

## **Agenda for 2nd Round of Reform**

An Article

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South Korea has made a tremendous effort to transform its economy since the Asian crisis, and the results have been impressive.

The banking system has been strengthened; the corporate sector has undergone significant restructuring, and with the expansion of the capital markets, market discipline now plays a more important role.

More recently, the government has made good progress in re-privatizing the nationalized banks and improving corporate governance. As a result, compared to five years ago, Korea's economy is much more open, dynamic, and competitive.

However, the agenda is not yet complete, and structural problems in the corporate and financial sectors still persist. The corporate sector remains dominated by the large chaebol, whose corporate governance raises concerns in the markets.

Some large investment trust and credit card companies remain weak and are a source of financial distress. Despite its rapid growth, the corporate bond market remains prone to paralysis.

As we saw last year, these structural weaknesses have left the economy vulnerable to shocks and held back growth.

Sustaining high growth in Korea will require addressing these structural weaknesses.

I would emphasize three critical tasks: restructuring the non-banking sector, improving corporate governance further, and strengthening the corporate bond market.

After the banks, attention has now shifted to reforming the non-banking sector.

The first step should be to restore stability and health to the credit card sector. To do so, financial supervisors should ensure that distressed credit card companies raise new capital quickly to cover their expected losses and adopt realistic restructuring plans.

Those companies that fail to fulfill their plans should be subject to prompt corrective action or be sold off quickly to a suitable buyer.

In addition, measures are needed to strengthen the risk management of credit card companies so that these problems do not occur again.

Here, encouraging greater information sharing among credit bureaus and providing more ``positive'' data on payment histories and income would help credit card companies to better assess the potential risk of their cardholders and to restructure the debts of their delinquent borrowers.

Eventually, companies should be encouraged to move to a revolving credit card system. This system, which is common in other OECD countries, would allow creditworthy borrowers who are experiencing temporary cash flow problems to have more time to pay their bills.

The next step would be to restructure the investment trust sector, which has been a weak link in the financial system for some time.

Here, the government has made good progress by completing the sale of Hyundai Investment Trust & Securities and by announcing plans to sell off the remaining two large government-owned ITCs in 2004.

Returning these institutions to the private sector will help transform the investment trust sector and further develop the capital markets in Korea.

This is important because Korea needs a sound asset management sector and well-functioning capital markets if it is to achieve its goal of becoming a regional financial hub.

The second important area is corporate governance.

Improved corporate governance will allow companies to access cheaper financing and reward investors with higher returns. Research has also shown that countries with sound corporate governance and strong investor protection have deeper capital markets and are less vulnerable to financial crisis.

That is why we broadly support the FTC's three-year roadmap for corporate reform, which aims to ease regulations on chaebol that improve their governance.

In addition to regulatory steps, it would be helpful to strengthen the role of the market in promoting sound corporate governance.

The new law to improve accounting and auditing practices and the introduction of class action lawsuits will help enhance market discipline by improving financial transparency and strengthening shareholder rights.

Another helpful step would be to encourage companies to follow the recommendations in the Korea Corporate Governance Service's Code of Best Practices.

One way would be to require listed firms to either comply with the best practices or if they chose not to comply, to simply explain their reasons to their shareholders. This “comply or explain” system has been used in other OECD countries as an effective way to improve corporate disclosure and transparency.

The last area is to further develop the corporate bond market. Korea’s corporate bond market has grown into one of the largest in Asia.

However, the market still remains vulnerable to shocks and temporary periods of paralysis, particularly for low-rated issuers.

One way to strengthen the market would be to enhance the role of market discipline. Here, it would be important to remove any perceptions of an implicit guarantee from investing in corporate bonds.

Guarantees, whether explicit or implicit through a promise of a bailout, distort the markets, promote reckless lending, and discourage the kind of careful credit assessment that is needed in Korea to promote the market’s development.

To sum up, Korea has made substantial progress in reforming its corporate and financial sectors. These deep reforms have helped to strengthen the economy and lay the foundation for its remarkable recovery following the crisis.

Looking ahead, it will be important to build on this progress in order to keep the economy on a sustainable path for rapid growth.

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