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GOVERNMENT-WIDE COOPERATION

Korea Economic Update (Aug 17, 1999)

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Korea Economic Update (No. 99-15)**Financial and Corporate Sector Reforms Korea's Real Rapidly Perking Up Labor Market Flexibility Improved Crisis Wage Gap Widened between Low and High-Wage Following Economic Crisis CPI in July Records Unprecedented Negative Growth**

Financial and Corporate Sector Reforms

Following is the excerpts from the "Korea's Financial and Corporate Sector Reforms to Date," released by the Korean government.

1. Financial Sector Restructuring

Financial sector reforms are being implemented under the following principles: First, reforms are implemented swiftly to regain the soundness of the financial system. Second, unviable financial institutions are liquidated, while public funds are pumped into viable institutions. However, public funds are injected into clean banks. stockholders and staff of the financial institutions promise to absorb their losses. Third, in order to enhance the soundness of financial

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and financial management aimed at profitability are established.

Financial Sector Reforms

Prompt action is being taken to remove unviable financial institutions from the market. As of July 1999, 144 financial institutions have been liquidated, 48 have been merged, and 59 have had their licenses suspended.

(as of July 1999)

	Banks	Non-Banking Institutions*
Number of Institutions	33	2,069
License Suspended	5	54
Merged	4	44
Liquidated		144
Subtotal	9	242
Ratio (%)	27.3	11.7

* denotes merchant banks, securities firms, investment companies, mutual saving & finance companies, credit unions, and leasing companies. In this process, public funds have been provided to financial institutions that have merged or acquired ailing financial institutions. Through these efforts, nearly all banks' BIS-required capital adequacy ratio has surpassed 10 percent and are well on the way to becoming sound banks.

	End of '97	June '98	
Recapitalized Banks* (Average BIS ratio)	6.9-10.29(7.25%)	8.16-13.3(9.28%)	10

* Commercial Bank of Korea, Hanil Bank, Kookmin Bank, Industrial Bank of Korea, Credit Bank, Housing & Commercial Bank of Korea, Shinhan Bank, Hana Bank

As of the end of July, the government has mobilized fiscal funds of 51.1 trillion won to help the troubled sector recover from the crisis. 51.1 trillion won has been injected into ailing banks. In detail, approximately 30.8 trillion won was used for recapitalizing ailing financial institutions and the remaining 20.3 trillion won was injected into the disposal of non-performing loans (NPLs). The government is endeavoring to retrieve the public funds through various measures, such as the disposal of holdings of local bank stocks and issues of asset-backed securities.


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well.

Efforts to normalize or sell unsound financial institutions vigorously made. In July, the government pumped public Korea First Bank to normalize its operations. Negotiations Newbridge Capital are expected to be finalized in the near. Negotiations between Seoul Bank and HSBC are underway. parties signed a Memorandum of Understanding in February. between Cho Hung Bank and Kangwan Bank will be completed by September. The Korea Life Insurance Co. will be sold off and normalization of its operations with the help of public funding failing insurance companies, including Kookmin and Donga, sold off by September.

(Unit: Trillion won)

	11/97-7/
Purchase of NPLs	20.3
Deposit Payment,Recapitalization, and Loss Coverage	30.8
Total	51.1

Legal and Institutional Reforms

The Financial Supervisory Commission was established last year as a consolidated authority to implement and monitor uniform practices. Its main job is to monitor the troubled banks' improvement progress of their capital adequacy ratios while also imposing corrective actions. As a result, not only has the soundness of financial institutions been enhanced, but their capital adequacy ratios have also improved. In tandem with this, financial institutions have taken on a more market-oriented approach toward conducting business activities. Various institutional measures to further develop the capital market have been devised.

2. Corporate Sector Restructuring

Corporate sector restructuring has been led under the Five Principles of Corporate Restructuring agreed upon between the government and business leaders in February 1998. The five principles are: improvement of corporate governance; prohibition of cross-debt guaranties between business affiliates; improvement of corporate financial structure; concentration on core competence; and responsibility reinforcement.

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revised to facilitate corporate-wide implementation of the principles, i.e., enhancement of corporate governance, pro cross-debt guarantees, and responsibility reinforcement.

two principles, i.e., improvement of the corporate financial business concentration on core competence, are being fur

Improvement of Corporate Governance

Since last year, legal and institutional reforms have been i that have resulted in the improvement of corporate gover following is the efforts that have been made thus far to im governance: Consolidated financial statements were adop the beginning of fiscal year 1999. Domestic companies' ac standards were adjusted to internationally accepted stand December 1998. Listed companies were mandated to app directors effective February 1998. The rights of minority sl were strengthened from February 1998. Institutional inve allowed to have voting rights from September 1998. An in system that allows minority shareholders to designate bo was introduced in December 1998.

For the purpose of fundamental improvement of corporat Corporate Governance Improvement Committee, which is civil specialists, has been launched. The committee will d improvement agendas by the end of August and complete ad hoc hearings. Institutional reforms have been made as

Financial Structure Improvement and Core Competence Concentration of Big Five Chaebols

On December 7, 1998, the top five chaebols - Hyundai, Da LG, and SK - reached an agreement on reducing their debt to below 200 percent through such measures as the liquic non-core affiliates. Later in December, the five conglomer creditor banks signed Financial Structure Improvement P stipulate debt-to-equity ratio targets.

(Unit: Trillion won)

	Hyundai	Daewoo	Samsung	LG
Assets	82.0	76.7	61.0	48.0
Debts	61.5	59.9	44.7	36.4
Debt-to-Equity Ratio (%)	312.3	355.1	258.0	315.

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under the supervision of creditor banks.

**Chaebols' Financial Structure Improvement Efforts in 1998
(Unit: Trillion won)**

'98 ? 1st Q '99	Hyundai	Daewoo	Samsung
Self-Rescue Plans*	7.3	6.5	6.4
Done	7.5	1.2	6.2
Ratio of Plans to Accomplishments (%)	105.0	19.0	96.1

*** denotes asset sales and right issues****Improvement of Capital Structure by Businesses Ranked 64th and Middle and Small-Sized Companies**

As of the end of July 1999, a total of 80 companies - 42 large companies and 38 medium-sized companies - were selected as candidates for workout programs. Of these, workout programs for 38 affiliates of 15 companies and 38 medium-sized companies - were completed.

	Firms Ranked 6th to 64th	Firms Ranked 65th to 100th
Applied	47	41
Plans Fixed	38	38
Not Yet	4	
Unqualified	5	2
Done		1

Fresh loans have only been provided to facilitate the structural reforms of those mid- and small-sized companies who had to reduce debt ratios, sell assets, and recapitalize themselves.

Korea's Real Economy Rapidly Perking Up

Korea's major economic indicators in June painted a rosy picture of recovery, according to the "Industrial Activity Trends in June 1998" released on July 30 by the National Statistical Office (NSO). Industrial production, shipments, average operating ratios in the manufacturing sector, consumption, and facility investment soared in June 1998. Year-to-year industrial production rose 29.1 percent, a bullish rate increase in industrial production reflected a technical rebound; the figure was also higher than the rate of increase in the first half of 1998. Shipments grew 30.7 percent. Reflecting the trend...

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manufacturing sector also climbed by a whopping 79.8 percent, almost the same ratio as the pre-crisis level. Underlying the growth in industrial production was the improved export performance and strong domestic demand, according to the NSO. Regarding domestic consumption, wholesale and retail sales were up 14.2 percent in June of last year.

Domestic machinery orders received - which serve as a leading indicator of investment - also sent a positive signal with a 43.8 percent increase compared to the same month of last year. Domestic construction orders received - another leading indicator of investment - dropped 6.2 percent.

The leading composite index, which forecasts economic conditions over the next six months, rose 1.8 percent-points to 184.1 in June from May. The coincident composite index, a measure of current economic conditions, also recorded a 0.9 percent-point increase in June from May.

(Units: Year-on-Year, %)

	'98			
	2nd Q	1st Half	Jun	2nd Q
Industrial Production	-12.2	-9.3	-14.0	22.8
Shipment	-11.8	-8.4	-13.3	24.1
Inventories	-8.0	-8.0	-8.0	-10.0
Average Operation Ratio	67.0	67.9	66.3	76.0
Wholesale and Retail Sales	-16.0	-13.7	-15.9	10.0
Domestic Machinery Orders Received	-43.8	-41.4	-43.6	38.0
Domestic Construction Orders Received	-53.4	-40.2	-43.9	27.0


Labor Market Flexibility Improved After Economic Crisis
Labor market flexibility in Korea has improved a little since the onset of the economic crisis late in 1997, according to an analysis by the Bank of Korea. The improvement in labor market flexibility was mainly due to the introduction of new laws that allowed for easier layoffs and the hiring of temporary workers. However, the decline of real GDP growth to create additional jobs decreased the impact of the economic crisis, implying that employment will be much more difficult to recover in the future.

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ECONOMIC POLICIES	<p>According to the analysis, the labor force participation had once surged to 62.2 percent in 1987, fell to around 1998. In particular, the labor force participation ratio of men reversed its increasing trend after the economic crisis, and the economic crisis deepened employment gender discrimination. In addition, the number of unemployed young men, defined by the OECD as those aged 15 and 25, grew to 15.9 percent in 1998 and then climbed to 16.5 percent from January to May this year. This increase was due to the fact that after the economic crisis, more young people entered the labor force but failed to find jobs in order to offset decreased income.</p> <p>Structural unemployment rate, which had hovered around 3 percent before the economic crisis, recorded around 4.5 percent in the second half of 1998, and then rose to around 5.5 percent level in the first quarter of this year. This structural unemployment rate in Korea is higher than the 5.6 percent rate in the U.S. and the 3.5 percent rate in Japan. The analysis also pointed out that in order to prevent the high structural unemployment rate from being sustained, some measures should be taken as follows: First, Institutional reforms geared to improve labor market functioning should be pursued; Measures to hire as temporary workers should be sought after; Policies to increase the number of employed should be devised; Young job seekers should be given more chances to work, either by providing them with training subsidies or by nurturing an atmosphere where they can study and work concurrently.</p> <p>Small and medium-sized companies, as well as venture businesses, should be developed to create more jobs.</p> <p>Wage Gap Widened between Low and High-Wage Brackets after Economic Crisis</p> <p>Wage gap between low and high-wage brackets was widened since the onset of the economic crisis late 1997, according to a report published by Ministry of Labor. An analysis of last year's data showed that 3,400 firms put the nation's Gini's coefficient at 0.2542, up from the previous year's 0.2521. The Gini's coefficient is a measure of degree of inequality in income distribution. A coefficient of 0 indicates absolute equality, while that of one translates to absolute inequality. The rate of low wage brackets with monthly</p>
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college education rose by 2.1 percentage points to 23.8 percent in 1998 from 21.7 percent in 1997.

CPI in July Records an Unprecedented Negative Growth
Mainly due to the decrease in the prices of agricultural products, consumer price index (CPI) in July recorded a negative growth compared to the end of last year. This negative growth was the first time since the data were compiled in 1983. Compared to June, CPI in July dropped 0.3 percent, but year-on-year CPI recorded a 0.3 percent rise. The average CPI for the first half of July rose 0.6 percent compared to the same period of last year. If the current trend maintains its pattern through the second half of the year, the inflation rate for this year is projected to reach the targeted two percent-level.

Regarding producer price index in July, it dropped by 0.3 percent compared to the same month of last year. The decrease was mainly due to agricultural and fishery products, as well as the industrial products. Compared to the end of last year, the index was a 1.6 percent decrease.

Notable Quotes

Financial Times (August 9, 1999, "Union Backs Daewoo's Financial Troubles")
"I do not expect that Daewoo's financial troubles and problems with its assets would lead to labour unrest. Nobody fights on a ship. Have you seen Daewoo going on strike? The worst thing is that strikes would not save the Titanic Daewoo," Kim Ho-jin, chairman of Korea's labour relations committee.

Reuters (August 9, 1999, "Creditors Demand Daewoo Sell Assets")

"The debt maturity extension and liquidity infusion are necessary to buy time in order to effect an orderly dissolution of the Daewoo Group, which (we) believe is a positive development in the government's effort to reduce economic concentration and excess capacity in the Moody's."






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