



(not for quotation)

Globalization and Korea: The Agenda for Reform

Kenneth Kang
IMF Resident Representative, Korea
2005 FKI Jeju Summer Forum
July 29, 2005

(The views expressed are those of the author and do not necessarily reflect the views of the IMF)



Structural Reforms: Why Important?

- Over long-term, structural reforms will help Korea be more competitive in a rapidly changing global economy.
- Significant progress in reforms since 1998.
 - Banks and large corporates restructured.
 - Market discipline is more prevalent.

Result: Economy is much more open, dynamic, and competitive.

- However, unfinished reform agenda remains, particularly in the labor market.



1. Labor Market Needs Greater Flexibility

- Economic structure evolving to one based on developing and manufacturing advanced products.
- Firms need to be able to shift their output as demand and technology changes.
- Significant expansion of service sector requires flexible labor force and working conditions.
- Will make Korea a more attractive place to invest, for both domestic and foreign firms.
 - One key to becoming a regional financial hub.



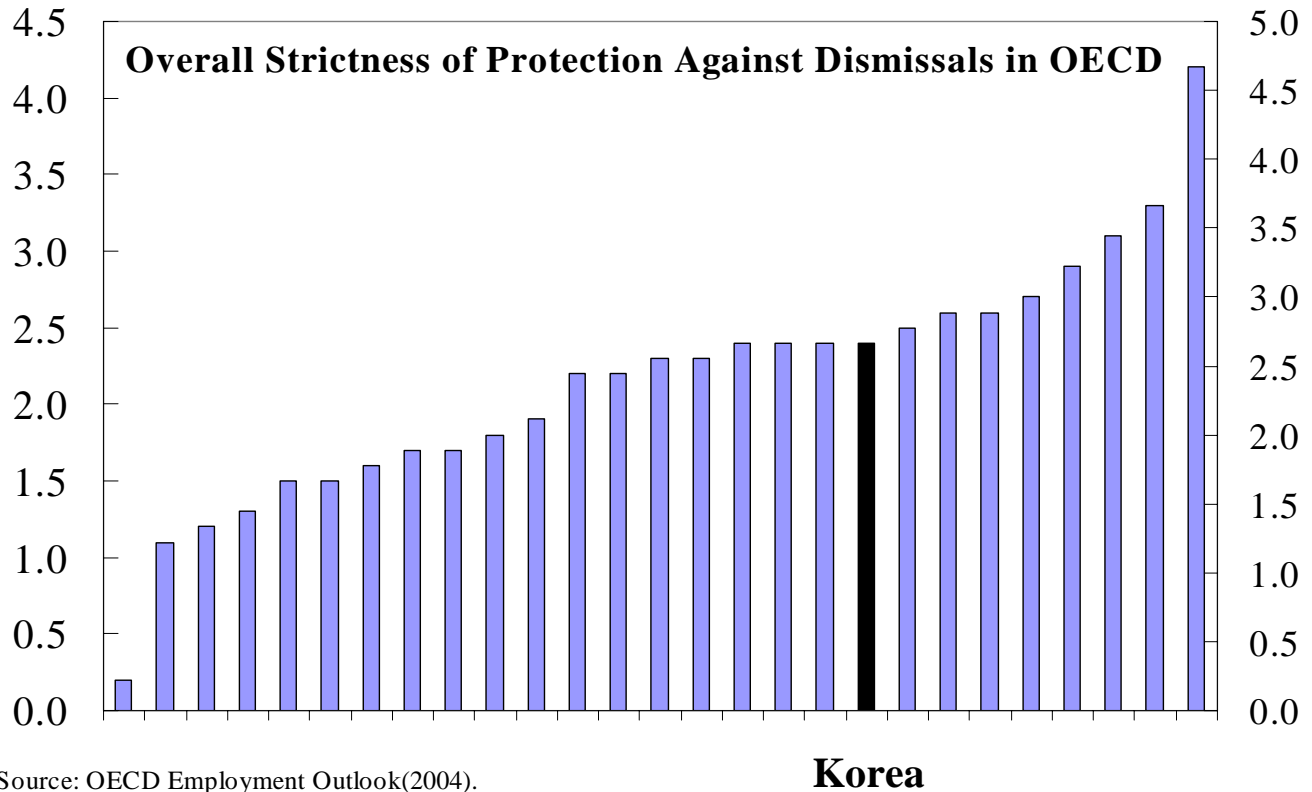
Korea's Dual Labor Market

- Labor market duality in Korea.
 - Core of regular workers with high degree of protection.
 - Temporary workers whose numbers can adjust in line with economic conditions.

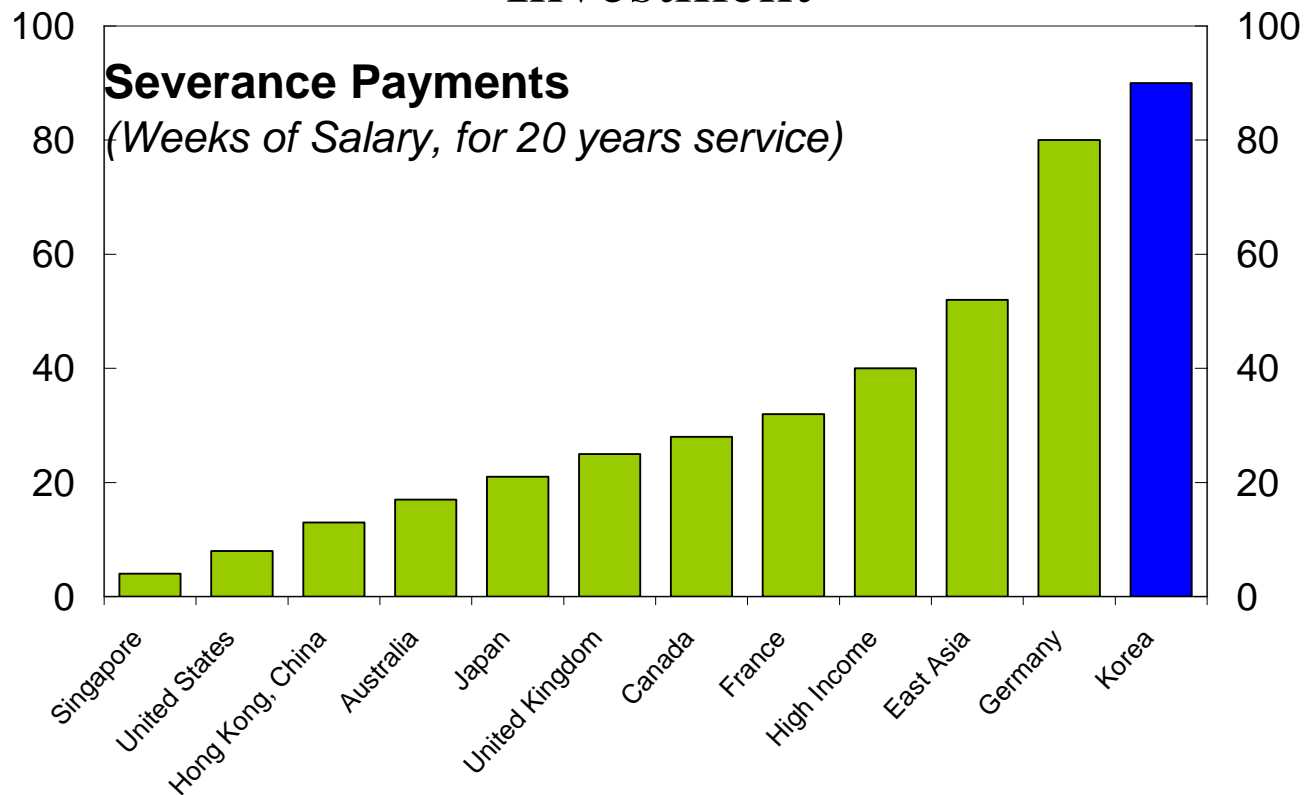
Results:

- Firms have shifted to hiring temporary workers.
- Increase in job insecurity.
- Hampers domestic investment.

Regular Workers Benefit from Strong Employment Protection Among the OECD.

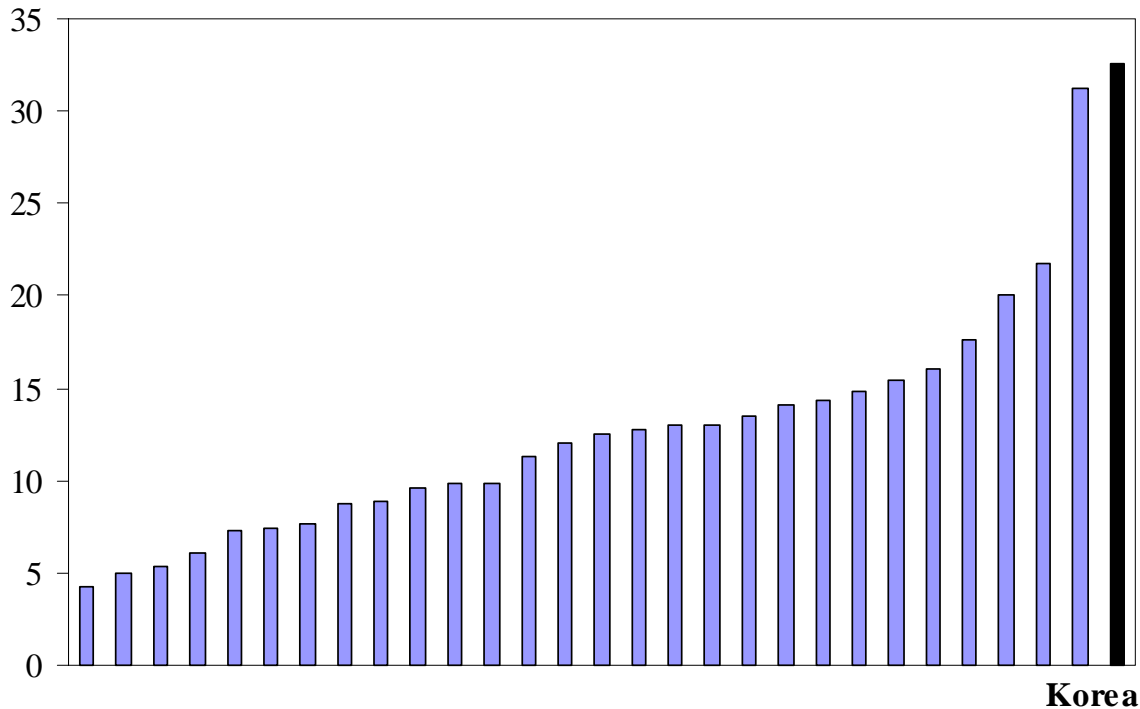


And High Severance Payments Deter Risky Investment



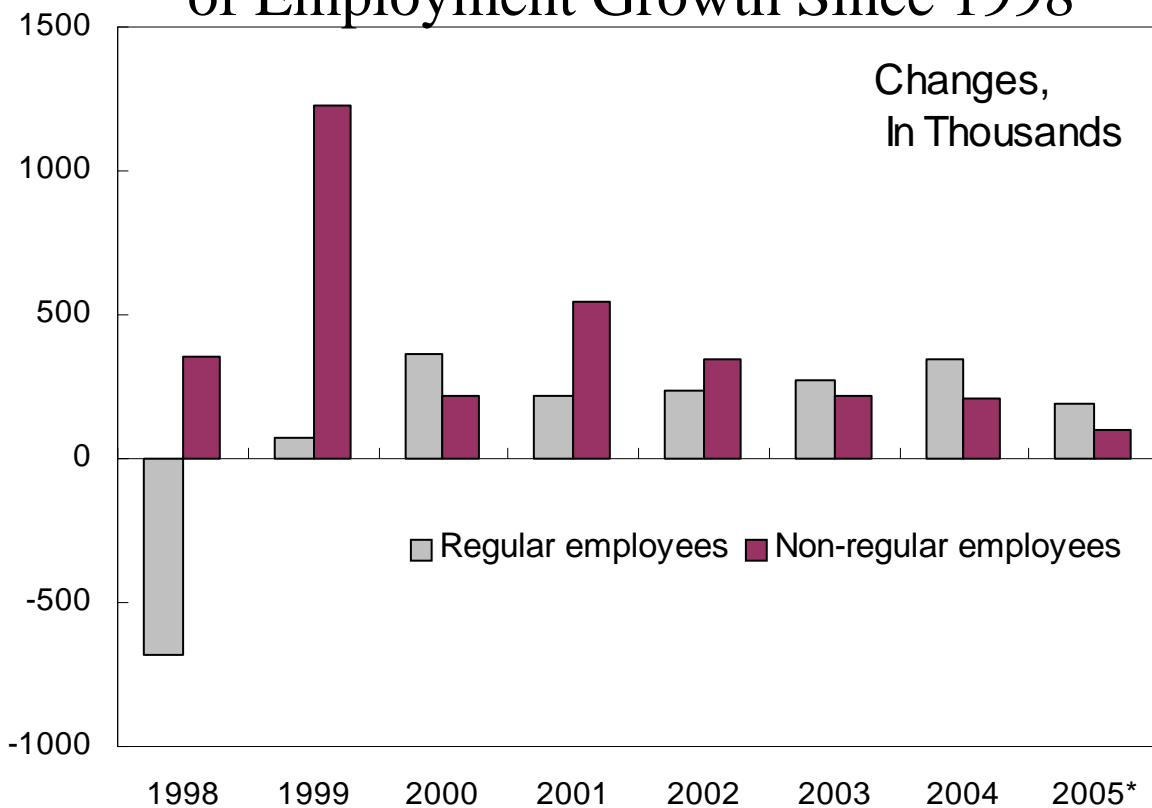
Share of Non-Regular Workers is the Highest in the OECD

Share of Non-Regular Workers in OECD



Source: Ministry of Labor(2003) and OECD(2002)

As Non-Regular Jobs Account for 76 Percent of Employment Growth Since 1998



* As of May, 2005.



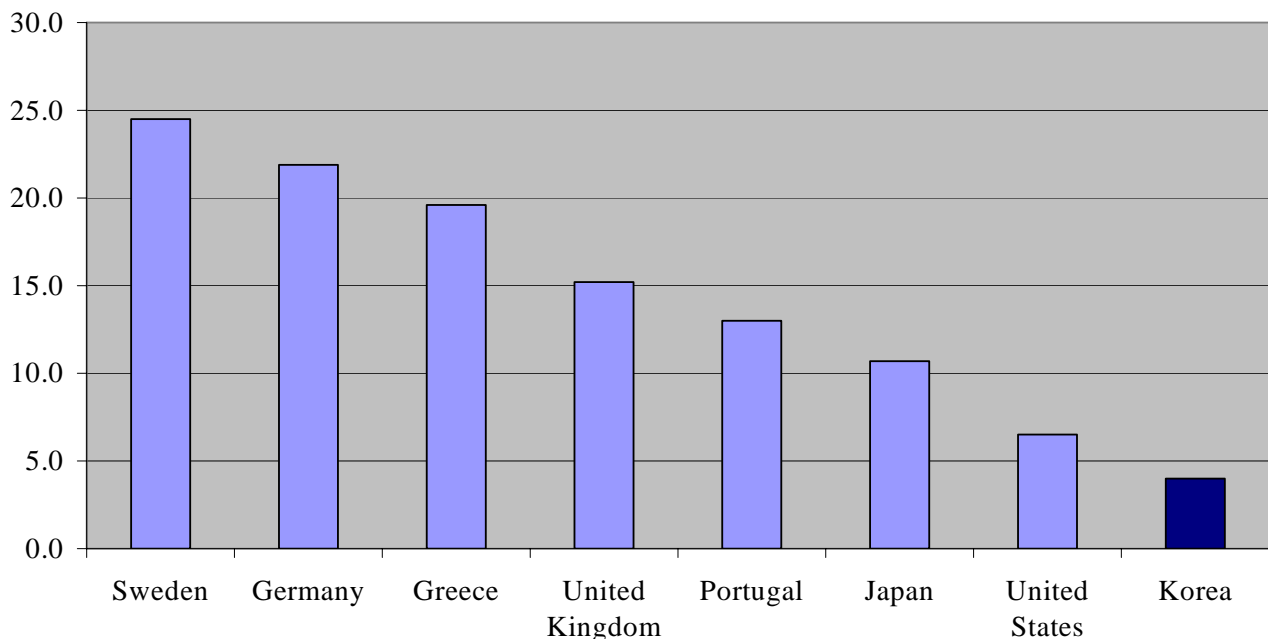
How to Make the Labor Market More Flexible?

- **Reduce protection for regular workers.**
 - Support government's "Reform Proposal for Sound Industrial Relations" to improve flexibility.
 - Examine Spain's experiment with new, more flexible "regular" contract.
- **Strengthen social safety net.**
 - Only one-fifth of unemployed receive benefits.
 - Support plans to expand unemployment insurance and basic livelihood protection.

Korean spending on social safety net is small compared to other OECD countries

Government Spending on Social Protection

(percent of GDP)



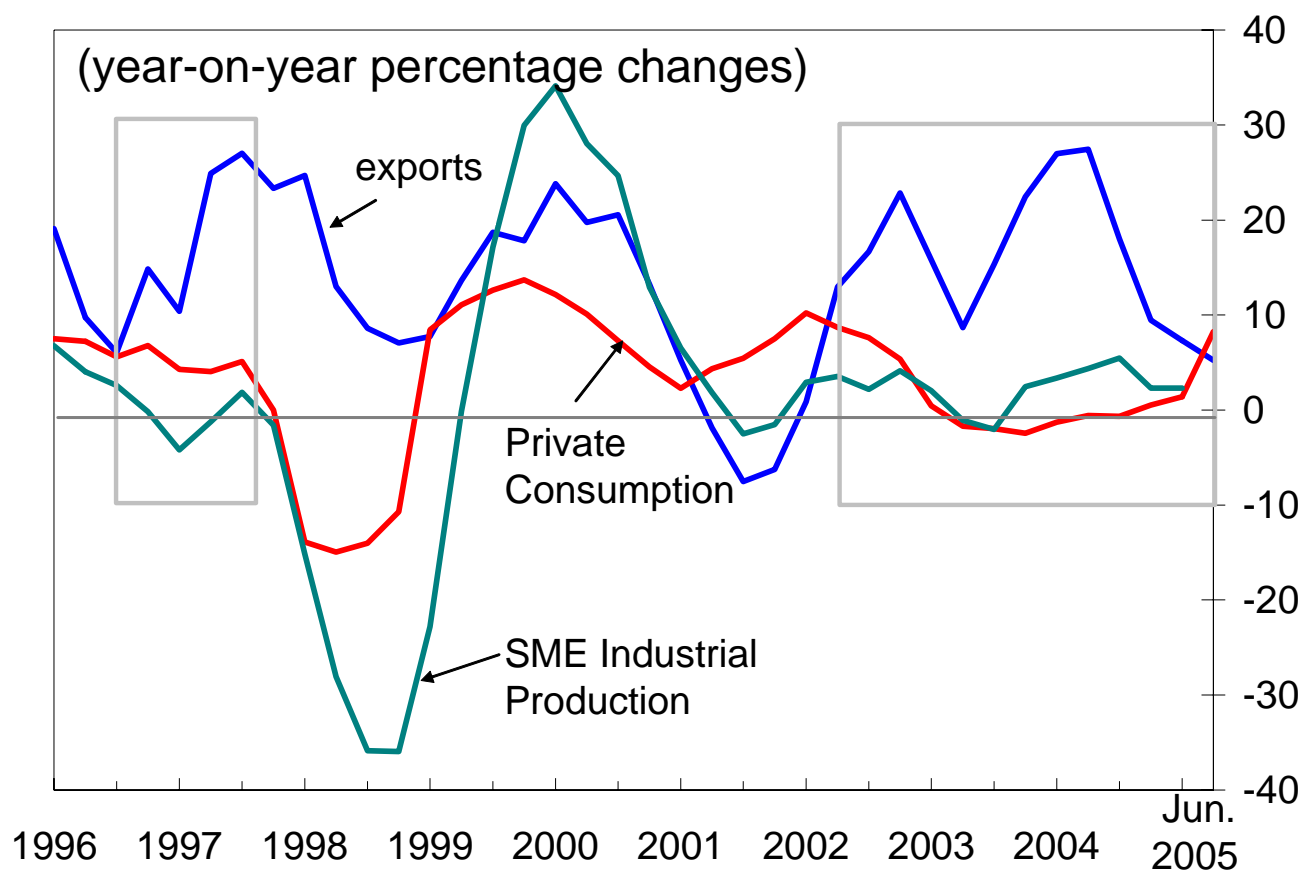


2. Restructuring the SME Sector*

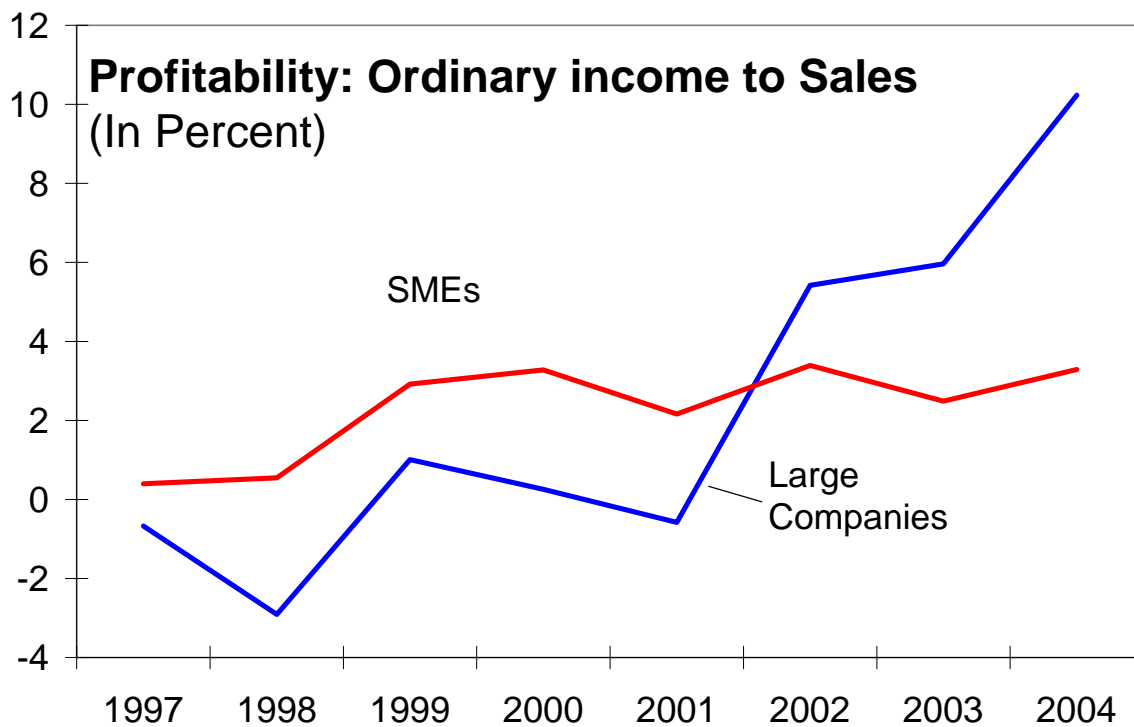
- SMEs are an important part of the economy.
 - 85 percent of employment; 50 percent of manufacturing output; 40 percent of exports.
 - Cover wide range of industries.
 - Banks have significant exposure to SMEs.
- Current difficulties: cyclical AND structural.
 - Hit hard by slowdown in domestic demand.
 - 1/3 of SMEs with interest coverage ratio below 1.
 - But profound structural problems as well.

* SMEs are small and medium-sized enterprises.

SMEs Have Close Links to Domestic Economy



SME Profitability Has Fallen Below That of Large Companies



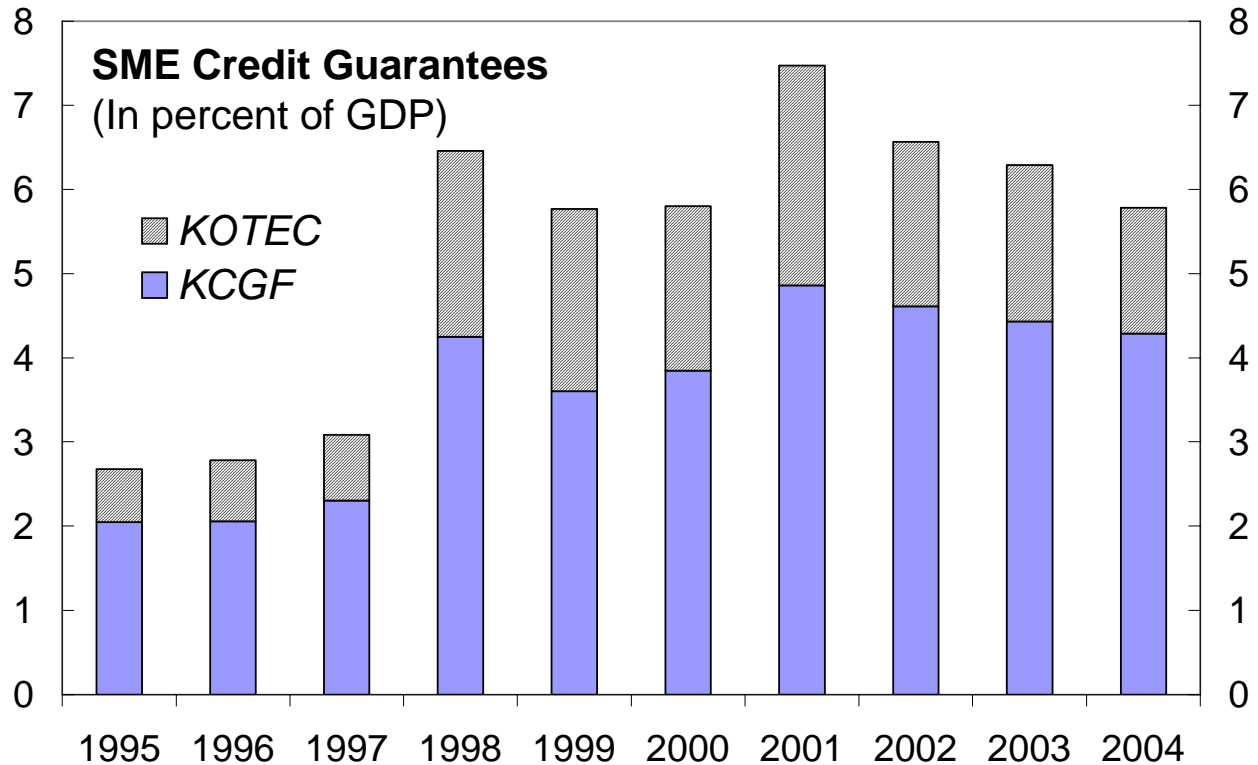
Source: Financial Statement Analysis (2005), BOK



Revitalizing the SME Sector: Comparison with Taiwan

- Taiwanese SME sector similar to Korea's.
 - 80 percent of labor force; 20 percent of exports.
- But profitable despite competition from China.
- High entry and exit rates.
- Small role for government credit guarantees
 - 1½ percent of GDP vs. 6¼ percent in Korea.

SME Credit Guarantees in Korea Have Increased Significantly Since 1997



Sources: Korea Credit Guarantee Fund and Korea Technology Credit Guarantee Fund



Lessons for Korean SMEs

- Strongly support government plan to redirect guarantees to start-ups and new tech firms.
- Need to gradually scale back gov't guarantees.
 - Reduce loan coverage from current 85 percent.
- Relax legal rules on venture capital firms.
- Amend Civil Code to allow for wider range of collateral and securitization, e.g. receivables, technology.
- Support unified insolvency law (new DIP system in '06)



To Summarize...

- **Korea has made tremendous progress in reforms.**
 - Banking system strengthened.
 - Large corporations restructured.
 - Capital markets expanded.
 - Transparency improved.
- **However, agenda is not complete. Key priorities:**
 - Enhance flexibility of the labor market.
 - Restructure the SME sector.
 - Improve further corporate governance.

