MAINTAINING REFORM EFFORT ESSENTIAL FOR KNOWLEDGE-BASED ECONOMY IN KOREA

Following are excerpts from a speech by Lee Hun-jai, Minister of Finance and Economy at the APEC Forum on Shared Prosperity and Harmony. (Editor's Note)

I would like to point to the three main factors behind fast recovery and transformation. They are the government's timely macroeconomic policy adjustments to facilitate a quick rebound, implementation of sweeping reforms to restore market stability and to prevent recurrence of a future crisis, and strengthening the social safety net to preserve national cohesion in carrying out reform programs.

Our first priority was to resolve the foreign exchange shortage and regain access to the international financial market. To this end, the government closely cooperated with the international financial institutions, including the IMF, the World Bank, and the ADB. In addition, the government quickly initiated negotiations with private lenders, and successfully extended the maturity of most of the nation's short-term debt.

Having addressed the liquidity problem, Korea had to deal with the severe domestic credit crunch. Korea undertook a tight monetary policy in line with the IMF policy recommendations. It resulted in many negative consequences such as the record high level of interest rates and corporate bankruptcies.

To resolve these problems, the Korean government put special efforts into adjusting its macroeconomic policies, including the adjustment of interest rates downward. This has helped to ease the severe credit crunch and acted as a stimulus to the stock market and domestic demand. A similar adjustment was made in the fiscal policy to promote recovery and preserve national cohesion by expanding the social safety net.

Then, the government initiated drastic reform measures to correct its deep-rooted structural problems.

The economic reform drive has been underpinned by the "four plus one" approach. The "four" means comprehensive reforms in the financial, corporate, public and labor sectors. And the "plus one" represents our strong commitment to market opening, particularly the liberalization of the capital market and the promotion of foreign direct investment.

In the financial sector, non-viable financial institutions have been closed or merged. Viable institutions cleaned up their balance sheets through recapitalization and the settlement of non-performing loans.

In the corporate sector, non-viable corporations have been pushed to exit at the initiative of creditor banks. For financially distressed but viable corporations, workout programs were established in partnership with creditor institutions and management.

Special emphasis has been placed on reforming Korea's big conglomerates - or chaebols. Chaebol reform aims at ending fleet-style management, and making each individual subsidiary an independent and competitive unit with a sound capital structure. To date, the chaebol have undertaken fundamental changes. This means improved debt leverage structure, reduced excess capacity, upgraded corporate governance standards, and greater concentration on core competence.

Concerning the labor market reform, Korea has achieved substantial progress. Labor's traditional militant stance is changing, particularly in terms of disciplined respect for rules and laws.

In the public sector, the government has eliminated red tape and streamlined its organizational framework. The government is also moving ahead on privatizing many state-owned enterprises.

We have greatly liberalized and opened Korea's markets to draw foreign investment and competition under the principle of national treatment. Indeed, foreign direct investment into Korea surged to a record high of $15.5 billion in 1999, up from $8.9 billion in the previous year.

Liberalization of the foreign investment regime has greatly contributed to the Korean economy through the provision of productive financial resources, the creation of value-added job opportunities, the transfer of technology and management know-how, and the expansion of export markets via new strategic alliances.

"Are structural reforms and market liberalization actually essential for overcoming a crisis in any country?" I believe that the answer to that question will be different depending on the causes of the crisis. In the case of Korea, the government correctly recognized that the economic crisis was caused not just by a temporary shortage of foreign reserves, but by long-standing structural weaknesses in the economy.

If we had simply replenished our foreign reserves with the help of the outside world and international organizations, or simply changed the direction of our macroeconomic policies without correcting the root problems, we would not have been able to overcome the crisis on the most fundamental level.

Recognizing this, the Korean government decided to undertake sweeping reforms to establish a new economic paradigm. This paradigm is based on President Kim's governing philosophy of the "parallel development of democracy and market economy." Korea's economic reform goals have been far-reaching - with the dual purpose of preventing recurrence of economic crisis and achieving sustainable economic growth in the 21st century.

Korea has a number of key challenges facing us. Most important, we must address two inevitable adverse consequences of the crisis resolution process: the widening of the income gap, and increasing fiscal deficits and government debt.

The inequitable distribution of income came about with the shrinking of Korea's middle class alongside the bankruptcies of many small- and medium-sized enterprises. With economic recovery, however, we are seeing an opposite effect. There is a burgeoning of new small- and medium sized-firms and venture businesses. The middle- and low-income classes are already experiencing benefits from this new growth.

The government has also proactively worked to address this issue by establishing a new work-based social welfare system. "Productive welfare" measures include improving the tax system, expanding further the social safety net, and increasing investment in human capital development.

The government has been faced with the challenge of a large jump in the fiscal deficit To restore fiscal soundness, the government has instituted a plan to achieve a balanced budget by the year 2003. VIP