



By: Anne O. Krueger

# South Korea's new industrial policy as a response to geopolitical turmoil



In the early 1950s, after the devastation of the Korean War, South Korea was among the world's poorest countries.

Today, it is an advanced economy, with a per capita income that **exceeds** that of Japan.

Much of South Korea's transformation took place under the protection provided by the US military, underscoring the threat that President Donald Trump's policies now pose to its long-term prosperity and security.

Over the past decade, the global economy has been rocked by five major shocks: Trump's first-term trade war with China and his second-term tariffs, the COVID-19 pandemic, Russia's invasion of Ukraine, and the war in Iran.

Together, these interconnected crises have fueled inflation, disrupted energy supplies, driven up shipping costs, constrained fiscal space, and heightened uncertainty about the future of global trade and the international order.

Few countries have felt these shocks as acutely as South Korea. Its economy is deeply integrated into the global trading system, with exports accounting for **44% of the country's GDP** in 2024.

It is also highly dependent on energy imports: oil and natural gas make up about **82% of its energy consumption**, and roughly 92% of that is sourced from the Middle East.

As a result, it has been hit hard by Trump's tariffs and the energy-market disruptions brought about by his war with Iran.

## Defense spending

South Korea's reliance on manufactured exports, especially high-tech goods, adds to its vulnerability.

In 2025, it was the world's **eighth-largest exporter**. China and the United States, its two largest trading partners, account for nearly **40% of its exports**, leaving it particularly

exposed to their escalating great-power rivalry.

Moreover, unlike many advanced economies, South Korea has never been able to scale back its defense spending, given the persistent threat posed by its northern neighbor.

With Trump calling into question the long-standing security alliance with the US, South Korea must perform a delicate balancing act: maintaining its partnership with America, improving relations with China, and expanding its own military capabilities.

In 2025, President **Lee Jae-myung** signaled a strategic shift, announcing that South Korea would seek to become the world's fourth-largest arms manufacturer by 2030.

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But its export sector remains caught in Trump's tariff vise, despite the recent US Supreme Court ruling limiting his ability to impose discriminatory tariffs.

Seeking legal means to reinstate them, the administration has launched **Section 301 investigations** into 16 trading partners, including South Korea, over alleged unfair trading practices.

## External headwinds

Compounding the problem, South Korea's trade deal with the US carries high fiscal costs.

In January, the Trump administration agreed to **reduce tariffs** on South Korean goods to 15% after the country committed to invest \$350 billion in the US—including \$150 billion in the shipbuilding sector—through a state-run investment corporation.

This is an enormous sum for an economy of South Korea's size. Last year, total investment in the country was about \$567 billion (based on calculations using World Bank data on investment as a **share of output** and nominal GDP).

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Inflation **hovers around 2%**, unemployment is relatively low, and public debt stands at roughly 48% of GDP.

Although political stability was briefly shaken in late 2024, when then-President Yoon Suk-yeol attempted to declare martial law, order was quickly restored, and early elections were held.

Earlier this year, Yoon was convicted of insurrection and sentenced to **life in prison**. Because macroeconomic fundamentals were solid, providing room for **supportive fiscal and monetary policies**, the shock had only a limited impact.

Growth in 2026 is **projected** to be modest, at around 2%, though demographic decline means that per capita growth is somewhat stronger than the headline figure suggests.

## Development of high-tech industries

Meanwhile, South Korea's stock market has **boomed**, as renewed investor confidence has reduced the "Korea discount" that has long served as a drag on performance.

But the country's dependence on imported energy remains a critical risk, with near-term growth prospects largely hinging on how

quickly the Strait of Hormuz reopens and oil and natural-gas markets return to normal.



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To address these risks, the government has **proposed** new measures aimed at supporting and accelerating the development of high-tech industries, particularly those in which South Korea already has a competitive edge, such as AI and semiconductors.

This marks a return to industrial policy on a scale not seen since the military dictatorship of Park Chung-hee.

Whether such policies will prove effective in today's global economy remains to be seen.

Encouragingly, in the face of a rising China and an increasingly unpredictable US under Trump, South Korean policymakers have responded with prudent macroeconomic and security measures.

But when a country's closest ally becomes a major source of risk, stability can no longer be taken for granted.

Anne O. Krueger, a former World Bank chief economist and former first deputy managing director of the International Monetary Fund, is Senior Research Professor of International Economics at the Johns Hopkins University School of Advanced International Studies and Senior Fellow at the Center for International Development at Stanford University.