

# BTI 2010 | South Korea Country Report

<b>Status Index</b>	1-10	<b>8.72</b>	# 12 of 128	
Democracy	1-10	8.90	# 12 of 128	➔
Market Economy	1-10	8.54	# 12 of 128	➔
<b>Management Index</b>	1-10	<b>7.24</b>	# 4 of 128	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Transformation Index (BTI) 2010. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 128 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	48.5	HDI	0.94	GDP p.c.	\$	26833
Pop. growth	% p.a.	0.3	HDI rank of 182	26	Gini Index		31.6
Life expectancy	years	79	UN Education Index	0.99	Poverty <sup>2</sup>	%	<2
Urban population	%	81.2	Gender equality <sup>1</sup>	0.54	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

## Executive Summary

There was much to celebrate in 2007, which marked the twentieth anniversary of democratic transition in the Republic of Korea (henceforth ROK or South Korea) – or so one would have thought. After all, democratic rules have become firmly established, several peaceful changes in government have occurred, civilian control over the military is beyond question, and judicial review has become institutionalized. In addition, South Korea boasts one of the most vibrant civil societies in Pacific Asia. The ROK has not only managed the transfer from conservative to progressive leadership (and back again) without any severe political strains but also weathered the severe financial and economic crisis of 1997 – 1998 without any danger of a relapse into authoritarianism.

Still, Korea was in no celebratory mood in 2007. While progressives in the ROK considered the country's politics to be insufficiently liberal and decried existing (and indeed growing) social inequalities, conservatives criticized then-President Roh Moo-hyun, complaining that not enough was done to advance the economy. During his term in office (2003 – 2008), President Roh indeed put most emphasis – eventually with only limited success – on domestic political reform issues (abolition of the National Security Law, introduction of a Commission on Truth and Reconciliation to clear past history, media reform aimed at curbing the dominant market positions of various media outlets, reform of private schools' governance), while the management of the national economy remained to a substantial degree on autopilot. Yet, with the economy growing by a respectable average of 4% per year during Roh's term in office, there was not objectively much to complain about.

Risks associated with the high degree of global interconnectedness of South Korea's economy became plain to see in 2008, when the ROK was first hit by a steep rise in energy prices and then, with a vengeance, by the global financial crisis. Incoming President Lee Myung-bak, who took office in February 2008, was denied the usual honeymoon period enjoyed by incoming

presidents. The new administration's unpopular and badly-communicated policy plans contributed to a series of massive protests against the government. The protests were triggered most immediately by health concerns related to the planned resumption of beef imports from the United States. But ROK citizens also had other grievances vis-à-vis the government. President Lee was forced into repeated apologies, a pledge to put his relations with the public on a better footing, and a retraction of pet policy ideas. The onset of the global crisis then undermined Lee's grandiose visions of propelling the economy and living standards to ever-new heights. The remainder of 2009 will in fact see a significant contraction of the economy. Lee's administration will now have to show that it possesses the management skills needed for containing and quickly overcoming the local effects of the global crisis. Concerned observers will also closely follow the Lee administration's attempts to quell rumor-mongering on the Internet and on the part of the media, watching for signs that the effort is degenerating into an authoritarian reflex to stifle the freedom of expression.

## History and Characteristics of Transformation

South Korea has served as a model of economic development since the 1960s. Socioeconomic modernization eventually led to democratic change in the late 1980s. The foundation for a successful market economy was laid by the authoritarian regimes of Presidents Park Chung-hee (1963 – 1979) and Chun Doo-hwan (1980 – 1988), both generals. Democratic transformation did not begin until the mid-1980s. At that time, a strong opposition movement led by Kim Young-sam and Kim Dae-jung successfully mobilized urban workers, students, intellectuals and the middle class. The combination of the opposition leadership's skillful political management, political failures by the ruling elite, and external constraints set by the U.S. government and the upcoming Olympic Games, forced the ruling generals to open their regime in June 1987.

Roh Tae-woo won the presidential race in free and fair elections in December 1987. During his term (1988 – 1993), democracy became the only game in town. The success of the transition to democracy was evident in 1993, when Kim Young-sam became the first civilian president after three decades of military dominance in politics. During his term (1993 – 1998), democratic reforms continued in the areas of civilian-military relations, electoral politics and the judicial system. Finally, the election of former dissident Kim Dae-jung as president in December 1997 demonstrated that all relevant forces had been integrated into the political system. In 2002, former labor lawyer Roh Moo-hyun became President. With Roh, a new generation of politicians entered the top echelons of South Korean politics and put an end to the rule of the so-called Three Kims – Kim Young-sam, Kim Dae-jung and Kim Jong-pil– who had dominated party politics since the 1970s.

Roh's lackluster performance in office coupled with economic growth perceived by many citizens as suboptimal paved the way for a return to conservative rule in South Korea. Lee Myung-bak, a former CEO of a construction company turned mayor of Seoul, easily won the presidential election in 2007. After 10 years of progressive rule, a new chapter in South Korea's democratic development was thus opened. In his first year in office, Lee first antagonized many citizens with unpopular and badly communicated policy proposals. He then proved unable to ward off the downturn of the South Korean economy, which had been badly hit by the global crisis starting in the latter half of 2008. Korea's transformation into a full-fledged market economy occurred gradually. Major liberalizing steps were undertaken in the 1980s, the early 1990s and most recently after the financial and economic crisis of 1997 – 1998. The key elements of state-led industrialization, which began in the 1960s, concentrated on strategic planning, government guidance of domestic economic actors, a selective approach to foreign direct investment and imports, and world market integration. A legacy of Korea's late and rapid industrialization remains in the pivotal position of the chaebol, or big business conglomerates, that have dominated economic activity ever since the 1970s.

South Korea was able to realize democratization during a high growth period based on a solid foundation of industrialization and social modernization. The avoidance of large-scale poverty, a fairly equal distribution of income, a well-developed social infrastructure and the emergence of a professional and effective public administration were positive legacies of the Korean developmental model that contributed to a smooth political transformation. In addition, democratic transformation occurred during a period of high economic growth. In 1997, however, the contagion effect of the "Asian crisis" reached South Korea. In the space of weeks, the Korean currency devaluated drastically. Accordingly, the value of foreign currency loans held by private banks and companies skyrocketed. To escape the collapse of the Korean financial markets, the government turned to the IMF. An Economic Development Program prevented a collapse, but imposed painful reforms on politics, economy and society. Prompted by the Asian crisis, and in close cooperation with foreign donors, the government implemented far-reaching reforms in the banking and financial sector, the institutional hardware of the economy, corporate governance and the welfare system. While these reforms have helped to overcome the crisis, diminish corruption and broaden the formerly negligible social security net, challenges remain, especially with regard to rooting out corrupt practices in business and politics and bracing for the coming demographic juggernaut: the rapid aging of the population, a phenomenon that goes hand-in-hand with a declining fertility rate.

## Transformation Status

### I. Democracy

#### 1 | Stateness

The state's monopoly on the use of force is not threatened or questioned by domestic actors. South Korea is involved in a territorial dispute over the Tokdo islet, which it controls but which is also claimed (under the name of Takeshima) by Japan. However, the dispute does not threaten the integrity of the nation.

Monopoly on the use of force

A vast majority of the population supports the country's constitution and the existence of South Korea as a nation state. Minor radical splinter groups continue to pay allegiance to North Korea. Ethnic, religious or cultural minority groups (insofar as they exist at all) are not denied basic political rights.

State identity

The state is defined solely in secular terms. Religious dogmas have no visible impact on politics or the law.

No interference of religious dogmas

The administrative structure of the Korean state is highly differentiated, while the bureaucracy is very professional and merit-based. E-government services have been introduced on a large scale in recent years. There are no regional or other enclaves ruled by non-state actors. Tax evasion by corporate and other actors remains a problem and leads to recurrent scandals.

Basic administration

#### 2 | Political Participation

Elections at the national, regional and local levels are held in a free and transparent manner. Though elections are still fairly cost-intensive for the political actors involved, the extent of money-driven politics during elections has declined substantially in recent years.

Free and fair elections

Elected rulers have the effective power to govern. There are no veto players that lack a constitutional basis.

Effective power to govern

The freedoms of association and assembly are in principle respected. However, South Korea has not signed four of the basic conventions of the International Labor Organization, including two on the freedom of assembly. The government has repeatedly denied selected groups of employees the right to form unions, most recently migrant workers. It is also very difficult to call a strike that would be legal by official definitions. Demonstrations also require approval, which can be hard to come by as anti-government protestors learned in spring and early summer 2008. As noted by the Asian Human Rights Commission, assemblies by those who oppose government policies are generally not allowed, while those who support government policies can even count on police protection for their assemblies.

Association /  
assembly rights

The freedoms of opinion and the press are constitutionally guaranteed, but recent illiberal trends give cause for concern. Major restrictions on the freedom of expression are focused on activities in favor of North Korea (real or construed). The National Security Law (NSL) is from time to time used to prosecute persons advocating positions that are seen as favoring the North (and thus undermining the legitimacy of the ROK and its policies). This law has led to a certain degree of self-censorship on the part of the media and other actors. Information-gathering by the media on government activities is also circumscribed by the system of press clubs, which are attached to the various ministries. Media that are too critical of government actions can be excluded from individual press clubs. Most newspapers and news stations exhibit a conservative outlook on political affairs. The conservative tendency of the daily newspapers has been somewhat balanced in recent years by alternative online news and information resources including the online newspaper OhmyNews, which receives its articles from so-called citizen reporters. Steps taken in 2008 by the Lee Myung-bak administration to criminalize rumors (concerning individuals and institutions) spread via the Internet suggests that the new government is trying to constrain the freedom of expression that bloggers have so far enjoyed. Press freedom also took a blow in 2008 when the chief executive officer of public broadcaster KBS was dismissed for alleged misinformation of the public concerning the health risks of beef imported from the United States.

Freedom of  
expression

### 3 | Rule of Law

South Korea's constitution provides for substantial powers of the executive in general and of the president in particular. The president can initiate legislation (via the State Council, essentially the cabinet), issue decrees and veto legislation. The president's power is strongest when the governing party controls a majority in the unicameral parliament. Although this has been the case since the parliamentary elections of April 2008, temporary parliamentary boycotts by the opposition prevented the president from making full use of the potential for pursuing legislative action until early 2009.

Separation of  
powers

The South Korean judiciary is highly professionalized and fairly independent, though not totally free from governmental pressure. In particular, state prosecutors are from time to time ordered to launch investigations (especially into tax matters) aimed at intimidating political foes or other actors not toeing the line. The Constitutional Court has underlined its independence through a number of landmark rulings. Rulings by the Constitutional Court are accepted by all political actors. However, there were no major politically sensitive rulings in the 2007 – 2008 period.

Independent  
judiciary

Pressured by a civil anti-corruption movement, which was launched in 1996, the Korean government enacted an anti-corruption law in June 2001. In May 2003, a general code of conduct for public officials went into force at central and local administrative organs, and at education authorities. The Korea Independent Commission Against Corruption, established under the Anti-Corruption Act, handles whistle-blowing reports, recommends policies and legislation for combating corruption, and examines the integrity of public institutions. The Public Service Ethics Act is designed to prevent high-ranking public officials from extracting financial gains related to their duties during or after their time of employment.

Prosecution of  
office abuse

Vigilant civil society organizations regularly conduct surveys of how parliamentarians fulfill their duties. “Blacklisted” candidates running for office face problems in parliamentary elections. Though far from perfect, the blacklisting system has helped to increase voters’ awareness of problems. However, lawmakers who have been convicted for illegal fundraising and other illicit activities sometimes benefit from the presidential amnesties that are granted every year (as was the case in August 2008).

Civil rights conditions in South Korea have improved dramatically since the onset of democratization. However, a number of problems remain. Among the most serious issues are the inadequate rights enjoyed by migrant workers, the widespread physical abuse of sex workers, the imprisonment of conscientious objectors, and the continuing use of the NSL to detain and imprison individuals believed to be sympathetic to North Korea’s communist ideology. On a more positive note, a moratorium on executions announced in late 1997 has remained in place.

Civil rights

#### 4 | Stability of Democratic Institutions

Adversarial relations between political parties led again to parliamentary logjams on a number of issues in 2007. In one noteworthy case, National Assembly opposition to President Roh’s proposed constitutional revision of the presidential term of office forced Roh to postpone (and eventually abandon) the proposal. After April 2008, new President Lee Myung-bak possessed a majority of his own in the parliament, in

Performance of  
democratic  
institutions

theory promising a smoother functioning of parliamentary procedures. However, repeated displays of physical violence clouded the prospects for more business-oriented parliamentary proceedings. Between June 2008, the inauguration month of the newly elected parliament, and the end of that year, only nine bills could be approved.

The National Assembly remains in many ways an archetypical arena parliament in which parliamentary committees play only a minor role in terms of sorting out positions and reaching compromises. During the period of review, opposition parties used their constitutionally enshrined inspection and deliberation rights to keep the government in check, sometimes producing legislative stalemates. While the current balance of power in parliament helps to check the executive, the price is recurring gridlock. Korea's justice system also has some problematic aspects. These include the lack of a comprehensive civil code, which means that even minor transgressions become a crime. Also problematic are the vast powers of prosecutors.

There is no substantial support for non-democratic alternatives to the current political system. Unless dramatic developments occur (e.g., a rapid unification with North Korea that runs out of control), all relevant political actors will continue to accept democratic institutions as legitimate. However, the massive anti-government protests occurring in Seoul in 2008 also showed that a substantial number of citizens feel their interests are not sufficiently represented by existing formal democratic institutions. Moreover, the fact that opposition politician politicians joined these rallies casts doubts on the unconditional acceptance of indirect (i.e., representative) democracy on the part of policymakers who happen not to belong to the majority in parliament.

Commitment to democratic institutions

## 5 | Political and Social Integration

Until the beginning of the new millennium, all major South Korean parties were basically run by powerful individuals with strong regional links. Parties were founded, fused, renamed and dissolved largely at will, leading to a relative high degree of voter volatility. The ruling Grand National Party, which has now been around for more than eleven years, is the only party that might be considered institutionalized. Ideological polarization of the party system has remained limited due to the absence of genuinely extremist parties. The fragmentation of the party system has also remained moderate since the onset of democratization (it stood at 2.36 in 2004, the most recent figure available). The jury is still out as to whether the progressive-conservative cleavage that has become more visible in recent years will lead to a higher degree of institutionalization of parties and the party system as a whole.

Party system

Business and labor are well represented by networks of interlocking and sufficiently staffed interest groups. The unionization rate, which had been declining since 1990, increased slightly in 2008 to 10.8%, in large part due to the legalization of the Government Employees' Union. Most unionized employees belong to company unions; more broad-based unions exist only in some sectors (e.g., among metal workers). Corporate interests are organized in a few high-level organizations connected to the conservative political establishment. There are also numerous civil society organizations (CSOs) in South Korea, which often have clear-cut political agendas. Personal networks link former pro-democracy and human rights activists in society and the political system. On the conservative side of the political spectrum, similar networks (often based on marriage or alumni ties) link societal and political actors. Opposing collective interests tend to clash with each other, and there are no institutional devices or norms that might help to bridge differences. Attempts to bring together opposing parties, such as the establishment of a tripartite commission (including representatives of the state) for labor relations, have largely floundered.

Interest groups

Repeated surveys have shown that South Koreans overwhelmingly support democracy, even though many citizens have misgivings about the actual performance of individual political institutions. Trust in political parties continues to be low, and the authority of the office of the president has also visibly declined in recent years. As witnessed by the massive anti-government protests in 2008, the gulf separating the president from discontented citizens further widened after the inauguration of President Lee Myung-bak, who alienated many South Koreans with unpopular, badly communicated policy ideas and decisions.

Consent to  
democratic norms

Reflecting the general vibrancy of South Korea's civil society, there are many voluntary associations engaged in self-help activities. A substantial number of these groups are linked to religious organizations. Such self-help associations complement informal (school- and university-based, or regionally oriented) networks, which are often relied upon. South Korean society's capacity for collective action was thrown into the spotlight in late 2007, when a disastrous oil spill left 40 kilometers of coastline soaked in crude oil. Environmental NGOs worked together with the government and ordinary citizens to organize a massive clean-up campaign. More than 300,000 volunteers from across the country participated in the relief effort. However, there is no culture of trust-based interactions between capital and labor. Still, the number of labor disputes has declined substantially in recent years, falling from 462 in 2004 to 115 in 2007.

Associational  
activities

## II. Market Economy

### 6 | Level of Socioeconomic Development

South Korea's rapid industrialization process, from the mid-1960s onward, was coupled with a fairly equitable distribution of income. The country's extraordinary growth trajectory came to a halt when the financial crisis that struck the country in 1997 developed into an economic crisis. Even though the immediate crisis was quickly overcome, job security has declined significantly since. In 2007, temporary workers accounted for 28% of the total workforce, around double the OECD average. In fact, the ROK exhibits the second-highest share of temporary workers (behind Spain) among OECD countries. Temporary employees' incomes average just 60% of permanent employees' salaries. Though income disparities in South Korea are still lower than in many other developing and newly developed countries, their recent rise – the Gini coefficient for household income rose from 0.296 in 1996 to 0.352 in 2007 – threatens the equitable development pattern that has been a hallmark of Korea's economic "miracle." According to the OECD, rising inequality has contributed to a rise in the rate of relative poverty to 14.6% in the mid-2000s, well above the OECD average of 10.6%, and the sixth-highest level in the OECD area.

Socioeconomic  
barriers

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	721975.3	844863	951773.5	<b>1049236</b>
Growth of GDP	%	4.6	4.0	5.2	<b>5.1</b>
Inflation (CPI)	%	3.6	2.8	2.2	<b>2.5</b>
Unemployment	%	3.7	3.7	3.5	<b>3.2</b>
Foreign direct investment	% of GDP	1.3	0.7	0.4	<b>0.2</b>
Export growth	%	19.7	7.8	11.4	<b>12.6</b>
Import growth	%	11.7	7.6	11.3	<b>11.7</b>
Current account balance	\$ mn.	28173.5	14980.9	5385.3	<b>5954.3</b>

		2004	2005	2006	2007
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
Total debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	0.1	0.9	1.1	<b>4.3</b>
Tax Revenue	% of GDP	14.2	14.7	15.2	<b>16.6</b>
Government consumption	% of GDP	13.3	13.9	14.5	<b>14.7</b>
Public expnd. on edu.	% of GDP	4.6	4.4	-	-
Public expnd. on health	% of GDP	2.9	3.2	3.6	-
R&D expenditure	% of GDP	2.8	3.0	3.2	<b>3.5</b>
Military expenditure	% of GDP	2.3	2.4	2.4	<b>2.4</b>

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security.

## 7 | Organization of the Market and Competition

South Korea's economy has been substantially liberalized in the past two and a half decades, with the most recent wave of liberalization occurring after the financial crisis of 1997. The basic market economy parameters are intact. Prices can be freely set and the currency is fully convertible. There are no significant entry or exit barriers to domestic companies, and entry barriers to foreign companies have been significantly lowered since the 1990s. Smaller companies face difficulties in procuring finance – a problem deepened by the credit crunch resulting from the global financial crisis starting in the latter half of 2008 – and finding adequate employees. However, these problems are not (or are only marginally) due to government restrictions.

Profits can be freely used and transferred by domestic enterprises, but foreign enterprises which earn substantial profits through the sale of domestic assets often create popular backlashes which, in turn, can cause the government to intervene. In a recent high-profile case, South Korea's Financial Services Commission refused to approve the sale of Korean Exchange Bank (KEB) by the U.S. hedge fund Lone Star to HSBC Holdings. In June 2008, an appeals court finally cleared Lone Star of accusations of stock tampering, which had allegedly occurred after the original KEB purchase in 2003. In the end, the envisaged deal between Lone Star and HSBC failed to materialize due to differences between the two companies over the sale

Market-based  
competition

price. Lone Star will now have to come up with a different exit strategy, which may see KEB being bought by another South Korean bank.

Although there are no exact statistics, the Korean informal sector is said to be the largest among OECD countries. According to the International Confederation of Trade Unions, 80% of the more than two million workers in the country's construction industry are irregular workers.

As a consequence of Korea's "condensed" industrialization process, in which the formation of the large-scale chaebol conglomerates was actively promoted by the state, there still is a high degree of industrial and market concentration. Government efforts to rein in the conglomerates have been haphazard since the 1990s, as the government has avoided putting too much pressure on enterprises deemed vital to the country's economic development. Regulatory reform was stepped up in the aftermath of the financial crisis of 1997. Overall, the Korean government has steadily, if not always consistently, raised the country's competition regime towards global standards. In 2007, the Korea Fair Trade Commission actively promoted amendments to the Monopoly Regulation and Fair Trade Act. The new regulations imposed stricter sanctions against abusive practices by market-dominant enterprises, and identified and corrected a host of cartels. A special focus was put on regulatory inconsistencies in the food market, and on the often difficult relationship between large conglomerates and their subcontractors. According to the Global Competition Review and its assessment of the world's competition authorities in 2008, the KFTC was ranked 1st in Asia and 10th in the world.

Anti-monopoly  
policy

Korea has made efforts to further liberalize its trade and investment regime since the 1997 financial crisis. The tariff structure nevertheless remains complex, with industrial tariffs being fairly low while agricultural tariffs remain fairly high. Out-of-quota tariffs apply to many other commodities. In the past couple of years, Korea has been actively pursuing bilateral trade deals. Agreements with Chile (2005), Singapore (2006), the European Free Trade Association (EFTA, 2006) and ASEAN (2007) have already entered into force. Free trade agreements with the United States, the European Union and Peru are either pending or under negotiation.

Liberalization of  
foreign trade

The share of bad loans in the portfolios of banks operating in Korea has been reduced significantly in recent years. All banks now meet the international standards set by the Basel accords. However, the deepening economic slump in South Korea will lead to the souring of more loans, potentially undermining the successes of the recent past. The onset of the global financial crisis also threw the huge short-term foreign debt held by banks based in South Korea (\$182 billion as of January 2009) into the limelight. In the face of the crisis, South Korean banks increasingly experienced difficulties in securing foreign exchange liquidity. The government had to tap into its \$240 billion (as of fall 2008) in foreign exchange reserves to provide alternative sources of liquidity (an option that did not exist to a

Banking system

comparable degree when the Asian financial crisis hit the ROK in 1997). Still, Moody's Investors Service lowered the rating outlook for the ROK's four major banks from stable to negative. In addition, private indebtedness levels remained high in 2007 – 2008, worrying foreign and domestic lenders. Despite the government's attempts to quell worries, international concern over a new financial crisis in South Korea was on the rise in early 2009.

Capital markets are open to domestic and foreign actors, and foreign banks now play a prominent role in Korea's financial industry. In 2008, 35 foreign banks operated 53 bank branches in South Korea.

## 8 | Currency and Price Stability

In terms of exchange rate policy, Korea's legally independent central bank (the Bank of Korea, BOK) has for many years followed a broad managed-float strategy combined with an inflation target. Inflation has essentially remained low and the annual consumer price index (CPI) rose by an annual average of only 2.4% from 2004 to 2007. In 2008, in the face of rising energy prices and the subsequent onset of the global financial and economic crisis, the exchange rate of the Korean won worsened considerably, and CPI growth almost doubled to 4.2%. In reaction, the BOK switched its priority from price stability to growth stimulation and the need to shore up financial markets. The bank cut its policy interest rate in several steps to a record low of 2.5%. The government announced additional measures aimed at assisting commercial banks to boost their capital base. It remains to be seen whether further measures will follow, and how the exchange rate policy will be handled after the immediate crisis passes. Regardless of the outcome, informal governmental pressure on the BOK is bound to continue.

Anti-inflation /  
forex policy

Korea's national budget saw moderate spending increases in 2007 and 2008, with above-average increases in the areas of defense and education. Spending growth exceeded revenue growth, inevitably leading to a rise in the national debt. Overall, national debt was predicted to reach around 312 trillion won or 33.7% of GDP at the end of 2008. Per se this is not alarming (the estimated 2008 OECD average is 75.4%) but the pace of debt accumulation is remarkable: At the end of 2000, overall debt amounted to 19.2% of GDP while in 1996, before the financial crisis, the relevant figure stood at 5.7%. With the global financial and economic crisis hitting South Korea hard – the economy is set to decline in 2009, with estimates in early 2009 ranging from -2% to -7% – the country's overall macroeconomic situation is expected to worsen substantially in 2009. A massive stimulus package, which will again negatively impact on Korea's national public debt, was under negotiation in early 2009.

Macrostability

## 9 | Private Property

Private property rights are generally well protected in South Korea, and expropriation is highly unlikely. However, legal proceedings on contractual matters can be slow. Skyrocketing real estate prices have led in recent years to a public debate as to whether real estate should be regarded as a kind of public property, with subsequently restrictive regulations on use. So far, however, official regulations governing real estate basically reflect international standards (e.g., restrictions on floor area ratio, environmental and height regulations).

Property rights

Private enterprises are regarded as the engines of growth in South Korea. Full public ownership is largely limited to public utilities. Still, the state is involved in around a hundred state-run enterprises and investments. Ambitious privatization plans presented by the incoming Lee Myung-bak administration were soon scaled down in the face of public opposition and falling stock prices. In August 2008, the government presented a list of 41 state-owned enterprises and investments, which it plans to privatize or divest in the future. Inter alia, the state aims to privatize 25 state-run and state-owned enterprises (including the Korea Development Bank and the Industrial Bank of Korea), merge two others and adjust the functions of two additional enterprises.

Private enterprise

## 10 | Welfare Regime

Since the late 1990s, South Korea has undertaken a number of steps toward the establishment of a social security net that includes public insurance schemes for sickness, pension, accident and unemployment. However, entitlements are generally restrictively defined, and cover only the bare minimum for a limited amount of time. Recently, the authorities have expanded the proportion of persons eligible for unemployment benefits. As of 2008, the impact of taxes and transfers in reducing poverty in the ROK was by far the weakest among OECD countries.

Social safety nets

In principle there is no discrimination on the basis of race, religion, gender, age or ethnicity. In reality, migrant workers, handicapped persons, refugees from North Korea, women and young professionals face difficulties in terms of legal protection from abuse, access to job opportunities and/or just and equal payment. The public is slowly becoming more aware of problems concerning the (mis)treatment of migrant workers. Refugees from North Korea receive initial guidance and benefits but are then basically left to their own devices. An increasing number of equal opportunity programs for women are in place, but much remains to be done in practice (see special section in BTI country report 2008).

Equal opportunity

The unequal treatment of Korean women is reflected in various UNDP data. While

South ranked 25th in the 2006 UNDP's Human Development Index (HDI) and 26th in the 2006 Gender-Related Development Index (GDI), the country only ranked 68th (out of 108 countries) with respect to the Gender Empowerment Measure (GEM), which focuses on women's roles in economic and political life.

## 11 | Economic Performance

On the back of strong exports and domestic consumption, South Korea enjoyed steady annual growth of around 4% to 5% between 2004 and 2007. In the first half of 2008, inflation increased due to rising energy prices, while equity prices and the value of the won fell considerably. The economy started to slow considerably during the second half of the year, as a result of the global financial and economic crisis. General macroeconomic data began to weaken. South Korea's trade balance and current account balance deficits widened as import prices fell fast. Unemployment and public debt remained largely unaffected in 2008, but are likely to increase in 2009. With the global financial and economic crisis continuing, export-oriented Korea is posed to experience a further slowdown in its economic activity in the first half of 2009, and will probably not recover before 2010. In early 2009 the government was poised to implement an economic stimulus package aimed at fighting the economic downturn through investments in infrastructure and education.

Output strength

## 12 | Sustainability

As of 2008, South Korea was the world's 10th largest energy consumer, but only its 13th biggest economy. The government has strengthened environmental laws in recent years. Korea has also reduced emissions of major air pollutants such as sulfur oxides and has improved water quality and waste recycling. Heavy investments have been made in renewable energy research. Spending on the environment amounted to over 2.4% of GDP in 2008. Much remains to be done, however. In autumn 2006, the OECD called on South Korea to a) strengthen its international environmental cooperation, in particular on ozone layer protection, greenhouse gas emissions and marine issues; b) carry out a green tax reform, identify environmentally harmful subsidies and strengthen the use of economic instruments; c) integrate water quality and quantity management programs, fully implement its water reform, and use pesticides and fertilizers more efficiently, d) better integrate environmental concerns into energy and transport policies, and improve efficiency in energy and material use; and d) increase efforts to protect nature, biodiversity and the landscape, both as assets for recreation and tourism and for the provision of services such as flood protection.

Environmental policy

South Korea's expenditures on education (7.2% of GDP in 2005) are well above the OECD average. A large part of these costs is borne by private individuals (3.0% of GDP in 2005); families spend vast sums on the education of their children. Also, in terms of R&D investment (2.9% of GDP in 2005), Korea is among the leading group of countries. However, there are problems: 1) Much of the private investment on education is spent on expensive cram schools; 2) Research cooperation between universities and enterprises is scarce; 3) Many Korean universities suffer from quality problems; 4) Korean universities in general are not very attractive to foreign researchers and students; 5) There is a mismatch between the demand of employers and the skills provided by universities; and 6) There is little interest in life-long learning.

Education policy /  
R&D

# Transformation Management

## I. Level of Difficulty

The structural constraints on governance in South Korea are low (except for the perpetual challenges posed by North Korea). In terms of territory, the ROK is a fairly compact nation with nearly half of the population and economic activity concentrated in the greater Seoul area. Living standards are similar to those in a number of other OECD member states, with the per capita income in 2007, at purchasing power parity, estimated to be \$24,750 dollars (higher than in Portugal or the Czech Republic but lower than in Slovenia or New Zealand). Korea is not much affected by natural disasters or pandemic infections; about 13,000 people were estimated to be living with HIV/AIDS in 2007. In the 2008 U.N. Education Index, Korea was ranked at a remarkable 7th place (with a score of 0.988, between Norway and Ireland).

Structural  
constraints

South Korea boasts what is perhaps the most vibrant civil society in Pacific Asia. Civil society organizations (CSOs) have taken an active oversight role in monitoring and assessing the activities of government and companies. Most CSOs focus on domestic issues, so there is not much activity with regard to transnational issues. Tellingly, South Korea's most well-known activists in the international stage have been farmers protesting against the liberalization of Korea's trade regime. The demonstrations against the resumption of U.S. beef imports in 2008 underlined the strength of CSOs. South Korea has no culture or tradition of trust or compromise-oriented settlements between opposing groups. Confrontations between groups (especially in the case of labor disputes) can become militant at times.

Civil society  
traditions

There are no deep-seated religious or ethnic cleavages in the South Korean society. Regional fault lines have become weaker (in terms of development disparities) but still affect electoral politics. The recent rise in social and income inequalities has raised public concern, and might develop into more genuine cleavages. The question of how to deal with North Korea divides the population, with disagreements on this issue overlapping with intergenerational differences. It remains to be seen whether this division will develop into a structural cleavage affecting politics in the long term.

Conflict intensity

## II. Management Performance

### 14 | Steering Capability

The South Korean political leadership is committed to constitutional democracy, notwithstanding recent attempts of the Lee Myung-bak administration to provide the state with greater control and monitoring rights (e.g., monitoring of cell phone calls and Internet activities, prohibition of mask-wearing during demonstrations). The government is able to prioritize political activities and follow long-term political agendas. Such agendas can, of course, be embedded in broader ideological frames (e.g., a basic belief in the efficiency of market-based solutions and schemes, as in the case of the current Lee Myung-bak administration). The economy's high dependency on global capital and trade linkages and the pronounced domestic role of large-scale conglomerates limits South Korean governments' array of available policy options to some extent, though not decisively (except perhaps in times of deep economic crises). The government is generally committed to the idea of a market economy combined with social safeguards, and has sought to expand the existing social network when state resources permit.

Prioritization

The government is committed to constitutional democracy and the market economic system. However, partisan and adversarial politics in the parliament, as well as the need to yield to public pressure and short-term requirements, render the implementation of reform measures in these two fields inconsistent at times. At the time of this writing, there were no important reform items on the political agenda which would affect the political system or the overall framework of the economy in a decisive way.

Implementation

Orthodoxy usually prevails when it comes to assessing past policies. A change in any policy linked to the identity and interests of political actors is seen as the equivalent of defeat. The partisan, and more often than not adversarial, approach to party politics buttresses such an attitude. Major policy shifts are usually the result of a change in government, popular attitudes that can no longer be ignored by the incumbent government, and/or external shocks and pressure.

Policy learning

### 15 | Resource Efficiency

Nearly 97,000 new public servants were hired during the Roh Moo-hyun administration (2008 – 2008). Nevertheless, public employment (as a percentage of

Efficient use of assets

the workforce) in South Korea is well below the OECD average, as is government spending as a percentage of GDP. Public debt has been rising in recent years but remains at manageable levels (see section 8.2). Civil servants are, with few exceptions, hired, promoted and paid in line with transparent and merit-based standards. The office of the Ombudsman of Korea has the authority to conduct investigations into grievances submitted by the people. However, the current system does not give the Ombudsman any statutory authority to open investigations on its own initiative. Likewise, the Ombudsman's recommendations for corrective measures have no legally binding character for the government agency under review.

Despite decentralization moves undertaken in the 1990s, South Korea remains a fairly centralized polity, with power concentrated in the executive. Provincial governments, although they to some extent have their own functions, basically serve as an intermediary between the central and municipal governments. Local governments depend heavily on the central government for decisions, as well as for funding of their roles and functions, organization, personnel, and budgets. Their main function is to implement centrally determined policies and programs as directed, and as guided by central government ministries and agencies. Local governments do not have their own judiciary, prosecution, police, or education systems. The continuing high degree of centralization allows for largely coherent implementation of policies. Likewise, interministerial squabbles do not affect overall policy-making in a substantial manner.

Policy  
coordination

Despite strengthened government and continuous civil society organization attempts to root out corruption, corruption is still perceived to be common in South Korea. Such perceptions were bolstered recently by a high-profile case involving former Samsung Chairman Lee Kun-hee, who in July 2008 was found guilty by a district court of large-scale tax evasion and sentenced to a suspended three-year prison term and a fine of \$110 million. At the same time, he was cleared of breach-of-trust and bribery charges. The allegations against the former tycoon became public when a high-level corporate whistleblower stated that several Samsung companies had created bank accounts to stash funds used for bribing influential South Korean citizens. Lee received a fairly lenient ruling after he resigned as chairman of the 59 Samsung companies, and agreed to repay taxes. Lee might eventually be pardoned by the president of the ROK, as many CEOs have been before him. In August 2008, for example, President Lee Myung-bak pardoned 74 businessmen as part of the sweeping annual amnesty program announced in celebration of Liberation Day. Included among the pardoned was former Hyundai Motor Chairman Chung Mong-koo, who was convicted in 2007 of maintaining a slush fund to bribe government officials. The recurring amnesties of convicted CEOs regularly raise questions about the sincerity of the government's determination not to tolerate illicit business behavior.

Anti-corruption  
policy

## 16 | Consensus-Building

All major political actors in South Korea subscribe to the goal of maintaining a constitutional democracy as conceptualized by the BTI, even though authoritarian tendencies can still be witnessed within political organizations. All political actors also agree in principle to the aim of establishing a socially responsible market economy, implying “not only free markets and property rights, but also principles of social justice, responsibility and sustainability” (BTI), though there is variation in what political actors understand by the latter three principles. In particular, social justice is defined differently by unions and their political representatives on the one hand, and corporate lobbying organizations on the other.

Consensus on goals

There are currently no anti-democratic veto actors in South Korea. It is unclear whether an unforeseen major crisis, such as a chaotic process of reunification with the North, might give rise to anti-democratic activities by potential veto actors (including the military).

Anti-democratic veto actors

Ethnic, class or regional conflicts did not figure prominently in South Korea in 2007 – 2008. Growing resentment among South Korean Buddhists (a population of about 10 million, compared to 13.7 million Christians, the ROK’s dominant religion) over what they perceive as a “Christianity-first policy” on the part of the Lee Myung-bak administration culminated in a mass rally in Seoul, attended by tens of thousands of participants – including 7,000 monks – in late August 2008. Buddhist orders have accused Lee, an elder at a Presbyterian church, of favoritism (13 of the 16 members of the president’s first cabinet were Christians, a group that included individuals from the president’s own church, while only one was a Buddhist) and of using the government as a “proselytizing tool.” Buddhists were also angered by the fact that an official map of greater Seoul marked Christian churches but not Buddhist temples. The rise of anger among Buddhists reflects a sense of crisis over their declining influence in South Korean society. President Lee subsequently made some conciliatory gestures towards Buddhist leaders. Genuine sectarian strife in South Korea seems unlikely, as no side is interested in conflict escalation. However, the protests by Buddhists and the preceding mass protests against the government in spring 2008 signal that the government has to improve its relations with groups outside the circles of the ruling elite.

Cleavage / conflict management

The administration of former President Roh Moo-hyun (2003 – 2008) took civil society organizations seriously, and made repeated attempts to incorporate their ideas into official policy. Members of civil society were given high-profile posts in the cabinet and in advisory commissions. The Lee Myung-bak administration is unlikely to continue this inclusionary approach. Notably, during his first year in office Lee exhibited a pronounced top-down approach to policymaking. As a consequence, CSOs are likely to agree (even) less than before with government policy.

Civil society participation

The ghosts of the past still continue to haunt South Korea both in terms of domestic and bilateral relations (especially with Japan). Talk of the past can be a hot-button issue, as opinions about the authoritarian Park Chung-hee era (1961 – 1979) and its legacy, to take one example, diverge sharply. While recent attempts by private organizations to compile lists of collaborators during the Japanese colonial period are in principle necessary and useful, examinations of the past sometimes become intermeshed with present-day politics (e.g., the former leader of Korea's ruling GNP is the daughter of Park Chung-hee). The ongoing debate about collaboration shows that the colonial past not only can be used to conjure up mythical stories of struggle and redemption (witness the attempts by North Korea to foster a pan-Korean national consciousness) but can also be used as a political football in South Korea. A truly bipartisan approach at reconciliation remains a long-term goal that seems for now unreachable. Indeed, the recurrent problems in dealing with the past perhaps bode ill for the future, as what may be the nation's biggest challenges – how to deal with wrongdoings in North Korea, and the problems of assessing the North's political history – are yet to come.

Reconciliation

## 17 | International Cooperation

South Korea no longer receives official development assistance (ODA). It has hosted a number of international development conferences and has expanded its own ODA to other countries. Such assistance nonetheless remains miniscule in relative terms (0.05% of GNP in 2006) and also small in comparative terms (South Korea provides the lowest ODA volume of all OECD countries). Due to its solid macroeconomic fundamentals (and establishing a clear difference between the present day and the Asian financial crisis in 1997), South Korea did not ask for emergency funds from the IMF during the global financial and economic crisis of 2008.

Effective use of support

Commercial risk ratings have improved substantially since the financial and economic crisis of 1997 – 1998. The South Korean government, for its part, is seen as a reliable and trustworthy partner on the international stage. The country's positive international reputation was underlined in late 2006 when former South Korean Foreign Minister Ban Ki-moon was chosen as the new secretary general of the United Nations.

Credibility

South Korea actively participates in regional and interregional initiatives, as well as in institutions at the regional level such as APEC, ASEAN + 3, the ASEAN Regional Forum (ARF), the Asia-Europe Meeting (ASEM), and the six-party talks on North Korea. South Korea is also actively engaged in expanding monetary cooperation in East Asia and in negotiating a host of bilateral free trade agreements. Korea's geographical position (the peninsula is surrounded by major regional powers) acts as a spur for South Korean attempts to speed up both regionalism and

Regional cooperation

regionalization in East Asia and the broader Asia Pacific. For domestic reasons, South Korean governments occasionally play the history card in relations with Japan.

## Strategic Outlook

The global financial and economic crisis, which started in 2008, has hit South Korea with full force and will lead to a significant contraction of the country's economy in 2009. Dealing with the immediate effects of the crisis will require concerted efforts on the part of all actors concerned. As the world's 13th biggest economy, Korea should also engage in dialogue with its partners in the G-20 group in order to contribute to the debate on a new financial and economic world order. On the back of the lessons learned during the financial and economic crisis of 1997 – 1998, the latest crisis should be seen as an opportunity, and further long-term economic reforms undertaken. Effective crisis management hinges on the ability to generate trust. This in turn requires comprehensive and consistent government communications with regard to the rationale and implications of measures taken in the face of crisis. However, the anti-beef protests in mid-2008 showed that the current government lacks a proper public communication strategy. While Korean leaders have historically privileged a top-down approach to decision-making, more public debate and political participation are needed. This is especially true with respect to involving younger generations and women, who are still underrepresented in politics.

Increasing social and economic inequalities, including the widening gap between rich and poor, pose a serious threat to social peace in South Korea. Much has to be done by the government in the coming years to assure that wealth is (again) redistributed equitably. In this respect, the existing gaps between urban and rural areas also should be properly addressed.

Although relations with the North do not exclusively depend on South Korea's will, it will remain necessary for Seoul to continue inter-Korean dialogue and cooperation in order to promote peace and stability on the Korean peninsula and in the entire region. South Korea should try to use the momentum enjoyed by the new Obama administration to help bring Pyongyang back to the negotiation table. Dealing with North Korea on an unequal basis is a recipe for failure.

The current economic crisis does not render obsolete basic overarching policy goals such as deepening constitutional democracy and the socially responsible market economy, pursuing sustainable development, minimizing social tensions and discrepancies, and maintaining a favorable regional and international environment. On the contrary, these goals should continue to guide the actions of reform-oriented actors in South Korea. Particular attention should be paid in the medium term to the following objectives:

- turning the National Assembly (and its committees) from an arena into a real working parliament;
- preserving the independence of the media, both public and private, from government interference;

- protecting the freedom of expression on the Internet (only slanderous speech should be banned);
- rooting out corruption in public and private institutions;
- bolstering the social security net significantly, especially with regards to unemployment insurance and welfare benefits;
- swiftly preparing the pension system for the challenge of the world's most rapidly aging society;
- keeping economic policy free of neomercantilist and nationalistic impulses vis-à-vis foreign investors;
- actively working to end discrimination against women at the workplace;
- working in good faith to forge a bipartisan approach to North Korea; and
- substantially expanding overseas development assistance.