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Korea in the World Economy: An OECD Appreciation of Its Newest Member

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Good morning ladies and gentlemen. I would like to thank Dr. Il SaKong for inviting me to address the Institute for Global Economics. I am doubly happy to be here. First, because it is a pleasure to be able to exchange views with such a distinguished group of scholars who are concerned with many of the issues that OECD is grappling with. The second reason is because this visit to Korea gives me the opportunity to express my admiration for the courage of the Korean people and the Korean government in facing the recent economic crisis and so quickly taking the difficult steps to put the Korean economy back on track. Certainly, the crisis is not fully over, but the "policy courage" you have shown is already bearing fruit and merits emulation by many governments, including among OECD Members. Given the remarkable development of this country from the ashes of war to becoming one of the world's great economies, your rebounding from this crisis should come as no surprise. Courage, hard work and tenacity have been hallmarks of Korean success.

This morning I will address a number of themes which I hope will be of interest to you: the outlook and challenges in the global economy; perspectives on the Korean economy; and Korea and the OECD.

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The outlook for the world economy in 1999

In its Economic Outlook published in December 1998, the OECD projected continued slow growth at around 2 per cent for the world economy in 1999. We anticipated a significant drop in growth in the United States and smaller declines in Europe. But we thought that the impact at the world level would be offset by an end to the recession in Japan and, as conditions in the countries affected by the Asia crisis stabilise, a modest pick-up in growth in rest of the world. In many respects this picture still appears valid. Macroeconomic projections are often overtaken by events. These projections may be especially vulnerable given the volatile and uncertain environment that has prevailed since the Asia crisis began in 1997.

In December 1998, the OECD Outlook emphasised the downward risks to the outlook. In view of the global financial turbulence that followed the Russian default last year, our economists felt that there were a number of fragile elements in the world economy that could reinforce any downside risk that might materialise. The difficulties now faced by Brazil could seriously weaken near-term growth prospects there and in neighbouring countries. This may have adverse effects in OECD countries through trade and financial linkages. It is also having repercussions in Asia. The Hong Kong dollar has come under pressure and the fixed parity of the Chinese currency has again become a subject of discussion. Moreover, although financial markets in OECD countries have so far been little affected, continuing financial unrest in any major area of the world can ultimately have adverse global effects.

Another uncertainty for the world economy in 1999 is whether the strength of the U.S. economy can continue. The most recent data point to significantly stronger momentum than we anticipated: growth of employment is still robust and consumer confidence is

strong. We expected weaker corporate profits in 1998 to lead the slowdown in the economy, but profits seem to be holding up better than we—and many others—anticipated. This in itself would lead us to increase our growth projections for the current year. However, there are still important downside risks looming over the economy. Corporations can be expected to cut back on capital spending since their cash-flow positions continue to show signs of weakening. At the same time, a drop in the stock market could depress household spending. Since stock prices on Wall Street appear very high if judged by criteria commonly used in the past, there is clearly a risk of some market correction. The same observation was made when the market was much lower. Investors are nervous, and with good reason, if one uses historical valuations as a yard stick.

Challenges facing the global economy

Now, let me focus on three important challenges facing the global economy: 1) creating the conditions for a recovery in Japan; 2) making a success of the single currency in Europe; 3) and creating conditions that would stabilise cross-border capital flows in the emerging markets.

Japan: creating conditions for a recovery

The continued weakness of the Japanese economy is very disappointing. Consumer confidence continues to deteriorate as unemployment lines become longer and the reduction in employment continues unabated. Business confidence shows little signs of improving, even if it is no longer on a downward course. The increase in the value of the yen since last summer has clouded the horizion still further, worsening the outlook for the export sector, the only part of the economy that has recently shown any vigour. And the increase

in long-term interest rates since December 1998 threatens to make things worse. For all these reasons, the recession looks set to last even longer than we had expected in autumn 1998.

In fact, the weakness of the economy continues despite the recent measures taken by the Japanese authorities. In November 1998, the Diet passed legislation to deal with the mountain of bad loans in the banking system and the under-capitalisation of banks. Tackling this problem was a precondition for lifting the economy out of recession, and now the way is open for the authorities to act. In mid-November of 1998, the government also introduced a new fiscal package, the second in 1998 and the eighth since 1992, to support demand in the economy. This was the most ambitious package to date, estimated to cost the taxpayer close to 5 per cent of GDP. And the monetary authorities took measures in the autumn to ease the credit crunch.

So, why have these measures not been able to improve prospects for a recovery? We might first note the fiscal expansion is less important than the figure of close to 5 per cent of GDP implies. The budget was originally set in 1998 to be contractionary, so that a large part of the fiscal expansion was to offset the programmed tightening. With a fiscal stimulus of 60 trillion yen, the package has nevertheless given some support to activity. There are also reasons to believe that a fiscal expansion may no longer be very effective in supporting overall demand. Government finances have deteriorated sharply in recent years, and Japan now has by far the highest budget deficit of all the countries in the OECD area. Financial markets are acutely aware of the financing needs of the government, and the recent rise in long-term interest rates may have been at least partly related to expectations of government bonds flooding the market. Furthermore, households which are increasingly worried about jobs in the near term and pensions in retirement may prefer to save rather than spend tax reductions. As for the banking sector, the officially estimated size of bad loans has been surprisingly low compared with pri-

vate estimates, and credit-rating companies continue to downgrade Japanese banks.

In all these circumstances, what more can the Japanese authorities do to improve economic prospects? With fiscal policy becoming less effective and virtually no scope for policy-determined interest rates to go lower, the room for manoeuvering using macroeconomic policies would seem extremely small. The authorities could expand liquidity at a faster rate, and many commentators have been urging a liquidity-driven expansion of credit and the broad money supply in order to jump-start the economy. However, such a policy might prove to be less effective than many suggest, and could also be difficult to implement.

But even if the room to use conventional macroeconomic policy is limited, this does not mean that policy makers can stand idle while the economy remains mired in recession. They must use all opportunities to reduce uncertainties for households and thereby revive consumer confidence. Achieving credible solutions to problems in the banking sector should allay fears of employees that their companies will not be able to obtain the credit they need. The authorities also need to move swiftly to agree on a clear plan that would put the pension system on a sound footing. This would clarify future pension entitlements of the current working-age population, and remove one of the major uncertainties that weighs on households' confidence.

To conclude my discussion of Japan, let me emphasise that there is also much that can and should be done in structural policy to improve economic prospects. The tax system needs to be reformed to reduce its distortionary effects. Entry barriers and price controls need to be eliminated in order to stimulate competition in product markets and thereby raise productivity. Rigidities in the markets for capital, land and labour need to be reduced so that resources flow to the areas where they make the greatest contribution to wealth crea-

tion. The Japanese authorities have already taken measures that go in the direction of improving the functioning of markets, and consumers and businesses have already benefited from deregulation and regulatory reforms in many areas. However, OECD experts believe that more rapid and comprehensive regulatory reform is necessary to strengthen the foundations for long-term growth.

Making a success of the euro

On 1 January, the euro was born by irrevocably fixing the rates of change between the currencies of the 11 participating countries. By 2002, national currencies will be replaced by the euro. The immediate objective of the euro is to deepen the economic integration of the European Union countries beyond the single market that was established in 1992. The single currency is also part of the broader process of political integration that has been going on since the early post-war period.

The major implication of the single currency is that countries in the euro area can no longer pursue independent monetary policy. They can no longer individually vary interest and exchange rates for domestic purposes. Monetary policy for the euro area as a whole is now set by the independent European Central Bank in Frankfurt, which has the primary objective of ensuring price stability (defined as inflation below 2 per cent). The loss of an independent national monetary policy is not problematic when the euro-area countries are faced with general distrubances, such as business cycles common to all the countries. Imbalances at the level of the euro area can be addressed directly by the European Central Bank, tightening monetary policy when there are inflationary pressures and relaxing policy when a downturn is imminent.

However, dealing with national imbalances in the absence of independent monetary policy could become a major challenge for the

countries in the euro area. The euro arrangement does not involve a centralised fiscal policy. Countries facing local imbalances—or asymmetric shocks—will not receive any fiscal transfers from other countries when their economy is slumping, nor pay taxes to other countries when their economy is overheating. They will have to tackle their imbalances at home. This means that domestic fiscal policy will have to bear the brunt of local shocks. But the euro countries have decided to put prudential limits on fiscal positions in order to make credible the "no bail-out rule" in the single-currency agreement. These call for an upper limit on government budget deficits of 3 per cent of GDP, which in turn imply that cyclically-adjusted positions need be "close-to-balance" in order to respect the deficit ceiling in a normal downturn. Only a few of the euro countries currently have fiscal positions that respect the "close-to-balance" limit. In the near future, most of the countries in the euro area will not be in a position to allow automatic stabilisers to work fully, let alone allow to use counter-cyclical measures. And even when the countries have brought their structural budget positions to "close-to-balance", the room to pursue discretionary fiscal policy will still be limited. Indeed, one of the major challenges facing the euro countries is to build up sufficiently strong fiscal positions so that they can use fiscal measures to meet unforeseen local shocks.

Since the euro countries will have only limited access to traditional macroeconomic policies, it seems clear that they will have to rely more on flexibility in labour and product markets to deal with local economic disturbances. Flexible markets have been critical in the United States to restore balance after regions have been hit by a shock. For example, a downturn in one region is typically followed by emigration out of the area and/or the lowering of wages relative to those in other areas. But labour and product markets are relatively inflexible in most of the euro countries—which is one of the reasons for the persistence of high unemployment rates there. There is much

that the euro countries can do to make their markets more flexible, and the OECD Jobs Strategy has charted a programme of structural reforms for these countries (as well as other Member countries) that has proven successful in lowering unemployment and making markets more adaptable. Such structural reforms, which must be compatible with each society's commitments to good social protection, would yield a double dividend in the euro countries at present. First, the markets would better manage the adjustment to adverse shocks. Second, lower unemployment and, in consequence, a stronger fiscal position would give individual euro countries more room to manoeuvre in applying policies to adverse shocks.

To round up my remarks on Europe, let me stress that it remains a considerable challenge to achieve the benefits of economic integration intended by the euro. One of the main benefits of deeper integration is greater efficiency of economic activity, and, in turn, higher standards of living. The main mechanism to strengthen efficiency is for producers to gear their activity to production for a large integrated market. But this also means accepting the discipline of a large, unified and competitive market and will inevitably involve the restructuring of whole sectors within the area. Activities that are currently carried out in all euro countries may be consolidated in fewer geographic areas, and carried out by fewer companies, each operating more efficiently. To take just one example—but perhaps the most obvious—at present, most financial market activities are carried out by locally-based institutions in each of the countries in the euro area. Increasing competitive pressure will almost certainly lead to mergers, restructuring, and consolidation within the sector, provided that local regulations regrading closures and labour lay-offs allow these to proceed. But the result will be a broader, deeper, more liquid and user-friendly financial market that will allow the euro to realise its potential as one of the two dominant international currencies, and, more fundamentally, facilitate the financing of productive investment.

New Financial architecture: stabilising cross-border capital flows to emerging markets

The instability of cross-border capital flows in the 1990s is one of the most disturbing economic phenomena of the decade. I do not need to describe this instability at any length today. The pattern of strong inflows followed by sharp outflows which precipitate a financial crisis is common to a long list of emerging economies: Mexico in the mid-1990s, the Asian countries in 1997, Russia in 1998 and Brazil more recently. The root cause of the volatility seems to have been home-grown in the crisis countries, but lenders and investors in mature economies also share part of the blame. The outflows have left behind countries in deep recessions, with an alarming increase in poverty and a strained social fabric. It is clearly very important to find ways to avoid capital-flow instability and the associated costs to emerging market economies.

Various international fora are now discussing changes to the international financial architecture that would create the conditions for more stable capital flows and reduce the risks of crises. There is recognition that policy adjustments are required in several areas in both emerging and mature market economies alike. I will list five key areas.

First, it is essential that host countries of foreign capital pursue sound macroeconomic policies, and avoid the emergence of large current account and budget deficits. The build-up of large external and internal imbalances has frequently preceded crises in the 1990s.

Second, emerging-market countries need to adopt more flexible exchange-rate arrangements than those operated by the crisis countries prior to the crises. Even if pegged exchange rates can be an effective tool for reducing inflation, it is clear that many of the crisis countries held on to pegs for longer than was useful, and the loss in external competitiveness set the stage for a currency crisis.

Third, the disclosure and the quality of economic and financial data must be improved. Incomplete and delayed official data of foreign reserves and the maturity structure of public debt have proved destabilising in the past. Opaque financial reporting practices of borrowing and lending institutions in both mature and emerging market economies have undermined market discipline and made it difficult for supervisory agencies to carry out their tasks.

Fourth, prudential standards of financial institutions need to be strengthened and effectively enforced in many emerging market economies. The G-7 countries have committed themselves to strengthen the regulatory focus on risk management systems and prudential standards in financial sector institutions in their own countries, especially where leverage is high.

Fifth, the international community is also looking for ways to increase private sector involvement in international rescue packages. If investors and lending institutions in mature countries have to shoulder some of the costs of such rescues they will put more emphasis on careful risk assessment in their lending and investment decisions.

Even if all these preventative measures were in place, it would be unrealistic to expect to avoid all crises. The international community is therefore discussing and implementing measures to improve crisis management. One proposal is for a new facility in the IMF that would provide contingent credit lines to countries facing adverse contagion effects, as long as they make the policy adjustments needed to restore and sustain financial stability. There have also been calls to establish some kind of international lender of last resort to help to prevent and contain financial crises. However, it would be a major challenge for the international community to establish an effective institution of this kind without infringing excessively on national sovereignty. Moreover, unless the private sector becomes more implicated in international rescue packages, the existence of an inter-

national lender of last resort might encourage investors to take excessively risky positions in anticipation of being bailed out if things went badly.

But even if it will be difficult to make fundamental changes to the international financial architecture, we have to persist in finding ways to stabilise cross-border capital flows. In the absence of credible new measures, emerging-market economies may be tempted to resort to restrictions on the flow of capital in ways that would permanently reduce their access to international financial markets. This could deprive them of growth opportunities in the longer run. For the mature economies, restrictions of cross-border flows would reduce the rate of return for domestic investors and limit their ability to diversify their portfolios. It is in the joint interest of both emerging and mature market economies to improve the functioning of the international financial system, and countries should immediately start implementing reforms in the five areas that I cited.

Korea in crisis and reform

Kores's accession as the 29th Member of the OECD in December 1996 represented the culmination of 35 years of extraordinary growth and change that transformed one of the poorest nations in the would into the 11th-largest economy and exporting country. Less than a year later, however, Korea was hit by one of the most severe financial crises ever experienced by an OECD Member. Given Korea's long-standing strengths—such as sustained rapid economic growth, high levels of saving and investment, moderate inflation, small external deficits and large government financial surpluses—the crisis was largely unexpected. In retrospect, though, it is clear that certain structural weaknesses had made Korea vulnerable to the financial turbulence that was sweeping through Asia during 1997. I would suggest that three weaknesses were fundamental.

First, the corporate sector was characterised by low profitability and high levels of debt due to widespread diversification. By the end of 1997, the debt to equity ratio had risen to around 400 per cent, imposing onerous debt service costs on firms.

Second, Korea had a poorly-functioning financial system. With the string of corporate bankruptcies in 1997, banks were further weakened by a sharp rise in bad loans.

Third, Korea had a high level of short-term foreign debt relative to its international reserves, reflecting its decision to liberalise short-term rather than long-term capital inflows against advice from the OECD, among others.

When Korea requested emergency assistance from the IMF in November 1997 to avoid a moratorium on its foreign debt, it was clear that far-reaching economic reforms were vital. In essence, Korea needed to complete the transition from a government-directed economy to a market-driven economy. Creating this "new economic paradigm" required fundamental changes in the relationships between enterprises, labour, financial institutions and government. The challenge of implementing such far-reaching reforms was amplified by the depth of the recession that followed the crisis. Korea faced interest rates as high as 30 per cent and saw real domestic demand decine by a quarter in 1998. And the human cost has been staggering: the three-fold rise in the number of unemployed has imposed real distress in a country with only a very basic social safety net.

Compared to the darkest days during the crisis, the outlook for Korea is much brighter now. To cite a few indicators supporting this optimism:

- Industrial production levelled off at the end of 1998, following double-digit declines recorded earlier in the year.
- Useable foreign exchange reserves have increased to almost US$ 50 billion, significantly higher than the approximately US$30 billion in short-term foreign debt.

- The exchange rate has appreciated about 70 per cent from its low during the crisis, although the level of around 1170 Won to the dollar in early February 1999 was still one-fourth below the pre-crisis exchange rate. Meanwhile, short-term interest rates have fallen to record lows of around 6 per cent, about half their pre-crisis levels.

Given these favourable developments, economic growth is expected to resume this year.

A decisive response to the crisis

The quick resurgence in the Korean economy reflects several factors. First, the easing of macroeconomic policy is helping to pull the economy out of recession. Interest rates have been reduced sharply, while the decision to let the "automatic stabilisers" function has allowed fiscal policy to play a supportive role. Second, the prospects for growth this year reflect the progress Korea has made in implementing important structural reforms. OECD Members are particularly pleased at the government's success in putting in place the reforms recommended in the 1998 *OECD Economic Survey of Korea.* The optimism generated by these reforms is reflected in the inflows of foreign direct investment, which increased in 1998 to an all-time high of US$8.8 billion despite the severe recession. Let me briefly summarise the key reforms introduced to improve the financial sector, strengthen corporate governance and increase the flexibility of the labour market.

To rehabilitate the financial sector, the government introduced a 64 trillion won package, an amount equal to about 15 per cent of GDP. This is an enormous sum. But, a well-functioning banking system is essential to assist in restructuring the corporate sector and to achieve an efficient allocation of resources. About half of the package is being used to purchase non-performing loans from finan-

cial institutions while the other half is helping to re-capitalise banks. Access to public funds has only been available under very stringent conditions. The prompt action in this area has helped limit the credit crunch, which had serious negative impacts on the economy in 1998 and would have delayed the recovery if it had persisted. In addition to assisting viable banks, the government has closed weak banks by merging them with healthy ones. Finally, the decision to lift the restriction on foreign ownership of banks allowed Korea First Bank to be sold to foreign investors. Increased competition from foreign institutions will have a beneficial impact on the Korean financial sector.

The rehabilitation of the financial sector is closely linked to the restructuring of the corporate sector, which is responsible for the bad loans. The expansion of the chaebols into high-risk industries, often at the expense of shareholder value, played a key role in the crisis by boosting the level of debt. A market-based restructuring of the conglomerates requires improved corporate governance practices. Important reforms introduced in this area include:

- Steps to increase the rights of minority shareholders while strengthening the legal liability of controlling owners of the chaebols.
- The role of boards of directors of listed companies has been strengthened by including outside directors.
- There have been measures to increase the transparency of chaebols' operations by requiring consolidated financial statements, introducing external auditor committees and improving auditing standards.

The restructuring of the corporate sector has required greater flexibility in the labour market. In the past, high employment security virtually ruled out the possibility for firms to reduce their work force, even in cases of mergers and acquisitions. The labour law reform of February 1998 enhanced the scope for restructuring by

allowing firms to eliminate redundant workers. Greater employment flexibility has been accompanied by measures to assist the unemployed—a very important priority since the number of unemployed rose from half a million prior to the crisis to almost 1.7 million at the end of 1998. Unemployment insurance, which prior to 1998 had been limited to firms with more than 30 employees, is now available to all firms. The duration of benefits has been lengthened, and this year, coverage will also be extended to part-time and temporary workers. For the unemployed who do not qualify for benefits, the government has increased training opportunities and temporarily created more than 350,000 public works jobs.

The agenda for further reform

This is an impressive list of measures. While the crisis and its aftermath has been a very painful episode, Korea has made it an opportunity to adopt fundamental reforms touching nearly every aspect of the economy. The extent of reforms introduced since the crisis began is perhaps unmatched in the experience of the OECD countries.

However, reforms are not yet complete—the transition to a market-based paradigm is still in progress. The forecast of positive growth this year should not weaken the commitment or the sense of urgency to pursue reform. Indeed, the sustainability of the recovery that now appears underway will depend on the success in establishing the new economic paradigm. In the longer term, it will determine the growth potential of the Korean economy. As the expansion of the labour force decelerates, achieving high rates of growth will increasingly require larger total factor productivity gains. Later in 1999, the OECD will produce another *OECD Economic Survey of Korea*. It will address some of the key remaining issues in the reform of the Korean economy.

Perhaps the greatest challenge is to reduce the still-high levels of excess capacity and debt in the corporate sector. How should policymakers reconcile the need for quick restructuring of the corporate sector with the objective of reducing government involvement in business decision-making? From an OECD perspective, it is important that the government create a framework that will encourage market-driven restructuring while limiting its direct involvement. Many of the problems leading to the crisis were a legacy of past industrial policies which had created distortions and moral hazard problems. The priority today should be to create a legal and institutional framework that provides rational incentives for economic behaviour. In the current context, this would include:

- Expediting the resolution of "debt workouts" currently underway between firms and their creditors in order to allow viable enterprises to restructure their capital.
- Improving the exit mechanism to facilitate the restructuring of failed firms.
- Continued reforms to improve corporate governance practices.

OECD Members, including Korea, are currently developing principles which spell out best practices in the area of corporate governance, in particular, for disclosure and transparency, the rights of shareholders and equitable treatment among them, and the role of stakeholders and of boards. These will be available to all Members to help them assess the quality of their own corporate governance frameworks.

Full rehabilitation of the financial sector is another key priority. The government has already committed considerable resources to the banking sector, but more funds may be necessary, depending on how many loans eventually become non-performing. The unique character of this capital injection should be clear: it will not be repeated in the future for banks that perform badly. In order to avoid a repeat of such problems, it is essential to improve prudential

supervision. The single, independent regulator established last year must follow through on its commitment to require disclosure, auditing and accounting practices that are consistent with international standards. The OECD Committee on Financial Markets reviewed Korea's financial system and reforms last December. This was an opportunity to exchange experience among Members, including a number who had also experienced banking crises.

Unemployment, which reached almost 8 per cent at the end of 1998 and is likely to increase further during the next few months is a serious problem. The on-going restructuring of firms faced with excess capacity and high levels of debt will reduce the demand for workers. While public work jobs are a temporary solution to assist the unemployed, it is essential to maintain an environment that encourages job creation in the private sector as it emerges from the difficult restructuring progress. In the meantime, it will be important to provide sufficient assistance to the unemployed in order to sustain social cohesion and limit the rise in poverty. However, any permanent expansion in the social safety net should not be so generous as to undermine the incentives to work and save. The *OECD Jobs Strategy* provides a detailed analysis of factors that promote job creation and includes recommendations tailored to the cirumstances of each OECD Member. In 1999, a team from the OECD will come to Korea to prepare an in-depth study of the Korean labour market.

A related issue is reform to improve trade union and collective bargaining rights such as freedom of association and collective bargaining, to bring them into line with internationally accepted standards. Such reform was part of the commitments undertaken by Korea when it joined the OECD. The Korean government has already undertaken significant reforms such as the package of March 1997 and the compromise agreement reached by the Presidential Tripartite Commission in February 1998. Nevertheless, a number of issues still needs to be resolved. In the past, the adversarial nature of

labour/management relations in Korea has led to labour strife and to arrests and imprisonment of trade unionists. Many OECD members have expressed deep concern about these developments. The arrest and imprisonment of union leaders—on account of legitimate trade union activities—cannot be an effective way to build a new era of confidence and cooperation in Korean industrial relations.

There is also a need for regulatory reform in Korea, as in almost all other OECD countries. The government's leadership role in directing the development of the country has left Korea with a high degree of regulation. Controls on entry and exit have been pervasive. Prior to 1998, there were 11,000 regulations in effect. While some regulations are based on law, many are enforced through internal rules and administrative guidance. In addition, more regulations have been introduced to deal with growing concerns over safery, health and environment. Regulatory reform—which encompasses both better regulation and deregulation—benefits consumers by improving quality and choice and reducing prices in many sectors, while opening up new business opportunities for firms. The positive economy-wide effects of regulatory reform will help Korea as it emerges from the crisis. The OECD is currently in the midst of an important multi-year project on regulatory reform. Korea has been chosen as one of the Members for which a country report on regulatory reform will be prepared later in 1999 and we hope that this will help accelerate the pace of reform.

Finally, Korea needs to improve the efficiency of its public sector. While Korea has traditionally maintained a cautious fiscal policy stance that has limited budget deficits, there has been a sharp rise in government debt in the wake of the crisis. The policies needed to assist the unemployed, restructure the financial sector and improve social infrastructure may put additional pressure on public finances during the next few years. As the economic recovery strengthens, it will be important to reduce the government deficit in order to avoid

a run-up in public debt that would have negative long-term consequences. Increasing public-sector efficiency can play a key role in helping to limit government outlays and balance the budget.

This is an ambitious agenda for further reform in Korea. I believe that the OECD is well-placed to assist Korean policymakers in each of the areas that I have discussed.

Korea in the OECD

In what preceded I have tried to indicate some of the ways that OECD is trying to support Korea—as it does all its Member countries—in its search for better policies. Before I close I want to be sure you understand that if the OECD hopes it can help Korea, it is already certain that Korea helps the OECD.

Korea has followed a unique and very interesting development path. No country has accomplished so much so quickly. The contribution of this experience to debates among OECD Members on all sorts of policies is, in itself, extremely valuable.

In addition, although Korea has been an OECD member for only two years, it already demonstrates enthusiasm and leadership across a broad range of policy questions. I will give just a few examples:

I mentioned the OECD's project to develop principles of corporate governance. Korea has been an active participant and, in addition, is helping OECD to engage non-member countries, especially in Asia. In March 1999, the Korea Development Institute and the Government hosted with OECD in Seoul, a major Conference on "Corporate Governmance in Asia: A Comparative Perspective."

Korea played a strong role in the development of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Korea has ratified the Convention and was one of the 11 founding countries when it entered into force on 15 February 1999. Korea fielded a skillful team to the negotiations,

and helped all Members to solve many difficult technical legal problems. In April 1999, it was one of the principle examiners of Germany's anti-bribery laws as part of the process to ensure that each Party to the Convention does a good job of implementation.

The Korean Ministry of Finance and Economy has established with OECD a tax centre at Chonan. This Centre offers workshops on difficult issues of tax policy to experts from some 18 countries throughout Asia. It enables OECD countries to share their experience with Asian countries and provides the only place where Asian tax experts can meet regularly.

These are only three examples. I could cite many more. Korea has quickly become a very valuable contributor to OECD.

In conclusion, the progress of Korea during 1998 in overcoming the crisis is remarkable. The success is due, in part, to the effective implementation of reforms in a wide range of areas. While a resumption of economic growth appears close at hand, the priority should remain on following through on Korea's ambitious reform agenda. The objective of the OECD is to assist Korea in the transition to a new economic paradigm. Successful reform will create a solid foundation for long-term growth and accelerate the convergence of income levels in Korea to those in the most advanced OECD countries. In the meantime, OECD can admire Korea's determination to reform and be grateful to Korea for the impressive contributions it is already making to work at the OECD.

Question & Answer

Q Do you believe Korea's entry into the OECD was too early? Could it have been a cause for the financial crisis?

A I alluded to that in my comments because the OECD did recommend the liberalization of foreign direct investment and long-term capital flows into Korea, but not the liberalization of short-term capital flows which proved to be the crux of the problem. This is especially true as short-term capital flows and foreign exchange reserves were so dependent on short-term as opposed to long-term capital. I also point out that, at present, with around US$50 billion in foreign exchange reserves, there now is a good balance with long-term capital investment. In fact, since the crisis began, the Korean government has accelerated the reform of long-term capital flows, as had been recommended by the OECD. Essentially, they've sped up the process. My understanding is that they're ahead of schedule in the relaxation of the restrictions on long-term capital flows.

OECD members did ask Korea to accelerate and broaden the scope of Korea's original liberalisation plans for foreign direct investment, including takeovers. They also asked Korea to permit the permanent establishment of subsidiaries by foreign banks and securities firms and further foreign participation in Korean financial institutions. That's seen as important for all emerging markets in order to bring discipline and competition to those markets as well as transparency, thus allowing foreign competition. I would point out also that now, with this restructuring, the sale of a Korean bank to foreign investors is seen as very positive.

Also, the OECD suggested that Korea liberalise other long-term capital inflows, e.g. the foreign purchase of Korean listed shares,

corporate debt securities purchased for one year and longer, and the 'bona fide' inward credits which are linked to foreign trade. So, I can't imagine how any of the recommendations of the OECD with respect to the accession process contributed to the crisis. In fact, had these measures been implemented sooner, in terms of the liberalisation of long-term capital debt, perhaps the crisis could have been alleviated to some degree.

But this isn't intended to attribute fault, one way or another. I think that if anyone says to you that accession to the OECD contributed to the financial crisis in Korea, you can look them straight in eye and say, "definitely not." In fact, I think that belonging to the OECD membership and having its support has probably contributed to Korea's progess out of the crisis. This is also the case with Mexico, which did not back off from any of its liberalisation undertakings. Mexico rebounded remarkably in a short time. Quite frankly, I don' t think anyone anticipated that Korea would rebound as quickly as it has. Of course, Mexico had a very strong trading partner in the United States during that period. Japan has not been the locomotive for Korean recovery which the United States was for Mexico. That's the long answer to the short question.

Q In 1996, when you visited Korea, you mentioned that the U.S. was not a founding member of the OECD but had started as an associate member. Was this an accurate assessment? Also, do you think it is in the best interests of Korea to remain an OECD member? Would it be better to retreat temporarily until Korea has fully recovered from the economic crisis? What are the benefits of belonging to the OECD, particularly applicable to Korea, which would help expedite recovery of the Korean economy and successfully complete Korean reform?

A On the first question, your observation with respect to the

United States was not quite what I said in 1996. The predecessor of the OECD was the OEEC, the Organisation for European Economic Cooperation, through which the Marshall Plan was administered. The United States was an associate member of that organisation. But when the OEEC became the OECD in 1960-61, the United States and Canada became full members. Subsequently, non-European membership areas were broadened to include Australia, New Zealand, Japan and, since 1994, Mexico, the Czech Republic, Poland, Hungary, and Korea, the latest member.

I can think of no reason why Korea would retreat from membership in the OECD. As I mentioned, Korea has played a very valuable role in the organisation, contributing to its deliberations and becoming a major rule-maker in the growing global interdependence. Whether it's in areas of bribery and corruption, in which, as I mentioned, Korea has played a very strong role, or in electronic commerce, e.g. establishing the international framework for conducting electronic commerce, the OECD is a very central player. This means that members of the OECD have a very key role to play in developing this architecture and in consistently bringing in other developing countries into fora where they can participate. That is true for the issue of governance, where Korea will be taking a major lead in the areas of regulatory reform and investment. Korea has played an up-front role in the issue of the multi-lateral agreement on investment, though this issue is currently on a back burner. But the issues of investment continue to be valid.

So, is it important for Korea, as the 11th largest economy in the world, to play a central role in designing the international architecture for trade, investment, liberalisation, and development? I would say yes. As I say, I can't think of any reason why Korea would want to retreat from the OECD or from any of the obligations and commitments it has made. There is no reason to retreat from a liberalisation process which is clearly going to be very beneficial in bringing back

the Korean economy to sound long-term economic growth.

Q What do you think of the recent trial in Korea?

A I'm not inclined to get into the issue of domestic politics. And I would never criticise parliamentarians, having been one myself. So, I presume that they've instituted the proceedings because they think it's in the public interest to clarify the facts. I hope that in the course of that, they'll report objectively on the importance of being in the OECD and, as I say, put an end to some of the rumors that accession to the OECD has contributed to the financial problems of Korea.

Q What is your personal view on the idea of a target zone for the three major currencies? Though a floating exchange rate is ideal, in today's globalised economy, the exchange rate may not reflect economic fundamentals in the short run. Despite some problems associated with this system, several European leaders have been considering the idea to maintain exchange rate stability among the U.S. dollar, the yen and the euro. Also, what is likely and desirable to be on the agenda at the WTO's new round of trade talks?

A Opinions on these questions are very divided. As we know, the challenge and the frustration of leadership is exchange rate volatility, which can take place in the short term. Having recognised that the floating exchange rate is the answer, how can short- term capital volatility be dealt with? A number of options are being looked at in various fora, including the issue of target zones and whether the issue of volatility can be handled with institutional arrangements. My participation in the international gatherings that I have attended suggests to me that there is not a great deal of taste for new institutions. But there is an interest in joining the system up in a more effective and coordinated way to prevent these volatile situations

from arising.

A number of options are available. The issue of target zones, which has been endorsed by various leaders, is one. Probably within the next six months or so, a gathering of consensus will take place. Recommendations based on the report of the G22, G26 and now G32 Group, in which we participated quite actively should come out shortly. Now, that doesn't answer your question as to my opinion on the issue because I don't have a firm view on it myself. I will wait and see what all the options are and rely on the input of experts.

As for the WTO round, our trade committee is very active. We play a very key role in supporting the WTO. I think that's often not well understood. We have a trade committee whose work goes directly to the WTO. So, we provide a very solid basis of analysis, a 'pre-cooking' of issues.

Agriculture is central to the next round. We had an Agricultural Ministers' Meeting last year which I think was very helpful in preparing the groundwork to see where the various countries were, and what changes have occurred. As you know, preliminary work is being done, e.g. on the famous OECD PSE and CSE, the Producer/Consumer Subsidy Equivalents, to measure tariffication. Also, there are other new issues which may or may not find their way into the next round. That has yet to be decided. We're doing a lot of work in the areas of trade/competition laws, trade and the environment, and trade and labour standards.

There is now recognition that the real challenges in trade are not tariff barriers anymore, but non-tariff barriers, some of which are conscious, some unconscious. For example, why is everyone interested in regulatory reform in Japan? Well, it's not just because we're trying to help the Japanese, but because the penetration of goods and services into Japan is inhibited by the regulatory structures within Japan. So, we are addressing a very key trade issue. As to the breadth of the round, I don't think that issue was sorted out yet in

its entirety because some members wanted a full round and others didn't. Again, that's not a very satisfactory answer to your question. It's just my own perception as Secretary-General of an organisation very much involved in the trade side.

Q Since the euro is becoming a vehicle currency for reserves, there is likely to be a substantial switch-around from the dollar to the euro. Also, a substantial switch-around should occur because of the interest rate differential between the U.S. and the EU countries. Unless the U.S. Fed and ECB have coordinated interest rate policies, the effect would be to destabilise the foreign exchange markets. What is your view on this?

A There are more issues involved than interest rates. It seems logical that there would be a move to what is seen as another reserve currency. I don't think that was unanticipated. It is probably a very good thing. In fact, some of the European leadership expressed a great deal of concern that the currency would become too strong, which might turn Europe into what the Americans call themselves " the importer of last resort." This would be beneficial, in a sense, for the United States, and could help reduce its own trade imbalances. But I think it's a bit early to tell exactly what the relationship is going to be between the two currencies at this stage.

Q The recent OECD regulatory review in Korea focused on specific industry sectors such as telecommunications equipment, telecommunications services, and the electronic and automobile sectors, as well as on government capacity and competition policy and trade openness. What are the policy implications or reasons for the OECD review of these particular industry sectors? Also, what are the benefits of the OECD in the global economy, as compared with the IMF and World Bank?

A As to the first question, governments request that these sectors be reviewed, not the OECD. For example, the United States has asked us to look at specific sectors that they regard as important. I don't know how long these reviews by the OECD will continue. My personal view is that countries have to set up mechanisms to systematically review their regulatory frameworks. The National Assembly members and members of parliaments around the world have a tendency to adopt a lot of legislation and leave huge areas of it for regulation. So we have to devise mechanisms to address this at the political level.

On the issue of the OECD as opposed to the World Bank and the IMF, the IMF has not traditionally dealt with the areas that the OECD deals with. The IMF has looked at the macroeconomic fundamentals of countries in its articles for reviews. These are not public documents. The OECD deals with governments as a whole, including macroeconomic policies, and publishes reports on 12~18 month cycles. In its reports, it takes on a structural area, whether it's health policy, educational policy, etc., of a given country. So, the OECD has what is commonly referred to as an interdisciplinary capacity. The OECD nets together all public policy with the exception of defense, which it doesn't deal with.

Of course, the problem is that we operate in a relatively limited universe. We deal with 29 countries, and certain others with which we have specific programs. For example, we've done a full review of Russia; we're doing another review of Russia; we've done one recently with Bulgaria; and we're doing one on technology in Brazil. We' re struggling with the problem that former Ambassador Koo remembers, of how to deal with all the countries that wish to get involved in OECD processes with a relatively limited resource base. That's an issue that we're dealing with now. It may be that we'll do more work with the World Bank in some of these emerging market economies because we offer things that they don't.

But the IMF is very direct. For example, when I was a Cabinet Minister, in charge of economic and regional development, the IMF never talked to me. They would only talk to the Minister of Finance. But we, on the other hand, talk to ministries across government because we deal with the full range of government policies.