Preliminary Version

Cooperation and Coordination between the Financial Authorities in Postcrisis Korea*

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I. Introduction

So far as financial stability is concerned, the 2007-09 Global Financial Crisis has recently driven policy interdependency home to the whole world. For example, the Crisis taught the whole world that central bankers should take financial stability into account in their formulation of monetary policy and that macro-prudential policy should be added to make the whole macroeconomic policy framework internally coherent (IMF 2011). The issue of cooperation and coordination between the financial authorities involved in policymaking has therefore moved higher on the agendas in both advanced countries and emerging-market economies.

Inter-agency cooperation and coordination presuppose good regulatory governance, as aptly suggested by an old saying "Good fences make good neighbors". Extant literature has much to say about regulatory governance to this effect. It is however normally applicable to normal times, but not to the crisis situation which is often likened to a war. Given that the specter of the Global Financial Crisis has so far been lingering around for years under the name of either the Eurozone Crisis or the Great Recession, the problem is that the conventional distinction between crisis and normalcy has been almost blurred out these days. As a result, the crisis situation has now globally become the norm rather than the exception. Considering that it is typically the government that takes the lead in crisis management,[1] arm's length that is to be kept between the government and the other financial authorities during normal times may not be preserved any longer during the crisis management. Regulatory governance may then be at risk.

Suppose that a government may think it justified, allegedly for crisis management purposes, to use jawboning and arm-twisting to force other financial authorities to cooperate and coordinate with it. Although such forceful, top-down government leadership may prove quite effective temporarily, it will, if applied over an extended period of time, certainly mess up regulatory governance. Forced cooperation and coordination are a contradiction in terms. The instant they are forced, inter-agency cooperation and coordination will have gone. Regulatory governance, once damaged, will not be repaired easily, since it is essentially about conventions, behavioral patterns and institutions, after all. Crisis management will, if abused with regulatory governance left damaged, contribute to the accumulation of huge economic distortions over time. In fact, such crisis management will even work to delay the return of normal times. The government, which is by nature subject to short policy horizon and thus time inconsistency problems, may often be tempted to perpetuate its leadership for crisis management, as well. Presumably, a country with weak institutions in normal times will, when hit by a crisis, have a higher chance of such forceful, top-down government leadership to emerge to intervene in the economy and the markets in the name of crisis management, severely damaging its regulatory governance and inviting distortions to accumulate to huge proportions.

Recent literature in crisis management, including IMF (2009b) and Tsutsumi, *et al*. (2010), for example, certainly discusses the need to implement a timely, gradual phase-out (or unwinding) of intervention measures taken by the financial authorities for crisis management

[1] In this paper, crisis management is defined as consisting conceptually of crisis mitigation (or crisis containment) and crisis resolution. Crisis mitigation has to do with "contain[ing] crisis, limit[ing] damage, stop[ping] widespread contagion and restor[ing] confidence" (European Parliament 2011, p.8), whereas crisis resolution involves "restructuring debt and defining the burden of losses" (European Parliament 2011, p.18). However, some authors, for example Claessens, *et al*.(2012), narrowly defines crisis management as the synonym for crisis mitigation.

and to have the market forces fill in instead, as things get normalized. IMF (2009b) further recognizes the need for the government and other financial authorities to review their respective policy mandates in terms of regulatory governance, since their roles may have been stretched in some way or other during crisis management. However, the regulatory governance concerns relating to the inter-agency cooperation and coordination that are raised in the preceding paragraph have never been properly taken care of in the literature of crisis management. In this regard, the paper attempts to take the case of postcrisis Korea to demonstrate that those concerns are not imaginary but real, and to provide a diagnosis and analysis of the Korean government's tendency towards wielding top-down leadership to intervene in the economy for crisis management.

The perspective that the paper brings up for discussion is not wholly new, though, in the sense that the Korean government has been known for its continued adherence to the interventionist approach ever since early in the 1980s when the economy, having outgrown the old tradition of the government-driven economic growth during the period of the 1960s and 1970s, began to turn increasingly to market principles instead. For example, Dornbush (1997) once noted that "[s]tatism has become counterproductive [in Korea]." Also, IMF (2005, p.5) pointed out that "since the [Asian] crisis Korean governments have continued to intervene in the economy, and the after-effects of these interventions are now holding back a recovery", referring to Korean governments as "The Ubiquitous Hand". But neither Dornbusch nor IMF tried to look further beyond. Thus, the paper provides a socio-cultural context to understand those old governance-related problems of the Korean government.

The significance of probing into such matters as the government leadership and behavior is not confined to Korea only. It will have implications for, and relevance to, not only emerging markets with weak institutions, but also advanced countries whose recent domestic reforms have enabled their governments to win a larger and stronger presence in financial and macro-prudential policymaking.

The plan of the paper is as follows. In Sections II and III, we discuss the importance of and the preconditions for inter-agency cooperation and coordination, and brush up on how the financial supervisory framework in Korea has changed, since the 1997 Asian crisis, to what it is now. We then review in Section IV how the policy responses evolved in Korea upon the strike of the Lehman shock over the period of September 2008 to March 2009. Taking up our main theme, Section V explores how the system of crisis management worked in postcrisis Korea, with a special focus on a wide variety of inter-agency meetings exploited as the instrumental vehicle of top-down government leadership. The deep forces underlying that government leadership, its attributes, and its implications to inter-agency cooperation and coordination in Korea, are discussed. Finally, Section VI concludes with the main findings of the paper and some remarks.

II. Inter-agency Cooperation and Coordination: Their Importance and Preconditions

This section provides a concise explanation of why cooperation and coordination between the financial authorities are important and what their preconditions are.

Why Cooperation and Coordination Matter for Financial Stability

Financial stability is a 'multi-faceted' concept, in the sense that microeconomic and macroeconomic facets interact to produce it (Healey 2001). Microeconomic facets include

financial institutions, markets, and infrastructures, while macroeconomic facets consist of interest rates, asset prices, credit aggregates, and monetary aggregates, *etc.* (Borio, *et al*. 1999). This multi-facetedness is illustrated in Figure 1.

Figure 1. Multi-facetedness of Financial Stability

Source: Borio, *et al*.(1999); Healey(2001)

Therefore, it takes multiple financial authorities, but not a single authority, to safeguard financial stability (Hayward 2000). Typically, they are the central bank, the financial supervisor(s), deposit insurer(s), and government (in particular, Treasury or Finance Department). These multiple authorities provide the official financial safety net policy functions such as the lender-of-last-resort function, monetary policy, macro-prudential policy, financial consumer protection, deposit insurance, public funding, and crisis management.

As long as these policy functions each relate to the interaction of microeconomic and macroeconomic facets in some way or other, there arises room for policy interdependency, that is, policy conflicts and complementarities (Kim, *et al*. 2002). The global financial crisis has driven such policy interdependency home to the whole world, since it has taught us that central bankers should take financial stability into account when they set policy rates of interest for monetary policy and that macro-prudential policy should be added to make the whole macroeconomic policy framework internally coherent (IMF 2011). Hence comes the need, more urgent than ever, for the financial authorities to cooperate and coordinate, reducing policy conflicts and promoting policy complementarities, in their common pursuit of financial stability (Kim 2004b; Kim 2009a).

The Preconditions for Cooperation and Coordination

In principle, there are a couple of preconditions for each of the financial authorities to cooperate and coordinate with others. They are *goodwill* and *ability*. First, a financial agency is said to have goodwill to cooperate and coordinate when it is willing "to share information

and cooperate with other agencies, and, if necessary to financial stability, to tolerate and to exert checks and balances" (Kim 2004b, p.35). Without such sincere willingness on the part of each authority, cooperation and coordination in the real sense of the words will not be expected to arise between the financial authorities, to begin with (FSFWGDI 2001). It is noteworthy that goodwill is importantly conditioned by a country's history, politics, culture, and its attitude toward dispersion of powers, and so on (Kim, *et al*. 2002; Kim 2004a·2004b).[2]

Second, a financial agency has the ability to cooperate and coordinate with others only if it has good fences *and* if it is provided relevant institutional arrangements (FSFWGDI 2001; Kim 2004a·2004b). Here, good fences imply autonomy allowed to, and accountability imposed on, a financial agency. Such good fences enable the agency to protect itself when a "Trojan horse" sneaks in, in the guise of inter-agency cooperation and coordination (Viñals 2011). Institutionalized arrangements are necessary to keep communication channels open between the financial authorities, which normally handle sensitive information (FSFWGDI 2001). Such institutionalized arrangements currently found in a sample of six advanced countries─Australia, Canada, Norway, Sweden, the United Kingdom, and the United States─are discussed in Box 1.

Box 1. Types of Arrangements for Inter-agency Cooperation and Coordination in Some Advanced Economies

The financial authorities typically operate coordinating committees and/or committees for macro-prudential supervision. Often, cross board representation as well as secondment of staff is used to exchange information between the authorities. A financial agency usually consults with others in advance when it contemplates some major change in policy. In some countries inter-agency cooperation with respect to examinations is institutionalized. The financial authorities sometimes collaborate for joint development of expertise. And in most countries these arrangements are documented and agreed in forms of general MoUs or special MoUs. Specific examples of each arrangement currently at work in some advance countries are as follows:

- **Coordinating Committee**

- Council of Financial Regulators (Australia)
- Financial Institutions Supervisory Committee (Canada)
- Senior Advisory Committee (Canada)
- Tripartite Meetings (Norway)
- Stability Council (Sweden)
- Standing Committee on Financial Stability (United Kingdom)

- **Committee for Macro-prudential Supervision**

- Council for Cooperation on Macro-prudential Policy (Sweden)
- Financial Policy Committee (United Kingdom)
- Financial Stability Oversight Council (USA)

- **Cross Board Representation**

- Australian Prudential Regulation Authority and Reserve Bank of Australia (Australia)
- Treasury and Reserve Bank of Australia (Australia)
- Canada Deposit Insurance Corporation and four federal financial authorities including Ministry of

[2] A good case in point is found in Korea, in which the vertical hierarchy prevails between the financial authorities. There, the hierarchy is traced back to Confucianism. For further details, see Section V of the paper as well as Kim (2004b) and Kim and Lee (2006).

(Box 1 continued)

Finance, Bank of Canada, Financial Consumer Agency of Canada, and Office of the Superintendent of Financial Institutions (Canada)
- Bank of England and Financial Services Authority (United Kingdom)

▪ **Secondment of Staff**
- BoE and FSA (United Kingdom)

▪ **Cooperation with Respect to Examinations**
- APRA and Australian Securities and Investments Commission; RBA and APRA (Australia)
- CDIC and OSFI (Canada)
- Federal Reserve Board, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation (USA)

▪ **Prior Consultation with Other Authorities on Policy Changes**
- APRA, ASIC and RBA (Australia)
- Norges Bank and Finanstilsynet (Norway)
- BoE and FSA (United Kingdom)

▪ **Joint Development of Expertise**
- Norges Bank and Finanstilsynet (Norway)

▪ **General MoUs** (on the division of responsibilities, information sharing, and crisis management)
- Bipartite MoUs (Australia; Sweden)
- Tripartite MoUs (Norway; United Kingdom)
- Quadripartite MoUs (Sweden)

▪ **Special MoUs** (on a special issue)
- Bipartite MoU on Payment Systems (Norway)
- Bipartite MoU on Macro-prudential Supervision (Sweden)
- Quadripartite MoU on Crisis Management (Australia)

▪ **Other**
- OSFI/CDIC Guide to Intervention to Federally-Regulated Deposit-taking Institutions (Canada)
- OSFI/CDIC Strategic Alliance Agreement (Canada)

Sources: Chung and Kim (2012); Kim (2009a).

III. Financial Supervision in Korea: The Recent Evolution and the Current Framework[3]

Before presenting the current financial supervisory framework in Korea, this section casts a brief look at the recent evolution of financial supervision during the last 15 years since the 1997 Asian Crisis. Focusing on financial supervision, we discuss the 1997-98 financial reform, the February 2008 reorganization of the financial ministries, and recent institutional changes made since the Lehman shock of September 2008, to understand how the financial supervisory framework has come to take its current shape.

The 1997-98 Financial Reform and Its Implications to Financial Supervision

In the aftermath of the Asian Crisis, the Korean economy underwent the financial reform in

[3] A good part of this section draws on Kim (2008·2009b).

1997-98, as a result of which the institutional structure of financial supervision has been radically changed (Kim, *et al*. 2002; Kim 2006; Kim and Lee 2006). Supervisory changes brought about by the reform are as shown in Figure 2.

Figure 2. Changes in Institutional Structure Made by the 1997-98 Financial Reform

Source: (Kim, *et al*. 2002; Kim 2006; Kim and Lee 2006)

The strong consensus that drove the 1997-98 reform forward was that "policy decision-making had become overly concentrated, thereby undermining the checks and balances required for effective government" (MOFE 2002; quotation taken from Kim and Lee 2006, p.415). In this context, the Ministry of Finance and Economy (MOFE) was reorganized by the reform such that its tasks relating to monetary policy and financial supervision were separated from it and transferred instead to the Bank of Korea (BOK) and the Financial Supervisory Commission (FSC), respectively, and that it ended up with financial sector development and policy coordination tasks so far as the financial system was concerned. As a result, central bank independence was strengthened as the BOK Governor was newly empowered to chair the Monetary Policy Committee (MPC).[4] Regarding financial supervision, newly adopted was the model of integrated financial supervision in which both the Financial Supervisory Commission (FSC) and the Financial Supervisory Service (FSS), taken together, were supposed to take the role of the integrated supervisor. However, this institutional peculiarity reflected in such a dual structure has since been a source of huge supervisory distortions and institutional conflicts, as will be discussed shortly. Lastly, deposit insurance functions in the banking and non-banking sectors were unified into the Korea Deposit Insurance Corporation (KDIC).[5]

Overall, the reformed financial system was supposed to operate on the basis of the institutional division of labor between the financial authorities (Kim 2004b). However, the reality turned out different than had been intended, and the reason for that lay in the fatal flaw imbedded in the reformed system—the dual structure of financial supervision according to which the supervisory authorities consisted of FSC and FSS (Kim 2006; Kim and Lee 2006). FSC was the state agency which was charged with integrated financial supervision and thus responsible for all types of institutions and markets. It was created, organizationally under the Office of the Prime Minister, as a nine-member administrative committee. And this committee FSC had a public corporation FSS as its own executive arm. In addition to FSS, there was a unit of government officials that, being adjunct to FSC, was supposed to assist the

[4] Before the reform, the MOFE Minister had been chairing the BOK's MPC for decades.

[5] There were some exceptions to this unification of deposit insurer functions. It was decided that such sectors as mutual banking and postal banking and insurance continued to operate their own deposit insurance funds respectively. See Kim, *et al*. (2002) for details.

nine-member committee *not* in terms of financial supervision *but* in terms of administration. It was not long before this unit proved the most vulnerable spot in the dual structure. The non-supervisory unit of government officials was later expanded in both size and function by early 2001 to become "another state supervisor that, as the FSC Secretariat, interposed between FSC as the nine-member committee and FSS" (Kim 2006, p.55). Since then, MOFE began to use the FSC Secretariat as the formal channel through which to have its systematic influence on financial supervision. This gave birth to the following set of five structural problems, with huge supervisory distortions and inefficiencies accumulated for most of the first decade in the 21th century (Kim 2004b·2006·2007):

• Policy dominance: MOFE tended to dominate FSC in terms of policy. That is, MOFE's economic as well as financial sector policy stance tended to dominate FSC's supervisory policy. Operational autonomy in financial supervision was thus damaged;

• Identity confusion: Supervisory officials in FSC tended to identify themselves wrongly as economic policymakers, since they formally frequently moved to FSC from MOFE, and *vice versa*;

• Risk of political and/or industrial capture: Being closely under the influence of MOFE officials who were often made sensitive to politics by their innate preoccupations with economic growth and employment, FSC officials ran a high risk of being politically-captured. Note that political capture often gets mixed up with, and thus indistinguishable from industrial capture;

• Short policy horizon: "[T]he [formal] practice of rotating appointments of supervisory government officials" between FSC and MOFE and their tendency to politicization, contributed to shortening of the supervisory government officials' policy horizon (Kim and Lee 2006, p.422); and

• Lack of supervisory expertise: All the structural problems discussed above hindered cultivation of supervisory expertise within FSC and FSS.

The February 2008 Reorganization of Financial Ministries and Its Implications to Financial Supervision

With the start of the Lee Myung-bak Administration in February 2008, the financial ministries including MOFE and FSC were so reorganized that the financial sector policy function was separated from MOFE and transferred to FSC. Financial Supervisory Commission (FSC) which came to be in charge of both financial supervisory function and financial sector policy function was renamed as Financial Service Commission (FSC). MOFE and Ministry of Planning and Budget (MPB) were merged into Ministry of Strategy and Finance (MOSF). Bereaved of the (domestic) financial sector policy, MOSF has since been left with international finance, so far as finance is concerned. Domestic finance and international finance have thus ended up being charged with FSC and MOSF, respectively.

This reorganization was, if anything, for the worse (Kim 2008). First, financial supervision was likely to be in conflict with financial sector development, for the former is by definition geared toward stability while the latter, toward efficiency. The standard contract theory suggests that FSC, which is given two opposing mandates, will not be free from the potential conflicts of interest and thus that the allocation of resources between the conflicting mandates within FSC will be distorted highly in favor of financial sector development which the markets will always welcome. In addition to the dual structure of financial supervision, it was

simply another fatal structural flaw to the Korean financial system to combine both financial supervision and financial sector development within the charges of FSC. Second, the institutional separation of finance between MOSF and FSC was *unusual*, given that finance is already highly globalized.

Institutional Changes Made since the Onset of the Global Financial Crisis

In the wake of the Lehman shock of September 2008 followed several institutional changes including the birth of a couple of MoUs agreed among the financial authorities, the revision of the Bank of Korea Act, and the creation of the Macroeconomic Policy Meeting (MPM) to discuss macro-prudential issues.

First, some efforts were made among the Korean financial authorities to improve information sharing and to enhance the system of joint examinations (Kim 2009a). As a result, the MoU on information sharing and the MoU on joint examinations each were agreed on September 15, 2009. The former was signed between MOSF, FSC, FSS, BOK, and KDIC, whereas the latter between MOSF, FSC, FSS, and BOK. In line with these MoUs, the financial authorities set up and operated the Financial Business Meeting (FBM) on a quarterly basis.

Second, the Bank of Korea Act was revised and passed in August 2011 (BOK 2012; Chung and Kim 2012). Among others, the revision has made it explicit that monetary policy "shall pay attention to financial stability" in addition to price stability, empowering BOK to collect data from a wider range of financial institutions including nonbanks, enhancing the its system of emergency liquidity support, and refining its system of reserve requirements.

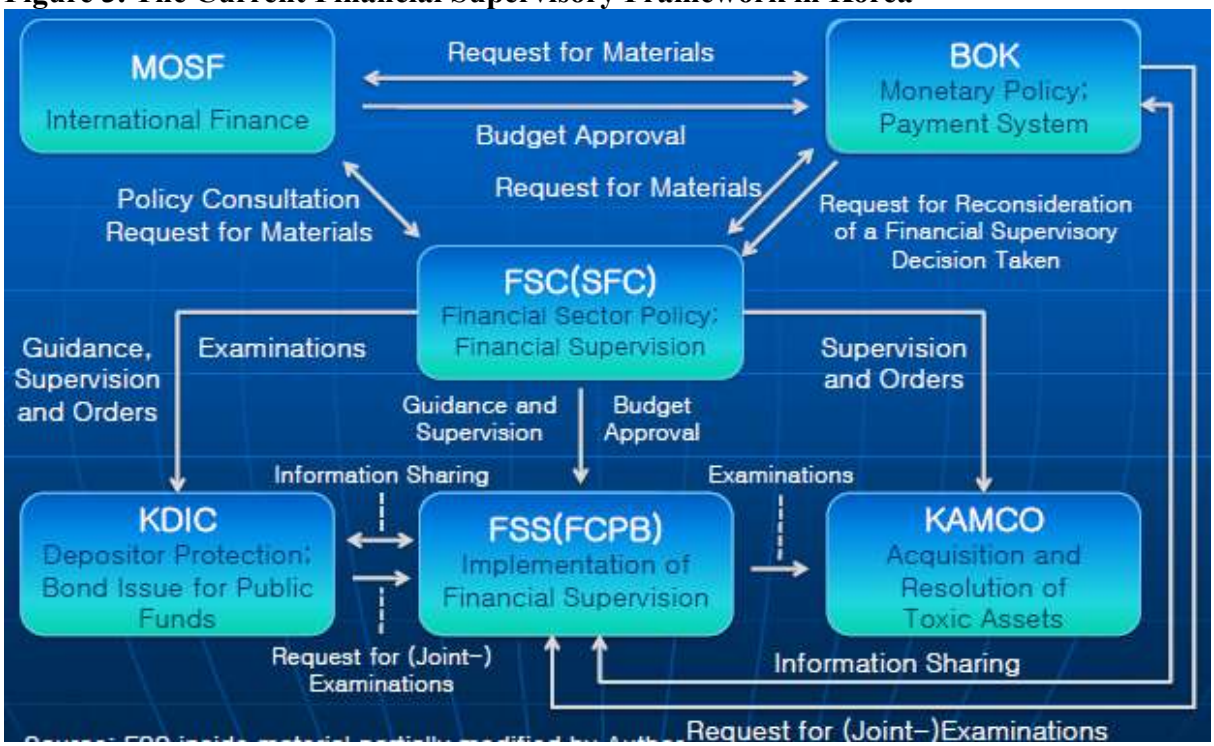
Third, MPM, being the deputies level meeting between MOSF, FSC, FSS, BOK, and KDIC, first met in July 20, 2012 to discuss issues in the macro economy and financial markets from the macro-prudential point of view (MOSF 2012). MPM was newly created in fact to be the amalgam of the three existing meetings including Emergency Meeting on Financial Situation (EMFS), Foreign Exchange Market Stabilization Meeting (FEMSM), and FBM. MPM regularly meets on a quarterly basis, and may also meet, if necessary, at other times. Although MPM is based on Regulations on the Establishment and Operation of the Macroeconomic Policy Meeting, which was issued and enforced on September 7, 2012, as Presidential Directive No.300, it is not legally based, to be strict.

Current Financial Supervisory Framework in Korea

We have briefly covered major changes made in the institutional structure of financial supervision in Korea during the last fifteen years. They certainly contributed to the current shape of the financial supervisory framework as shown in Figure 3. In addition, Box 2 provides a current list of institutionalized arrangements for inter-agency cooperation and coordination in Korea. Note that the system of financial supervision in Korea as presented in Figure 3 and Box 2 looks fine. They are enough to convey the impression that the responsibilities are clearly divided among the financial authorities and that inter-agency cooperation and coordination are well institutionalized. But this seems to be quite contradictory to the discussion in the preceding subsections. How can it be reconciled?

One should be reminded here that appearances are often deceptive and misleading. The reality that the Korean system of financial supervision has long been suffering a serious illness, is hidden behind the figure (Chung and Kim 2012). The same can be said of the arrangements for inter-agency cooperation and coordination listed up in the box.

Figure 3. The Current Financial Supervisory Framework in Korea



Source: FSS inside material (undated) partially revised by the Author.

For example, Korea has no general MoUs agreed upon either by all the financial authorities or by any relevant subset of them. By a general MoU here is meant an MoU that covers all the major core contents such as the division of responsibilities between the relevant financial authorities, the institutionalization of information exchange and sharing arrangements, and the protocols for crisis management, *etc*. The fact that there is no such general MoU simply indicates that "[a]s far as institutional collaboration between the financial authorities in pursuit of financial stability is concerned, Korea has remained seriously backward" (Kim 2009a, p.1).

Furthermore, a variety of inter-agency meetings (meetings, hereafter) have been operating, but most of them are improvised from time to time as the need arises. Typically, the Korean government (MOSF, in particular) takes the lead in creating those meetings, and seizes the initiative in operating them. At *any* such meeting, and regardless of its level, it is MOSF that, formally (or informally at least in some cases) plays the role of the leader and agenda-setter. As these meetings are set up on an *ad hoc* basis with few exceptions, good governance relating to their set-up and operation cannot be expected at all. Although press releases which announce what the relevant financial authorities have decided at the meetings are issued, the *modus operandi* of those meetings often remain obscure and opaque (Kim and Lee 2006). This feature leads one to an informed suspicion that most meetings may *not* serve as an arrangement for inter-agency cooperation and coordination *but* as a vehicle for justifying and transmitting top-down government (MOSF) leadership.

Before we further develop such a critical perspective later in Section V, we will examine the workings of the current financial supervisory framework over the phase of crisis management in Section IV.

Box 2. Types of Arrangements for Inter-agency Cooperation and Coordination in Korea

Korea currently has many such arrangements as are usually found in a sample of six advanced countries (see BOX 1). For example, there are coordinating committees, committees for macro-prudential supervision, overlapping (but not cross) board representation, secondment of staff, prior consultation with other authorities on policy, cooperation with respect to examinations, and special MoUs. In this respect, Korea seems to bear more resemblance to, than distinction from, what is usually observed in some of the advance economies. There should however be more than meets the eye (see Section V). Now here is the list of inter-agency arrangements at work in Korea:

▪ **Coordinating Committee**

- National Economic Advisory Council (NEAC): statutory meeting chaired by the President, with 5 or less ex-officio members (ministerial representation from the Office of the President, MOSF, and FSC, *etc*.), 30 or less appointed members, and designated members
- National Economic Council (NEC): non-statutory meeting chaired by the President, with ministerial representation from the Office of the President, MOSF, FSC, and BOK
- Economic Policy Coordination Meeting (EPCM): statutory meeting chaired by the MOSF Minister, with ministerial representation from Executive Ministries and Agencies
- Meeting on Macroeconomic Policies (MMP): non-statutory, deputies level meeting with representation from MOSF and BOK
- Emergency Economic Meeting (EEC): non-statutory meeting chaired by the President, with ministerial representation from the Office of the President, MOSF, FSC, and BOK
- Crisis Management Meeting (CMM): non-statutory meeting chaired by the MOSF Minister, with ministerial representation from Executive Ministries and Agencies
- Financial Business Meeting* (FBM): non-statutory but MoU-based, deputies level meeting chaired by MOSF Minister, with representation from FSC, FSS, BOK, and KDIC
- Foreign Exchange Market Stabilization Meeting* (FEMSM): non-statutory but MOSF Notification-based, deputies level meeting chaired by MOSF Vice Minister, with representation from FSC, FSS, BOK, National Tax Service, Korea Customs Service, Korea Financial Intelligence Unit, and Korea Center for International Finance, *etc*.
- Emergency Meeting on Financial Situation* (EMFS): non-statutory, deputies level meeting chaired by MOSF Vice-Minister, with representation from FSC, FSS, and BOK

* FBM, FEMSM, and EMFS meetings were ceased to function in July 2012, being merged into Macroeconomic Policy Meeting (MPM) meetings instead.

▪ **Committee for Macro-prudential Supervision**

- Economic and Financial Meeting (EFM): non-statutory meeting with Ministerial representation from the Office of the President, MOSF, FSC, and BOK (FSS 2012; Lee 2008; Lee and Namkoong 2009)
- Macroeconomic Policy Meeting (MPM): non-statutory, deputies level meeting chaired by MOSF Vice-Minister, with representation from FSC, FSS, BOK, and KDIC

▪ **Overlapping Board Representation**

- BOK's Monetary Policy Committee (MPC): MOSF Vice Minister or FSC Vice Chairman may be present at the meeting not as a member but to state his or her opinions [BOK Act].
- FSC committee meeting: MOSF Vice Minister, KDIC President, and BOK Vice Governor are present at the meeting as Commissioners [Act on the Establishment, etc. of the Financial Services Commission].
- KDIC's Deposit Insurance Committee (DIC): FSC Vice Chairman, MOSF Vice Minister, and BOK Vice Governor are present at the meeting as members [Depositor Protection Act].

▪ **Secondment Programs**

- Some are two-way (ex. FSS↔BOK), and others one-way (ex. FSS→FSC; FSS→KDIC; FSS→ Office of the President)

(Box 2 continued)

- **Cooperation with Respect to Examinations**

- FSS and BOK; FSS and KDIC

- **Prior Consultation with Other Authorities on Policy**

- BOK consults with MOSF about setting the inflation target.
- BOK advises on MOSF;s exchange rate policies.

- **Special MoUs** (on a special topic)

- MoUs on Information Sharing signed by MOSF, FSC, FSS, BOK, and FDIC
- MoUs on Joint Examinations signed by MOSF, FSC, FSS and BOK

- **Other**

- MOSF Minister may request for reconsideration of a decision taken by the BOK's Monetary Policy Committee (MPC), when he or she finds it conflicting with the Administration's economic policy [BOK Act].
- BOK's MPC may request for reconsideration of a decision taken by FSC, when MPC finds it relating directly to monetary and credit policies [BOK Act].
- The Workshop on Joint Examinations is held annually by those authorities concerned including BOK, FSS, and KDIC.

Sources: Relevant legislation as noted; Various press releases from the Lee Administration since February 2008, unless noted otherwise.

IV. An Overview of Developments and Policy Responses in Korea for over Six Months following the Lehman Shock of September 2008

The Global Financial Crisis wreaked enormous havoc on the world economy as a whole, with its lingering but forceful presence felt in many jurisdictions including the United States of America, Japan and the Eurozone, among others. Some countries are however noted to perform better, and Korea stands out among the rest. For example, Korea won almost simultaneous credit rating upgrades from the Moody's Investor Service, the Fitch Ratings, and from the S&P's, respectively, as of September 2012, which was about four years since the Lehman shock.[6] IMF (2012, p.12) assessed its external vulnerability to be "markedly lower than it was during 2008", attributing that improvement to "[a] stronger external position, combined with the use of macro-prudential measures."[7]

Although the Korean economy was, as most emerging markets were, a bit distanced from the epicenter of the Global Financial Crisis,[8] it was so open both to financial flows and to

[6] The Moody's Investors Service, the Fitch Ratings and the S&P's upgraded their credit ratings for South Korea from A1 to Aa3 on August 27, 2012, from A+ to AA- on September 6, 2012, and from A to A+ on September 14, 2012. See the Office of the President (2012) for details.

[7] As it happens, the Korean economy has tended to be noted for its successful reforms and thus its rather early recovery from a crisis. In the aftermath of the 1997 Asian crisis, OECD (1999, p.10) highly praised it as being "the front-runner among crisis-hit Asian countries in implementing … reforms." In addition, favorable comments on the Korean economy seen in a broader context since the 1997 Asian crisis, abounded as well. Among them were, for example, Kim and Seo (2012) who wrote that "[s]ince the 1997-1998 slump, South Korea has ridden economic crises better than most advanced economies" and Pesek (2012) who remarked that "Korea has gotten as far as it can, … with the export-led model that powered its postwar boom and restored living standards after 1997."

[8] Judging the severity of a crisis in terms of liquidity support, restructuring costs, nationalizations, guarantees, and asset purchases, Laeven and Valencia (2010, p.8) report that there have been "13 systemic banking crises

trade that it could not help avoiding "the dual onslaught of a sudden stop in capital flows and collapsing exports" upon the strike of the Lehman shock (IMF 2009a, p.6). Due to its openness to financial flows, domestic dollar shortage and financial market instability resulted from the freezing of the international financial markets. For example (BOK 2010; IMF 2009a), the rollover rates on short-term external bank debt fell down to 40%; stock prices and the Korean Won values both fell down by 20~30%; and daily volatility of KRW-USD exchange rates went up to ten times. Its openness to trade led the Korean economy to contract sharply as recessions set in on a global scale. For example (BOK 2010; IMF 2009a), real GDP in the 3rd and the 4th quarter of 2008 fell down to 0.2%(q/q) and -5.1%(q/q), respectively.

Fortunately, it was however not long before some positive signs of stabilization of the Korean markets and economy from the Lehman shock emerged. Real GDP growth soon turned up to be positive at 0.1%(q/q) in the 1st quarter of 2009, being on the rise since, with its record of 2.6%(q/q) and 3.2%(q/q) for the 2nd and the 3rd quarters of 2009, respectively, while yields on corporate bonds and exchange rates each were stabilized to normal levels by around mid-2009. Equity prices returned to pre-Lehman collapse levels as well. These and other pieces of favorable evidence led IMF (2009a, p.6) to conclude in retrospect that "[d]efaults on banks' external obligations and a credit crunch have been avoided and economic activity stabilized in the first quarter of 2009."

But how was this circumstantial turnaround made possible? The paper finds the very answer in what IMF (2009a, p.3) dubbed "[t]he authorities' speedy and comprehensive response." We now look into this issue and evaluate the policy responses of the financial authorities that were made at the heels of the Lehman shock.

Box 3 presents a chronological selection of some major policy responses that had been made in response to the outbreak of the Lehman shock in September 2008 and evolved up to March 2009, when some favorable signs of recovery began to be visible. Throughout the

Box 3. Policy Responses over the Period of September 2008 - March 2009: An Epitome

The following is a chronological epitome of several important policy responses that are selected to convey an idea of how the Korean financial authorities effectively responded to the Lehman shock.

1. September - October 2008 (FSC/FSS 2008; MOSF Minister, FSC Chairman, and BOK Governor 2008)

▪ The FSC/FSS Joint Task Force for Financial Market Stability was set up on September 16, 2008

▪ MOSF Minister, FSS Chairman, and BOK Governor issued the Joint Statement on October 19, 2008, proposing comprehensive measures mainly focused on emergency USD and KRW liquidity provisions - The Joint Statement was, at that time, the first of its kind of late years.

- It was issued just when globally the emerging markets were about to come under the direct influence of the Global Financial Crisis.
- It presented virtually a complete set of market-stabilizing measures from A even to Z, ranging from immediate ones including provision of emergency liquidity to structural ones expected to come later including recapitalization of financial institutions.

2. November 2008 (MOSF 2008)

▪ MOSF announced on November 3, 2008 the Administration's firm posture on the then evolving

and 10 borderline cases [globally] since the year 2007". The former group includes Austria, Belgium, Denmark, Germany, Iceland, Ireland, Latvia, Luxembourg, Mongolia, the Netherlands, Ukraine, the United Kingdom, and the United States, while the latter group consists of France, Greece, Hungary, Kazakhstan, Portugal, Russia, Slovenia, Spain, Sweden, and Switzerland. According to their classification, Korea has not suffered a systemic banking crisis nor a borderline one since the onset of the Global Financial Crisis.

(Box 3 continued)

crisis situation, proposing the apparently exhaustive set of mid- and long-term measures focused on stimulating the real economy and on supporting SMEs and low-income people as well as short-term ones focused on stabilizing the foreign exchange and financial markets.
- The complete and apparently exhaustive package of measures was enough to convey to the market participants and the general public the idea that the Government was determined to combat the crisis.
- Although most short-term measures in the package were merely a reiteration of the contents of the Joint Statement issued two weeks earlier, the MOSF and others' package presented a good supplementary set of mid- and long-term measures.

3. December 2008 (FSC 2008)
▪ As the crisis had folded out for a couple of months since mid-September, FSC presented in a press release a timely and concise analysis of the crisis, together with a clear context, in which a sense of what we had gone through, where we were at the moment, and of what was expected to come before us was provided.
- Analytic review was given of how the crisis had evolved during the previous couple of months and how the financial authorities had coped with it.
- Envisioning prospective developments of the crisis, FSC made it clear that it was well-prepared to meet them as they would get materialized.
- In that context, FSC suggested a partial shift in its policy focus in the press release such that for many months to come it would move closer to mid- and long-term measures including encouraging restructuring and strengthening social safety net, etc.
- FSC emphasized yet that it would continue its all-out efforts to tackle short-term liquidity problems. Policy responses that were later announced in the press release of February 26, 2009, was the action taken in that spirit (MOSF, FSC, and BOK 2009).

4. January - March 2009 (FSC 2012)
▪ During this period, FSC, focusing on mid- and long-term, created the following variety of public (or quasi-public) funds that aimed mainly at bank recapitalization or corporate restructuring.
- Bank Recapitalization Fund (KRW 20 trillion) was set up to inject capital into banks to help them with upholding the real sector through restructuring process.
- Financial Stabilization Fund was created within KPBC (Korea Policy Banking Corporation) in March 2009 to enable financial institutions including non-banks to recapitalize preemptively.
- Corporate Restructuring Fund (KRW 40 trillion) was set up within KAMCO to resolve NPAs held by banks.
- Corporate Credit Support Task Force was set up in support of corporate restructuring by FSC/FSS in November 2008.
- Fast Track was launched in January 2009 to help speed up restructuring of SMEs, while financial support for SMEs was made in the form of guarantees and liquidity.
- Cuts in the interest rates for residential mortgage loans, etc., were made in the spirit of micro-finance support in January 2009.

5. September 2008 - March 2009 (BOK 2012)
▪ BOK cooperated effectively with MOSF and FSC during the seven-month period. Market-stabilizing measures taken by BOK over the period included the following:
- A series of cuts in the policy rates by 325bp in total from 5.25% to 2%
- Provision of emergency liquidity through open-market purchases of RPs and bonds, uses of the Aggregate Credit Ceiling Loans, and interest payment on bank reserves (KRW 22.4 trillion in total; mostly concentrated in October/November 2008)
- Other liquidity supports and capital contribution (KRW 5.5 trillion in total) made for Bond Market Stabilization Fund (December 2008), Bank Recapitalization Fund (February 2009), and Korea Credit Guarantee Fund (March 2009)

Source: FSC/FSS 2008; MOSF Minister, FSC Chairman, and BOK Governor 2008; MOSF 2008; FSC 2008·2012; BOK 2012.

period, the financial authorities, including most importantly MOSF, FSC, FSS, and BOK, waged an all-out war against the market instabilities and economic recessions. Several characteristics concerning the behavior of the financial authorities and their policy responses as delineated in Box 3 merit attention.

First, the policy responses were swift and timely. For example, it was just one day after the Lehman Brothers Holdings, Inc., filed for Chapter 11 bankruptcy protection on September 15, 2008 that FSC, together with FSS, set up a joint task force to monitor the markets intensively. Further, the full-scale policy responses began with the three-party joint statement issued by MOSF Minister, FSC Chairman, and BOK Governor, on October 19, 2008. The statement was quite timely in the sense that it came out just when globally the emerging markets were about to enter, around the middle of October 2008, the sphere of direct influences of the Lehman shock (BIS 2009). Also, the joint statement was quite visible since it was the first of its kind of late years and thus enough to show decisiveness to fight it out on the part of all the financial authorities..

Second, the policy measures were presented so comprehensively from the outset and implemented so consistently throughout that they were perceived to be well-conceived and increasingly credible by the market participants. The joint statement made it clear that the financial authorities were very ready to use every means on their list. Although its main focus was certainly on the emergency support measures, the statement covered an almost complete set of market-stabilizing measures from A even to Z, ranging from immediate ones for use including provision of emergency liquidity to structural ones expected to come later including recapitalization of financial institutions. No measures that ensued were beyond the wide scope of the ammunitions list the joint statement had initially come up with.

Third, MOSF, being the executive ministry of the Korean government primarily responsible for managing the crisis, came to the front, taking the lead in waging the war against market instability and economic recession, while the other authorities followed in cooperation and coordination. For example, MOSF Minister was said to seize the initiative in having FSC Chairman and BOK Governor agree to issue the tripartite joint statement of October 2008. In about a couple of weeks after the joint statement was issued, MOSF, together with nine other ministries and agencies including FSC, proposed another comprehensive and exhaustive package of measures with a slight tilt in focus toward mid- and long-term. Their package of measures was again timely and comprehensive enough to reassure the market participants and the general public of the government's strong commitment to combat the crisis.

Fourth, in the middle of December 2008, FSC produced a concise analysis which provided the clear context to the evolving crisis. As the crisis had folded out for a couple of months since mid-September, it was about time that such an analysis was released. In this sense, FSC's analysis was timely. And it was enlightening as well, in that it showed clearly where we had been meanwhile since the Lehman shock, where we were at the moment, and where we would be going for some time to come. In addition, the first quarter of 2009 saw a surge of measures taken for corporate restructuring and for sector-specific support. In spring 2009, FSC, in its capacity of the financial sector development policymaker and financial supervisor, poured out its own policy measures that were mostly about creating various funds for purposes of bank recapitalization and corporate restructuring, *etc*.

Fifth, BOK was also cooperative enough to cut its policy rates by 3%p five times in about four months (October 27, 2008 - February 12, 2009) since the joint statement was issued on October 19, 2008, and to provide emergency liquidity of KRW 22.4 trillion in total over the period of September 2008 - March 2009. Further, BOK made capital contributions of KRW

5.5 trillion in total to several funds including Bank Recapitalization Fund and Bond Market Stabilization Fund that had been created at the FSC's initiatives.

To be brief, the policy responses, especially the early ones since the Lehman shock in September 2008, were swift, visible, decisive, exhaustive, convincing, and effective. Of them, MOSF Minister, FSC Chairman, and BOK Governor (2008), MOSF (2008), and FSC (2008) were particularly important. The financial authorities thus succeeded in restoring market sentiments back to normal in s short span of time and preventing the recession from getting worse. They may must have benefited much from their crises-weathering experiences and skills acquired when the Asian crisis had hit the Korean economy in November 1997.

Note further that a variety of inter-agency meetings that were operating at several levels were the main vehicle through which MOSF forcefully elicited concerted efforts from the other financial authorities for crisis management, *i.e.*, its intervention in the economy. There are a couple of caveats, here. One is that appearances can be deceiving. That is, what outwardly appears inter-agency cooperation and coordination through meetings may not be in fact as they look. This aspect needs some elaborations in the next section. The other caveat is that there must have been some important role played by the Office of the President during crisis management. However, the Office hardly produces any publicly available information at the level of details relevant to our purposes, so that it finds no proper place in our discussion, being thus left out almost as a black box.[9]

V. A Critical Review of Inter-agency Cooperation and Coordination in Postcrisis Korea

Beginning by presenting the standard view of the government's roles in crisis (or crisis management) and in normal times, this section focuses on the meetings that have been operating in postcrisis Korea to provide a critical review of inter-agency cooperation and coordination during recent crisis management. In so doing, it also offers a multilateral analysis of the Korean government's top-down leadership.

The Standard View: The Government's Roles in Crisis Management and in Normal Times

The standard view, as discussed in Kim, *et al*. (2002) and Kim (2004a), distinguishes between the government's roles in crisis management and those in normalcy. In times of crisis, it is necessary that the government (currently MOSF in Korea, for example) come to the fore and take the lead in managing the crisis situation, not only because there may arise the need for the government to make a decision regarding injecting public funds, but also because it is the government that takes the ultimate responsibility for the financial sector. In contrast, in normal times the government is supposed to monitor the market functioning closely, and yet to keep the other financial authorities at arm's length so that it may not hinder their respective operational independence (autonomy) in policy. Each financial authority (other than MOSF) needs the operational independence in formulating and implementing its policy, so that it may have its policy kept aloof from the influences of the politics and of the markets, and thus be free from the time inconsistency problems.

[9] Throughout the paper, the author makes use of the publicly available information only. Here, the publicly available information refers to press releases from the financial authorities and the Lee Administration and the news articles from the media.

We have earlier reviewed the policy responses of the financial authorities for the period of September 2008 through March 2009. Now we take a look at the meetings that were held over the years 2008 through 2012. The period of our review in this subsection is further extended beyond March 2009 up to the year-end of 2012, as the Korean economy has so far been under crisis management since the latter part of 2008, except for the nine-month period of January to September 2011.

All the meetings that have operated during the five-year period can be classified to three levels depending on who chairs: the President chairs EEC, NEC, and NEAC meetings, while MOSF Minister presides over EPCM and CMM meetings, and MOSF Vice-Minister does over MPM meetings. MPM is the amalgam of EMFS, FBM and FEMSM, each of which operated separately under MOSF Vice-Minister's chairmanship up until July 2012. Of all these meetings, only NEAC and EPCM meetings are statutory, while the others are non-statutory and *ad hoc*.

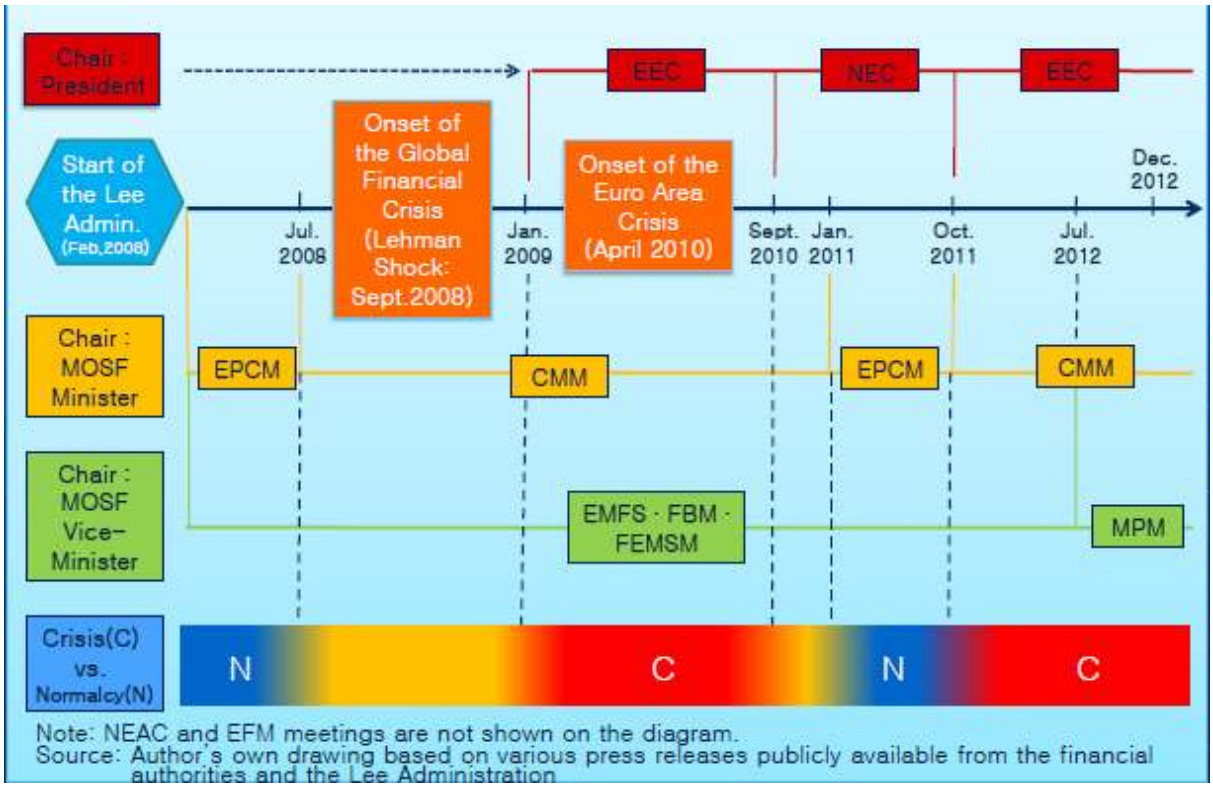
Some of the meetings have operated in the crisis situation, others in normal times, and still others, all the time regardless of crisis or normalcy. To be specific, both EEC and CMM have operated in crisis management, working in tandem (MOSF 2010), while both NEC and EPCM have operated in normal times, working in tandem as well. MPM and its precursors including EMFS, FBM, and FEMSM, have operated regardless of the economic state. In other meetings, EFM seems to have operated backstage all along, whereas NEAC has not stood out for the last five years under review.

Figure 4 provides a summary diagram in which the workings of all these meetings classified to three levels are depicted around the timeline. It also shows the revealed judgment of the government concerning a state of the world at any point in time over the last five years. That is, the figure makes a distinction between the phase of crisis management and that of normalcy, in which the former (in red) is defined as when both EEC and CMM meetings operate, while the latter (in blue) as when neither EEC nor CMM meetings work. The in-between period (in orange) is defined as a transition in which either EEC or CMM meetings function.[10] The figure shows that over the years 2008 to 2012 there have been three regime shifts (ignoring the two in-between periods): two from normalcy to crisis management, and one from crisis management to normalcy.

Now, a chronological look at the meetings held over the years 2008 to 2012 helps. Consider EEC, first. EEC was created, in response to the onset of the Global Financial Crisis, as the weekly headquarters meeting of the Emergency Economic Administration which the current Lee Myung-bak Administration declared itself at the very beginning of 2009 (Lee and Namkoong 2009; The Office of the President 2010). No public information has yet been available concerning the formal procedure, if any, that led to the declaration. In response to the hikes of energy prices, CMM had already taken the place of EPCM, operating since July 2008, half year in advance of the creation of EEC (MOSF 2010). As financial markets and the real economy were getting normalized, EEC was replaced by NEC in September 2010, and CMM by EPCM later in January 2011. This 'gradual' exit from crisis management was reportedly to minimize any possible impact on the financial markets (MOSF 2010).

[10] Defining each of the three states of the world—crisis management, normalcy, and a transition—as stated in the text assumes quite plausibly that the government's judgment regarding the state of the world at any point in time is revealed simply by one's observation of the types of meetings that are operating at the moment.

Figure 4. Inter-Agency Meetings at Work over the Years 2008-2012



According to our definitions of normalcy and of crisis management, the Korean economy was in crisis management from the start of 2009 till September 2010, when the in-between period of transition toward normalcy set in for several months to come. With the start of 2011, the Korean economy was in normalcy for the first nine months. And in October 2011, EEC and CMM replaced NEC and EPCM, respectively. Reportedly, this lightning shift in regime was made at the directions given by the President to the Office of the President's Senior Secretaries Meeting held on September 28, 2011(Lee, *et al*. 2011). The Korean economy has been in crisis management since then on.

For over the last five years, the decision making regarding regime shifts signified by the alternate operation of either an EEC-cum-CMM pair or an NEC-cum-EPCM pair may have been politically motivated at least in part, and may have been made in some backstage discussions between several officials of the highest ranks. This conjecture draws from some circumstantial evidence. First, no formal analysis but just a short line of mention has been provided in public concerning any regime shift that was made since 2008. Second, no formal procedure that led to a regime shift has been known in public, and no expert agency has been said to play any role before the President finally arrives at a decision concerning a regime shift. Such a political approach, if taken at all, may work briefly, but the intentional, prolonged or repeated use of it will certainly generate time inconsistency problems, credibility problems, and thus huge economic distortions. We may well suspect that MOSF lies behind such a political approach, as the next subsection suggests.

Institutional Hierarchy, Mofia Syndrome, and MOSF Leadership

As discussed earlier, MOSF has shown strong and effective leadership in the forefront of

crisis management. It has played, together with FSC, the leading role to have BOK and FSS aligned by means of a systematic use of several layers of meetings such as EEC, CMM, EFM, MMP, EMFS, FBM, and FEMSM, the last three of which were merged into MPM in July 2012. The faster recovery of the Korean economy from the Global Financial Crisis is attributed importantly to MOSF leadership.

Now arises the question as to how MOSF has been enabled to wield its top-down leadership so forcefully and effectively after all. It is *not* that MOSF leadership arrives out of thin air *but* that it has long been underlain by deep-rooted vertical hierarchy between the financial authorities. Concerning this aspect, some relevant factors merit discussion. First, MOSF has inherited the past glory of marvelous records of economic growth from early 1960s to 1980s. The leading role in setting the record high growth during those years was then played by the Economic Planning Board (EPB) and the Ministry of Finance (MOF), to both of which MOSF (and for that matter, FSC Secretariat, as mentioned below) are traced far back.[11] With this institutional memory of EPB and MOF's glorious past lasting for decades, MOSF (and FSC) officials have long been known for their ability, self-confidence and for their commitment to be the first in whatever they are pursuing. Now FSC, which is a state agency under the Prime Minister, actively falls in line with MOSF. Second, Confucianist cultural tradition which emphasizes order and hierarchy has fostered vertical relationships between the financial authorities in Korea (Kim 2004b; Kim and Lee 2006). MOSF, being stipulated to be the number one ministry of the highest rank by the Government Organization Act, has formally played the patriarchal role on top of the vertical hierarchy.

Consequently there emerges a clear picture of the vertical institutional hierarchy (Kim 2004b). MOSF is located on top of it, closely followed by FSC right beneath. MOSF and FSC are birds of a feather in that they are part of the government bureaucracy. Furthermore, formal transfers of government officials are quite usual between MOSF and FSC Secretariat (Kim and Lee 2006). Although BOK is given *de jure* independence, it lacks *de facto* independence. Lagging far down on the hierarchy, BOK often acquiesces. It is a matter of course that both FSS and KDIC, being guided and supervised by FSC, are at the bottom of the hierarchy. In a word, MOSF leadership has been destined to be top-down in nature and wielded forcefully as it is supported by vertical hierarchy that governs the financial authorities.

However, vertical hierarchy is not enough to explain the effectiveness part of MOSF leadership, since strength may not always lead to effectiveness. Then how come MOSF leadership has been so effective in crisis management? It is time that we brought *Mofia Syndrome* into discussion.

'Mofia' is a coined term which combines MOF (Ministry of Finance) and Mafia (Italian gangsters). As the current version of MOF is MOSF, Mofia is commonly understood as a faction of current and former MOSF high-ranking officials. As the latter have typically

[11] An outline of MOSF's organizational history is provided as follows. The Planning Administration (PA) and MOF each were launched as part of the Korean government that was originally organized in 1948. PA was later expanded to become EPB in 1961. Over the period of 1960s through 1970s, MOF was responsible for "taxation, treasury operations, finance, currency, and foreign exchange policy, foreign exchange", while EPB for "government budgeting and economic development plans" (MOSF 2013). The two ministries were the driving force of record-high economic growth all through the period. They were later merged in 1994 to become Ministry of Finance and Economy (MOFE), from which the budgetary management function and the financial supervisory function were separated and transferred to the National Budget Administration (NBA) and the Financial Supervisory Commission, respectively, in 1998. NBA was soon to be merged with the Planning and Budget Committee into the Ministry of Planning and Budget (MPB) in 1999. And finally in 2008, MOFE and MPB were merged into MOSF as is. For details, see MOSF (2013).

moved on, through revolving doors, to politics, other relevant financial authorities, or to financial industries and markets, the faction as a whole has wielded huge power in markets as well as in policy circles. In so doing, Mofia has played a significant role in exercising bureaucratic finance (*Kwanchi Keumyung*) and bureaucratic supervision (*Kwanchi Kamdok*) for decades in Korea (Kim 2004b).[12] Many of the bureaucratic problems relating to the allocation and pricing of resources and to financial supervision have in fact been attributed to some deep forces which work behind MOSF leadership. Those *Kwanchi* problems are merely symptomatic of what can be broadly termed Mofia syndrome.

While Mofia syndrome beefs up vertical hierarchy between the financial authorities and *vice versa*, it may contribute importantly to making MOSF leadership effective by exploiting the influences of Mofia as a faction and policy network consisting of enthusiastic MOSF leadership proponents who are lining up not only within policy circles but also beyond them, *i.e.*, widely in the markets and industries. This feature, together with the high-quality policy responses that we have seen were engineered by MOSF, explains much of the effectiveness of MOSF leadership in crisis management.

MOSF leadership, as is usual with government leadership in many countries, is basically for intervention in the economy. What is unique to MOSF leadership, however, lies in the fact that it is structurally firmly supported by institutional hierarchy and Mofia syndrome. The consequence is that the intervention measures, once taken effectively, in response to the crisis situation, under MOSF leadership, do *not* tend to be undone over time *but* to stay put for longer than strictly necessary, generating those familiar economic distortions associated with time inconsistency, credibility, and moral hazard, *etc.*, and thus, in order to address them, inviting ever more intervention measures. At the same time, standard policy measures are "simply relegated to a back burner until the problems ... [reach] crisis proportion …" (Kim and Lee 2006, p.422). In a word, MOSF has been structurally inclined to the intervention spirals for decades.

The problems created by the Korean government's (*i.e.*, MOSF's) interventionist attitude are relatively well documented. For example, Dornbusch (1997) earlier identified "planning and intervention" of the Korean government as one of "several fundamental problems of the Korean economy that … [lay] behind the … [then] banking and corporate crisis". Years later, IMF (2005, p.5) explicitly attributed to "the after-effects of … [the continued] interventions … [since the 1997 Asian crisis]" the contemporary three problems such as household indebtedness, financial vulnerabilities of SMEs, and larger corporations' unwillingness to invest. Further, MOSF-related interventions and/or Mofia-related regulatory forbearance were responsible, to a considerable extent, for both supervisory failures of 2003-04 relating to

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[12] Although *Kwanchi* has been a household word for decades, it seems one of a few jargons in Korea that are used undefined. This may be because the jargon points to some amorphous and fuzzy phenomena that are hard to define. The paper follows Kim (2004b) who has attempted to define *Kwanchi* and its compounds as below (p.21, fn.2):

"[T]he Korean government (MOFE [currently MOSF], in particular) … [has] long been publicly regarded as "bureaucratic (*Kwanchi*)" in the sense that it, directly or indirectly, … [has] influence over, and … [intervenes] in, the decision-making process of the private/public sectors, not on the basis of financial laws and regulations but at its discretion. Thus, "bureaucratic finance (*Kwanchi Keumyung*) refers to when government's bureaucrats distort market discipline and limit, at their discretion, the financial sector autonomy, say in terms of allocation of financial resources or in terms of pricing them. Similarly, "bureaucratic supervision (*Kwanchi Kamdok*) refers to when government bureaucrats distort the market-friendly principles of financial supervision and limit, at their discretion, operational autonomy of public agencies (other than MOFE [currently MOSF]) including Financial Supervisory Commission [currently Financial Service Commission] (FSC) and Financial Supervisory Service (FSS)."

credit card companies and those of 2011 relating to mutual savings banks (MSBs).[13] Likewise, household indebtedness, which IMF (2005) had blamed continued interventions for, was in fact left snowballing unaddressed for years until the MSBs debacle occurred early in 2011. Since the SMEs have been treated as the object of financial support through improvised intervention measures, they still remain financial vulnerable. Viewed this way, those problems that IMF (2005) once fingered as the consequence of MOSF's continued interventions have since been with us for years by the same token.

All these problems and incidents show how the Korean government's leadership has worked in normal times, providing good evidence that MOSF's interventionist attitude is structurally imbedded in its organizational culture.

Being fundamentally conditioned by Mofia syndrome as well as vertical institutional hierarchy among the financial authorities, MOSF leadership embodies both the all-time interventionist attitude and the effectiveness supremacy. First, MOSF pursues all-weather intervention. MOSF officials seem to believe that they should intervene rain or shine, as shown in the following quotation (IMF 2010, p.18):

> "The [Korean financial] authorities[, presumably MOSF among others,] noted that their current coordination framework [i.e., crisis management regime] had worked well during the crisis and were of the view that it was well suited for normal times"

This feature of MOSF leadership easily extends to what Kim (2008, p.369) has once termed "bureaucratic excess" as opposed to integrity. Second, MOSF puts effectiveness first. MOSF officials seem to be excessively preoccupied with effectiveness supremacy as shown in the following quotation (IMF 2010, p.18):

> "The [Korean financial] authorities[, again presumably MOSF among others,] did recognize that a more formalized coordination framework would improve the transparency of the coordination process, but it was also noted that this would not necessarily result in effective coordination."

Both attributes of MOSF leadership above are intertwined, in a significant way, with MOSF's inherent political sensitivity, which is in turn ascribed to the fact that its main concern includes such issues as employment and economic growth. However, this sensitivity, being often accompanied by the short policy horizon, may well generate time inconsistency problems.

It is paradoxical that MOSF leadership which has critically contributed to successful crisis management may prove a fatal threat in normal times. In particular, if MOSF leadership were to continue to be exercised under the guise of crisis management in what is otherwise normal times, it would entail time-inconsistency and credibility problems, worsening the economy. In a word, MOSF leadership is a double-edged sword.

Is MOSF leadership Compatible with Inter-Agency Cooperation and Coordination?

Finally, consider how MOSF leadership relates to cooperation and coordination between the financial authorities. Simply put, inter-agency cooperation and coordination are *not*

[13] MOSF-related interventions were, on the whole, driven by MOSF's policy stance of boosting domestic demand, whereas Mofia-related regulatory forbearance was administered by FSC in the name of deregulation which was regarded as being conducive again to boosting domestic demand. Roughly speaking, these initiatives of MOSF and FSC have been consistently maintained at every opportunity since around the turn of the 21th century. See Kim and Lee (2006) and Kim (2008).

compatible with MOSF leadership that is supported by vertical institutional hierarchy above all (Kim 2004b). Inter-agency cooperation and coordination may begin to develop only when good regulatory governance is firmly in place, that is, only when the relationship between the expert agencies is function-based and horizontal. In contrast, institutional hierarchy implies the rank-based vertical relationship settled in between the financial authorities. Thus, when institutional hierarchy prevails, inter-agency cooperation and coordination are hard to develop to begin with. Inter-agency cooperation and coordination are a process-oriented concept viable within a system of distributed functions and powers, whereas institutional hierarchy is a result-oriented concept well-suited to a system of concentrated functions and powers. Inter-agency cooperation and coordination cannot be hoped for, when institutional hierarchy prevails between the financial authorities. Viewed this way, institutional hierarchy could prove useful only temporarily in a war-like crisis situation where the result, rather than the process, should be the government's absolute priority.

VI. Conclusion

We conclude with the main findings of the paper and some further remarks. First, the preconditions for institutional cooperation and coordination are not generally met in Korea, for the hierarchical relationship between the financial authorities has been firmly in place for decades. Specifically, in terms of good will and regulatory governance, Korea lags far behind. As for institutionalization, Korea has a variety of arrangements that are often found in such advanced countries as USA, UK, Sweden, Norway, Canada, and Australia. And yet, some of those arrangements, particularly the meetings, many of which are set up *ad-hoc* and sometimes operate in an opaque way, are used, not for inter-agency cooperation and coordination, but for top-down MOSF leadership.

Second, top-down MOSF leadership may yet turn out to be successful as has been the case with Korea for years following the Lehman shock of September 2008. The financial authorities including MOSF and FSC among others, were efficient and decisive enough to manage the critical situation proactively. In particular, MOSF's political sensitivity has been what enables it well-aligned with its legitimate role as the leader during crisis management, which may require a sense of politics anyway. The use of this specific type of leadership must be however restricted only to the crisis management phase, provided MOSF officials are highly qualified for the job.

Third, top-down MOSF leadership, being fundamentally conditioned by Mofia syndrome and vertical hierarchy between the financial authorities, will do more harm than good to the economy, if MOSF falls into temptation and continues to take the reins for an extended period of time under the guise of crisis management (well past the phase of crisis management in fact). This is because, in normal times, MOSF leadership armored with political sensitivity, effectiveness supremacy, and all-weather interventionist attitude, will soon be imbued with short-termism and disaster myopia (Kim 2004a). Both IMF (2005) and Tsutsumi, *et al*. (2010) have advised to this effect. As did IMF (2005), years after the Asian crisis, warn us of the heavier cost that the prolonged use of the Korean government's intervention measures would incur, so did Tsutsumi, *et al*. (2010), years after the Lehman shock, warn us of the heavier cost of delaying the phase-out of the emergency measures that the Korean government had taken in for crisis management.

Fourth, Korea should develop good regulatory governance including setting up a statutory formal framework which, being equipped with transparency and accountable arrangements,

promotes inter-agency cooperation and coordination in the real sense of the word. While MOSF leadership can be a valuable asset in crisis management, it runs the risk of being used for too long. Thus the formal procedure for decision-making on a regime shift between crisis and normal times should be established. Regulatory governance matters even in a crisis regime, since arbitrariness and discretion of the financial authorities, particularly of the leading authority, should be kept to the minimum. For example, meetings should be legally-based and comply operationally with governance standards and principles. In normal times, the expert authorities including the central bank, the financial supervisor, and the deposit insurer, should keep arm's length from the government and be ready to stand on their own feet. At the same time, the expert authorities should overcome the temptation to "stay in peace under the wing of [MOSF]" (Kim 2004b, p.54). This can happen only when they have the expertise with which to arrive at their own judgment and policy decisions *and* when they are willing to take their due accountability. In a word, the regulatory governance reform is long overdue in Korea.

Most fundamentally, Korea should undertake the public sector governance reform in addition to the regulatory governance reform, to deal with MOSF leadership and to activate and invigorate inter-agency cooperation and coordination.[14] This is because MOSF leadership, which is by nature simply incompatible with inter-agency cooperation and coordination, is a structural cultural phenomenon firmly supported by mutually reinforcing deep forces such as Mofia syndrome and vertical institutional hierarchy. This perspective is perfectly in line with the governance-nexus view advocated by Quintyn, *et al*. (2007) and with the institutional interdependency view put forward by Kim and Lee (2006).

[14] For the author's point of view concerning the public sector governance reform and the regulatory governance reform, see Kim (2008) and Kim (2012), respectively.

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