

# **Social Capital in Structural Reform**

## **– Korea's Experience –**

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### **1. Introduction**

Five years have passed since the 1997 financial crisis hit the shores of Korea. There have been tremendous changes in Korea since then that have been brought about by economic restructuring. By virtue of ongoing economic restructuring, Korea has in a very short period of time become a model of successful economic recovery.

From a country on the brink of bankruptcy, Korea has transformed itself into a creditor nation with foreign exchange reserves totaling \$121 billion at the end of last year. Amid a global economic slowdown it posted a solid 6 percent growth rate with only 3 percent unemployment. The country has made a remarkable progress in information technology and is striving to emerge as an advanced knowledge-based economy. Korea's sovereign credit rating has soared from non-investment grade to grade A since March last year.

Many of these achievements can be attributed to the success of structural reforms, both economic and social. Of course, the Korean government played an instrumental role in overcoming the crisis, by implementing and institutionalizing new systems. But the role of social capital, invisible social assets for instance, has been equally important. It is usually derived from the relationship between individuals, groups and society, and contributes to the achievement of certain goals in the society. This includes social network, norms, values, practices, traditions, consciousness, trust, civil movements, and the list goes on. The characteristics and types of social capital in Korean society have changed dramatically as part of the structural reform process.

The purpose of this paper is to examine the role social capital has played in the structural reform of the Korean economy and explore the challenges that lay ahead in an

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era of 'participatory' government.

## **2. The Role of Social Capital in Structural Reform**

The crisis that Korea encountered in 1997 was not just a matter of dwindling foreign exchange reserves, but rather, indicative of shortcomings of the Korean economy as a whole. The Korean style of corporate management, for example, combined with a foreign exchange reserve shortage, mismatched maturity structure of short- and long-term debt, and financial turmoil in some neighboring Asian countries, revealed previously hidden weaknesses of the Korean economy. More specifically, the crisis was precipitated by structural flaws in the economy accumulated during 3 decades of accelerated development and obscured by prevailing moral hazards in every aspect of Korean society.

The growth imbalance that existed among various economic sectors for nearly 30 years had made the entire socio-economic system susceptible to external shocks. Various mismatches existed conspicuously in the incongruent relationships between the form and substance of economic, financial, industrial, service, and social sector management. Inappropriate relationships between politicians and businessmen were generously tolerated by Korean society, as was corruption to some extent. The myth that only the fattest rather than the fittest survived prevailed in business circles. In that sense, I believe, the crisis was for Korea not simply an unfortunate accident but instead an inevitable consequence.

The policy response to the crisis in Korea occurred in two stages. The first was a short-term and emergency attempt by the government desperately seeking to resolve a liquidity shortage. It began with borrowing from such international organizations as the IMF, IBRD, and ADB that required accepting harsh terms and conditions. Non-viable financial institutions were closed or had operations suspended. Rescheduling of matured foreign debt by financial institutions was vigorously sought and the amount rescheduled by early 1998 reached \$23 billion. Higher interest rates and stricter fiscal policies were also accepted to induce the inflow of additional foreign capital.

The second stage began in the second half of 1998 and was based on a medium- and longer-term perspective. The goal was to stabilize interest rates and expand public expenditures to bring about the recovery of the real economy. Ongoing corporate, financial, public, and labor sector reforms were pursued at the institutional level, while policy efforts were made to develop such venture and knowledge-based industries as information

technology, biological technology, environmental technology, nano-technology, and cultural content technology. Strategic support was also provided for small- and medium-sized enterprises (SMEs) to improve economic fundamentals and increase competitiveness so the Korean economy would become more flexible in responding to abrupt changes in the global business environment. It was these restructuring efforts that made a V-shaped recovery beginning in 1999 possible for the Korean economy.

Social capital, however, played a remarkably significant role in laying the groundwork for overcoming a critical economic situation in Korea. In early 1998, for example, Korean citizens mobilized to rescue a sinking economic ship from near-bankruptcy. As an aside, it is worth noting an interesting characteristic of the Korean psyche. While neighbors may be ignored when all is going well, once a crisis or danger is recognized everyone pitches in to help. The Korean social network may at times appear downright anemic to the untrained eye, but the fact is, community cohesion is greatest during times of crisis. In other words, it is a fighting spirit evolved over the course of many years of invasions that helped Korean people find the strength within to meet this national economic danger head on.

This character was revealed in a form of, so called, “Gold Gathering Movement” in 1997 crisis. In January 1998, the movement was initiated by a civil organization and then received nationwide support, particularly from civil and religious organizations. More than 3.5 million people, around 30 percent of total family, participated in the movement by bringing out gold they had kept home. In several months, 227 tons of gold worth more than \$2.2 billion was gathered. It helped replenish foreign exchange reserves at stake and certainly played the role as an ignition stone for the recovery of the economy.

The movement described above received international media coverage as a human interest story about the citizens of a small Asian country trying to rescue their homeland from disaster by individual self-sacrifice. Beside the significance in economic sense, it succeeded in giving strong confidence to international institutions, like IMF, IBRD, and creditors that Korea can do recover from the crisis. It has been suggested that the self-help and confidence of the Korean people played a significant role in the successful debt rescheduling negotiations conducted in early 1998.

Social capital also contributed significantly to maintaining social cohesion and integration during the very trying times of structural reform. There were many

bankruptcies, for example, and more than half of the 30 largest Korean conglomerates, disappeared from the 'Chaebol' list. Of the 2,101 financial institutions that existed prior to the crisis, more than 600 are no longer in business. Almost all Korean companies, even those without serious financial problems were forced to tighten their belts in such a manner as massive layoff of workers. The unemployment rate soared to a record high 8.6% in February 1999 as 1.8 million people were out of work.

The jobless came out to street searching for job and some of them fell to the homeless. As the situation worsened, social security and integration deteriorated. Easing the conflict between the haves and have-nots was of great concern to the government. It was these circumstances that spurred civil and religious organizations into action to alleviate the social pain associated with economic restructuring. Voluntary donations of food, clothing, and shelter to help the homeless mushroomed. This lightened the load significantly for public organizations whose mission is to care for the needy. This proved to be a fertile period for the sprouting of various types of non-government organizations (NGOs).

Social capital played a major role in expediting the institutionalization of new socio-economic policies and systems. The activities of non-government organizations became more comprehensive and socially effective. They began to monitor the whole process of structural reform very closely while beating the drum for transparency and accountability louder and with greater frequency.

NGO-led civic activity played a significant role in the societal changes that occurred in Korea in the 1990s. The number of non-profit organizations which had grown modestly since the mid-eighties began to swell. One survey has indicated approximately two thirds of all Korean NGOs were established in the 1990s. They run the gamut from political, to economic, social and environmental.

The activities of these civil groups tapered off temporarily during financial difficulties associated with IMF loans, but were soon reenergized in terms of quality, quantity and social influence. According to the Korean Civil Organization Directory, there were approximately fifteen thousand such organizations at the end of 2000 if branch offices and affiliates are included. If branches and affiliates are excluded the number climbed from 3,899 at the end of 1997 to 4,023 at the end of 2000. More recent figures released by the Ministry of Government and Home Affairs indicate there are now 4,123 civil organizations.

The introduction of the National Basic Livelihood Guarantee System is frequently noted as an NGO success story in that it demonstrates they can effect institutional change. This system was initiated by the petition of 45 NGOs to give every citizen a right to the basic necessities of life regardless of income level. The petition was accepted by the Government, legislated by the National Assembly and enacted in October 2000. Thanks to the efforts of NGOs, Korea's social safety net was put into place in a relatively short period of time.

It is no exaggeration to say that two civil organizations in particular had a catalytic effect on economic restructuring. The Citizen's Coalition for Economic Justice (established 1989) and the People's Solidarity for Participatory Democracy (established 1994) took a lead role in increasing economic transparency, accountability, and fairness by spearheading a minority shareholder rights movement. It is expected that the role of these two groups will become even more influential as economic and political reform continues.

### **3. Changes effected by Social Capital during Structural Reform**

Social capital made substantive contributions to the maintenance of social integration during the economic restructuring process by minimizing social costs and thus the tension that accompanied the financial crisis. It also played an active role in changing economic and social structures, although it is worth noting the very nature of social capital itself was altered by the process of economic reform. Certain characteristics evolved to accommodate changing circumstances, while others became obsolete and disappeared only to be replaced by newly emerging adaptations.

Taken as a whole, there has been a significant paradigm shift in terms of economic management. Substance and content has replaced appearance and form. Quality now takes precedence over quantity. A balance between growth and distribution, as well as freedom and fairness is now the norm. Welfare is receiving more attention than ever before. Knowledge-based industries, SMEs, and venture start-ups are being developed and nurtured as new sources of economic growth. Stable and sustainable development is being pursued as opposed to the high growth rates sought in the past. These are conceptual changes that have been put into practice during policy formulation and implementation.

Similarly, business practices have been forever altered in significant ways.

Profitability has replaced corporate size as the primary concern. Competition is fierce now that it is no longer limited to the domestic market. The trend is toward meeting global standards, which makes transparency an ongoing consideration. Professional CEO managers are now widely accepted. Self-regulation has become increasingly important, as additional autonomy has been allowed to corporate level by government-led economic regulation reform. It is due to the oversight and initiative of civil organizations and minority shareholders that certain corporate management issues now end up in court.

According to financial indicators the result has been a remarkable improvement in performance. The average debt ratio for listed companies declined from 396.3 percent at the end 1997 to 130.1 percent in September 2002. The capital adequacy ratio rose from 20.2 percent at the end of 1997 to 35.4 percent by the end of 2001. The interest coverage ratio also improved from 129.1 percent in 1997 to 253.6 percent by September 2002.

The labor market has been no exception. Expectations of lifetime employment have gradually faded and replaced with the notion of lifelong career development. Flexibility of labor market is enhanced. Labor market "flexurity", the composition of "flexibility" and "security" is sought instead of simply emphasizing job security. The participation of women in the workplace has been increasing and a merit system based on objective work performance criteria is replacing academic cliques, paternalism, and cronyism as the basis for promotion.

Compensation is now determined on the basis of performance rather than seniority. Annual salary contracts are becoming increasingly common and are gradually displacing the monthly salary system. One survey indicates that the portion of firms that have adopted the annual salary contract system increased from 3.6 percent in 1997 to 32.3 percent in 2002. The Tripartite Commission of labor, management and government representatives established in February 1998, has played a significant role in keeping the channels of communication open between the three parties to reach important social agreements that helped overcome the crisis. It has been somewhat of a letdown recently to notice that the Commission seems to have lost sight of its original compromising function.

Unfortunately, change isn't always in a positive direction. It seems that bad news almost always accompanies good news. The overall Korean commitment to work, for example, seems to have weakened. Loyalty and enthusiasm have waned and difficulties associated with individual egos have become commonplace. Job-hopping has become

more widespread, especially for those in their late thirties. Increased labor market flexibility and difficulty finding decent work have resulted in an involuntary army of daily, temporary, and part-time workers. How to control this surge in the underemployed and protecting them from undue dismissal, low pay, and inadequate social insurance coverage has become one of the hottest industrial relations issues of the day.

Changes in individual daily life are also worth examining. While competition has indeed become fiercer, it is also more acceptable now. The issue of the day has become transparency, be it at home, school, work, or society in general. Individuality has also become more acceptable, which on the whole has meant a more creative Korean society. This has, of course, been a good thing for the infrastructure development of knowledge-based industries such as IT, BT, and CT.

As the Korean sense of attachment to work has ebbed, people have begun to invest more time and financial resources in leisure activities. Social gatherings and a sense of belonging are increasingly based on hobbies or religious affiliation, rather than having the same employer.

It must be noted, however, such changes have brought unforeseen side effects. There is still a kind of duality in social norms, in terms that people feel difficulty in accepting competition result even though they know they should compete. Traditional oriental virtues of patriotism and filial piety become to collapse. Beautiful tradition to respect elders is rapidly disappearing. The increasingly disproportionate distribution of wealth in Korea has made the people in low- and middle-income class more vocal for distribution justice, which subsequently brings about increased tension or conflict in the society.

Social relations in Korea have traditionally been organized according to a vertical hierarchy. There has always been a very precise way of doing things in every social context, be it family, school, army, work, or government. Things have changed, though, since the financial crisis. Class-consciousness has, to a large extent, given way to rational individualism. Practices in private and government workplaces have changed to allow specialists, regardless of position, to work as members of a team.

In the age of the Internet and cell phones people can communicate any time or place, even with those they don't know. It should come as no surprise, then, that in Korea – one of, if not the most wired countries on the planet – the anonymity of online communication

is expediting the transition to more horizontal and equal social relations. The result seems to be a well-woven social fabric, the warp and weft of which is vertical order and horizontal equality. Of course, the increasing number of civil organizations that use these same technologies to unite in pursuit of common goals has also had a major impact on horizontal social network formation.

#### **4. Tasks for the Future: Structural Reform and National Integration:**

It is true that the nature of social capital has changed radically during the structural reform period. Some of these changes have been desirable and others not. It is equally certain, though, that social capital has also had a transformative effect on Korean society during this same period. Had the crisis never occurred, the subsequent structural reforms would have certainly taken much longer and may have never occurred. In this sense it seems Korea has been able to skip a step in the process of change. The crisis served as a stimulus without which Korea would not have recognized the socio-economic weaknesses it is now in the process of remedying

In one sense, Korean social capital precipitated what has come to be known in Korea as the 'IMF crisis.' Traditions and values that emphasizing the importance of lifelong bonds of kinship, academic affiliation and interpersonal associations, were translated into irrational business management practices. It seems a bit ironic that it was precisely this brand of Korean irrationality that contributed so greatly to the speedy resolution of the crisis. The somewhat irrational decision to collect gold in early 1998, for example, was well received by the Korean community. Put differently, Korea's social capital based on trust in family, group, and community proved effective when it came to mobilizing individuals for collective action to solve a national problem.

It is no exaggeration to claim that the five-year restructuring of Korean society has been successful, although it must be admitted the impetus for reform came from the international community. Korea is now entering another phase of reform after the inauguration of new "Participatory Government". The new administration came to office with the enthusiastic support of a youthful Internet generation and civil organizations. It has vowed to pursue a vigorous socio-economic reform agenda aimed at national integration. Given that the momentum for reform is this time the democratically expressed will of the Korean people, one could conclude that the desire for change in a positive



direction has become an internalized norm.

The reform agenda ranges widely but includes items requiring political and economic attention. From a social perspective, the most important item on the agenda is the social integration of classes, generations, and regions. Eradicating discrimination based on gender, physical disability, academic background, and employment status is now an explicit national imperative.

The inequality in income distribution, which worsened significantly during the economic crisis, causes social complication and hampers cohesion of society. If not properly dealt with, it may become a significant obstacle against sustainable development of the country. Other discriminations in various areas may also work as an impediment to sound development of the country. Recognizing that, new 'participatory government' has a strong commitment to correcting distribution of wealth and socially unjustifiable discrimination. Ultimately, this is the way to enhance social cohesion, to build national integration, and to upgrade the nation.

In order to achieve the reform agenda of social integration successfully, Korea's social capital should be more institutionalized. The social capital, which worked pretty well in the past, is mostly based on trust in individual, family, neighbor, and community. The relation and network in a group was quite vertical. However, this type of social capital will be no more effective. With the development of society, trust in person and group shall be transformed to trust in institution. Vertical network shall be changed to a more horizontal one. Reform led by top shall become more voluntary. Strong leadership by the top must be fully supported by the voluntary participation of the masses. Dramatic growth of civil movement by NGOs as well as increased voluntary network affected by Internet would make social reform more plausible and sustainable.

One final point to be made has to do with the connection between reform and social integration. Reform can be somewhat noisy and painful, and on occasion involves a process that erodes social cohesion and efficiency. Correcting inequities in the wealth distribution structure, for instance, or various affirmative action programs to rectify social discrimination may result in conflict between those who find themselves on opposite sides of an issue. Similarly, steps taken to increase transparency in corporate management may temporarily hinder efficiency and entrepreneurial efforts that are underway. If rightly aimed and well coordinated, however, efforts to insure social welfare and security will fuel

national development in the long run. If consensus can be reached on that point, the question then becomes how to mobilize the social capital of a nation in a way that insures the entire population is pulling and pushing in the same direction at the right time.

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