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FINANCIAL AND CORPORATE RESTRUCTURING IN SOUTH KOREA

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Preface

In 1997, a series of bankruptcies of the *chaebols* destabilized the financial system and triggered a currency crisis. President Kim Dae-jung who took office in February 1998 showed his strong leadership to move forward with swift and bold structural reforms, which restored high economic growth in 1999 (Figure 1). This paper reviews the reforms of the past five years and discusses their implications for Japan[1].

Summary

The Currency crisis and its causes

1. During the 1990's, the *chaebols* overextended their business scopes and investments, leading to a surge in corporate debt and causing the current account deficit. Under the strict capital controls on inward direct and portfolio investments, the current account deficits were financed mostly through short-term borrowings by the domestic financial institutions from foreign banks, which resulted in accumulation of unstable, short-term external debts. Once non-performing loans held by the domestic financial institutions soared due to successive bankruptcies of medium-sized *chaebols* in 1997, foreign banks pressed *en masse* for repayment, leading the country into a currency crisis.

The views expressed in this paper are entirely the personal opinions of the authors and do not reflect the official views of either the Bank of Japan or the International Department.

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[1] For details on financial, corporate and labor market reforms in Korea, see the International Department Working Paper Series available on the Bank of Japan web site, particularly, "Financial Restructuring in South Korea: Outline and Comparison with Japan"(October 2002), "Corporate Restructuring in South Korea: Transition from Government-led to Market-led Reform"(March 2003), and "Labor Market Trends in South Korea since the Currency Crisis: The Mechanism of Rapid Adjustment and Recovery"(December 2002) , these papers are Japanese only.

2. The excessive investment and indebtedness of the *chaebols* were attributed to inadequate governance not only by shareholders, characterized as lack of separation between ownership and management, but also by creditor financial institutions. The "overly cozy relationships" between the *chaebols* and the government, which intervened in banks' management, caused the banks to maintain easy lending towards the *chaebols*. And liberalization of non-banks' ownership by *chaebols* in the 1990's spurred excessive investments and indebtedness.

Financial Sector Restructuring

3. The government responded to the banking crisis by injecting fiscal funds, equivalent to 30 percent of GDP, including capital injections, non-performing loan purchases, and depositor protections. The under-capitalized banks received capital injections, while the ailing non-banks were closed and their depositors were protected. The government also actively invited foreign capital to recapitalize banks and strengthen banks' governance.

4. There are three features characterizing the injection of public funds into the banks: 1) it is accompanied by the resignation of the existing management and capital reductions; 2) the government is involved in management by imposing numerical targets; and 3) the government collects public funds by selling its shares of nationalized banks to private investors. This framework gives the government an incentive to increase banks' values to minimize ultimate costs. At the same time, the government has adopted stricter standards for asset classification in order to inject sufficient public funds and restore investors' confidence towards the banks.

5. The government-run assets management company (AMC) has purchased non-performing loans worth more than 20 percent of GDP, at market value, and has disposed of them by various methods including issuance of asset backed securities (ABS) and direct sales. This centralized AMC created a market for non-performing loans, and encouraged banks to sell off non-performing loans in the market.

6. These programs resulted in significant improvements in the financial situation and corporate governance of banks. Switching over profit-oriented management, banks have reduced lending to the *chaebols*, and increased lending to households and small and medium-sized enterprises, particularly in the service sector, which yield higher profits. Combined with policies to bring greater flexibility to the labor market, these changes transformed the economic structure, which had been overly centered around the *chaebols*.

Corporate Restructuring

7. The government was directly involved in corporate restructuring as well. It imposed numerical targets for debt reduction on the *chaebols* and required them to select core companies. The government also required the creditor banks to sort out financially ailing companies either as viable or nonviable. As a result, a number of nonviable companies were liquidated while the viable ones were revitalized under out-of-court private workout procedures.

8. The then President Kim Dae-jung called on the *chaebols* and labor unions to form "Tripartite committee", in which the unions accepted employment cut to overcome the crisis. Together with introduction of foreign capital by swift capital account liberalization, this facilitated companies to sell off their non-core businesses and improve capital base. In addition, the government adopted institutional frameworks to strengthen corporate governance.

9. The *chaebols* have made steady progress in restructuring; the ratio of corporate debt to GDP has been declining and paving the way for listed companies to set record-high profits in 2002. However, a handful of blue-chip companies were responsible for the improvement in aggregate profits. There are still many companies that are slumping and continue to carry excessive debts.

10. The corporate restructuring is becoming more market-driven. The banks with sufficient capital and good governance and the stock market more driven by foreign investors are becoming more selective about companies to invest in. As a result, slumping companies are forced to restructure, by selling off non-core businesses in order to make interest and principal payments.

Implications

11. The first feature of Korea's structural reforms is the active involvement of the government, particularly in the early stage, and the comprehensiveness of reforms, including financial, corporate and labor market reforms, and capital account liberalization. It is noteworthy that the government tackled corporate governance problems, which were the root of the crisis. The second is that the comprehensive reforms have increased flexibility of the economy. Korea has quickly restored financial intermediary functions, enhanced and developed its capital markets including the ABS market, brought more flexibility to its labor market, and attracted foreign capital. These efforts facilitated the reallocation of resources and even relieved the deflationary pressures of reform. The third is related to sequencing of reforms. Korea restored the soundness of the banking system in a short period, while corporate restructuring is still in

progress. This sound banking system laid a foundation for continuous corporate reform, by putting pressures on the *chaebols* to restructure.

12. The experience of Korea has implications for the Japanese structural reform, although the nature of underlying problems are different in the two countries. With respect to broad government involvement: 1) in the Korean episode, the serious crisis requiring IMF support warranted government intervention; 2) Korea had the fiscal soundness which enabled injection of massive public funds; and 3) the Korean presidential system was able to respond more quickly to the crisis. We should also note differences in the degree of complexity involved in structural reforms: 1) Korea had fewer factors exacerbating instability of financial system, it experienced no asset price bubble in the pre-crisis period and banks held fewer stocks; 2) the Korean economy was centered around a small number of *chaebols*; and 3) the Korean economy had a relatively small employment mismatch against a background of younger demographic structure and no "lifetime employment" system. Structure problems were therefore much less complex than those in Japan. Third, with respect to short-term conflicts between structural reform and economic growth: 1) Korea had room for fiscal expansion as well as high export dependence, which propped up the economy owing to significant exchange rate depreciation; and 2) Korea had a greater scope for reorientation towards services and growth potential among its small and medium-seized enterprises, which led to early creation of new demand and recovery of bank lending.

1. The currency crisis and its causes

(1) The currency crisis

In the early 1990's, the *chaebols* over-extend their businesses and accelerated their investments[2], which resulted in a sharp rise in corporate debt to 175 percent of GDP in 1997 from 115 percent of 1998 (Figure 2) caused the current account deficits. Under strict capital control on inward direct and portfolio investments, the current account deficits were financed mostly through short-term borrowings by domestic financial institutions from foreign banks, resulting in accumulation of a vast amount of unstable short-term, foreign debts (Figure 1). (see Box 1 for capital transactions in South Korea).

[2] According to the Bank of Korea's "Financial Statement Analysis," interest coverage ratio (ICR) in the manufacturing sector declined in the 1990s and was even below 100 percent for the construction industry from about the middle part of that decade. The ICR has been consistently below 100 percent for the retail and wholesale sectors (Figure 2).

As the economy slowed down in 1997 against the backdrop of monetary tightening and sluggish exports, a number of medium-sized *chaebols* went bankrupt, and non-performing loans increased rapidly at domestic financial institutions. As their credit ratings fell, foreign banks began to press *en masse* for the repayment of funds. But the domestic financial institutions were not able to repay foreign funds because they had lent their short-term foreign currency borrowings to the *chaebols* as capital investment funding. With its foreign reserves almost depleted, the Korean government requested the IMF support at the end of the year.

(2) Causes of the currency crisis

The currency crisis is attributed to the inadequate corporate governance over the *chaebols*. There were three long-standing factors: 1) shareholder governance over the *chaebols* was weak because there was no real separation between ownership and management (the *chaebols* were family-run and shares were held by affiliated companies[3]); 2) although the banks had already been privatized, the government was still involved in their lending decisions, and the "overly cozy relationship" between the government and business community maintained easy lending to the *chaebols*; and 3) the financial liberalization measures that began in the 1990s allowed the *chaebols* to own "non-banks" including merchant banking corporations[4] and investment trust companies, which made it even easier for them to raise funds. The *chaebols* had strong incentives to own non-banks because the government had eliminated their dominance over the banks by prohibiting a single investor from holding more than 4 percent of each bank's shares.

In the 1990s, the *chaebols* rapidly increased fund-raising through non-banks. The borrowings by corporate sector from merchant banking corporations rose sharply, and while they increased financing in the capital markets by issuing bonds and commercial papers, the vast majority of these securities were also purchased by non-banks. Also, borrowings from banks grew in parallel with nominal GDP growth (Figure 3).

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[3] At the end of 1997, the "internal stock holding ratio" that is the percentage of shares owned by the owners, their families and affiliated companies, for the 30 largest *chaebols* was in excess of 40 percent (Figure 14).

[4] Merchant banking corporations are non-banks that provide a wide range of services that include: corporate investments and loans; bill discounting and trading; securities underwriting, placement and sales; and deposit-taking.

Box 1:Capital account liberalization in South Korea

It is generally preferable for capital account liberalization to go through an appropriate sequencing, moving from stable long-term funds to short-term funds and from equity to debt. In Korea, the liberalization of short-term debt funding proceeded long-term debts funding, as a move to protect domestic industries. For the ASEAN countries, the problem was that the capital account was liberalized too rapidly. For Korea the problem was the inappropriate sequencing of liberalization that led to the frailties in its external financing structure. Many ASEAN countries saw their currencies flow into offshore markets where they were subject to speculation by non-residents, but South Korea restricted the offshore transaction of won.

The process of capital account liberalization in Korea began with foreign bond issuance by government-owned banks. Then domestic banks were allowed to raise funds in foreign currencies. The domestic banks generally raised their foreign currency funds in the short-term interbank market, and this caused banks' short-term debt to accumulate as the current account deficit widened in the 1990s.

Inward direct investments were formally liberalized in Korea in conjunction with its membership in the OECD (1996), but there were restrictions on fund-raising by foreign companies that constituted strict *de facto* investment regulations. The restrictions barred foreign companies from borrowing directly from foreign banks (generally banks in their home country) without going through Korean banks, and from borrowing through their parent companies. This prevented them from expanding their business in Korea, which in turn restrained direct investment. For inward portfolio investments, South Korea gradually raised the nonresident ownership ceiling during the 1990s, but the ceiling was still low prior to the crisis. Similarly, domestic companies were prohibited from directly borrowing foreign currency funds from foreign banks abroad and forced to go through domestic banks instead, which caused the short-term foreign debt of domestic banks to rise even further.

Korea rapidly liberalized the capital account after the currency crisis, partly to promote financial and corporate restructuring, and partly to rectify its distorted external financing structure.

Relaxation of restrictions on inward investments after the crisis

1997 December	Full liberalization of bond investments
1998 May	Full liberalization of equity investments, certificates of deposit and commercial paper
1998 July	Liberalization of corporate medium- and long-term foreign borrowings
1999 July	Liberalization of corporate short-term foreign borrowings

The ceiling on shareholdings of non-residents **%**

	Total foreign investment	Individual foreign investor
1994 December	12	3
1995 July	15	3
1996 April	18	4
1996 October	20	5
1997 May	23	6
1997 November	26	7
1997 December 12	50	50
1997 December 30	55	50
1998 May	100 (Full liberalization)	100 (Full liberalization)

2. Financial Restructuring

(1) Outline of financial restructuring (Figure 4)

The government responded to the crisis with three methods: 1) capital injections (equivalent to 14 percent of GDP); 2) purchasing of non-performing loans (7 percent of GDP); and 3) depositor protection (5 percent of GDP). The public fund support amounts to approximately 30 percent of GDP (155 trillion won, or approximately 15 trillion yen; see Figure 5). For commercial banks and insurance companies, the government focused primarily on capital injections and purchases of non-performing loans, while merchant banking corporations and non-viable smaller financial institutions (mutual savings banks, credit unions) were shut down and their depositors were fully protected. All financial institution deposits were fully insured from November 1997 to the end of 2000.

Under-capitalized institutions, whose capital adequacy ratios were below 8 percent, were restructured by "purchase and assumption" (P&A) and purchase of NPLs. The government encouraged influx of foreign capital, allowing foreign investors to hold more than 4 percent of banks' shares.

There are four distinguishing features as for public fund injections: 1) the existing management is forced to resign and capital is reduced in order to avoid moral hazards; 2) injections take the form of purchases of common shares[5]; 3) the

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[5] Preferred shares were purchased to provide capital injections to sound institutions that absorbed failing institutions by P&A.

government does not send in management staff, but imposes numerical targets on the managers, including NPL ratios, capital adequacy ratios, ROA, ROE; and 4) the shares are ultimately to be sold to private investors. This framework gives the government an incentive to increase the value of banks to minimize ultimate costs. This has also eliminated the "overly cozy relations between the government and business" that had been observed prior to the crisis.

At the end of 1997, 14 out of 26 commercial banks had capital adequacy ratios below 8 percent (of which, two were insolvent). The first injection of public fund was made during 1998 and 1999. Against a background of adoption of stricter standard for asset classification "Forward Looking Criteria" (FLC), and bankruptcy of Daewoo in 1999, the capital adequacy ratio of eight of a total 17 banks were found to be below 8 percent in the latter half of 2000 (of which, five were insolvent); This prompted the second injection of public funds. Non-performing loans rose sharply in 1999, much of which was due to the adoption of FLC (Figure 6)[6].

The Korea Asset Management Corporation (KAMCO) has purchased loans worth more than 20 percent of GDP on book value basis. KAMCO purchased these loans at market prices, and disposed of them by various methods including issuance of asset backed securities (ABS) and direct sales (see Box 2 for more information on KAMCO). KAMCO's intensive purchase and disposal of a large volume of non-performing loans have created a market for NPLs and encouraged the banks themselves to issue ABS and sell loans (Figure 6). This also led to a rapid expansion in the market for ABS backed by other credits not in default, for example, credit card debt (see Box 3 for more information on the ABS market).

Box 2: Korea Asset Management Corporation (KAMCO)

KAMCO began purchasing non-performing loans in November 1997, eventually coming to hold 110 trillion won (92 billion dollars, approximately 20 percent of GDP) in book value and 40 trillion won (33 billion dollars) in market value at average discount of 64 percent. By November 2002 it had disposed of 57.2 percent of NPLs, with the sales value (19 trillion won) higher than the purchasing value (16 trillion won).

KAMCO purchased non-performing loans at market prices and was liable for eventual losses. It raised funds primarily by issuing government-guaranteed bonds, which were purchased by the financial institutions selling NPLs. During the initial stages, KAMCO needed to increase the confidence of financial institutions by making quick purchases, and so purchased loans in bulk at 45 percent of collateral value for secured credits and 3 percent of book value for unsecured loans. The

6 The definition of non-performing loans has been tightened as shown in the table below:

June 1998	“Arrears” for 6 months or more" changed to "arrears for 3 months or more”
December 1999	Introduction of "Forward Looking Criteria" (FLC)
December 2000	Elimination of special exceptions excluding "workout" companies from being categorized as non-performing loans.

financial institutions were given call options to be exercised if market prices rose to a level set above selling prices. KAMCO likewise had put options to sell loans back to the financial institutions if market prices sank to a level set below purchase prices. The financial institutions bought back a little less than 20 percent of the loans they sold. The purchasing ceiling of KAMCO was set at all non performing loans as for unsound banks (excluding small credits worth less than 10 million won) and 50 percent of non-performing loans held by sound banks (the same exclusions applied).

KAMCO used a variety of means to dispose to the NPLs, including direct collection, auction, ABS issuing, international bidding, and sales to Asset Management Companies (AMCs), Corporate Restructuring Companies (CRCs) and Corporate Restructuring Vehicles (CRVs). At the initial stages, direct collection and auctions were the primary methods, but the weight of ABS issues and international bidding has grown in recent years. AMC, CRC, and CRV are joint ventures between KAMCO and foreign capitals. AMC purchases secured credit (collateral collection), CRC purchases credits against companies in receivership, and CRV purchases credits from companies in workout procedure (see below).

The government's stake in KAMCO is large (the government owns 42.9 percent, the Korea Development Bank 28.6 percent and other banks 28.6 percent), but the government is now considering the possibility of privatizing KAMCO.

NPL resolutions by KAMCO trillion won

		Book value	Purchase price (a)	Sales price (b)	(a)/(b) (%)
Credit collection		22.3	8.4	10.9	130.3
	Direct collection	8.6	2.3	3.5	149.4
	Auction,etc.	8.3	2.6	3.2	122.9
	Planned repayment	5.4	3.4	4.2	123.1
Repayment, securitization		21.3	7.2	8.2	113.9
	International bidding and direct sales	8.4	1.9	2.3	124.3
	ABS issuance	8	4.2	4.1	98.2
	Sales to AMC, CRC and CRV	4.9	1.1	1.8	155.6
Repurchases		19.2	10.2	10.2	100
Total		62.9	25.8	29.3	113.8

Box 3: Asset backed security (ABS) market in Korea

South Korea enacted the legal framework for asset backed securities in September 1998, and KAMCO began to issue ABS backed by NPLs in 1999. As the NPL market developed in 2000, banks began to make active use of ABS issues, and investment trust companies began to issue ABS (collateral bond obligations or "CBOs") backed by bonds issued by Daewoo Group. During 2001 there was a large increase in the issuing of ABS backed by credit-card debt and other non-defaulted credits. As a result, ABS issues have accounted for a major part of corporate bond issues since 2000. The main investors in ABS are domestic institutional investors, particularly insurance companies and investment trust companies.

ABS issuing trillion won

	1999	2000	2001	2002
ABS issue	**6.8**	**49.4**	**50.9**	**39.8**
Non-ABS corporate bonds	26.2	17.7	47.6	48.5

Breakdown by issuer trillion won

		2001	2002
Financial institutions		**43.9**	**33.3**
	Banks	12	1.8
	Securities companies	8.3	2
	Credit-card companies, etc.	21.5	28.5
	Others	2	1.4
Public-sector		**2.9**	**0.2**
	KAMCO	1.4	0.1
	KDIC	1	0.2
	Others	0.6	0
Non-financial private companies		4.1	6.3
Total		**50.9**	**39.8**

Breakdown by underlying asset trillion won

		2001	2002
Marketable securities		**8.7**	**1.9**
	Outstanding bonds	1.1	1.2
	Newly issued bonds	7.5	0.8
Loans and credits, etc.		**41.4**	**37.3**
	Loans	14.7	3.7
	Leases Automobile loans	1	4.6
	Credit card debt	20.6	22.2
	Other	5.1	6.8
	Real estate	0.9	0.6
Total		**50.9**	**39.8**

(2) Result of financial restructuring

Improvements in the financial status of commercial banks

The non-performing loan ratios at the commercial banks have substantially fallen from its peak of 13.6 percent in 1999 to 2.4 percent in 2002, and the capital adequacy ratio have risen from its bottom of 7.0 percent in 1997 to 10.5 percent in 2002[7] (Figure 7). The vast majority of NPLs were subject to final disposal in the form of direct write-offs and sales rather than indirect write-offs. Credit ratings have also gradually recovered, and there was no significant upheaval when the blanket deposit insurance was lifted in the early 2001.

[7] However, the Financial Supervisory Service (equivalent to the Financial Services Agency in Japan) said there is still need for improvement. In June 2002, capital adequacy ratios were lower than those of European (11.5 percent) and U.S. (12.2 percent) banks, and the weight of Tier 1 capital was also low (South Korea 64.8 percent, USA 70.5 percent, and Europe 69.0 percent). The Tier 1 capital of South Korean banks does not include deferred tax assets from tax effect accounting.

Commercial banks posted profits for the first time in five years in 2001 and recorded high profits in 2002(Figure7). The contributing factors were: 1) the reduction in NPLs; 2) significant restructuring effects; and 3) significant growth in lending to households and small and medium sized enterprises (SMEs). Between 1997 and June 2002, number of employees in the commercial banks declined by approximately 40 percent from 114,000 to 68,000. As a result, deposits per employee roughly quadrupled.

Currently, foreigners, mainly European and North American investors, are among the major shareholders of the commercial banks, and there has been a noticeable rise in the number of foreign investors nominating directors to bank boards (Figure 8). The influx of foreign capital has helped to eliminate the "overly cozy relationship" between the government and business that was observed prior to the crisis, and has put priority on profitability in the bank management. In 2002, the government began to privatize the nationalized banks and it will help to strengthen market mechanisms even more[8].

Up until about 1999, consolidation of the banking system was led by the government, including P&A and merger deals among under-capitalized institutions. From about 2001, an increasingly competitive environment has prompted large private sector-led mergers and the establishment of holding companies throughout the industry. As a result, the number of banks has dropped significantly from 26 banks at the end of 1997 to eleven banks and groups currently (Figure 9).

Active retail lending by commercial banks

While Banks have cut their lending to the *chaebols*, they have increased their lending to households[9] and SMEs primarily in the service sector as their risk-taking capacity recovered (Figure10). The reduction in lending to the *chaebols* is attributed to two factors. Large companies have shown a stronger preference for raising funds on capital markets, and banks, for their part, have greatly changed their lending behavior. Prior to the crisis, the "overly cozy relationships" with the government and a belief that the government would never allow the *chaebols* to fail, banks actively lent to the *chaebols*. After the crisis, however, banks reoriented their lending by clear risk/return standards that resulted in a sharp rise in more lucrative loans to

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[8] The privatization of nationalized banks began in 1999 with the sale of Korea First Bank to foreign investors. After a long hiatus, it restarted in 2002 with the sale of Seoul Bank to a local bank, and sale of a portion of the shares in the Woori Financial Group to retail investors. Negotiations are underway for the sale of Chohung Bank to a local bank as well (Figure 9). In 2002, Korea raised the ceiling on the ownership of a single entity in a bank to 10 percent in order to facilitate sales of the government-hold stocks (However, investors are allowed to exercise no more than 4 percent of voting rights.)

[9] There are some worries that banks' over-lending to households lead to a rise in personal bankruptcies and housing prices (Figure23). The Financial Supervisory Commission has ordered commercial banks to tighten loan-to-value ratio for home-loans and increase provisions against loans to households.

households and SMEs, which had been crowded out by lending to the *chaebols* in the pre-crisis period.

As a result, the service sector dominates a greater share in the GDP than before the crisis. There has also been a sharp rise in employment in SMEs, including start-ups (Figure 11). The restoration of banks' financial intermediary capacity and their reorientation towards profitability, combined with greater flexibility in the labor market (discussed later), have transformed Korea's economic structure, which tended to center around the *chaebols* in the past.

3. Corporate restructuring

(1) Outline of corporate restructuring (Figure 12)

The framework of corporate restructuring has three main aspects: 1) financial restructuring through debt reductions and the selection of core companies; 2) promotion of closure and revitalization of ailing companies; and 3) improvement of corporate governance.

Financial restructuring

In 1998, the government required the top 64 *chaebols* to sign "the capital structure improvement plans" with their major creditor banks. The plans sought: 1) reduction of debt ratios (debt divided by capital) to below 200 percent in order to alleviate over-indebtedness; and 2) reduction in the number of affiliate companies[10]. The government also required the five largest *chaebols* to swap business areas between themselves ("Big Deals") so as to concentrate on their main lines of business. However, the government-led "Big Deals" lacked economic rationality in some cases and revealed the limitations of the government-led corporate reform (Figure 13).

The momentum for reform has continued even after the economy started to show a strong recovery and the government continued to strengthen the framework. In 1998, immediately after the crisis, some *chaebols* tried to reduce their debt ratios by issuing new stocks and making their affiliates buy them, and to expand their business by raising funds through issuance of bonds and commercial papers[11] most of which were purchased by investment trust companies (Figure 14, Figure 2).[12] In

[10] If a *chaebol* is unable to achieve its capital structure improvement plans, both mandatory interest and tax penalties were imposed.
[11] In 1998, the government lifted restrictions on total stock investment by *chaebols* (no more than 25 percent of net worth) in order to facilitate the cross-payment guarantee within the *chaebols*. This led to a sharp rise in internal stock holding ratios for the 30 *chaebols* from43 percent in 1997 to 51 percent in 1999, but the reintroduction of total holding ceiling in 1999 brought the ratio back down to 45 percent in 2001(Figure14).
[12] The Daewoo Group continued to expand its business scope even after the crisis, and this over extension led to its bankruptcy in 1999. As Daewoo group defaulted on its bonds, retail investors ran on the investment trust

response, the government reimposed the ceilings on total stock investment by the *chaebols*, and placed caps on investment by investment trust company in bonds from any single company and required them to use mark-to-market accounting.

To push forward structural reforms, President Kim-Dae-jung established a “Tripartite Committee” formed by the government, business community, and labor unions, which agreed on job cuts and wage-restraints so as to encourage companies to reduce their debt and concentrate on their core businesses.

As companies reduced the number of full-time workers as well as part-time workers[13], the unemployment rate soared from 2 percent to almost 8 percent in 1998 (Figure 15). In spite of the sharp output fall, the wage restraints helped to reduce unit labor costs and the ratio of labor cost distribution (Figure 16). Meanwhile, the capital account liberalization invited inward direct and portfolio investments that made it significantly easier for firms to sell off non-core businesses and improve their capital base. The breakdown of major stock purchasers between 1997 and 2001 shows that foreign investors were the largest purchasers, households, investment trust companies, and non-financial institutions were also active purchasers (Figure 14).

Promotion of closure and revitalization

In 1998, the government required creditor banks to select nonviable companies among the financially ailing ones, and 55 companies were deemed nonviable. The selection was basically left to the creditor banks, but there was undeniable government involvement in this early stage[14]. Other companies that had liquidity difficulties but were considered viable have been reorganized under a private out-of-court "workout"[15] in which creditor groups set management improvement targets for

companies since most of Daewoo bonds and commercial papers were purchased by investment trust companies. The government responded with two measures: 1) it ordered investment trust companies to guarantee principal in order to curb cancellations; and 2) it orders banks to establish a bond purchasing fund in order to prop up bond prices.

[13] Korea has a high proportion of part-time workers in its workforce (45 percent of all workers prior to the crisis), facilitating adjustments in labor market (Figure 15).

[14] For example, the government told creditor banks to review their selections because the first list did not include the firms that belonged to the largest five *chaebols.*

[15] The workout was applied to companies ranked 6 through 64 and the Daewoo Group. A total of approximately 210 financial institutions were involved, including banks, insurance companies, investment trust companies and merchant banking corporations. The committee formed by the creditor financial institutions is required to formulate a revitalizing plan (requiring approximately three years to complete) and obtain at least 75percent (credit value based) agreement to begin the workout. If the creditor financial institutions are unable to reach a consensus, the issue is referred to the Corporate Restructuring Coordination Committee, a group made up of non-government experts (however, there was heavy government involvement in actual practice). Most of the financial support involves rescheduling and interest waivers. A total of 83 financial institution-led workouts were initiated. By the end of 2002, 55 companies had successfully achieved their plans and completed their workouts, with twelve companies still in the workout process. Some 16 companies abandoned their workouts and moved into receivership and liquidation (Figure 13).

companies. They were required to cut costs, sell assets and restructure their operations, but also received suspensions of principal repayments, interest waivers, debt-equity swaps, loans of operating capital, and other financial supports from the creditor groups (Figure 13). It is worth noting that South Korea did not establish an institution similar to Japan's Industrial Revitalization Corporation.[16]

After 2000, Korea continued to take steps to reinforce its corporate closure and revitalization programs. Not enough companies had closed, and since financial institutions were not compelled to participate in workouts, some institutions had begun to opt out of the programs. In 2000 the government again told creditor banks to select companies to be closed (52 were selected), and in 2001 obligated them to review every six months, whether or not certain high-risk companies[17] required closure (the "continuous credit risk assessment" system). More than a thousand companies have been subject to the review each time, with a total of approximately 200 deemed nonviable since 2001. Meanwhile, a new legislation (the "Corporate Restructuring Promotion Law") obligated financial institutions to participate in workout schemes, and financial institutions that opposed to the reorganization plans were forced to sell their credits at market prices to other creditor banks.

The government mitigated the deflationary impact of a sharp economic contraction by expanding fiscal outlays, providing "public work", enhancing safety nets, and enacting special tax incentives for the establishment of SMEs. The workout procedure was also effective in this regard by avoiding many companies from being forced into receivership and enabling corporate activities to continue while protecting ordinary creditors.

Corporate governance and transparency

There were four main features in Korea's efforts to strengthen corporate governance: 1) attracting foreign capital; 2) strengthening of shareholder rights

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[16] KAMCO, which purchased NPLs, and CRV (a joint venture of KAMCO and private financial institutions), which purchased the credits of workout companies from KAMCO, are also involved in the workout process as creditors. (See Box 1.)

[17] The Korean Financial Supervisory Service issued the following guidelines on the selection of high-risk companies:

(1) A recorded interest coverage ratio less than a certain ratio for three consecutive years.
(2) Credits classified as "precautionary" or lower under FLC.
(3) Deemed potentially ailing by creditor banks’ own set of bylaws.
(4) Received one of audit opinions; "qualified opinion"(received during the recent six month period) "disclaimer of opinion" or "adverse opinion”.
(5) Significant and rapid decline in credit rating by heavy borrowings from non-banks.

(strengthening minority interests and institutional investors[18]); 3) introduction of outside directors (obligation on large listed companies to have outside directors accounting for the majority of their boards); and 4) clarification of management responsibilities of the *chaebol* owners (forcing the *chaebol* group chairmen who had no legal status to assume overt director status representing one of their main *chaebol* companies).

This was accompanied by programs to improve financial disclosure: 1) elimination of cross-payment guarantees among the *chaebol* affiliates[19]; and 2) obligations on *chaebols* to produce group-wide consolidated financial statements. Although it would take some time for the institutional framework of corporate governance to take root, as the accounting scandals at some companies illustrate, introduction of foreign capital has significantly improved corporate governance in the short term.

(2) Progress in corporate restructuring

These programs have reduced total corporate debt as a percentage to GDP from 175 percent in 1997 to 145 percent in June 2002 (Figure 2). The borrowings from non-banks and commercial paper issuance declined sharply, largely due to the closure of most of the merchant banking corporations (Figure 3). On the other hand, the borrowings from banks have been increasing since 2000, but as discussed earlier, this represents greater borrowings by SMEs. Corporate debt ratios (debt divided by capital) have significantly declined due to equity financing and the sales of non-core assets (Figure 17).

The corporate profits have shown significant improvement. The listed companies posted profits in 2001 after negative profits in 1998 and 1999, and registered record-high profits in 2002 (Figure 18).

It should be noted, however, that some of the major blue-chip companies were responsible for this improvement in profits. Slumping companies continued to carry excessive debt. According to the Bank of Korea's "Financial Statement Analysis", the interest coverage ratio of the manufacturing industry improved substantially in the first half of 2002 and is over 200 percent on average while the distribution curve indicates that nearly 30 percent of these are still below 100 percent (Figure 18). We should also note that total corporate debt of Korea’s companies as a percentage of GDP is only slightly below that of Japan and significantly higher than that of the

[18] The minimum number of shares required to file suits or submit proposals to general shareholders meetings was significantly reduced, and the "shadow voting" system among institutional investors (allocation of the institutional investors’ votes in proportions equivalent to the yeas and nays votes of other shareholders) was abolished.

[19] Immediately prior to the currency crisis, the cross payment guarantees among affiliates of the 30 largest *chaebols* reached nearly half of their net worth, making it extremely difficult to determine their risk profile.

United States; net financial liabilities (financial liabilities minus financial assets) are even higher than that of Japan (Figure 19).

(3) Transition to market-led corporate restructuring

Corporate reform is moving from government-led to market-driven. The stock market and banks are becoming more selective about companies, and companies are forced into two groups. The share of total market capitalization accounted for by the top ten companies, most of which are blue chips, has risen by almost 20 percentage points since the crisis and now exceeds 50 percent of the total. Companies with liquidity problem are forced to appropriate their depreciation to make interest and principal payments, causing them to refrain from new investments[20]and to sell off non-core businesses as well. In other words, market pressures are forcing them to restructure.

The Korean stock market was led by individuals before the crisis, but it is more driven by foreign investors after the crisis as a result of capital account liberalization, which is increasing selectivity on the market. At the end of 2002, foreign investors held a 12 percent share of stock, and 36 percent in terms of market capitalization, indicating a marked preference for large blue chips stocks (Figure 20). Having secured public funds to write off non performing loans and improved governance by eliminating government meddling and introducing foreign capital, bank lending is becoming more selective about the companies. Banks have continued to write off large amounts of NPLs even after public capital injections came to an end in 2000 (Figure 6).

There are plans to overhaul the Korean bankruptcy laws towards more rule-based approach, as the current workout program and the Corporate Restructuring Promotion Law provide private frameworks for corporate closures and reorganizations.

4. Some Implications

(1) Distinguishing features of structural reforms in South Korea

There are three characteristics of the structural reforms in terms of implications for Japanese structural reform.

First, the government was actively involved from the initial stage, and the reforms were comprehensive. Aware of the interrelation of each structural issue, the government intervened in a broad range of the financial institution, corporate and

[20] Along with interest payments, depreciation resulting from the past excessive investments is also a factor weighing down earnings, so corporate cash flow is not as bad as interest coverage ratios suggest (Figure 16).

labor union activities. Rather than just temporary reforms, these efforts were keenly aware of the need to reform corporate governance itself, which was seen as a fundamental cause of the crisis. Among the crisis-stricken countries that received the IMF supports, South Korea was the only country whose reform program explicitly included the strengthening of corporate governance[21].

Second, the comprehensive reforms have significantly increased flexibility of the economy. Korea quickly restored financial intermediary functions, enhanced and developed the capital markets (including the ABS market), introduced foreign capital, and brought greater flexibility to the labor market. These efforts redistributed resources to service sectors and SMEs, which corrected the concentration on the *chaebols* in the economic structure. What's more, the reallocation of the factors of production relieved the deflationary impacts of reform (Figure 1).

Finally, corporate restructuring is making the transition from government-led to market-led. Government-led reform is at most the "second-best" policy; market-led reforms are essential to the appropriate allocation of resources and the sustainability of reforms. Korea worked quickly and intensively to restore banks' soundness. Corporate reform is still in progress, as companies continue to be over-indebted. The sound banks with sufficient capital and good governance are now forcing companies to restructure, which will drive the reforms forward.

(2) Differences between Japan and South Korea

We should also note that there are a number of differences between Korea and Japan.

The first is regarding active government involvement. Broad government intervention was warranted in Korea because the crisis required IMF assistance. In addition, Korea had a healthy fiscal position that enabled injection of massive amounts of public funds into the financial institutions[22]. Prior to the crisis, Korea's fiscal balance was more or less at equilibrium, with the government debt at only about 10 percent of GDP (Figure 21). Finally, Korea concentrated political authority in the president, and this made it easier for the country to respond quickly to crisis.

The second difference stems from the degree of complexity of structural

[21] The South Korean government proposed to include improvements in corporate governance in the IMF program (Fukagawa [2000]).

[22] According to estimates by the ministry of finance published in June 2002, assuming that the government sells all of the bank shares over a period of 3-4 years, roughly 69 trillion won of the 155 trillion won of public capital injected into the banks will be uncollectible. The total estimated loss in this scenario is approximately 87 trillion won (17percent of GDP), including 18 trillion won in interest payments on government-guaranteed bonds issued by the Korea Deposit Insurance Corporation (KDIC), which provided capital and deposit insurance to financial institutions, and KAMCO. The vast majority of the uncollectible amount is thought to be deposit insurance.

problems. In comparison with Japan, Korea had fewer factors contributing to financial system instability and prolonged NPL problems: 1) Korea did not experience an asset price bubble in the pre-crisis period (Figure 22)[23]; 2) bank shareholding was comparatively low (Figure 23)[24]; and 3) banks lent very little to non-banks because merchant banking corporations were allowed to accept deposits on their own (Figure 23); and 4) there were fewer banks[25]. It was also easier for the government to become involved in corporate restructuring because much greater proportion of the economy was concentrated in the large *chaebols*; in 1996, Korea's five largest *chaebols* owned approximately 30 percent of total assets, and its 30 largest *chaebols* approximately 50 percent. Another major difference between Korea and Japan was that Korea's demographic structure was younger and the country did not have an "lifetime employment" system, which made employment mismatches relatively small (Figure 24, Figure 25)[26].

The third difference is related to short-term conflicts between structural reform and economic growth. The higher export ratio in South Korea, which is approximately 35 percent of GDP, and healthy fiscal position made it possible to alleviate the deflationary impact of the reform. The rapid increase in exports backed by the weaker won, coupled with fiscal expansion and proactive employment program staved off a prolonged economic adjustment. Because there had been potential demands for loans, the bank lending recovered quickly as soon as they restored risk-taking capacity. The Korean economy was less mature than Japan’s and there is greater scope for reorientation toward services. There is latent demand for loans among SMEs that had been crowded out by the *chaebols* before the crisis.

23 When housing prices rose sharply in South Korea at the end of the eighties as democratization caused wages to soar, the government imposed ceilings on residential floor space acquisition and on land transactions. This move prevented real-estate bubble during the economic overheating of the nineties.

24 In the pre-crisis period, the banks that were controlled by the government had little incentive to hold shares on a long-term basis and monitor the management of the *chaebols.* There were also restrictions on *chaebol* ownership of bank shares, and therefore the cross shareholding ties between banks and *chaebols* were weak.

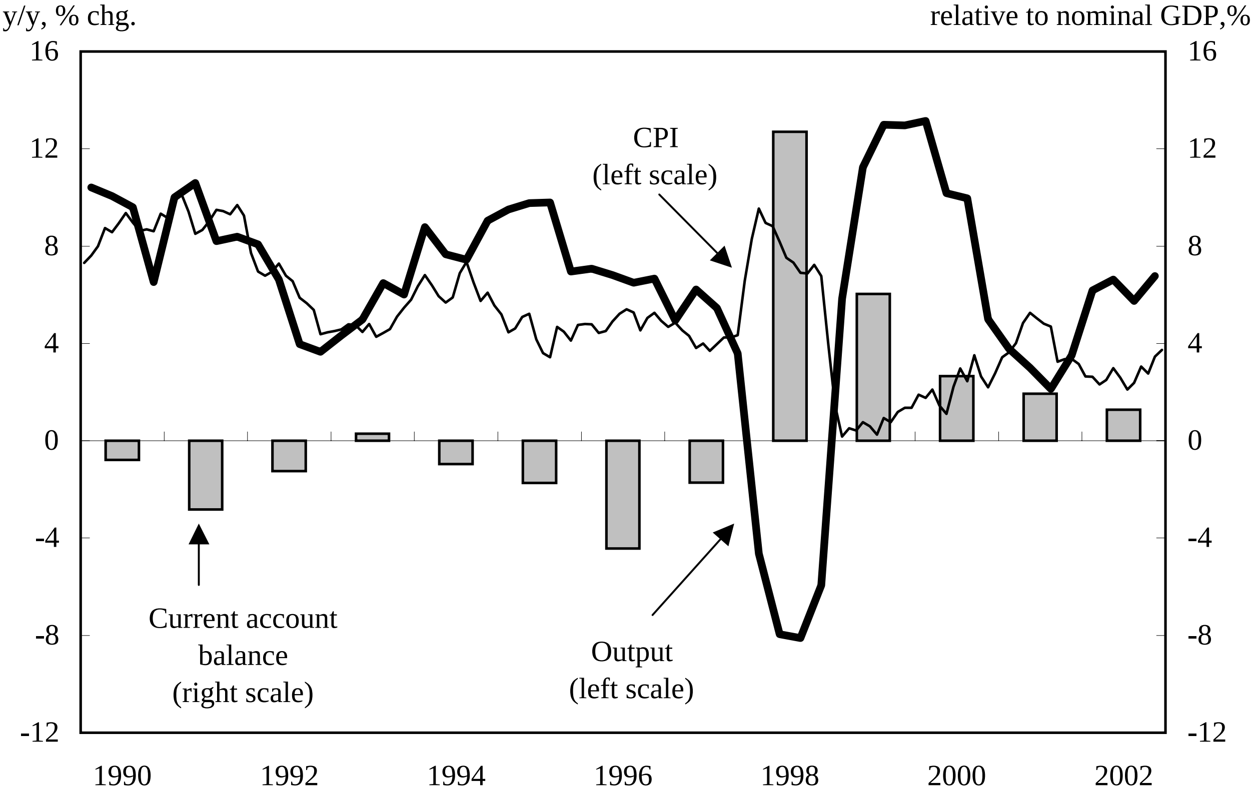
25 At the end of 1997, there were 16 nationwide banks and ten regional banks. What’s more, Korea has a small Postal Savings System and no government-housing loan company.

26 The approvals of the temporary staff business and further rise in proportion of part-timers have brought further flexibility to the labor market.

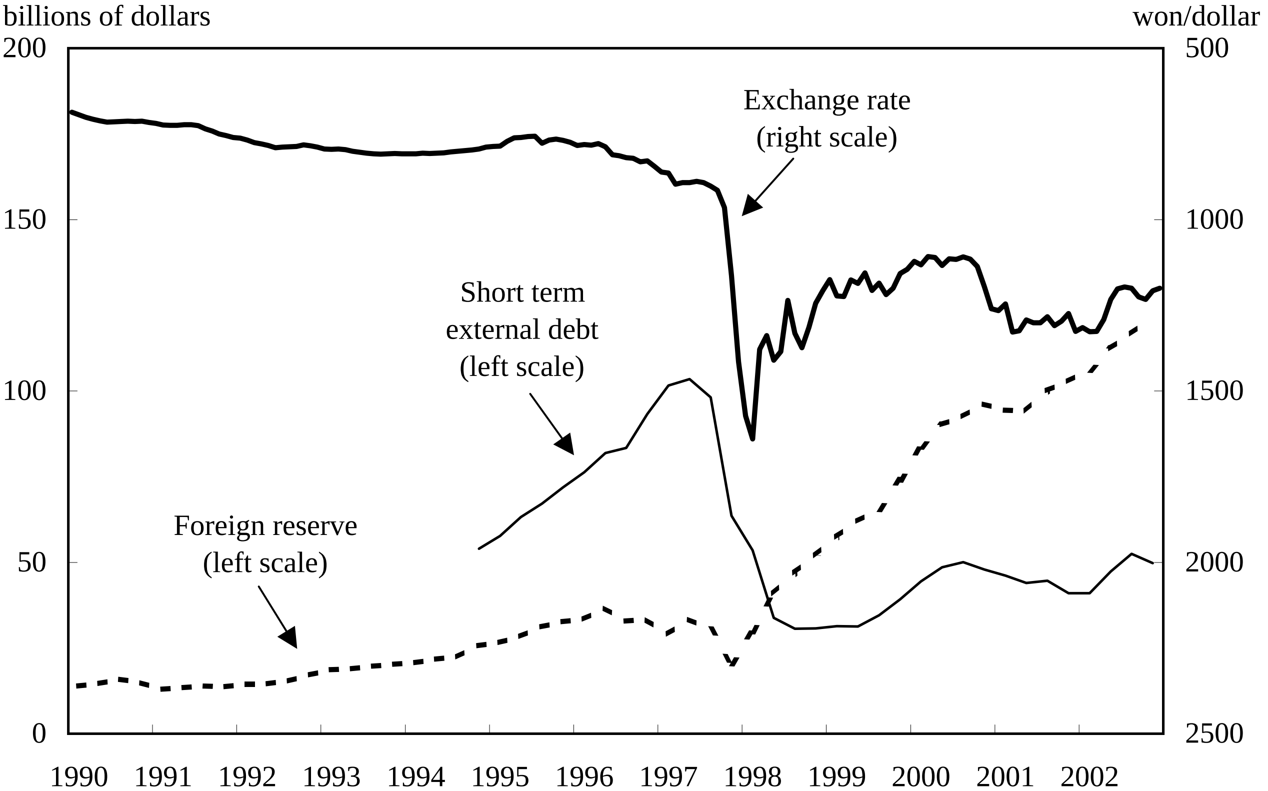
Chart 1

Selected Economic Indicators of Korea

1. Economic Trends



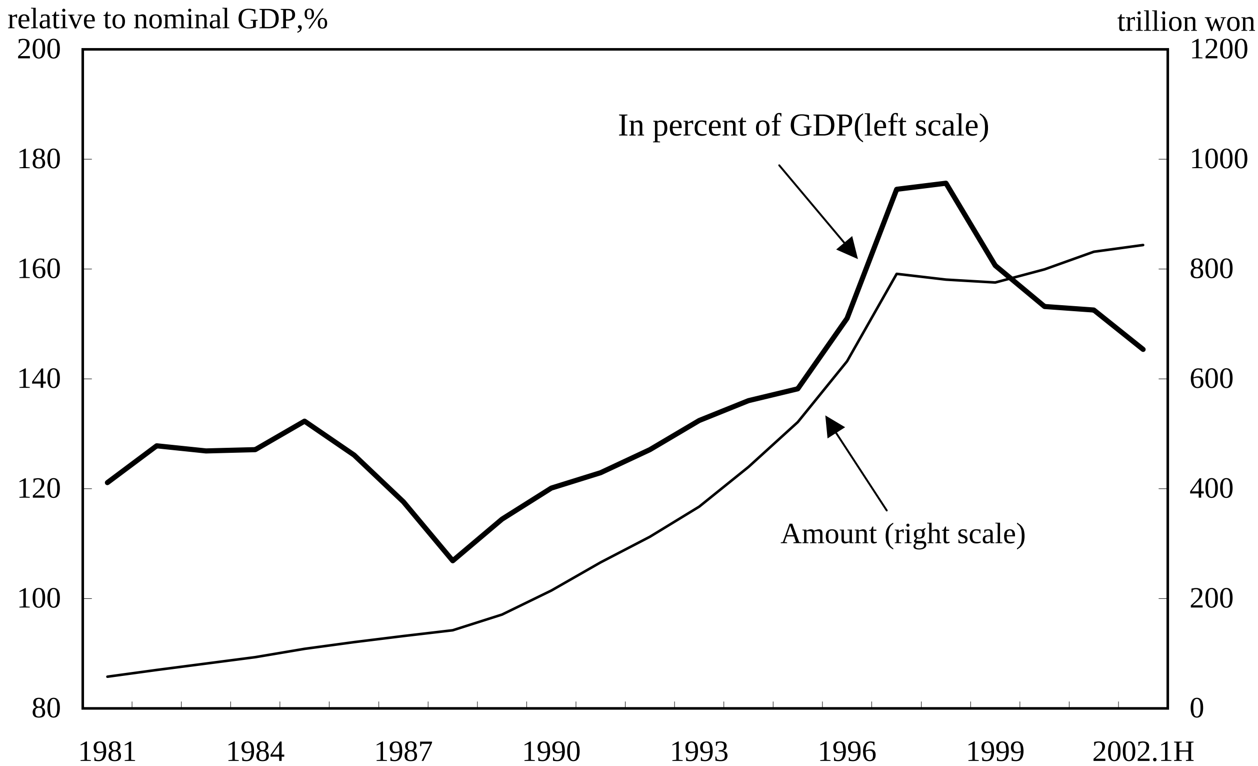
2. Exchange Rate and External Positin



Sources: Bank of Korea, Korea National Statistical Office, CEIC

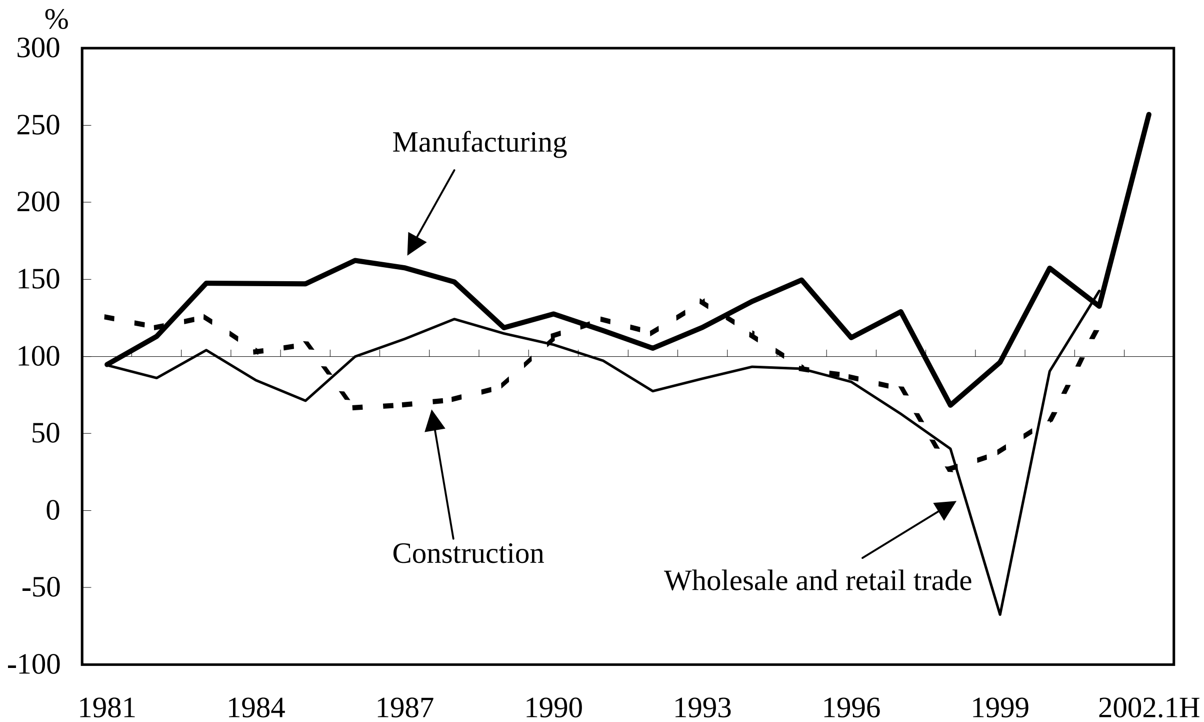
Corporate Debts and Interest Coverage Ratio

1. Corporate Debts



Source: Bank of Korea, "Flow of Funds."

2.Interest Coverage Ratio (operating income/interest payments)

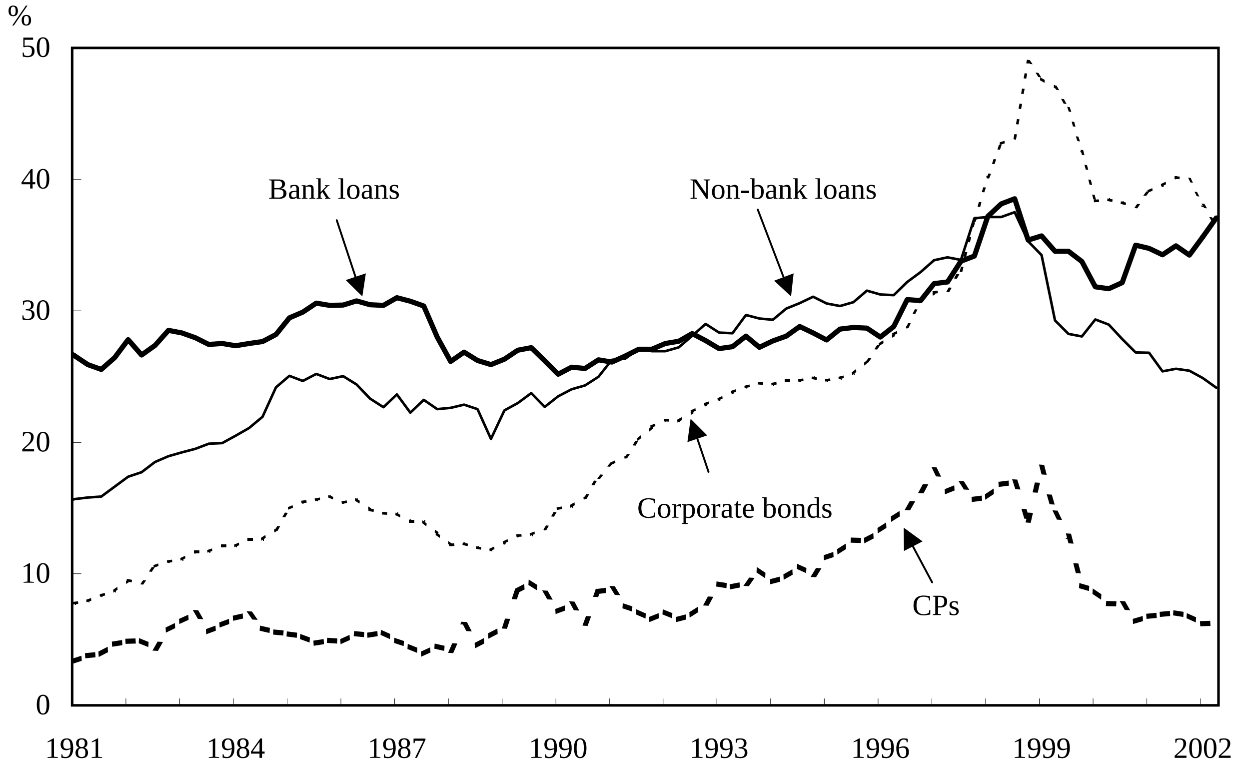


Source: Bank of Korea, "Financial Statement Analysis."

Chart 3

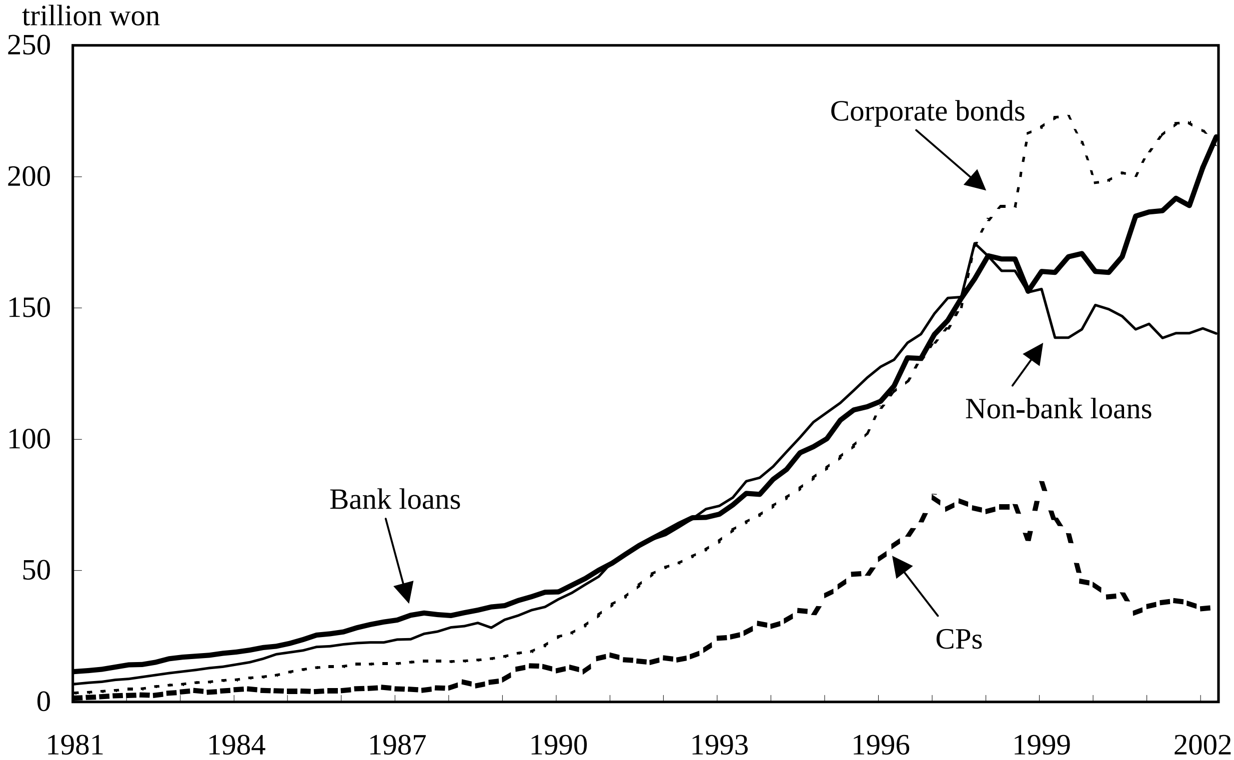
Composition of Corporate Debts

1.Relative to Nominal GDP



Source: Bank of Korea, "Flow of Funds"

2.Amount



Source: Bank of Korea, "Flow of Funds."

Chart 4

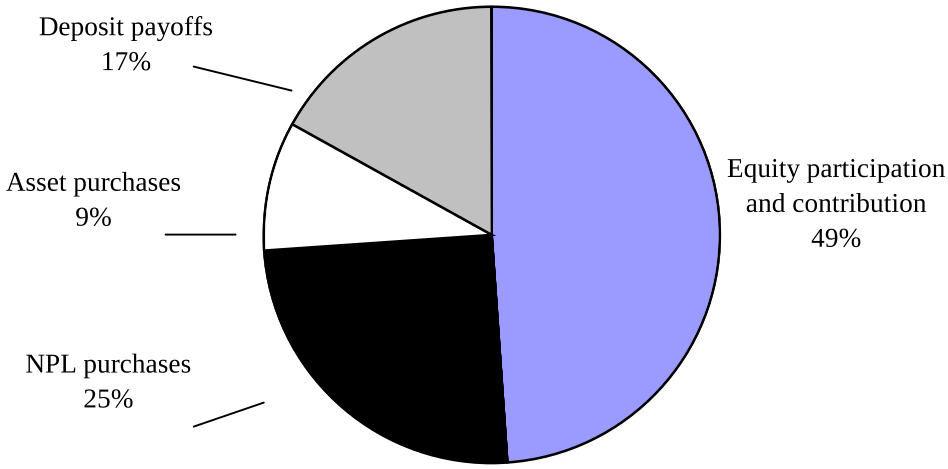
Financial Restructuring

Round 1	**1997**	Hanbo Group (14th ranked *chaebol*) went bankrupt in January, followed by a string of medium-sized *chaebol* bankruptcies.
	November	Comprehensive Program for Market Stabilization and Structural Reform Financial Industry 1) Increase in funding for the Korea Asset Management Corporation (KAMCO) 2) Liquidation and integration of financial institutions 3) Depositor protection(adoption of blanket deposit guarantee through the end of 2000) Request for IMF support (Nov. 21)
	December	Approval of support by IMF (Dec. 4) --The main content of the financial restructuring component of the IMF program was: 1) suspension of the licenses of merchant banking corporations (if unable to formulate an appropriate rebuilding plan within one month offer operational suspension), 2) achievement of BIS capital adequacy ratios within the year, and 3) elimination of public deposit guarantees by the end of 2000.
	1998 January	Nationalization of Korea First Bank and Seoul Bank
	February	President Kim Dae-jung took office
	April	Establishment of Financial Supervisory Commission (FSC)
	May	Announcement of first Financial Reorganization Plan --Injection of 64 trillion won of public funds (primarily for the purchase of non-performing loans from commercial banks and their recapitalization). (Full amount injected by the end of August 2000.)
	1999 July	Daewoo Group faces liquidity problems
	September	Korea First Bank sold to Newbridge Capital
	December	Asset assessment criteria strengthened (introduction of "forward-looking criteria" [FLC])
Round 2	**2000** June	FSC required for eight banks that received public capital and were still below 8% of BIS ratios using the FLC criteria to submit business improvement plans.
	September	Announcement of second Financial Reorganization Plan 1)Additional injections of public capital (50 trillion won [investment trust companies, merchant banking corporations, credit banks, Korea First Bank, etc.]), 2) introduction of financial holding companies, and 3) promotion of bank mergers
	November	Hyundai Group faced liquidity problems
	December	Five banks were deemed insolvent and nationalized (Hanvit Bank, Peace Bank, Kwangju Bank, Cheju Bank, Kyongnam Bank) --Four of these institutions were consolidated in April 2001 under the Woori Financial Holding Company
	2001 January	Removal of blanket deposit insurance --Settlement deposit continues to be guaranteed until 2003
	2002	Privatization of nationalized banks --Sale of Woori Financial Holding Company shares to begin --Seoul Bank sold to and merged with Hana Bank (December)

Chart 5

Public Fund Support to Financial Institutions

The amount of public fund support (end of 2001)
155 trillion won (30% of Nominal GDP)



	Methods	Amount, relative to GDP
Commercial banks	Capital injection NPL purchases P&A	16%
Merchant banks	Closure, Deposit payoffs	4%
Investment management companies **Securities companies**	Capital injection	3%
Insurance companies	Capital injection	4%
Credit specialty financing companies, **Mutual saving banks**	Closure, Deposit payoffs	2%
Others	--	30%

Sources: KDIC, Ministry of Finance and Economy, Korea.

Chart 6

Resolution of NPLs

At book value, trillion won

	Total NPLs	Net changes	Increases		Decreases			
				change in definition of NPLs		by KAMCO	by banks themselves	
								ABS/sales
1998	33.9	1.4	39.7	7.9	38.3	22.3	16.0	0.0
1999	61.0	27.1	53.7	31.1	26.6	7.8	18.0	0.8
2000	42.1	-18.9	20.6	5.6	39.5	1.0	35.9	8.4
2001	18.8	-23.3	17.8	n.a.	41.1	0.6	40.3	13.5
Total	-	-13.7	131.8	-	145.5	31.6	110.2	22.7

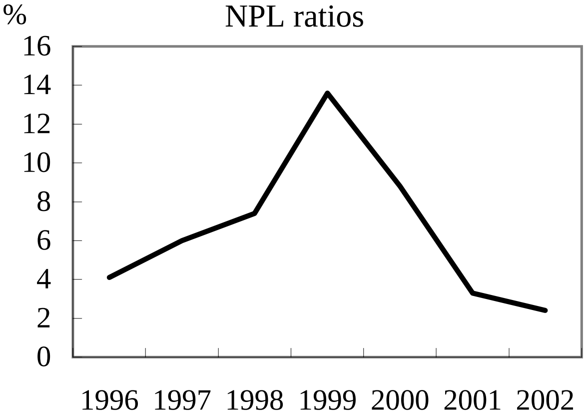
Note: Resolution by banks themselves includes write-offs, securitization, direct sales, recovery of loans and debt-equity swap.

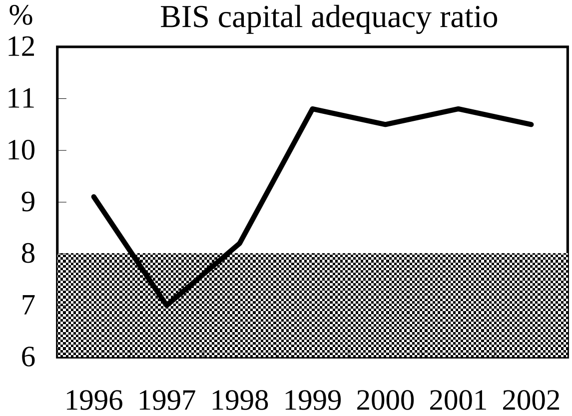
Source: Bank of Korea

Chart 7

Financial Indicators of Commercial Banks

1. Non-performing Loans and BIS Capital Ratio

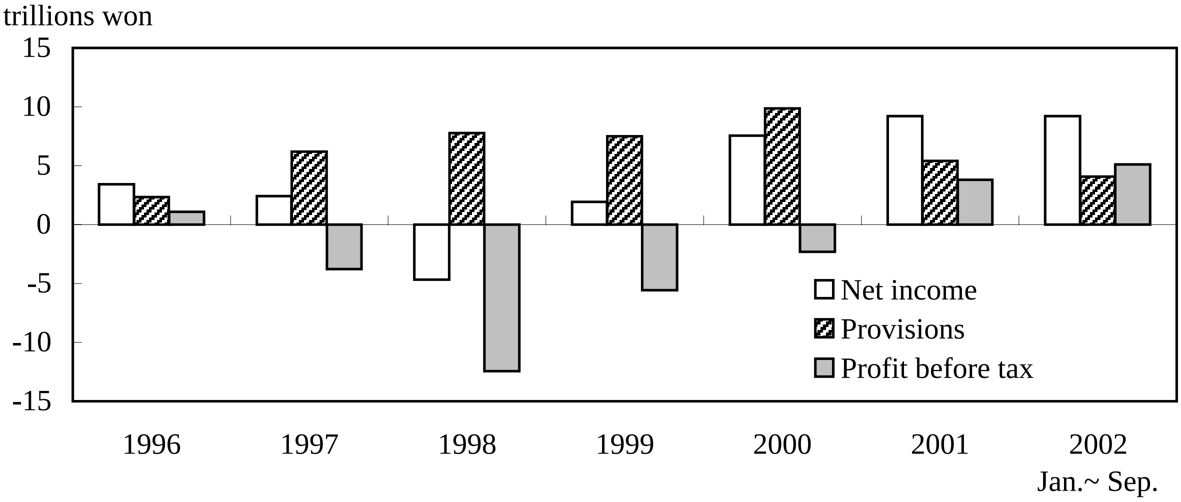




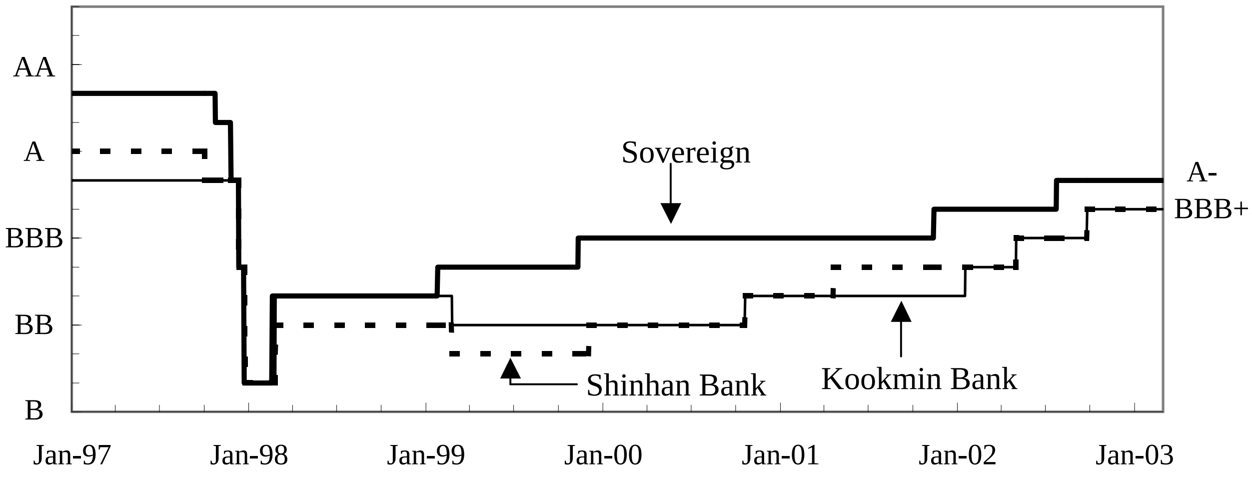
Note: The definition of NPLs was changed in Jun. 1998 and Forward Looking Criteria was introduced in Dec.1998.

Source: Financial Supervisory Service

2. Profits



3. Credit Ratings, S&P, Long-term foreign currency denominated debts



Source: Bloomberg

Chart 8

Ownership of Commercial Banks

	Foreign ownership	Government ownership
Kookmin	63.39	9.6
Woori (holding company)	0.48	87.7
Hana	29.53	27.9
Chohung	3.01	80.1
Shinhan (holding company)	47.03	-
Korea Exchange	34.29	43.2
KorAm	68.35	-
Korea First	50.99	49.0

Note: Foregin ownership and government ownership represent proportions of shares held by foreigners and the government, respectively. Figures for foreign ownership are as of Feb 2002, and those for the government ownership are as of the end of 2002.
Source: OECD

Consolidation of Finanical Institutions

1. Commercial Banks

1997		1998	1999	2000	2001	2002	2003
BIS ratio over 8%	Kookmin	P&A of Daedong	Merged		Merged		Kookmin
	(Long-Term Credit Bank)						
	Housing & Commercial (H&CB)	P&A of Dongnam					
	KorAm	P&A of Kyungki					KorAm
	Hana	P&A of Chungchong	Merged			Acquiring Seoul	Hana
	Boram						
	Shinhan	P&A of Donghwa			Shinhan Financial Group	Shinhan FG acquired Cheju	Shinhan (Note2)
	Cheju *			Nationalized			Cheju
	Daegu *						Daegu
	Pusan *						Pusan
	Jeonbuk *						Jeonbuk
	Kyongnam *			Nationalized		Woori Financial Group	Kyongnam
	Kwangju *			Nationalized			Kwangju
BIS ratio below 8%	Commercial	Merged into Hanvit		Nationalized	Merged	Woori	Woori
	Hanil						
	Peace			Nationalized			
	Chohung		Merged				Chohung (Note 2)
	Chungbuk *						
	Kangwon *						
	Korea Exchange (KEB)						KEB
	Donghwa	P&A by Shinhan					
	Daedong	P&A by Kookmin					
	Dongnam	P&A by H&CB					
	Kyungki *	P&A by KorAm					
	Chungchong *	P&A by Hana					
Other	Korea First (KFB)	Nationalized	Aquired by Newbridge Capital				KFB
	Seoul	Nationalized				Acquired by Hana	

Note1: * Regional Banks

2: Shinhan Financial Group is under negotiotions with the government to acquire Chohung Bank.

2. All Financial Institions

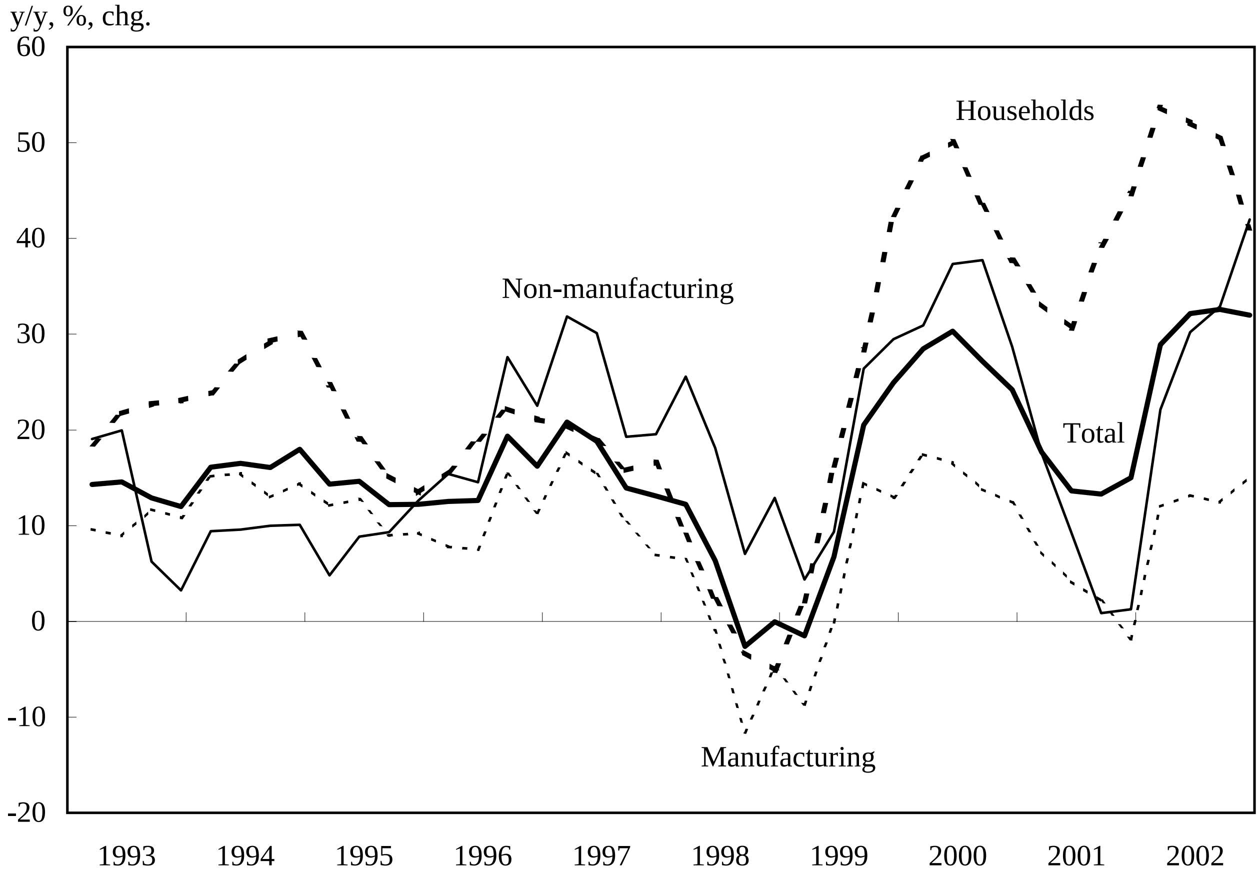
	End of 1997	End of 2001	1998 ~ 2001		
			Closure	Merger	Newly established
Banks (Note)	33	20	5	8	—
Merchant banking corporations	30	3	22	6	1
Securities companies	36	46	6	1	17
Investment trust companies	31	30	6	1	6
Insurance companies	45	33	7	6	1
Mutual savings & finance companies	231	122	72	25	12
Credit Unions	1,666	1,268	305	102	9
Total	2,072	1,522	456	170	54

Note: Including Specialized Banks.

Source: Bank of Korea

Bank Loans

1. Bank loans by sector



Source: Bank of Korea

2. Bank loans by size of firms

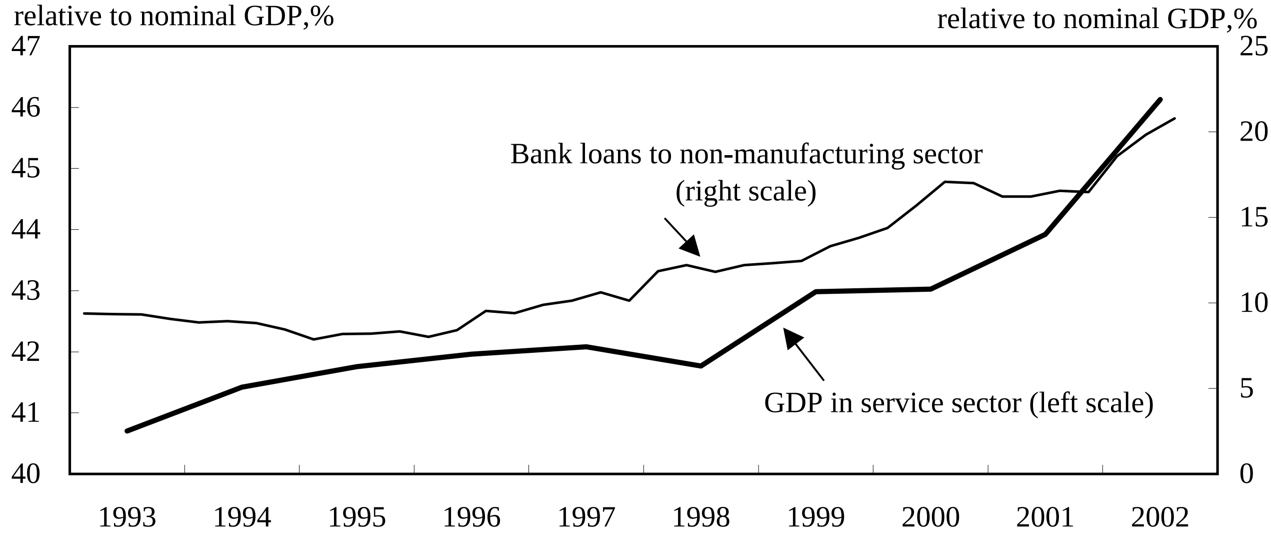
changes over the previous period,trillion won

	2000	2001		2002		Contribution ratio in 2002
	4Q	1H	2H	1H	2H	
All firms	-0.3	7.0	6.0	24.1	11.6	10.4%
To large firms	-2.3	-0.3	-3.1	1.6	-1.5	0.0%
SMEs	1.9	7.3	9.1	22.5	14.6	10.4%

Note: 1.Excluding changes in connection with the disposal of bad loans and debts equity swaps.
2.The contribution ratios are to annual changes in total bank loans in 2002.
Source: Bank of Korea

Increase in Service Sector and SMEs

1. Share of Service Sector



Note: Service sector includes wholesale and retail, transportation and communication, finance and real estate and social and personal service, etc.
Source:Korea National Statistical Office

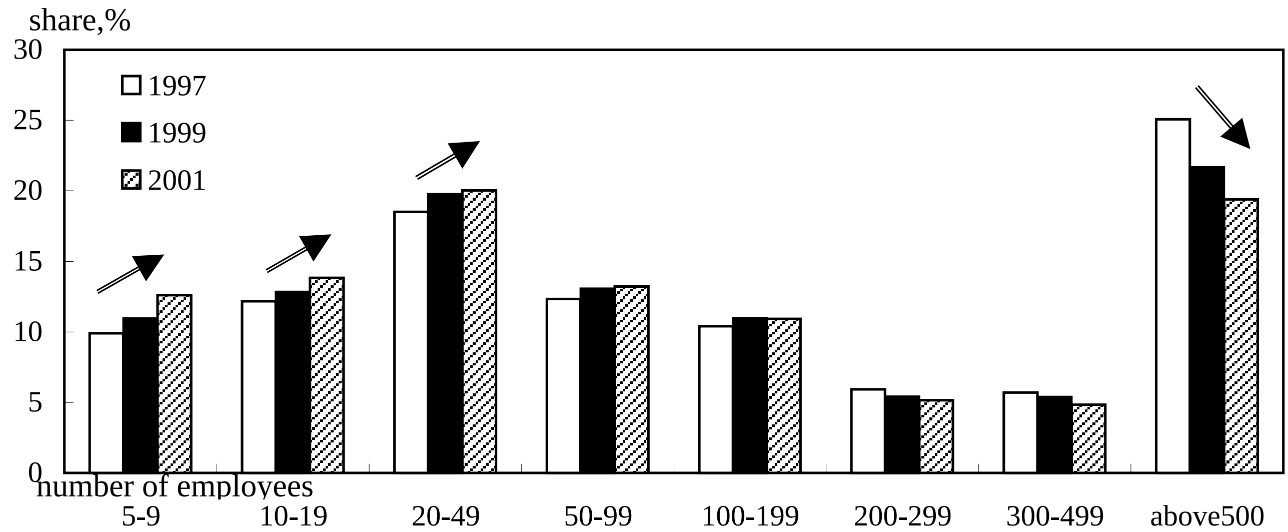
2. Creation and Bankruptcy of Firms

number,%

	1996	1997	1998	1999	2000	2001	2002
Bankruptcies (a)	3,879	6,277	7,728	2,479	2,800	2,349	1,973
New establishment (b)	19,264	21,831	20,095	30,701	41,460	39,609	38,972
(b) / (a)	5.0%	3.5%	2.6%	12.4%	14.8%	16.9%	19.8%

Note: The survey covers eight major cities(Seoul, Pusan etc.)

3. Distribution of Employees by Size of Firms



Source: Korea National Statistical Office

Chart 12

Corporate Restructurng in Korea

	Bankruptcies of chaebols	Corporate restructuring	Other structural reforms Financial reform, labor reform capital account liberalization
1997 **Breakout of crisis**	*Series of bankruptcies of medium-sized chaebols *Currency crisis (Request of IMF package)		*Adoption of blanket deposit insurance *Purchase of NPLs by KAMCO *Closing merchant banks
1998 **Establishment of framework for structural reform**	*Many chaebols faced liquidity problem hit by currency crisis	*5 principles of corporate restructuring 1.Selecting core companies -big deals 2.Improving financial structure 3.Eliminating cross payment guarantee 4. Improving transparancy 5. Strengthening corporate governance *Introducing work-out -for the 6th largest chaebols and under *Announcing 55 companies for liquidation	*Nationalization of Korea First bank and Seoul bank *Launching "the Tripartite committee", Labor Law reform(increase in labor market flexibility) *Removal of limit of equity investment by foreigners *First financial reform plan (public fund injection) *Introduction of limit holdings of corporate bonds by investment trust companies
1999 **Reinforcement for structural reform** ↓	*Bankruptcy of Dae woo groups	*Additional 3 principles of corporate restructuring 1. Separation of industry and capital fund 2. Restraint of circular investment and unfair internal transaction 3. Shut-out of irregular inheritance Daewoo group joined work-out	*Limit of stock investment by chaebols *Stricter classification of NPLs (Introducing Forward-Looking-Criteria)
2000	*Some Hyundai group companies faced liquidity problem	*Announcing 52 companies for liquidation	*Second financial reform plan (Additional public funds injection) *Additional nationalization of 5 commercial banks
2001	*Hynix faced liquidity problem	*Enhancement of Corporate Restructuring Promotion Law (Strengthening workout)	*Removal of blanket deposit insurance *Launching the regular evaluation of credit risk
2002		*200 companies for liquidation	*Acceleration of sales of nationalized bank's stocks

Big Deals and Workout

1. Big Deals

Semiconductor	Hyndai aquired LG
Petrochemical	Hyundai and Samsung were not merged
Home appliance	Exchange between Samsung and Daewoo was materialized
Oil manufacture	Hyundai aquired Hunhua. SK and SsangYong were not merged
Aircraft	Hyundai, Samsung and Daewoo were merged
Power plant	Korea Heavy Industry aquired Hyundai and Samsung
Ship engine	Korea Heavy Industry and Samsung were merged
Railroad vehicle	Hyundai, Daewoo and Kanjin were merged
Automobile	Hyundai aquired Kia. Exchange between Daewoo and Samsung were not materialized

2. Workout

number of firms, at the end of 2002

Total	Completed	Court-receivership/Liquidation	At work
83	55	16	12

3. Finaicial Support for Companies under Workout

	Rescheduling		Debt-equity swaps	Others	Total
	Interest payment reduction	No interest payment reduction			
1999	54.8	4.5	28.9	4.2	92.4
Excluding Dae woo	19.4	3.7	2.2	2.5	27.9
Dae woo	35.4	0.8	26.6	1.6	64.5
2000	57.5	2.7	6.0	5.3	71.5
2001	26.4	1.8	4.7	2.4	35.3

Note: 1. The figure for Daewoo in 1999 is based on plan. Debt equity swap includes acquisition of corporate bonds.
2. Others include off-setting between deposits and debts, write-offs etc.

4. Restructuring Measures for Companies under Workout

trillion won

	Sales of Assets		Partition	Capital increase	Foreign participation	Others	Total
		Real estate					
1999	13.5	10.3	1.0	3.0	9.6	5.3	32.5
2000	14.7	4.1	1.7	2.6	2.6	4.5	26.0
2001	24.5	6.2	2.1	1.7	2.6	3.3	34.2
Total	52.8	20.6	4.8	7.4	14.7	13.1	92.7

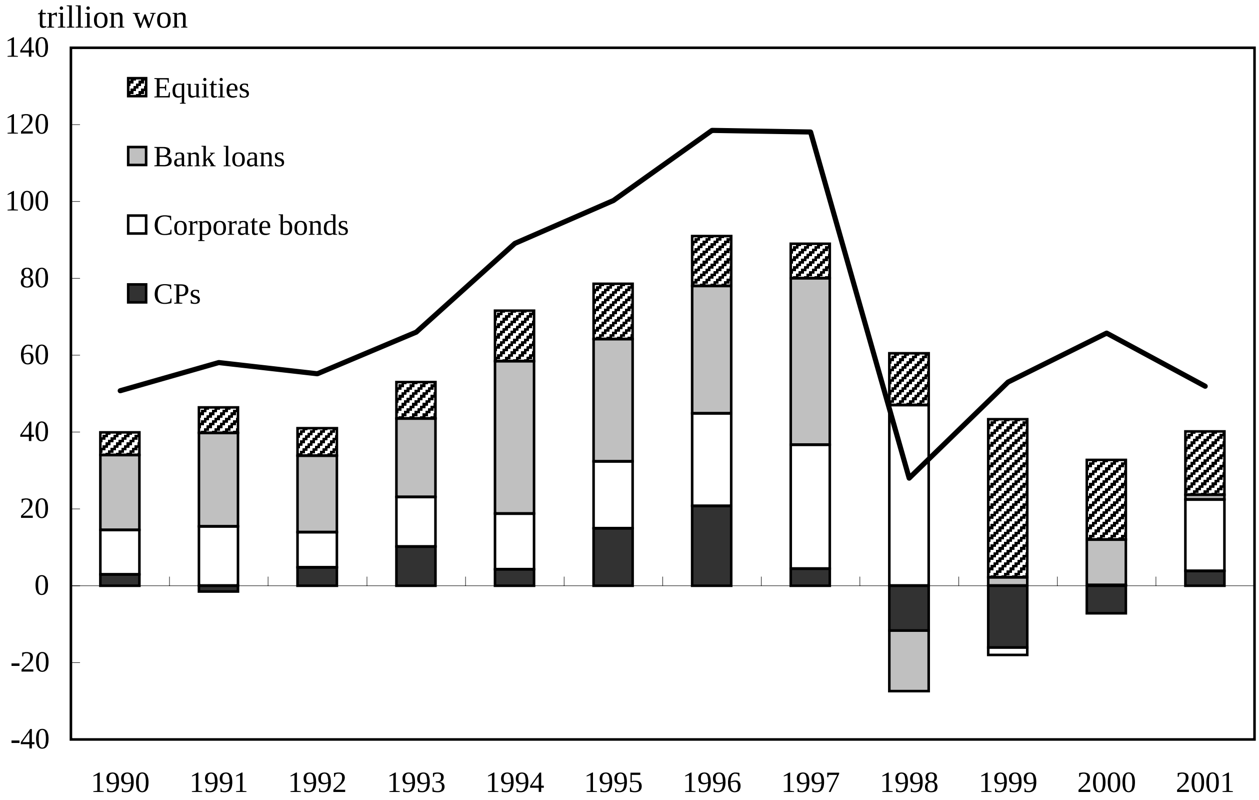
Note: The figure for 1999 does not cover Daewoo group.

Source: Financial Supervisory Service

Chart 14

Fund Raising by Firms

1. Fund Raising by Instruments



Source: Bank of Korea, "Flow of Funds."

2. Internal Share Holdings of 30 Largest Chaebols

%

	1990	1993	1995	1997	1998	1999	2000	2001
Total	45.4	43.4	43.3	43.0	44.5	50.5	43.4	45.0
Family	13.7	10.3	10.5	8.5	7.9	5.4	4.5	5.6
Subsidiaries	31.7	33.1	32.8	34.5	36.6	45.1	38.9	39.4

Note: Figures are propositions for shares held by families and subsidiaries.

3. Equity and Bond Investment by Investors(aggregated net purchases, 1997-2001)

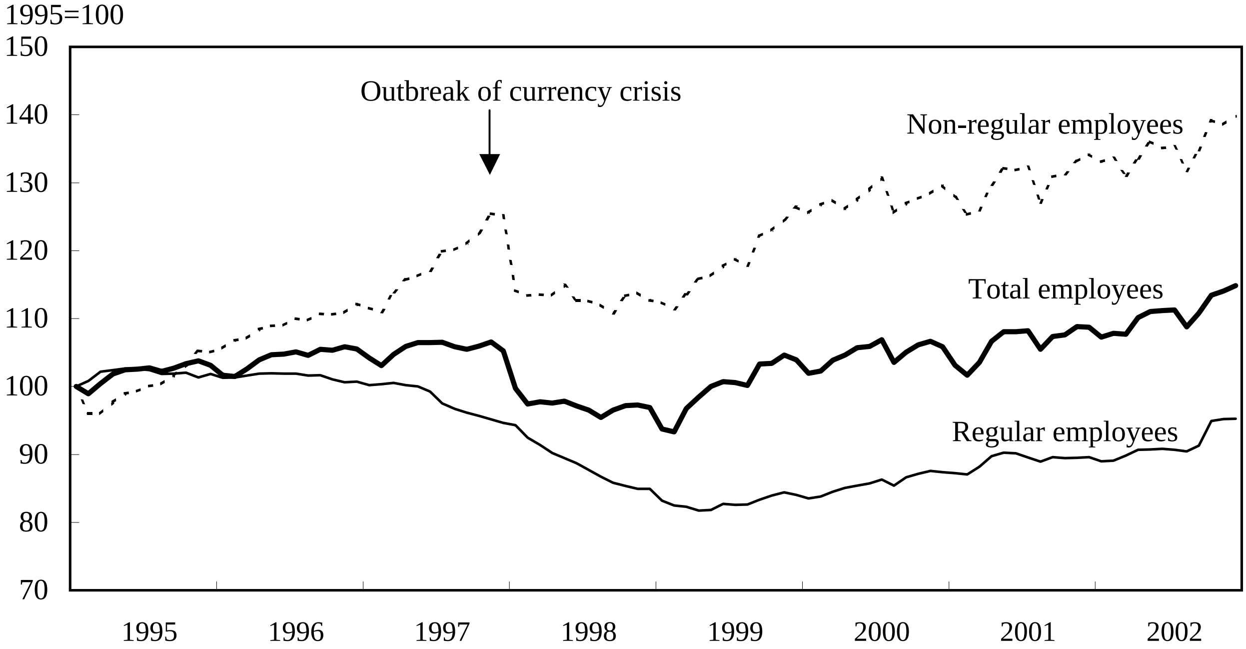
trillion won

	Financial Institutions	Government	Non-financial firms	Household	Foreigners
Equities	27.9	9.6	21.7	37.7	51.3
Corporate bonds	207.0	31.5	10.5	7.9	0.1

Source:Bank of Korea, "Flow of Funds"

Labor Market

1. Employment by Types of Employees

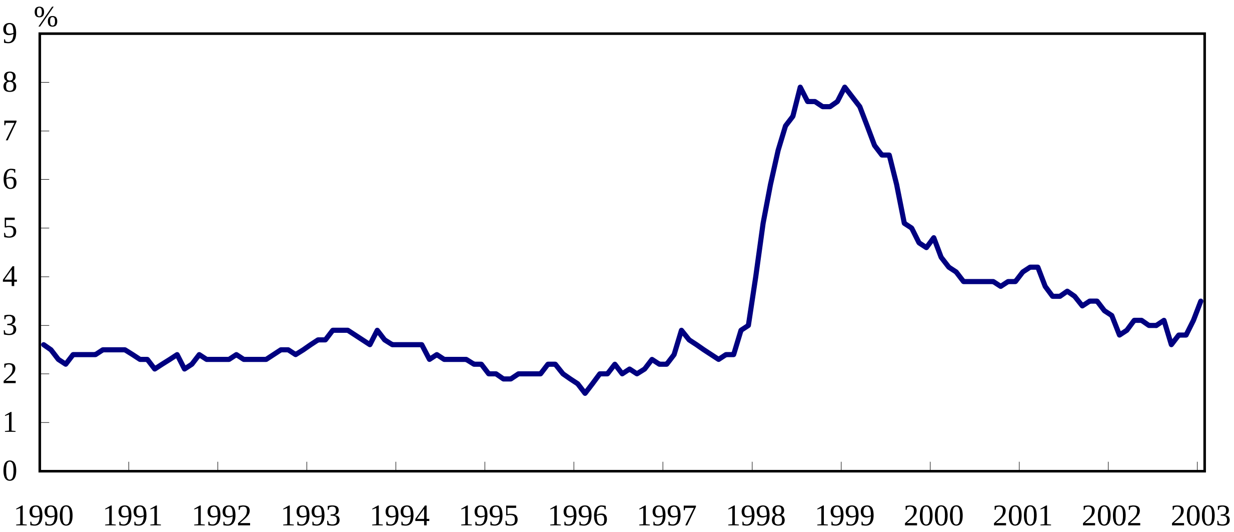


2. Changes in Employees

change in the previous year, 10 thousands

	1996	1997	1998	1999	2000	2001	2002	No.of employees end of 2002
Total	30	-3	-105	88	24	36	97	1441
Regular	-8	-44	-70	-7	24	16	49	698
Non-regular	38	41	-35	95	0	20	48	743

3. Unemployment Rate

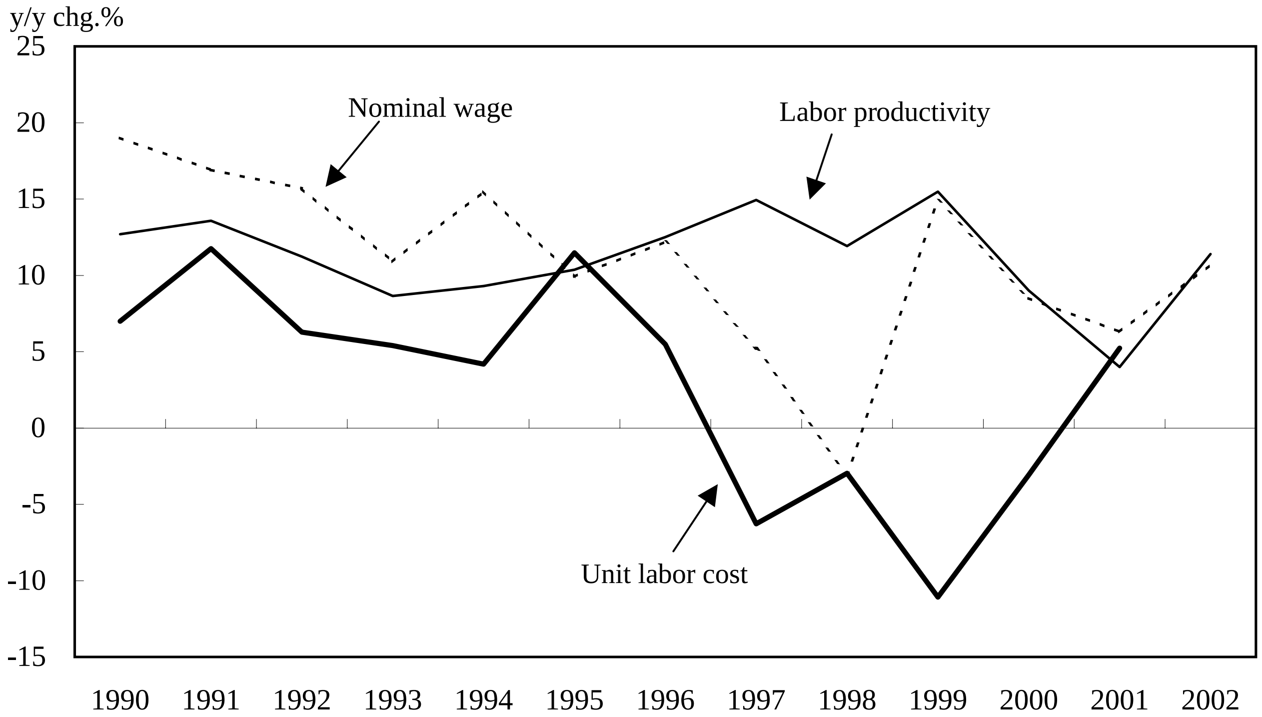


Source:Korea National Statistical Office

Chart 16

Employement Costs

1. Unit Labor Cost (Manufacturing)

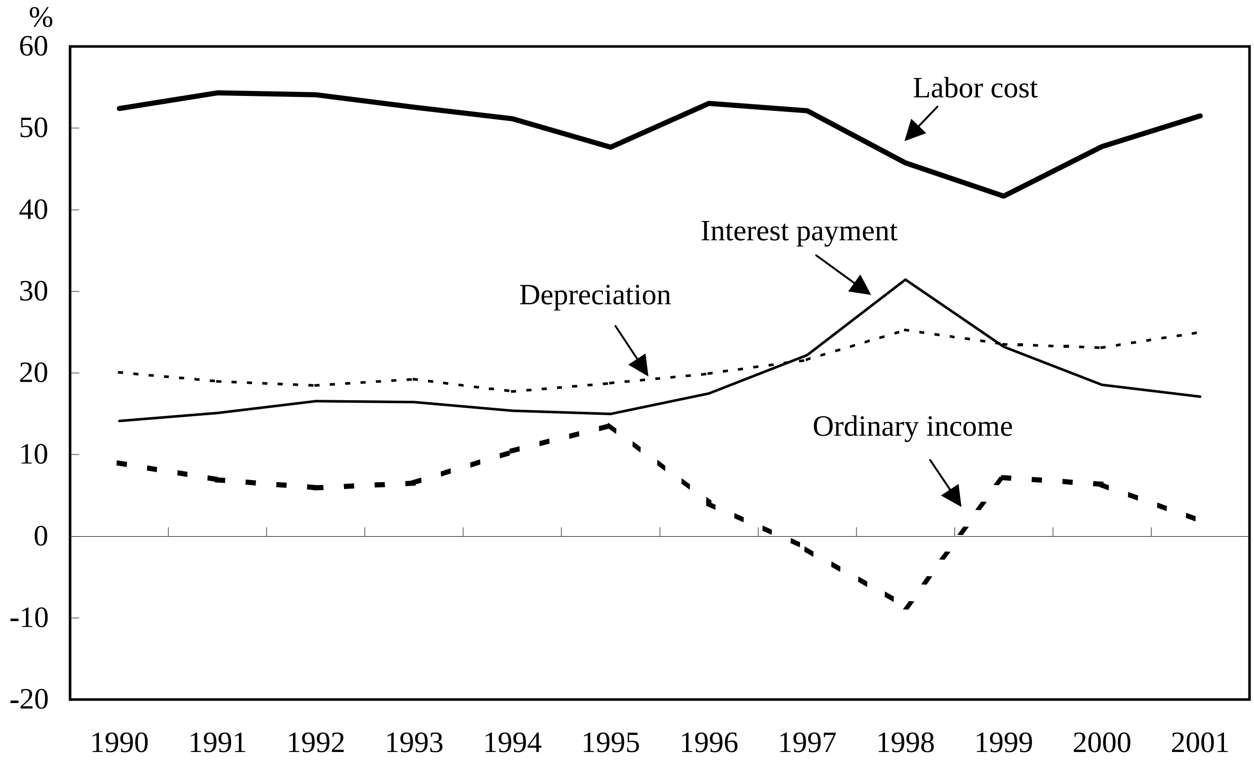


Note 1. Figure for nominal wage in 2002 is an average from Jan. to Jul, and figure for labor productivity in 2002 is that of 1st half of the year.

2. Nominal wage is for regular employees.

Source:Korea National Statistical Office.

2. Distribution of Gross Value Added to Sales (Manufacturing)

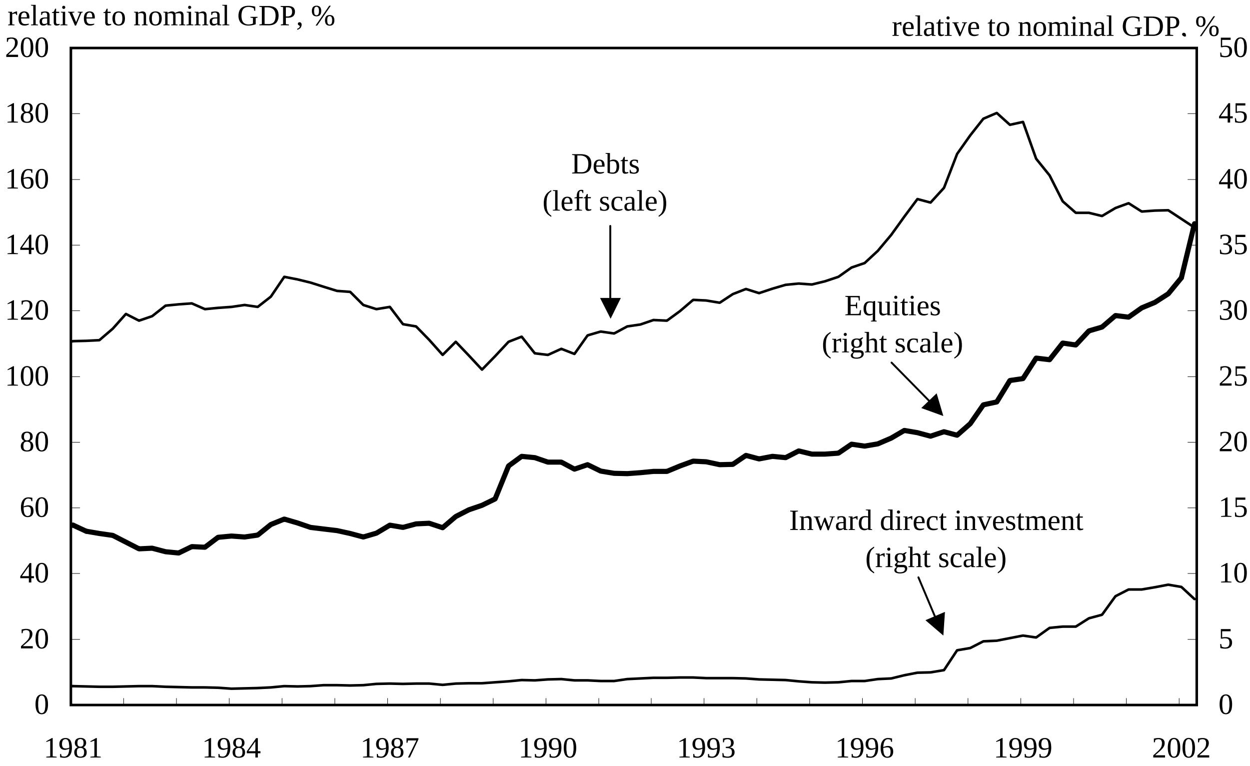


Source: Bank of Korea, "Financial Statement Analysis"

Chart 17

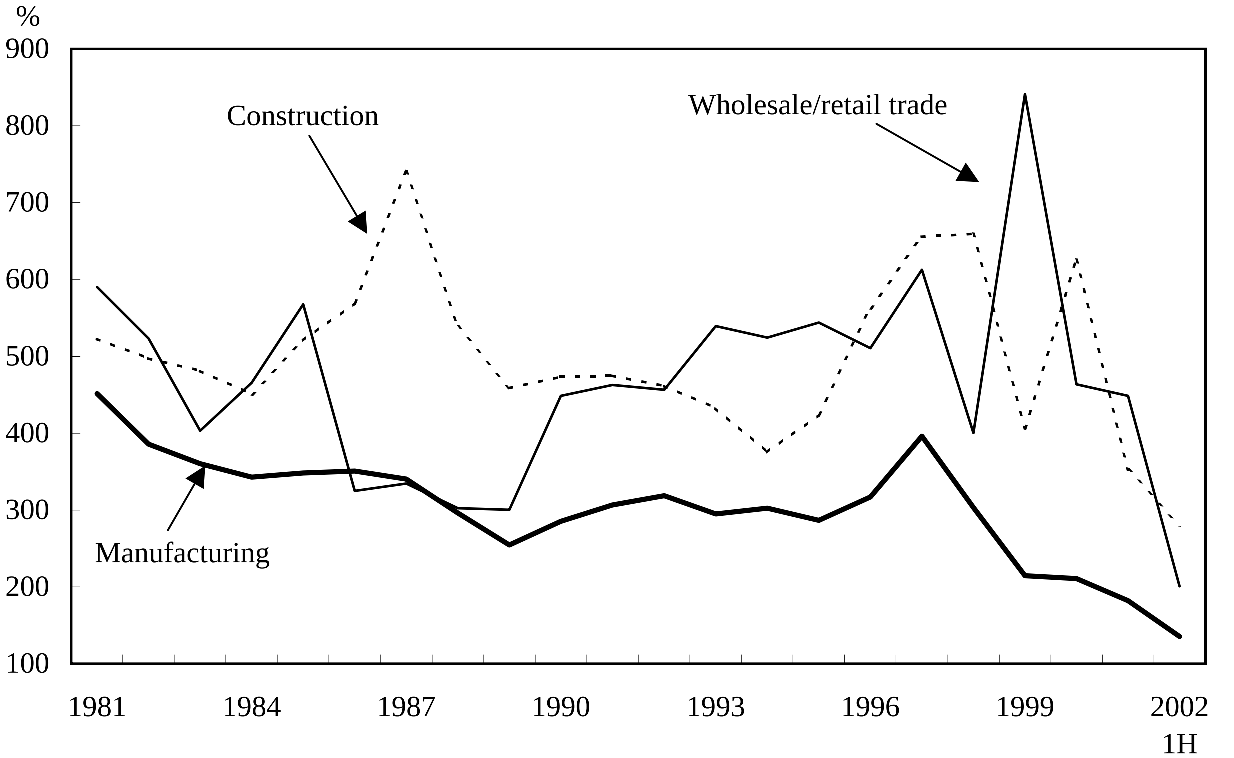
Debt Ratio of Enterprises

1.Corporate Debts and Equities



Source: Bank of Korea, "Flow of Funds"

2. Debt Ratio by Industry



Source: Bank of Korea, "Financial Statement Analysis"

Corporate Profits

1. Financial Status of Listed Companies

trillion won,%

	No.of listed companies	Total Assets	Total Liabilities	Total Shareholder's Equity	Debt ratio	Total Sales	Net Income	ROA	ROE
1997	611	375	274	101	271.4	359	1.8	6.7	1.8
1998	597	488	381	107	356.9	420	-3.2	-11.3	-3.0
1999	575	486	364	122	299.0	435	-15.6	-51.7	-12.8
2000	575	513	309	204	151.6	424	12.0	27.9	5.9
2001	569	527	321	206	156.1	498	6.6	14.3	6.4

Note: Companies in financial sector, newly listed ones and those changed their business years are excluded.

Source: Korea Stock Exchange

2. Distribution of Interest Coverage Ratio in Manufacturing Sector

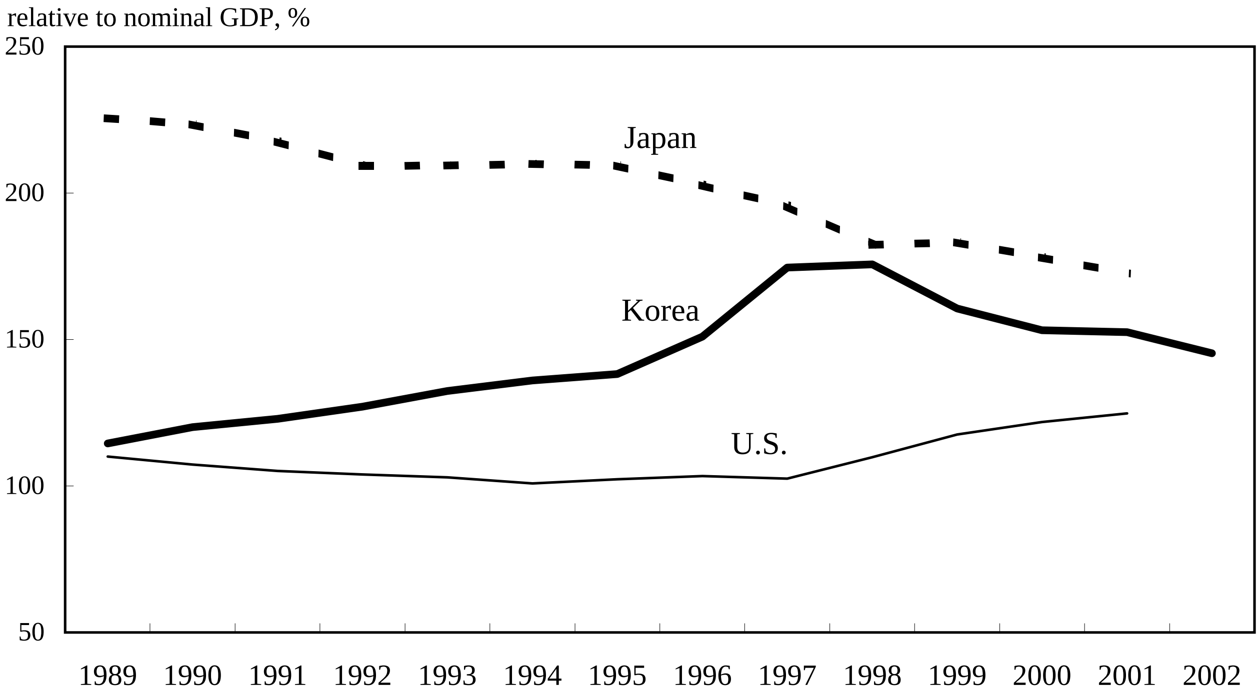
based on No. of companies, %

	under0%	0-50%	50-100%	100-150%	150-200%	above200%	under100%	Total
1999	14.3	7.8	10.5	15.6	10.6	38.6	32.6	96.1
2000	11.3	6.1	8.9	14.1	10.3	46.6	26.3	157.2
2001	14.1	6.0	8.5	13.0	9.1	46.4	28.6	132.6
2002 1H	16.0	5.4	5.4	7.0	7.0	53.4	26.8	257.0

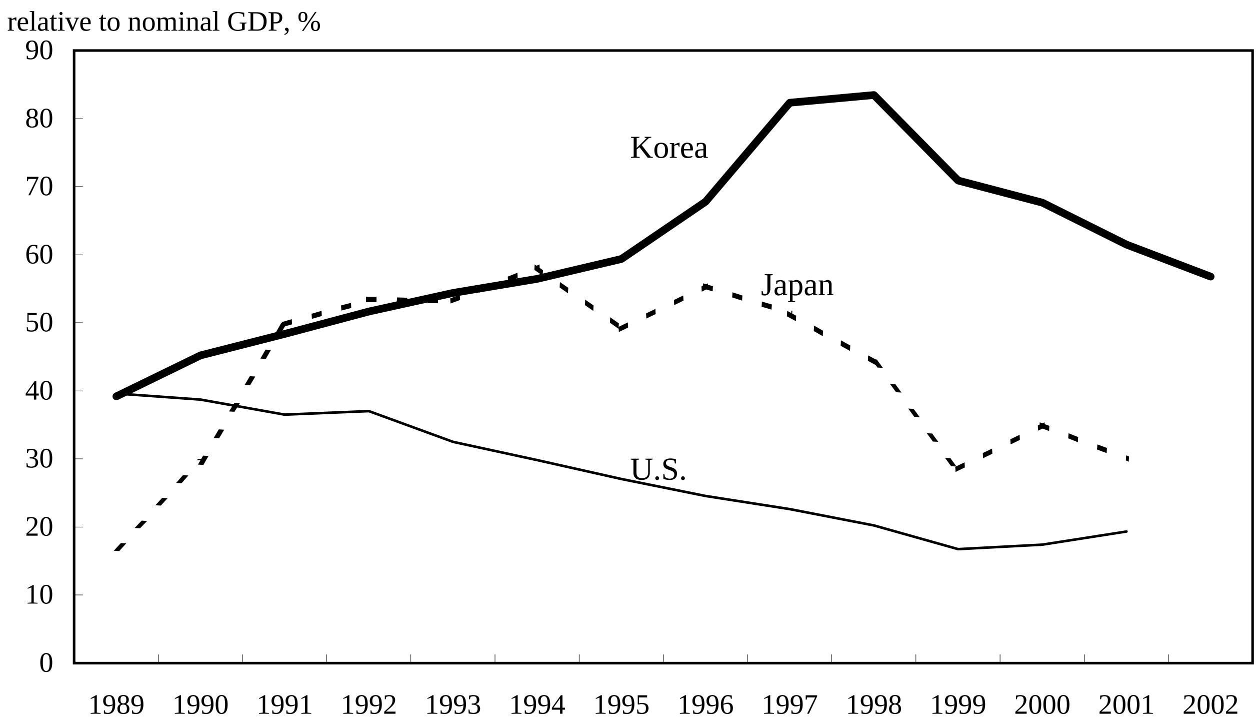
Source: Bank of Korea, "Financial Statement Analysis"

International Comparison of Corporate Debts

1. Corporate Debts



2. Corporate Liabilities net of Assets



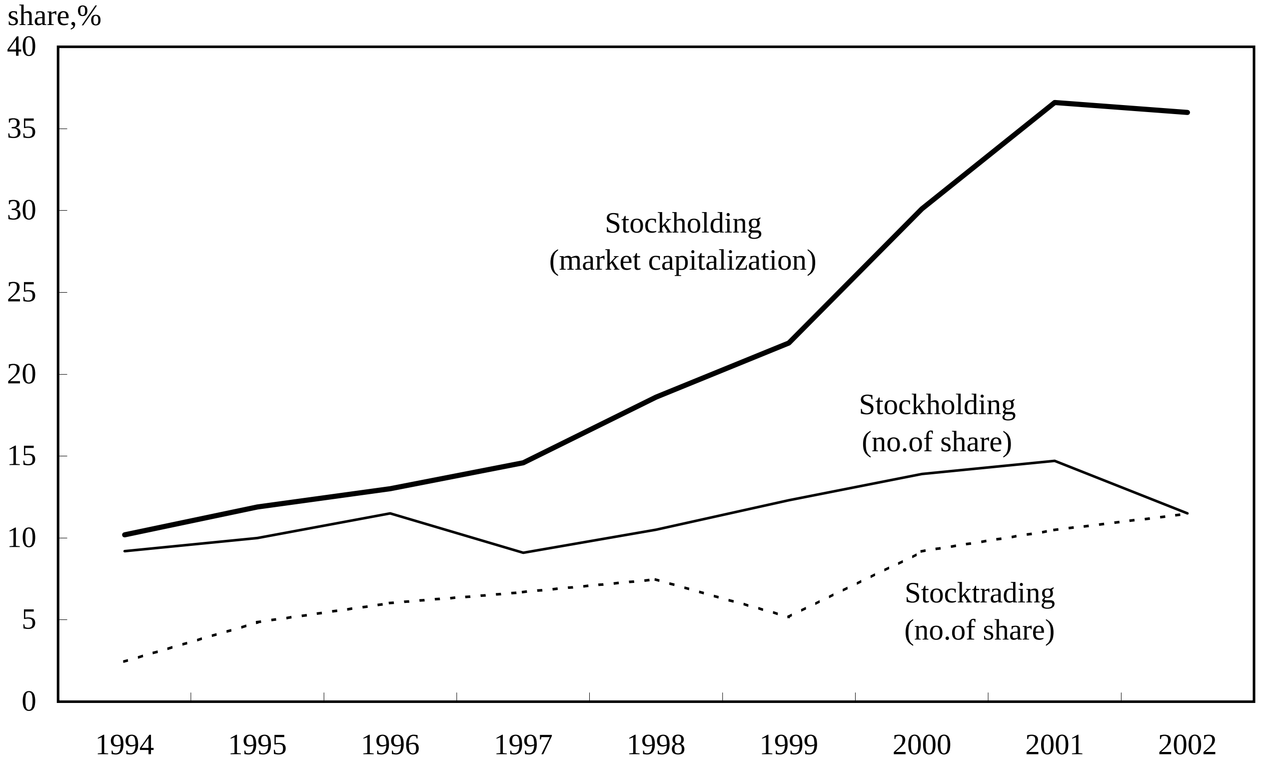
Note 1.Definitions of corpotrate debts are as follows.

2. Korea:Total liabilities-stocks, equities other than stocks and inward direct investment.
3. Japan: Total liabilities-stocks and other equities.
4. U.S.: Total liabilities-stocks

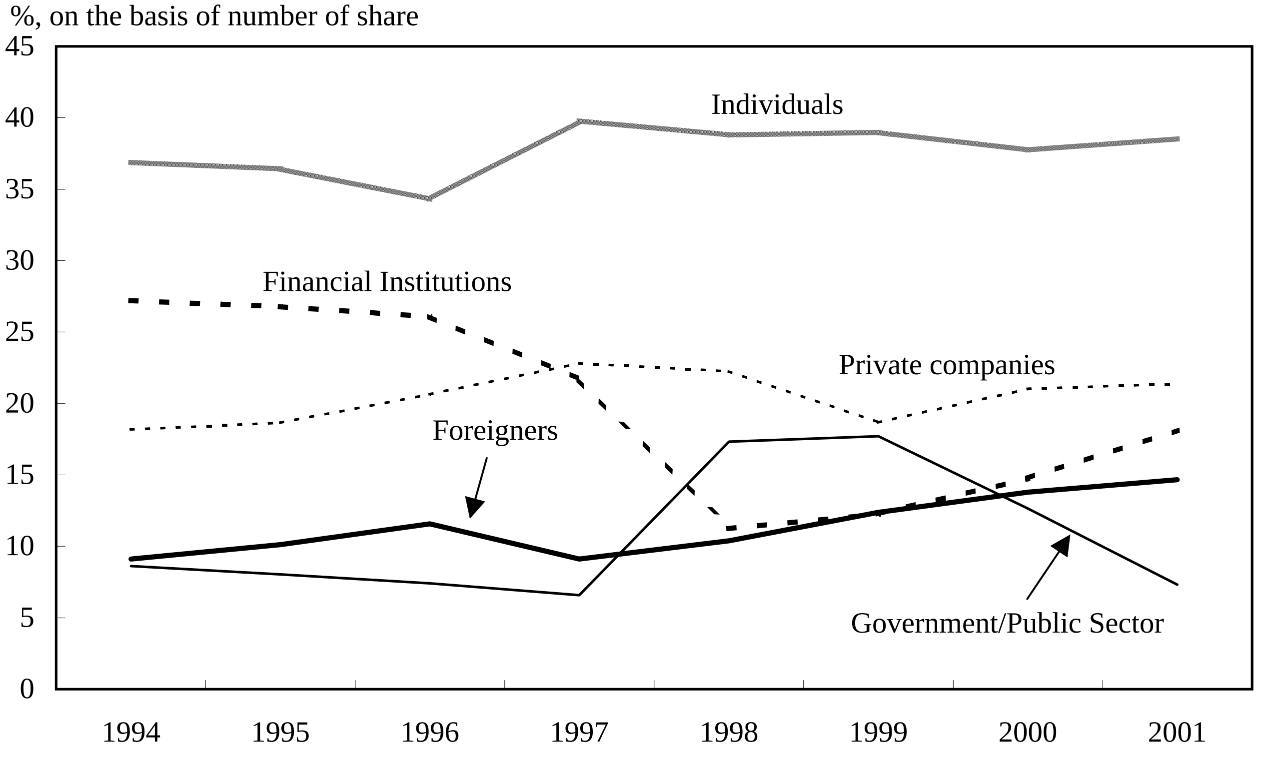
Sources: "Flow of funds" in Korea, Japan and U.S.

Stock Investment by Foreigners

1. Stockholding and trading



2. Distribution of Stockholding

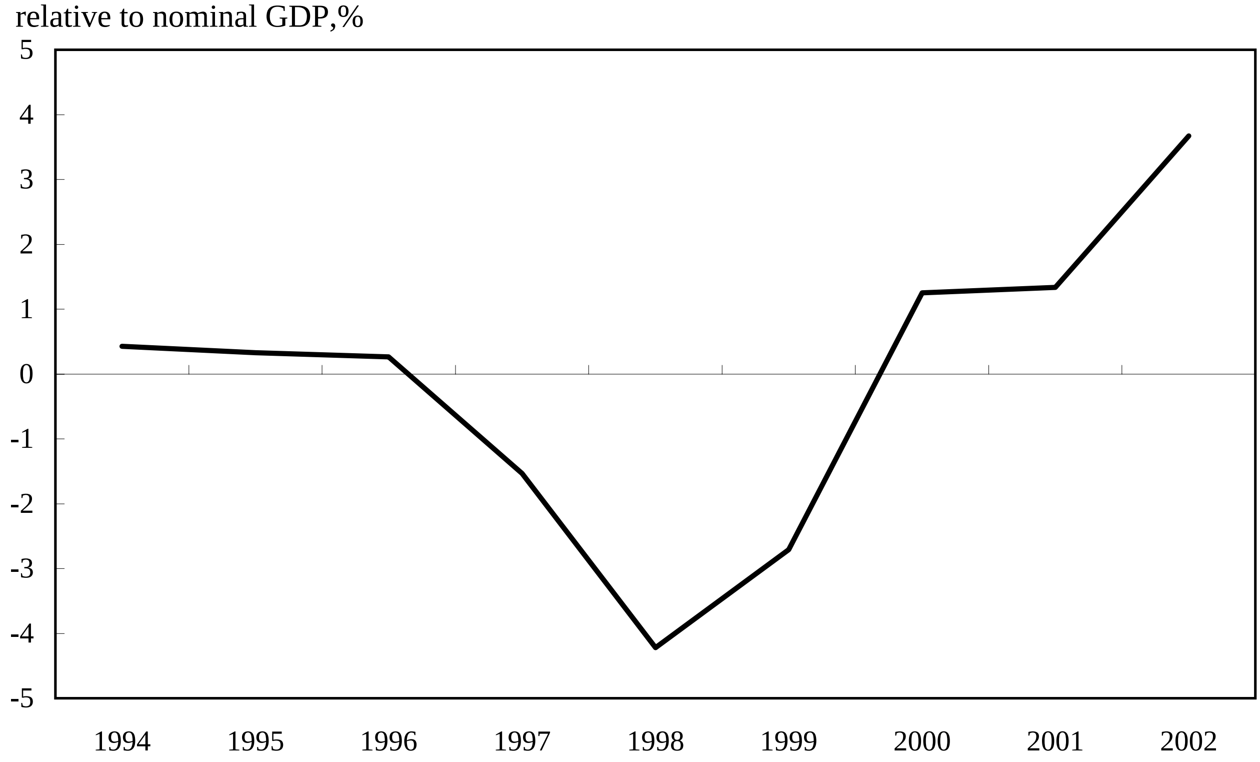


Source:CEIC

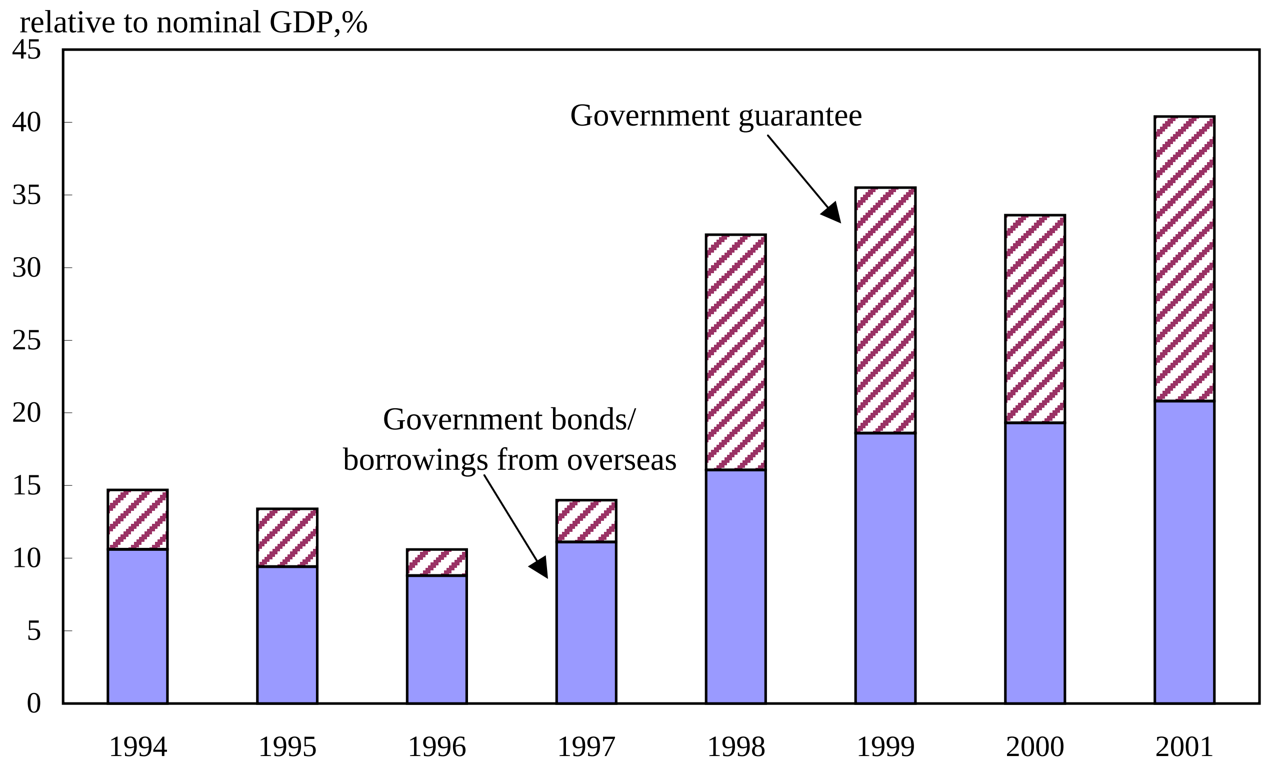
Chart 21

Public Finance

1. Fiscal Balance



2. Central Government Debts

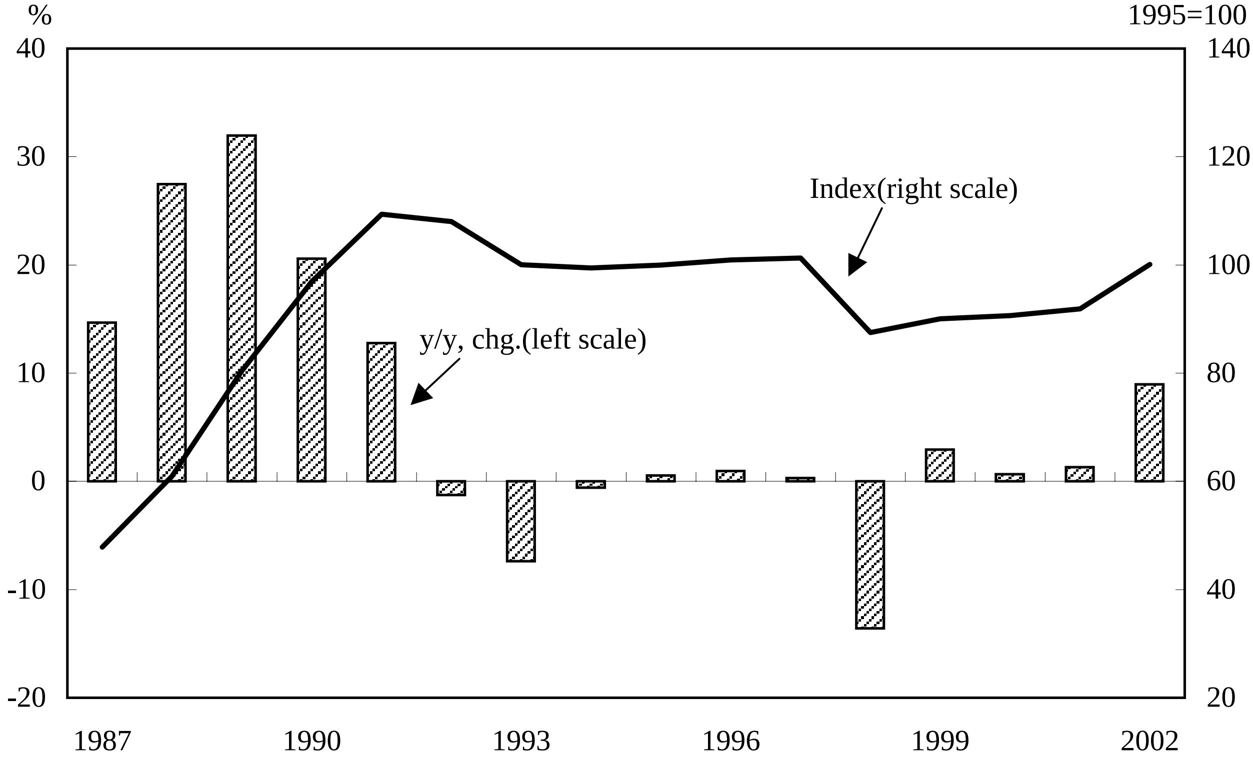


Note: Guarantees are for bonds issued by KAMCO and KDIC.

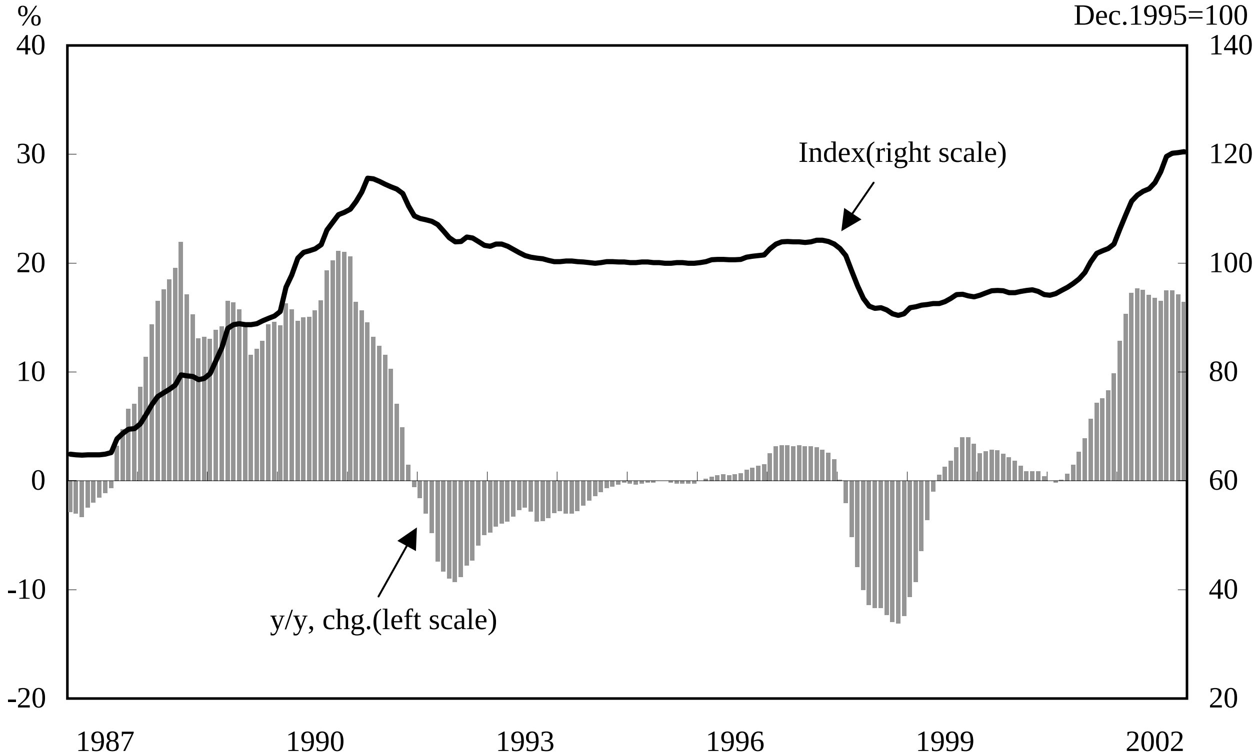
Sources: CEIC, Ministry of Planning and Budget

Real Estate Prices

1. Land Prices



2. Housing Prices



Source:CEIC

Assets Composition of the Korean and Japanese Banks

1. Asset Composition of the Korean Banks

share,%

	Lending	Securities				
			Public bonds	Corporate bonds	Equities	Foreign loans
1997	58.3	17.1	5.8	4.6	2.1	3.0
2001	54.6	24.7	13.5	6.2	1.3	1.3

Note: Government-guaranteed bonds issued by KDIC and KAMCO are included in Public bonds

2. Asset Composition of the Japanese Banks

share,%

	Lending	Securities				
			Public bonds	Corporate bonds	Equities	Foreign loans
1989	54.5	15.4	5.6	3.1	3.7	2.0
2001	59.1	22.2	10.2	2.7	5.1	3.2

3. Bank-lending by industry in Korea

share,%

	Manufacturing	Non-Manufacturing				Household
			Real estate	Construction	Non-bank	
1997	37.1	33.1	1.0	6.9	1.9	29.2
2002	21.5	27.2	5.1	4.1	1.6	47.1

Notes: 1.Based on lending by deposit money banks

2. Service for firms is included in Real estate.

4.Bank-lending by industry in Japan

share,%

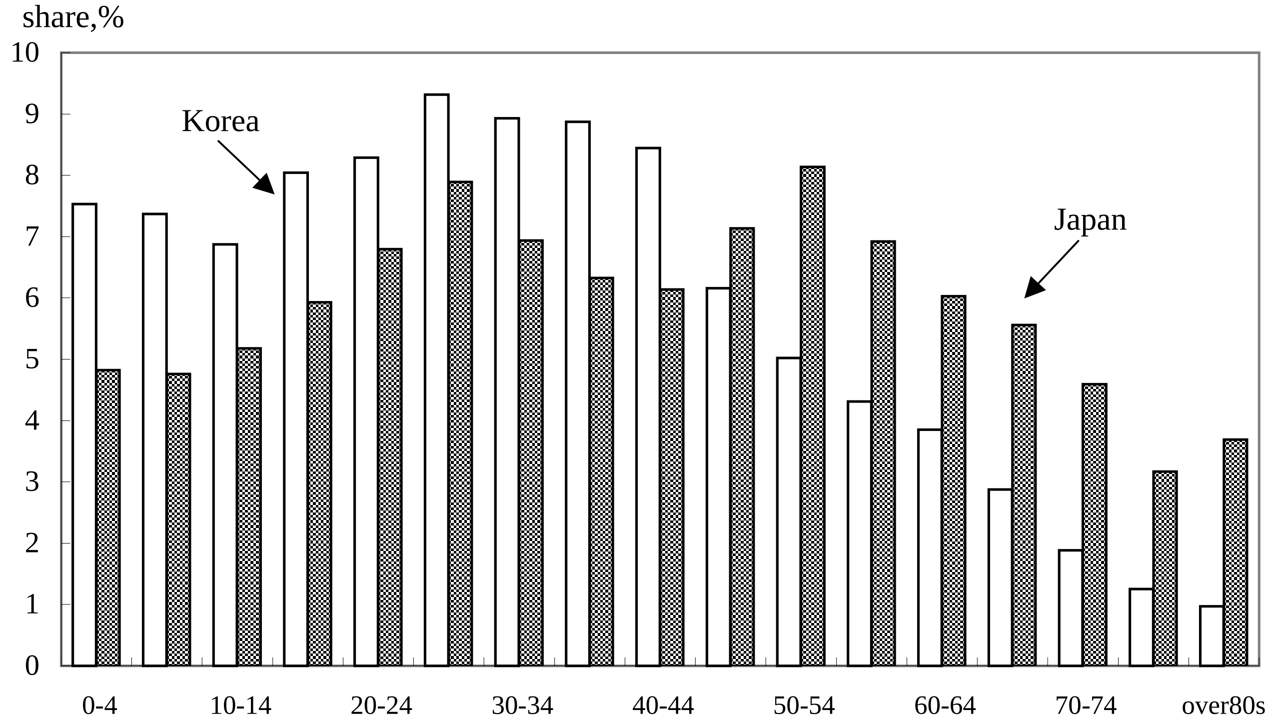
	Manufacturing	Non-Manufacturing				Household
			Real estate	Construction	Non-bank	
1989	16.7	64.2	11.5	5.4	10.3	15.2
2001	14.6	60.8	12.5	6.0	8.4	21.6

Note: Based on lending by domestically-licenced banks

Sources: Financial Supervisory Service, Bank of Japan

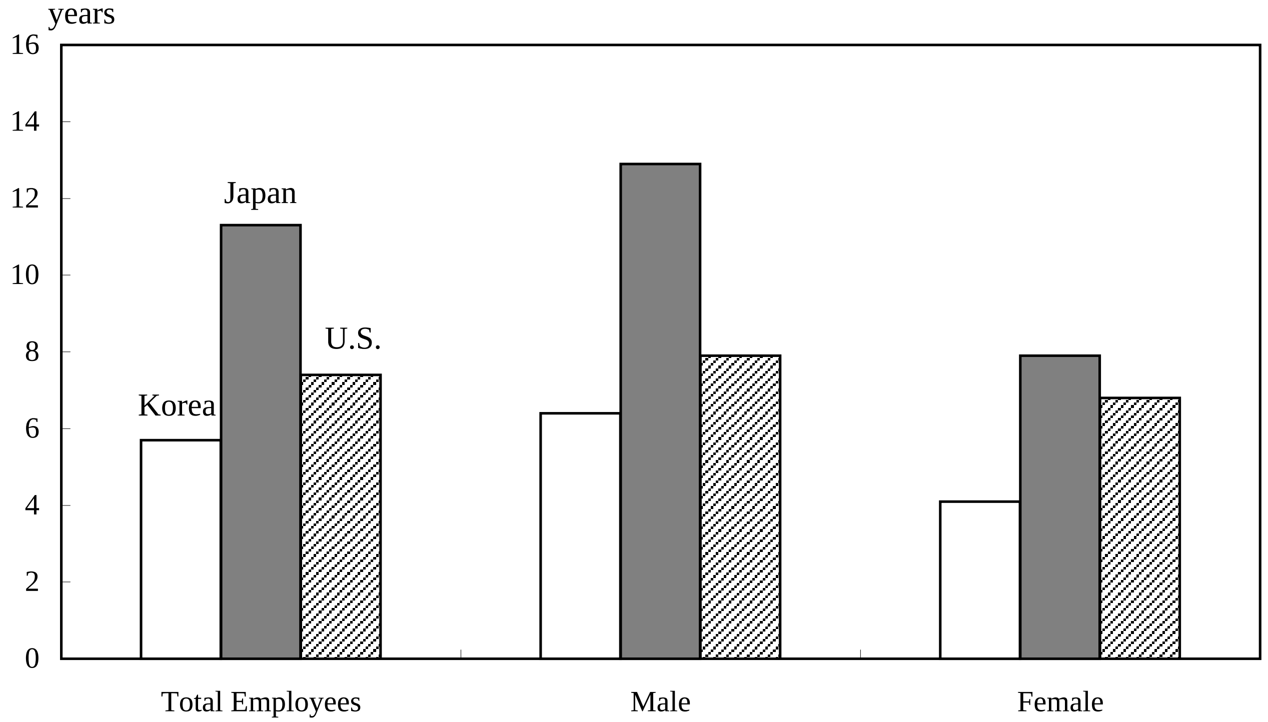
Labor Mobility in Korea and Japan

1. Demography in Korea and Japan



Note: As of 2001.
Source: Korea National Statistical Office

2. Average Employment Duration

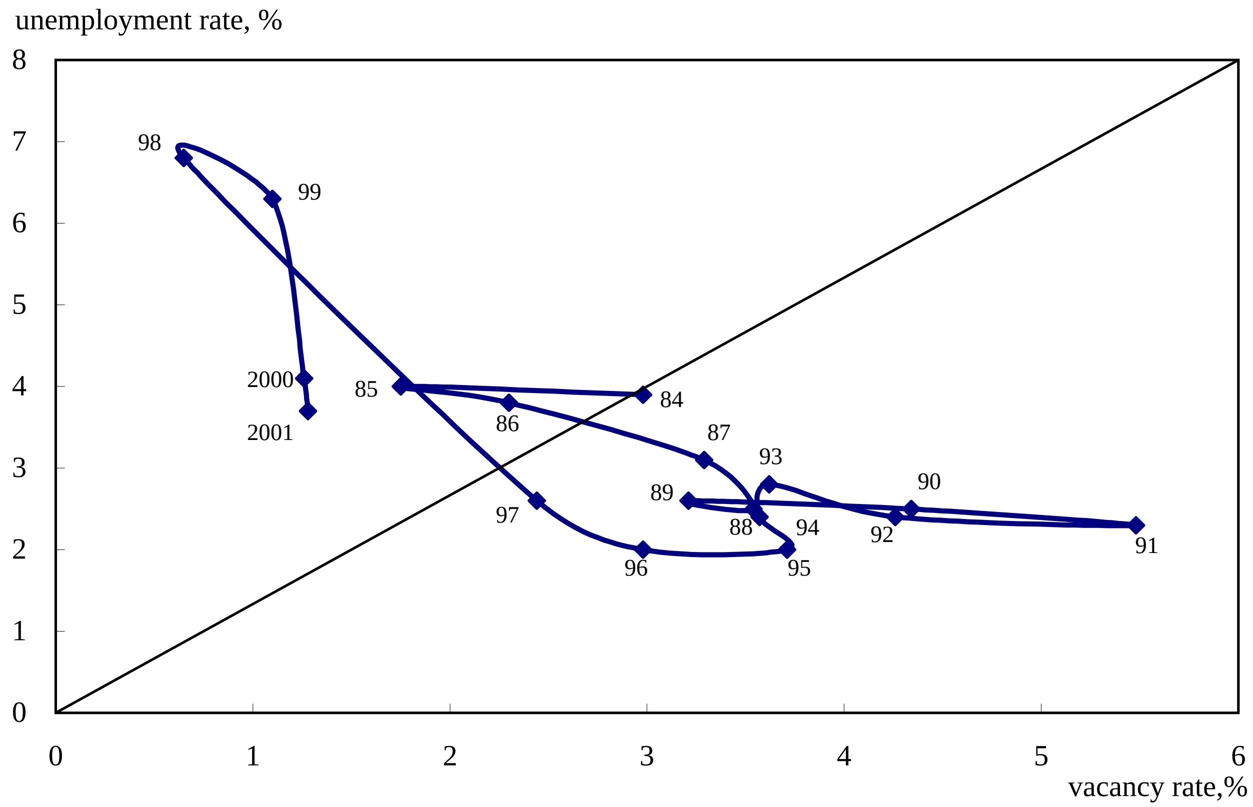


Note: Average employment duration for regular employees in 1999.
Source:OECD

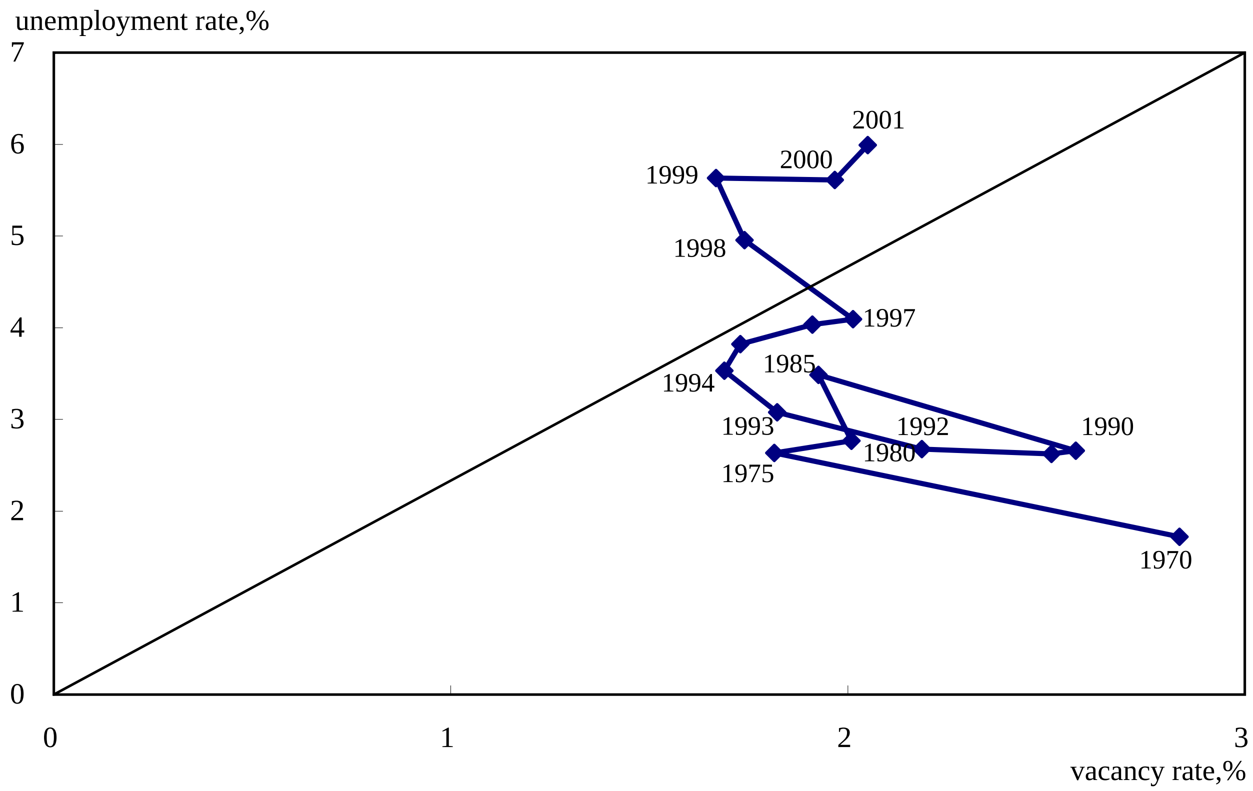
Unemployment and Vacancy Curve

Chart 25

1. Korea



2. Japan



Note: Coverage of vacancy rate in Korea changed from companies with more than 10 people to those with more than 5 people since 1999.

Sources: For Korea:National Statistical Office, Ministry of Labor
ForJapan: Ministry of Health, Labor and Welfare, and Ministry of Public Management, Home Affairs and Post and Telecommunication.