

Neoliberal Paradox? Explaining the Unremitting Corruptions in the Deregulated Korean Economy

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The recent financial scandal in Korea surrounding savings banks call into question two kinds wisdom we have about corruption: corruption is a result of political rent-seeking, and corruption in East Asia is manageable with the help of the centralized and strong state. Contrary to the expectation that the double advent of democratization and globalization would scale down, if not eradicate, such a political rent-seeking, the recent corruption seen from the scandal has been encompassing the entire regulatory regime. The profile of the corruption was also ugly along with blatant trades between regulatory favors and bribes. This paper defines the Korean scandal as a bureaucratic institutional corruption resulting from the decline of a few management mechanisms occurred throughout the political and economic liberalization during the 1990s. First, the financial scandal is understood in this paper as a policy failure involving misbehaviors while implementing regulatory policies, differently from a generic political failure where policy favors are awarded to selected businesses in return for payments, mostly illegal, at the stage of policy making. It happens with an unsettled economic reform like in Korea where the liberalized financial market meets with a few still highly discretionary government policy agencies. Second, a few fallouts of bureaucratic institutional deterioration or abuse have collectively driven the financial regulatory regimes down to corruption. Most fatal, this study suggests, is the disruption of deferred compensation to policy agents.

Keywords: *financial scandal, Korea, bureaucracy, institutional corruption, deferred compensation*

1. INTRODUCTION

The Korean financial scandal in 2011 was rampant across many savings banks and their regulators. As of February 2013, as many as 20 savings banks were suspended of business by the Financial Supervisory Service (FSS), six of which were ranked within top ten biggest. The number marked 20 percent of the entire businesses enlisted. Individually, 137 people were indicted for violating financial regulations, out of which 62 actually went to jail. Worse than the scale, though, was the gloomy profile of the scandal. Illegal activities were not limited to a few private banks and collaborating officials, but encompassed the entire regulatory circle within the government.

Although Korea has never been immune to corruption with all the outstanding performances in economic growth, the past corruptions were mild and manageable as the highly centralized state could hold them from going out of control. The corruption control enabled Korea to continue its economic growth despite a few nation-wide economic scandals during the decades of high growth. At the same time, the manageable character differentiated Korea's corruption from many predatory states that made the best of the state policy autonomy to the benefits of selected ruling elites. Therefore, the recent Korean scandal is truly surprising since East Asian economies could avoid such a rampant corruption even if they have suffered from pervasive political rent-seeking throughout the entire period of

economic growth (Rock and Bonnett, 2004).

The 2011 scandal is a different type of corruption, as Korea's democratization during the 1990s has already significantly dropped political rent-seeking. Instead, the 2011 financial scandal invoked more of a bureaucratic corruption than political, which calls for an updated explanation: corruptions resulted from improper policy implementation when the usual political rent-seeking in the stage of policy making is highly restrained. Any theory in the vein of political corruption would expect that corruption should be further lowered with democratization in Korea. Conversely, the expected democratization effects have yet to be fully exercised, or must have been mitigated by a new kind of corruption.¹

This study tackles institutional deterioration of bureaucracy to address the puzzling financial scandal in the democratized Korea. In the proposed theory, the policy transparency expected from Korea's political liberalization is tempered by the bureaucratic corruption driven by the decreasing policy incentives due to democratization. The scandal is therefore defined as a bureaucratic policy failure rather than a political failure. The scandal is an outcome of the institutional deterioration within bureaucracy regarding compensation system and policy forbearance as a consequence. The process toward corruption by bureaucrats is under-investigated, while studies on political corruption abound.

In this paper, such internal institutional mechanisms of the Korean bureaucracy are reviewed to specify their path toward institutional erosion as insufficient compensation, lingering policy autonomy, and the restructuring regulatory agencies are working collectively.

The proposed institutional explanation of the financial scandal opposes to the characterization of the scandal as an illegal behavior of a few individuals and businesses involved. An institutional corruption does not limit corruption to a few bad government officials, but broadly cover various ranks and agencies. The bureaucratic institutional view is also against the explanations subscribing to generic political corruption. In a political corruption, law makers work for a new regulation or a revision of the existing law in return for votes or financial supports by private interests. Against such a political capture of policy making, my theory suggests a bureaucratic capture of policy implementation. The policy capture then leads to corruption due to the asymmetry of resources between public and private services, i.e., the disproportionately higher compensation in the private sector (Choi, 2006).

The bureaucratic institutional view of the Korean financial scandal is developed in this paper in the following order. First, East Asian economies are theoretically reviewed from the standpoint of their status between the state and market in the advent of globalization and democratization. The literature review aims at reconsidering the lingering regulatory power of the government despite the neoliberal reforms across the region. Next, a further theoretical elaboration follows the big picture of East Asian political economy in order to highlight the separate function of bureaucratic institutions from the political policy making process. The effects of globalization and democratization are assessed in a few key bureaucratic institutions to see how the double advent results in the drop of job performance of bureaucrats. Finally, the recent financial scandal is reviewed to figure out how the historical and procedural development of Korea's regulatory regime ends up with an avenue for

¹ The monetary magnitude or effect of corruption might look the 2011 scandal only a miniscule of other mega-scandals in Korea like the Lee-Chang scandal in 1982, but the character of the 2011 scandal is no less ugly. What this study inquires is the scope and depth of corruption by regulatory agencies, which was rare in the past history of Korea's economic development.

bureaucratic corruption. The paper concludes with summaries and implications.

2. THE STATE, BUREAUCRACY AND EAST ASIAN ECONOMY IN THE 21ST CENTURY

Policy autonomy has been a well-known merit of East Asian developmental state (Johnson, 1982; Amsden, 1989; Wade, 1990). Passing the post-Cold War liberal reforms, however, a consensus seems to be made on the retreat of the state from the economy. At the same time, the return of the state is also gaining weight if the role of the state is modified. Some studies redirect the focus on individual issues, either public compensation (welfare state) or macroeconomic stability, instead of the aimless debate over the state-versus-market (Pierson, 2001; Vogel, 1998).

Regarding the theories on policy autonomy solely, the logic to fend off private interests have been much better developed than political interests. The autonomy enables the state to pursue long-term development goals including economic reforms despite expected resistance from powerful businesses with embedded interests in the existing systems. The autonomy from political interests, on the other hand, is less sophisticated. The developmental state theories uncritically assume that political elites are right by nature and seek collective goals before private interests of their own. Then the presumption is supported by the absolutely strong political power to direct national policies to the righteous interest in public goods by leading politicians.

The fact that East Asian economies made their successes through a few radical reforms calls into question a generic version of the political autonomy against private interests. Reform is risky for regime stability as seen in leadership crisis in some countries and therefore a strong political objection is expected. Or even if political elites agree on the agenda for reform in general they would switch their positions at any time in the face of the cost that they should pay individually on the course of actual policy execution (Grindle and Thomas, 1991). The critical reflection raises a possible separation of bureaucratic autonomy from political leadership where economic bureaucrats can even stand up against political interests. An independent bureaucratic autonomy from political leadership makes more sense with the double advent of globalization and democratization in East Asia that required a complete overhauling of the existing political economic structures. While the studies on East Asian economies since the turn of the century have unjustifiably skewed to either to country-specific institutions (Kang, 2002; Amyx, 2006) or region-wide common characters (Pempel, 2005; Aggarwal and Koo, 2008), this study argues for bureaucratic autonomy as a better indicator of the economic performance of East Asian economics after the double advent.

First, the proposed independent policy power of economic bureaucrats better defines the relationship between globalization and democratization in East Asian countries. Comparative theories on the effects of liberalization in developing countries have so far suggested mixed outcomes (Przeworski, 2001; Moon and Mo, 1991). On the one hand, neoliberal economic reforms are supposed to empower businesses over labors by removing restrictions in the market. Consumers and labor workers are disadvantaged vis-à-vis businesses in terms of organizational and budgetary capability. Paradoxically, a liberal economic reform ends up with a non-liberal political outcome if we understand that liberalism brings more benefits to the majority.

Democratization works to the contrary. By strengthening civil societies, democratization

enhances the political clout of the previously suppressed like labor unions. It predicts an improved social equity. The political pressure cuts the freedom for private businesses to maneuver in the market by lowering labor flexibility or raising employee benefits (Diamond, Plattner, and Chu, 2013). The upshot of the process is either to oppose to a radical move toward market economy or at least to run the reform in a modified way as to meet with the labor interests that may require a *limited* market competition.

Under the environments of conflicting pressures to the market, the bureaucracy holds a key in East Asia to drive the double advent either way. To begin with, democratization leaves only bureaucratic elites in the state for an executive decision in need. Political elites are pushed out of an independent state and merged to the society where they have to beg votes. Next, East Asian countries are expected to manage economic reforms, or globalization in a broader sense, in a top-down way. The state is still asked to lead the reform while inputs from the society are either only fledgling or not well organized yet, but political elites are readier to passively follow popular demands than lead them. In sum, when the two courses of liberalization are expected to go for collision, the bureaucracy determines a way by taking a point in the middle as the steer of reform.

Second, the narrowly defined bureaucratic policy autonomy, i.e., remaining portion of the state autonomy, better define the course East Asian developmental state in the 21st century. The studies on East Asian economies in the advent of globalization and democratization are divided between those for an obsolete and lingering developmental state. The former group takes more on the external conditions of economic internationalization, (Keohane and Milner, 1996) whereas the latter holds for the stickiness of internal infrastructures (Weiss, 2003). The radical environmental changes since the end of the Cold War devalues the developmental state by pointing out that no state is able to sustain an independent policy goal from the interests of private actors. On the other hand, path-dependence of the developmental state still holds key institutions unaffected by the external changes. As the advocates of a resilient development state contend, existing institutions leave neoliberal reforms wide open to state interventions even if the reform targets at curtailing them.

The remaining state influence, if any, does not as much account for the outcomes of state intervention as the process. In the face of both positive and negative consequences of state initiatives, theories and perspectives are hesitant to put a final verdict over the role of developmental state in neoliberal reforms. As such, existing studies are equivocal about the future of developmental state in East Asian economies.

Bureaucratic autonomy is the one that keeps the integrity of developmental state amidst the transforming external environments. With the advent of democratization, political elites need to respond to the constituents' interests that are sensitive to economic environmental changes. They easily drop the ball of sustaining an independent and long-term national interest when challenged by pressing interests in votes. The presumably development-minded political elites of the past are hard to find after the political liberalization while the economic liberalization still calls for a government leadership in East Asia. The bureaucracy is the single remaining actor to hold an independent key of the state from parochial interests involving in the process of economic liberalization.

2.1 Bureaucracy in Korea's Financial Market

Institutions are subject to change. External pressures often provide the spur for change, but the process of transformation is, in most cases, endogenous. The members (agents or

organizations) initially respond to pressures from outside but soon begin to direct the transformation according to their own rationale (North, 1990). The process steadily advances toward a fixed goal if the members are able to accommodate the demands of external changes. Otherwise, an institutional transformation would either drag on endlessly or lead nowhere.

Existing institutional explanations on East Asian financial development stress the political conditions that newly developed after democratization. A type of political coalition among politicians, labor, and private banks explains the history of financial development and reform. A bureaucratic institutional view provides a different version. The outcomes of financial development may vary depending on the level and effects of bureaucratic autonomy. Both factors should be related with democratization, but are not exactly squared with the timing or deepening of the political change, i.e., democratization.

Given the surviving bureaucratic policy autonomy in Korea, the undesirable or incomplete financial reforms including the 1997 financial crisis and a few financial scandals later are arguably caused by an abuse of the autonomy. In turn, as the autonomy relates with multiple institutions surrounding the bureaucracy, its corruption should also involve with a deterioration of the institutions. Distinctive among others is the institution about compensations. To tackle the compensation factor as an important bureaucratic institution may contrast with the popular socio-political interpretation of the Korean bureaucracy (Evans and Rauch, 1999), but is still reasonable considering the mismatch between the constant social factors like meritocratic recruitment and lifetime employment and the corrupt autonomy since the 1990s. Compensation is a significantly varying factor within the bureaucracy if it is concerned about deferred compensation, or second careers of retiring bureaucrats in the private sector.² The disrupting institution of long-term compensation brings about corruption when policy autonomy is still given to those who seek the compensation.

Korea's financial reform during the 1990s confirmed the negative effects of corrupting policy autonomy and destabilizing compensation institutions. Korea launched its massive financial restructuring since 1993 including the introduction of Real Name Bank Account/Transaction (RNBA), opening the market for Non-Bank Financial Intermediaries (NBFIs), Bank merger and scale-up. Except the RNBA, Korea's efforts for the radical liberalization proved failure. Financial scandals that involved the top political leadership directly also bulged for the first time under the Kim Young-sam Government. His son was later punished for giving favor to a few financial businesses in return for political supports (slush funds).

Liberalization of interest rate that was pretty much done by 1993, in contrast, stepped through several stages under the close watch by economic agencies against non-economic interventions. The interest rate part had actually been expected to be the most intractable but ended up with the easiest as the rest of the reforms got messed up due to the declining bureaucratic autonomy associated with its organizational commotion initiated from the merger of Economic Planning Board and Ministry of Finance into Ministry of Finance and Economy (MOFE).

Post-crisis restructuring seemed to be more orderly and organized than the pre-crisis financial reforms. The reform after the 1997 crisis in Korea emphasized improving bank supervision and a *prudent* regulation. The government also initiated two administrative

² I have argued somewhere else for the decisive effects of disrupting deferred compensation in Korea's political economy (Kim, 2006).

reforms: reorganizing the regulatory regime to separate independent agencies like the Financial Supervisory Commission (FSC), the Financial Supervisory Service (FSS), and the revised Bank of Korea Act to award more policy power in regulating commercial banks. The reality, however, was not like the plan, as we saw in the financial scandal described below.

2.2 Korea's 2011 Financial Scandal

The financial scandal in Korea began with the suspension of Samwha Bank, a savings bank, by the Financial Supervisory Service (FSS) in January 4, 2011. Within a month or so, Pusan savings and its three subsidiary banks were also suspended. The reason for suspension was the illegal loans that the banks made by violating the regulation of limiting the amount to a single customer. While investigating the banks in trouble, however, it was revealed that the scope of illegal businesses within the suspended banks was much wider than initially accused for. Worse than the size of the illegal activities, a significant portion of them were committed in collaboration, either through collusion or forbearance, with the regulators, i.e., government/public officials in charge of financial inspection like the FSS. The investigation instantly expanded to all savings banks from the suspicion that multiple other bank managers and government officials might be involved with such illegal businesses. As of February 2013, dozens of banks were suspended and over 100 politicians and bureaucrats were indicted as a result.

From the business point of view, the suspended savings banks committed two kinds of unacceptable behaviors: illegal loans and private appropriations. The Korean government capped the loans of savings banks to a single business or person at a certain percent of equity or amount. The law on savings banks had revised the regulations several times, but was raising the ceiling to 20 percent and 8 million US dollars (for businesses) until the financial scandal erupted, unless the bank in question was a member of the 8-8 club.³ When Samwha Bank was suspended in January 2011, it had already loaned 180 million dollars in total over the limit of single loan. Samwha as well as other small-scale savings banks was easily enticed to loan over the limit to a single business when the business offered an interest rate (5.5 percent) way over the regular bank rate (4.0 percent). The price Samwha had to pay for the higher interest rate was the risk running with the businesses due to the uncertainty of the projects where the loans were made. For example, the loans were heavily concentrated on service areas like real estate development. The so-called 'project-financing' could borrow a large amount of loans from savings banks in this way only with business portfolios.

The large shareholders of the suspended savings banks also violated the bank laws by appropriating bank money for their own businesses or personal expenses. In the previous example of Samwha, additional 320 US dollars were reported to have been personally managed by bank president Shin Sam-gil and his five cohort managers (Yonhap News, November 11, 2011). Some of the money was directly appropriated for personal usages like political slush funds or luxury lives, but most of it went through the personal businesses other than finance either owned or controlled by the top bank managers. They as the largest shareholder of the bank pushed the bank managers to loan tremendous amount of money to

³ Since 2005, the Korean government relaxed the loan regulation to forgive the limit of a single loan when a savings bank was qualified with over 8 percent of equity capital ratio (BIS ratio), and under 8 percent of non-performing loans (NPL). They were still under the restriction of the general bank law that limited the loans to a single business at 20 percent of the equity.

their own businesses that suffered from financial shortage. That kind of preferred loans included those that flew to the personal associates of Mr. Shin and his family. As the Korean news media described about his behavior, Mr. Shin used Samwha Savings Bank as something like his personal safe (*Joongang Ilbo*, November 9, 2012).

From the big picture of Korea's political economy, however, the business version of the story was only the prelude of the big scandal. The wrong behavior of private businesses triggered chain reactions that ended up with a national turmoil. To begin with the business owners and managers sought a political solution to revoke the suspension. They went to key political leaders and bureaucrats to restore their businesses. Instantly that Samwha and a few others later were suspended by the FSS, they sought somebody to save the banks from going under. Their lobbies were indiscriminately spread to the Blue House (Korea's presidential residence), the National Assembly (congress), government ministries, and inspection agencies like the Bureau of Audit and Inspection (BAI) and the FSS. Then the public figures actually responded to the lobbies, but while doing so they inadvertently revealed their connections with the private banks along with some prior cases of collusion. Also disclosed was the fact that both the prosecutors and the BAI had known about the illegal financial transactions. Now all three government agencies that were supposed to promote transparency in the financial businesses were disclosed to have worked against their missions. A seemingly small corruption in a field of the financial sector finally fully bloomed to a nationwide financial scandal.

The true character of the scandal should still be found in the ways that the initial policy of business suspension was responded by the punished banks and then escalated to a nationwide scandal. They together constructed the profile of the scandal as a bureaucratic institutional failure. First, instead of accepting the punishment for their wrong business behaviors and seeking to correct them, the accused banks tried to revoke the suspensions in a round way, i.e., lobbying the men of policy influence to reverse the policy decisions. Second, when the banks in trouble were seeking illegitimate solutions like pressures to policy executors, they could utilize the existing networks so that the routes toward corruption had already been institutionalized. Third, the connections between the banks and government officials were built on a longer-term basis of reciprocity than a typical rent-seeking seen in other countries.

The first surprise came from the choice of action by the owners and top managers of the suspended banks. They ran to political and bureaucratic leaders instead of lawyers. They instantly mobilized their own networks as described later, but if necessary asked some brokers to lay the bridge with such non-business figures as lawmakers and tax agents. That explains why two financial brokers, Yoon Yeo-sung and Park Tae-kyoo were investigated by the prosecutors as the primary suspects for hooking governmental officials to Pusan Savings Bank (*Chosun Ilbo*, June 6, 2011). The two brokers were later known to have held a variety of celebrities in their pockets to sell someone who sought a political solution to a trouble. They helped the lobbies of the suspended savings banks to reach out and pressured the FSS to withdraw the suspensions.

As the inspection went on, it became clear that the business of savings banks had been perceived as political rather than market decisions both internally and externally. A newspaper, for example, simply summarized the problem with Pusan Savings Bank at the early stage of investigation as an expected outcome of the dark connections built on the same regional basis of Gwangju (*Joongang Ilbo*, June 5, 2011). Although the bank was first purchased by Park Sam-goo in 1981, a few colleagues of him from Gwangju could expand

the bank businesses massively during the 1990s when Kim Dae-jung was the president of Korea. The president was from the same region and also went to the same high school with Mr. Park. Later, Mr. Park brought a group of alumni of another school in the area, the most prestigious GwangjuJeil High School, to the bank management and converted the business managers to a political association. In their eyes, the policy decision to suspend Pusan Savings was not irrelevant with the new conservative political regime that succeeded the previous liberal regimes including Kim's in 2008. It must be a due course then for the bank managers to seek a political solution for a political accusation.⁴

The case of Pusan Savings was only tip of the iceberg of political-business connections, and thereby demonstrated the political nature of savings bank businesses in Korea. As revealed after the special inspection began in June 2011, most of the savings banks had been running one kind or another politically-connected business projects. Either responsive to political demands or flattering them in advance, the bank managers treated those projects as a part of usual businesses. In retrospect, the pervasive political connections across savings banks were fully anticipated from the history of developing the banks. The history structured the vertical frame of Korea's political economy surrounding savings banks. It began with the 8.3 Special Decrees on Freezing Private Debts in 1972. In order to release the financial stress of major industrial firms in the face of the first oil shock, the Korean government decided to forgive the debts that the firms owed to private financiers. Instead, the private financiers were allowed to be institutionalized as regular banking businesses. Since then, the newly entered financial businesses were divided to investment and savings businesses, and together formed Korea's secondary financial markets. In the savings side, the businesses renaming themselves several times from Mutual Trust Funds to Mutual Savings Banks, and finally Savings Banks (Park and Cole, 1983: 142-5). The history of savings banks, therefore, was the history of policy decisions to deal with private credits, which in turn colored the entire business sector as the close connection with the government.

The second unique aspect of financial scandal was the bureaucratic foundation of the political externalities in the business scandal. With all the political economic blending of savings banks, the past history as well as current scandal fell, if anything, to the realm of policy execution rather than policy making. No doubt was the decision to restructure the private credit market – or more correctly to clean up the financial black market – made by then president Park Chung-hee and his Blue House staffs. Also true was that the restructuring of savings banks in the advent of democratization was directly ordered to meet with local economic demands by the top political leadership during Kim Yong-sam and Kim Dae-jung administrations. The political decision making nevertheless spared little room for the interests of private businesses.

For instance, industrial corporations including the big ones like chaebols worked a lot to participate in the savings bank market only to fail. They tried to exploit Korea's neoliberal economic reform to expand their businesses to the financial sector. First, they knocked on the door of regular commercial banks that used to be under government ownership of management but were being privatized during the economic reform. When their ambition

⁴ For a counter argument against the political accusation, refer to the article written in *Chosun Ilbo* by Song Hee-young who is also a Gwangju Jeil High School alumnus. Mr. Song compared the amount of politically-considered businesses with the total business capacity of savings banks, and also with the practices among regular commercial banks. The amount was only 1/3 of the commercial banks (*Chosun Ilbo*, June 3, 2011).

was defeated by the public pressure against Korea's deepening economic monopoly, the chaebols switched their target to savings banks. Turned down by the government again, the plan of the private firms was confined to chip in the other Non-bank Financial Businesses (NBFIs) like investment banks or credit card businesses (Kim, 2006: 196-218).

On the other hand, deregulation in savings banks businesses was accelerated after the financial crisis, while even the top political leadership was not so much enthusiastic about liberalizing the financial sector. The direction of deregulation was to raise the loan limits and ownership of savings banks, which had been set earlier to prevent a financial instability due to their institutional inexperience. Hearing the cries of savings banks over the competitive loss against commercial banks with Korea's neoliberal financial reform, the government decided to address the unfair regulations between the two by improving the business conditions of savings banks. The current name of savings banks was also adopted during the time to replace its previous name of 'mutual savings banks.' The ceiling of loans was raised and M&A among savings banks became easier as a result. They were also given permission to cross over their business boundaries and expand to previously prohibited businesses like beneficiary certificates (BD) (Kim & Lee, 2006: 410-12).

The course of development of savings banks in the way as it did was then arguably taken over by policy implementers. While neither top political leaders nor savings banks themselves exercised a decisive sway over the financial market, bureaucrats played both policy executors and makers. The active roles of economic bureaucrats were confirmed by both in the attitudes or speeches of the bureaucrats in key regulatory positions and the external critics of government policies by civil societies. First, when asked to comment on the erupting financial scandal, leading bureaucrats in economic policy agencies inadvertently conceded that they made up those policies while justifying their policy choices. Yoon Jeung-hyun, Minister of Strategy and Finance (MSF), answered to the questions about the financial crisis as follows. He was the chairman of the Financial Supervisory Commission (FSC) in 2004-2007.

Q 1: Was the regulatory relaxation (of savings banks) the decision by the MSF?

A: Yes. It was an inevitable choice of the commission to save them out of the business trouble driven by the clogging money circulation. Another trouble might have occurred unless we deregulated them.

Q 2: But wasn't it still problematic for the commission to drive the deregulation by itself?

A: Agree. We also tried to hold project financing of savings banks at 30 percent of the bank equity, but we could not because the plan required a congressional ratification. We submitted the proposal for a new law to the 17th National Assembly only to fail to pass. The 18th National Assembly passed it instead. (*Chosun Ilbo*, June 1, 2011)

The commission was domineering in the policy process as seen from his remarks such as the commission decision for deregulation and the dominance in enacting a new law on savings banks businesses. The policy autonomy by bureaucrats was substantial insofar as the financial regulatory policies are concerned.

In addition, the critic of the financial policies by non-governmental activists blamed the bureaucracy for the main cause of the financial scandal. The bureaucratic policy autonomy was taken for granted by Korea's civil society as well as projected by the bureaucracy. In the report prepared by People's Solidarity for Participatory Democracy, one of the leading non-

Table 1. Policy Failure and Responsible Civil Servants (52)

<ul style="list-style-type: none"> • Large Stockholders (3): <ul style="list-style-type: none"> - Ryoo Dong-chun (President, Jeil Savings Bank) - Shin Hyun-kyoo (President, Tomato Savings Bank) - Cho Yong-moon (President, Parangsae Savings Bank) • Managers (21): Jeil I, II Bank (12), Ace Bank (6), Tomato (4), Parangsae (3), Prime (1), Dae-young (4) • Politicians (3): <ul style="list-style-type: none"> - Jung Yoon-jae (Blue House Staff) - Park Bae-soo (Staff to National Assembly Man) - Kim Jae-hong (Director-general, KT&G Welfare Foundation) • Bureaucrats/Regulators (12) <ul style="list-style-type: none"> - Financial Supervisory Service (8) - National Tax Agency (4) • Brokers (5): • Employees (5) • Large Depositor (1) • Others (2)
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governmental organizations, the savings banks scandals were analyzed as an outcome of the five policy failures made by 26 bureaucrats. For each step of policy failure, the organization identified those who planned and executed. The failures included: name change of savings banks in March 2001, lifting loan limits in November 2005, M&A in August 2008, sale of non-performing PF loans to Korea Asset Management Corporation (KAMCO) in December 2008, and rolling over of the non-performing loans held by the KAMCO in July 2011.

Given the accepted bureaucratic dominance over the regulatory policies, the decline of institutional performance surrounding the bureaucracy drove the policies toward a systemic corruption. This final distinctive aspect of the financial scandal as the combined institutional decline of policy networks, deferred compensation, and policy coordination. They were intertwined among themselves and when a part of it went corrupt the entire group of institutions went bad. The deepest ground for the institutional decline was laid by the thick networks among policy players including politicians, bureaucrats, and business elites. The networks have developed since Korea took off its industrialization in the 1960s. Then, the networks compensated for the lower salary of public officials than private firms by helping the retiring officials to seek reemployments in the private sector. Finally, close policy coordination, either positive or negative, became available surrounding certain policies including business regulations.

The interpretation converts a bureaucratic policy capture to bureaucratic policy corruption much like political rent-seeking. Policy capture by itself may work either for public or private interests. It is true that Korea has long been known for its positive management of policy discretion over economic decision in the market by limiting the chance for abusing the strong policy power. Since the neoliberal reform both in politics and in the economy during the 1990s, however, private interests have overwhelmed public goods due to the increasing gap between the resources for public and private goals. As previously mentioned regarding the democratization effects in the economy, struggles for public goods by economic bureaucrats became less attractive while political considerations began to

Table 2. Financial Regulators Involved with the Scandal

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- Mr. Ha, ex-FSS Head Inspector: while in office, he took the bribe worth USD 80K from the ACE bank; after he retired, he was reemployed by the TOMATO bank as the internal inspector and took about USD 50K from the ACE for his brokerage with the FSS
 - Mr. A, FSS Prime Inspector: took about USD 80K from the ACE (over 37 times)
 - Mr. B, FSS Deputy Director: took about USD 20K from the TOMATO (5 times)
 - Mr. C, FSS Researcher: took about USD 45K from the JEIL (10 times)
 - Mr. D, FSS Head Inspector: took about USD 12K from the JEIL, and USD 6K from the ACE
 - Mr. E, ex-FSS Deputy Director: took about USD 65K from the JEIL (8 times)
 - Mr. F, ex-FSS Deputy Director: took about USD 100K from the ACE
-

override bureaucratic decisions.

The pervasiveness and strength of Korea's policy networks were reconfirmed and abused in the recent financial scandal. With all the efforts to overhaul the Korean economy through the neoliberal reform of the 1990s, most policy networks that had been constructed for the past decades survived the reform. In the area of savings banks where government regulations remained stronger than commercial banks, the network produced the mingling of the regulators and the regulated. On the one hand, the regulators formed a circle where personal ties held different agencies together leaving no room for checks and balances. The usual school, regional, and cultural factors contributed to the unofficial ties among them. Personnel exchanges had also strengthened the ties among the institutes. Accordingly, the FSC, FSS, and BAI became vulnerable to a collusive behavior despite their different organizational identities as government economy agency, semi-public regulatory association, and constitutionally independent institute for inspection, respectively.

On the other hand, the regulators and the regulated were mixed in the regulated field of savings banks. The relationship was built on the transfer of regulatory officials to private firms, i.e., savings banks after the officials retired. Their position suddenly changed from regulators to the regulated, but their personal ties with the remaining regulators sustained. The public mission of regulating private businesses was endangered due to the closeness between the two sectors through personnel exchanges. Furthermore, since their moves from the public to private sector were massive and systemic, the connections did not limit themselves to the ties between retired/rehired official and their intimates but spread to the entire agencies from which they retired. In this way, a big pool of incumbent and retired government officials came to work together in the same playing field of regulating savings banks.⁵

The concentrated group became an easy prey of lobbying and exploitation by private businesses. On the list of convicted was included even Kim Jong-chang, ex-chief of the FSS. A few directors of the FSS and Eun Jin-soo, high-ranking inspector of the BAI were also indicted. According to the testimony of arrested bank managers, savings banks set up

⁵ We may say that the size of the retirees to savings banks was tiny in comparison with those who moved to bigger and more established financial intermediaries like commercial banks, so should be marginalized from the positive performance in general. It is nevertheless a matter of consequence because those involved in the scandal were wide-spread across the entire field of savings banks, which marked a radical difference from previous big financial scandals where only a few selected people caused the trouble.

detailed plans to treat the regulators where they sometimes divided the targeted agents between those in a position and those not, and between individual and collective lobbies among the banks the other times (*Chosun Ilbo*, June 8, 2011). The regulatory circle then became the center of the lobby and corruption, spreading to other parts of the government and politics. Hence, they reached Lee Sang-deuk, brother of then president and key figure in the leading political party; Jeong Sun-tae, Minister of Government Legislation; Kim Gwang-soo, chief of Financial Intelligence Unit (FIU); Kang Hee-bok, City Mayor of Asan; and Mr. Chang, chief of Sok-cho Tax Office. The wide web of connections grew out of the bureaucratic networks.⁶

3. CONCLUSION

Government agencies in Korea, either in the quality of individual officials or managerial strategies, have little changed since the launch of economic development in the 1960s. A few times of reorganization that were restricted to minor changes in the format of the government hardly account for the sharply exacerbating moral hazard of government officials in the new millennium. The systemic problems within savings banks like the lack of internal oversight mechanism are similarly limited to fully explicate the recent scandal. The internal system by itself has been improved throughout the long history of savings banks since 1972. To the contrary, the level of corruption related to government agencies has only gone up, and furthermore skyrocketed after the neoliberal economic reform in the 1990s.

What happened in Korea recently provides a good example. A few savings banks seek a dishonest solution to save themselves out of trouble by lobbying the regulators. The action brought a chain of events escalating the initial financial violations by a few banks to a nation-wide scandal. First, several inspectors of the FSB either neglected their jobs intentionally or betrayed the agency by trying to protect the savings banks in trouble instead of monitoring or correcting their wrong behaviors. Second, a member of the Board of Audit and Inspection (BAI: independent agency under the president) worked to save a savings bank from being suspended rather than straightening them up through a tight investigation. Third, the commissioner of the Korea Financial Intelligence Unit (KoFIU) under the Ministry of Strategy and Finance (MOSF) was indicted to have taken bribes from one of the troubled savings banks. Finally, a few political figures including four law makers were accused for taking illegal political funds in return for pressing the government agencies to relax the prosecutions. In brief, the savings banks were revealed to serve a department store with all kinds of government corruption imaginable.

This paper argues that the financial scandal is an institutional corruption from policy implementation: the negative turn of the Korean bureaucracy passing Korea's economic and

⁶ An addition explanation is required to sum up the financial scandal as a bureaucratic institutional corruption. As the same institutions existed in the past, a reason for the previous uncorrupted system should be provided. The process of qualitative deterioration of the bureaucratic institutions is skipped in this paper, but the essential part of the process is the conflict between democratization and globalization that happened in Korea simultaneously. Collective control over the elite transfer was available before democratization but later it went out of control due to the disruption of promotion system within the bureaucracy and the disorder in personnel policies as a consequence. Refer to Kim (2012) for more details.

political reform in the 1990s. It is driven by the deteriorating but still existing deferred compensation to government officials in Korea. Following the decades-long practice of seeking post-retirement jobs in private sectors, the officials in the financial supervisory agencies exploit the discretionary power to secure their positions after they are done with the government. Whereas it previously served well the deferred compensation for policy performance, the opportunities for second job in private businesses these days work more for a systemic trade of policy favors and post-retirement positions. Politics explains most part of the systemic deterioration, but the effects are becoming realized in the economy. Korea's democratization along with the collapse of the existing policy networks has disrupted the controlled and thus positive transfer of bureaucratic elites to private businesses. As a consequence, the lingering practice of deferred compensation turned itself to a naked competition to seek post-retirement jobs, raising the level of rent-seeking much higher than expected by liberal economic theories in general. The area of financial monitoring provides an open turf for competition with all means including illegal policy favors to the potential employers.

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