Korea’s Economic Crisis and Cultural Transition toward Individualism

by

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October 2003

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Korea’s Economic Crisis and Cultural Transition toward Individualism

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This study re-examines the cause of Korea’s 1997 financial crisis from a cultural point of view in response to remaining questions such as the sudden collapse of Korea’s healthy-looking economy.
Abstract

Despite many analyses of the causes of Korea’s 1997 financial crisis three questions still remain: 1) Why did a healthy-looking Korean economy come to a crisis so suddenly? 2) Why did the Korean economy get worse despite the announcement of bailout programs? and 3) Why could Korea succeeded in implementing reform plans so quickly?

This study re-examines the causes of the Korean crisis from a cultural point of view and analyzes evidence of cultural transition. The answers to these three questions are closely related to public attitudes. Korea’s system of mutual support and guarantees that emphasized solidarity among firms proved to be a vulnerability. When companies ran into financial difficulty, the tradition of sharing burdens set off a chain of bankruptcies that spread throughout the economy. Before the crisis the Korean government had already prepared reform packages, including financial and labor market reforms, but failed to garner sufficient support to have them enacted. Reform plans could be implemented so promptly after the crisis because they were ready. Inflexibility of markets, including no layoffs, the seniority system, and corporate cross-guarantees, reflected cooperative/collectivist values that contributed to weaknesses in labor and financial markets.

Compared to Western societies, East Asian culture is closer to cooperativism/collectivism than individualism. East Asia’s traditional culture historically originates from the philosophies of egalitarianism and familism under the logic of harmony. The extremely cooperative/collectivist attitudes that are not consistent with the growing global culture contributed to the amplification of Korea’s financial crisis. After the crisis Korea increasingly moved to more individualistic approaches to reassure foreign investors, maximize the vitality of the market mechanism, and reflect the growing individualism of Koreans. Highly cooperative/collectivist manners are not entirely compatible with the global market that requests a new balance between traditional cooperative/collectivism and western-style individualism.
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I. Introduction

In November 1997, Korea suffered a severe financial crisis, a phenomenon the country had not experienced previously. An International Monetary Fund (IMF) mission team visited Korea in October, immediately before the crisis, and its preliminary assessment was that Korea’s economy was fundamentally healthy. The mission chief informally indicated a rosy outlook that Korea’s domestic and external economic fundamentals were sound overall despite a string of significant corporate bankruptcies and estimated that the economy would grow by a robust 6.5 percent in 1998 (Korea Herald, October 16, 1997). Until about one month before the crisis, the opinion prevailed that the Korean economy was fundamentally healthy despite the moderately severe 1996 downturn that, in hindsight, provided glimpses of some structural weaknesses.

Korea had consistently registered relatively stable macroeconomic indicators for growth, inflation, unemployment, and trade volumes. Therefore, some experts predicted that the Korean crisis was just a temporary currency shortage due to the depletion of foreign exchange reserves when foreign capital flowed out of the country and the exchange rates soured. But the crisis did not stop with the currency crisis, despite IMF promises to inject sufficient currency. It was only in the second half of 1998 that the Korean crisis began to subside, and Korea entered a period of rapid recovery. In 1999 Korea regained pre-crisis levels of growth and output. Following the crisis and subsequent economic downturn, the Korean government introduced a wide variety of reform programs that were intended to cure the economy’s structural weaknesses and vulnerabilities in a short period of time. Korea has succeeded in recovery by introducing prompt and consistent structural reforms.

Many economists have analyzed the causes of the Korean crisis. These analyses have mainly focused on Korea’s structural vulnerabilities or mistakes of economic policy. A full analysis, though, should also consider the following questions: Why did the Korean economy experience such a severe crisis although many experts felt its economic fundamentals were solid? Why did the Korean economy continue to worsen despite IMF
bailout programs? Why could Korea introduce and implement structural reform programs so promptly? Traditional macroeconomic analysis failed to anticipate Korea’s 1997 crisis. To adequately respond to the above questions, it is necessary to consider the institutional and cultural changes inherent in Korea’s development, as well as standard economic analysis. In particular, intangible factors such as the practices and attitudes of economic players should be incorporated, and the East Asian countries’ history and cultural background should be recognized.

The aim of this study is to re-examine the causes of the Korean crisis from a cultural point of view and analyze evidence of the cultural transition. Section II explores three questions tracing the economic situation from 1996 to 1998. Section III reviews the causes of crisis and describes cultural barriers that hamper the shift toward global trends. Section IV describes the cultural conflict between Korea’s traditional culture and the emerging global culture, tracing its historical background and introducing evidence of continued transition after the crisis, and Section V presents conclusions.
II. Three Questions on the Korean Financial Crisis

The Korean financial crisis has been the topic of considerable debate and analysis. As one of the strongest of the “Asian Tigers,” Korea’s sudden and severe difficulties led to a re-examination of the Korean “miracle.” New interpretations were explored through consideration of the causes of the sudden collapse of a healthy-looking economy and the causes of the worsening of problems despite the introduction of bailout programs and prompt implementation of reform plans.

Why Did the Healthy-Looking Korean Economy Come to a Crisis So Suddenly?
There did not seem to be significant signs of severe problems in Korea’s economy until mid-October 1997, about one month before the crisis. It is understandable that the IMF mission team assessed the Korean economy as fundamentally healthy. Balino and Ubide (1999), who studied the causes of the Korean financial crisis, also concluded that there was no significant indication of the impending crisis in the economic fundamentals, although some indicators related to external imbalances were an increasing source of concern. Demirguc-Kunt and Detragiache (1998) suggested that financial crises emerge more easily when the macroeconomic environment is weak, as indicated by low Gross Domestic Product (GDP) growth, high inflation rates, and high real interest rates. As early warning indicators as much as 24 months in advance of a currency crisis, Kaminsky, Lizondo, and Reinhart (1998) recommended checking international reserves, the real exchange rate, domestic credit, inflation rates, trade balance, money growth, real GDP growth, and the fiscal deficit. For Korea, none of these factors suggested that a crisis was imminent. Furman and Stiglitz (1998) estimated the possibilities of crises using the models of Frankel and Rose (1996), Demirguc-Kunt and Detragiache (1998), and Kaminsky, Lizondo, and Reinhart (1998) and concluded that the East Asian crisis did not follow the general patterns of the past two decades.

Review of Korea’s macroeconomic situation from 1995 through October 1997 provides few hints of the events that were to follow. GDP continued to grow strongly, recording
quarterly growth rates generally exceeding 5.0 percent, although the growth rate started to moderate in 1996. Unemployment rates remained stable and low, averaging about 2 percent during the period. The rate jumped temporarily to 3.4 percent in March 1997 but then returned to the 2 percent level. The production index also showed a steady, increasing trend until October 1997.

Nor could any symptoms of inflation or a collapse in asset prices be found. The Consumer Price Index (CPI) was stable, fluctuating around 5 percent, and asset prices such as housing and stocks were steady, although stock prices showed cyclical ups and downs.

Domestic monetary and fiscal positions appeared to be sound as well. Interest rates were stable, although a little higher than in other OECD countries, with yields on corporate bonds at around 12 percent. Money supply was sufficient to support domestic demand but not excessive or leading to inflationary pressures; M2 growth was somewhat above nominal GDP growth rates. The central government budget had a surplus of 0.3 percent of GDP and public debt was below 11 percent of GDP.

Korea’s external economic situation did not appear to give significant hints of the difficulties that were to follow. The exchange rate was managed within a small daily band of fluctuation of 2.25 percent around 800 won per dollar (Figure 1).\(^1\) Foreign exchange reserves were maintained at the level of 3 months of imports, as recommended by the IMF at the time (Figure 2).\(^2\)

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\(^1\) Some observers felt that the Korean won was overvalued due to the small band of daily fluctuation permitted by the government. Korea’s currency is not explicitly pegged to another currency but is allowed to “float” within a tight band that can be adjusted daily. Rather than being overvalued, it is likely that the market was temporarily unable to adjust sufficiently. Although Korea recorded a huge current account deficit, it was balanced by capital account inflows.

\(^2\) The Korean government followed the IMF guidelines for foreign exchange reserves; however it was later learned that the BOK had lent some portion of the reserves to commercial banks. Therefore, the foreign exchange reserves actually available were lower than indicated by government statistics. When Korea increased reserves to more than 10 months of imports after the recovery, an IMF study advised it to reduce reserves to 6 months of imports.
The only difficulties in sight were a worsened current account balance caused by a slump in exports and a series of bankruptcies and subsequent increase of non-performing loans (NPL) in the financial sector.\(^3\) Korea had experienced an economic downturn in 1996 due to a slump in exports, and there had been concerns about the economy’s health. In 1996, the Korean export sector began to slow down, particularly due to weakness in semiconductor exports, and Korea recorded a record monthly current account deficit of 3.6 billion dollars. By the end of 1996, Korea’s current account recorded a huge deficit

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\(^3\) In hindsight, Korea had an unduly large amount of short-term debt in the banking and corporate sectors that proved to be a weakness; however, neither the government nor analysts recognized the problem at the time.
of $23 billion, compared to a deficit of $8.5 billion at year-end 1995. This development was particularly significant because high levels of investment and strong exports had supported Korea’s strong growth. Exports account for 40 percent of Korea’s GDP, so the current account balance is an important indicator of business activity and economic health.

But those concerns peaked at the end of 1996 and began to fade in 1997. The current account deficit improved substantially during 1997, beginning in April, and ended the year with a surplus (Figure 3). For much of 1997, Korea’s economy seemed to be improving.

Perceptions of the economic performance were reflected in stock prices as well. The Korea Composite Stock Price Index (KOSPI) plunged from a peak of 986.84 on May 7, 1996 to 651.22 at year-end, a decline of 34.0 percent. After it hit a low of 611.05 on January 7, 1997 a bull market emerged until September 1997 when it turned to a bearish market (Figure 4). This trend in part reflected fluctuations in its trade balance and corporate bankruptcies.
Bankruptcies continued to be a major threat to Korea’s economy. With the economic downturn, several large business groups faced serious cash flow problems. This development led western bankers to be more cautious in lending to Korean chaebols. At the beginning of 1997 the Hanbo Group, the 14th largest chaebol in Korea, declared bankruptcy. The 1997 economy was marked by troubles in other ailing chaebols and their affiliate firms. The domino effect that started with Hanbo in January spread to other large firms including Sammi, Kia, Jinro, Daenong, Newcore, Haitai, and Halla (Table 1). As the “Kia crisis” dragged on, the economy suffered along with Kia, alerting major international credit rating firms and financial institutions that further economic trouble was brewing in Korea. The government took actions to cope with the growing problem of NPL in the financial sector, passing the “Law on Efficient Management of Non-performing Assets of Financial Institutions and Establishment of Korea Asset Management Corporation (KAMCO)” in August and rushing to launch KAMCO in November.

Table 1 Bankruptcies of Chaebols in 1997

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 23</td>
<td>Bankruptcy of Hanbo Group</td>
</tr>
<tr>
<td>Mar. 19</td>
<td>Bankruptcy of Sammi Group</td>
</tr>
<tr>
<td>Apr. 21</td>
<td>Jinro Group filed under Corporate Bankruptcy Postponement Accord</td>
</tr>
<tr>
<td>May 28</td>
<td>Daenong Group filed under Corporate Bankruptcy Postponement Accord</td>
</tr>
<tr>
<td>July 15</td>
<td>Kia Group filed under Corporate Bankruptcy Postponement Accord</td>
</tr>
<tr>
<td>Nov. 1</td>
<td>Bankruptcy of Haitai Group</td>
</tr>
</tbody>
</table>

It is generally acknowledged that the wave of financial crises that was sweeping across countries in Southeast Asia added to Korea’s problems as well. A rapid currency depreciation occurred in Thailand July 1997 and was followed by currency crises in the Philippines, Malaysia, and Indonesia. Korean economic authorities were concerned and watched the on-going currency crises closely through the summer but nothing happened in Korea until autumn.

Seemingly defying the difficulties elsewhere in Asia, the Korea Development Bank, a state-run bank, succeeded in issuing $1.5 billion in global bonds in September 1997 without any difficulty. It was the largest foreign currency bond issue ever offered by a Korean bank or corporation. The bank originally planned to issue $1 billion in bonds but added $500 million more to meet the demand of foreign investors seeking safer alternative investments as South Asian economies stumbled. The September issue, though, was a last show of strength.

Following the September bond issue, market sentiment toward Korea and the effect of the Asian crises on its economy turned ambiguous. Some funds flowed out in response to overall anxiety regarding the Asian economies while other investors saw Korea as an opportunity. At the end of October, though, sentiment turned sharply pessimistic. Korea’s eighth largest chaebol, Kia Group, faced extreme financial difficulties; the Hong Kong stock market faltered; and then the credit rating agencies downgraded Korean debt. Foreign investor confidence plummeted, and the abrupt outflow of short-term foreign portfolio investment funds initiated an overall capital flight and currency tumble. In November 1997 the won plunged 27.5 percent against the U.S. dollar; over all of 1997, December to December, the won lost 40.3 percent of its value against the dollar.

**Why Did the Korean Economy Continue To Worsen Despite the Announcement of Bailout Programs?**


On the eve of the Korean crisis, the soaring foreign exchange rates were considered just a temporary symptom of the financial jitters caused by foreign investors’ concerns over the depletion of foreign exchange reserves. It was expected that the IMF loans to support the foreign reserve position would ease foreign investors’ concerns, on the assumption that Korea’s economy was fundamentally healthy. But they did not.

From the beginning of November, the foreign mass media carried articles critical of Korea’s financial situation. The Asian edition of the Wall Street Journal (November 3, 1997) pointed out that the central bank’s foreign reserves were disappearing fast. The Financial Times (November 4, 1997) said that the Korea economy had serious structural problems resulting from significant industrial overcapacity and a fragile banking sector, as well as a grave debt crisis due to high levels of short-term private debt in the corporate and banking sectors. On November 5, 1997 Bloomberg News Service and the International Herald Tribune reported that Korea would soon ask for bailout funds from the IMF.

On November 10, the won/dollar rate passed the 1,000 won/dollar mark for the first time, and on November 16 Michel Camdessus, Managing Director of the IMF, secretly visited Seoul to discuss rescue loans. On November 17, another effort to soothe foreign investors’ concerns failed when the National Assembly failed to approve a package of 13 financial reform bills before the end of the regular session.

On November 19, the government announced a financial stabilization package intended to encourage the return of foreign funds into the domestic market. The package widened the acceptable band for daily foreign exchange fluctuations of the won from 2.25 percent to 10 percent; introduced measures to stabilize the financial sector by streamlining mergers and acquisitions (M&A) of financial institutions; provided for the liquidation of bad corporate debts at local and merchant banks; and further liberalized the

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4 On November 19, President Kim Young-Sam partially reshuffled his cabinet, replacing Finance and Economy Minister Kang Kyung-Shik and Senior Economic Affairs Secretary Kim In-Ho in an effort to reverse the economic crisis. The new Minister of Finance and Economy, Lim Chang-Yuel announced the financial stabilization packages.
bond market. These measures, though, failed to prevent the country from sliding further into financial turmoil, and won/dollar exchange rates soared from 1012.8 on November 19 to 1139 on November 21.

Figure 5  Won / Dollar Exchange Rates

![Won/Dollar Exchange Rates Graph]

Source: Bank of Korea (2002)

On November 21 the Korean government officially announced that it had decided to apply for a bailout loan from the IMF. The date marked a turning point in the crisis. Boosted by the government’s decision to seek assistance from the IMF, both Korean stock prices and currency rebounded briefly but became unstable again.

Although Korea had requested financial assistance from the IMF, downgrades by credit rating agencies fueled a depreciation of the won and a sharp tumble in stock prices. On November 25, Standard and Poor’s (S&P), a U.S. credit rating firm, lowered its rating on Korea’s long-term sovereign debt to single A-minus from A-plus, stating, “The downgrades reflect the rapid deterioration in Korea's financial position and the authorities’ continued reluctance to recognize and effectively manage the confidence crisis affecting the banking and corporate sectors.” Another U.S. credit rating agency, Moody’s Investors Service Inc., lowered Korea’s sovereign rating from A1 to A3 on November 28. Reflecting these actions, won/ dollar exchange rates rose again from 1076.4 won on November 24 to 1249.5 won on December 4.
On December 3, Korea and the IMF reached an agreement on a financial aid package totaling $58.35 billion that included loans worth $21 billion from the IMF, $10 billion from the World Bank, $4 billion from the Asian Development Bank (ADB), and $23.35 billion from the G-7 and other countries. The nation, however, was obliged to accept the terms and conditions imposed by the IMF in order to resolve its financial crisis stemming from a foreign exchange shortage and stock market collapse. Economists expected that the award of the IMF aid would serve as a kind of guarantee, and foreign financial institutions would feel confident enough to roll over most of Korea's short-term debts, helping to ease the foreign currency crunch. However, Korea's ever-deteriorating international credit rating dominated and made it increasingly difficult to obtain foreign currency, leading to further depletion of the country’s foreign reserve holdings.

On December 10 Moody’s downgraded Korea’s debt again, from A3 to Baa2, semi-junk bond level. One day later, S&P also downgraded Korean debt three steps from A- to BBB-. These downgrades reflected concerns about the effective implementation of the IMF’s restructuring plan. Won/dollar rates, which were 1156.1 won on December 5, sharply soared to 1719.39 on December 13.

On December 21, Moody's downgraded the country's credit rating to non-investment grade, to Ba1 from Baa2, based the outflow of funds from the markets and the resulting currency depreciation that added to the banking sector’s existing asset quality problems. Two days later, on December 23, S&P also downgraded Korea, by four steps from BBB- to B+, mentioning that “recent steps taken by the government to assist its banking sector placed the nation's own external position at risk and were inconsistent with the spirit of the IMF bailout program.”

<table>
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<tr>
<th>S&amp;P</th>
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<th>Fitch</th>
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<tr>
<td>AAA</td>
<td>Aaa</td>
<td>AAA</td>
</tr>
<tr>
<td>AA+</td>
<td>Aa1</td>
<td>AA+</td>
</tr>
<tr>
<td>AA</td>
<td>Aa2</td>
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Table 2 Credit Rating Agency Downgrades of Korean Debt
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<tr>
<td>A</td>
<td></td>
<td>A2</td>
<td>A Nov. 26, 1997</td>
</tr>
<tr>
<td>A-</td>
<td>Nov. 25, 1997</td>
<td>A3 Nov. 28, 1997</td>
<td>A-</td>
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<tr>
<td>BBB+</td>
<td>Baa1</td>
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<td>BBB+</td>
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<td>BBB</td>
<td>Baa2 Dec.11, 1997</td>
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<td>BBB</td>
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<tr>
<td>BBB-</td>
<td>Dec. 11, 1997</td>
<td>Baa3</td>
<td>BBB- Dec.11, 1997</td>
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<table>
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<th>Non investment-grade</th>
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<th>Ba1</th>
<th>BB+</th>
</tr>
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<tr>
<td>BB</td>
<td>Ba2 Dec. 21, 1997</td>
<td></td>
<td>BB</td>
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<tr>
<td>BB-</td>
<td>Ba3 Dec. 21, 1997</td>
<td></td>
<td>BB-</td>
</tr>
<tr>
<td>B</td>
<td>B2 Dec. 23, 1997</td>
<td></td>
<td>B</td>
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<tr>
<td>B-</td>
<td>B3 Dec. 23, 1997</td>
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<table>
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<th>Default-grade</th>
<th>CCC+ Caa CCC+</th>
<th>CCC- Caa CCC-</th>
<th>CC+ Ca CC+</th>
<th>C+ C Ca C+</th>
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</table>

The international credit-rating agencies’ lowering of Korea’s credit rating to junk bond status brought about a tremendous downturn in the Korean currency. On December 24, the exchange rate rose to 1,964.8 won per U.S. dollar, a depreciation of 16.6 percent from the previous day. On December 25 the IMF and the international agencies, along with the U.S. and 13 industrialized countries, announced their willingness to provide $10 billion between that date and early January as part of the bailout package. Due to immediate aid by the IMF-led international community, Korea avoided a full economic disaster, and the won/dollar exchange rate temporary exceeded 2,000 won for the first time.

But effect of the IMF aid lasted for only a few days. In the early days of 1998 foreign exchange rates rebounded and moved around 1700 won. The Korean government
realized that it needed to negotiate with private banks to stop the currency outflow. A Korean government delegation began discussions in New York with 13 foreign banks to reschedule short-term debt, and on January 28 they reached an agreement to roll over and extend the maturity of Korean commercial banks’ short-term debts by one to three years, with interest premiums and government payment guarantees. On March 16, the government announced the results of additional rollover negotiations. A total of $21.8 billion, representing 94.8 percent of the targeted short-term debt, was successfully rolled over after two and a half months of negotiations. After this, the won/dollar exchange rates started to stabilize rapidly.

Presentations (“road shows”) aimed at issuing global bonds to foreign investors were held concurrently in 12 major cities in seven countries including Hong Kong and New York from March 26 through April 3. The effort successfully issued $4 billion in bonds, $1 billion beyond the projected target of $3 billion. The successful issuance of the foreign exchange equalization fund bonds indicated that Korea could raise new money in the market and the foreign-exchange turmoil was over. Following the successful rollover of the banks’ short-term debts and the $4 billion global bond issue, Korea’s foreign exchange conditions improved and stabilized, with won settling at the 1,300 won per dollar level.

**Why Could Korea Introduce Reform Plans So Quickly?**

After the financial crisis occurred, Korea was able to implement most reforms of its legal framework and organizations within a year. Considering the needs of building consensus and working with the administrative and political processes, Korea’s reform implementation was amazingly speedy and orderly. For example, the U.S. took more than one year to reorganize the Department of Homeland Security after the September 11 attacks.

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5 The rescheduled loans would bear a floating interest rate of LIBOR plus 2.25 percent for one year maturities, LIBOR plus 2.5 percent for two year maturities and LIBOR plus 2.75 percent for three year maturities. At that time, LIBOR was 5.6 percent.

6 In the first state bond offering since financial turmoil gripped the nation, 10-year bonds worth $3 billion were priced at 355 basis points over the U.S. Treasury benchmark while five-year bonds worth $1 billion were at a spread of 345 basis points.
Korea’s financial crisis was approximately coincident with the transition of the nation’s leadership. The Presidential election was held on December 18 and opposition leader Kim Dae-Jung was elected to a 5-year term as the 15th President of the nation. This shift of political power to the opposition party was the first in Korea’s political history.

The transition was orderly and peaceful, without the confusion and turbulence that occurred in neighboring countries. In Indonesia, the economic crisis triggered economic and political turbulence and eventually President Suharto stepped down on May 21, 1998 following fierce anti-government demonstrations. In Malaysia, Prime Minister Mahathir objected to the IMF bailout programs and suggested a “Wall Street conspiracy” of hedge funds that hoped to profit from currency speculation.

On December 22, immediately following the election, President-elect Kim Dae-Jung met with the out-going President and launched an interim Emergency Economic Committee composed of cabinet members and leading politicians from the President-elect’s party to deal with current economic issues. After Kim was inaugurated on February 25, the newly-installed government created the Economic Policy Coordinating Council, headed by the President and consisting of senior advisors and economic ministers, the head of the Financial Supervision Commission (FSC), the governor of the Bank of Korea (BOK) and a private professor. At its first meeting, on March 11, the group discussed measures to overcome the economic crisis facing nation.

After the election, the National Assembly promptly re-convened in an extraordinary session and passed a package of 13 financial reform bills on December 29. The financial reform package, which revised the laws governing the BOK and created a new financial supervisory agency, was designed to speed up the previously proposed structural renovation of the nation's financial sector. The revisions to the law governing the BOK made the central bank more independent to better enable it to control inflation and designated the head of the BOK to lead the policy-making Monetary Board. A new, consolidated financial supervisory agency was created through the merger of the three
existing agencies that supervised banks, securities houses, and insurance firms. The new agency was to be under the control of the Prime Minister's Office rather than the Minister of Finance and Economy (MOFE) in order to avoid undue concentration of power in the MOFE.

One of the government’s next steps was to initiate negotiations with the business and labor communities in order to build a consensus regarding solutions to problems based on the traditional approach of sharing the nation’s pains. On January 13, 1998 an agreement on five key principles of corporate reform was made between President-elect Kim Dae-Jung and the leaders of the top four chaebols. The agreement called for: (1) enhanced corporate transparency; (2) elimination of debt cross-guarantees; (3) capital structure improvement; (4) business concentration on core competencies and strengthened cooperation with small-and-medium-sized enterprises; and (5) improvements in corporate governance including toughened management accountability.

Negotiations with the labor unions were also undertaken but were very contentious. Korea’s labor unions maintained a strong position against the introduction of layoffs, in keeping with business practice throughout the decades of rapid development and accepted social norms. However, one of the key conditions attached to the IMF bailout programs was increased flexibility in labor markets, including layoffs. A compromise seemed very difficult to reach in a short span of time. The Tripartite Commission, a labor-management-government consultative body, was inaugurated on January 15 to facilitate labor-management reconciliation. On February 6, after 20 days of painstaking negotiations, a pact among labor, management, and government was finally reached that was intended to make the labor markets more flexible and included provisions for layoffs – a first for Korea and a sharp break with previous practice.

The government rapidly established legal frameworks to implement reform programs based on the agreements. On February 14, ten economics bills, mostly revisions to laws related to labor and corporate restructuring, were passed during an extraordinary Assembly session. Under the new layoff law, companies were able to dismiss workers
without consent from their unions when the firm faced “emergency situations” such as mergers and acquisitions. Other legislation covered bankruptcy, corporate liquidation and employment insurance, all aimed at speeding up the reform of industry structure and financial markets. Hostile mergers and acquisitions of domestic firms by foreigners were allowed as the Assembly approved a bill on the introduction of foreign capital.

Following the introduction of the revised legal framework, the institutions to take charge of financial reform and restructuring were quickly launched. The KAMCO and its affiliated Non-Performing Loan Management Fund had been established on November 24 to address some of the problems in the banking sector. KAMCO, modeled after the U.S. Resolution Trust Corporation, was charged with resolving the non-performing loans from ailing financial institutions. A revamped Korea Deposit Insurance Corporation (KDIC), modeled after the U.S.’s FDIC, and the Financial Supervisory Commission (FSC), an integrated financial supervisor, were newly created on April 1, 1998. The KDIC took charge of maintaining the stability of the financial system by protecting depositors, supporting the resolution of insolvent financial institutions, and providing capital to banks, while the Financial Supervisory Service (FSS) monitored and inspected the financial industry more closely.

Table 3 Chronology of Korea’s Financial Crisis (1997 – 1998)

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
</table>
| 1997 | Nov. 21 Request for IMF bailout loans announced  
      | Nov. 24 KAMCO and NPL Management Fund Set Up  
      | Dec. 3 Agreement with the IMF on bailout programs  
      | Dec. 18 Presidential election. Kim Dae-Jung elected  
      | Dec. 22 Emergency Economic Committee Launched  
      | Dec. 29 Package of 13 financial reform bills passed  |
| 1998 | Jan. 13 Agreement on five key principles of corporate reform between President-elect and leaders of top four chaebols  
<pre><code>  | Jan. 15 Inauguration of Tripartite Commission to discuss labor issues  |
</code></pre>
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>Feb. 14</td>
<td>Ten economics bills on corporate and labor reforms passed</td>
</tr>
<tr>
<td>Feb. 18</td>
<td>Kim Dae-Jung Inaugurated as 15th President</td>
</tr>
<tr>
<td>March 11</td>
<td>Opening of first meeting of the Economic Policy Coordinating Council</td>
</tr>
<tr>
<td>April 1</td>
<td>Financial Supervisory Commission Established</td>
</tr>
<tr>
<td>April 1</td>
<td>Consolidated KDIC Launched</td>
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</table>
III. The Causes of the Crisis

A number of analyses of the Korean financial crisis have been conducted and a variety of causes have been proposed. Economic and institutional factors provide a picture of an economy ripe for a sharp downturn. A more complete understanding of the causes of Korea’s crisis and its failure to anticipate the crisis, though, requires consideration of a number of cultural factors as well as standard economic analysis.

Economic Analysis of the Causes of the Crisis
The Korean crisis reflected the combination of a number of vulnerabilities. Most immediately, the sudden outflow of foreign currency led to depletion of foreign currency reserves and skyrocketing won/dollar exchange rates. Deteriorating balance sheets of financial institutions, high levels of short-term debt in the private sector, and a string of bankruptcies among chaebols shook investor confidence, along with the epidemic of crises in neighboring countries. Many of the economy’s fundamental problems can be traced to the structure of its corporate sector and difficulties in its immature labor and financial markets.

Figure 6 Causes of Korea’s Financial Crisis

\footnotetext{7 See, for example, Baily et. al. (1998), Goldstein (2001), Shirazi (1998), and Williamson (1998).}
Economic and institutional causes of the crisis can be classified into three general categories: liquidity problems, structural problems, and external shocks. First, it is widely acknowledged that insufficient foreign currency reserves triggered the crisis. Korea’s high level of short-term external debt and heavy debt ratios in the corporate sector hurt investors’ confidence. At the end of 1996 the ratio of short-term debt to reserves was 2.0 and the debt/equity ratio reached nearly 400 percent, both high by international standards. Foreign investors worried about the rapid increase of nonperforming loans in the financial sector due to the many bankruptcies. The ratio of NPLs to total credit increased from 5.2 percent at the end of 1st quarter to 6.0 percent at the end of 4th quarter of 1997 due to corporate bankruptcies. Additionally, the Korean won was overvalued against the dollar. Although Korea did not have a fixed exchange rate system like Thailand and Malaysia, the won seemingly was overvalued due to the relatively small adjustment band.
Table 4 Ratio of Short-term Debt to Reserves (1996)

<table>
<thead>
<tr>
<th>Country</th>
<th>South Africa</th>
<th>Pakistan</th>
<th>Russia</th>
<th>Singapore</th>
<th>Bulgaria</th>
<th>Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>11.6</td>
<td>5.1</td>
<td>2.3</td>
<td>2.3</td>
<td>2.1</td>
<td>2.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1.9</td>
<td>1.4</td>
<td>1.4</td>
<td>1.3</td>
<td>1.2</td>
<td></td>
</tr>
</tbody>
</table>


Table 5 Comparison of Corporate Debt by Country (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Korea</th>
<th>Malaysia</th>
<th>Thailand</th>
<th>Taiwan</th>
<th>Japan</th>
<th>U.S.</th>
<th>Germany</th>
<th>Sweden</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Debt/GDP</td>
<td>167</td>
<td>200</td>
<td>86</td>
<td>170</td>
<td>130</td>
<td>60</td>
<td>53</td>
<td>91</td>
</tr>
<tr>
<td>Debt/Equity</td>
<td>395</td>
<td>160</td>
<td>450</td>
<td>90</td>
<td>194</td>
<td>106</td>
<td>144</td>
<td>154</td>
</tr>
</tbody>
</table>

Source: IMF (1998), Republic of Korea—Staff Report for 1998 Article IV Consultation

Table 6. Trend of Non-Performing Loans (billion won)

<table>
<thead>
<tr>
<th></th>
<th>1997 Q1</th>
<th>1997 Q2</th>
<th>1997 Q3</th>
<th>1997 Q4</th>
<th>1978 Q</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Credit (A)</td>
<td>326,094.5</td>
<td>331,572.3</td>
<td>343,363.3</td>
<td>375,831.7</td>
<td>354,602.4</td>
</tr>
<tr>
<td>NPLs (B)*</td>
<td>16,864.9</td>
<td>17,287.1</td>
<td>22,438.4</td>
<td>22,652.1</td>
<td>25,998.2</td>
</tr>
<tr>
<td>B/A (%)</td>
<td>5.2</td>
<td>5.2</td>
<td>6.5</td>
<td>6.0</td>
<td>7.3</td>
</tr>
</tbody>
</table>

Source: MOFE (1998)
* Includes credit classified as substandard, doubtful and estimated loss.

Second, a variety of fundamental weaknesses in Korea’s economic structure have been identified, particularly in the financial, corporate, government, and labor sectors. In the financial sector, institutions overextended credit and tended to concentrate lending in a few industries. In funding that lending, banks mismatched maturities and currencies, leading to magnification of the credit quality problems. In the corporate sector, the chaebols pursued excessive expansion with borrowed money, and a lack of transparency in corporate governance undermined investors’ confidence. In the labor market there was
a lack of flexibility, including especially the inability to implement layoffs. The government failed to manage the foreign exchange reserves appropriately and neglected exchange rates difficulties. It ignored the high level of short-term debt in the private sector and failed to provide adequate supervision of the financial sector.

Third, external shocks -- especially the contagion effect of the Asian financial crises -- contributed substantially to Korea’s difficulties. Difficulties in the region led to a closer examination of Korea’s fundamentals by foreign investors and intense competition hastened the deterioration of exports. The contagion effects of the foreign exchange crises were evident even at the time. In considering how the difficulties in the small economy of Thailand spread to much larger economies, including Korea, Goldstein (2001) explained the channel of contagion. Thailand’s difficulties provided a “wake-up call” for investors to reassess their investments in Asia, and one country’s currency devaluation could lead to competitive devaluations of neighboring countries’ currencies.

These economic factors indicate several profound underlying weaknesses in Korea’s economy, despite its apparent strength in the months immediately before the crisis. Once conditions began to deteriorate, Korea’s economy fell into a crisis rapidly.

**Failure of Korean Style Cooperative Measures**

Why did a healthy-looking Korean economy collapse so suddenly? Although some corporations had financial problems, the overall macro-economy of the country looked healthy until about a month before the crisis. The rapid transfer of firm-level problems to the national level is closely related to the flaws in a corporate structure, chaebols, that stressed burden-sharing among affiliates. Similarly, the microeconomic difficulties within Korea’s chaebols were made worse by the country’s overall macroeconomic condition. The domestic origin of Korea’s crisis can be traced to structural weaknesses in the financial and corporate sectors. A series of chaebol bankruptcies began with Hanbo in January 1997 and peaked when Kia Group revealed its financial difficulties in July 1997.
Because of the relationships among firms within a chaebol, one company’s problems could quickly extend to all companies in its group. The Kia Group provides a prime example. Kia was the eighth largest chaebol with a total of 28 affiliates. In the summer of 1997, the Kia Group began to experience financial difficulties because of its heavy debt burden and reduced cash flow during the business slump. At the end of May 1997, Kia had 9.5 trillion won in debts to the financial sector. The large debts and losses were attributed primarily to three affiliated companies -- Kia Steel (producing special steel products), Asia Motors (buses and trucks), and Kisan (construction). The problems at these three eventually led to cash flow problems for the group as a whole.\textsuperscript{8} While western business practice would suggest that Kia Group quickly close or sell off its ailing subsidiaries, the chaebol structure and culture did not permit this. Because of protests by managers and workers, Kia Motors could not be sold and would likely have failed with the rest of the group.

Korean chaebols operated somewhat like a family. Parent companies looked after their affiliate companies and sibling companies provided mutual aid. Chaebol culture dictated that it was keenly necessary for affiliates to help each other in adversity, even when a more practical (western) business strategy would be to let an ailing affiliated company fail so that the other companies can survive. Cross debt guarantees by the parent company and cross shareholding among affiliates helped provide easy access to credit and financial supports.\textsuperscript{9} Intra-group transactions among affiliates served as a key strategy for the conglomerates to expand business, but these practices can also lead to collective insolvency of the conglomerate as a whole if business turns bad. Additionally, relationships between chaebols and the banking sector can lead to non-optimal credit risk management. In the case of the potential bankruptcy of the Kia Group, the massive

\textsuperscript{8} Asia Motors had 2.24 trillion won in outstanding debts, while Kia Steel had 1.31 trillion won and Kisan had 1.18 trillion won in outstanding debts, respectively. Kia Motors, the parent company of Asia Motors, had 5.62 trillion won in debts at the end of May 1997, although Kia Motors still showed a profit. In 1996, Kia Steel recorded a net loss of 89.5 billion won, Asia Motors a loss of 29.4 billion won, and Kisan a loss of 6.7 billion won. Kia Motors, though, was a blue-chip company with a net profit amounting to 7 billion won.

\textsuperscript{9} For example, as of April 1997 Kia Motors provided guarantees of 2.24 trillion won to its sibling subsidiaries; these guarantees accounted for 88.4 percent of the group’s total guarantees.
increase in non-performing loans would have threatened the viability of the chaebol’s creditor banks.

The structure and culture of Korea’s banking sector also contributed to the rapid collapse in 1997. The Corporate Bankruptcy Postponement Accord is one example of the linkages among banks and the barriers to prompt resolution of problems. In April 1997, the nation’s 35 state-run and commercial banks signed the Corporate Bankruptcy Postponement Accord. Under the Accord, creditor banks agreed to provide rescue loans for a group’s key affiliates under a cooperative agreement to prevent a chaebol that is temporarily suffering cash-flow problems from being forced into bankruptcy. Under the Accord, lenders would be financially penalized if, without consent from their colleagues, they prematurely collected loans from companies where the primary creditor bank had requested assistance. Western bankers doubted that the Accord would be able to achieve its goals and were opposed to its cooperative framework. Rather than require each lender to evaluate each credit decision, the Accord undermined the lenders’ responsibility and forced them to maintain troubled credits. While propping up the struggling chaebols may have been socially desirable in the short run, the Accord only strengthened linkages among the already weakened lenders.

Between April and November 1997 the Jinro, Daenong, and Kia Groups benefited from the Corporate Bankruptcy Postponement Accord and were able to shift their corporate financial troubles to the financial sector. Because of the Accord, all financial institutions were affected, without distinction between originally healthy or unhealthy institutions. Because of the cooperative action, banks could not reduce loans to troubled borrowers and lost the opportunity to resolve non-performing loans promptly. The Accord allowed weaknesses in several creditors to spread to the entire banking sector.

These problems at the chaebol-level and within the banking sector quickly extended to the national level. From July on, Korea’s primary economic problem was the fallout from Kia’s financial crisis. Under the Corporate Bankruptcy Postponement Accord creditor banks were considering selling the profitable Kia Motor. However, Kia
managers wanted to survive by implementing a self-rescue plan, and its labor union protested fiercely against selling Kia Motor. In addition, civic groups launched a campaign to save Kia under the slogan, “Let’s save Kia, a company of people.” The resolution of Kia continued to be delayed, and the government eventually intervened. It placed the group’s two auto-manufacturing units -- Kia Motor and its subsidiary Asia Motor -- under court receivership. Kia Motor was to be recapitalized with state funds and operated as a public company until its management was normalized. The Korea Development Bank, a state-run bank, converted Kia’s debt into investment capital. Domestic business welcomed the government decision to intervene, and stock prices rebounded.

Foreign investors’ reaction to Korea’s difficulties was completely different from the domestic reaction. On October 24, two days after the government announced a rescue plan for Kia, Standard and Poor’s, a U.S. credit rating firm lowered its rating on Korea’s long-term foreign-currency sovereign debt to single A-plus from double A-minus. This was the first time the nation’s credit rating had been cut, although some of Korea’s corporations and banks had been downgraded. S&P explained its action citing “the escalating cost to the government of supporting the country’s ailing corporate and financial sectors.” The government rescue of Korea First Bank (KFB) in September made the government’s official backing of the banking system’s obligations increasingly explicit. On November 28, three days after the KFB rescue, another U.S. credit rating agency, Moody’s also cut Korea’s sovereign debt rating from A1 to A3. The creditrating downgrades dealt a severe blow to Korean corporations and financial institutions that were already struggling to secure foreign-currency funds. The credit-rating downgrade initiated an abrupt outflow of foreign capital and fall in the currency. The events of these weeks were only exacerbated by the Hong Kong stock market shock that had occurred on October 23, and the worldwide reaction to that stumble in a neighboring Asian economy.

10 Most Korean chaebols are owned by one family. Kia was one of the few exceptions. Its major shareholder was its employees union. In that sense, interest groups called Kia “a company of the people” and were reluctant to have it sold, particularly if it would eventually be owned or dominated by one family. 11 Kia Motors and Asia Motors were sold to Hyundai Motors Co. in November 1998.
To a large extent, then, the chaebols’ cooperative corporate structure and approach to “live and die together” by sharing burdens and risks among affiliates brought about Korea’s crisis. Firm-level difficulties that would have been recoverable, small troubles if they had been addressed and resolved quickly, developed into a national disaster as they spread from a company to a group, from a group to the financial sector, and finally to the national macro-economy. The Korean business approach based on cooperation had been effective during the period of rapid growth of the 1970-80s. However, as Korea entered the global economy and its business sector was forced to coexist with western-style individualistic capitalism, its cooperative corporate structure and culture based on familism proved to be a profound weakness.

**Earlier Failure to Gain Sufficient Support for Reform**

Why could Korea introduce and implement reform packages so quickly? How had Korea reached consensus on labor and corporate reform, revised its legal framework, and established institutions for financial restructuring within six months of the crisis? The answer is simple: Korea had been preparing for reform well before the crisis.

At the end of 1996 and into the beginning of 1997 Korea had experienced a shock in response to a slump in exports. Concerns about the country’s macroeconomic condition were reflected in the dramatic drop of the KOSPI in January 1997. At that time, the Korean government had already recognized that structural problems in two areas in particular impeded sustainable growth: labor markets and financial markets. It prepared two reform plans -- a financial market reform package and a labor reform package to increase market flexibility. Although the government worked to build support for the reform packages and have them passed by the National Assembly, the reform plans did not win widespread support until the economic crisis occurred in November 1997.

In 1996 the government proposed labor law reforms to permit lay-offs and introduce some labor market flexibility measures. Labor unions and the opposition parties protested fiercely, however. The National Assembly passed the laws in December 1996
in a predawn parliamentary session with only lawmakers from the ruling party attending. The highly unusual passage of the reform measures touched off nationwide labor protests, and President Kim Young-Sam promised to rewrite the laws in January 1997 and then postponed their implementation for two years. In the end, necessary reforms, including lay-offs, were not implemented until a full-blown financial crisis occurred.

In 1997 the MOFE proposed a package of 13 financial reform bills to initiate the Korean version of the “Big Bang.” The bills called for the central bank, the BOK, to act as an independent authority over monetary policy with the head of the BOK replacing the Minister of Finance and Economy as the head of the policy-setting Monetary Board. To enforce supervision in the financial sector, a consolidated Financial Supervisory Commission (FSC) was proposed through the merger of the three independent regulatory bodies for banking, securities, and insurance. The Office of Bank Supervision within the BOK was to relinquish its inspection rights over banks to the soon-to-be-established FSC. Under the proposals, all financial companies would be supervised under the new FSC. Deposit insurance funds were to be merged as well. Korean business groups, chaebols, would be required to prepare and publish consolidated financial statements linking the performances of all of their subsidiaries by fiscal year 2000.

The majority ruling party promised to support passage of the reform package at the general assembly session in September, but passage of the reform package was delayed while the government worked to achieve political consensus between majority and minority parties. As the session’s close drew near, passage seemed assured as the government secured a favorable response from opposition party leaders. Newspapers incorrectly reported that the political parties had reached an agreement and the reform package would be passed on November 14. By November, though, Korean financial markets already showed signs of instability, and there were rumors that Korea would need help from the IMF in the near future. Experts urged passage of the reform package, praising it for its contribution to restructuring Korea’s inefficient financial sector and stabilizing its financial markets. Political consensus, though, remained elusive. The opposition party did not formally oppose the reforms, but it did not support them actively.
and its members did not attend the session when the vote was to be taken. Although it held a majority, the ruling party hesitated to enact the reforms without participation by the opposition party for fear of losing votes in the upcoming Presidential election.

On November 14, the BOK and the three financial supervisory bodies held a joint rally in front of the National Assembly to protest possible passage of the financial reform bills. They complained that the BOK would be stripped of supervisory authority over banks, suggested that the merger of the regulators would provoke instability, and criticized the fact that the new FSC would be under the control of the MOFE. Trade unions at financial institutions nationwide threatened to launch a general strike to support the central bank employees’ protest. Lawmakers from both the ruling and opposition parties suddenly became reluctant to pass the reforms, each party fearing the loss of popularity ahead of the presidential election to be held on December 18. On November 17, the Korean won broke the psychological barrier of 1,000 per U.S. dollar for the first time on, closing at 1,008.60 on the back of foreign currency shortages and uncertainty over financial reform bills. Eventually the financial reform package was not passed until after the crisis occurred.

It is generally said that the failure to pass reform measures that might have averted Korea’s financial crisis can mainly be attributed to a lack of leadership and to politicians’ irresolute search for popularity. However, it is difficult for even a strong political leader to push reform measures that are not supported by the majority of citizens. This is the nature of democracy. Public attitudes needed to change before reforms could be introduced and implemented. A pertinent issue is the basis of the public attitudes that led the initial failure of the reform efforts. In many ways, Korea’s culture based on cooperativism/collectivism and humanism kept it from introducing reforms that, in the long run, would allow it to better compete in international markets.

12 The President’s leadership had rapidly eroded in the wake of the Hanbo corruption scandal and the arrest and conviction of his son. He was a “lame duck” president who was losing influence and control over the government. The lack of forceful presidential leadership contributed to gridlock in the Assembly and near paralysis of the Korean political system.
Many Korean leaders and analysts accepted that a labor system that includes the possibility of lay-offs is indispensable in helping domestic firms restructure in times of prolonged economic slumps and so regain international competitiveness. Most citizens, though, were more concerned with the social costs of mass lay-offs and lost jobs, and workers had grown accustomed to the security of the existing system. Public opinion generally did not support lay-offs and felt that management should and could find alternative solutions such as reduced work hours. Because of the success of Korean companies in recent decades, many workers felt that the business groups, having made plenty of money in previous years, should bear the burden of addressing the current difficulties. The Korean labor movement had grown strong beginning in the latter half of the 1980s and enjoyed considerable public support. Overall national sentiment was that the economy would support its workers, even if it meant going down with its workers in support of collective action.

Overall and importantly, then, well before the crisis in 1997, Korea had already recognized some of its fundamental structural vulnerabilities and tried to introduce reform packages that were very similar to those later imposed by the IMF. Although Korea had some vulnerabilities such as high real foreign exchange rates and high levels of short-term debt that would not have been addressed by the reform measures specifically, these factors would have been minimized as Korea more fully adopted market mechanisms.

13 In fact, the people had sympathy for the unions that wanted to avoid mass lay-offs followed by mergers and were not concerned with the concentration of power in the MOFE. Generally, they were indifferent to the reform plans.
IV. Conflict between Individualism and Cooperativism/Collectivism

Over its long history, Korea has assimilated influences from other cultures. Traditional Korean culture reflected the influence of China and other countries. Most recently, following World War II, Korea adopted capitalism, developed a market economy, and has begun to assimilate a “western” culture based on individualism. The financial crisis accelerated several aspects of the cultural transition of traditional values towards individualism. On the social axis, East Asia has retained a considerable degree of cooperativism/collectivism, stressing egalitarianism and human relations, whereas western culture is associated with individualism, attaching importance to professionalism and tolerating inequality as an incentive system.

Individualism and Cooperativism/Collectivism

Public attitudes are commonly the subject of sociology and anthropology. These fields adopt a dichotomy between individualism and collectivism to analyze cultural effects of public opinion. Korea traditionally has a cooperativist/collectivist culture where the self is defined in terms of in-group memberships in which shared values and norms, common goals, and utilitarian relationships are highly regarded. In contrast, western societies have an individualistic culture where the self is defined in terms of autonomy, personal liberty, and the supremacy of self-interests over those of the group (Earley and Gibson, 1998). In economic terms, in western societies individualism emphasizing each individual’s freedom to choose and his responsibility is a basic idea underlying western market economies. In cooperativist/collectivist societies, however, the group assumes a share of responsibility along with individuals, and collective welfare is often considered to be more important than individual rights (Chow 1997). Individual efforts are often intended to maximize common welfare.

A variety of fields including sociology and economics have investigated the effect of cultural values, particularly individualism versus collectivism, on output and productivity on both the microeconomic and macroeconomic level. At the microeconomic level, some
studies found support for the proposition that the group can be more effective (Guzzo, Yost, Cambell, and Shea, 1993) and “team spirit” contributes high productivity (Bandura 1997). However, Sosik and Jung (2002) found that individualists attained higher levels of group performance than did collectivists when they empirically tested the performance of American and Korean students.

Similar mixed conclusions have been found at the macroeconomic level as well. A wide range of researchers have considered how a country’s culture, particularly the degree of collectivism versus individualism, influences and is influenced by economic development. Cultural attitudes shape individual behavior and social institutions that in turn shape economic development. It is agreed that differences in collectivism versus individualism are highly correlated with per capita income in contemporary societies, with most of the developing countries exhibiting a relatively collectivist culture and developed countries a more individualist culture. The precise role of these characteristics in development and the direction of causality are not fixed, however.

For example, Franke et. al. (1991) and Hofstede (1991) studied survey data from IBM employees in 53 countries and university students in 20 countries and found that national wealth is closely correlated with individualism. More individualistic countries tend to be wealthier, and countries tend to shift towards individualism as the economy develops. The studies found several exceptions, though. The East Asian countries, such as Japan, Korea, Taiwan, Hong Kong and Singapore, succeeded in achieving high rates of economic growth while conserving considerable collectivist elements in family, school, and workplace relationships.

Arguments can be made on either side as to whether a collectivist national culture facilitates or impedes economic growth (Ball 2001). In countries where economic markets and formal institutions for resolving social conflict (e.g. courts) are absent or ineffective, collectivism can substitute for institutions in the maintenance of social and economic order and so facilitate growth and development. For example, collectivism can provide enforcement mechanisms based on social norms to encourage parties to honor
business agreements and can serve as an alternative to formal insurance markets. On the other hand, collectivism can place a drag on economic development to the extent that jobs and resources are allocated based on social norms and relationships rather than economic efficiency. Search costs for personalized exchange are higher than for anonymous market exchange, and social enforcement mechanisms tend to be less efficient than institutional mechanisms. Paradoxically, though, a well-functioning collectivist culture may impede the creation of formal institutions and commercial markets that are necessary for a competitive modern economy. To the extent that the division of labor is a necessary condition for long run sustained economic growth, formal institutions that support anonymous exchange facilitate economic development (Greif 1994).

The influence of collectivism versus individualism on economic development likely depends on the initial conditions in a country. Collectivism can maintain order and encourage growth in a country that does not have formal institutions, but as wealth increases, incentives to deviate from cooperation and engage in opportunistic behavior also increase. As persons deviate from the social norms, the norms begin to erode and persons move toward individualism. Ideally, the country will have introduced alternative, more individualistic mechanisms to maintain order. If not, economic performance can suffer if neither collectivist nor individualist institutional structures are functioning. If more formal mechanisms are in place, the diminishing role of collectivism in the economic sphere that accompanies the development of markets will likely spill over and lead to decreasing collectivism and increasing individualism in other areas.14

In the case of Korea, the country has adopted a market economy but, to a considerable extent, has maintained its cooperativist/collectivist culture. In particular, historically it has frequently relied on cooperativist/collectivist-style measures to share burdens and risks as the country coped with economic difficulties. During the 1997 crisis, however,

14 In theory, further economic development in the individualistic, developed countries may result in a movement back toward collectivist attitudes and practices. The diminishing marginal utility of income and material goods may lead people to place increasing weight on nonmaterial objectives. This move back
Korea started to realize that such measures were not optimal in a modern industrial economy. Economic globalization appears to be promoting convergence towards individualism and away from collectivism (Barber 1995).

**Cultural Background of Cooperativism/Collectivism in Korea**

Korean culture dates back to at least 2,000 years ago. Like other Asian countries, its development reflects a historical and philosophical tradition that differs in several fundamental aspects from the western tradition.

**Harmony Rather Than Competition**

Harmony is a key concept of East Asian philosophy. One of the classic books of Confucianism, I Ching, in describing the cosmological principle said that the universe is formed by harmony between different dispositions or materials. It explained the principle of changes as the movement between the cosmic forces of Yin and Yang, meaning “shaded” and “sunny.” Yin, for example, represents dark, moist, receptive, earthy, and female elements, whereas Yang is bright, dry, active, heavenly, and male. Their movements are symbolized by a circle divided into two sections and a whirlpool. They are opposite and compete against each other. They are, however, complementary. This means that Yin cannot exist without Yang, nor Yang without Yin.

The balance between the two is very important. For instance, Chinese doctors believe that sickness results from an imbalance between Yin and Yang. The doctor determines which part is insufficient and supplements it. Balance should be achieved by harmonization between the two forces rather than by conflict. This is in contrast to western philosophy. For example, Hegel’s Dialectic Progress explains that a concept gives rise to its opposite and as a result of the conflict between the two, a third view, the synthesis, arises.

toward collectivist attitudes from individualism would be observed only after people have attained a degree of security in their basic material needs.
East Asian philosophers have been absorbed in investigating ways to smoothly reach harmonization without conflicts. Confucianism studies how to reach harmonization between humans and society; Taoism, between humans and nature; and Buddhism, between the present life and life after death. East Asian religious and philosophical scholars in the past reached the conclusion that egalitarianism and familism will help to achieve harmonization without conflict. Social harmony can be woven from egalitarianism and Confucian hierarchical social order.

**Egalitarianism**

Buddhism particularly stresses egalitarianism. Buddhism was founded around the 6th century B.C. by Siddhartha, an historical person, and a prince of Sakyas in Northern India. India in those days was dominated by the Brahmans’ caste system, a system based on class distinctions that did not allow mobility out of the position to which a person was born. Siddhartha’s enlightenment, emphasizing that a person is noble and valuable regardless of race, class and gender, was a revolution in terms of human equality.

Siddhartha has been generally called a Buddha. “Buddha” is a title meaning “the Awakened One.” The Buddha is not a god in the strict sense, but a holy existence that is close to a god. The ultimate goal of a Buddhist is to reach “emancipation” (Vimoksa) which means freedom from desire and suffering, or “extinguish” (Nirvana) which means a state of tranquility when fire-like anxiety is extinguished - and then to become a Buddha. This unrestricted and undisturbed state can be reached through self-development. Siddhartha taught that each person has the capacity to reach this level because all humans are noble, whether they belong to the wealthy or lower castes. All humans can advance, even if born in humble circumstances, if they continuously strive to grow by following Siddhartha’s enlightenment. It is a central tenant of his egalitarian ideology that

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15 The core of Siddhartha’s enlightenment is composed of “the Four Noble Truths” (Cattari Ariya Saccani), and “the Eight-fold Noble Path” (Ariya Attangeka Magga). Buddha realized that all forms of existence are subject to suffering. To reach Nirvana one has to fully comprehend and absorb “The Four Noble Truths.” They consist of the following: (1) To live is suffering that consists of birth trauma, old age, sickness, death, losing what one loves, enduring what one hates and so on; (2) The cause of suffering comes from desire that leads to peoples’ constant craving or desire for sensual pleasure and existence; (3) The way to cure suffering is to remove desire; and (4) To remove desire, follow the Eight-fold Noble Path.
everyone, irrespective of class, position, gender, wealth, and race, can become a Buddha, the nearest level to god.

Egalitarianism implies that social actors must consider themselves more or less the same in order to feel of equal value. It teaches, first, not to disregard the humble or poor class; and second, any human can advance if he strives to grow. Egalitarianism fosters a spirit of nondiscrimination and incentives that stimulate self-advancement.

Egalitarianism can be found in Taoism due to the exchange of knowledge exchange with Buddhism. A Taoist textbook, *Dao De Jing* (or *Tao Te Ching*), said “Soften the glare, equalize the dust,” (Chapter IV) meaning to tone down the brightness in order to better harmonize and resemble the equality of dust. This expression is also used by Buddhism. Imagine a parking lot where splendid and luxurious cars are parked along with inexpensive, nearly worthless cars. If the wind blows, all the cars are covered with dust; the dust falls on the cars without discrimination (Kim 1999). Thus, nature is close to equality.

Buddhism spread from India into a number of Asian countries, including Sri Lanka, Tibet, Laos, Cambodia, Vietnam, Burma, China, Korea, and Japan. Buddhism mixed with and adapted to the countries’ native cultures, and slightly different types of Buddhism evolved in each country, such as Thailand Buddhism, Tibetan Buddhism, Japanese Buddhism, and Korean Buddhism. Further, within each cultural sphere, many different paths, lineages, and sects emerged.

In Korea, the Paekche Dynasty (18 B.C. – 660 A.D.) first adopted Buddhism as the state religion in 384, and it became the dominant system of thought in the Silla (57 B.C. – 935

“The Eight-fold Noble Path” which the Buddha recommended can be achieved through self-advancement and consists of: (1) Right Knowledge, meaning understanding the Four Noble Truths; (2) Right Thought, deciding to set one’s life on the correct path; (3) Right Speech, not lying and saying nothing that hurts others; (4) Right Conduct, refraining from killing, stealing and promiscuity; (5) Right Livelihood, earning a living that does not harm living things; (6) Right Effort, conquering all evil thoughts and striving to maintain good thoughts; (7) Right Mindfulness, becoming intensely aware of all the states in the body, feelings, and mind; and (8) Right Concentration, deep meditation leading to a higher state of consciousness (enlightenment).
A.D.) and Koryo (918-1392) Dynasties. As the religion was revered and practiced by all the people, from the king to the populace at large, Buddhism played a vital role in the intellectual and cultural life. During the Koryo Dynasty, Confucianism began to dominate aristocratic society, and the influence of Buddhism started to fade. During the Chosun Dynasty (1392-1910), the rulers suppressed Buddhism, but Buddhism has continued to coexist with Confucianism and other religions and been incorporated into Korean culture.

The basic spirit of Buddhism that teaches nondiscrimination still lives in Koreans’ minds, whether they are formally Buddhists or not. The premise that a person’s standing in human society, whether a high position or a humble position, is only an illusion has influenced Koreans’ implicit cultural tendency toward egalitarianism.

**Familism Based On Human Relationships**

Compared with Buddhism, Confucianism is relatively practical and secular. Importantly, it establishes a hierarchical division of society. The main topic of Confucius’ study was to find practical wisdom to establish a harmonious society. Confucius stated that human society consists of five relationships that prescribed social order precisely: parents and children, ruler and subject, husband and wife, older sibling and younger sibling, and friend and friend. All relationships are based on authority and subordination except the last. Confucians believe if people perform their role in these relationships, society will be peaceful as well as better.

These relationships not only form the social order but also impose a set of responsibilities: between father and son, affection is needed; between ruler and subjects, righteousness is needed; between husband and wife, recognition of their separate functions is needed; between old and young, their recognition of proper order is needed; and between friends, faithfulness is needed (“Sangang Wulun”). These Confucian social relations are intended to integrate individuals harmoniously into a collective society rather than to stimulate individuals’ activities and creativity through competition. This hierarchy is not inherently fixed and people naturally advance to a higher position as they
advance in years. High ranked persons have a high moral duty to those less highly ranked. In practice, the doctrine emphasized hierarchy in human relations and self-control for the individual. Lifetime employment and the seniority-priority system reflect these principles in the workplace.

The dominant subject in Confucius’ teachings is how to become a good person, a so-called “superior person,” by improving one’s own character. Confucius’ main method for attaining these virtues is education. Confucius said, “Man is born equal, and there should be no discrimination in education.” However, without effort none can reach this goal of self-improvement. The principles of Confucianism are contained in nine ancient Chinese books\(^\text{16}\) handed down by Confucius and his followers.

These philosophical traditions underlie the Korean culture that evolved over the centuries and led to a social system based on cooperativism/collectivism rather than the individualism of the West. In the modern era of international economic competition in global markets, Korea’s collectivist tradition has begun to move closer to individualism in the interest of the country’s economic progress.

**Measures Influencing Cultural Transition**

The evolution in Korean culture has been accelerated by implementation of changes in a variety of practices and workplace traditions. These changes have had a profound impact on Korean society and in some cases led to turmoil as centuries-old practices fall to the pressures of 21\(^\text{st}\) century life.

**Introduction of Lay-offs**

The implementation of lay-offs has begun to change the practice of lifetime employment. The financial sector was particularly hard hit by layoffs following the 1997 crisis and

\(^\text{16}\) The classics of Confucianism are four books and five scriptures.\(^\text{16}\) The four books are: (1) *Analects (Lun Yu)*; (2) *Mencius (Meng Zi)*; (3) *The Higher Education (Da xue)*; and (4) *The Doctrine of the Mean (Zhong yong)*. The five scriptures are: (1) *The Book of Poetry (Shi Jing)*; (2) *Book of History (Shu Jing)*; (3) *Book of Changes (I Ching)*; (4) *Book of Rites (Li Jing)*; and (5) *Spring and Autumn Annals (Chun Qiu)*. The five scriptures present basic teachings and principles, while the four books record the opinions and the theories of Confucius.
subsequent reforms. Starting with the closures of 12 ailing merchant banks in February 1998, 548 financial institutions, equivalent to 29 percent of total institutions, disappeared during the crisis. The number of financial institutions in Korea fell from 2,101 at the end of 1977 to 1,553 in November 2001. Even those institutions that survived underwent significant restructuring reforms, including massive lay-offs, as a condition of capital injections and purchases of non-performing loan using public funds. Cho Hung Bank, for instance, released 700 of its 9,000 employees in the first half of 1998 through “honorary retirement programs” and then was forced to lay off an additional 2,949 employees in subsequent months. Korea Exchange Bank was asked to cut its 7,420-member workforce by 2,197 (Korea Herald, September 23, 1998).

It was a shock to the Korean population that at least one in three workers in the financial industry was let go in such a short time. Jobs in financial institutions, particularly in banks, had been regarded as among the most secure, one of the strongest examples of lifetime employment, along with chaebol and public sector jobs. During the reforms, the financial sector inevitably implemented massive lay-offs that changed the old regime of workplace practice.

Hyundai Motors announced plans for massive layoffs in May 1998. This was the first massive job-cut by a chaebol since the change in policy toward layoffs in February. Hyundai management announced its intention to layoff about 20 percent of its 45,000 work force in order to overcome sluggish sales and overcapacity. For more than 30 days the labor union protested fiercely, and tensions between riot police and workers ran high at a number of demonstrations and factory occupations. The Hyundai confrontation was settled peacefully in August, although the number of workers to be laid off was reduced to 277, far below the announced plan. However, the Hyundai Motors layoffs established a precedent, and many chaebol began to fire large numbers of employees according to their restructuring plans as the labor movement lost public support.

Following the onset of the financial crisis, the unemployment rate started to climb dramatically from around 2 percent to over 8 percent. It soared from 2.1 percent in
October 1997 to 8.6 percent in February 1999 (Figure 7). In 1999 the rate gradually started to fall and stabilized at around 3 percent in the second half of 2000. The number of unemployed persons rose to nearly 1.5 million in 1998, a large jump from less than 0.5 million in 1996. These numbers reflected both the business downturn and the massive lay-offs. Because of the tradition of lifetime employment, Korea’s social safety net was not fully prepared to absorb the impact of the sharp rise in unemployment. In response, though, the government has continued to extend unemployment insurance as a major social safety net for the unemployed.

Figure 7 Unemployment Rates

![Chart showing unemployment rates from 1997 to 2000.]


**Revisions of the Financial Guarantee Systems**

Following a serious credit crunch that resulted from the difficulties in the financial sector, including the very high interest rates that resulted from the IMF-imposed requirements, the traditional financial guarantee system based on the relationships of family, friend, community, and company were seriously damaged. Customarily, security for loans such as real estate or joint liability was requested and provided based on personal relationships. Unfortunately, liquidity troubles of one individual or company can be easily spread to
others through the practice of joint liability. The collapse of the traditional guarantee system undermined the traditional solidarity based on human relationships.

In traditional small communities, it was the custom to help each other by providing guarantees. In rural areas, residents of entire villages suffered from financial difficulties due to joint liabilities on loan guarantees when one household and then another fell into bankruptcy. A series of bankruptcies led to the replacement of the traditional joint liabilities based on human relationships with an institutional guarantee system using the Agricultural, Forestry and Fishery Producers’ Credit Guarantee Fund.

The construction industry also had relied on cross guarantees. Construction companies were secured by other builders who served as guarantors and were jointly liable. The severe credit crunch drove many financially sound construction firms into difficulties due to bankruptcies of other builders for which they had pledged surety. The government abolished a rule that had required construction companies to secure other builders as guarantors liable jointly and encouraged use of an institutional guarantee system where the guarantee fee depends on the company’s credit rating.

As part of the reform efforts, cross guarantees were phased out in steps. Initially, the Fair Trade Law prohibited firms affiliated with the top 30 groups from guaranteeing the debts of sibling firms in excess of 100 percent of their capital, with the possibility of fines for those groups failing to meet the limits. By March 31, 2000 chaebols were required to eliminate cross guarantees among affiliates entirely.

Cross debt guarantees by which profitable parent companies assisted affiliates to gain easier loan terms was used to expand the business of Korean chaebols, along with cross shareholding and intra-group transactions. But this system of linkages could contribute to the bankruptcy of an entire group. The collapse of Kia Group was an example. As of April 1997, Kia Motors provided guarantees of about 2.24 trillion won, accounting for 88.4 percent of the group’s total guarantees that were valued at 2.54 trillion won. Due to the guarantees, Kia could not promptly restructure itself or cut off ailing affiliates. After
that episode and in response to reform efforts, Korea’s corporate culture started to change gradually. The emergence of a liquidity crisis at Hyundai Engineering & Construction, which was not able to get financial support from other affiliates of the Hyundai Group, reflects Korea’s changing business environment.

**Performance-Based Salary Systems**

The introduction of performance-based salary systems has begun to change Korea’s long-standing seniority-based pay system. Under the traditional system, employee wages were established by job position ranking and the number of years of service; promotions were also decided mainly by the employee’s number of years of service. Even those Korean firms that had a bonus system still tended to fix salary levels in direct proportion to the number years of service, regardless of growth in productivity, making the labor market extremely inflexible. In contrast, western corporations have introduced compensation programs based on workers’ performance, and salary levels reflect the market pricing system for the labor force and the employer’s financial status.

Despite criticism that the traditional system was not suitable for fair compensation or creating incentives, it prevailed in both the public and private sectors until the late 1990s when both sectors began to move to more flexible systems. The details of the new programs vary widely but generally try to introduce mechanisms to adjust base salaries to market levels (annual salary system) and to link individual employee’s annual pay increases to their job performance (merit system). Business conglomerates have pushed the spread of the new systems due to concerns that they are increasingly losing superior employees to venture firms that provide more flexible, incentive-based compensation. In answer to the exodus of workers to venture firms, businesses have introduced the yearly salary system along with stock options to discourage superior workers from leaving.

According to a survey conducted by the Ministry of Labor, 32.3 percent of the companies had adopted the annual salary system and 23.4 percent a merit system in January 2002, jumping from 1.6 percent and 5.7 percent respectively in November 1996. Large corporations and the public sector have led the introduction of the new systems where an
employee's wages link payment to performance as opposed to the traditional hierarchical system where salary is based on length of tenure or age. In particular, the financial sector, heavily damaged in the crisis, has played a leading role in spreading the new wage systems and has implemented the new system in about half of the institutions.

Table 7 Trends of Annual Salary Systems and Merit Systems (%)

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<tbody>
<tr>
<td>Annual salary system - banks &amp; securities</td>
<td>1.6</td>
<td>3.6</td>
<td>15.1</td>
<td>23.0</td>
<td>27.1</td>
<td>32.3</td>
</tr>
<tr>
<td>Merit System - banks &amp; securities</td>
<td>5.7</td>
<td>7.0</td>
<td>16.0</td>
<td>20.6</td>
<td>21.8</td>
<td>23.4</td>
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<td>Source: Ministry of Labor (2002)</td>
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Evidence of Cultural Transition

Changes in public attitudes and behaviors are sometimes difficult to measure, often because such changes can be subtle and gradual over time. In the case of Korea, at least some cultural changes have come about very quick and are reflected in changes in behavior.

Income Inequality

The income gap between high and low-income brackets dramatically widened after the 1997 crisis. According to a household consumption survey by the National Statistical Office, households in the top of 20 percent income bracket earned 6.75 times as much as those in the lowest 20 percent in 2000, shifting from a multiple of 4.49 in 1997. The change indicates a rapid change in income distribution. Korea’s Gini index, a measure of income inequality, rapidly grew from 0.283 in 1997 to 0.351 in 2000. This index ranges from zero to one with zero indicating perfect equality in income distribution and one indicating maximum inequality. The change in the index number is interpreted as indication that Korean society is shifting from an egalitarian-oriented to an individualist, profit-pursuing society.
### Table 8 Trend of the Gini Index in Korea

<table>
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<tbody>
<tr>
<td>Gini Index</td>
<td>0.290</td>
<td>0.283</td>
<td>0.316</td>
<td>0.320</td>
<td>0.351</td>
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<tr>
<td>Income Multiple</td>
<td>4.74</td>
<td>4.49</td>
<td>5.41</td>
<td>5.49</td>
<td>6.75</td>
</tr>
</tbody>
</table>

Note: Income Multiple = the top 20 percent income / the bottom 20 percent income. Gini index ranges from zero (perfect equality) to one (maximum inequality). Source: National Statistics Office (2002)

### Table 9 Gini Index Numbers for OECD countries

<table>
<thead>
<tr>
<th></th>
<th>0.200-0.300</th>
<th>0.300-0.400</th>
<th>Over 0.400</th>
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<tbody>
<tr>
<td>Sweden</td>
<td>0.250 (1992)</td>
<td>Canada</td>
<td>0.315 (1994)</td>
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<tr>
<td>Finland</td>
<td>0.256 (1991)</td>
<td>France</td>
<td>0.327 (1995)</td>
</tr>
<tr>
<td>Denmark</td>
<td>0.247 (1992)</td>
<td>Germany</td>
<td>0.300 (1994)</td>
</tr>
<tr>
<td>Belgium</td>
<td>0.287 (1996)</td>
<td>Austria</td>
<td>0.310 (1995)</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>0.269 (1994)</td>
<td>Netherlands</td>
<td>0.326 (1994)</td>
</tr>
<tr>
<td>Italy</td>
<td>0.273 (1995)</td>
<td>Spain</td>
<td>0.325 (1990)</td>
</tr>
<tr>
<td>Czech</td>
<td>0.254 (1996)</td>
<td>Ireland</td>
<td>0.359 (1987)</td>
</tr>
<tr>
<td>Hungary</td>
<td>0.244 (1998)</td>
<td>Switzerland</td>
<td>0.331 (1992)</td>
</tr>
<tr>
<td>Japan</td>
<td>0.249 (1993)</td>
<td>Portugal</td>
<td>0.356 (1995)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Greece</td>
<td>0.327 (1993)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Poland</td>
<td>0.316 (1998)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Australia</td>
<td>0.352 (1994)</td>
</tr>
</tbody>
</table>

Note: ( ) is year of survey. Source: WB (2002), World Bank databases: GDF & WDI central

This was the first rise in Korea’s Gini index since it was first calculated 20 years ago (MOFE 2002). Comparison with other OECD countries’ Gini index numbers clearly indicates the transition in Korean society. Before the 1997 crisis, Korea had belonged to the 0.20-0.30 group, with the welfare-state Nordic European counties, former socialist East European countries, and one Asian country (Japan). Following the crisis, Korea
jumped into the 0.30-0.40 group with most western European countries and is approaching the level of the U.S.

The wider income gap could be attributable to mass-unemployment, salary cuts, and the drop in asset values during the financial crisis. But after the recovery this trend did not cease. Increased income inequality has become a general trend stimulated by the spread of the merit payment system and the decline of the lifetime employment system, although the trend is expected to decelerate as the government bolsters the social safety net. Overall, the widening income inequality is one sign that the Korean society is shifting toward individualism from cooperativism/collectivism.

**Reduced Savings Rate**

Korea was well known for its high savings rate. Thrift and diligence are two pillars that supported the country’s rapid economic growth. The gross savings ratio, total savings over GDP, has been gradually dropping after reaching a peak of 40.5 percent in 1988. The downward trend accelerated following the financial crisis, dropping by 4 percentage points in 3 years from 33.9 percent in 1999 to 29.9 percent in 2001. Between 1990 and 1995 the rate had fallen 2 percentage points, from 37.5 percent to 35.5 percent.

The first signs of changing consumption and savings patterns appeared in 1996 and seemed to be in response to trade and capital liberalization. Koreans started to spend more on luxury imported goods and enjoy travel abroad. At that time, NGOs initiated a nationwide frugality campaign. Middle-aged and older people expressed concerns about erosion of moral values among the younger generation and demanded that they “tighten the belts and save more.” Due to the financial difficulties during the crisis, the rise in consumerism stopped, but after the recovery the patterns started to shift dramatically again. Now Koreans accept the trend in reduced saving and the frugality campaigns have not re-emerged.

The Koreans traditionally valued and emphasized their families. Parents have a duty to protect and help their children by supporting their education, wedding costs, and even
buying a house. Leaving behind assets for their children is a main goal of Korean householders’ saving. This ethic tempers current consumption and increases savings for the family. Increasingly there are signs of a shift toward a modern consumer society as Koreans increasingly begin to seek self-fulfillment rather than the future welfare of their family.  

Figure 8 Trend of the Gross Saving Ratio

![Figure 8 Trend of the Gross Saving Ratio](image)


**Cultural Change in the Labor, Corporate and Banking Sectors**

Some economists suggest that Korean labor-management relations have not changed even though institutional reforms were introduced. Labor tensions are again on the rise as restructuring accelerates. The number of labor disputes has risen, increasing to 250 in 2000 after decreasing dramatically from 322 in 1990 to 78 in 1997 (Figure 9). However, the number of workdays lost in these conflicts is not high compared with the early 1990s. In 2001 there were two joint strikes led by the Korean Confederation of Trade Unions (KCTU), but these strikes were smaller in scale and intensity than expected because the Korean Metal Workers’ Federation did not join the strike. This trend suggests movement to promote a new labor-management culture and try to avoid violent and hostile confrontations. Labor relations are still not satisfactory but seem to have improved.

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17 Another factor mentioned as contributing to the drop in the saving ratio has been the decline in interest
The movement of public attitudes toward individualism also had an impact on the culture within corporations and financial institutions. The relationship among affiliates in a chaebol began to change from that of unquestioning supporters to independent firms pursuing their own interests. For example, Hyundai Asan, which has been in charge of the Mt. Kumgang tours in North Korea, experienced financial difficulties. Politically this project contributed to reducing tensions between the North and the South, but economically the project was a failure and the business continued to lose money. The president of Hyundai Asan, who was also the owner of the Hyundai Group, asked Hyundai Merchant Marine, a profitable and healthy affiliate company of the group, to lend assistance to Hyundai Asan. Surprisingly, the CEO of Hyundai Merchant Marine, Kim Choong-shik, refused. Kim was determined to withdraw from the money-losing Mt. Kumgang tour project in order to focus exclusively on shipping.\textsuperscript{18} Until several years ago, it would have been difficult to imagine in Korea’s chaebol culture that a professional manager could refuse the owner’s request. This event is an indication that Korea’s chaebol culture is changing after the crisis.

\textsuperscript{18} Then-CEO of Hyundai Merchant Marine, Kim Choong-Shik, subsequently resigned. But the group’s creditor banks continued to monitor the owner’s involvement in other companies.
The move toward individualism has also influenced the relationship between banks and government and is reflected in banks’ lending practices. When Hyundai Asan requested help from its main bank, the Korea Exchange Bank also refused to extend further loans to the company. The Korea Exchange Bank was originally a private bank but has become a state-owned bank after the crisis. Before the crisis, it would have been very difficult to imagine that a government-owned bank would refuse to assist a government-supported business due to a lack of profitability. This is an example of the changes in banks’ lending practices, even though the overall level of change is not yet satisfactory.

Traditionally, Korea was close to cooperativism/collectivism. Under the influence of Confucianism, Buddhism and Taoism, Korean social values put priority on cooperation rather than competition, and egalitarian ideas prevailed bringing a reluctance to permit large income differences based on personal capacity. After the crisis, the Korean culture shifted toward individualism, which encourages competition and allows more material incentives based on achievements. As a result, individualistic behavior increasingly accompanied “market flexibility.”
V. Conclusion

It is obvious that some traditional public attitudes that were not consistent with the growing global culture contributed to the amplification of Korea’s financial crisis and obstructed efforts to implement structural reforms. Until now, cultural aspects of Korea’s difficulties have been neglected or passed over in analyzing the causes of the financial crisis with the claim that Koreans were just “victims of their own success.”

Korea’s financial crisis raises three questions: 1) Why did a healthy-looking Korean economy come to a crisis so suddenly? 2) Why did the Korean economy get worse despite the announcement of bailout programs? and 3) Why could Korea succeed in implementing reform plans so quickly? The answers to these questions are closely related to public attitudes. Regarding the last question, reform plans could be implemented so promptly after the crisis because Korea had already prepared and considered reform packages, including financial and labor market reforms, before the crisis. The Korean government had tried to pass the reform packages but failed to get sufficient public support. People were sympathetic to the working class and would not accept the introduction of a system with lay-offs.

As to the second question, when the financial crisis that had been caused by the depletion of foreign reserves and soaring exchange rates hit the economy, the coordinated actions by the IMF and other governments were expected to stop the outflow of funds from Korea. Despite substantial assistance from international organizations and other governments, Korea finally realized - late - that it needed to negotiate with private investors on the basis of individual firms’ profits. Koreans had to be convinced that the solution was to focus on individual firms’ interests and profits rather than on the cooperative measures of the past.

As to the first question, Korea’s system of mutual support and guarantees that emphasized solidarity among firms proved to be a vulnerability. When companies or
individuals ran into financial difficulty due to the business slump, the tradition of shared burdens set off a chain reaction of bankruptcies that spread throughout the economy.

What kind of public attitudes had obstructed earlier efforts to prevent the crisis? Compared to Western societies, East Asian culture is closer to the concept of cooperativism/collectivism than individualism. East Asian cooperativism/collectivism historically originates from the philosophies of egalitarianism and familism under the logic of harmony. Under familism, based on the Confucian principles of hierarchical order and responsibility, employees were loyal to companies and companies protected employees. This approach gives priority to seniority and led to the lifetime employment systems. Egalitarianism originated from Buddhism and Taoism and functioned as an incentive mechanism to promote self-improvement by its teaching that humans can step up the hierarchical ladder. Harmonization of the two ideologies in Korean culture emphasizes cooperation and collective values.

Why did East Asian behavior and values that seemed to work well until the 1980s produce problems in the 1990s? Before globalization, the Korean tradition of burden sharing through solidarity was an effective solution to overcome economic slumps. During the crisis some cooperativist/collectivist attitudes even helped to save nation. The gold collecting campaign was one example. Most citizens participated in this campaign by selling gold and items such as rings and gift keys to earn foreign currency. When the won/dollar rate was skyrocketing just after the crisis, selfish behavior would have been to purchase dollars to realize personal gain, but most Koreans sold dollars to help to stabilize won rate. When several merchant banks abruptly collapsed and two out of six major nationwide banks came close to bankruptcy, a financial panic did not happened because many depositors cooperatively controlled their withdrawals.

However, the extremely cooperativist/collectivist approach of solidarity, emphasizing human relationships, was not well suited to coping with the new era of globalization. Globalization creates opportunities for growth and efficiency gains by stimulating competition and rapid technological innovation, but it produces increased risks and
volatility at the same time. In a more competitive market economy, though, collective/collectivist linkages within the economy can amplify the spread of financial difficulties from a company to a whole business group, from a bank to the whole banking sector and eventually to the national level. As the importance of foreign factors in the national economy increased, Korea could not neglect foreign investors’ reactions. Foreign credit rating agencies did not appreciate the Korean approach. Koreans started to realize that the country needed to introduce more individualistic approaches to reassure foreign investors and to maximize the vitality of the market mechanism. This does not mean that traditional cooperativism/collectivism was wrong or bad but that it is not particularly compatible with the modern global market. Membership in the contemporary global market calls for a new balance between traditional cooperativism/collectivism and western-style individualism.

Changing public attitudes is very important to fully implementing Korea’s reforms. For western countries, “reform” often entails simply implementing new legal and institutional mechanisms or supplementing the existing framework. For Korea, reform will also require changing long-standing practices and mindsets. These cultural issues must be included in the reform process. Although Korea has implemented a new legal and institutional system, these reform efforts will be in vain if cultural practices are not changed. For example, because of the tradition of familism, managers rarely use layoffs, even if they are permitted. Further, the chaebols seem to find it difficult to refrain from helping their subsidiaries, just as bankers seem to find it difficult to stop helping friends who work for particular businesses. Additionally, because Korea is a small country, most managers in the supervisory authorities, external auditors, banks, and corporations graduated from the same schools or otherwise feel a personal relationship with those they supervise or work with. If supervisors, auditors, and corporate decision-makers emphasize friendship rather than professionalism, it will be very difficult to develop a viable system of supervisory oversight, even if Korea has an appropriate system of checks “on paper.”
With the success of economic development and the emergence of globalization, Korea has begun to assimilate some of the individualistic aspects of western economies, although it is difficult to change public attitudes and mindsets and the evolution often takes time. Reforms in the labor markets, including the introduction of lay-offs and the merit and contract-based salary systems, and revisions of the cross-guarantee system have contributed to the spread of individualism and its emphasis on individual performance and competition. Korea’s Gini index numbers indicate that egalitarian ideology has been rapidly breaking down and Korean society is moving closer to an individualistic society. The rapid drop of the savings ratio suggests a change in household behavior from saving for the family’s future to increased current consumption.

But changing culture is tremendously difficult and can lead to social problems. Although Korea has moved from cooperativism/collectivism toward individualism in a short period, Korean society has to face two new shocks that are caused by a clash between traditional and new cultures. The first shock is an education problem. Many parents have started to send their children abroad for study at an early age. The number of children studying abroad as early as elementary, middle and high school reached 20,145 in 2000, nearly twice the number from the previous year. As the economic paradigm shifts from an industrial economy to a knowledge economy, many Korean feel that the domestic educational system is not providing the education necessary to succeed in global markets. Although the Korean elite work hard and face extreme competition, their education will not be as useful if they are not familiar with English and western terminology. In addition, there is a clash between the new education system based on the market mechanism and traditional education based on Confucian values. The policy of uniform education introduced in 1974 is thought to have caused a significant decrease in scholastic abilities, and extreme competition for college admission led to a significant increase in spending for private tutoring. In addition, the curriculum reforms introduced in 1998 are widely thought to lead to a devastation of traditional Korean education.

The second shock is the middle class’s enervation and disillusionment. Most Koreans think they belong to the middle class and should enjoy the fruits of a stable society and
dynamic economy. For many years they devoted themselves to their jobs under the lifetime employment and seniority-priority system. During the boom years of the late 1980s and early 1990s they enjoyed additional income from bank deposits, stocks, and real estate investment. But now companies have moved to the new salary system, jobs are no longer secure, and returns from deposit, stock and real estate are substantially reduced. This new economic environment has led to a degree of hopelessness among many middle class people and reduced incentives to work hard. In the new economy, only few highly educated knowledge workers have attained great wealth. The middle class adjustment to the new economy has proven to be a challenge.

The 1997 crisis proved to be a watershed event for Korea. After the crisis, Korea appeared to become a different society. Public attitudes surprisingly and dramatically shifted toward individualism from cooperativism/collectivism, moving much closer to western culture. During the 1990s, Korea had been undergoing a number of profound changes in several areas. Its economy emerged as a leading industrial power, reflected in Korea’s inclusion in the OECD in 1995. Many traditional practices and attitudes, such as life-long employment and mutual support among businesses, had come under pressure in the face of global economic competition and finally collapsed in the wake of the crisis. Increasingly, Korea’s business practices and culture are converging toward an international culture disseminated by globalization while seeking a new balance between the new and traditional cultures.
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