

VISIBLE SUCCESS AND INVISIBLE FAILURE IN POST-CRISIS
ECONOMIC REFORM IN KOREA:
INTERPLAY OF THE GLOBAL STANDARDS,
AGENTS AND LOCAL SPECIFICITY*

LEE KEUN

Seoul National University

KIM BYUNG-KOOK

Korea University

CHUNG H. LEE

University of Hawaii at Manoa

YEE JAEYEOL

Seoul National University

Post-crisis reform was one of the most comprehensive and decisive reform that was implemented in Korea. This paper develops a model of reform dynamics. This paper subsequently uses this model to discuss the following arguments. First, while reform tends to achieve some nominal success in terms of making new laws and several quantifiable targets, it has not been able to achieve much success in really changing institutional conventions, habit and beliefs, such as enhancing transparency in the management or trust in labor relations. Second, it had mixed results as a result of the reform process involved tension between global standard and local specificity. Third, one source of the implementation difficulty in reform has to do with the institutional complementarities, and we need to take a proper sequence in reforms. One possible logical sequence seems to be moving from banking reform, corporate governance, labor relations, and finally to business restructuring. The paper concludes by tossing up a question of whether the Korean response (the reform blueprint) was right.

Key Words: *Post-Crisis Economic Reform, Korea, Global Standards, Local Specificity, Institutional Complementarities.*

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INTRODUCTION

Once famous for its rapid economic growth and tagged as an East Asian miracle, Korea was subject to the shame of being one of the crisis-struck economies. However, the Korean economy also showed one of the quickest and strongest turn-round since 1999. While some attribute this recovery to the reform achievement, others still challenge this view and observe that not-much has been changed actually.

We consider Korea as a very unique country which has experienced, within a very short period of time, "everything" from miracle to crisis, and a stunning turn-around. As such, the Korean case raises two important issues. The first issue is how to link the old success regime to the recent crisis. In other words, the financial crisis of 1997 has again brought to surface the old debate on the role of market vs. state in economic development. On one side is the market-based view that finds state intervention in financial markets (i.e., over-regulation by government and/or crony capitalism) as a culprit for the crisis (Summers, 1998). On the other side is the statist view that blames the crisis on the reckless deregulation of financial markets inspired by neo-liberalism (Chang, 1998; Crotty and Lee, 2001).

While this first question has been sufficiently addressed by the literature, another issue that needs to be resolved is the need to interpret the post-crisis reform and the subsequent quick recovery. Some studies on this subject do not dig into the broad questions of whether the Korean growth regime has really changed, whether institutional reform can be done so quickly and thoroughly, and whether recovery is really due to the reform (C. Lee et al., 2007; Coe and Kim, 2002; Hooley and Yoo, 2002).

Examining how Korea's economic systems have been reformed offers an exemplary case study of the process and outcome of the reform intended to introduce global standards but conditioned by a country's political economy and initial conditions. This study will examine the role that various interest groups (agents) played in the reform and how initial conditions constrained its process and the performance of the system that has emerged from that process. Specifically, the study will examine the role played by chaebols, bureaucrats, external pressures, and the prevailing ideas on reform and liberalization espoused in academia. Thereby, the analysis will reveal the motivating reasons for reform initiatives and will identify the factors responsible for the success and failure parts of the reforms in Korea. For instance, we will discuss how the influence of chaebols and the strategic

behavior of bureaucrats affected and/or manipulated the choice of reform blueprint as well as its implementations. This is borne out of the prediction of the thesis of economic entrenchment proposed in Morck, Wolfenzon, and Yeung (2004). We also aimed to find out how the initial conditions, such as segmented labor markets, high premium for owner-controller of the firm, and so on, affected the course of corporate restructuring so that the standard Anglo-Saxon model has not realized at its purist form, and/or has not worked as originally expected. This is consistent with the argument by Rodrick, Subramanian, and Trebbi (2004) stating that desirable institutional arrangements have a large element of context specificity arising from differences in historical trajectories.

As analyzed in K. Lee (2006), Fanelli and McMahon (2005) and Fanelli and Popov (2005), questions regarding the reform can be addressed in terms of the followings. First, why were some countries able to undertake reform while others were not? Second, what factors enabled some countries to successfully implement their reform programs while the programs failed in others? Third, why were some reforms more successful at delivering the expected outcomes than others? This paper is also an attempt to answer these questions.

Korea has been relatively successful in carrying out policy and institutional reform. However, it is yet to be seen whether this success has served the country well by putting the economy on a sustainable growth. It is important to find this out because new institutions, especially when they are alien institutions such as so-called "global standards," do not necessarily work harmoniously with locally-specific institutions. That is, successful institutional reform – successful not simply in changing institutions but in achieving its ultimate objectives – is not simply a matter of transplanting an institution from another society. Moreover, it must contribute to helping the country achieve a sustainable economic growth.

The next section discusses a theoretical framework for analysis and derives several hypotheses. Section Three is the main part that provides an analysis of the post-crisis reform to verify the hypotheses. Finally, the paper concludes with a summary of the findings of the study and a reflection on the current state of the Korean economy.

THEORETICAL FRAMEWORK: A MODEL OF DYNAMICS OF INSTITUTIONAL REFORMS

Currently, a new consensus in economic development beyond the Washington consensus has emerged. This consensus recognizes institution

as a dominant determinant over others of economic development (Acemoglu, Johnson, and Robinson, 2001; Rodrik et al., 2002). Institutions of a given society affect the path of its economic development by structuring political, economic, and social interactions among its members (Greif, 1994; North, 1981; Williamson, 1985). As such, institutions can either promote economic development or retard it. As noted by North (1998), societies that are stuck in an “institutional matrix” and do not evolve into impersonal exchange will fail to achieve economic growth, as they are unable to capture productivity gains that come from the specialization and division of labor. Thus, one of the critical things that the developing countries must undertake to bring about economic development is to introduce “correct” institutions in the areas of market regulating, market stabilizing, and market legitimizing (Rodrik et al., 2004).

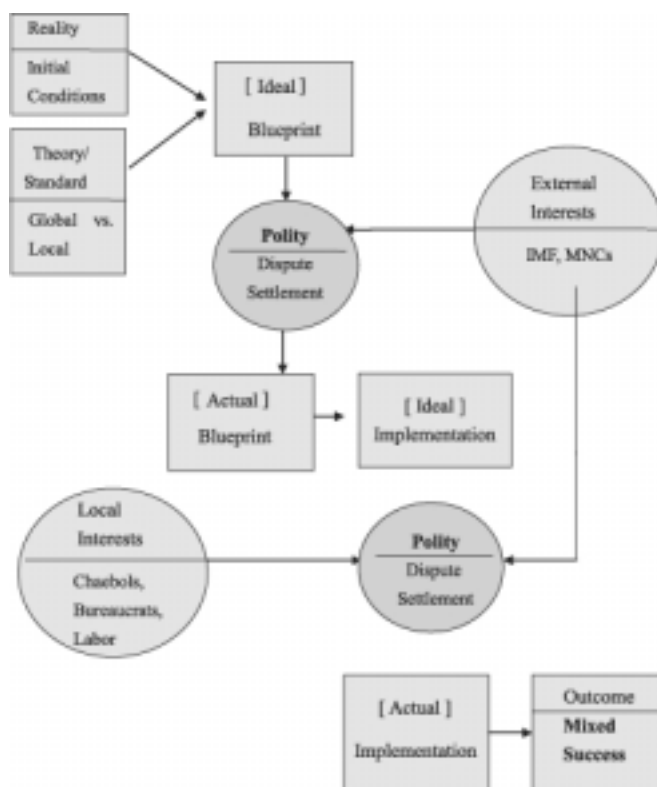


FIGURE 1. MODEL OF REFORM DYNAMICS: INTERPLAY OF DIVERSE MODELS AND INTERESTS.

But for a number of reasons, such institutional reform is difficult to implement and that has to do with the incompatibility that may exist between initial conditions or local specificity on the one hand and the institutions being introduced into the country on the other (Lin and Nugent, 1995: 2362). This is demonstrated in the case of reforms in the transition economies in Central and Eastern Europe. Thus, the mere transplantation of successful institutions from DCs to LDCs is unlikely to have the expected positive effects on performance.

In our theoretical framework, the reform is perceived like a two-stage game. First, it involves the formation of the reform blueprint, and, the second is the blueprint implementation (see figure 1 above). Various players participate in the formation of the blueprint and its implementation (figure 2). Thus, diverse ideas, theories, and interests compete against each other in this reform game. We posit that there exists an ideal blueprint, and that the actual blueprint tends to deviate from this ideal because it is affected by the contests among theories and interest groups. The same is posited for the implementation process, such that actual implementation tends to fall short of ideal implementation.

The ideal blueprint is the one that reflects objectively the existing reality of the economy (the initial conditions) and the existing economic theories or ideas. Some key components of the initial conditions (or local specificity) include: the historical role and perception of the state in the economy, the long prevailing structure of ownership and governance in firms, and the level and structure of trust between management and labor. Depending

<p><u>Players and their goals</u></p> <p>〈External〉</p> <p>IMF: stability of financial order and international legitimacy</p> <p>MNCs: investment return and access to the local market</p> <p>〈Local〉</p> <p>Big Business: continuing control over the firm</p> <p>Government: economic growth and political popularity</p> <p>Bureaucrats: private benefits and promotion</p> <p>Labor: economic security and political power</p> <p>NGOs: values (justice, equity; transparency etc)</p> <p><u>Strategies</u></p> <p>Each player proposes its own inputs/ideas for reform process to maximize their objectives</p> <p>〈Stage 1〉 Formation of the Blueprint for reform</p> <p>〈Stage 2〉 Implementation of the Blueprint</p>

FIGURE 2. PLAYERS AND STRATEGIES IN REFORM-DYNAMICS IN KOREA.

upon which economic theories are adopted, the interpretation of reality (data) is different and the prescription is also different. For example, at the time of the crisis, the dominant economic view was that Korea needed to follow the Anglo-Saxon model of the economy as the old "Korean" or "east Asian" model failed and resulted in the economic crisis. In other words, the old model was suddenly abandoned despite the miraculous achievement in the past decades.

Thus, we can state the first hypothesis as follows:

Hypothesis 1:

A possible tension between the global standard vs. local specificity tends to become the cause for the mixed results and/or the sources for conflicts.

With this hypothesis, we would like to emphasize the correct handling of conflicting goals and ideas to reconcile the tension between the global and local standards. First, leadership should identify the correct reform goal, and then study the initial conditions (local specificities) of the country to write a good blueprint suitable for the goal. It must be kept in mind that global standards are often suitable only for developed countries (eg. a bias for profitability against growth).

In our model, whatever the "ideal blueprint" may be, the actual blueprint is affected by various objectives of interest groups and their habits (behavioral patterns. eg, inertia, rigidity, and so on). It involves the interests of the IMF and MNCs as external interests. It is also affected by those of local interest groups, such as big business, bureaucrats, labor and so on. Each of these players has its own objectives and habits, and tries to represent its interests toward the blueprint (see figure 2). For example, the chaebols wanted to keep their control over the business empire, whereas the bureaucrats wanted to preserve their influence over the economy and tended to rely on "uniform regulations" as reform measures (Jwa, 2003). Workers wanted to be economically secure and protected by social safety nets. For their part, civil activists or NGOs pursued such values as justice, transparency and equity with less concern about economic competitiveness.

The voices of those interest groups had a significant effect on the actual course of the reforms undertaken in Korea. The political elite and bureaucrats, who were used to the practices of command and discretion, now began to be increasingly co-opted by interest groups, and the vested interests of domestic producers who benefited from those practices fought their read-guard action against the forces of change. They did this by

blocking or distorting the reform efforts in many sectors in the economy. Consequently, the reforms that were actually implemented were an outcome of conflicts and contradiction between these traditional and new forces.

As a consequence of complicated interest politics, the actual blueprint would be far from the ideal blueprint. The gap between ideal and actual blueprints can be a source for the low performance of reforms. Even after the agreement on the blueprint, however, the process of implementation itself is again subject to interest politics. We note that in the implementation stage, local interest groups tended to raise their voices more effectively and succeed in representing their interests, whereas these local interests or ideas were dominated by the “global standards” and external pressures or interests during the stage to form the blueprint. Furthermore, one of the difficulties in bringing radical changes has to do with the durability of informal institutions which constrain the type and speed of changes in the areas of formal institutions because the newly-introduced formal institutions must be compatible with informal institutions if they are to be effective (Lin and Nugent, 1995). For these reasons, we can expect that the actual implementation of the blueprint is likely to deviate from the ideal implementation and that their impacts will be limited or distorted. Thus, we have the following hypothesis.

Hypothesis 2:

2-1. While reforms tend to make more successes in the area of quantifiable or tangible targets, less satisfactory are often the areas related to the habits and intangible institutions.

2-2. Even the quantifiable or more visible successes are often made in a disguised manner without real changes. This tendency could in turn result in unintended “undesirable” consequences, such as eroding future growth potentials.

The case of the post-crisis reform in Korea is consistent with the above stated hypothesis. The initial state of the economy at the beginning of the reform was characterized by the following: an economy under heavy regulation by the state bureaucrats; family-controlled business with opaque corporate governance; confrontational labor-management relations; and state-owned or controlled banks. After the waves of the reform, the present state of the economy seems to be the same from the initial conditions although some progress has been made. One pattern we noticed is that the reforms tend to achieve some nominal successes in terms of making new laws and several quantifiable targets (eg. debt-equity ratio standards; the introduction of outside directors in the corporate board), and to be more

successful in the areas where interests conflicts are less acute. In contrast, the reforms tend to make little successes or take more time in really changing institutional conventions, habits and beliefs, such as enhancing transparency in management or trust in labor relations.

While the hypothesis addresses the consequences of strategic responses from the agents who are affected by the reforms, the reformers face some difficulties as the result of the inter-connected nature of various institutions comprising a national economy. We need to find out the ‘general equilibrium’ blueprint and/or take a proper sequence in reforms because the character of one reform critically depends on the character of the others. It is important for the reformers to recognize this point.

The concept of institutional complementarity has been utilized in various contexts since Aoki and Okuno (1996) introduced it to explain the Japanese economic system, more especially in the debate on shock therapy vs. gradualism in transition economies. In the case of reform in Korea, we also have found various examples of complementarity or clustering of institutions. For example, a successful banking reform would involve the writing-offs of bad loans, debt restructuring, and prudential regulation. These are directly linked to business restructuring and labor market reform. However, to go ahead with business restructuring, it encounters the difficulty associated with the owner-controlled nature of Korean firms and corporate governance. In labor market reform, the low level of transparency in management and governance tends to interfere with the reform effort to bring in more flexibility in the labor market. The above discussion suggests the following logical (maybe not practical) sequence of reforms. It involves the movement from banking reform, to corporate governance reform, to labor relations reform, and then finally to business restructuring. Thus, we have the following hypothesis.

Hypothesis 3:

3-1. One source of the implementation difficulty in reform has to do with institutional complementarity (Aoki and Okuno, 1996) among sectors.

3-2. In consideration of the inter-connectedness of institutions, the reform implementation should take a proper sequence, possibly moving from banking reform, to corporate governance reform, to labor relations reform, and then finally to business restructuring .

ANALYSIS OF REFORM DYNAMICS

In this section, we provide an analysis of several cases in the post-crisis

reform in Korea with a view to verify the hypotheses derived in Section Two. Verifications are done by delving deeper into the cases consistent with the hypotheses.

1) Tension between the Global vs. Local Standards

Hypothesis 1: A tension between the global standard vs. local specificity tends to become the cause for mixed results and/or the sources for conflicts.

Case 1: Tension in corporate governance reform

Anglo-Saxon model vs. chaebols

What would have been the ideal blueprint for corporate governance and restructuring in post-crisis Korea? The Korean model had no solid theoretical model despite its great achievement in the past. Thus, it failed to defend itself successfully against the sudden pressure of the global or Anglo-Saxon model. The only defense of the Korean model was its successful economy, but the financial crisis and the collapse of many Korean firms nullified this position in a day. Therefore, the dominant blueprint became the Anglo-Saxon model in the post-crisis reform era.

The core of the Anglo-Saxon model is known to be the central position of shareholder value in corporate governance. Along this line, we can find the definition of efficient corporate governance. Shleifer and Vishny (2000) state that the efficiency of the corporate governance system should be considered in view of the possibility that investors can get back the returns from their investment. They also pointed out two concrete conditions to construct an efficient corporate governance system in firms. The first is the existence of large shareholders as holders of negligible share would not have much interest in monitoring firm behaviors and management because they are subject to the free-rider problem. Here, there may be two types of large shareholders. The one is the permanent large shareholder, like the main banks in Japan and Germany or owner-families in Korean firms. The other is the contingent large shareholder, which appears as a take-over bidder or an LBO association in M&A only when the firms perform badly. This is the case of Anglo-Saxon firms. The large debt-holder is also eligible because they too have a big stake in the firms where they lend their money.

The second condition for efficient corporate governance is the protection of minority shareholders' rights against possible expropriation by the controlling shareholders. As such, diverse devices have appeared for this purpose, such as derivative suits, rights of access to accounting books and so on.

We can see that the underlying idea of conditions for the efficient corporate governance system is that there should be an owner-controller who has a vital stake in firms and takes responsibility for outcomes. At the same time, while such a person is given authority and initiative to run firms, he should not be allowed to sacrifice the interests of non-controlling minority shareholders.

While these are general conditions for efficient corporate governance, we can address another issue which is especially important in the Korean context, namely, the reduction of chances of enjoying private benefits by being the controlling-owner. This is important because the reason for the controlling-owner to want to set up the controlling minority structure is to enjoy private benefits from such control. The bigger the private benefits from controlling firms, the more likely it is for the controlling-owner to take the otherwise-unjustifiable projects. In a similar context, Bebchuk (1999) observes that the founder of a firm would like to maintain control over the firm, rather than take the firm public, when there is a bigger private benefit which is available. The same logic applies to the case of a CMS (controlling minority structure) firm. The controller would like to maintain the CMS structure as long as it continues to give him/her private benefits. Therefore, if the CMS or the separation of control rights and cash flow rights is the source of the problem for the chaebols, then we have to first reduce the private benefits from controlling the firm. Then, the owner-controller would have less incentive to maintain the CMS setup of the firm by circular stock-ownership and/or stock-pyramids. In the Korean context, the higher protection of non-controlling shareholders' rights, and the more disclosure of accounting and financial information of a firm would be effective.

Now, given the dominance of the Anglo-Saxon model and the definition of efficient corporate governance, let us examine to what extent the Korean reform followed this model and blueprint. First, we can see that we should not try to get rid of the owner-controller from Korean firms. It is so good to have a family that has a stake in the firms. Rather it is necessary to induce them to increase their share in the firms. Second, there is a definite urgency to increase and protect the rights of non-controlling shareholders and investors. Third, it is important to reduce the private benefits of the controlling shareholders. Fourth, if we are also concerned with competitiveness of firms, the firms are to be given full freedom in their investment decision-making. Then, the revival of regulation on inter-firm equity investment within each big business group should be avoided. Any shortcomings or illegal matter had better be handled now by shareholder activism than by the clumsy visible hands of the government.

Now let us compare this ideal blueprint with the actual blueprint. Then, we first notice that despite the fact that the active role of the board is not one of critical components in the ideal blueprint, post-crisis corporate reform put heavy emphasis on the reform of the board system and the introduction of outsider directors. However, as noted before, the board is a key institution in the Anglo-Saxon model of firms, and it is important because the board is expected to provide a check and balance against management so as to alleviate an agency costs problem between shareholders and the top management. Nonetheless, it is also well known that the board's role in this check and balance is limited because directors on the board are usually friends of the top management.

A more critical area should be the strengthening of the rights of non-controlling shareholders in light of the ideal blue print. Shareholders' rights have of course increased in terms of the threshold for exercising rights to file suit, making proposals at a general meeting, the inspection of firms' accounts, and the dismissal of directors. But a class action suit against directors, which is one of the most effective tools to enhance the rights of shareholders was not introduced early, but delayed for a later period like 2002. It seems somewhat strange why the scheme was put off for a later period. Maybe the Anglo-Saxon package did not realize the importance of this measure, or maybe the strategy of big business was to allow not-so-critical components such as the outside directors but to try to delay this critical measure like a class action. Only a few agree that currently in Korea the non-controlling shareholders have effective means to protect their rights in a firm. It is for this reasons that we can say that the second important conditions for efficient corporate governance have not yet been fulfilled in Korea. In this sense, it was a kind of "partial implementation" (Ruie and van de Walle, 2003) meaning that the least onerous components or the ones that have the least impact on the status quo tend to be implemented.

Reversal of the global standards: the revival of the cap on equity investment

If non-controlling shareholders are given effective means (e.g. class actions) to protect their rights (invested capital and returns), then the government would neither have to worry so much about firm management nor have to maintain so many regulations over the behaviors of firms. In this regard, one interesting example is the regulation against equity investment by a company to other companies. The Korean government and the Fair Trade Commission, a government bureaucracy, set a maximum limit of the equity investment as 25 to 40% of net assets of each affiliated-company. It

was well known that with this circulating equity-investment among affiliates, the chaebol families had been able to keep their control over their business empires, and it seemed natural for the regulation body to try to limit such investment. However, it was against the global standards since it regulated the investment behaviors of private firms. In the US, there were no such restrictions. Furthermore, the foreigners' share-holding increased rapidly with the opening of the domestic stock market and the heavy inflow of foreign portfolio investment in the market. Korean firms then complained about the possibility of hostile takeovers by foreign firms, whereas they could not defend themselves given the regulation against the inter-firm investment. Such a restriction against investment was also perceived as a hindrance to restructuring, an entry into new businesses and an exit from old businesses. Thus, this regulation was abolished in February 1998.

However, from April 2001, just three year after the abolishment, the restriction was reinstated. It was argued that without this restriction, the chaebols had been trying to just issue more stocks to meet the requirement for reducing debt-equity ratios rather than paying off their debts. As table 1 shows, the debt-equity ratios actually declined substantially without paying off debts. This was made possible as the top chaebols issued simply more stocks taking advantage of the re-bounding stock markets. However, this revival of investment restriction signifies the reversal of the global standards or the reform by the bureaucrats. While many foreign firms have now entered the Korean market competing with Korean firms, and while any former barriers to M&As are now all abolished, it is against the market principle that Korean firms are discriminated in terms of investment. Owing to this restriction, many Korea firms now find themselves exposed to hostile M&As, as exemplified by the famous case in 2003-5 of the SK Corp. versus

TABLE 1. REFORM OF CAPITAL AND BUSINESS STRUCTURE AND THE OUTCOMES

〈Part A. Debt/Equity Ratio – Simple Average〉

Debt/equity Ratio	Top 5 chaebols	6th-30th chaebols				Top 30 chaebols
		6th-10th	11th-20th	21th-30th	6th-30th	
2002 end	177.14%	135.95%	353.61%	232.78%	261.75%	247.65%
2001 end						171.19%
2000 end	253.21%	193.42%	707.33%	57.94%	344.79%	329.53%
1999 end	212.02%	234.21%	330.55%	627.53%	430.07%	393.73%
1998 end	335.00%				497.70%	
1997 end	472.90%				616.80%	

〈Part B. Gross Debt – Simple Average〉

Gross Debt (Tril. Won)	Top 5 chaebols	6th-30th chaebols				Top 30 chaebols
		6th-10th	11th-20th	21th-30th	6th-30th	
2002 end	56.93	13.64	11.04	3.92	8.55	16.61
2001 end						
2000 end	51.01	10.98	6.03	2.71	5.69	13.24
1999 end	47.02	13.19	5.37	3.87	6.33	13.11
1998 end	46.91				5.30	
1997 end	44.27				5.46	

〈Part C. Net Profits or Losses – Simple Average〉

Net Profits or Losses* (Tril. Won)	Top 5 chaebols	6th-30th chaebols				Top 30 chaebols
		6th-10th	11th-20th	21th-30th	6th-30th	
2002 end	4.67	0.97	0.11	0.10	0.28	1.01
2001 end						
2000 end	1.08	0.35	-0.15	-0.23	-0.08	0.11
1999 end	1.68	-3.96	5.37	-0.39	-0.90	-0.47
1998 end						-0.95
1997 end						-3.2

* Net Profit = (Revenue - Cost) - Interest - Tax = Operating Profit - Interest - Tax
= Ordinary Profit - Tax

〈Part D. Net Profits/Sales – Simple Average〉

Net Profits/Sales*	Top 5 chaebols	6th-30th chaebols				Top 30 chaebols
		6th-10th	11th-20th	21th-30th	6th-30th	
2002 end	6.69%	5.81%	3.04%	1.14%	2.83%	3.48%
2001 end						
2000 end	1.06%	2.16%	-2.01%	-20.12%	-8.42%	-6.84%
1999 end**	2.97%	-16.74%	3.41%	-19.21%	-9.67%	-7.56%
1998 end	-3.30%				-7.90%	-4.50%
1997 end	0.00%				-2.00%	-0.80%

Source: Korean Fair Trade Commission (released in April each year).

the Sovereign Asset Management, and they are spending substantial amount of firm resources to defend themselves.

Despite not being a component of the global standards, the regulation of inter-firm investment was revived as a need of political leadership to satisfy activist NGO groups and general attitudes in the Korean public against the power of big business, as well as the probable wishes of the bureaucrats who

want to maintain their influence. In a sense, it might be called another example, or a Korean version, of clientalism, although in this case the clients were not big business but NGOs and populism (Ruis and De Walle, 2003).

Rigid imposition of the global standards: the debt-equity ratio of 200%

Another important reform measure was the reduction of debt-equity ratios. In the Anglo-Saxon model and in most developed countries, the debt-equity ratio of firms is lower than 200%, while it used to be around 400% in Korea. With the development of the capital market, progress in related reforms, and the experience of financial crisis itself, it is natural to expect a gradual and eventual decline of this ratio in Korean firms. But the Korean government declared the uniform and abrupt goal of the 200% as the ultimate target. While Korean firms actually fulfilled this target, it is out of question that such a uniform regulation is neither efficient nor beneficial to competitiveness (Jwa, 2003). An acceptable or optimal debt-equity ratio varies among firms, industries and countries.

The issue of the uniform reduction of debt ratios is the problem of both the blueprint and implementation accorded to our model. A preference for such extraordinary practices like uniform regulation sits at the bottom of the habit set of the Korean government and bureaucrats. As a legacy of state-led industrialization, the paternalistic government, refusing to discriminate among different firms, has often found it "politically safe" to apply the same disciplinary measures to all firms across the board (Jwa, 2003).

Case 2: Tension in the Labor Market Reform and the Consequences

Whereas the post-crisis reform aimed to restore market principles in the bureaucratically-structured labor market, the interaction with local politics and power relations among major actors and groups has produced such a segmented labor market, in which core sector workers are over-protected while periphery workers are marginalized.

The gap between aspiration and achievement cannot be explained without considering local specificity, such as the institutional and cultural context for reform. Whereas the central intent of the reform agenda was to alter Korea's institutions, the reform effort was itself embedded in that same institutional matrix. As a result, it was inevitably compromised. Notwithstanding the apparent triumph of the market, the acclimation of domestic culture and social institutions to the imperatives of economic and financial liberalization and "global standard" remains incomplete.

One of the key reasons for the confusion and conflict during the post-crisis labor reform is closely related with the conflict between two different types of the economic system. In return for the bailout program, the IMF imposed the liberal market model that had been a ready-made prescription for the economic illness in Latin America or in Eastern Europe. Without enough time to reflect on the validity of the model, then-President Kim Dae Jung hastily accepted the prescription of the IMF.

Reviewing the history of capitalism, we find varieties of capitalism based on different institutions and reflecting diverse natural environment, culture and historical backgrounds (Hall, 1986). Notwithstanding the differences in the details, the Korean version of capitalism has been rather closer to the Japanese than the Anglo-American or European version of capitalism. This is revealed in a close relationship between state and business, the enterprise-based welfare system, and firm-based internal labor markets.

However, after the economic crisis, the reform was equated with imposing the global standard, which is in fact another name of the Anglo-American model, on the local context. However, we find at least three different types of institutions are mixed as a result of the reform. First of all, restructuring and change in corporate governance were based on the Anglo-American model, while the tripartite commission consisting of labor, business and government representatives was based on the European model of "private interest governments." In this model, the state delegates its power to the peak organizations in labor and business sectors. For their parts, these peak organizations with representation and power over their affiliated members coordinate and bear the responsibility for macro-economic policy. Two different blueprints were in conflict with each other, and with the local employment system.

Anglo-American model and increasing segmentation as its consequence

The Korean employment regime (K-type hereafter) is quite different from the Anglo-American employment regime (A-type hereafter) as a result of the long tradition of paternalism and its propensity for a long-term relationship between employers and employees. This Korean model resembles the Japanese employment system in several points, especially its emphasis on harmony among workers and the role of leadership and teamwork. Wages are determined by seniority of workers, having a very rigid structure that is well protected from the fluctuation of economic environment. Therefore, the speed of promotion becomes the main incentive, as it ultimately determines the amount of life-long remunerations. In the Korean model, like the

Japanese case, the most important skills are firm-specific and general, and knowledges regarding the management of human networks within and between organizations.

It is obvious that the Korean type employment has characteristics opposite to the Anglo-American system, or to the "global standard" of the employment system. Therefore, labor market reforms come as a shock in several aspects. First, layoffs give more impact on K-type workers than to A-type workers. Layoffs deprive of the contextual knowledge from workers, as it is embedded in tightly coupled employment relationship in the K-type system. As a K-type is a 'task-oriented system,' laid-off workers find it more difficult to find a comparable job in different firms. Secondly, the dynamism of K-type employment has been maintained by the rapid growth of the economy and the implicit agreement that the workplace is a ground for life-long commitment comparable to the family. However, the economic crisis and stagnation have destroyed the myth of family-like and life-long engagement. Economic stagnation undermined the stability of the promotion system. Thus, this renders some higher positions increasingly redundant. Thirdly, many companies have identified layoffs as a panacea to their problems. For the first time in Korea's recent economic history, these core workers, usually highly educated managers and skilled technicians, became the target of mass layoffs. However, mass layoffs of core members undermined the moral foundation of the K-type system, such as harmony and commitment. Gradually, the implementation of layoffs confronted the resistance of labor, especially in the well-organized sector.

Eventually, the main burden of labor markets is the enhanced flexibility that was borne by "labor" via the "labor-market flexibility" mechanism prevalent in the Anglo-American countries. It is not surprising that joblessness rose, particularly among unskilled workers (see table 2). As shown in the table, the unemployment rate of teenagers was 20.8% in 1998, and that of the age group in their 20s was 11.4%. In 2002, the overall unemployment rate was 3.1%, while that of teenagers showed 11.1%, of people in their 20s 6.3%, in their 30s 2.8%, and in their 40s 1.9% respectively. Unemployment and underemployment rose in terms of both quantity and duration. There appeared a significant proportion of "atypical," part-time and daily workers in the "employed" pool.

Flexibility was most needed in large firms. The increase of non-regular workers was least noticeable there, while the proportion of non-regular workers increased very fast in small- and medium-sized firms. It shows that the burden of introducing flexibility at the macro-level was unequally imposed in the labor market. As a result, the dual structure of the labor market was strengthened, and the market was segmented into the core

TABLE 2. UNEMPLOYMENT RATE BY AGE GROUP

Time	Unemployment rate(%)	Age Group					
		15-19 Years old	20-29 Years old	30-39 Years old	40-49 Years old	50-59 Years old	60 Years old & over
1990	2.4	9.2	4.9	1.6	1.2	1.1	0.4
1991	2.4	9.3	4.9	1.3	1.2	0.9	0.3
1992	2.5	10.2	5.3	1.4	1.1	0.9	0.4
1993	2.9	11.0	6.3	1.8	1.2	1.0	0.4
1994	2.5	9.3	5.4	1.6	1.3	0.8	0.3
1995	2.1	7.9	4.3	1.4	1.1	0.9	0.4
1996	2.0	7.4	4.4	1.4	1.1	0.9	0.4
1997	2.6	9.8	5.3	1.9	1.5	1.2	0.8
1998	7.0	20.8	11.4	5.7	5.6	5.3	2.4
1999	6.3	19.5	10.1	5.3	5.2	5.1	2.3
2000	4.1	13.8	7.1	3.4	3.3	2.9	1.3
2001	3.8	13.3	7.0	3.0	2.8	2.6	1.1
2002	3.1	11.1	6.3	2.8	1.9	1.8	1.0

Source: Statistical Office. *Statistical Yearbook of Labor* (various years).

and the periphery. The unions of large firms, led by KCTU, used the opportunity to demand massive wage increases, and the wage gap between large and small firms continued to grow. The unions of large firms increased their job security at the cost of new employment of the youth and the wage of peripheral workers. It is noteworthy that the scapegoat is the youth group. The unemployment rate of the youth skyrocketed at the beginning of the crisis, and it still remains very high. Increasing inequality is reflected in the Gini coefficient, which rose from 0.283 to 0.320 between 1997 and 1999.

Implanting the European corporatist model to the Korean soil

For the first time in Korean history, the government, business, and two labor organizations established the Tripartite Commission (TC). The Federation of Korean Trade Unions (FKTU) and the more radical Korean Confederation of Trade Unions (KCTU) joined the TC. The promotion of labor market flexibility was the most important among the agenda agreed by the TC. The union accepted employers' right of redundancy lay-off and dispatch of workers. In return, unions were entitled to more political representation, unemployment insurance, and extended social safety nets.

The pact was regarded as the elimination of a major barrier to the economic reform, i.e., removing labor market rigidities. However, the tripartite

committee was hurriedly constructed without institutional legacy. There are several reasons for the failure of the TC in Korea. Despite the potentials shown during its initial years, the impacts of the TC accord are mixed. The TC has contributed to the maintenance of social peace at the early stage of the reform, but it failed to stabilize industrial relations.

First of all, there is no tradition of party-politics based on class-cleavages in Korea. The TC was rather an arbitrary arrangement without the support of the political party that represents the interests of the working class. Both KCTU and FKTU did not hold the real power to properly represent affiliated unions. Enterprise-based unionism, which has been the tradition in Korean trade unionism, was not functionally compatible to the TC that was developed in a corporatist institutional framework. As the peak labor organizations have neither the capacity for policy-making nor the power to impose their decisions to affiliated unions, the social pact became a mere scrap of papers. Secondly, Korean companies have developed the enterprise-based employment system. This is represented by the internal labor market of firms. Likewise, labor unions tried to develop an isomorphic structure to respond effectively to the enterprise-based employment system. Companies tried to develop "employee consciousness" and trade unions responded with "union-member consciousness," but both of them were based on the same enterprise.

2) Visible Success and Invisible Failure

Hypothesis 2:

2-1. While reforms tend to be more successful in the area of quantifiable or tangible targets, less satisfactory are often the areas related to habits and intangible institutions.

2-2. Even the quantifiable or more visible successes are often made in a disguised manner without real changes. This tendency could in turn result in unintended "undesirable" consequences, such as eroding growth potentials.

Case 3: Post-crisis Corporate Governance Reforms

Post-crisis corporate restructuring has significantly improved the capital and business structure by reducing debt-equity ratios and increasing profitability. This should be taken as very important because in the past the typical strategy by the chaebols in response to any government reform initiatives against them tended to be a "time earning" strategy, delaying the implementation of any specific measures as long as possible. However, it is important to realize that the reduction of debt-equity ratios was not made by

paying off debts, but by issuing more stocks. In part B of the table 1, the average amount of the gross debt in the top 5 chaebols rather increased from less than 50 trillion won to more than 50 trillion won between 1997 and 2002, and the other smaller business groups showed the same trend in this regard. In other words, quantifiable or more visible successes were often made in a disguised manner without real changes.

Next, the outcomes are even less satisfactory or mixed when we look at the areas where the habits and mindsets of firms are involved. In table 3, let us first look at the survey results of corporate governance in ten Asian countries done by CLSA in 2001 and 2002. According to table 3 part A, the scores of

TABLE 3. RESULTS OF CORPORATE GOVERNANCE SURVEY IN ASIA

〈Part A. Overall Scores〉

Countries	2002		2001		Change from 2001	
	Ranking	Score	Ranking	Score	Ranking	Score
Singapore	1	65.4	1	64.5	0	0.9
Hong Kong	2	64.4	2	62.9	0	1.5
Malaysia	3	64.1	3	56.6	0	7.5
India	4	62.2	4	55.6	0	6.6
Korea	5	62.0	8	47.1	3	14.9
Thailand	6	60.0	5	55.1	-1	4.9
Taiwan	7	59.2	6	54.6	-1	4.6
China	8	50.8	7	49.1	-1	1.7
Philippines	9	44.0	9	43.9	0	0.1
Indonesia	10	38.2	10	37.3	0	0.9

Source: CLSA (2001 and 2002), recited from Jang (2003).

〈Part B. Rank by Areas〉

Korea Ranking in Asia 10		2001	2002	Changes in Ranking from 2001 to 200
		5	8	3
Ranking Survey Questions	Disciplin	6	8	2
	Transparenc	1	8	7
	Independenc	7	4	-3
	Accountabilit	2	4	2
	Responsibilit	7	8	1
	Fairnes	7	9	2
	Social awarenes	2	4	2

Source: CLSA (2001 and 2002), recited from Jang (2003).

Korea have increased from 47.1 in 2001 to 62.0 in 2002 with its ranking improved from the 8th to 5th. In part B of table 3, such improvements are decomposed into several sub-areas.

It shows that transparency improved its ranking in a great degree, possibly reflecting the requirement to file the consolidated/combined financial statement. Also, a progress has been made in such areas as accountability and responsibility, reflecting the increased rights of shareholders. Although class actions are still not allowed in Korea, we can say that the rights of general shareholders are now better recognized than before. We are now seeing and hearing many cases, which we have never heard before. In these cases, minority shareholders raise objections to, or raise suits to, the transactions of the top management or controlling shareholders. Actually, the increasing rights of minority shareholders have become part of the social movement, involving an organization called "People's Solidarity for Participatory Democracy"(PSPD). In the meantime, management is now starting to say that independent management is increasingly threatened by such movements as activists are promoting shareholders' rights. Such a voice from management is understandable too, given the lack of sufficient "business judgment" safe harbors as in the American system (OECD, 1998). Now, an increasing number of Korean companies are buying their directors insurances for their legal liabilities in preparation for increasing lawsuits. In sum, the important matter should be how to balance the interests of management and shareholders and, furthermore, how to align these two interests. The OECD (1998) suggests that a performance-based compensation is a useful tool for this purpose, with stock options as one of the best. However, in Korea the stock option measure is just being introduced although it is being spread very rapidly.

Turning back to the survey results in table 3, one noteworthy feature is that all sub-areas have made progress except the independence of the boards. We take this feature very telling. All other aspects such as transparency, accountability and responsibility are measured in the survey by specific quantifiable or tangible targets. For example, the survey asked whether shareholders can demand the general meeting of shareholders and whether they have the rights to see accounting books, and whether group-affiliated firms report consolidated and/or combined financial statements and so on. As you see, these are basically minimal formal requirements and cannot be directly translated into transparency, accountability, and responsibility. However, an assessment of the independence of the board requires a subjective or qualitative perception, and in this area the survey shows deterioration. The appointment of outside members on the boards has been

TABLE 4. RANKING FOR COMPETITIVENESS AND CORPORATE GOVERNANCE, 2002

〈Part A. IMD Survey〉

	Country Competitiveness	Corporate Boards	Shareholder Value	Insider Trading	Rights and Responsibilities
Korea	27	41	39	36	40

Source: IMD (2002), recited from Jang (2003).

〈Part B. WEF Survey〉

	Competitiveness	Corporate Boards
Korea	28	61

Source: WEF (2002), recited from Jang (2003).

one of the core reform measures, and the role of the boards may have more direct links to corporate governance than other aspects.

Table 4 compares Korea's ranking in national competitiveness with that in corporate governance. We see there is a substantial gap in the results by both the IMD and the WEF (World Economic Forum).

Korea was ranked as the 27th in national competitiveness, but its ranking in corporate governance is well below this. Also, in this comparison, the ranking in corporate boards (independence) is lowest. At present, in most cases, these independent directors are known not to play any active role in corporate governance, with a few exceptions.

Last, we would like to point out that the visible successes come with some sacrifices in other important aspects. Owing to restructuring, corporate profitability has improved significantly. This pattern indicates that big businesses in Korea have been reorienting their focus from sales or market-share expansion to profitability or the rate of returns. These achievements might have come by sacrificing investment in physical capital and R&Ds. As noted in the preceding section, the 'investment to GDP' ratio has fallen substantially now, although it should be lower than the level of the excessive investment period before the 1997 crisis. More specifically, we can ask what has happened in terms of real competitiveness and efficiency of firms. This is important because more transparent corporate governance itself might not be the ultimate goal of firms unless it is translated into performance.

The empirical analysis using the firm data by Park (2003) shows a little improvement in efficiency or productivity. It indicates that the rate of the total factor productivity change has rather decreased steadily from 2.4 % between 1996 and 1997 (pre-crisis period) to 1.2% between 1999 and 2000 (post-crisis period), in the case of the top 30 chaebols. When he decomposes

this productivity change into three sub-components of 'technological change (rate of innovation),' 'scale efficiency change' and 'technical efficiency (distance from the production frontier) change,' we note that the rate of technological change and technical efficiency change has rather declined over the entire (pre- and post-crisis) period.

3) Institutional Complementarity and Sequencing

Hypothesis 3:

3-1. *One source of the implementation difficulty in reform has to do with institutional complementarity among sectors.*

3-2. *The implementation of reforms should take a proper sequence, possibly moving from banking reform, to corporate governance reform, to labor relations reform, and then finally, to business restructuring.*

Case 4: Connectedness between Business Restructuring, Capital Market Efficiency and Corporate Governance

Before the onset of the 1997 financial crisis, the Korean economy was a symbol of high growth. Thus, Korean firms had not experienced much restructuring of their businesses, namely, the process of selling-out, closing-down, or reducing unprofitable segments and subsidiaries. For this reason, the 1997 crisis was a big shock for the business sector. Post-crisis business restructuring was initiated by the government. The so-called 'big deal' program was to implement business swaps among the chaebols, or big conglomerates. Although the amount involved was so big, and thus, it was thought that the government had to play as an intermediary, the government-initiated big deal had achieved only mixed results. For example, the sale of LG's semi-conductor line to Hyundai did not guarantee the success of Hyundai semi-conductor (Hynix after a name change). The troubled Hynix emerged as one of the biggest headache for the post-crisis Korean economy, although it has made a stunning turnaround recently.

As there were many criticisms of the government-initiated business restructuring, the government tried to take a different approach to those sectors which still seemed to need restructuring. The government only designated the names of those sectors and decided not to direct any concrete or detailed ways to restructuring for the second round of business restructuring starting in early 2001. These sectors included chemical fiber, paper production, cement, agricultural machines and so on. While the situation of these sectors was particularly bad, there was not much market-driven restructuring in the form of M&As, divestments, or

closing-downs. Thus, the government wanted to do something, but there was really not much things to do. Moreover, they did not want to be blamed again for “inefficient government intervention.”

However, the ‘voluntary restructuring’ was not easy, either. While the government wanted firms to commit themselves to the major hauling of their businesses, the firms were saying that, without debt-equity swaps or debt rescheduling or reductions, horizontal restructuring among firms such as M&As would not happen. Commercial banks then said that without some words or even implicit signals from the government, they could not afford to give such favors as debt reductions or swaps to firms, and that it was better for the government to pour its own money to those troubled firms.

Below, we will see what went wrong in this second round of business restructuring with the paper production industry as a representative case (C. Lee et al., 2007). The paper industry was a mature industry, and there was world-wide restructuring mainly in the form of M&As. On the other hand, while Western firms refrained from expanding production capacity, Korean firms continued to expand the capacity throughout the 1990s with their capacity more than doubled from the 1990 level. The firms made losses and their debt ratios increased as the market turned into an excess capacity situation.

Korean firms tried to deal with this situation in their own ways, with strategic alliances as the main responses. For example, two companies signed an agreement of ‘comprehensive strategic alliance’ in February 2001. This agreement was to coordinate their production, marketing, procurement, and logistic. Their motivations were known to overcome the limits of within-firm restructuring by affecting the market with some coordinated actions among the players.

However, it was an easy task to realize any merger deal. And the reason for this is noted as deficiency in market infrastructure, including the lack of intermediary bodies, corporate governance issues, and the related transparency problem in firms. First of all, since information revealed in the accounting books of the firms is neither accurate nor reliable, it cannot serve as the basis for price negotiation in M&A deals. While this is the first and immediate source for the price haggles, another source is the high premium for management control rights. As corporate governance is not clear, some diverse channels for the expropriation of company resources by the controller exist, so-called “tunneling.” They wanted to maintain their control over firms unless they are paid substantial premium because the stakes are very high for controlling management. For these reasons, the two sides tend to find it difficult to agree upon the prices of the target.

While this case shows the limit of the so-called 'voluntary restructuring' without direct government involvement, it also exemplifies a market failure in the sense of the lack of an intermediary vehicle to facilitate the M&As and sales of firms, associated with the efficiency and size of the overall capital market in Korea. Another reason has to do with the prevalence of group-style firms in Korea. Since many firms are affiliated firms of one business group or another, the restructuring is driven by group-level considerations, rather than at the level of each firms, which makes the process end up "intra-group" restructuring.

But, the point of the above story is not to blame the market-based or global standard approach itself, but rather, it is to emphasize the need to address certain necessary conditions for such an approach to be effective, or equivalently the importance of local specificity. We first noted the insufficient development of an intermediary vehicle to facilitate the M&As and sales of firms, and then pointed out the extra premium attached to the owner-controllers of the firms associated with the opaque nature of corporate governance. The existence of controllers' premium suggests that this part should be tackled first before we take the "market will do the job (M&A)" attitudes.

Case 6: Connectedness between Labor Reform and Corporate Governance.

As Lee and Lee (1992) stressed, labor market in Korea during the high growth period used to be flexible, with management commanding full authority over workforce restructuring. Employment also used to be short-term oriented. However, after the turning point toward labor shortages and especially since the 1980s, employment practices gradually became longer. With democratization from the Roh Tae Woo government and after experiencing mass-scale labor strikes in 1987, the power of labor unions became stronger and the labor market turned into a very rigid one. However, this change was okay at least when the economy continued to grow as businesses were always in need of more work forces.

Since the mid-1990s, the economy started to slow down and fell into the crisis in 1997. With this turn of events, labor market flexibility, especially the downsizing of workforce, emerged as one of the most issues in overall corporate restructuring. Actually it was in early 1997 even before the onset of the crisis that the first revision of labor-related laws was made by the strong demand from a management side. However, it was right after the crisis, namely February 1998, that the revised law officially allowed management

the right to discharge “redundant” workforce when companies are in bad situations.

To examine the process of workforce restructuring, we took the case of an automobile company which experienced, for the first time as a big company, a large-scale downsizing of workforce, after the revised labor law had come into practice. Well analyzed in C. Lee et al (2007), this was a very noteworthy case that attracted national and international attention given its size and meanings.

The company felt the need for workforce restructuring and initiated it since mid-1997 with the slowdown of the domestic market. The company formally announced the downsizing plan in April 1998. The plan estimated about 40.6% (18,730 employees) of its workforce as redundant workforce, as the firm was experiencing a 40% cut of production volume from the normal level. The company first started to invite three rounds of voluntary quit-off from April to June with a total of 4,455 workers filing for retirement. The initial response from labor was that no single worker can be laid off and work-sharing combined with the reduction of work hours should be introduced. As the bargaining between management and labor did not reach an agreement, the firm came up with the list of 2,678 workers to be discharged on July 20, and soon issued the actual order of discharge to 1,538 workers on July 31. The labor union responded with six rounds of strikes, the occupation of work floors and sit-ins, starting on July 20, 1998.

Finally, the government decided to intervene in the recognition of the importance of this case, especially for international investors. With the intermediary role of the government, on August 24, both sides of management and labor reached an agreement of the lay-off of 277 workers and 2,018 workers, given on-leave without pay as its core content. This agreement of lay-off, though the numbers were small, was an important compromise from the labor side, in light of its initial position against any lay-off, and, on the other hand, the reflection of management’s strong will, given the symbolic meaning of involuntary lay-off, the first case of its kind in Korea.

In sum, the company can be said to have achieved its goal, although not solely by the lay-off means, close to its original target of 10,166, if one includes those separated in the form of retirement and on-leave without pay. The short run cost of this process from the management side amounted to roughly 1 billion US dollars worth of cars with 100,000 units to be produced during the period of strikes, as well as minimum living subsidies to those on leave without pay and one-time complementary pays for those discharged and retired. Taking into these costs, the net benefits of the whole plan of

workforce downsizing are quite problematic. Moreover, as the company made a remarkable turn-around in 1999 even to the level of acquiring another major automobile company, the company recalled those who had been on-leave without pay and those who had been discharged earlier.

Also, if one knew such a quick turn-around in advance, one doubts whether it really had to go through all the hassles that hurt both sides of management and labor, in terms of not only monetary costs but also such symbolic values as job security and loyalty. This makes one wonder why both sides did not avoid the path toward mutual destruction or huge costs. We would like to point out the lack of transparency in the firm management and accounting matters as one of the most important reasons for both sides not to have reached an agreement in a better manner (C. Lee et al., 2007). It is often observed that management does not provide the labor side with sufficient information about the status of the company and tends to avoid huge profits from appearing in accounting books with a view to ward off the distribution demand from the labor side. At the same time, it is also the case to avoid losses, too, since they do not want to be blamed. As a matter of fact, the labor side argued that the accounting book showed a profit of 700 million won, but in reality the company (A automobile) made losses in 1997. It is widely broadcasted that the post-bankruptcy investigation of the accounting books of two other major automobile companies revealed the manipulation of the magnitude of several billion US dollars.

Given this situation and practices, it is hard to blame the labor side not believing what is told by management about the situation of the company. It is meaningless to provide the labor side with the accounting information of the company and to demand such information, since the accounting books are manipulated. Thus, labor unions had no choice, but simply demanded more from the other side, regardless of the situation of the company (C. Lee et al., 2007). Even when the company falls into troubles, the labor side perceives it as a fault of the management side, but feels that they are not responsible for it. As a result, they feel furious when they have to be laid off out of the situation which they are not responsible for.

At a more fundamental level, the issue of management transparency goes beyond the level of labor-management conflicts to the level of the top level governance. Only when a good corporate governance system is in place, one can expect transparent management and information disclosure to the labor side. Only after that, a more efficient and less costly bargaining between labor and management can prevail. This story is indicative of the connected nature of reforms, namely, the linkage between labor reform and corporate governance reform.

SUMMARY AND CONCLUDING REMARKS

1) Summary of the Findings

First, our analysis confirms that informal institutions take time to change or reform. This implies that macroeconomic reform might be easier than microeconomic and institutional reforms. We have found that reform tend to achieve some nominal success in terms of making new laws and several quantifiable targets (eg. debt-equity ratio; introduction of outside directors), and to be more successful in the area where interests conflicts are less acute (opening capital and M&A markets to foreigners). In contrast, the reform tend to make little success because it takes more time in really changing institutional conventions, habits and beliefs, such as enhancing transparency in management or trust in labor relations. Then, the lesson is that any serious reform blueprint should take this point into account.

Second, one source of the implementation difficulty in reform has to do with institutional complementarity (Aoki and Okuno, 1996) among sectors. Because the character of one reform critically depends on the character of the others, we need to find out "general equilibrium" blueprint and/or take a proper sequence in reforms with the following connectedness in mind. To successfully carry out banking reform, which involves the writing-offs of bad loans, debt restructuring, and prudential regulation, is directly linked to business restructuring and labor market reform. But, to go ahead with business restructuring, it encounters the difficulty associated with the owner-controlled nature of Korean firms and corporate governance. Since the owners of firms have a high stake in the firms owing to opaque corporate governance, they tend to resist inter-firm restructuring (M&As or sales) of firms under their control unless paid very high premium. In labor market reform, the low level of transparency in management and governance tends to interfere with the reform effort to bring in more flexibility in the labor market.

Third, the reform process tends to involve tension between the global standard and local specificity, which often becomes sources for the mixed results or new conflicts. Then, the difficulties arise from the fact that the new conflicts of interests and the related bargaining process add new complexities so that good elements are often blocked or distorted. In corporate governance reform, while the main agency cost problem in the Anglo-Saxon model of the firm is that of hired management, in the Korean chaebols it is the agency costs between controlling shareholders and minor non-controlling shareholders. In labor market reforms, one pre-condition for

labor flexibility is life-time education and the retraining system, which lacked in Korea. Without this, laid-off workers would find it more difficult to acquire new skills and jobs, and thus they resist strongly against layoffs.

2) Concluding Remarks

Korea implemented one of the most comprehensively and decisively implemented reforms. As of now after 10 years after the break of the 1997 crisis, the economy looks fine and some are concerned about the long term vitality of the economy. While the reform has brought Korean firms into the more stable, profitable and transparent state of business, the national economy is now suffering from weak investment and slow job creation. Some critics like Chang and Shin (2002) and K. Lee (2006) argued that such a situation is the price which the economy has paid in replacing the old catch-up model or East Asian one, not by the new catch-up model but by the Anglo-Saxon model which is more suitable for developed economies. Then, a valid question is whether our response (the blueprint) was right, namely the possibility of a wrong blueprint as noted in Fanelli and McMahon (2005), and also whether the sequencing was right (K. Lee, 2006).

Our reflection is that post-crisis Korea tried to become more market- or Anglo-Saxon model-oriented, but without paying attention to growth and competitiveness. For instance, banks were sold to foreigners who are basically conservative and focusing on consumer lending rather than industrial banking. While the Korean economy should continue to have a growth with more investment, the firms have stopped doing that now with one of lowest debt-equity ratios in the world, now about 100%.

The issue of a wrong or right blueprint underscores the need to define a reform goal correctly. The goal of reform should not just be a movement toward a market-oriented economic system, but toward a growth-oriented one/or pro-growth market-oriented one. The final criterion for success should be whether it is able to enhance the long term growth potential and the competitiveness of the economy, which is the ultimate safe guard against the possibility for another crisis. The firms had better be encouraged to pursue long term growth than short term profitability. The Korean corporate tigers look tamed on the surface, like Anglo-Saxon ones, but in the heart they still need to grow. Along this line of thought, we can identify three sub-goals of the reform, and the goals should be 1) creating jobs, 2) boosting new firms, and 3) reaching new markets, as they are most consistent with long term growth.

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LEE KEUN is Professor at the Economics Department of Seoul National University. He received his Ph. D in Economics from the University of California at Berkeley. His research interests include economics of technology, institutional economics, economic development, and Chinese and Asian economies.

KIM BYUNG-KOOK is Professor at the Political Science Department of Korea University. He received his Ph. D in Political Science from Harvard University. His research interests include international relations, democracy and security, globalization, East Asian regional studies.

CHUNG H. LEE is Associate Dean at the College of Social Sciences and Professor at the Economics Department of University of Hawaii at Manoa. He received his Ph. D in Economics from the University of California at Berkeley. His research interests include development of the Asian NICs, role of government and institutions in economics development.

YEE JAEYEOL is Professor at the Sociology Department of Seoul National University. He received his Ph. D in Sociology from Harvard University. His research interests include risk, social network analysis, trust, and economic sociology.

