banks. As defaults mounted, foreign investors sold their won-denominated assets. Thus continued the downward spiral of a depreciating currency, rising real liability values, and continued macroeconomic instability. In response to this panic, the South Korean Central Bank tried in vain to stem the flight from the won, depleting their foreign reserves to prop up the value of their currency. Alas, this did not stem the tide. At the height of the crisis, short-term external debt as a percentage of foreign exchange reserves exceeded 700 percent. Total foreign debt as a percentage of foreign exchange reserves totaled approximately 2000 percent. These staggering liabilities dwarfed the South Korean monetary response,

forcing South Korea to devalue their currency, default on myriad liabilities, and seek an IMF-sponsored bailout.

To the South Koreans, the lessons learned were simple: unrealistically overvalued currencies, financial imbalances, and structural weakness made them vulnerable to crisis. Insufficient foreign exchange reserves and monetary excess left them bereft of the tools necessary to stage an intervention in the currency markets to stabilize their currency. Correcting these material factors would help them avoid the destruction inherent to financial market panic per their experience of the Asian Financial Crisis.

III. THE 2000s: A QUICK REBOUND AND LESSONS LEARNED?

With the memories of the Asian Financial Crisis fresh and the impetus for reform high, the South Koreans responded to their financial crisis by better regulating their lenders, building a veritable war chest of foreign exchange reserves, and decreasing their reliance on foreign debt. This stark contrast is illustrated in table 1.

Table 1. ROK: Material Changes of Financial Market Reform

Foreign Reserves, Banking & Corporate Sector Stability: 2008 v. Asian Financial Crisis		2008	Asian Financial Crisis (1997)
Foreign Exchange	Foreign Currency Reserves	$212.3B	$8.9B
	Short-Term External Debt / FX Reserves	68%	717%
	Total External Debt / FX Reserves	173%	1,957%
Banking Sector	Bank Non-Performing Loan Ratio	0.7%	6.0%
	BIS Ratio	11.6%	7.0%
Corporate Sector	Debt to Equity Ratio	106.5%	424.6%
	Interest Coverage Ratio	404.8%	115.0%

By all traditional measures, at the start of 2008, the South Korean economy was insulated from foreign external shock. Current account deficits, imprudent domestic lending, excessive borrowing from abroad, and an overvalued currency could be fixed, the South Koreans believed, by building up a large currency reserve base. By buying dollars with their won, they prevented the won from appreciating against the dollar while building up large stockpiles of foreign exchange reserves to fight speculative panic akin to that of the Asian crisis. Edward Sullivan of the Institute for International Economics (IIE) deemed this process “self-insurance” against future crises. Indeed, South Korea’s foreign exchange insurance policy led it to build up foreign exchange reserves equal to

25 percent of its GDP, which made it the fifth-largest foreign exchange holder worldwide.

In contrast to its large deficits during the 1997 Asian Financial Crisis, South Korea ran large current account surpluses from 2004 to 2007, totaling $54 billion. Surely their economic authorities were surprised at by the speed at which this veneer of economic security evaporated during the global crisis of 2008.

IV. THE 2008 CRISIS AND THE AMERICAN RESPONSE

Problems with the U.S. economy emerged in 2007 with the default of several large mortgage originators. The preceding period of expansionary fiscal and monetary policy, rising asset prices, increased leverage across the U.S. economy, American household dis-savings, and a global liquidity glut laid the foundation for the monumental tumult in the global economy in 2008.

Yet at the start of the crisis, economists believed that the fallout from the bursting of the housing bubble could be contained. America's Chairman of the Federal Reserve, Ben Bernanke, iterated the prevailing market sentiment at the start of subprime crisis in May 2007:

> [G]iven the fundamental factors in place that should support the demand for housing, we believe the effect of the troubles in the subprime sector on the broader housing market *will likely be limited, and we do not expect significant spillovers from the subprime market to the rest of the economy or to the financial system*. The vast majority of mortgages, including even subprime mortgages, continue to perform well. Past gains in house prices have left most homeowners with significant amounts of home equity, and growth in jobs and incomes should help keep the financial obligations of most households manageable.

Contrary to Bernanke's optimistic forecast, falling home prices continued to spill over into all elements of the U.S. financial system. From May 2007 to September 2008, pent-up distress in the financial system came to a head: investment bank JP Morgan purchased Bear Stearns for $10 a share—less than 10 percent of the firm's share price during its heights of 2007; America's housing agencies, Fannie Mae and Freddie Mac, were put into receivership by

the federal government; several large mortgage originators such as IndyMac Bank had to have their deposits fully backed by the FDIC; and worldwide asset markets reeled. Yet this duress failed to fully prepare global markets for perhaps the most ominous point of the entire global panic of 2008—the failure of investment bank Lehman Brothers.

The collapse of Lehman Brothers marked a turning point of the financial crisis, making it a truly global phenomenon. Global investors sold assets that they perceived as risky in favor of traditional safe havens such as U.S. Treasury securities in a process known as the “flight to quality.” Unfortunately for the South Korean economy, global institutional investors dumped their won-denominated securities in favor of dollar-denominated ones.

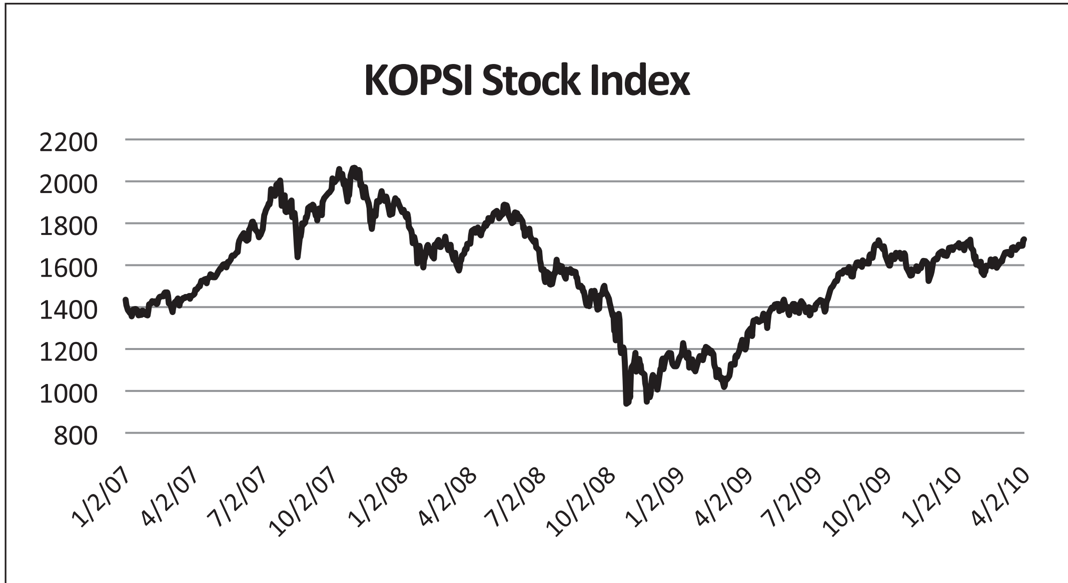
For South Korean policymakers, this process belied their perception of stability in their economy. During the first two quarters of 2008, South Korea maintained strong growth rates, with real GDP at 5.8 percent and 4.8 percent, respectively. But financial market instability bled into the real economy, depressing consumption, exports, investment, and net capital flows. This deterioration is summarized in table 2.

Table 2. ROK: Real Economy Contraction

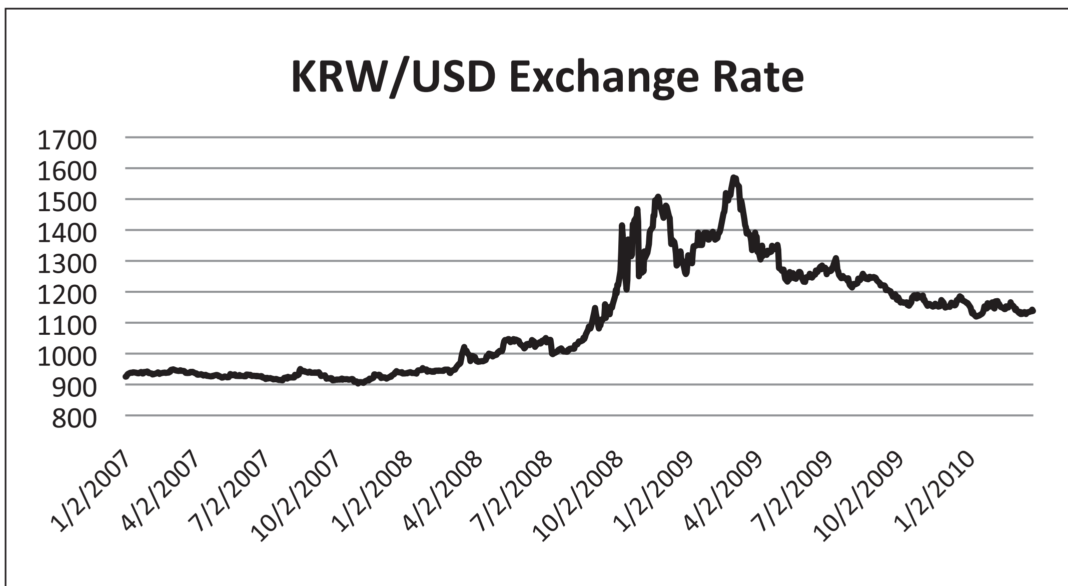
South Korea Economic Indicators (% or % change)	2007	2008			
		Q1	Q2	Q3	Q4
GDP growth rate	5.0	5.8	4.8	3.8	-3.4
Consumption Growth	4.5	3.4	2.3	1.1	-4.4
Investment Growth	7.6	1.4	0.7	4.7	-14.0
Export Growth	14.1	17.4	23.1	27.0	-9.9
Interest Rate (Corporate bond, 3 yr. AA-, %)	5.7	6.4	6.3	7.2	8.3

Sources: Bank of Korea; Korea National Statistical Office

As global deleveraging continued in the wake of the Lehman Brothers bankruptcy, foreign investors unwound their holdings in Korea because of Korea’s relative capital market liquidity. In 2008, risk averse foreign investors recorded net sales of 43.2 trillion won out of total holdings of 176.2 trillion won, and foreign investors’ share of the Korea stock market fell from 42 percent in 2004 to 29.4 percent in 2008. Changing demand conditions led to a predictable outcome in the South Korean currency and asset markets. The KOPSI stock index fell precipitously during September and October 2008, while their currency depreciated against the dollar, illustrated below.



Source: Yahoo™ Finance



Source: Federal Reserve

To combat this capital flight and precipitous fall, the South Korean government guaranteed $100 billion in foreign debt and pumped an additional $30 billion into their financial sector on October 19, 2008. The proximate effects of this intervention were clear: despite the announcement, the won continued to depreciate and the stock market continued its skid. South Korea was not able to autonomously stem capital outflows.

With credit frozen worldwide and ratings agency threats of sovereign downgrade, the Federal Reserve intervened to loosen credit in emerging markets. On October 30, 2008, the Federal Reserve announced a $30 billion currency swap arrangement with South Korea. After this announcement, the KOPSI index rose 12 percent and the won rallied, reflecting renewed investor confidence in the South Korean economy.

The correlation of the announcement of this coordinated intervention and the South Korean market stabilization provides *prima facie* evidence of a link between U.S. involvement in the South Korean economy and material outcomes. Did the creation of the swap agreement stabilize the South Korean financial markets? If so, what was its mechanism?

V. CONFIDENCE-BUILDING MEASURES: THE UNITED STATES' INTERVENTION

South Korea's stock market and nominal currency value were in freefall prior to the Fed's announcement of the currency swap arrangement. The Federal Reserve's stated reasoning, per their official announcement of the swap line, gave the purpose of the swap as the following:

> [It is] designed to help improve liquidity conditions in global financial markets and to mitigate the spread of difficulties in obtaining U.S. dollar funding in fundamentally sound and well managed economies.

Further, the Fed concluded that South Korea was a "systemically important" economy.

This characterization bolstered the credibility of South Korean monetary authorities. The financial press—an imperfect barometer of market sentiment—echoed the case that financial panic in South Korea had been overdone. Asset

managers believed that with the credit of the United States, outright default in South Korea became a distant possibility. Given that other systemic actors in the United States received near-virtual guarantees of their liabilities, this word carried particular symbolic importance for the South Koreans.

But this begets the question: what was the actual mechanism of transmission between the currency swap arrangement with the United States and Korea and the stabilization of the Korean financial market?

The Swap Agreement's Material Insignificance

To judge whether the swap agreement had a lasting material effect on the South Korean economy, it is important to consider the evolution of the execution of the swap. The currency swap's actual implementation took place far later than the announcement of it.

Taken in context, the announced notional value of the currency swap, $30 billion, ostensibly provided South Korea with additional firepower to fight the extensive net capital outflows from won-denominated securities. For instance, $30 billion is over three times the value of their foreign exchange reserves during the crisis of 1998. And $30 billion constituted an additional 12 percent of their total foreign exchange reserves. This extra ammunition would have given South Korea a sufficient buffer against speculative panic in their financial markets.

But a closer examination of the swap's treatment reveals a different story. For most of November 2008, the Fed did not physically fund any of the currency swap with South Korea. No dollars were exchanged for won during this time period. On November 27, 2008, South Korea received $4 billion from the Federal Reserve. The Bank of Korea claimed this action would "ease dollar shortages at local banks, and help ease market jitters as well." On February 4, 2009, South Korea extended the deadline of the swap with the United States to October 30, 2009. No more of it was funded.

To date, South Korea has funded merely $4.5 billion of the $30 billion notional of the swap. Although South Korea and the Fed extended the facility several times, they have tapped very little of it. This amount, $4.5 billion, constitutes less than 2 percent of South Korea's foreign exchange reserves. Moreover, this additional dollar infusion paled in comparison to the net monetary and fiscal stimulus that the central bank and the South Korean government put into the market.

And although South Korea struck other bilateral currency swaps with other economic powers, namely China and Japan, these swaps also went widely unused. Moreover, these swaps were created prior to the acute panic of 2008.

Still, the lack of material stimulus did not preclude material outcomes from the Fed's actions. South Korea's KOPSI stock index touched its three-year low prior to the Fed's announcement. The market was in freefall and volatility was high. After the Fed's announcement, however, the markets stabilized. On the one hand, the market presented a material outcome—the stabilization of the asset markets—but on the other hand, material stimuli were absent. Something else must have accounted for this stabilization.

VI. IDEATIONAL INTERPRETATIONS OF INSTITUTIONAL CHANGE

Ideational accounts for economic change draw on a sociological interpretation of political economy. Per the methodology of Mark M. Blyth, as outlined in his *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century*, ideational or constructivist political economy focuses on interest formation of agents. Blyth issues a caveat about material interpretations of economic crises, saying:

> "[E]xogenous material changes may help to explain why a particular institutional order becomes unstable, [though] infusions of instability do not themselves explain how the new or modified order takes the form that it does.

In other words, new institutional orders do not come from these exogenous material shocks.

Applied to the Korean case, the exogenous material change in the financial market was the deterioration of credit markets first in the United States and later worldwide. The "modified order" is the post-swap stabilization of the Korean won and KOPSI stock markets. Materialists view both the uncertainty faced by agents within their model and the ideas available to them as both exogenous and irrelevant in explaining this institutional change. Instead, they contend that the imposition of the swap was the most important material change that led to the stabilized outcome. On the contrary, ideational accounts insist that these factors must be exogenous in cases of economic crises. Blyth continues:

> Agents must argue over, diagnose, proselytize, and impose on others their notion of what a crisis actually *is* before collective action to resolve the uncertainty facing them can take any meaningful institutional form … [and] … [t]he set of available ideas with which to interpret the environment, reduce uncertainty, and make purposeful collective action possible becomes crucially important in determining the form of new institutions.

In short, Blyth contends that economic ideas matter during crises, and these ideas become the guiding principles of agents.

To wit, Blyth quotes economists Frank Hahn and Robert Solow:

> The way the economy actually does work can depend on the way agents believe the economy to work … [and] … the way the economy responds to a policy move by the government can depend on the interpretation that other agents place on it, and therefore on the beliefs about the way things work. … If participants believe that every increase in the money supply will be fully translated into the price level … then they are likely to behave in ways that will make that happen.

Herein lies the critical distinction between rationalist, material interpretations of the South Korean financial crisis and ideational ones—if agents believe in a certain outcome, this outcome will recursively occur.

Constructing the South Korean Case

There are four stages of the South Korean financial crisis in 2008. In each stage, a unique ideational environment pervaded. These narratives are causally important because of South Korea's openness to international capital flows. As mentioned above, openness to international capital flows leaves South Korea's development at the behest of fickle global financial market investors. Thus, these narratives determine the behavior of these actors, thereby creating the material outcomes that these actors anticipate, per the ideational self-fulfillment cycle described above.

Phase 1: Pre-crisis Equilibrium (2006-2007) During this phase, the dominant narrative about the South Korean economy was one of rebound, stability, and lessons learned from the prior Asian Financial Crisis. South Korean authorities had regulated their financial system, exports surged, and the central bank accumulated foreign exchange reserves equal to a quarter of their total GDP. Net capital flows poured into South Korea, while a global liquidity glut precipitated a fall in world interest rates.

Phase 2: Contained Crisis (2007–mid-2008) During the contained crisis mode, world institutional investors believed that cracks in the U.S. housing market would be contained and that the macroeconomic fallout would be limited worldwide. Korean exports surged during this period as global growth had yet to take a hit from the impending disaster of the global financial crisis. Market participants believed that Asian economies had decoupled from the United States.

Phase 3: Global Crisis (mid-2008–October 2009) After the bankruptcy of Lehman Brothers, global investors sold their risky assets in favor of dollar-denominated ones. It was here where investors seized on the notion that South Korea's financial sector could be vulnerable to the maladies of the 1990s. This marked the height of market uncertainty.

According to Tom Kang, founder of Kang & Company and private equity fund manager in South Korea, market participants believed that imprudent dollar bets by South Korean banks led to market fears of their solvency. This is an example of agents forming narratives to effect material change.

Phase 4: Confidence Restored (October 29, 2009–present) During this phase, the Federal Reserve announced its swap agreement with the Bank of Korea. Net capital outflows halted, the KOPSI's fall ended, and the outright panic of the preceding period receded.

Immediately after the announcement of the swap, market participants recognized that the mere acknowledgement of Fed backing would lead to material outcomes: "The Fed agreement itself is recognition of the soundness of the Korean economy and currency," said Lee Min-koo, a strategist at SH Asset Management Company in Seoul.

Indeed, market participants saw that the announcement of the swap represented a watershed moment in South Korea's financial crisis. The actual execution of

the swap went commensurately underreported in the mainstream financial press.

The critical point in this narrative occurs at the announcement of the swap agreement. Given the Knightean uncertainty of the market panic of 2008, agents sought narratives. The Federal Reserve provided one; given the Fed's credibility, South Korea was able to stem the financial market panic and assuage the fears of sovereign default.

Implications of the Ideational Response

The notion of market sentiment (ideas) leading to market outcomes (material change) is central to the above framework. Thus, South Korea should aim to achieve the following two goals. First, South Korea should mitigate the mechanism by which the whim of market sentiment can influence material outcomes. Second, given the status quo, South Korea should work to create its own narrative of its economy through material change.

Openness to Capital Flows: A Double-Edged Sword

The above theoretical section noted that ideas and interest formation were largely ignored by rationalist interpretations of crises. As the South Korean case vividly illustrates, policymakers must treat these variables as both endogenous and central to policymaking writ large. South Korea's openness to foreign capital flows leaves it vulnerable to the changing ideational context of the international financial markets. As its experience during the Asian Financial Crisis portended, capital flows are pro-cyclical in nature. Their pro-cyclicality, both amplifying market buoyancy and deepening market downturns, must be understood.

This paper does not argue for wholly closed capital markets, as access to foreign portfolio investment often leads to higher real returns and benefits for target countries. Moreover, monitoring and eliminating all forms of cross-border portfolio investment is difficult if not impossible. But the speed by which cross-border portfolio flows can travel in South Korea is essentially instantaneous: institutional investors in the Netherlands, for instance, can easily sell their won-denominated securities and convert their currency at ease. This encourages market participation but also lays the groundwork for speculation.
To combat the propensity of investors to speculate, South Korea—along with other Asian tigers—should consider the use of a Tobin tax, or minute penalty on speculation as a percentage of cross-border capital flow. Although Tobin taxes

could draw the ire of global investors who want access to South Korean markets, empirical analysis done by Blake LeBaron at Brandeis University confirms that Tobin taxes decrease overall market volatility. This would allow policymakers who typically engage financial markets with a lag to properly conduct economic policy without the short-run vulnerability to systemic risk because of speculative asset market traders.

Ideationally, the use of the Tobin tax could serve as a market signaling mechanism that the South Koreans are serious about deterring capital flight. Indeed, countries with capital controls, such as China, were better insulated from the panic of 2008.

Still, the United States government remains opposed to the use of Tobin taxes in emerging markets. It would be up to South Korea to weigh this cost against the potential benefits of such a proposal, though this essay prefers the use of a Tobin tax to regulate cross-border financial flows, regardless of the political ramifications qua the United States.

Building International Credibility

Given that international market sentiment often leads to self-fulfilling economic outcomes, South Korea should understand several principles of the global economic order. First, institutional investors still see South Korea as a risky or emerging market. Despite gains in per-capita income, capital deepening, large currency reserves, a low unemployment rate, and high scores on development indices, South Korean securities still were perceived as risky by institutional investors, as shown by the fact that these were sold en masse during the panic of 2008.

According to Kwun Jun-il, founder of Actium Corporation and private equity fund manager in South Korea, corporate governance structures in South Korea render the shareholder comparatively weak, especially compared to corporations in Japan and elsewhere in East Asia. Avenues to increase shareholder rights should be explored by South Korean corporations. In so doing, they could change investors' perceptions of the staid and insular nature of Korean business.

Second, simply stockpiling currency reserves does not preclude international financial panic from engulfing the South Korean economy. Such a singular focus could lull South Korean monetary authorities into blindness to the other accumulating risks in their economy. Additionally, Kwun also emphasized that

South Korea should try to accumulate approximately 100 percent of GDP in currency reserves, amassing an even larger buffer than originally anticipated. In sum, crisis prevention should take a multifaceted approach. As a corollary, crisis resolution should assume a multifaceted approach as well.

Third, and perhaps most important for the U.S.-ROK bilateral economic relationship, South Korea should work to decouple its economy from the United States' economy. This is a difficult task and encapsulates several other factors in the global economy.

VII. U.S.-ROK MONETARY RELATIONSHIP: CHALLENGES IN 2010

In the wake of the Asian crisis of the late 1990s, countries such as the ROK, China, Japan, and the Gulf States stockpiled massive dollar reserves to combat prospective speculative panics. In so doing, these countries accumulated large current account surpluses relative to America. The United States ran twin current account and budget deficits, being the driver for global demand.

Economic theory dictates that current account deficits smooth themselves over time. With the U.S. consumer currently reeling from 10.2 percent unemployment and falling asset prices in numerous classes, the global economy can no longer reliably depend on the U.S. consumer as the spender of last resort. Luckily, countries such as China, Japan, and South Korea have large savings bases that could be used to spur their own domestic consumption.

South Korea should attempt to rebalance its economy by spurring more consumption domestically. Moreover, Korea can no longer be dependent on the United States to fuel its growth. Although exports to China have grown during the last decade, its economy is still dependent on foreign consumers. Given that investors view South Korea as the economic proxy of the United States, diversifying its economy ideationally from the United States is an essential first step to avoid global financial contagion.

And although the Korean peninsula remains a chief security concern for the United States, its economic influence is a second-tier priority for the United States. Indeed, the global economy depends on several nodes, the most important of which include the United States and China. The global decision to maintain the G20 as the chief body for global economic coordination reflects the recognition by the United States, Western Europe, and Japan of the rising

economic importance of emerging markets, such as India and China. A shifting economic balance of power could result in trade disputes, a disruption of the global monetary architecture, and protectionism if economic growth does not resume.

South Korea should not sit idly as the composition of the global economy changes. Although its version of Western capitalism has served it well, South Korea should not be afraid to break with the West in its economic policymaking. Some triangulation between China and the United States would serve South Korea well, as its interests predispose it. Practical implementation of such a policy would include finding its voice in multilateral institutions, perhaps pushing for the ratification of the U.S.-ROK Free Trade Agreement, or joining in on global calls for less fiscal profligacy of the United States. Such a policy would signal a distinct shift from the status quo, but South Korea should not hesitate to explore this new ground.

On the United States' behalf, it should understand that the South Korean economic relationship is one facet of a complex web of interdependence between the two countries. Yet the complexity of this is rising with each succeeding rise in Chinese power. Allowing the above latitude to the South Koreans would afford the Chinese a valuable regional ally, as well as one who could help to broker economic agreements to achieve the goals discussed here.

Ultimately, the challenge for both countries is not a material decoupling, but an ideational decoupling, wherein investors do not associate macroeconomic weakness in the United States with fear of spillover contagion in South Korea. The above measures help mitigate and change this investor perception, which proved instrumental in driving the material outcomes in South Korea during the financial crisis of 2008.

VIII. CONCLUSION

Using the methodology of ideational political economy, this paper has described how the United States helped construct an ideational narrative or social equilibrium of economic stability in the Republic of Korea. Because of South Korea's open capital markets, agency of global institutional investors becomes a critical variable in explaining material change in the South Korean economy. This agency depended on the ideas formed by the narratives of global economic actors. Material measures to fight crisis, such as large currency reserves, failed to achieve their desired result precisely because they lacked a strong ideational

complement to fight crisis. As such, the currency swap between the United States and South Korea of October 2008 helped constitute this credibility.

This paper then argued that South Korea should work to dissipate vulnerabilities to international capital flows, through either the implementation of a Tobin tax or increased domestic ownership of its domestic securities. Even if this reform is not passed, South Korea should use the wake of the financial crisis to do its part to rebalance the global economy. Structural change in South Korea should develop with this in mind.

Finally, policymakers in both the United States and South Korea must come to grips with the reality of a changing economic balance of power worldwide. For its part, the United States should afford South Korea the policy latitude it needs to triangulate between the United States and China, as South Korea is a fertile ground for cooperation between these two wary superpowers. On its behalf, South Koreans should understand that the prior economic hegemon can no longer fuel the international economic system, and it should attempt to find its voice in global economic institutions. Coming to grips with this changing reality will allow South Korea to construct its own narrative for its capricious institutional portfolio investors.

Of course, the above analysis must be taken in context. Many issues face both the United States and South Korea, most notably issues of nuclearization of the Korean peninsula. But these multiple channels of interaction can lay the groundwork for cooperation elsewhere. The United States should not lose sight of this—perhaps conjuring the political will to pass the Korea-U.S. Free Trade Agreement could be in order.

Although the events of 2008 and 2009 proved tumultuous for the global economy, through the economic wreckage come signs of hope. The global economy could not depend on the United States to fuel the international economic system forever. As such, the next year marks a chance for countries such as South Korea to claim a larger voice in shaping the contours of the global economy in ways that better suit their interests and long-term stability.

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