

Reform agenda unfinished

An Article

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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. As a result, compared to five years ago, Korea's economy is much more open, dynamic, and competitive.

However, despite the tremendous progress made over the past few years, Korea still faces an unfinished reform agenda. The large number of credit delinquents and slow pace of restructuring suggest that the problems in the household and credit card sectors are deep and will take time to resolve. The corporate sector remains dominated by the large chaebol, whose corporate governance raises concerns in the financial markets.

And despite making large profits, Korean companies are holding back from investing, partly out of concerns over the flexibility of the labor market. In sum, these structural weaknesses have held back a strong domestic recovery and left the economy vulnerable to shocks.

Now the question has turned to what further reforms Korea will need to sustain rapid growth and remain competitive in the global economy. In its most recent staff report, the IMF identified three reform areas where further progress is needed. They are: improving corporate governance, strengthening the financial system, and modernizing the labor market. These reforms are important because they will help Korea not only to adapt quickly and efficiently to changes in the market and technology, but also to expand domestic sources of growth to complement its strong exports. Making progress in structural reforms will be crucial for Korea to realize its goal of doubling per-capita incomes and joining the ranks of advanced economies.

First, improving corporate governance, such as through greater transparency and stronger rights for minority shareholders, will ensure that Korea remains an attractive place to invest. Improved corporate governance will help companies to access cheaper financing and to invest more efficiently. 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. For these reasons, we broadly support the KFTC's three-year roadmap for corporate reform, which aims to ease regulations on chaebol that improve their corporate governance.

Ultimately, the shareholders and the markets will decide on the right industrial structure for Korean companies. The key will be to strengthen their role in pushing for these

improvements in corporate governance. Greater transparency and strengthening the rights of minority shareholders, such as through cumulative voting and class action lawsuits, will help the market to push for these changes. Over time, market-based mechanisms will be more effective in exerting discipline on corporations than regulatory controls which can become complicated and ultimately be circumvented.

Second, strengthening the financial sector, including by developing sound institutions, will help to better guide Korea's large pool of savings to productive investment. Here, restructuring the investment trust and credit card companies is a high priority. 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 this year. Returning these institutions to the private sector will help transform the asset management industry and restore investor confidence. A strong asset management sector will also expand the range of investible assets for Korea's large savings and be an important building block in Korea's drive to become a regional financial hub.

In addition, measures are needed to strengthen the risk management of financial institutions, particularly for credit card companies. Here, encouraging greater information sharing among financial institutions and providing more "positive" data on payment histories and income would help lenders to better assess the potential risk of their customers and to restructure the debts of their delinquent borrowers. A well-functioning credit bureau system will help Korea to develop a stronger credit risk culture where borrowers and lenders manage effectively their risks.

Finally, Korea needs to modernize its labor market. A flexible and dynamic labor market will not only produce more and better quality jobs, but also help Korean companies to remain competitive in the global economy. The question is how to achieve this.

In order to enhance the flexibility of the labor market, we need both to make more flexible the market for regular workers and to strengthen the social safety net for the most vulnerable.

Regular workers in Korea benefit from some of the strongest employment protection among advanced countries. Because of the high cost of firing workers, Korean companies have shifted away from regular workers to hiring mainly nonregular workers, such as those with one-year contracts. This has reached the point where non-regular workers now account for almost one-third of the labor force, one of the highest ratios among OECD countries. As a result, job security has worsened. After reaching a peak of 6.1 years in 1998, the average job tenure in Korea has fallen to around 5(r)? years, below that in the E.U., Japan, and the U.S. which is considered to have one of the most flexible labor markets in the world. To encourage firms to hire more regular workers and invest more in Korea (as opposed to elsewhere), employment protection for regular workers will need to be relaxed to enhance the flexibility of the labor market.

But easing employment protection alone is not enough. Currently, only about one-fifth of the unemployed receive unemployment benefits. Expanding the coverage of the social safety net,

especially the employment insurance system, will help protect the most vulnerable workers and promote a more mobile labor market where the unemployed can move more easily to new jobs. Expanding the social safety net will also prepare Korea to better meet the growing needs from its rapidly aging society.

To sum up, making progress in these three areas-corporate governance, financial restructuring, and labor reform-will be crucial for Korea to sustain rapid high-quality growth. These structural reforms will not only help to expand domestic sources of growth, but also lay the foundations in the long-run for a more efficient and competitive economy.