# Kicking The Dog: Korea's Bureaucratic Resistance To Globalization In Reaction To Democratization

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Seven years have passed since the Korean economy was engulfed by the 1997 Asian Financial Crisis. Arguably, the country is still not fully recovered from the catastrophe almost a decade later. In those intervening years, numerous books and papers have attempted to diagnose the origins of the extraordinarily sharp downturn in what was once a high-performing economy, known internationally as one of the four Asian Tigers.[1] Some have traced the development of the crisis, or its effects, but none have yet offered a comprehensive view of the crisis that delineates each aspect of the event against the backdrop of Korea's full economic history, and most of those theories have failed even to demonstrate what actually happened, despite their claims to have done so.

After years of observing the process of post-crisis restructuring, including the early actions that were taken to settle down the liquidity crisis, I believe the time has come for us as political economists to shift our attention away from *what* happened and to focus instead on *why* the crisis occurred. Subsequent investigation should be organized in such a way as to address the primary issue of contention, i.e. whether the crisis was a mishap that just happened to break out in the midst of economic restructuring, or whether it was due instead to an intrinsic flaw in Korea's restructuring plan that would inevitably have a negative effect on the economy.[2] Delving

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[1] Debates on Korea's financial crisis focused on the combined effects of external and internal causes. If the unstable movement of international capital beyond state boundaries after globalization was the main external cause, Korea's declining productivity and weak financial system was the domestic cause. Some stories took either side of the story and deepened the logic, focusing on the demand (internal) or supply (external) of the crisis, respectively. For a good summary of the debate, see, among others, Gregory W. Nobel and John Ravenhill, "Causes and Consequences of the Asian Financial Crisis" in their edited book, *The Asian Financial Crisis and the Architecture of Global Finance* (New York: Cambridge University Press, 2000).

[2] Many economic explanations, either international or domestic versions, fall into these short-sighted views. Financial theories were well argued in Steven Radelet and Jeffrey D. Sachs, "The East Asian Financial Crisis:

into the deeper causes of the crisis calls for a single analytical framework within which the crisis can be seen to be interconnected with past economic performance, pre-crisis quandary, and post-crisis recession. That framework, in turn, requires a single determinant that is applicable to both Korea's past and present economies.

This paper proposes that this single determinant is in fact Korea's bureaucracy. The bureaucracy's responsibility for economic outcomes in good times and bad is given more prominence, and will be shown to hinge on material incentives that were available to economic bureaucrats based on their performance in setting economic policy. Specifically, I propose that post-retirement jobs comprised a main source of bureaucratic compensation and incentive under Korea's pre-crisis structure. I will argue that these deferred compensations were what enabled the high performance of the Korean economy in the 1970s and 1980s and that, conversely, the decrease in these compensations resulted in economic disturbances throughout the 1990s, including the 1997 financial crisis.

The logic of this argument is simple on the surface: deprived of their material benefits, bureaucrats are likely to neglect their public duties, including the setting of intelligent economic policy.[3] However, applying this logic to specific events is much more complicated and harder to justify. One first has to tackle such established views of the Korean economy as the "developmental state" and "corporate coherent bureaucracy". One must perhaps also be able to explain away globalization as the cause of decline in the bureaucracy. More importantly, once needs to be able to fix the locus of bureaucratic compensation within the Korean economy, so as to be able to figure out what suddenly caused its deterioration, and explain why it happened in the 1990s. As a preliminary step to building the theory of bureaucratic responsibility proper, I will briefly describe the interrelationship I believe exists between bureaucratic compensations, democratization, and economic reform in Korea.

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Diagnosis, Remedies, Prospects" *Brookings Papers on Economic Activity*, 1: 1-90; Paul Krugman, "A Model of Balance-of-payment Crises" *Journal of Money, Credit, and Banking* Vol. 11, No. 3 (August 1979) and his *mimeo* version in 1999 on the Asian Crisis, "Balance Sheets, the Transfer Problem, and Financial Crisis." There are also some industrial theories such as, Jeanne Gobat, "Corporate Restructuring and Corporate Governance," *Republic of Korea – Selected Issues, IMF Staff Reports* No. 98/74 (1999); Peter M. Beck, "Revitalizing Korea's Chaebol" *Asian Survey* Vol. 38, No. 11 (November 1998).

[3] Korean studies mostly oriented by public administration produced several papers in this vein. For example, Byungjun Kim, "*Gongmuwon e bokjubuding kwa jikmumolipdo* (Bureaucratic *Bok-ji-bu-dong* and Job Concentration)", *Hankuk Haengjung Hakbo (International Review of Public Administration)* Vol. 28, No. 4 (Winter 1994), pp. 1279-1299; Hojung Kim, "*Hankuk Kwanry Haengtae e Kyuljung Yoin: Bokjibuding e Wonin* (Deciding Factors of the Korean Bureaucratic Behavior: the Causes of Bok-ji-bu-dong)", *Hankuk Haengjung Hakbo (International Review of Public Administration)*, Vol. 28, No. 4 (Winter 1994), pp. 1255-1277.

Reform characterized 1990s Korea. Both economic and political liberalization had been transplanted wholesale into the topsoil of long political authoritarianism and a state-governed economy. In launching both reforms simultaneously President Kim Young-sam (1993-1998) appealed to the nation with the slogan “no political reform without economic liberalization”, and it seemed to make good sense until the contradiction between the two became apparent at the juncture of bureaucracy. The Kim government failed to realize that top-down economic reform would necessarily be on a collision course with political liberalization. The bureaucracy, formerly efficient and autonomous, was doomed to lose both these positive traits under rapid political democratization. Likewise, the deterioration of the bureaucracy was highly inimical to the success of top-down economic reform that it would have to implement.

I believe the evidence shows that decreasing deferred compensation, more than anything else, exacerbated that deterioration. Political liberalization disturbed the stable supply of post-retirement jobs for economic bureaucrats, which in turn led to a drop in their efficiency and a reduction in their autonomy. In retrospect, President Kim could be said to have pursued to incompatible goals at the same time: decentralization of state power for political reform, and strong state guidance in economic reform. Caught between the two irreconcilable political demands, the bureaucracy had no choice but to adopt a passive policy posture, and “rationally” concentrated its efforts on pursuing its own self-interest. In sum, Korea’s efforts to de-centralize its political system inadvertently diminished bureaucratic compensation, and therefore ultimately diminished the capability of the very actors it needed to carry out its centrally-determined economic reform. An economic debacle was then inevitable.

**Korea’s economic crisis: diminishing developmental state or immature democracy?**

For most of the 1990s, Korea was slammed by democratization and globalization, although the 1997 economic crisis impressed outsiders more. It is no wonder that debates on the crisis focused on the two master concepts. Although the two concepts often mingled with one another and were treated in research as a single variable “double advent,” the two processes possessed quite stark differences. Those who adhered to the global idea regarded Korea’s economic troubles as an expected outcome for a declining developmental state under globalization. The Korean economy was supposed to be adrift, according to the idea, while the government was losing its power to influence macroeconomic outcomes or to determine strategies for managing the industrial economy.[4] On the other hand, advocates of democratization effects pointed to the inability of Korea's political system to manage macroeconomic issues since the country began its transition to democracy. Diverse private demands on the economy were not efficiently channeled through economic policies when the old authoritarian-style practices were intermingled with the new democratic legal system.[5] The appropriateness of either stream remained controversial even after the crisis was settled, and tended to continue as the recession in the Korean economy was prolonged after the crisis.

The bilateral debate provides an opportunity for further research. To begin with, the debate throve on the empirical limits of identifying the "double advent" with Korea's economic troubles. Taiwan, one of Korea's economic look-alikes, has also gone through a "double advent." It should also have likewise suffered from waning state power and political transition *if* the two pressures were the key causes of Korea's economic troubles. Taiwan's economy, however, remained steady, not to mention the fact that it weathered the Asian Financial Crisis.[6] Insistence on the double advent to account for Taiwan's stability, on the other hand, imperiled both globalization and democratization by the misleading idea that the exogenous pressures were minor compared to domestic economic factors such as industrial structure or the size of foreign exchange reserves. In other words, Korea's industrial sector, concentrated around a few business conglomerates (*chaebols* hereinafter), and its debt-driven development strategy seemed to make much more difference from Taiwan's, than either democratization or globalization was known to do.[7] A simple juxtaposition of Korea's economic troubles with the double advent, therefore,

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[4] For a survey of debates on developmental state, see Meredith Woo-Cummings, ed., *The Developmental State* (Ithaca: Cornell University Press, 1999). An application of the debate to the Korean case is excellent in Meredith Woo-Cummings, "The State, Democracy, and the Reform of the Corporate Sector in Korea," in T. J. Pempel, ed., *The Politics of the Asian Economic Crisis* (Ithaca: Cornell University Press, 1999).

[5] For a general view on democratization effects on Korea's economy, see Jongryn Mo and Chung-in Moon, eds., *Democracy and the Korean Economy* (Stanford: Hoover Institution Press, 1999). For details, see, Jongryn Mo, "Political Culture and Legislative Gridlock: Politics and Economic Reform in Pre-crisis Korea," *Comparative Political Studies* Vol. 34, No. 5 (2001), or Stephan Haggard and Jongryn Mo, "The Political Economy of the Korean Financial Crisis," *Review of International Political Economy* Vol., 7, No. 2 (2000).

[6] Taiwan's experiences are well portrayed in Peter Chow and Bates Gill, eds., *Weathering The Storm: Taiwan, Its Neighbors, and The Asian Financial Crisis* (Washington: Brookings Institute Press, 2000).

[7] Gregory Noble and John Ravenhill, "The Good, The Bad and the Ugly?" in their edited book, *Ibid*., pp. 80-107. Tun-jen Cheng and Yun-han Chu, "State-Business Relations in South Korea and Taiwan" in Laurence Whitehead ed., *Emerging Market Democracies: East Asia and Latin America* (Baltimore: Johns Hopkins University Press 2002).

significantly diminished the effects of democratization or globalization. Refinements of either the globalization or democratization ideas became necessary.

Accordingly, sophisticated theories of either globalization or democratization process were articulated or applied to the Korean case in the hope of covering the empirical limits of the simple exogenous theories. First, a group of scholars have incorporated institutional perspectives to globalization and argued for "diverse" ways of adaptation. In opposition to the "Washington Consensus" and worldly convergence of economic systems on the one hand, and with the help of new institutional economics theories on the other, some studies successfully constructed theories of endogenous institutional effects on the process of globalization, e.g. diverse paths of "deregulation" or "transformation." To apply the theories to East Asia, these scholars differentiated Korea's financial fiasco from Taiwan's stability through Korea's heedless financial deregulation in contrast with Taiwan's caution, and Korea's declining transformative capacity contrary to Taiwan's solid capacity.[8]

This research agrees with the endogenous institutional arguments in that the Korean state was resilient in the globalization era. The difference between the idea of a developmental state and that of institutional adaptation is only a small factor in explaining Korea's economic downturn. Both point out the weakness of the state to handle the pressure of globalization. Their small difference lies in the definition of state power: whether it is state power over the market in general, or the power of "transformative capacity." If the former focuses on failures in short-term macroeconomic policies, the latter looks at the wider span of non-performing economic reform. In my view, the latter makes more sense not only because the transforming Korean economy was still under the duress of strong state intervention, but because the economy is also known to have suffered more from poor reform policy coordination, a symptom of weak transformative capacity, than from powerlessness in individual policy execution.[9] These facts conflated into the systemic dysfunction of the Korean state that was still strong. A few signs of state weakness like policy forbearance, e.g. the failure to monitor money flows, look small compared to the disharmonious or unorganized state of the government.

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[8] This research indebts much of this idea to, Linda Weiss, *States in the Global Economy: Bringing Domestic Institutions Back In* (New York: Cambridge University Press, 2003).

[9] Weiss, *Ibid*., pp. 7-10.

Nevertheless, it is doubtful that Korea's economic troubles were self-evident judging solely from declining transformative capacity. The different path of Taiwan still remains uncovered under the diagnosis: how could Taiwan sustain capacity while Korea could not? Besides, it remains obscure why the past high capacity of economic transformation, say in the 1960s and 1970s, disappeared in the 1990s. At a glance, it seems reasonable to blame President Kim Young-sam for his imprudent economic policy decisions and the drop of transformative capacity as a result. For instance, his decision to close the Economic Planning Board and to hasten Korea's entry into the OECD are worth naming as triggers of Korea's institutional deterioration at a critical time of global adaptation.[10] But it should not be taken for granted that the decisions were fatal enough to deactivate Korea's past efficient institutions suddenly and on a large scale. President Kim is also known to have craved successful economic reform, at least as much as he desired reorganizing the government. Leading reform agencies should be empowered by political resolution to control the direction of reform. If this is the case, however, then why does the positive pressure to reform seem much weaker than the destructive EPB dissolution, resulting in something like reform failure? Interestingly, Korean bureaucrats are reported to have resisted the presidential idea of economic deregulation and the sudden withdrawal of the government from the economy. The lesson here is that the reasons for and means of Korea's institutional deterioration still remain unclear, despite the useful concept of transformative capacity. All told, globalization theories by themselves (including their institutional sibling) are unable to properly explain why Korea's once-performing state sharply deteriorated during the 1990s.

Second, democratization theories became refined toward a better diagnosis of corruption, the central part of Korea's negative democratization effects. Several *chaebol* scandals swept through Korea's political economy immediately before the 1997 crisis. Hanbo and Kia, the two major financial scandals, radically pulled down the credibility of the economy and caused the withdrawal of foreign capital. Initially, efforts to disentangle the unprecedented corruption

[10] There are some studies that agree with President Kim's responsibility for the economic trouble. For instance, Chang, Ha-joon, Hong-jae Park, and Chul-gyue Yoo, "Interpreting the Korean Crisis: Financial Liberalization, Industrial Policy and Corporate Governance" in Ha-joon Chang, Gabriel Palma, and D. Hugh Whittaker, eds., *Financial Liberalization and the Asian Crisis* (New York: Palgrave, 2001).

scandals paid attention to the "political uncertainty" that democratization had brought.[11]Private firms, *chaebols* in particular, channeled black monies to key political figures or bribed high-level governmental officials to make their business futures certain when everything turned uncertain in the advent of democratization. Put differently, corruption was largely understood as "insurance" bought by private firms against political uncertainty.[12] Soon, however, analysts testified that such political-business trades had been practiced for a long time and were not limited to the 1990s. Challenged by the fact that the whole Korean political history was plagued by bribes and corruption, democratization researchers had to turn their eyes to the issue of controlling corruption and sought for an answer as to why corruption suddenly went out of control in the 1990s.

Two kinds of theoretical refinement were made to get closer to the causes of deteriorating management of political financing. One attributed Korea's structural degeneration to "money politics" while the other argued for transitory instability. According to the first group of studies, democratization increased participants in Korea's political economy from the realms of both politics and private business. The numerical expansion spun corruption out of orbit by disturbing the mutual watch between the state and private sector against an excessive level of corruption, i.e., beyond the point of market operation. Since the Korean economic system was built and propped up by oligopolistic state-business relations, a leash in the tight network (following the structural view) was supposed to plunge the system into "crony capitalism." Democratization acted like the leash in Korea and triggered the downfall of the Korean economy.[13]

The other stream of democratization theories treated corruption as a transitory phenomenon in Korea's policy decision making process. Policy making in Korea was put in chaos temporarily when practical policy processes worked differently from established formal or legal procedures. Elections, for instance, were dominated by regional or personal connections, while such political mechanisms as party platforms or organized interest groups were not yet

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[11] The theoretical framework was developed in, Adam Przeworski, *Democracy and Market: Political and Economic Reforms in Eastern Europe and Latin America* (New York: Cambridge University Press, 1991).

[12] The theoretical framework was developed in, Adam Przeworski, *Democracy and Market: Political and Economic Reforms in Eastern Europe and Latin America* (New York: Cambridge University Press, 1991).

[13]David Kang, *Crony Capitalism: Corruption and Development in South Korea and The Philippines* (New York: Cambridge University Press, 2002).

available.[14] In addition, the shallow ideological grounds of the political parties and a lack of fixed supporters forced party leaders to beg financial contributions for each and every election from private businesses, exacerbating political corruption even more.[15] Maverick labor power that suddenly arose as a key political actor in Korean politics also added to the political fuss in the 1990s. While the political process was suffering from its immaturity in such ways, the economy was equally in trouble due to its negative exploitation of the political transition. The result was the economic downturn in parallel with skyrocketing corruption.

The effects of democratization on the economy through the medium of corruption, however, should not be exaggerated. They tend to limit major actors in the Korean economy to politicians and *chaebols*, thereby underestimating the role of bureaucracy as a junior partner to politics. This is contradictory to the established view on the Korean economy, wherein the bureaucracy was not merely effective but also so autonomous as to have its own discretionary power in economic policies. We should not take it for granted that the bureaucracy tamely acquiesced to the political demands of private collusions or corrupt economic policies. That is, the fact that organizational resistance to political-*chaebol* collusions were rare, or that some bureaucrats voluntarily assisted the collusions, should not be interpreted to mean that all Korean bureaucrats readily degraded themselves from leading developers to predators of the economy at the stroke of democratization. Instead, we need to further investigate the democratization process and demonstrate how it drove most key players in the Korean economy, including politicians and bureaucrats, to corruption.

The seemingly insurmountable weaknesses of each opposing argument can substantially be overcome by combining the processes of globalization and democratization. However, it should not be a simple mixture of the outcomes of both pressures, like those adopted by the early studies. Instead, interactions between the two pressures should be identified and looked at in the light of Korea's economic performance in the 1990s. *This research suggests that the bureaucracy was in a position to connect the two processes, and therefore drove the interactions into Korea's sharp economic downturn in the 1990s.*

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[14] Byung-Kook Kim, "Electoral Politics and Economic Crisis, 1997-1998," in Larry Diamond and Byung-Kook Kim, eds., *Consolidating Democracy in South Korea* (Boulder, Colorado: Lynne Reinner Publishers, 2000).

[15] Gregory W. Noble, Collective Action in East Asia: How Ruling Parties Shape Industrial Policy (Ithaca: Cornell University Press, 1999).

To begin with, democratization threatened economic bureaucrats with the loss of material compensations by taking away the chance at post-retirement jobs. Concerned about the expected deprivation of compensation privileges, Korean bureaucrats suddenly changed their attitudes from high performance to policy passivity or even sabotage. The effects appeared in the form of declining institutional capacity to transform the economy and thus cope with globalization. Under the resulting institutional deterioration, there remained no mechanism to block political-business collusions, hostile behavior by foreign capital, or unproductive investments by *chaebols*, all of which had previously been managed efficiently by bureaucratic policy performance.

Without considering the element of bureaucracy in the development of Korea's economic troubles, a number of domestic economic determinants look more relevant to the economic downturn than democratization or globalization that might only marginally affect economic progression. One might find some clues to the independent roles of the two exogenous pressures in the Korean context, but these factors are not applicable beyond Korea. Neither transformative capacity nor political-private collusions can effectively differentiate Korea's troubles from the stability of others, especially Taiwan's. Korea's bureaucracy, however, was capable of absorbing the two exogenous pressures into Korea's institutional responses and then generating economic outcomes, whether in policy making, market operation, or structural reform. I will go through the bureaucratic mechanism, the effects of democratization, and the responses to globalization one after another in the following sections.

**Korea's Bureaucracy: Developmental Administration and Deferred Compensation**

In contrast with such familiar characteristics of Korea's bureaucracy as meritocratic recruitment and lifetime employment, the aspect of compensation is under-investigated. This paper particularly attends to deferred compensation defined as *bureaucratic material rewards for government services after retirement*. Since Korea's economic takeoff in the 1960s, bureaucrats, especially economic bureaucrats, have been systematically transferred to public or private firms. Salaries and other benefits in these firms are much higher than those of the government services, providing opportunities for recouping from previous insufficient government compensations.

**Table 1: Recruitments of Retiring Bureaucrats by Public or Private Firms, 1960-2000**

| | EPB | MOF | MCI | MOC | Sub Total | Government Total |
|---|---|---|---|---|---|---|
| 1960s | 10 (7%) | 22 (16%) | 11 (8%) | 4 (3%) | 47 (34%) | 138 |
| 1970s | 22 (11%) | 45 (23%) | 34 (17%) | 6 (3%) | 107 (54%) | 198 |
| 1980s | 35 (13%) | 49 (18%) | 38 (14%) | 19 (7%) | 137 (50%) | 274 |
| 1990s | 46 (13%) | 56 (16%) | 45 (13%) | 21 (6%) | 168 (49%) | 345 |
| Total | 109 (11%) | 172 (18%) | 128 (13%) | 50 (5%) | 459 (48%) | 955 |

Notes: (Parentheses) denote percentage of the government total in each decade. EPB: Economic Planning Board; MOF: Ministry of Finance; MCI: Ministry of Commerce and Industry; MOC: Ministry of Construction. Calculated from data drawn from ***Who's Who***, various issues, published by Yunhap News (Associate News), Joong-ang Ilbo, and Chosun Ilbo.

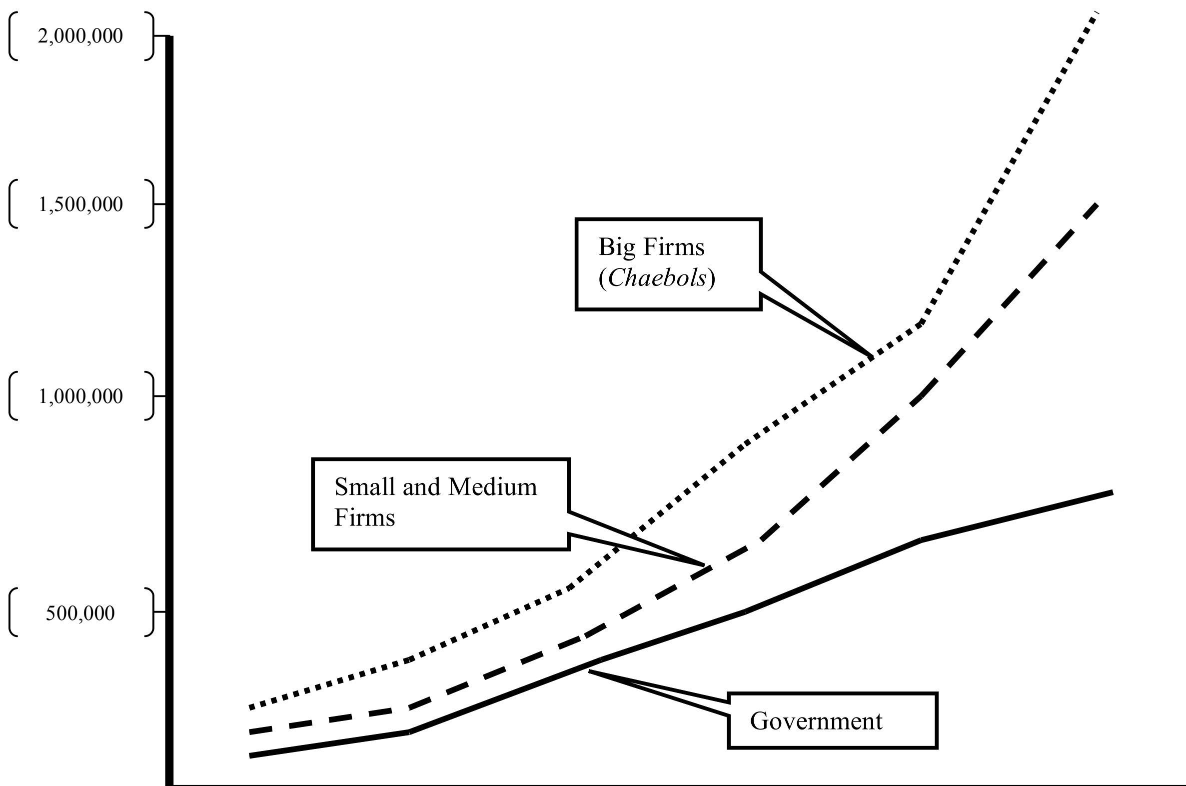
Deferred compensation is meaningful in Korea's economic process because of its contribution to Korea's bureaucratic performance. Few political economists would refute the indispensability of bureaucratic guidance, often evaluated as "developmental administration," for Korea's past economic performance.[16] But the bureaucratic performance is not fully explainable by the factors that these studies have suggested. Systemic merits such as meritocratic recruitment and lifetime employment might contribute to attracting capable youngsters to government service, but they are not necessarily able to encourage those already in office to struggle for better policies.[17] Low compensation relative to the private sector deepens the suspicion. How does job security promote high performance with low compensatory incentives?

*This paper asserts that post-retirement jobs filled the gap between low compensation and high performance*. Much higher salaries in private sector second careers, sometimes more than tenfold, drove bureaucrats to compete for promotion or particular posts, both of which connected to lucrative post-retirement jobs. Korea's bureaucratic performance was the final product of such a deferred compensation system, while competition for a better policy outcome improved both the efficiency and the autonomy of the bureaucracy.

[16] For instance, see Dongsuh Park, "*Hankuk e Kwanryoje wa Jungchi Balchun* (The Bureaucracy in Korea and Political Development)" *Hankuk Jungchihak Hwaibo (Review of Korean Political Science Association)* Vol. 11 (1977). The same author suggested the uniqueness of the Korean public administration in comparison with western countries even after the public choice theories became popular in Korea, too, during the late 1990s. His main points were: distinct historical development, slow democratization, welfare state, and cronyism. Dongsuh Park, "*Hankuk Haengjung e Yungu wa Gaehyuk – Kwaido Sujung* (A Study on Korea's Government Reform – Redirection)" *Hankuk Haengjung Hakbo (Review of Korean Administration)* Vol. 32, No. 1 (Spring 1998), pp. 1-10

[17] The systemic merits were investigated in detail in Peter Evans, *Embedded Autonomy: States and Industrial Transformation* (Princeton: Princeton University Press, 1995).

**Figure 1: Salary Difference between Government and Private Firms**

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|---|---|---|---|---|---|---|
| Government Position | 9th Grade, 1st year | 7th Grade, 1st year | 6th Grade, 16th year | 5th Grade, 20th year | 4th Grade, 20th year | 2nd Grade, 22nd year |
| Private Position | High School Graduate 1st year | College Graduate 1st year | Assistant Section Chief | Section Chief | Department Manager | Director |

*Source*: Ministry of Government Administration, *Annual Report on Welfare of Government Officials*, 1981, p. 184.

The cost of deprecating the aspect of compensation proved high to academic research immediately after the Korean economy began to slide. There remained no way of incorporating the formerly high-performing bureaucracy into the rapidly deteriorating performance of the economy. The only way for a political economist to avoid criticism was to hide the formerly-efficient bureaucratic capability behind political-private collusions, when the systemic merits (meritocratic recruitment and lifetime employment) remained as they used to be but the economy slid. Suddenly, studies on the Korean economy turned to only political behaviors in an attempt to lay responsibility for the poor economic outcomes upon the state.

Sliding deferred compensation brings the bureaucracy back to the center of Korea's political economy. The sharp decrease of deferred compensation, along with the expectation of further decrease, matches up well with the sharp economic downturn. Calculations based on the same ground data that the Table 1 exploited estimate only half of the previous three decade-average in the 1990s.[18] The age of retirement on average has expanded from 40.3 in the 1960s to 46.6, 52.0, and finally 54.9 in the 1990s, which revealed the part of decreasing deferred compensation in parallel with the shrinking time for second careers (and less chance of compensation). But the decrease in working years after retirement was not so drastic as the diminishing opportunities for private jobs, which dropped from 83-87 percent of total post-retirement employments during the previous decades to 68 percent in the 1990s. There should be some factor in the 1990s that caused the precipitous drop in private job opportunities. Democratization, this paper suggests, did not merely trigger the shrinking of deferred compensation, but also created an expectation of continued shrinkage as it deepened.

**Korea's Rapid Democratization: the Cause of Decreasing Deferred Compensation**

Democratization caused both quantitative and qualitative deteriorations of deferred compensation. Three aspects of Korea's rapid political liberalization in particular exacerbated the compensatory destabilization. To begin with, Korea's democratization, as previously mentioned, simultaneously occurred with economic liberalization. We have also mentioned that structural conflicts might occur between political and economic liberalization. The interaction between the two liberalizations, however, was not fully investigated in previous research, let alone their relevance to deferred compensation. This interaction was defined by the other two features of Korea's democratization, military retreat and increasing regionalism.

With the ascendance of the first civilian president in three decades, Korea witnessed massive withdrawal of the military from politics throughout the 1990s. Data on the backgrounds of lawmakers, for instance, testified that those from military backgrounds were downsized from about ten to five percent of the total number of the National Assembly (Korean Congress).[19] On the other hand, Korea's democratization aggravated regionalism that had existed in Korea since

[18] The calculation and a table of basic variables are attached as an appendix at the end of this paper. When holding constant the government pay as 100, deferred compensations were calculated 450, 454, 433, and then *253*, respectively for the 1960s, 1970s, 1980s, and *1990s*.

[19] The numbers and percentages of military backgrounders in each Assembly were, 30 (11percent) in the 11th (1981), 29 (10) in the 12th (1985), 28 (9) in the 13th (1988), 34 (11) in the 14th (1992), and finally 18 (5) in the 15th (1996). *Choong Ang Ilbo* (Daily), *Who's Who*, various issues.

the 1960s.[20] Three presidential elections since 1987, the year of departure to democratization, had been dominated by the regional interests of major areas such as the middle (*Chungchung*), South East (*Kyungnam* and *Kyungbuk*), and South West (*Cholla*).

If military withdrawal downsized the quantity of deferred compensation, regionalism significantly spoiled the quality of the elite transfer system. Military withdrawal from politics entailed the closing of the political appointment of retiring military generals to public firms. The vacancy was filled by career politicians who gradually encroached on bureaucratic turfs beyond the former quota for military appointments. The ramifications of the military withdrawal spread into to private businesses where many new politicians sought their second careers based on their experiences with public firms. Some of them even bypassed public firms with the help of political connections. Eventually, military withdrawal decreased opportunities for deferred compensation both in public and private firms.

In the mean time, rising regionalism disturbed the established order of distributing deferred compensation. It began with regional favoritism within the government. Giving more consideration to regional backgrounds rather than to personal talents or careers in the appointment of key government positions first destroyed the so-called "elite course" within the government. This practice immediately expanded into the post-retirement job market as well. Previously, capable bureaucrats climbed to the top positions within the promotion pyramid, moved to public firms, and then were recruited by private firms. Since regional considerations were prioritized by political leaders of the democratized regimes, individual bureaucrats had to seek political connections to obtain fancy post-retirement jobs instead of exerting themselves in policy performance in order to climb the promotion ladder. Only a few who curried the favor of politicians had better chances in deferred compensation, while most others were excluded. Deferred compensation was no longer an incentive for policy performance, but accelerated a route to corruption instead.

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[20] Some argued that region-based political confrontations began as early as 1970. Soon-bo Moon, "*Han-kuk Jiyuk-juhe Sun-guh e Won-in kwa Ki-won, kurigo ku Sim-hwa Kwa-jung* (The origins and deepening of Korea's regionalism)" *Sa Hwai Yun Ku (Social Research)*, Vol. 7 (2004), pp. 203-243. In the caucus for presidential nomination of the Liberal Party, oppositional at that time, Kim Dae-joong won over Kim Young-sam by appealing to the collective minds of the Cholla region. The strong collective action of Cholla, once formed, continued in the 1971 presidential election and survived until the 2002 presidential election. Others traced further the regional conflicts back to ancient times like the tenth century when the newly constructed kingdom excluded Cholla people from government positions. Heung-hwa Kho, *Han-kuk-in e Ji-yuk-gam-jung (Korea's Regionalism)* (Seoul: Sungwonsa, 1989), pp. 49-65. But the regionalism in a meaningful sense had begun to shadow Korea's politics since the takeoff of Korea's democratization in 1987.

By looking at how things worked in the past, we can see more clearly how these democratic consequences deteriorated, and are continuing to deteriorate deferred compensation. The central piece of the deferred compensation mechanism is hedging policy performance to deferred compensation. Once a capable youngster is admitted by the government, he should do his best to be promoted or selected by prestigious agencies. While immediate compensations are not available under the seniority payment system in Korea, job performance is finally compensated after retirement when the type and position of a second career are mainly determined by his final position and job specialty in the government. Hard work while in government office ultimately endows individual bureaucrats with abundant deferred compensation, the upshot of the process being Korea's high bureaucratic capability.

Next, the way in which deferred compensation is distributed is also conducive to bureaucratic performance. Policy networks, or ex-bureaucrats who are now working in public firms or quasi-public business associations do the distribution on behalf of individual bureaucrats, while economic agencies interact closely with the networks. Put differently, bureaucrats are transferred to private firms through negotiations in group but not individually. There is little room for collusion between bureaucrats and private firms in regard to deferred compensations. In sum, deferred compensation promoted *efficiency* of bureaucratic job performance by providing incentives on the one hand, and still facilitated policy *autonomy* by disconnecting direct deals around compensation on the other.

To rephrase the process of democratization-driven bureaucratic deterioration from the systemic point of view, *military withdrawal and regionalism destabilized deferred compensation by breaking down policy networks.* Political incursion into public firms as a consequence of military withdrawal increased heterogeneity within policy networks because new political elites and bureaucrats had few chances of mingling together before they met in public firms. In contrast, elite bureaucrats and military officers had had diverse channels of association previously.[21] With the breakdown of policy networks, objective standards for distributing post-

[21] Two main sources of interaction between the two elite groups are Korea's draft system and the Graduate School of National Defense. When a junior governmental official has to go for military service after he passes the high-level civil service exam, he is usually assigned to headquarters or other high level command posts. The military services provide a meeting place between future bureaucratic and military elites. By the time the government official becomes a director in an economic agency, he has to go for national security study in the Graduate School where future military generals come for education. Therefore, elite bureaucrats and military officers have chances to know each other twice, both in critical moments of their careers.

retirement jobs were lost. The military withdrawal was full of misfortune for bureaucrats although it might have been good for the new political elites. Economic bureaucrats lost their interest in job performance and Korea's bureaucratic policy efficiency dropped concomitantly.

Regionalism, as hinted earlier, was conducive to corruption. Political elites or bureaucrats with political connections thrust themselves into private firms, increasing the probability of political-business collusion. Otherwise, some bureaucrats sought a private position for themselves, which opened economic policies in their jurisdiction to high vulnerability to favoritism. Policy autonomy that had supported Korea's bureaucratic capability for decades was doomed to disappear. After all, deferred compensation lost its merits as incentive for bureaucratic job performance and as a mechanism to protect economic policies from private interventions. Hence, Korea's bureaucratic capability rapidly decreased during the 1990s as fast as democratization advanced.

**Policy Slippage in Financial Reform: Declining Bureaucratic Capability**

Hints of Korea's declining bureaucratic policy capability, whether it belongs to "transformative capacity" or "developmental state," are observable in every corner of the economic policies of the 1990s, but defining them is totally another matter. Considering the cohesive character of the Korean government between political and bureaucratic leadership, it is not easy to separate bureaucratic policy slippage from political corruption. It is not surprising, therefore, that most studies have taken Korea's policy mistakes of the 1990s as political failure, either driven by the shallow policy experience of new political elites or dominated by political collusion with a few powerful private firms.

This paper seeks to uncover *bureaucratic* responsibility for the unsuccessful outcomes of two critical policy projects of Korea's 1990s financial reform. They are the 1993 Plan for Financial Liberalization and Market Opening and the 1997 Law of Financial Reform. The two projects constitute double axes of Korea's financial reform.

The 1993 Plan marked the blueprint for financial deregulation of both entry and business barriers in Korea. It included designs to numerically increase Non-bank Financial Intermediaries (NBFIs hereinafter) and allowed them to compete with commercial banks. The 1997 Law represented Korea's efforts at institutional reconstruction toward a liberal financial system. Its grand strategy set out to decentralize policy power on financial affairs by reconfiguring the status of the central bank, the Bank of Korea, in its relations to the Ministry of Finance. In both cases, low bureaucratic capability was in sharp contrast with the strong and righteous political resolution to reform the financial sector.

However, the patterns of policy slippage appearing in bureaucratic behaviors were quite different between the two projects. In the earlier case, or the 1993 Plan, there was executive slippage; in the latter, systemic slippage. Put differently, the deregulation project suffered from low bureaucratic capabilities to execute established policy agendas while the decentralization process would undergo bureaucratic sabotage to cater to a political agenda. The two kinds of policy slippage are applicable to most cases of bureaucratic policy mistake, or declining policy capability in general. Hence, most unsuccessful reform projects are attributable to either bureaucratic resistance to political leadership or for executive incapability.

*A. 1993 Plan for Financial Liberalization and Market Opening*

The plan was announced as an executive blueprint of the 1991 Four Stage Interest Rate Deregulation Plan. It was a critical policy decision to substantially deregulate the financial sector through removing government controls over interest rates. Korea had kept tight control over interest until the 1980s in order to funnel sufficient capitals to strategic industries. During the 1980s, the government privatized most commercial banks as a preliminary step to financial liberalization (including interest rate deregulation).[22] The 1993 plan was much more drastic and comprehensive than the 1980s policies. The plan not only facilitated unlimited competition among commercial banks but also introduced non-bank financial intermediary into the competition.

The 1993 project, however, was not equipped with a comprehensive execution plan. The blueprints manifested micro-projects in each period of the long-term timetable for interest rate deregulation (1991-1997). The 1993 agenda included abolishing the barriers in financial businesses and encouraged market decision on interest rates by diverse financial intermediaries and various financial products. A comprehensive plan to orchestrate the process of deregulation was not merely necessary but indispensable as well in such a critical moment of economic transition. Korea’s financial market was still under a significant influence of the government and

[22] Korea’s financial system before the 1990s was well portrayed in, Byung-sun Choi, “Financial Policy and Big Business in Korea: The Perils of Financial Regulation,” in Stephan Haggard, Chung H. Lee, and Sylvia Maxfield, eds., *The Politics of Finance in Developing Countries* (Ithaca: Cornell University Press, 1993).

business skills and experts were far from sufficient in the private sector. Economic agencies did not, however, responded to the 1993 project with detailed executive timetable as political leaders had expected. Cracks in financial deregulation appeared in many cases. For example, short-term interest rates such as the rates of commercial papers were deregulated far ahead of long-term rates of commercial banks. The decision might be good for monetary control or capital supply to major firms, but it was extremely harmful for the original policy goal (deregulation of interest rates) because the reform process had to suffer from inconsistency among financial intermediaries.[23]

Policy favors to NBFIs over commercial banks were even more harmful for a comprehensive deregulation project. NBFIs went out of government control, both in macroeconomic policy guidelines or business regulations. Many studies regarded the biased NBFI policies as an outcome of political domination in economic polices over the bureaucracy. Political interests, according to the view, pressed for the expansion and selection of new NBFIs without considering their business qualities and consequences in financial managements.[24]On the other hand, neglect of duties by economic agencies was largely overlooked by these studies. In fact, economic reports of both public and private research institutes were warning against the decreasing profits of increasing NBFIs and their negative consequences in Korea's financial market. The MOFE (Ministry of Finance and Economy) was the single regulatory agency after the EPB was dismantled and had all means to control NBFIs. However, it did not merely ignore the warnings but also neglected to oversee and supervise financial intermediaries.

The way that NBFIs were developed in Korea might provide a reason for the political domination in NBFI policy decisions. From the beginning, NBFIs were allowed by the Korean government in order to placate private capital that had been suppressed by the government authorities. When President Park Chung-hee froze private debts of corporate firms in the curb market in 1972, he asked the bureaucracy to articulate a means to moderate the loss of private funds. The MOF, following the political demand, enacted the Short-Term Financing Business Act which first created NBFIs in Korea's financial market and offered business advantages to the new financial firms such as higher interest rates to depositors than commercial banks provided

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[23] Jin-wook Choi, "Regulatory Forbearance and Financial Crisis in South Korea" *Asian Survey*, Vol. 42, No. 2 (March/April 2002), p. 258.

[24] Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington D.C.: Institute for International Economics, 2000).

and regulatory exemptions. By 1976, six *danjasa* (short-term financing companies) appeared in the form of merchant banks in Korea. Although major industrial capital established these merchant banks and controlled them, financial policy directions by the government were not disturbed by these private funds, because their specialty and limit of financial mediations were well defined and managed by economic agencies.[25] The NBFI area went out of control with the 1994 introduction of nine *tukeumsa* (investment and financing companies) under the presidential slogan of increasing competition and better financial services. Fifteen more *tukeumsa* were created in two years and total twenty one investment and financing companies that were permitted to deal with every financial intermediary service including direct deposits were incorporated in merchant banks. Political interests regain their dominance in the field of NBFI in the 1990s as we saw in the exorbitant concentration of new businesses in a particular region (five out of nine in Pusan, or President Kim's political hometown, as of 1994).

Policy failure by the bureaucracy, however, was more critical to the overall mismanagement of NBFI market in the 1990s than the deplorable political mistakes in expanding NBFIs and their insufficient business quality. For instance, the MOFE initiated to enact the revision of the Merchant Banking Act in 1995. It lifted the limit of NBFIs' international businesses and allowed them to finance abroad. The decision did not take the lack of relevant monitoring mechanism of capital inflows and outflows into consideration. The indiscreet decision by the MOFE to expose NBFIs to international markets eventually encouraged the NBFIs to engage in risky financial intermediations between international lenders and domestic borrowers, resulting in the big mismatch between short-term foreign loans to long-term domestic investments.

Finally, bureaucratic policy slippage in financial deregulation, lax oversight over money flow in particular, resulted in an unstable financial market in Korea immediately before the 1997 crisis. The grand plan of interest rate deregulation skewed more to an earlier deregulation of short-term based commercial papers and foreign loans than to that of commercial banks and domestic investments. The rest of the story has been well illustrated by many crisis studies, such as mismatches of interest rates between NBFIs (high) and commercial banks (low), and the mismatch between short-term foreign loans and long-term domestic investments. Deteriorating profits of NBFIs due to their sudden increase, as also well investigated, resulted in their

[25] Choi, *Ibid*., p. 30-32.

investments in unproductive areas. Likewise, bureaucratic slippage in policy execution prevailed in Korea's financial reform, triggering the financial fiasco in 1997.

*B. 1997 Law of Financial Reform*

President Kim Young-sam pushed for another project to reform the financial sector in 1997. This time the target was to decentralize governing authorities over financial affairs. Bureaucratic responses, however, were not so enthusiastic as the political initiative. Each economic agency under review for adjustment began to narrowly demand its own interest from the institutional reconstruction. In case of an irreconcilable conflict between two agencies, there came up an all out war between the two by mobilizing every means possible including organizational resistance to the 1997 Law itself. In the mean time, economic reform policies slipped away from the political initiative. Economic bureaucrats should have done their best to pass the law and thereby promote public interests, but they were attending to their own interests. The upshot of the organizational resistance to the law was policy deadlock or immobility in Korea's political economy in its critical time of economic reform.

Fights between the MOF and Bank of Korea (BOK hereinafter) over supervisory jurisdiction of financial intermediaries were most vivid. The bouts between the MOF and BOK had a long history, stemming from the special status of the BOK within the government. The BOK was established as Korea's central bank in 1950 and assumed independent power in managing moneys, foreign exchange, and bank supervision. Its independence, however, was soon usurped by the MOF when the Park Chung-hee government endowed the ministry with an absolute power over the financial sector. Since different voices from the central bank sounded like an obstacle to the strategy of target-industry-development, the president preferred a hierarchical order to checks-and-balances in financial policies. Foreign exchange policies went to the hands of the MOF, and the Monetary Board Meeting, the final authority on financial guidelines, was put under the control of finance ministers. Even the appointment of a BOK governor required the ratification from the finance minister.[26] The five more revisions about the status of the BOK since then have been no more than a series of efforts to reconfirm the supremacy of the MOF over the BOK in financial affairs. Therefore, employees of the BOK,

[26] In lieu of protest to the humiliating revision, the then chairman of the Bank of Korea, Yoo Jang-soon, resigned two days after the new law was passed. *Shindonga*, April 1991, p. 142.

though recruited through a separate channel from the government, were treated a part of Korea's bureaucracy and have come to stand at odds with MOF officials in the planning and execution of many financial policies.

On the other hand, the bank continuously challenged the MOF authority on financial affairs. Highly reasonable were the demands from the bank to establish a new monetary indicator, i.e., M2B instead of M2, or apply the rule of cash reserves to non-bank sectors as well as commercial deposit banks did. Equally reasonable were the responses from the MOF to the BOK demands that an efficient management of existing policies was more necessary than a new policy. The expansion of the financial sector in parallel with Korea's rapid industrial growth, however, was supposed to empower the central bank that held the supervisory authority over commercial banks. The MOF, in response, had constantly tried to take the Bank Supervisory Board from the BOK and give the board an independent status since the 1960s. Although unsuccessful in the final decision, the MOF could put down the demands of the BOK with the threat of weakening the bank's authority over commercial banks.[27] The pendulum swung again to the BOK with the advent of democratization and globalization. Jumping on the "New Economy" under the Kim Young-sam government, the bank revamped its demand for independence. The two sides prolonged the bouts even during and after the 1997 crisis each with seemingly meaningful reasons for finding a batter plan to keep sound financial order.

The 1990s opened another era of showdown between the two financial supervisors. By the end of the 1980s, or with the full advent of democratization, most commercial banks were privatized and the central appointment of ex-bureaucrats to their presidencies became nearly unavailable. NBFIs provided good alternatives to the commercial banks that now could fend off pressure from the government with help from large private stockholders. It began with deregulations on entry barriers and business areas. Merchant banks opened the battle. They were allowed to deal with individual deposits and transform themselves from corporate financers to deposit banks. That would additionally weaken the regulator over commercial deposit banks, or the BOK, and endow the MOF with strengthened power that had held control over the non-bank sector. It was supposed to become an all-out war between the two economic agencies. Several steps of negotiation went on, such as a swap of interests between the non-bank sector and the legal independence of the central bank, but the battle was dragged to the National Assembly and

[27] *Shindonga*, April 1991, pp. 438-449.

finally outlasted the 1997 crisis. While key staff members of the two agencies were struggling for a better excuse, and employees of each agency were spending time on pushing for their own demands in the agenda, national policy goals were neglected and less cared for than necessary. One scholar expressed the deplorable fights for organizational interests as follows:

> The employees all threatened to strike immediately after the National Assembly passed the reform legislation, and a group of former central bank governors held a press conference to voice their opposition to the bills. What is remarkable about this episode is that it took place in the middle of the national financial crisis.[28]

**Conclusion:**

This paper raised the issue of Korea's structural decline in economic performance. Building on ideas about globalization and democratization, it redirected attention to domestic institutional decline in the double advent. The research settled down to the issue of Korea's deteriorating bureaucratic capability to steer the economy, and economic reform in particular. In short, this research expected to find a *structural cause of Korea's economic decline* in the answer as to why the formerly high-performing bureaucracy lost its policy efficiency and autonomy at the same time.

Concerns about the 1990s bureaucratic downturn eventually called for a reinterpretation of its past performance from a different viewpoint. Past-prevailing systemic factors lasted until the 1990s but they could not cover the downturn. Deferred compensation was presented as an alternative criterion by which both past performance and the recent downturn were explained. On the one hand, this interpretation adopted the simple rational explanation of "more compensation, better performance," and refuted the traditional view of Korea's bureaucracy as either a culture- or system-based professional organization. This fresh perspective was also supported by the deteriorating state of deferred compensation during the 1990s.

Conversely, the mechanism of paying deferred compensation defined the relationship between democratization and globalization, and made it possible to better explain Korea's economic downturn from the effects of the double advent. Democratization destabilized deferred compensation, and the deteriorating compensation in turn downed Korea's bureaucratic capacity

[28] Jongryn Mo, "The Politics of Economic Reform: South Korea" *mimeo*, p. 20.

to transform the economy. Globalization failed to adapt the Korean economy to a liberal economy with ease and stability, resulting in the financial fiasco of 1997. Democratization and globalization stood at odds with each other when they passed through the bureaucracy. The double pursuit of political liberalization and top-down economic liberalization proved incompatible in Korea.

Finally, this paper presented two critical cases to testify to the importance of bureaucratic deterioration in Korea's economic outcomes. Bureaucratic policy failures in both the 1993 and 1997 projects were fatal to the success of Korea's financial reform efforts, leading to the 1997 financial crisis. Whereas most existing studies on the 1997 crisis treated the unsuccessful outcomes in both policy projects as political failure, i.e., corruption or crony capitalism, this study interpreted it as the low policy capacity of the bureaucracy to handle the project with the same efficiency and autonomy that it used to have.

## APPENDIX

### Calculations of Deferred Compensations in Four Decades

The following formula is constructed by incorporating all considerable factors that could influence the total amount of deferred compensation.

**Total Earning After Retirement = Probability of Getting a Post-retirement Job * {(Salary of Public Firms * Years of Service in Public Firms) + (Salary of Private Firms * Years of Service in Private Firms * Probability of Getting a Private Job)}**

The results are shown in the table at the end of this page where I fixed the government salary as 100, payments of public firms as 1.28 of government salary, and the age of "final" retirement as 65. The ground for 1.28 times of government pay by public firms is that the Korean government set up the rule of thumb in adjusting salaries of both government and public firms compensation as 1: 1.28, or with government salary approaching 79 percent of public firms counterparts. The age of final retirement borrowed from the most popular retiring time in Korea, i.e., 65.

There are exceptions where some bureaucrats moved to private firms directly but they are fully reflected in the averaged years of service in public firms. Expected deferred compensations shown in the last column of the table are equivalent to the total amount of post-retirement earning in a relative term of government salary, i.e., 100. That is, a bureaucrat of the 1970s could expect an equivalent of four and half year-equivalent government salary when he retired from the government. The recent deterioration of deferred compensation is clear from the results where the retiring bureaucrats of the 1990s could expect slightly over half of those of previous decades.

**Results**

| | Government Salary (absolute) | Public Salary (absolute) | Public Service (years) | Private Salary (relative to government) | Private Service (years) | (Expected) Deferred Compensation |
|---|---|---|---|---|---|---|
| 1960s | 100 | 128 | 12.1 | 103 | 12.5 | **450** |
| 1970s | 100 | 128 | 8.9 | 127 | 9.3 | **454** |
| 1980s | 100 | 128 | 7.7 | 158 | 5.2 | **433** |
| 1990s | 100 | 128 | 3.9 | 172 | 6.5 | **253** |