

## EVALUATING RESTRUCTURING IN EACH SECTOR

*The Public Sector*

Public sector reform is an extremely critical issue for the Korean economy. Over the past year under the IMF program, restructuring efforts have been concentrated on the corporate and financial sectors for various reasons. Not only were there clear calls for reform in these areas from the start of negotiations with the IMF, but it was also pointed out by many that the direct causes for the currency crisis lay in these two sectors. Accordingly, public sector restructuring seems to have taken a back seat to corporate and financial restructuring.

However, if one examines the situation more deeply, it is clear that public sector reform is the most critical and urgent task for the Korean economy's revitalization. The fundamental reason why Korea's enterprises and banks lack competitiveness is the government's habitual interference in financial and industrial policy. Especially in Korea, the public sector has had the tradition of controlling and regulating the private sector. Therefore, for restructuring in the corporate and financial sectors to be truly effective and meaningful, public sector reform must be carried out fully.

Public sector restructuring over the last year can be divided into 3 parts: reorganization of the government's structure, privatization of state-owned enterprises, and deregulation. Initial efforts centered around structural reorganization, resulting in a general reduction in personnel and size and also a redefinition of functions. For example, the Deputy Prime Minister

system was abolished, trade-related responsibilities were transferred to the Ministry of Foreign Affairs, and the Office of the National Budget was established.

The highlight of public sector reform has been the privatization of state-owned enterprises. Firms like POSCO, Korea Electric Power Corporation, and Korea Telecom, are to be sold off to private hands, including foreign capital. It is expected that privatization will provide various benefits, including the inducement of foreign capital, introduction of competition to the current monopoly or oligopoly system, and enhanced managerial efficiency, among others.

In the case of deregulation, a Deregulation Commission under the direct control of the President was established with the goal of eliminating 50% of all regulations at the ministry level within 1998.

Progress in public sector restructuring to date has been somewhat lacking in terms of visible results. Regarding the reorganization of the government structure, the biggest problem has been policy confusion among the various ministries and/or special commissions which have been established since the new administration stepped in. For example, there is confusion and overlap on trade-policy-related duties and functions among the Ministry of Finance and Economy, the Ministry of Foreign Affairs and Trade, and the Ministry of Commerce, Industry and Energy. A similar situation exists among the Ministry of Finance and Economy, the Bank of Korea, and the Financial Supervisory Commission. There is also the overlapping of

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the budget function between the Planning and Budget Commission, which is an independent office and the Office of National Budget, which is under the control of Ministry of Finance and Economy. The policy confusion and overlap among the government authorities makes the private sector even more uncertain about the future direction of the economy.

Regarding the privatization and restructuring plans for public organizations, even though the government has announced the general plan and direction, some of the announced plans have been infeasible from the start, while others have been delayed or postponed due to resistance from related businesses or government organizations. And as for deregulation, reform has been piecemeal and centered around the number of regulations scrapped as opposed to their effectiveness, with administrative practices remaining virtually the same.

There is also the problem that it has not been officially announced who should be leading public sector reform, who should be mediating the various interests, and who should be coordinating policy.

For public sector restructuring to proceed as planned, the first step should be to designate a certain ministry or organization to be responsible for policy coordination. Toward this end, reviving the office of the Economic Deputy Prime Minister could be an alternative, as well as making the currently horizontal policy making and implementation process into a more vertical one.

Second, to effectively pursue the downsizing of government personnel, an obstacle to government restructuring, measures allowing greater labor flexibility need to be implement-

ed. Just as in the private sector, the government should introduce a restructuring layoff system, job sharing programs, temporary on-demand employment and other flexible measures.

Third, to make the privatization of public corporations truly effective, it is essential that privatization is pursued in harmony with the overall industrial policy as well as the fair trade policy. Concrete plans should be developed to ensure that competition is fostered in conjunction with privatization.

And finally, in the case of deregulation, entry barriers and price regulations hindering private economic activities must be abolished. Also, deregulation should be undertaken from a qualitative aspect focusing on end-user satisfaction rather than a quantitative aspect focusing on the number of regulations which are eliminated, regardless of their relevance. In addition, a regulation evaluation system should be quickly implemented and applied to all regulations so that deregulation can be pursued more efficiently.

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### *The Corporate Sector*

Corporate restructuring efforts in Korea have been focused on three main areas: improving firms' financial structures, improving their governance structures, and improving their business structures. Toward this end, the Korean government has revised and expanded upon various laws and institutions to facilitate restructuring, while firms have been spontaneously trying to attract foreign capital, pursue M&As, and eliminate unprofitable business lines.

Progress has certainly been made in all three areas. First, various institutional measures and systems have been adopted or strengthened to provide enhanced management transparency and improved governance structure. These include the introduction of the outside-director system, the strengthening of the rights of minority shareholders, and the mandatory provision of combined financial statements. Second, firms are in the process of improving their financial structures through efforts including the gradual elimination of cross-subsidiary Debt guarantees and the reduction of their debt-equity ratios. Third, the big business groups are readjusting their business structures to focus on their respective core industries through means including the elimination of failing companies or business lines, work-outs with creditor banks, and business swaps among other things.

However, in spite of this progress in corporate restructuring, there are still several problems with the current economic policies. To begin with, there are negative side-effects stemming from the government's excessive intervention. Many markets to be affected by restructuring are not functioning properly, and some markets are totally unprepared. In that sense, government intervention is needed. But if the government does not limit its efforts to fostering markets to function more efficiently, then firms will lose their incentive to restructure spontaneously and take a passive response to the government's policies, which in turn will cause the restructuring actually needed to restore competitiveness to be delayed.

Second, because of hasty policies shooting for short-term results, the original objective of corporate restructuring has been lost, and restructuring is now only focusing on down-

scoping and downsizing. Restructuring should be aimed at eliminating inefficient areas and finding new competitive advantages in order to enhance a firm's overall competitiveness. However, the government policies have been overly focused on eliminating bad sectors. Not only is it unclear when this will translate into stronger competitiveness, but it could eventually lead to weakened growth potential.

Third, the government has not been able to provide a suitable environment or proper incentives for firms to restructure themselves autonomously. For example, allowing the establishment of holding companies would be a useful and practical means of facilitating restructuring, but this is still banned. In addition, the government has done little to promote the restructuring market in terms of expanding the buyer side or the brokerage function of the market, concentrating instead only on the supply side or business divestitures. This has, of course, caused asset values to fall but weakened any chances of real progress being made.

To sum up, the government has provided or improved various legal and institutional measures to promote the corporate restructuring process, and there have been some visible results. However, in order to truly stimulate corporate restructuring and have this translate into strengthened competitiveness, many additional steps are needed.

Of these, the first and foremost should be clearly delineating between the role of the government and the role of firms. The government should focus its efforts on implementing and putting into full effect the existing or planned restructuring measures, thereby providing firms with the requisite environment for pursuing restructuring autonomously.

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Toward this end, in the short term, the government should quickly adopt systems such as the holding company system which can catalyze restructuring, while quickly eliminating from the market companies which have been judged to be failing.

In the longer run, the government should focus its attention on setting up institutional measures to ensure better corporate governance and management transparency, while refraining from directly intervening in firms' business portfolios or their ownership or management structures.

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### *The Financial Sector*

Given that Korea's economic crisis originally started from financial market turmoil, it seems only natural that full-scale restructuring and enforcement measures have been implemented most strongly in the financial sector. Between the outbreak of the crisis and September of this year, 92 financial institutions were closed down. Even those who survived underwent severe downsizing programs. Despite these pains, the story is not ended so easily. Though the Korean government often says reform in the banking sector is over, what has happened in this sector is just a beginning of harder things to come as financial institutions continue to restructure from within.

In the course of financial restructuring many hardships and burdens have been thrust upon Korean businesses and Korean taxpayers as well. The amount of bad loans is expected to be even more than 100 trillion won and cannot be resolved by the financial institutions themselves.

The Korea Asset Management Corporation (KAMC), which is a government-held vulture company, is purchasing a major part of this debt. The Korea Deposit Insurance Corporation is injecting public fund for the recapitalization program with 64 trillion won to be financed for this operation.

As a result of this first stage of financial restructuring, the soundness of banks has improved significantly. The average BIS ratio is currently higher than 10%. A series of mergers, including Commercial-Hanil, Hana-Boram and Kookmin-Korea Long Term Credit, has created world class banks at least in terms of asset size.

Compared to one year ago, the financial market is dominated by apparently new rules which conform to principles such as openness, competition, and self-responsibility. Many regulations were liberalized not only for domestic institutions but also for foreign ones. As the business categories of banking industry are being integrated with each other, financial institutions are going to be exposed to more and more competition. Moreover, government has already set up the system that can quickly expel losers from the market.

While there have been these improvements, there have also been some shortcomings especially in the process of implementation. Even though it is true that Korea has made some significant steps in terms of financial restructuring, one year is too short a period to practice policies to their full extent. Also, it is hard to expect an improvement in the banking sector immediately after some of the 'soundness' measures were imposed. But being anxious about the apparent outcome, in many cases the Financial Supervisory Commission (FSC) directly forced private institutions to follow its own intentions. Instead, it

< Contents of The First Stage of Financial Restructuring >

Policies	Duration	Contents
Emergency action against Seoul and Korea First Bank and other merchant banks	97. 11 ~98. 3	- shut down financial institutions whose debts exceed assets
Confirming basic framework of financial reform	98. 4. 14	- put policy priority on banking industry - flexible policy for other financial sectors concerning market situation
Confirming the amount of public funds for financial restructuring	98. 5. 20	- 64 trillion won is planned for recapitalization and purchase of bad loans
Completing the first stage of financial reform	~ 98. 9	- set up prompt corrective action and general standard of soundness - restructuring by mergers, closure, P&A, bridge bank, etc. - recapitalization and purchase of bad loans

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should have focused on 'supervising' financial transactions. Some of the reform policies were executed based on ambiguous standards without a full consensus among the policy-makers, thereby evoking unnecessary confusion in the market. Some were lacking clear vision or action plans to follow. In addition, while many bad banks were forced to close or to be merged with other good banks, in some cases, some banks were heavily recapitalized by the government. This kind of government-led restructuring is in contrast to the ultimate goal of restructuring itself—the establishment of a free and competitive financial system.

While the government has finished just the banking sector restructuring, to be exact, other sub-areas of the financial sector have not yet been sufficiently restructured. With the corporate sector still being under the burden of

tremendous debt, restructuring in these areas could cause another wave of a credit crunch, which already severely hurt Korea's real economy in the first half of 1998.

The first year of financial restructuring has generally been recognized as having been successful. Korea tided over the financial crisis such that the credit crunch was significantly relieved. What should be done now is focusing on improving the competitiveness and efficiency of the financial industry. For this job, financial restructuring must be conducted in a way that conforms to the market principle. In order to avoid a possible credit crunch and to relieve the pain that is felt by businesses, future restructuring in other sub-areas of the financial sector should also be accompanied by the supplementary flexible monetary policy or by relevant tax policy measures.

### *The Labor Sector*

*"A flexible labor market where a firm can freely hire and fire depending on its business situation, however, is an indispensable component in the reform of the Korean economy."*

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Issues regarding labor and employment are often not just an economic problem but more frequently social and sometimes political ones as well. In Korea where most households are dependent on labor income and where most people have not experienced unemployment or lay-offs during the last 30 years, the situation is far more complicated. A flexible labor market where a firm can freely hire and fire depending on its business situation, however, is an indispensable component in the reform of the Korean economy. Naturally, policy makers in this field surely face an intrinsic dilemma in this sense. Therefore, the restructuring process in the labor sector should be one that is based on the principle of consensus and fairness as well as providing unemployed workers with a minimum level of subsistence. Toward this end, in 1998 the Korean government, labor, and businesses reached the tripartite agreement (Korean version of a social pact) for the first time in history. Among the issues that they discussed and reached an agreement upon were the social security net, basic rights of labor, and general conditions for lay-offs, among others.

These efforts have achieved many important steps for a more flexible labor market. Layoffs and the worker dispatch system were finally legalized. In actuality, layoffs were first legally supported by law from March 1997, but it was practically impossible to lay off workers since the law defined many complicated pre-conditions. By eliminating or simplifying most pre-conditions except for the obligations of sincere efforts of avoidance (of lay-offs) and priority in rehiring, however, it became a more effective legal system with the February 1998 amendment.

While this progress based on the tripartite agreement among the three parties is very encouraging, one can point out some shortcomings, too. First, though simplified, many pre-conditions are still ambiguous in their interpretation and as a result, subject to arguments from both labor and businesses. The definitions of making an effort of avoidance or the effort of rehiring are examples. Second, the flexibility of labor market must be more extended. The current legal system is just focusing on 'quantitative' flexibility. However, labor market flexibility is not just a matter of the number of the employed; it should include qualitative concepts such as expected income level, proper placement and positioning. In fact, the Korean labor market is far from being qualitatively flexible, in this sense. Complicated regulations related to employment, wages, working hours, and other issues, still remain as obstacles against enhancing labor market flexibility.

Labor market restructuring policy should focus on eliminating complicated regulations to effectively guarantee labor market flexibility. Also it should comprise providing infrastructure which will enhance the efficiency of the labor market not only from the viewpoint of employers (demand side) but from that of workers (supply side). The vocational training system and employment security network are typical topics that we should work on more. In addition, labor policy, in a larger sense, has to concentrate more on creating jobs. The ultimate goal of labor market flexibility is not only downsizing the workforce but also improving the labor market environment by providing new (kinds of) jobs. VIP

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