The Economist

January 30, 1999, U.S. Edition

South Korean banking. Seoul survivors

SECTION: Business, Finance and Science; FINANCE AND ECONOMICS; Pg. 70

LENGTH: 662 words

HAVING grown up under an authoritarian government, South **Korea's banks** are used to doing as they are told. These days, however, they are receiving very different orders. Once they were told where to lend their money. Now a less authoritarian (but still rather bossy) government says it wants them to fend for themselves. That instruction may actually be harder to obey than its predecessors'.

When financial crisis hit a year ago the IMF forced the government into financial **reform** in return for the $ 58 billion in rescue funds it arranged. Speedy repairs were essential to the banking system, and the government pumped in tens of billions of dollars. Last year it spent 41 trillion won ($ 34 billion) recapitalising the **banks,** disposing of their bad loans, and protecting their depositors. The IMF estimates the total bill will reach 75 trillion won--18% of GDP.

The industry was overhauled. The Financial Supervisory Commission (FSC), the banking watchdog, forced healthy **banks** to take over five sick ones. Another six merged into three commercial **banks.** The government sold 51% of **Korea** First **Bank,** one of the two most troubled, to a consortium of American financial firms, Newbridge and GE Capital. Meanwhile, the number of people employed by the banking sector has been cut by a third, from 114,000 before the crisis, and more redundancies are unavoidable. For example, Hanvit, formed by the merger of two **banks,** Hanil and Commercial, and now the country's biggest, promised regulators it would this year cut its workforce by 1,500--more than a tenth--and close 100 branches.

The **banks** do not attract much sympathy. They were blamed for bringing the country to the brink of insolvency, through their reckless lending to unprofitable firms. But many of them were victims of the government--they were forced to lend to firms it supported. Now, the FSC expects a "paradigm shift" in **bank** management: shareholders and directors will hold sway, at the expense of government. Many old-timers have been sacked, and their replacements will have no choice but to look after the interests of their shareholders, and concentrate on increasing profits.

Foreign bankers, meanwhile, are expected to bring with them sophisticated information technology and managerial skills.

So far so good. Yet analysts have not shaken off all their gloom about South **Korea's banks.** Their non-performing assets stood at 8% of outstanding loans at the end of last year--very low by the region's depressing standards. But they are expected to grow. Many big firms have yet to go through the financial restructurings they need. This will be expensive for the **banks,** entailing debt-for-equity swaps, debt forgiveness and reduced interest rates on **bank** loans.

Last year the **banks** went through similar restructuring. That, coupled with a ruling last July making them value all their bonds and shares at their market price, contributed to huge losses--after tax, the 22 commercial **banks** combined lost 14 trillion won. This year will not be much better. **Banks** will have to increase the provisions they make against some loans from 2% to at least 20%. Into that category fall many of their "policy" loans to once-favoured companies, now bust.

So it is hardly a brave new world for South **Korea's banks,** and it is not certain their managers can cope. They do not have the skills they need to develop businesses other than lending. This will be crucial, as **bank** loans are shrinking as a proportion of the corporate sector's sources of funding (see chart). **Banks** specialising in, say, private banking or in dealing with profitable small firms, may do quite well. But the big commercial **banks,** which used to depend on business from the large conglomerates, may find it hard to be reborn as prudent and innovative institutions. That might take another financial debacle.

LOAD-DATE: January 30, 1999

LANGUAGE: ENGLISH

GRAPHIC: chart

The Economist

September 25, 1999 , U.S. Edition

True-loves and truants

SECTION: The IMF and East Asia

LENGTH: 692 words

DATELINE: BANGKOK AND JAKARTA

AS THE International Monetary Fund began its annual meeting, along with the World **Bank's,** on September 21st, it had plenty of critics to contend with. So the Fund was understandably keen to highlight its successes, among which it would like to count the three East Asian economies it rescued in 1997. It had some good news to crow over. As the meetings began, Thailand announced that it would not need the remaining $3.7 billion of its $17.2 billion IMF-sponsored rescue package. South **Korea's** government, which has been repaying its own IMF loans, announced on September 17th that it had agreed terms to sell **Korea** First **Bank** to a foreign buyer, Newbridge Capital. And Indonesia...well, two out of three isn't bad.

Both the IMF and the World **Bank** have suspended loans to Indonesia because of a widening **bank** scandal. In July it was revealed that **Bank** Bali, a nationalised **bank,** had transferred 546 billion rupiah ($65m) to a company linked to Golkar, the ruling party of B.J. Habibie, Indonesia's president. The money was paid as a "fee" to help recover debts that had already been guaranteed by the government. An audit by PricewaterhouseCoopers revealed that much of the money went to members of the government and of Golkar, but the government has prevented the auditors from announcing the names to the public.

Until the problem is fixed, the IMF has postponed its latest $450m instalment of Indonesia's $43 billion rescue package, and the World **Bank** has put a $300m structural adjustment loan on hold. Indonesia's economics and finance ministers did not even bother to attend this week's jamboree in Washington. Combined with the recent violence in East Timor, the impasse provides further evidence that Indonesia is now a region unto itself, and may continue to deteriorate even if its neighbours recover sharply.

While the Indonesians were playing truant, Thailand's ministers were doing their best to pose as model students. But they have not quite graduated yet. Although the government does not plan to draw down any more IMF money, it is sticking to its IMF **reform** programme, which does not expire until next May. That will allow the government to fall back on the IMF package in the event of any big setbacks. But Chuan Leekpai, the prime minister, said that only a severe bout of renewed regional or global turmoil would make this necessary.

That seems reasonable, since the main reason that Thailand's currency, the baht, collapsed two years ago was a high ratio of short-term foreign debt to foreign reserves. Thanks to healthy current-account surpluses, reserves have now risen to $32 billion, from less than $1 billion after the baht plunged in July 1997. Many short-term foreign loans have been rolled over, relieving the potential strain on those reserves. The main risk is that the loans, so far merely postponed, will not be restructured. That could jeopardise the mild recovery that appears to be under way: the government is now forecasting growth of 3-4% this year.

In South **Korea,** too, there is still a need for structural **reforms** despite signs of economic recovery. The government is forecasting growth of 6-7% this year; and booming exports have boosted reserves. That has allowed it to begin repaying its debts under the biggest bail-out package in the IMF's history: $56 billion. So far, South **Korea** has borrowed $19.5 billion of the $21 billion pledged by the IMF; and repaid a total of $13.5 billion. South **Korea** has also borrowed $10.7 billion of the $14 billion pledged by the World **Bank** and the Asian

Development **Bank,** but it did not need the additional $21 billion-worth in standby loans from several countries. South **Korea** still has problems, including an irresistible urge to tinker in the capital markets, but its dependence on IMF bail-out money seems to have receded.

It is clearly a good sign that South **Korea** and Thailand no longer seem to need the IMF's money. But then, it was largely their need for cash that led both governments to undertake **reforms** in the first place. Will they remember what they were taught when school is over?

LOAD-DATE: October 7, 1999

LANGUAGE: ENGLISH

GRAPHIC: graphic, no caption

The Economist

August 21, 1999, U.S. Edition

On their feet again?

LENGTH: 2993 words

DATELINE: BANGKOK, JAKARTA, KUALA LUMPUR AND SINGAPORE

HIGHLIGHT: A string of recent setbacks will not stall East Asia's recovery. But if the former tigers really want to come roaring back, the region's reformers must redouble their efforts

IT DID not cost nearly as much as the half-built towers and empty golf courses that now litter South-East Asia. But the monument to the region's economies, standing in a pleasant park in Kuala Lumpur, now seems just as foolhardy a project. Commissioned before the region's financial collapse, the marble sculpture depicts a series of vertical columns, arranged in an arc, with each one much taller than the last. Until two years ago, that unrelenting upward curve seemed the perfect depiction of East Asia's dynamic economies. As did its title: "Growth".

No longer. During the collapse of the past two years, the sculpture would have seemed far more appropriate turned on its head. And lately, even the reports of a rapid recovery have begun to appear sadly exaggerated. This week South **Korea** announced the spectacular break-up of Daewoo, the country's second-biggest conglomerate (see). In Thailand, non-performing loans are still rising, five months after the finance minister said they had peaked. Malaysia's state-owned oil giant, Petronas, has been bailing out favoured companies. And a series of Indonesian scandals suggests that the country remains mired in corruption.

All this bad news must, however, be placed in perspective. Although it casts doubt on the extent of the region's structural **reforms,** it will do little in the short term to dent Asia's prospects for recovery (see). In South **Korea,** for example, the rebound has been extraordinary. Year-on-year industrial production was up 30% in June, and private economists are now forecasting 5-8% GDP growth this year. Thailand and Malaysia are also turning around quickly. Even Indonesia, which has sustained a 20% drop in output, is now expected to start expanding in the second half of this year.

Although some economists have predicted a rebound, its speed and extent have taken even optimists by surprise. Take the change in sentiment in the region's stockmarkets. Over the past 12 months those in Thailand and Malaysia have doubled. The main indexes in Seoul and Singapore are now above where they were in mid-1997, when the collapse began. Markets have slipped of late, but investors are still cheery.

As they should be. Despite the slow pace of **reforms,** the mounting signs of recovery are unequivocally good news. After two years of fierce contraction, the economies of East Asia are still operating at well below capacity. But with luck, the vacant offices and deserted golf courses will soon begin to fill up, as life in the region slowly returns to normal. But that will not be the end of the story. For "normal" may prove a rude disappointment to Asia's workers, investors and firms.

Purring not roaring

To many of them, recovery means the phenomenal growth rates of the early 1990s. Yet such growth will be much harder to come by than it was in the past, when the region could expand easily by throwing more people, money and trees at its problems. For all their advantages -- and they still have many -- Asia's economies are more developed now than they were a decade ago. They will retain the advantages of youth for many years yet. But growth will depend less on deploying more people and capital, and more on something rather harder -- raising productivity.

That demands thorough **reforms.** Which is why the news from Asia is so discouraging, even as its economies perk up. If Asia's governments fail to deliver on their promised **reforms,** they will have failed to lay the groundwork for the more efficient use of capital and faster growth in productivity. At best, such a failure would be a drag on economies that will almost certainly continue to grow anyway during the next decade. At worst, the lost opportunity could enshrine Kuala Lumpur's "Growth" monument as a symbol of the past.

This does not mean that Asia should focus solely on the long term, and take its imminent recovery for granted. Recessions have a way of grasping from the grave, and the region is still exposed to a number of potential hazards, especially shocks from abroad. But it does mean that the region's leaders should distinguish the impact of the business cycle from Asia's imposing collection of structural challenges.

Without such a distinction, it is hard to make sense of the mixed news that is streaming out of the region -- or the market's reactions to it. News about the pace of **reforms** undoubtedly affects confidence in the region, and also has some effect on the recovery itself. But for the most part, the litany of proposed **reforms** has less to do with terminating Asia's recent recession than with making the next one less vicious and promoting faster growth in between. So it should not be surprising that the recession is ending, even though so few **reforms** have actually been carried out.

Recovery has, nevertheless, taken many people by surprise. Less than a year ago -- after Russia had defaulted on its debts and a prominent hedge fund had collapsed -- the world financial system seemed to be teetering on the brink. And, as one ministerial summit after another failed to deliver solutions, it seemed the region, scene of one economic "miracle", needed another.

Instead, far-fetched as it seemed at the time, the recession appears to be ending for the reasons recessions usually end: because households, investors and firms have at last begun to consume and invest again. Statistics, as always, have played their part: after such a virulent downswing, year-on-year comparisons of output were, sooner or later, bound to start looking better.

But there has certainly been a turnaround -- even though economists will no doubt bicker for years about what caused it. The impressive resilience of America's economy, aided by interest-rate cuts late last year, has helped bolster the whole world. Fresh signs of growth from Western Europe and Japan have also helped. The IMF will no doubt want to credit its rescue packages for Indonesia, South **Korea** and Thailand, along with its insistence that those countries raise interest rates to bolster their currencies. Mahathir Mohamad, the prime minister of Malaysia, will be just as quick to denounce those policies -- which he ditched in mid-stream -- and give credit to his capital controls for stabilising his economy. (Some in his government have even suggested that Malaysia's controls saved the region.)

Tiger balm

Also crucial, however, was the decision to abandon the restrictive fiscal policies initially urged on many countries by the IMF. After at first tightening their belts, Indonesia and South **Korea** will be running deficits of more than 6% of GDP this year, with Thailand and Malaysia not far behind (see). Some will pay for rescuing **banks.** But most will go towards traditional fiscal-stimulus programmes, including everything from tax breaks to infrastructure projects.

The direct effects of those deficits are only now beginning to be felt. But the mere expectation of their arrival appears to have given the region a lift. One good example is Malaysia, where middle-class families are eagerly forking out for expensive items such as homes and cars. But elsewhere, too, consumers are beginning to spend again. In Thailand, consumer confidence has risen so sharply that the government has had to try to discourage well-off Thais from reverting to an old habit -- the shopping holiday abroad. Firms are responding to the improved outlook by rebuilding their stocks. That in turn is playing a leading role in the upturn in the business cycle -- especially in heavily industrialised South **Korea.**

As domestic demand revs up, so do exports within the region. Such trade, which accounts for around half of the total in the region, helped to accelerate its collapse. The severity of the downturn hammered exports: trade balances turned positive initially only because credit lines dried up and imports fell even faster.

Now, export volumes are beginning to lift off (see), especially within the region. The even more rapid recovery of imports is actually eating into some countries' current-account surpluses, but the process -- confirming that a demand-driven recovery is under way -- is a healthy one. In addition, Malaysia and the Philippines, which have big electronics sectors, have been helped by exports outside the region. And South Korean conglomerates, with well-honed marketing skills, have altered their export patterns.

The obvious risks to this recovery come from outside South-East Asia. Since a stirring Japanese economy has helped provide some demand for everything from electronics to tourist services to timber, a reversal there would be bad news. If China, which has kept growing through the downturn, were to have a crisis of its own, accompanied by a sharp devaluation of its currency, the yuan, regional confidence would, at the least, take a knock. Should America's economy -- and especially its demand for electronics -- falter, it would also deliver a sharp blow. And then there is the financial havoc that might be caused by a Wall Street collapse.

There is also another hazard lying within the region: its ailing **banks.** Compared even with other emerging markets, **bank** credit plays a huge role in East Asia's economies. In Malaysia, for example, total loans outstanding at the end of May amounted to almost 150% of GDP. In Brazil the corresponding proportion at the end of 1998 was 43%. If firms are to keep pace with demand growth, they must borrow to do so. Since demand has been so weak during the past two years, the **banks'** problems have not been a constraint on many healthy firms. Such companies had little desire for investment capital and chose to run down their current assets rather than borrow at sky-high interest rates.

But now that rates have come down and demand is picking up, those firms will need fresh working capital. If the **banks** are not prepared to lend, the recovery could stall. That is why the rush to repair Asia's **banks** has been a race against the clock.

Capital inadequacy

Despite these risks, Asia's economies are indeed showing clear signs of bouncing back. But the long list of proposed **reforms** to laws, regulations and business practices has had little to do with it. Those **reforms,** touted as essential by the World **Bank,** the IMF and foreign investors, are not intended to stimulate demand so much as to improve the efficiency with which Asia's economies marshal their resources. That means: stronger banking systems with more foreign involvement; less meddling with the local price of capital; more transparent dealings between governments and the private sector; a better system for handling bankruptcy; and incentives for people to learn more and to make less wasteful use of natural resources.

The most pressing changes involve capital markets. The region's economies have simply outgrown their existing financial systems. **Reform** should have twin aims: to fix the **banks** so they become more reliable; and to create a broader array of mechanisms for bringing savers and borrowers together.

The starting point must be the **banks'** ghastly ailments. Their origin is clear enough: for far too long, money was lent by **banks** that did not care about credit risk to companies that cared even less. Bad loans were replaced with fresh ones like so much dirty linen. Worse, many **banks** were part of bigger business groups, into which they funnelled **bank** deposits, unhampered by regulatory checks. Of course, Asia's economies differ, and this description does not fit all of them perfectly. Singapore and the Philippines were spared disaster partly because they prevented their **banks** from getting into trouble. In Malaysia, too, **bank** regulation was in many ways prudent -- one reason its economy has fared better than some neighbours. In South **Korea,** by contrast, the government actually ordered **banks** to make bad loans, lest they fail to do so of their own accord.

Efforts to clean up the banking messes have been under way ever since the crisis struck. But recapitalising **banks** and buying up bad loans will not cure the underlying problem -- which is that Asian bankers are a menace. If that is to change, **banks** will have to be infused with new credit cultures and then carefully watched. In some places the watchers are getting help: the World **Bank,** for example, has been helping to train **bank** regulators in Thailand. But without more foreign competition, and an injection of new expertise, the region's **banks** will always remain suspect.

That is why so many investors were encouraged last year, when countries such as Thailand and South **Korea** were promising to open up their banking sectors to foreigners. But after two years, far too little has happened. Thailand has sold one **bank** to the Netherlands' ABN AMRO, and another to Singapore's DBS. In South **Korea,** negotiations to sell two local **banks** have been stalled for months. Malaysia's banking system, too, appears to be in trouble. The **banks'** balance sheets are healing, but the government has recently announced a merger plan to force all 21 **banks,** along with merchant **banks** and finance companies, to merge into six big financial services groups. It has also named the six lead **banks,** and appears to have rewarded loyalists. And then there is Indonesia, whose banking system is as corrupt as any in the world. Out of the filth, one **bank** emerged earlier this year as fit enough to be bought by a big global player. That was **Bank** Bali, which was due to sell a 20% stake to Standard Chartered. Alas, that deal too has been jeopardised by corruption scandals.

Even if the region had decent **banks,** some companies would inevitably go bust. Yet Asia's bankruptcy laws are in even worse shape than its **banks.** Thailand passed fresh bankruptcy and foreclosure laws earlier this year, and Indonesia altered its own rules last year under pressure from the IMF. But in neither country do investors have any faith in the courts, and the mountains of bad debt continue to sit and rot.

Besides **bank** loans, East Asia will also need to develop new ways for firms to raise capital. In particular, there is a long-felt need for deeper local-currency bond markets. More developed capital markets demand companies that offer more transparency, stricter auditing and more rights for minority shareholders. One country that has made progress in these regards is South **Korea.** Indeed, in some ways it may have gone too far, allowing even the puniest minority shareholder to cause trouble. The others, however, have a long way to go.

Beyond the cycle

In one area, Asia's reformers do appear to have made great progress. That is monetary policy. Neil Saker, of SG Securities in Singapore, argues that central **banks** have learned one of the chief lessons of the financial collapse -- that they cannot follow targets for both inflation and the exchange rate -- and have rightly chosen to stress price stability. That new attitude is now being tested, as inflows of foreign capital are putting upward pressure on currencies. Many government ministers will want to keep interest and exchange rates low. But Mr Saker believes central bankers will maintain their focus, and raise interest rates if necessary.

Better monetary policy would indeed be a huge improvement, since misguided exchange rate policies had much to do with the region's collapse. But this change of focus itself serves to highlight the importance of carrying out further **reforms.** When exchange rates were kept at artificially high levels, East Asia's economies were able to borrow in dollars at ludicrously cheap rates, reinforcing a broader tendency to invest without regard to the cost. If the region's economies are to grow strongly in the future, they will not -- please, not again -- be able to resort to such short-term tricks.

Fortunately for Asia, it doesn't need them. Its economies were growing rapidly long before the bubble formed, and could do so again. But if the economies are to get the most from some of their great advantages -- high savings rates and clever entrepreneurs, to name but two -- they will have to make better use of their existing resources.

Besides overhauling capital markets, there are many other ways to achieve this. One is to keep business and the government from mingling too closely, so that government contracts go to the best (rather than the best connected) bidders. Another is to invest more in education (especially in Thailand and Indonesia, where schools have failed to produce workers with the skills their economies require). That goes for companies as well as governments. Skewed incentives have encouraged Asian companies to invest in physical assets such as property, rather than the human ones the region will need.

Get off those laurels

Some remarkable changes have indeed taken place, and it would be churlish to dismiss all of them as mere lip service to creditors' demands. Yet some Asian politicians and businessmen see little need to press on with further **reforms.** To them, the purpose of the exercise was simply to win the confidence of foreigners, appease the IMF and attract investment back into the region. The speed with which Asia is recovering serves only to reinforce such attitudes. Moreover, as the immediate crisis passes, there will be less need for IMF money, eliminating another incentive to shape up. And, whereas many of the leaders that initiated **reforms** were new -- in South **Korea,** Thailand and Indonesia, for example -- those governments are now nearing the end of their honeymoons.

As the crisis fades, the temptation to be nice to one's cronies mounts. Politics still costs money. Moreover, after two years of such agony, which politician would want to inflict further painful **reform** on his voters? Asia's reformers, or their successors, may well conclude that, for the time being, enough is enough. After all, if they were to settle for a period of moderate growth instead of "extreme" **reforms,** it would hardly be a uniquely Asian approach.

LOAD-DATE: August 20, 1999

LANGUAGE: ENGLISH

GRAPHIC: graphic, no caption

The Economist

December 16, 2000 U.S. Edition

Moribond

SECTION: FINANCE AND ECONOMICS

LENGTH: 711 words

DATELINE: seoul

ON DECEMBER 8th, the South Korean government decided to do something about the country's desperately dilapidated corporate-bond market. The Ministry of Finance ordered **banks** to lend to companies that are unable to issue bonds, and then themselves to issue bonds backed by the loans. In the absence of any likely buyers for the **banks'** paper, the government is also asking them to set up a special fund for the sole purpose of buying their own bonds.

It is a tall order. The country's **banks** are in no mood to buy bonds that nobody else wants. The state is already forcing them to roll over loans that they granted to 235 firms which narrowly avoided liquidation last month, and it is also twisting their arms to merge, as part of a grand plan to restructure the unhappy industry.

The idea is to create a number of very large **banks.** Each will come under the umbrella of a single financial holding company, which will also own investment **banks** and life-insurance companies. But the IMF has given a warning that the scheme could easily backfire. Placing **banks** of different sizes and characteristics under one roof can create more problems than it solves.

One of the problems is only too apparent. A proposal to merge **Korea** Exchange **Bank** with Hanvit **Bank** has already given the country's traditionally militant trade unions an excuse to flex their muscles. On December 11th the union members of the **Korea** Exchange **Bank** staged sit-ins and promised to go on strike if the deal goes through.

The employees of Kookmin, one of the country's largest **banks,** took even more drastic measures this week when they heard that their **bank** was talking about merging with Housing and Commercial **Bank.** Some 300 of them barricaded Kim Sang Hoon, the **bank's** chairman, in his office. He was released when he promised to withdraw the merger plan for the time being.

Without **reforms** to strengthen their balance sheets, the **banks** are unlikely to become the big buyers of corporate bonds that they were in the past. The corporate-bond market has virtually ceased to function since July 1999, when Daewoo collapsed under the weight of huge debts. Alarmed by the fall of the country's second-biggest chaebol, investors shifted money out of the investment trusts (the other big buyers of bonds) and into **bank** deposits.

The financial debacle this year at Hyundai, the biggest chaebol, has made the situation even worse. On November 20th Hyundai promised to raise $1 billion by the end of this year to reduce the debts of its building subsidiary. It has so far gathered only 40% of the target and is feeling the strain.

Although they are now sitting on huge deposits, the **banks** are loth to use them to buy risky assets such as corporate bonds. And the investment trusts are in no shape to take their place. The three biggest (**Korea,** Taihan and Hyundai) control two-thirds of the market, but all are in a mess. The state is proposing to spend about 8 trillion won ($6.7 billion) to turn around **Korea** and Taihan, while Hyundai has some 2 trillion won of cumulative losses. Its efforts to raise $900m on international markets have dragged on for months, further eroding investors' confidence in the industry.

The government bears much of the blame for the mess, says Jang Hasung, professor of finance at **Korea** University. Despite the trillions of won that it has already injected into the financial system (and the 50 trillion won that it plans to spend to complete its financial **reforms** by February), the government has failed to clear up the problems created by the investment trusts. The state should have dealt with them more radically when Daewoo collapsed, says Mr Jang.

The loss of confidence in South **Korea's** capital markets is of particular concern because corporate bonds worth some 60 trillion won mature next year. A few lucky companies with good credit ratings may be able to roll over their repayment by finding buyers for new issues. On December 8th, for example, Iljin Diamond, a maker of industrial diamonds with an investment-grade rating, issued 20 billion won-worth of three-year bonds. The price was high (a yield of 9.24%), but many others will not find investors at any price until confidence in the whole financial system is restored.

LOAD-DATE: December 14, 2000

LANGUAGE: ENGLISH

GRAPHIC: Kookmin's striking staff;

The Economist

March 27, 1999, U.S. Edition

Scourge of the chaebol

LENGTH: 939 words

HIGHLIGHT: South **Korea's** conglomerates, or chaebol, are used to being bossed around by political leaders -- but not by such private citizens as Jang Hasung

"SUBVERSIVE" is hardly the word that springs to mind when you meet Jang Hasung. His clothes are impeccably preppie, blue blazer framing a club tie and button-down shirt. His office is an oasis of civilisation in a concrete bunker that houses **Korea** University's economics department. As he works, opera burbles in the background; "The New Harvard Dictionary of Music" nestles next to "Financial Theory and Corporate Planning" on his shelves.

Yet Mr Jang is a revolutionary of sorts, as he proved on March 20th at the annual meeting of Samsung Electronics, flagship of the Samsung group. Time was that shareholders' meetings in South **Korea** were about as rowdy as a party congress in the communist North; often the entire agenda was wrapped up in only a few minutes. At Samsung Electronics, by contrast, Mr Jang and other minority shareholders kept the directors on stage for nine hours, while they heckled and shouted and bombarded them with questions.

Mr Jang and his movement are bent on rewriting the rules of business life in South **Korea.** "Corporate governance in **Korea** is a total mess," he says, his passion all the more powerful because of his perfect manners. There is no transparency, no accountability, no checks and balances. Mr Jang's solution is shareholder activism. He studied finance at Wharton Business School, where he learned that the purpose of public companies is to increase shareholder value, and that the purpose of corporate governance is to hold managers accountable. On returning to South **Korea** in 1990 he found business life to be organised on exactly the opposite principle: the purpose of companies seemed to be to enrich the founders and their families.

Since Mr Jang has politics in his blood, it was only natural that he should use a political movement as a vehicle for his ideas (and, many suspect, for a future career in politics too). In 1994 he helped to form the People's Solidarity for Participatory Democracy, a 200-strong group campaigning for liberal **reform.** But promoting shareholder rights has proved far from easy. Corporate law demanded that shareholders must own 3% of a company before bringing a motion at a shareholders' meeting -- a huge hurdle in a country dominated by the chaebol.

The chaebol did their best to intimidate Mr Jang, including bringing pressure to bear on his friends and relations. They put it about that he was bent on humiliating South Korean companies and selling them to foreigners, an argument that struck a chord with ordinary Koreans. Adding to his difficulties was shareholders' lack of awareness that they had any rights to exercise. People's Solidarity found it so hard to track down shareholders in the **Korea** First **Bank** that members took to walking the streets with placards asking them to come forward.

What did most to help this latter-day David was the country's brush with bankruptcy in late 1997. Before then, Mr Jang received almost no attention outside South **Korea.** Afterwards, he became a darling of the international crowd. The World **Bank** invited him to speak at its annual meeting; professional shareholder activists started asking him to their conferences; Bill Clinton even invited him to join a discussion group when he visited South **Korea** last November.

Two other forces are boosting Mr Jang's campaign. The first is the gradual opening up of his country's economy to foreign investment. South **Korea's** system of management works only in a closed economy in which deals are done over whisky in back rooms. But when foreign investors take bigger stakes they want to know what is happening to their money. One of Mr Jang's most famous victories -- over SK Telecom, a subsidiary of the giant SK group -- sprang from an alliance with foreign investors, including Tiger Management, Scudder Kemper Investments and Oppenheimer Global Fund, which between them owned 10% of the mobile-telephone giant. Mr Jang and his allies forced the company to appoint outside directors and an independent auditor, and to **reform** shareholder voting.

The other force on Mr Jang's side is the government. After the election of Kim Dae Jung as president in 1997, the shareholder movement became an official cause. President Kim has lowered the stake required to bring a motion from 1% (to which the previous government had cut it from 3%, in 1996) to 0.01%, changed the law so that public companies have to appoint a quarter of their directors from outside, and demanded that companies produce consolidated accounts. His advisers list "shareholder activism" as one of the forces that will revitalise the country.

Goliath in the lead

Mr Jang thinks that "everything now hangs in the balance" for South **Korea.** The country has a "once in a lifetime opportunity" to **reform** the chaebol, he says. People's Solidarity is taking action against a target from each of the top three chaebol. It is particularly exercised about Hyundai Heavy Industry's decision to buy a loss-making hotel from an affiliated group.

Mr Jang may have right on his side, but will he have might? One of the worst consequences of South **Korea's** economic troubles is that the chaebol are actually strengthening their grip over the economy, as smaller companies have gone bankrupt and **banks** have concentrated their resources on the safest bets. The chaebol now account for more than 80% of the loan market. Their bosses are taking control of affiliated companies in a bid to save them from bankruptcy. The Fair Trade Commission lacks the necessary weapons to do battle with the chaebol. Ominously, Mr Jang left the Samsung meeting without much to show for his efforts except a sore throat.

LOAD-DATE: August 6, 1999

LANGUAGE: ENGLISH

GRAPHIC: graphic, no caption

The Economist

May 29, 1999, U.S. Edition

Yin and yang

LENGTH: 618 words

HIGHLIGHT: Normally, it has been South **Korea** that has copied Japan. It is time for a reversal of roles

SOUTH **KOREA'S** economic strategy over the past four decades was to follow a few paces behind Japan. Its economic model was based on Japan's. It moved into new industries, such as television or microwave production, just as Japan moved out. Now, however, South **Korea** might offer its former colonial masters a lesson or two. Both countries have had severe financial crises, which left them with sick banking systems and massive overcapacity after years of artificially cheap capital. But the big difference is that South **Korea's** economy seems to be recovering quickly from recession, while Japan's continues to languish in the doldrums.

In the first quarter of this year South **Korea's** GDP jumped by an annual rate of 18%, to 4.6% above its level of a year earlier. Some economists now predict that the economy will enjoy growth of more than 5% for 1999 as a whole, following a decline of 5.8% last year. Industrial production is back at pre-crisis levels. Some of this rebound springs from firms adjusting their inventories, but consumer spending and exports have also perked up. In Japan, in contrast, industrial production is stuck almost 10% below its level of early 1997; the country's GDP is expected to shrink again this year.

Cynics argue that it is easy to bounce back sharply after a steep fall; and even if the South Korean economy does grow by 5% this year, it would still leave output 14% below its previous trend growth line. But applying the same logic to Japan, where growth has averaged only 0.7% a year over the past seven years, compared with a previous trend rate of 3-4%, one could argue that Japan's output has already fallen by as much as 15-20% relative to its previous trend. Yet nobody expects Japan to bounce back strongly this year.

South **Korea's** recovery partly reflects looser fiscal and monetary policies; but the government's greater boldness in pursuing **reforms** and cleaning up the banking sector have also been important. Under IMF tutelage, the government has opened up the economy to foreign direct investment and tightened accounting rules to make business more transparent. Most significant of all, it was quick to tackle its **banks'** ills. Many **banks** were closed, merged or nationalised, and the government has recapitalised the system by taking over bad loans wholesale. This has helped to shore up confidence, and allowed **banks** to make new loans.

Japan preferred to procrastinate instead. Only now is the government at last recapitalising the banking system -- six years after the seriousness of its problems became clear. Meanwhile, economic activity has been depressed by firms' and consumers' pessimism about the government's ability to resolve the banking crisis.

The wonder of pain

South **Korea's** government deserves credit for its efforts. But the job is far from complete. There are still many obstacles which could hinder a full recovery (see). The biggest barrier is the country's heavily indebted conglomerates, or chaebol. The government wants them to sell chunks of their bloated empires to foreigners, to reduce their debts, but the giants have been dragging their feet. There is also a more general risk of "**reform** fatigue" if the recovery causes policymakers and companies to conclude that they do not need to make further changes.

It is easier to implement painful policies in the midst of a crisis. Indeed, this may explain why South **Korea** has pushed ahead more quickly than Japan. It had the "advantage" of facing a real crisis, as capital fled the country, forcing it to go cap in hand to the IMF. Japan, in contrast, has been under no such outside pressure. But though this may explain Japan's errors, it does not excuse them.

LOAD-DATE: August 6, 1999

LANGUAGE: ENGLISH

GRAPHIC: graphic, no caption