

Four Wheels of Participatory Gov't Reform Vehicle



Lee Chung-Woo, Chairman of the Presidential Office Policy & Planning Committee, emphasized the need for sustained innovations and change to upgrade national competitiveness. Keynoting the national economic roadmap to the Cheong Wa Dae staff, Lee admitted the searing pain in some economic sectors but made clear, “We will not take makeshift action, instead, we will continue to resolve problems with a medium and long-term approach. We will work with confidence and a sense of responsibility for the nation and history.”

Lee elaborated on the four major wheels of the Participatory Government’s Reform Vehicle: balanced development, localization, new administrative capital and hub of Northeast Asian economy. The following is the full text of his speech. - (Ed.)

The Korean economy has already reached the limits of its past quantitative growth strategy and is now at a stage requiring conversion to innovation-led growth as a prerequisite. Therefore, innovation in all aspects of society must be at the core of strengthening national competitiveness. In view of their characteristics, the effect of these tasks will not appear in the near term but will only be evident in the long term.

→ Forward

Recently, a new phenomenon that we did not see in the past is taking place in our economy. In the past, when exports recorded strong progress, it was linked to higher employment and domestic demand before long. Now, however, the frozen domestic demand hardly shows any sign of life, as if there is something wrong with the export linkage.

The consumption recession and long-term economic slump we are suffering at present may be an inevitable result caused by 'random issues of credit cards on the street,' the precedent for which is difficult to find in the world. Now the process to remove such bubbles and belt-tightening is unavoidable.

Another issue is the real estate problem. Past governments shouted about the need to stabilize housing for the people and to resolve the real estate problem rhetorically, but did not maintain patient consistency in policies. Didn't those governments rush to use real estate policy as a tool to quell the 'overheated economy' when it worsened even just a little?

As a result, the agony and complaints of the people are skyrocketing due to the world's highest housing and land prices. Owing to high land costs and rental charges, enterprises are losing competitiveness

as well, consequently dreaming about the transfer of their factories abroad where they can lease land at nearly one-tenth of the price at home.

Now, we are in a transition period to eliminate the bubbles of both credit cards and real estate, and many people are suffering in the process.

For a period becoming more difficult, short-term policies are important but so are long-term policies. If reviewed later on, one of the most important factors to determine the success or failure of the government will depend on how long it takes for policy vision to be realized. The way to reinforce national competitiveness is to concentrate efforts on resolving tasks for long-term structural reform and improvement of economic constitution rather than striving for immediate results.

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Interpretations of Korean Economic Difficulties

→ Theory of Japan-Type Long-Term Economic Recession

Recently, some are expressing fears that Korea may be entering a Japan-type long-term economic recession. However, this theory does not seem to have sufficient basis. Rather, the likelihood of this appears to be very low because the Korean and Japanese economies have several important differences.

First, the Participatory Government is continuously pursuing real estate price stabilization policies, targeting a soft-landing, not a hard-landing as in Japan. Therefore, there will not be a rapid real estate contraction like in Japan and a subsequent overall economic recession. When taking real estate as loan security, Japanese banks recognize 100% of the value, but Korean banks' recognition rate is about 60%. This implies that if real estate prices fall, it would lead to major losses or bankruptcy of Japanese banks right away, while it will not cause such problems for Korean banks even if prices decline by as much as 40%. Therefore, it is interpreted that there is a safety net in Korea.

Second, whereas Japan could not take on full-scale financial reform, Korea has conducted large-scale financial reform since the 1998 financial crisis, though not with self-regulation, and achieved success in reducing the scale of delinquent receivables by a considerable extent.

Third, as compared with Japan, which continued a negative march in total factor productivity during the economic recession of the Heisei period, Korea continued positive growth of total factor productivity throughout the 1990s.

Fourth, Japan had no room for financial policy adjustments due to its nearly zero level of interest rates. On the other hand, Korea has the option to use interest rate cuts in an

Why Japanese-Style Long-Term Recession Unlikely in Korea

Sector	Japanese Case	Korean Case
Real estate price stabilization	Mortgage up to 100% of real estate value	40% percentage lower than Japanese mortgage rate, indication of less bubble phenomena
Financial reform	Not yet launched.	Sweeping renovation since 1997 foreign exchange crisis
Total factor productivity	Continuous negative growth	Positive growth
Interest rate	Nearly zero percent	Much higher than Japan, room to lower rate to invigorate the economy
Gov't debt ratio	130% of GDP	23% of GDP; sound and stable in line with global standard
Aging population index	130% level	30%, lowest in the world

emergency. Also from the financial policy perspective, there was no further room for Japan to use an expansionary fiscal policy, as its national debt exceeded 130% of GDP. Despite a considerable increase in its national debt recently, Korea still remains one of the countries in the best shape with a debt level of 23% of GDP, together with Singapore. So, Korea has the advantage that it can depend on the final alternative, an expansionary fiscal policy, in an emergency.

Fifth, an aging population can be cited as a long-term factor. As an indicator, compared with Japan's aging index of 130% (ratio of the population: those more than 65 years of age vs.

under 15 years), the highest in OECD, Korea's index is still at the 30% level. Of course, aging is proceeding rapidly also in Korea at present so, the nation is expected to become an aged society, probably in the shortest-period ever. Nevertheless, it is a matter of 10~20 years, and in view of the present situation, there exists, in fact, far more room than in Japan. Recently, a Japanese economic expert, a director of S&P, also said the possibility of the Korean economy having a Japan-type long-term recession is ludicrous.

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→ Theory of South America-Type Economic Setback

A theory we often hear along with the Japan-type long-term economic recession is a South America-type economic setback. Comparing Korea with South America requires a great imagination. Several East Asian countries, including Korea, are appraised as nations that have been pursuing external industrialization strategies in direct contrast to South America. South America and East Asia can be considered as having diametrically opposed development

models as underdeveloped regions after World War II. Therefore, arguing the likelihood of a South America-type economic setback in Korea all of a sudden is hard to understand from the viewpoint of economic development theory.

Mentioned from time to time is South America-type populism as well. This theoretical line is based on rationale that the South American economy was ruined due to populism and that Korea is pursuing populism

presently, so the Korean economy also will be ruined. However, these two preconditions themselves can not be substantiated. Rather, rare will be a government like the Participatory Government that does not resort to seeking popularity with the masses. It is characteristic of the Participatory Government to attempt unpopular reforms boldly with a view to the long-term development of the nation.

→ Theory of Hollowing-Out in Manufacturing Sector

The criticism is often raised that the manufacturing sector is being hollowed. This theory is based on fears that as some small and medium enterprises (SMEs) are moving their factories to China, there will remain only a shell, if this trend continues.

Recently, the phenomenon of factory overseas transfers by Korean enterprises is apparently occurring but the scale is not very large. Korean firms' overseas direct investment stands at the 5~6% level of GDP, which is still very low compared with the 50~

100% level of OECD countries. Moreover, some media reports of increased foreign transfers of the factories during the Participatory Government are incorrect. Compared with several years ago, they declined in 2003.

While there are firms that are moving factories abroad, there also are those that are returning to Korea. In the global era, this trend is unavoidable. Recently, Japan's SMEs have been advancing into Korea, a very good sign for Korea, which is weak in core parts

technologies. As jobs are moving here and there with the world as a stage, there is no need to express joy or sorrow, seeing only one side. Even if the advance of Korean firms into China increases, it can have a positive effect on Korea's export growth. No truth can be found if only negative aspects are observed.

→ Distributionism, Equalism, Socialism

It is not worth arguing these criticisms that are being asserted in some social circles as they are too far from reality. We are only embarrassed at the practice that is instigating instability by just attaching labels without clarifying what distributionism and equalism are and what are the social policies.

We are anxious to know what kinds of excessive burdens, if any, have been placed on enterprises due to the grand income redistribution policies promoted by the Participatory

Government for the past one and a half years. How many people are continuing a miserable life or have given up life itself because we have not been equipped with even a minimum social safety network, a prerequisite for a civilized society? Should there be a minimum understanding in our society, such criticisms would not be heard.

Above we have reviewed several recent criticisms. The fact that domestic demand has plunged into a slump is apparent. To explain this, theories of Japan-type long-term

economic recession, South America-type setback or populism, and even socialism and distributionism are emerging. However, none among these seems to have a clear-cut basis. Consequently, the right path will be to seek ways of reinforcing national competitiveness to strengthen the constitution of the Korean economy in the long term, together with preparation of economic policies for their role.



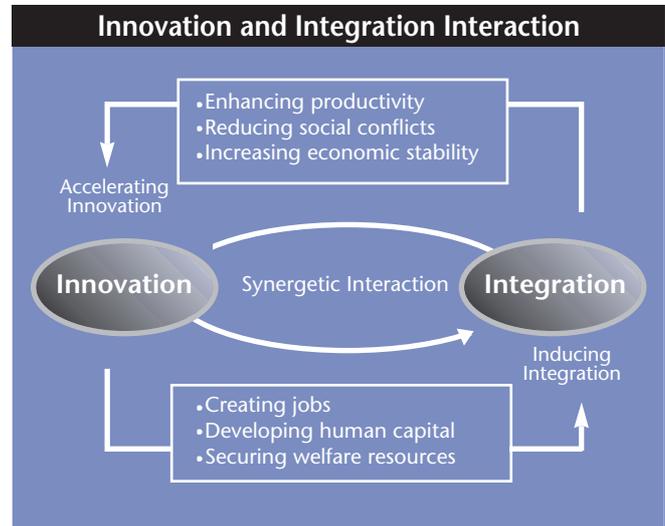
Ways to Reinforce National Competitiveness

Now, Korea has reached a limit to growth based on the increased input of quantitative factors and is at a stage necessitating conversion to qualitative growth that can enhance total factor productivity. This is the reason why a new paradigm, innovation-led growth, is necessary. The route being pursued by the Participatory Government is not the past-style quantitative growth pattern but qualitative growth, a paradigm change in society where all organizations are flexible and democratized and where people can produce creative ideas freely.

To this end, the Participatory Government is preparing a wide variety of ways to reinforce national competitiveness, featuring four characteristics: localization, long-term view, reform and social integration.

Among the four policies, localization is a spatial characteristic designed to exclude the previous uni-polar system development centered on Seoul and to pursue a balanced win-win

development model for Seoul and the provinces. As a time concept, long-term view means that the Participatory Government will overcome malpractices caused by the short-term policies of previous governments and to operate national policies from a long-term perspective. Next are reform and social integration. As complementary concepts, these two are like the two blades of the same sword for the Participatory Government to strengthen national competitiveness in the long run. Reform alone is not sufficient, and only when social integration is added



can society be upgraded to the next level. If these tasks are pursued consistently, national competitiveness and national dignity will be strengthened to enable the early advance of the nation into an industrialized country.

→ Localization

The Participatory Government is promoting full-scale division and dispersion of centralized administrative power, which past governments failed to implement. Through this, it will be possible to raise efficiency and balance development simultaneously. Linked to this is the metropolitan area's Northeast Asian hub project. When the administrative capital is moved, there will be momentum to ease various existing unreasonable restrictions hindering the development of the metropolitan area, assuring its dramatic development into a Northeast Asian economic center. Now, the situation is that Seoul and the provinces are holding each other back so mutual

survival and development are nearly impossible.

The four projects - balanced development, power decentralization, new administrative capital and Northeast Asian economic hub - are the same as the four wheels of a wagon that will upgrade our national competitiveness several stages. If even one of these is missing, the wagon can not advance. The wagon-moving effort is a national task. The work to divert the watercourse should have been done far earlier. Though repenting of having missed opportunities, it is useless deploring and at present, there is no other way but to do our best.

The Participatory Government's

regional development policies are much different from those of the past. The core lies in the establishment of a regional innovation system, targeted to select strategic industries appropriate for respective regional situations and to build an innovation system. Through the regional innovation system, the Participatory Government plans to contribute to balanced national development and to enhance national competitiveness at the same time. Its intention is to allow regional governments to produce creative ideas and to seek ways to survive while the central government supports them.



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→ Long-term view

Past policies, which focused mainly on short-term achievements, only resulted in impromptu economic conditions but also brought long-term negative effects, without being conducive to strengthening the constitution of the economy. The credit-card turmoil and real estate bubble of the previous government are clear examples. Economy-boosting policies must be used as necessary but serious caution is required in order not to have stopgap policies that may bring major adverse effects.

Having such a viewpoint is easy to espouse but not so easy to implement. Since Korea has sustained strong growth for the past 40 years, the people are very accustomed to high growth, employment and consumption. Therefore, hardly enduring short-term economic recession and unemployment, the people tend to hope that the government moves to take certain measures. Frequent criticisms are that 'the government is taking a hands-off approach.' Government authorities also are hard pressed to withstand the people's demands and pressure. Sometimes no policy is a good policy; when ill, endurance without using medicines can be a good prescription. Unfortunately in Korea, such awareness is lacking. More often than not, the people's demand and policy authorities' reaction coincide and measures, short-term prescriptions,

are developed from time to time; but they bring major negative effects as well. Therefore, we need to bear in mind that endurance and consistency are the basic virtues of government policy.

Here, we must pay attention to the existence of not a few reform tasks promoted by previous governments that were suspended in mid-stream because the economy worsened. The representative case is chaebol (large business conglomerate) reform. Whenever political power changed hands, the government often raised a sharp sword for chaebol reform at first but later put it away stealthily on the theory - how can we reform when the economy is in such a bad state? The Participatory Government's three-year market reform is different in nature from that kind of reform. The government suggests blueprints in advance and intends to achieve chaebol reform gradually and reasonably. In this respect, the present reform is basically different from those in the past and can be regarded as market-friendly.

As such, the Participatory Government is striving to implement structural reform and improvement of the economic constitution. Another example is the October 29, 2003, real estate measure. This policy is based on a gradual increase of real estate property taxes, increase of the transfer

income tax for those who have more than three houses and expansion of rental apartments for the low-income group. Therefore, we can say that it has approached the real estate problem of the nation in the right direction for the first time.

Other evidence showing that the Participatory Government is administering national policies with a long-term view is the 12 national task committees, advisory bodies to the President. It is quite natural for respective ministries to spend more time on urgent short-term tasks if long-term and short-term tasks are given at the same time. However important long-term tasks may be, there is a tendency to put them second in terms of priority. The presidential committees are expected to fill the gap.

So far, the presidential committees have held 51 national task meetings presided over by the President, adopting important long-term policies that are being translated into practice. The division-of-work system between the committees and ministries is succeeding. If this system is operated well, it will be possible to achieve progress on many long-term tasks that have been stalled and to implement them on a full scale. Then, these will contribute greatly to the enhancement of national competitiveness.

→ Reform

The Participatory Government is pursuing openness and reform at the same time. Certain problems are involved in FTAs, but as our nation has an export-oriented economic structure, it is inevitable that we join the huge wave of globalization and openness. Therefore, we can not but think that

only the simultaneous pursuit of openness and reform is the way for survival in the present fierce international competition era.

The fields that we have to reform are not just one or two. The present situation demands reform of all aspects of society. For example, let's look at

government reform. Government reform is focusing on overcoming the limitations and rigidity of a gigantic bureaucratic organization and enhancing efficiency. The Participatory Government emphasizes government innovation, in particular. The reason is that the government must reform itself



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first, prior to demanding social reform. The important element of government reform is efficiency enhancement. It is judged that there is considerable potential to increase efficiency and

improve service through innovation in governmental affairs. In doing so, government officials are inevitably reform partners, not just objects of reform. Government reform can be

realized successfully only when we encourage the morale of government officials and when they become reform partners.

→ Social Integration

There also is criticism that the government intends to employ welfare policies at the same level of US\$30,000-income advanced countries though our present per-capita income is US\$10,000. This is far from the truth. The ratio of our welfare expenditure to GDP is about 10%, but when they had US\$10,000 per capita income, the welfare ratio of advanced countries was 15% on average. It is, of course, much higher now. Criticisms describing the extent of worry about welfare side effects seen in advanced nations if Korea undertakes excessive welfare expenditure are groundless.

Controversies are often generated about growth and distribution as well. Some tend to see the relationship between growth and distribution as having to choose one or the other. This is too narrow-minded. The best way is to improve distribution, not in the style of traditional income redistribution that many bring negative side effects, but in seeking improvement in asset distribution, etc., including employee stock ownership systems. Then, it will end up being advantageous to growth. As such, growth and distribution are

not always mutually exclusive. Through proper means, these two can be achieved at the same time.

Another important aspect of social integration is labor-management relations. Now is the time to seriously pursue a social agreement between labor and management in which labor unions have to use self-restraint in seeking wage increases and management must implement transparent management and assure workers' participation within a limited scope. Moreover, when temporary workers exceed 50%, excessive wage increases should be restrained. The recent remarks by labor union leaders seem to imply that they are ready to resolve this problem. The bottleneck here, however, is the issue of labor unions' participation in management. In Korea, not a few entrepreneurs have a strong objection to this, regarding it as an infringement on their management rights. But this is really a near-sighted view. From the aspect of management participation, various types of workers' participation are emerging at blue-chip companies even in the United States, which is conservative compared with

Europe, and through it, positive factors for corporate growth are resulting. Among U.S. entrepreneurs, those who support labor participation are many. Coupled with management participation, capital participation also is important. Various empirical research has found that when workers hold stock in their own companies, there are several positive effects, such as a heightened feeling of belonging, morale enhancement, productivity increase and rise in corporate value.

There is one significant issue we should not ignore when talking about social integration. It is so-called collective egoism, a situation that arises habitually here and there in Korea. The solution to this problem is, consequently, only that the government sticks to its principles and promises. In the Participatory Government, the Sustainable Development Committee has the role of social jury and is preparing itself to settle social conflicts. If social conflicts can be resolved reasonably, it will further advance the upgrading of national competitiveness.

→ Conclusion

We must heed the 2003 G7 summit meeting's declaration 'No growth without reform.' Advanced countries, which have already resolved most of their structural problems, also believe that reform is necessary for growth. Will it be possible for Korea, which has not fixed all the irrationalities and

inefficiencies of the old era, to achieve growth while postponing reform? Maybe, if it is progress based on an increase in quantitative input as in the 1960s and 1970s. However, this model has reached its limits and Korea now can expect growth only from reform-based qualitative inputs. At this stage

of development, how can Korea realize growth without reform?

Another characteristic distinguishing the Participatory Government from previous governments is the promotion of policies with a long-term vision. It is very important to enhance competitiveness with a focus on

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structural problems and on long-term problems that we were not able to identify with a short-term view. The role of the Presidential National Task Committee is to remove the blindfold of short-term vision. Its work will bear fruit in the future.

It is not correct to say that the Participatory Government is concentrating on any one aspect of reform, growth and distribution. As in the case with its real estate policy or private education fee measure, we see policies that facilitate growth and distribution at the same time and that have to be promoted continuously. Why should we be pressured to catch only one rabbit, while we can catch two? We must push ahead with reform to prepare the foundation for growth, not reform for reform's sake. Growth and reform can proceed together anytime and in most cases at the same time. Isn't reform for the improvement of economic constitution the right path?

The Participatory Government's competitiveness reinforcement is focusing on the revitalization of local provinces as well. In the past, the uni-polar Seoul-concentration strategy was logical in terms of efficiency. But now, concentration on Seoul is so excessive that the strategy no longer is valid. Only when local provinces and Seoul

can mutually survive and develop will Korea's true competitiveness be realized through the achievement of balanced development. Turning to the labor-management issue, there is a path for labor and management to enjoy a win-win proposition. Through dialogue and compromise, labor and management can arrive at reasonable solutions, not necessarily a matter of advantage or disadvantage to either side. Mutual survival and conciliation are achievable targets.

Growth and distribution also can exist together. Land price stabilization through comprehensive real estate policy will not only ease the burden of low-income people without their own homes primarily, but it also will relieve enterprises of the burden of high rental and lease expenses and lower the wage increase pressure, leading to improvement of the corporate investment environment. Narrowing wage gaps and alleviation of temporary workers' problems through a grand labor-management-government compromise would be beneficial to both labor and management. Although the employee stock ownership system has been successful at numerous blue-chip firms in the United States and the United Kingdom, it is hard to understand the position of those who say it has left the track of a market

economy system. Management participation also is achieving good results. How prejudiced is it to call it distributionism, anti-free market and even socialist policy when only talking about such a system?

Reform is not something that is designed to benefit one person at the expense of another. Reform embraced by everyone is always possible. And above all, we must implement the Dasan Chung Yak-Yong (famous scholar of Yi Dynasty) style of reform that all people will take up themselves, being moved by the government's action in taking the lead. Distribution should not be a drag on growth, and neither should growth be realized at the expense of distribution or undermine innovation. Therefore, the Participatory Government is seeking a trinity of comprehensive, integrated social reform and democratization, innovation-based growth and fair distribution. With this, we will be able to eradicate irrationalities, the lack of transparency, irregularities and corruption from every corner of our society, which has been one-sidedly focused on growth, and to upgrade our national competitiveness one level higher. In the long run, our ultimate dream is to make Korea a graceful and proud nation in the world.