

2012 Modularization of Korea's Development Experience: Governance of SOEs and Public Institutions in Korea

2013



MINISTRY OF
STRATEGY
AND FINANCE



KDI SCHOOL
KDI School of Public Policy and Management

2012 Modularization of Korea's Development Experience:
**Governance of SOEs
and Public Institutions in Korea**

2012 Modularization of Korea's Development Experience
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and Public Institutions in Korea

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Preface

The study of Korea's economic and social transformation offers a unique opportunity to better understand the factors that drive development. Within one generation, Korea has transformed itself from a poor agrarian society to a modern industrial nation, a feat never seen before. What makes Korea's experience so unique is that its rapid economic development was relatively broad-based, meaning that the fruits of Korea's rapid growth were shared by many. The challenge of course is unlocking the secrets behind Korea's rapid and broad-based development, which can offer invaluable insights and lessons and knowledge that can be shared with the rest of the international community.

Recognizing this, the Korean Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI) launched the Knowledge Sharing Program (KSP) in 2004 to share Korea's development experience and to assist its developing country partners. The body of work presented in this volume is part of a greater initiative launched in 2010 to systematically research and document Korea's development experience and to deliver standardized content as case studies. The goal of this undertaking is to offer a deeper and wider understanding of Korea's development experience with the hope that Korea's past can offer lessons for developing countries in search of sustainable and broad-based development. This is a continuation of a multi-year undertaking to study and document Korea's development experience, and it builds on the 40 case studies completed in 2011. Here, we present 41 new studies that explore various development-oriented themes such as industrialization, energy, human resource development, government administration, Information and Communication Technology (ICT), agricultural development, land development, and environment.

In presenting these new studies, I would like to take this opportunity to express my gratitude to all those involved in this great undertaking. It was through their hard work and commitment that made this possible. Foremost, I would like to thank the Ministry of Strategy and Finance for their encouragement and full support of this project. I especially would like to thank the KSP Executive Committee, composed of related ministries/departments, and the various Korean research institutes, for their involvement and the invaluable role they played in bringing this project together. I would also like to thank all the former public officials and senior practitioners for lending their time, keen insights and expertise in preparation of the case studies.

Indeed, the successful completion of the case studies was made possible by the dedication of the researchers from the public sector and academia involved in conducting the studies, which I believe will go a long way in advancing knowledge on not only Korea's own development but also development in general. Lastly, I would like to express my gratitude to Professor Joon-Kyung Kim and Professor Dong-Young Kim for his stewardship of this enterprise, and to the Development Research Team for their hard work and dedication in successfully managing and completing this project.

As always, the views and opinions expressed by the authors in the body of work presented here do not necessary represent those of the KDI School of Public Policy and Management.

May 2013

Joohoon Kim

Acting President

KDI School of Public Policy and Management



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Summary

SOEs played a key role in the early stages of industrialization in Korea. Korea still has a large number of SOEs in many industries including energy, infrastructure, and finance sectors, although their proportion in the corporate sector decreased considerably over time as large chaebol groups expanded rapidly since 1980s. Governance of SOEs in Korea is fundamentally different from that of private firms as the government perceives them as policy instruments. In 1983, Park Chung-hee administration established a standardized governance structure for large SOEs in which the government's shares were 50% or more by the Framework Act for the Management of Government Invested Institutions. The law gave the line ministries a near absolute control over the management of SOEs subject to them while at the same time allowed then Economic Planning Board to provide checks and balances in a limited way. This structure succeeded in establishing large SOEs separate from the government sector.

In the early 1990s, however, it became clear that the governance structure prescribed by the Framework Act for the Management of Government Invested Institutions was inefficient as it did not allow the SOEs subject to it sufficient profit incentives and management autonomy. The governance structure was incompatible with the introduction of competition, which was unavoidable, either. In 1997, Kim Young-sam administration established a new governance structure in some of the largest SOEs at the time by the Special Act on Privatization after more than 3 years' preparation. The Anglo-American style governance structure installed in the SOEs allowed them operate based more on profit incentives and management autonomy while at the same time reduced the role of the line ministry.

Kim Dae-jung administration, which succeeded Kim Young-sam administration, privatized many SOEs which were selling goods and services which were of commercial nature, including four of the six largest SOEs and also amended the Framework Act for

the Management of Government Invested Institutions to give the SOEs subject to it more autonomy from the bureaucracy of the line ministries.

The two administrations that succeeded Kim Dae-jung administration did not attempt to increase profit incentives or management autonomy, which had been the policy of the two preceding administrations. Instead, Roh Moo-hyun administration established a unified governance structure for SOEs as well as public institutions, the nature of whose businesses is closer to that of the government than commercial firms, by legislating the Act on the Management of Public Institutions which replaced most of the laws on the governance of SOEs and public institutions that had existed before in 2007. By trying to apply the essentially the same governance structure in hundreds of SOEs and public institutions, the nature of whose businesses was diverse and significantly different from each other, the new governance structure resulted in the weakening of the profit oriented management of commercial SOEs.

The main lesson developing countries can learn from the Korean experience is that the governance of commercial SOEs needs to be based on strong profit incentives, independent of the policy functions of the line ministries and other government agencies. Developing countries that are in the infant stage of industrialization may be able to borrow some of the features of the governance structure of government invested corporations that Korea had used earlier.

2012 Modularization of Korea's Development Experience
Governance of SOEs and Public Institutions in Korea

Chapter 1

Introduction

Introduction

The objective of this paper is to explain Korea's State-Owned Enterprises (SOEs) governance structure, evaluate the structure and relevant policies, and suggest its implication for developing countries. In most developing countries, SOEs account for a significant portion of their national economies, and inefficiency of these SOEs considerably hinders their economic development. Especially in former socialist states where they had no private sector, SOEs played a crucial role even after they adopted the market economy. As there had been no private firms under the socialist economic regime, it was inevitable that most firms in the early years after adopting the market economy were SOEs or government businesses. These countries generally succeeded in building small firms as privately owned enterprises in the first few years of market economy, using a combination of privatization and establishment of new private firms. However, they tended to fail in building large private firms. As a result, they maintained most of large firms in their economies as SOEs or government businesses.

Korea is different from the former socialist countries in the ownership and governance structure of large firms. Since the very beginning of industrialization, the proportion of SOEs or government businesses in the corporate sector has always been significantly smaller. This is mainly due to the fact that Park Chung-hee administration, which industrialized Korea during the 1960s and 1970s, chose to build most of the large firms as private firms using the *chaebol* system. Still, Korea has had its share of SOEs as the government itself decided to build and run large firms in some industries, in particular, financial and network industries and ended up having a significant number of large SOEs.

Over the past fifty years, there were several waves of changes in the SOE management system used by the Korean government. After the amendment of the Constitution in 1987 which led to a five-year, single-term presidency, every time a new administration took over,

it included its SOE policy as an important part of its economic policy package. SOE policies of the past administrations usually targeted the privatization of some SOEs or changes in the governance structure of SOEs. Since the late 1960s, there have been a few large-scale privatizations of SOEs. The last wave of privatization which took place between 1998 and 2003 was the most comprehensive one that had far-reaching impacts to many sectors. On the governance side, the introduction of the Framework Act on the Government Invested Institutes in 1983 marked the beginning of a stable governance structure that governed most of the large SOEs until 1997. This act has had significant effects on the governance of SOEs even after it was abolished and replaced by another act in 2007. Another important legislation on the governance of SOEs was the Special Act on Privatization introduced in 1997, which prescribed a governance structure for four large commercial SOEs which were fundamentally different from that of other SOEs at the time.

Korea's SOE policy substantially differs from that of developed countries in the west: Compared to these countries, the separation between commercial functions and policy related functions of SOEs is less obvious, and the tendency to regard SOEs as a direct tool for policy implementation is very strong in Korea. However, compared to the policies of developing countries, which adopted the market economy at a later time than Korea, especially the former socialist countries in Asia, the separation between commercial and policy functions is more distinct in Korea. Korea was much more active in privatizing large SOEs, too. The evolution of the Korea's policy on SOEs certainly reflects the economic development of Korea in the last half a century. But it also reflects the unique characteristics of Korea's political and social structures. The choice of the policy on the ownership and governance of SOEs at a certain point in time depended on the incentives of politicians, bureaucrats, managers and employees of SOE, labor unions, and the *chaebols* that had strong business interests in SOEs. Thus, the past and current policies of Korea on SOEs can have significant implications to developing countries whose political and social structures share some of the crucial characteristics with Korea.

Apart from SOEs, which are enterprises that have strong commercial elements, many countries have institutions of public nature, which are not a part of the government itself but are established and run by the government in order to achieve some public policy objectives. In this paper, we will use the term "public institutions" to distinguish them from SOEs. Most developing countries have many public institutions. In particular, developing countries that had a socialist regime and adopted the market economy relatively recently have a large number of public institutions. As a result, the efficiency of the public institutions is an important issue in most developing countries. Korea also has established and run a large number of public institutions since it was founded as a nation in 1948. While most of these public institutions are small in size, some of them are large. The sheer number of them and

the fact that some of them are large in size and spend a large amount of budget make it an important policy objective to establish an efficient governance structure in Korea, too.

While both SOEs and public institutions are established by the government and are controlled by the government, the nature of their businesses is fundamentally different. As a result, the policy objectives behind them as well as the optimal mechanism that can achieve relevant policy objectives are different. One common mistake made by many developing countries is the failure to understand the difference between the SOEs and public institutions and the need to implement fundamentally different governance structures in them. Korea is not free from this drawback in dealing with SOEs. However, Korea generally allowed a governance structure in SOEs that was based on stronger profit incentives than most developing countries in the past. In particular, successive administrations kept allowing stronger profit incentives and more management autonomy between the early 1980s and 2000s, which contributed to the creation of large competitive commercial firms such as POSCO, KT, SKT, and KOGAS. However, the governance of SOEs has always been dominated by politicians in the ruling party and the bureaucrats of the line ministries who perceive SOEs as the instruments for the policies they favor.

This paper deals mostly with commercial SOEs. The reason for this is that the governance of public institutions was very incomplete and uncertain until very recently while the governance of SOEs was much clearer and well documented. The laws and regulations that applied to most of the large SOEs outside the financial sector have been well documented including the details of the governance structures installed since 1983. On the other hand, there were many public institutions which did not have well defined governance structures prescribed by laws before the introduction of the Act on the Management of Public Institutions in 2008.

This paper proceeds as follows: In the next chapter, we provide an overview of the policies of the various administrations that ruled Korea on the governance of SOEs and public institutions and the privatization of SOEs during 1948 – 2012. The main objective of this chapter is to give the reader a bird's eye view of the evolution of the SOE sector and the policies toward SOEs. Detailed discussion of the policies and evaluations on them will be given in subsequent four chapters. This chapter is quite complete in providing information on the privatization plan and the results of every administration from 1948 and allows one to compare the policies of the past administrations with those of the current administration on the privatization of SOEs.

Chapter 3 describes the governance of SOEs between 1948 and 1997 in detail. In particular, it contains a detailed discussion of the Framework Act for the Management of Government Invested Institutions (GIIs) introduced in 1983. One can see clearly from this chapter that

the nature of the governance structure applied to SOEs before 1997 was consistently based upon the idea that an SOE is a direct policy instrument of the ministry in charge of the industry despite several waves of changes initiated by successive administrations. Chapter 4 provides a detailed account of the Special Act on Privatization introduced in 1997 by Kim Young-sam administration, which was the first truly fundamental change in the policy toward the governance of SOEs that occurred in Korea. The policy of Kim Young-sam administration toward SOEs which came to power in 1993 was not much different from that of previous administrations in the first 3 years. However, the Special Act on Privatization which was introduced after 2 years' preparation is fundamentally different from the policies of all the administrations before and after Kim Young-sam administration except Kim Dae-jung administration in that it explicitly dealt with the *chaebol* problems that had been working as a crucial barrier to the privatization in Korea for a long time and gave a serious attempt to separate policy objectives from commercial objectives. This chapter includes detailed analyses of the 6 largest SOEs that existed at the time.

In Chapter 5, we summarize and evaluate various policies of Kim Dae-jung administration on SOEs and the relevant industries. This chapter discusses the policies of Kim Dae-jung administration on competition and regulations of the network industries that it privatized or attempted to privatize. It also covers the policies on more narrowly defined governance of SOEs, focusing on the consistency of various policies it implemented or attempted to implement.

Chapter 6 covers the policies of Roh Moo-hyun administration. In particular, it provides a detailed explanation of various aspects of the governance structure Roh administration introduced in 2007 by legislating the Act on the Management of Public Institutions, which still governs SOEs and public institutions in Korea today. Chapter 7 draws conclusions and summarizes implications for developing countries.

2012 Modularization of Korea's Development Experience
Governance of SOEs and Public Institutions in Korea

Chapter 2

Overview of Policies on State-owned Enterprises (SOEs) and Public Institutions since 1948

Overview of Policies on State-owned Enterprises (SOEs) and Public Institutions since 1948

SOE ownership and governance structure in Korea underwent five distinctive periods: (i) From the establishment of Korean government until just before Park Chung-hee administration, (ii) From 1961 when Park Chung-hee administration began till 1983 when the framework act on the management of SOEs was first enacted, (iii) From 1983 till 1997 when Act on the Improvement of Managerial Structure and Privatization of Public Enterprises was adopted, (iv) From 1997 till 2004 when the Framework Act on the Management of Government-affiliated Institutions was first introduced, (v) From 2004 till now. This section first summarizes SOE governance structure and its privatization in each period prior to 2004 and then gives a brief overview of the Framework Act on the Management of Government-affiliated Institutions in 2004 and of the law on the management of public institutions in 2007. Section 3 contains more detailed information on Act on the Management of Public Institutions that currently applies to most SOEs and public institutions, and the evaluation on this system.

When Korea was liberated from the Japanese occupation which had lasted for 36 years until the end of the World War II, there were a handful of firms left behind by the Japanese, which had been established and operated as government businesses and SOEs by Japan. Large scale government businesses left behind by the Japanese were railroad, telecommunication, and electric power businesses as well as monopoly businesses in ginseng, tobacco and salt. In addition, there were many small businesses that had been owned and operated by the Japanese government, private enterprises, and individuals, which the newly born Korean government took away and turned into government businesses, generally called “confiscated properties.”¹ It seems that there existed no clear distinction between

1. These properties are generally called *gui-sok-jae-san* in Korean, which we translated into confiscated properties.

a government business and an SOE at the time. There were a large number of confiscated properties in the beginning but they were purchased by private enterprises and individuals as the Korean government privatized them and sold them to whoever wanted to purchase them. In the late 1950s, there were only 36 enterprises owned by the government. The following <Table 2-1> lists enterprises identified as SOEs as of 1960. Some enterprises in <Table 2-1> such as Chosun Housing Administration, Chosun Machinery Workshop, Samsung Mining Company are presumed to be confiscated properties. Newly founded SOEs established by the Korean government include the Bank of Korea, Korea Development Bank, Korea Shipbuilding Corporation, Korea Coal Corp, Korea Shipping Corporation, Korea Transport Corporation, Korea Tungsten Company, Korea Heavy Industries, Korea Resources Corp, Korea Educational Books Corporation, and Chungju Fertilizer Corporation.

Table 2-1 | SOEs including Confiscated Properties (as of the end of 1960)

Organization Name	Year of Establishment	Share owned by the Government(%)	Parent Organization
<GIs>			
Bank of Korea	1950	100	Bank of Joseon
Korea Development Bank	1954	100	Choseon Industrial Bank
Korea Minting and Security Printing Corporation	1951	100	Printing Workshop
Korea Coal Corporation	1950	100	Mine Work
Choseon Housing Administration	1941	100	Choseon Housing Administration
Korea Shipping Corporation	1950	100	Choseon Mail Steamer Company
Korea Shipbuilding Corporation	1950	80	Chosun Heavy Industry Company
Korea Educational Books Corporation	1952	51	
Chungju Fertilizer Corporation	1958	100	
<Confiscated properties>			
Chosun Electric Power Company	1943	86	Choseon Hydroelectric Power, Choseon Transmission
			Bu-young Hydroelectric Power

Organization Name	Year of Establishment	Share owned by the Government(%)	Parent Organization
Gyeongsung Electric Company	1915	66	Seoul Electric Company
Chosun Electricity	1937	83	Daeheung Electric Company
Korea Transport Corporation	1958	66	Joseon Transport Company
Korea Tungsten Company	1952	88	Korea Tungsten Mining Company
Korea Heavy Industries	1953	100	Choseon Iron and Steel Company
Korea Iron Ore Corporation	1955	100	Samhwa Mining Company
Chosun Machinery Workshop	1937	100	Chosun Machinery Workshop
Samsung Mining Company	1943	100	Jang-hang Smelting Factory

Source: Kim Yiksoo, "Improvement in GII Management System," 『National Budget and Policy goals』, Korea Development Institute, 1984, p.392

Korea had started to set up an increasing number of enterprises since the early 1960s as the Park Chung-hee administration attempted to build firms in exporting industries and tried to subsidize private firms in the export industries through its unique industrial policy of heavy government involvement in the financial sector. In subsequent years, Park Chung-hee administration began to build large firms in heavy and chemical industries using the *chaebol* system in most industries and the SOE system including financial industries and network industries, such as telecom and electricity.² While Park Chung-hee administration launched these SOEs or government business, it also privatized many SOEs with high market potentials, most of which had operated in mechanical, transportation, and mining industries. The following <Table 2-2> summarizes privatized SOEs by Park Chung-hee administration.

2. The term *chaebol* system here means the industrial policy used by President Park Chung Hee, and the conglomerates called *chaebol* groups emerged as a result of the policy, which was to force banks to make large amount of loans to a handful of small and medium sized firms owned and controlled by a group of businessmen whom President Park trusted so that they could build large firms in strategic industries. Such a policy would be impossible in a democracy but it was possible only because Korea was under a dictatorship. Conglomerates in other countries are not *chaebol* groups as they are not created as a result of such an industrial policy which relies on a small number of businessmen as the agents to build large firms for the country. We believe that *chaebol* groups are unique in Korea.

Table 2-2 | Privatized SOEs by Park Chung-hee Administration

Year of Privatization	Organization Name	
1968	7	Korean Machinery Industries Corporation, Korea Express Corporation, Korea Shipping Corporation, Korea Airlines Corporation, Korea Shipbuilding Corporation, Incheon Heavy Industries Corporation, Korea Iron Ore Development Corporation
1971	2	Korea Mining & Smelting Corporation, Korea Salt Manufacture Corporation
1972	1	Commercial Bank of Korea
1973	1	Korea Fisheries Development Corporation
1978	1	Korea Reinsurance Corporation

Source: The Economic Planning Board(1988), 『A Report on SOEs』, p.66

Chun Doo-hwan administration which ruled Korea by force during 1979–1987 established several large SOEs. Chun administration turned the telephony unit within the Ministry of Postal and Telephony into Korea Telecom by corporatizing it in the early 1980s and also established KOGAS to import and distribute natural gas, and reorganized Korea Rural Community Corp into Korea Agro-Fisheries and Food Trade Corporation. It also encouraged SOEs in telecommunication and financial sectors to launch subsidiaries within their industries to effectively develop the market for telecom and financial services that became available in Korea. However, the growth of SOEs was limited to those sectors. After the early 1980s, private enterprises grew at a rapid rate in nearly all industries largely due to continued subsidies from the Chun administration in the form of credit rationing. Therefore, the establishment of new SOEs was limited only to branching out of existing SOEs in their related areas.

One important policy on SOEs implemented by Chun administration was the Framework Act on the Management of GIIs in 1983, which prescribed a governance structure of most of the large SOEs classified as GIIs. The governance structure of GIIs prescribed by this act was more effective than the governance structure that had preceded it in distinguishing SOEs from the government itself and in allowing more flexible management. The governance structure given by the act in 1983 had been used for an extended period of time without major changes and had far-reaching and long-lasting effects on the governance of SOEs and public institutions through the 1990s and 2000s. Although the Framework Act on the Management of GIIs faced few dramatic changes after 1997 and was finally abolished in 2007, its basic principles were maintained in the current public institutions management law.

On privatization, Chun administration sold quite a few SOEs including four commercial banks such as Hanil Bank, Bank of Seoul, First City Bank of Korea, and Joheung Bank as well as Korea Oil Corporation to private enterprises. The following <Table 2-3> lists SOE privatization results from 1977 to 1986. In the process of commercial bank privatization, government-owned stock was distributed evenly between cooperate investors and individual investors through competitive open bids, subject to the ownership ceiling of 5% for corporate investors and 5,000 shares for individuals. After the banks were listed for privatization, they placed 8% limit on the ownership by a single stockholder. Most *Chaebols* held shares within the 8% limit, but they were not allowed to take part in the management of the banks. Instead, powerful politicians in the ruling party and the bureaucrats who took orders from politicians and executed them controlled the privatized banks. Executives and managers of those banks did not function properly in the best interests of their banks. Large scale loans were made based on political considerations and their relationship, which ultimately led to the bankruptcy of most of those banks in 1997. Thus, the privatization of commercial banks did not achieve objectives that one normally associated the privatization of state-owned banks with increased efficiency and transparency. It actually produced an outcome that was close to a complete failure. It is worth noting that the privatization of Korea Oil Corporation was crucial to the establishment of the SK group, the fourth largest *chaebol* group in Korea today.

Table 2-3 | Privatized SOEs by Chun Doo-Hwan Administration

Year of Privatization		Organization Name
1979	10	Korea General Food, Dongshin Chemical, Samyoung Hardboard, Choil, Chilil, Korea Spinning, Korea Cement Manufacture, Pungsan Metalwork, Dongsung Iron Steel, Daeseon Shipbuilding
1980	3	Korea Mail Milk, Korea Raw-silk, Kyeongju-Bomoon Hotel
1981	4	Korean Dredging Corporation, Korea Oil Corporation, Hanil Bank, KAP
1982	11	First City Bank of Korea, Bank of Seoul and Trust Company, Onsan Copper Smelting, Korea Heavy Industries, Daewoo Shipbuilding, Hanseo Food, Buyeo Youth hostel, Kyeongju Choseon Hotel, Haeundae Development, Hansung, Korea Housing Development
1983	4	Joheung Bank, Korea Tourism, Daebo Securities, Choseon Hotel

Comment: Onsan Copper Smelting was merged into Korea Mining & Smelting Corporation

Source: The Economic Planning Board (1988), 『A Report on SOEs』, p.66 and KwakSoo Il(1988), 『A Research on Privatization of SOEs and Public Institutions』, KDI, p.12

Constitutional amendment in 1987 led to the emergence of a new political system of a single term, 5 year presidency. Since 1987, it became a custom that every administration that came to power announced its policy on SOEs as an important part of its package of economic policies shortly in the first year of its tenure. Each administration, starting with Roh Tae-woo administration, prepared a plan to improve the efficiency of SOEs and the performance of the relevant industries. However, except in the case of Kim Dae-jung administration, every administration failed to carry out its privatization scheme. Roh Tae-woo administration created a SOE privatization promotion committee, which drafted an ambitious privatization plan as well as a restructuring plan for several SOEs. However, it failed to implement most of its plans and ended up selling minority shares of three SOEs. The following <Table 2-4> and <Table 2-5> summarize the privatization plan and the actual outcome of Roh Tae-woo administration.

Table 2-4 | Privatization/Restructuring Plans of Roh Tae-woo Administration
(in June, 1987)

(Units: one hundred million won, %)

	Organization Name	Paid in Capital	Government Investment	Percentage of Shares hold
Complete Privatization	Korea Stock Exchange	30	20	65.2
	Kookmin Bank	822	597	72.6
	Industrial Bank of Korea	1,821	1,820	99.9
	Korea National Textbook	82	41	50.0
	Korea Exchange Bank	4,050	100	2.5
	Korea Appraisal Board	20	10	49.4
	Korea Engineering Consultant Corporation	352	73	20.8
Partial Privatization	KEPCO	30,417	30,417	100.0
	Korea Telecom Corporation	19,605	19,605	100.0
	Pohang Iron and Steel Corporation	4,114	1,373	33.4

	Organization Name	Paid in Capital	Government Investment	Percentage of Shares hold
Restructuring	Korea Overseas Development Corporation	9	9	100.0
	Korea Industrial Base Development Corporation	5,201	5,060	97.3
	Korea Agro-Fisheries and Food Trade Corporation	100	100	100.0
	Korea Development Bank	7,457	7,457	100.0
	Housing and Commercial Bank	490	473	96.4
	Korea Trade Promotion Corporation	5	5	100.0
	Korea General Chemical	878	44	5.0

Comments: 1) Residual equity 97.5% is 395 million won invested by Bank of Korea

2) Korea Development Bank, commercial banks, Daehan Tunsten each held 38.0%(156 million won), 26.1%(108 million won), and 2.5%(10 million won) of the residual equity

3) According to government-issued stock plan by the Ministry of Finance, three banks were planned to be re-designated as partial privatization targets, but the plan hadn't been confirmed at this time (December, 1987)

4) According to government-issued stock plan by the Ministry of Finance, the Monopoly Corporation whose paid-in capital and government investment was estimated to be 1.2 trillion is also a partial privatization target

Source: Review and Evaluation Office of the Economic Planning Board. Kang Shin Il(1987), "SOE Privatization and Relaxation of Government Regulations" 『Korea Development Research』, Book 9, Volume 4, p.140

Table 2-5 | Privatization Result of Roh Tae-woo Administration

Classification	Organization Name	Time of Privatization	Information on Privatization
Government-issued Stocks (partial)	Pohang Iron and Steel	1988	Sold 34.1% of the government shares
	KEPCO	1989	Sold 34.1% of the government shares
	Kookmin Bank, KEB	1990	Sold 34.1% of the government shares
Others	Korea Stock Exchange	1987	Sold to 25 securities companies
	Korea Appraisal Board	1988	Sold to commercial banks
	Korea Engineering Consultant Corporation	1989	Sold to existing private investors

Source: Kang Shin Il (1987), 'A Study of SOE Privatization', Policy forum on SOE privatization, KDI, 1987.4

Kim Young-sam administration attempted to sell shares of 58 different SOEs and merge eleven SOEs in 1993, but failed to carry out the plan. While the privatization of some commercial large SOEs were needed, it was difficult, if not impossible, to privatize even a single large SOE during its tenure. Instead, it introduced the Special Act on Privatization, which attempted to remove a crucial barrier to privatization of large SOEs in Korea. It also reformed the governance structure of large commercial SOEs to improve their efficiency before full privatization. The act acknowledged that allowing *chaebol* groups to purchase controlling interests of a large SOE would aggravate the problems the *chaebol* system had caused. As a result, it prohibited the purchase of controlling interests of large SOEs by *chaebol* groups by imposing a 15% ceiling on the ownership by a single party. The act also prescribed an Anglo-American style governance structure for large commercial SOEs that was fundamentally different from the governance structures for SOEs that had been in effect at the time. In particular, the act prohibited the line ministry from participating in the board of directors and attempted to separate the commercial operation of the SOEs from the policy functions line ministries attached to them more clearly. It originally targeted at four out of the six largest commercial SOEs that existed at the time; KT, KT&G, KOGAS, and Korea Heavy Industries. While Kim Young-sam administration did not succeed in meeting the goal on the privatization it had set for, it ended up contributing significantly to the improvement of the SOE sector by introducing the act. Following <Table 2-6> and <Table 2-7> summarize the privatization plan and the results of Kim Young-sam administration respectively. Detailed discussions on the Special Act on Privatization are given in Chapter 4.

Table 2-6 | Privatization/Restructuring Plans of Kim Young-sam Administration

Classification	Organization Name	Time of Privatization or Restructuring	Information on Privatization
Privatization Targets	Kookmin Bank	1994	Disposed of entire government shares (139 billion won)
	KEB	1994-95	Disposed of government shares(10 billion won) in 1994.Disposed of shares owned by Bank of Korea (395 billion won) in 1994-95.
	Industrial Bank of Korea	1996	Disposed of entire government shares (308 billion won)
	Housing and Commercial Bank	1997	Disposed of entire government shares(69 billion won)
	National Textbook	1994	Disposed of shares owned by the government and Korea Development Bank (8 billion won)
	KOGAS	1994-95	Privatized after conducting research on privatization methods in 1994.
	KT&G	1998	Privatized in line with policies on tobacco and ginseng farms
	Korea Tourism Corporation	1994	Disposal of subsidiaries and properties such as a golf course
	Korea Welfare Corporation	1994	Disposal of hospitals that deal with small number of industrial accidents
	Korea Technology Banking Corporation	1994	Disposed of shares owned by Korea Development Bank (4 billion)
Restructuring Targets	Korea National Oil Corporation - Korea Resources Corporation	1994	Merger
	Korea General Chemistry	1994	Dissolution after debt-for-equity swap of Korea Development Bank shares owned by the government
	Korea Land Development Corporation	1994	Abolishment of redevelopment and development function of foreign corporations
	Korea Trade Promotion Corporation	1994	Locating overseas branch in developing countries and strengthening the support for overseas expansion of small and medium-sized businesses
	Korea Agro-Fisheries and Food Trade Corporation	1994-95	Downscaling of retail sales in direct outlets land supporting exports of agricultural and marine products

Source: The Economic Planning Board (1983)

Table 2-7 | SOE Privatization Results (1993 ~ 96)

Classification	Number of SOEs in the Plan	Complete Privatization (21 in total)	Partial Privatization (7 in total)
Transfer of Management Rights	58	Korea Tungsten Company, Korea Engineering Consultant Corporation, Korea Land Development Installation Corporation, Korea Fertilizer, Gong Young Corporation, IBK Computer Development, Expressway Network (7 in total)	Kookmin Bank, National Text Book, Nam Hae Chemical, Housing and Commercial Bank (4 in total)
Partial Disposal of Government Shares		Eyang Coal Mine, Yeonhap TV News, MK TV News, Hansung Life Insurance, Korea Economic Daily, Korea Exchange Bank, Lucky Metal, Dongbu Chemical, Naejangsan Hotel (9 in total)	Korea Mobile Telecom, Korea Exchange Bank (2 in total)
Merger and Others	10	Housing Economy Institute, Korea Oil Driling Corp, Ginseng Export Corporation, Seonam Tourism Development, Wonjin Rayon (5 in total)	General Chemical (1 in total)

Source: The Board of Audit and Inspection(2002), 「A Report on SOEs」, p.24. and Ministry of Finance and Economy (2001) 「Management Efficiency Increase in SOEs and Statistics on Privatization」

The privatization of large SOEs, which had been thought to be impossible for various reasons before, suddenly became one of the policies given top priorities under Kim Dae-jung administration, which was elected in the middle of the large scale economic crisis at the end of 1997. Kim Dae-jung administration decided to privatize large commercial SOEs to raise money which was badly needed to cover the losses of the banks and other financial institutions, which fell in bankruptcy states caused by huge amount of bad loans they made to firms affiliated with a large number of *chaebol* groups that went bankrupt. It also wanted to increase the efficiency of large commercial SOEs and the industries which they operated. Kim Dae-jung administration privatized a large number of SOEs including KT&G, KT, Pohang Iron and Steel Corporation, and Korea Heavy Industries.

The following <Table 2-8> sums up a privatization plan that Kim Dae-jung administration drafted in the beginning. It classified SOEs into three groups; those that needed full privatization during the administration, those that needed full privatization eventually but was deemed infeasible during its tenure, and those for which privatization was not needed. The first group consisted of commercial SOEs for which a market based allocation of resources that would be induced by privatization was expected to yield a more efficient outcome than the allocation given by the government controlled governance that had prevailed in them. The second consisted of the commercial SOEs for which the government

controlled governance would yield a more efficient outcome overall in the relevant industry in the next few years but a market based allocation of resources would become more efficient eventually. The third group consisted of the SOEs for which government ownership and control was clearly a more efficient mechanism than a market based approach in the foreseeable future. The third group could have included public institutions which were different from SOEs. Kim Dae-jung administration actually outperformed its plan on privatization. Kim Dae-jung administration modified its initial plan for privatization several times and privatized more SOEs including four large SOEs. The following <Table 2-9> sums up information on large SOEs that were fully or partially privatized or sold by Kim Dae-jung administration.

Full privatization of KT was an important event that signaled the first full privatization of a major network industry that had long been run as a virtual government monopoly, although few in Korea understood the importance of it. Privatization of KT implied that the line ministry had to rely on competition policy and regulation of retail tariffs instead of wielding the control over KT as a dominant shareholder in trying to achieve the policy objectives it had pursued in the telecom industry. Replacement of the command and control approach of the line ministry by the combination of privatization of former SOEs, competition policy, and neutral regulation in a major network industry had been thought to be difficult to achieve in Korea before 2002. Full privatization of KT gave Korea an opportunity to test whether Korea had the capability to replace the old system based upon the command and control approach with a market based system. A complete transformation of the telecom industry into a market based system could signal that a similar transformation could be done successfully in other network industries such as electricity, gas, water, or railroad, as well.

Table 2-8 | Early Privatization Plans of Kim Dae-jung Administration (in July, 1998)

Classification	Type	Privatization Target SOEs	Number of Subsidiaries	Privatization Plans
Complete Privatization (5 in total)	Non-GII SOE	Pohang Iron and Steel	16	<ul style="list-style-type: none"> Sells the shares owned by the government and Korea Development Bank(26.7%) to domestic and foreign investors (a maximum of 3% per each investor) Abolishes the ownership limitation on foreign investors and the ownership limitation on each individual investor at the end of 2001 offers non-executive directors recommendation rights in order of major shareholder ranking includes more non-executive directors than executive directors in the board of directors
		Korea Heavy Industries	3	<ul style="list-style-type: none"> forms partnership with foreign companies to prevent insolvency due to de-monopolization Completes privatization through selling the shares <ul style="list-style-type: none"> - opens competitive bidding to both domestic and foreign investors - Composition ratio of the shares is set during the privatization process solely for profit maximization - promotes intense restructuring in order to maximize stock price
		General Chemical	1	<ul style="list-style-type: none"> Sells the shares owned to Namhae Chemistry(45%) separately and then sells its own assets <ul style="list-style-type: none"> - Allow Namhae to sign a private contract with Nonghyup .In case it fails, shares will be sold through competitive bidding (since Nonghyup can participate as a bidder, it is a fair bid)

Classification	Type	Privatization Target SOEs	Number of Subsidiaries	Privatization Plans
Complete Privatization (5 in total)	Non-GII SOE	Korea Technology Banking Corporation	1	<ul style="list-style-type: none"> Sells shares to famous foreign venture capital firms (secures advanced management techniques, know-how, and networks) Sells shares over the counter through open competitive bidding <ul style="list-style-type: none"> Attempts lump-sum disposal of government shares (10.2%), treasury stock (4.0%) etc. Time of disposal is flexible
		National Textbook	-	<ul style="list-style-type: none"> Revitalizes the publishing industry through its privatization With the condition of constant prices and supply for the next three years, sells the share through competitive bidding
Partial Privatization (6 in total)	GII	KEPCO	7	<ul style="list-style-type: none"> Separates power generation, transmission and distribution (Early privatization in power generating sector) <ul style="list-style-type: none"> Selling 5% government shares during the second half of 1998 determines the restructuring plans of electric power industry which includes relaxation of regulations such as a direct transaction of electric power (In October, 1998) and sells a portion of power generating units (1999) If the government borrows money from overseas, government shares should be more than 51% to satisfy contract conditions.
	Non-GII SOE	Korea Telecom	13	<ul style="list-style-type: none"> Privatizes in stages until the establishment of competitive market <ul style="list-style-type: none"> (1)listing of KT stock in the KOSPI, (2)strategic sale of 10% to a global telecom operator, (3)sale of 18% in foreign stock markets, (4)maintaining 33.4% government ownership until 2000, after which selling it to KT employees, institutional investors, and general investors. (After 2001) Selling the rest of the government shares(33.4%) considering domestic and foreign conditions

Classification	Type	Privatization Target SOEs	Number of Subsidiaries	Privatization Plans
Partial Privatization (6 in total)	Non-GII SOE	KT & G	1	<ul style="list-style-type: none"> • Completes privatization through selling the government shares owned by the government and banks by 2000 (give priority to the sale to employees) - Sells 25% government shares to both foreign and domestic investors within 7% ownership limitation on an individual investor from 1998 to the first half of 1999. • Abolishes tobacco production monopoly and ownership limitation on an individual investor and sells the rest of the shares with bank investment shares • separates ginseng business assets after due diligence in 1998 • finishes modernization of equipment, merger and restructuring by 2000
		Daehan Oil Pipeline Corporation	2	<ul style="list-style-type: none"> • Merges with a subsidiary and sells the government shares (2000) - collaborates with a consortium consisting of end users
		KOGAS	5	<ul style="list-style-type: none"> • privatizes in stages after accumulating assets since the pipeline system finished in 2002. - increases the capital up to 250 billion won in 1998-99 and sells the shares to domestic and foreign companies - sells a portion of stocks as government-issued stocks • establishes the grounds for privatization and introduces the market competition system such as a pipeline open access system from 1998 to 2000 • Completes privatization before 2002
		Korea District Heating Corporation	3	<ul style="list-style-type: none"> • Complete privatization by selling more than 51% of the shares in 2001 after separately disposing cogeneration plants in Bucheon and Anyang.

Source: Budget Planning Committee, "Primary SOE Privatization Plan," Press release (1998.7.4)

Table 2-9 | Privatization Results of Kim Dae-jung Administration

Privatization Target SOEs	Time of Completion	Privatization Method and Amount of Shares Disposed	Profit Earned	Ownership and Governance Structure	Revision of Laws and System Reformation
National Textbook	'98.11	Government 40%, Korea Development Bank 46.5%, Competitive bidding(86.5%)	46 billion won	Sold to Korea Textbook	Introduced market competition to the textbook market since 2002
Korea Technology Banking Corporation	'99.1	Government 10.2%, Korea Development Bank 2.0% Competitive bidding(10.2%) Sold in the stock market(2.0%)	12 billion won	Sold 10.2% to Future and Human Inc.	Abolishment of KTB law ('99.2)
Daehan Oil Pipeline Corporation	'00.4	Government 36.7% Existing shareholders bought the shares according to the investment contract	167 billion won	Existing shareholders (4 oil companies)	Prohibited any restriction on competition ('01.8)
Pohang Iron and Steel	'00.10	Government 3.1%, Korea Development Bank 23.6% Foreign DR(18.5%, 3 times) Treasury stock (8.2%, 3 times)	2.8 trillion won	Diffused ownership	Introduced board of directors system (Articles of association '00.3)
General Chemical	'00.11	Failure in bidding three times, Early liquidation due to deficit operation ('01.12)	-	-	Abolishment of 「Telecommunications Law」 ('01.12)
Korea Heavy Industries	'00.12	Korea Development Bank 31.2%, KEPCO 40.5% Public offering (24%) Competitive bid(36%)	4,29 billion won	Sold to Doosan	-
KT	'02.5	Government 28.8% Korea Development Bank- Industrial Bank of Korea- Export-Import Bank of Korea 52.8% Overseas (44.1%, three times), Domestic (29.5%, two times)	12.7 trillion won	Diffused ownership	Revision of 「Telecommunications Law」, Abolishment of 「Korea Telecommunications Corporation Act」 ('00.12) Revision in articles of association ('02.8)
KT&G	'02.10	Government 28.8% Korea Development Bank-Industrial Bank of Korea-Export-Import Bank of Korea 52.8% Overseas (39.7%, three times) Domestic (41.9%, three times)	3.5 trillion won	Diffused ownership	Revision of 「Tobacco Business Act」 ('01.3)

Source: Ministry of Strategy and Finance (2002), 「A Report on Government Reform in 2002」, p.94, p.110

Roh Moo-hyun administration did not have a plan to privatize SOEs and did not privatize any SOEs. It actually stopped the privatization of a couple of generation companies that were subsidiaries of KEPCO, which had been planned by Kim Dae-jung administration. The current administration, which succeeded Roh administration in 2008 had a plan to privatize or partially privatize quite a few SOEs including SOEs in the banking sector but failed to privatize most of them.

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Chapter 3

Evolution of SOE Governance Structure prior
to 1997 and the Framework Act on the
Management of Government-invested Institutions

Evolution of SOE Governance Structure prior to 1997 and the Framework Act on the Management of Government-invested Institutions

This section elaborates on the government policy on the governance of SOEs from the founding of the Korean government until the introduction of Act on the Improvement of Managerial Structure and Privatization of Public Enterprises, more commonly known as the Special Act on Privatization, in 1997. When the Korean government was first established, there existed no particular regulations or laws on SOEs and government businesses until Park Chung-hee administration. Some SOEs had laws that specified the governance structure of an SOE along with reasons for its establishment and objectives of its management generally termed “individual establishment laws.” Each of those SOEs was governed according to its individual establishment law. Individual establishment laws usually had the provisions that assigned the authority to draft and determine the budget of each SOE to the minister of the line ministry in charge of the industry in which the SOE operated. It appears that the distinction between a ministry and an SOE under its control was not clear until the Park Chung- hee administration. Governance structure of the rest of the SOEs which did not have an individual establishment law was not clearly defined, and virtually no information exists about it today.

There was no ministry or a government agency other than the line ministries within the government in charge of controlling the businesses and the budgets of SOEs. As a consequence, there was no government agency that could effectively provide checks and balances to the bureaucracy of SOEs and their line ministries. This may seem extraordinary today. But Korea was one of the poorest countries in the world at the time, and the sophistication of the government of the Korea was probably at a very low level.

In 1962, Park Chung-hee administration introduced the Government Invested Institutions Management, which applied to a subset of SOEs officially classified as government invested institutions (GIIs) in addition to their individual establishment laws. By this law,

the budgets for SOEs and government businesses were required to go through the line ministry, the Economic Planning Board, the cabinet council, and the president. In 1973, Government Invested Institutions Management Act was introduced to specify the common governance structure and the common procedure for drafting and determining the budget and accounting of all GIIs. This law also led to the emergence of a standardized system for the organizational form and personnel management in all GIIs. The governance structure of GIIs under this law gave the minister of the line ministry the authority to make virtually all decisions regarding the operation of a GII except decisions on budget. External audits were done by the line ministry and the Board of Audit and Inspection.

The governance structure of GIIs set by the Government Invested Institutions Management Act was not much different from that of GIIs which preceded it in that the operation of a GII was perceived as a part of the operation of the line ministry and that the line ministry had a strong authority and a tight control over the management of a GII. However, it did make the distinction between GIIs organizations and the bureaucracy of the more narrowly defined government clear and gave rise to a system of organization, personnel management, and remuneration of GIIs, which was substantially different from the system that applied to the government bureaucracy. Another important change brought up by the act was the active participation of the Economic Planning Board in the process of drafting and determining the budget of GIIs as the ministry in charge of the budget within the government.

Chun Doo-hwan administration replaced the GII Management Act with the Framework Act on the Management of GIIs in 1984, which led to the separation between the board of directors as a decision making body and the management as an executing body. Board of directors consisted of the CEO and non-executive board members, who were appointed from outside a GII. Non-executive members were prohibited from participating in the management, which was done by a group of executives headed by the CEO. Drafting and determination of the budget was officially done by the board of directors. The board members other than the CEO consisted of two government officials, one from the line ministry and the other from the Economic Planning Board, and civilians who were professionals, mostly lawyers, accountants, and professors. While there were quite a few board members, the one from the line ministry wielded a decisive power and played a key role in making the decisions of the board of directors. Thus, while the board of directors of GIIs looked quite independent in appearance, they were subordinate to the line ministry in reality. As a consequence, the line ministry kept maintaining a tight control over a GII, which belonged to the industry it was in charge of. The role of the Economic Planning Board was limited to partial control over the costs of operation of GIIs by and large. Its most powerful role was to determine the budget, the number of employees and their positions in each GII, and the remuneration.

The followings are other important aspects of the Framework Act on the Management of GIIs.

- Compared to the GII Management Act, it emphasized the importance of business aspects of GIIS by transferring the official power to make key decisions from the line ministry to the board of directors, thereby erecting a wall between the line ministry and a GII under its control although the wall was not strong or high.
- It attempted to give GIIs more autonomy in management by appointing the majority of board members from the pool of professionals outside the government who had background in areas that were relevant to the operation of GIIs.
- It required the executives of a GII to be selected from within its bureaucracy, thereby blocking the appointment of unqualified persons from outside of a GII as executives based on political considerations and giving employees a strong incentive to work hard and to acquire expertise.
- It gave the top management consisting of the CEO and executives the power to make decisions on day to day operations.
- However, the governance structure implicitly allowed the two board members from the government to play a decisive role in the board. In particular, the board member from the line ministry was allowed to make most of the key decisions. This allowed the line ministries of GIIS to keep its tight control over GIIs and to use them as a direct policy instrument rather than a firm.
- The act transferred the power to appoint executives of a GII from the minister of the line ministry to the CEO of GII, giving the CEO a stronger power to run a GII.
- Power to draft and modify the budget was transferred from the line ministries to GIIs, allowing the managers at GIIs to make decisions on the budget by using the information and expertise they possessed.

Instead of the ministry in charge, a GII was empowered to compile its own budget and adjust it.

- A GII was given more autonomy in procurement.
- It introduced a system of evaluation and remuneration that utilized experts outside GIIs and the government whose performance evaluation of GIIS partly determined bonuses of employees and executives of GIIs.

The governance structure for GIIS introduced by the Framework Act on the Management of GIIs had little to do with the introduction of the market based economy. Rather, it was an attempt to make the tasks in the defined government sector operated more effectively. GIIs

were perceived as direct policy instruments of the government before or after the Framework Act on the GII Management. The governance of GIIs was still based on the command and control approach. The important change brought by this law was that the power to make key decisions was shared with the Economic Planning Board, which was done only by the line ministry in charge. Before, the line ministry had the exclusive power to make virtually all key decisions regarding GIIs under its control. The exclusive power of the line ministries, lack of separation between the line ministries and GIIs under their control, and the shared incentives of the bureaucracy of the line ministries and the bureaucracy of GIIs to expand the assets under their control made them conspire together, which led to excessive expansion, inefficient allocation of budgets, and inefficiency in investment and operation. Requiring some distance between GIIs and their line ministries and reassigning some of the authorities, used to be exercised exclusively by the line ministries, to the Economic Planning Board, the board of directors, and executives of GIIs were used to alleviate these problems.

In addition, the act gave the GIIs a chance to operate efficiently by prohibiting politicians from being appointed as executives. Before the introduction of this act, roughly 50% of the executives of GIIs had been appointed from the pool of politicians or former generals in the military, who had little expertise in relevant areas or experience with the businesses of GIIs. Many of them not only turned out inefficient as executives of GIIs but also involved themselves in illegal activities in procurement or attempted to exert undue influence on recruiting and promoting employees of GIIs. According to Song (1994), 70 out of the 142 who had been appointed as executives of GIIs (49%) were politicians or former generals who were believed to have little expertise in the affairs of GIIs before the introduction of the act. Empowering GII heads to have a stronger say on their budget, personnel policy, procurement and other business areas was also understood as an attempt to separate GIIs from the government and to increase management efficiency by adopting a new operating system which differed from that of a government agency. Prior to the act, the minister of the line ministry had the authority to appoint board members and the executive officers by himself. While the act was far from sufficient to solve all the problems that led to inefficiency, it was regarded as having significantly alleviated the inefficiency that had been rooted in the exclusive control set by the bureaucracy of the line ministries in the earlier governance structure.

Overall, it would be fair to say that the governance structure given by the Framework Act on the Management of GIIs was reasonably close to a second best as a governance structure for large commercial state-owned enterprises in Korea in the early 1980s, considering the overall state of the economy and the political system that prevailed in Korea at the time. The private corporate sector was growing rapidly, but its proportion was still much smaller

than the public sector. The privatization of large SOEs through normal ways was impossible as there were few if any investors in the private sector who had enough capital with which they could acquire controlling interests of SOEs. The stock market was very small, too. *Chaebol* groups, which were still small and in the infant stage, depended heavily on credit rationing by the government and other preferential subsidies. Most of them were suffering from large debts and poor profitability and were not in a position to acquire controlling interests of large SOEs on their own. The only way that *chaebol* groups could acquire the controlling interests of a large SOE at the time was a debt financing of the acquisition through a preferential rationing of additional credits from the banking sector orchestrated by the government. In other words, the only feasible way of turning the ownership and control of a large SOE to the private investors was for the government to pick a *chaebol* group and lend money to it so that it could acquire a controlling interest of a large SOE with the borrowed money, which was far from a normal way of privatization.

Even if the privatization through normal ways of financing was possible, the privatization would have brought more negative effects than positive ones due to the inability of the government to enforce competitive policies and regulations on monopolies at the time. In short, the privatization of large SOEs, in particular those in financial and network industries, was infeasible and was not likely to result in a resource allocation that was clearly superior to government ownership and control.

It was difficult to implement a governance structure similar to the one that was applied to four large commercial SOEs in 1997 by the Special Act on Privatization in the early 1980s. Very few people in Korea were able to distinguish policy objectives from commercial objectives in Korea. Probably fewer people understood the concept of maximization of shareholder value or accounting transparency of limited liability companies. Large firms in the private sector probably suffered from the problems with governance more than SOEs. Virtually all large firms in the private sector were *chaebol* firms and were suffering from lack of accounting transparency and misappropriation of money by dominant shareholding managers. The idea behind the Special Act on Privatization, which was based on the idea of shareholder value maximization, probably did not exist, and even if it had existed, it would have been next to impossible to implement it in Korea.

The skeleton of the governance structure installed in GIIs by the act could be described as the one in which the president of Korea, who was a military dictator in the early 1970s, was given the role of the owner and chairman of a gigantic conglomerate consisting of GIIs, who delegated his power to make decisions concerning the affairs of GIIS to the ministers of the line ministries of GIIs and the minister of the Economic Planning Board. The line ministry played most of the roles of the state owner on behalf of the president while the Economic Planning Board provided some checks and balances against the line ministries to

ensure that the line ministries were working in the best interests of the president. CEOs of GIIS were officially given a large degree of freedom in making decisions on the operation of GIIS. But in practice, their roles were limited. Many of them were political appointees who did not have the expertise needed to exercise the control rights he was endowed with effectively. Their tenure was usually short, too. They were not given strong incentives to improve the performance of their GIIs, either.

In early 1980s, it would have been very difficult to impose the Act on the Improvement of Managerial Structure and Privatization of Public Enterprises in 1997 on GIIs with high commercial potentials such as KT, KEPCO, and KT&G. In the Korean government at that time, very few people understood the concept of the board of directors based in firm value profit maximization, the separation of public interests and commercial interests, etc. Private enterprises lacked transparency, and the governance structure was extremely abnormal. Consequently, considering Korea's political structure, public awareness, the relationship between the government and *chaebols*, and governance structure of private enterprises that were governed by politicians and *chaebol* chairmen, it was impossible to imagine a governance structure that gave priority to firm value maximization and transparency. Even if someone came up with such an idea, it must have been practically impossible to implement it.

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Chapter 4

Kim Young-sam Administration's SOE Policy and the Act on the Improvement of Managerial Structure and Privatization of Public Enterprises

1. The Status of Six Major SOEs and Corresponding Industries

Kim Young-sam Administration's SOE Policy and the Act on the Improvement of Managerial Structure and Privatization of Public Enterprises

1. The Status of Six Major SOEs and Corresponding Industries

The governance structure set by the Framework Act on the Management of GIIs in the previous chapter was used as the governance structure of GIIs for 10 years after its introduction. However, by the time Kim Young-sam administration took over in 1993, circumstances surrounding large commercial SOEs including some GIIs changed in a fundamental way both in Korea and in the world, which raised the possibility of privatizing at least some of the large commercial SOEs that existed in Korea at the time. The most important change was that many countries around the world privatized large SOEs, introduced competition into the industries which had been run by the government or as SOE monopoly, and implemented regulations on the privatized monopolies in bottleneck facility areas where competition was difficult to induce, starting with U.K. The economic and political circumstances domestically changed substantially over the 10 years, too. The size of the Korean economy became significantly larger. The number and the size of the large private firms in various industries increased significantly, too. Capital had also been accumulated substantially in corporate, financial, and household sectors. Kim Young-sam administration, which claimed to be the first real democratically elected administration since the early 1960s, wanted to transform the Korean economy into the one that was more compatible with democracy and pursued the privatization of large SOEs.

There were a substantial number of large commercial SOEs in 1993. Most of them were banks and GIIs. But some large SOEs were not officially classified as GIIs and were not subject to the governance structure prescribed by the Framework Act on the Management of GIIs. Commercial SOEs that were not subject to the Framework Act were generally called

non-GII-SOEs and included POSCO and Korea Heavy Industry.³ The criterion that was used in most cases to distinguish between Non-GII-SOEs and GIIs was the government ownership. An SOE was usually classified as a GII if the government ownership was 50% or higher and as a non-GII-SOE if the government ownership was below 50%. But there were some exceptions to this rule. For instance, Korea Broadcasting Service, the largest firm in the broadcasting industry with a high market share and market dominance, was 100% owned by the government, but was classified as a non-GII-SOE.

Kim Young-sam administration focused on the six largest commercial SOEs in the non-banking sector and studied whether privatization was desirable and feasible for each of them. In this chapter, we review the six SOEs and the industries they belonged to and discuss the optimal policy mix for them at the time. Among the big six, Korea Electric Power Corporation (KEPCO), Korea Gas Corporation (KOGAS), and Korea Telecom (KT) belonged to the network industries while Korea Tobacco & Ginseng (KT&G), Pohang Steel Corporation (POSCO), and Korea Heavy were in non-network industries. It soon became clear that the government ownership and control of the latter three firms in non-network industries would be harder to justify than the three firms in the network industries based upon the observation of OECD countries. Most OECD countries did not operate SOEs in steel mill, in tobacco manufacturing, in ginseng manufacturing, or in manufacturing of generation facilities while essentially all of the firms in the three network industries were maintained or had been maintained by the government or as a SOE monopoly.

In the three network industries, there also were some movements towards the privatization and competition in many OECD countries, although the speed at which restructuring proceeded and the magnitude of the restructuring varied among countries and industries. The trend for restructuring was most obvious in the telecom industry. By the time Kim Young-sam administration inaugurated, restructuring of the telecom industry was long over in U.K. and was over or under way in many other countries. Restructuring of the electricity and natural gas industries began a few years later than that of the telecom industry in U.K. and was still under way in 1993. Many other countries were preparing to introduce competition into the generation and retail stages at the time.

In order to determine whether to privatize the six SOEs, it was necessary (1) to identify the policy objectives that had been associated with each of the six SOEs, (2) to determine whether each of the policy objectives was still worth pursuing, and (3) to determine whether the government ownership and control was the best mechanism to achieve the objectives by comparing the expected performance of the government ownership and control with that of other mechanisms. Thus, we identify policy objectives that had been associated with each

3. Non-GII-SOE is my translation of the Korean expression *choolja-gigwan*, which is not a terminology officially used in laws and hence does not have an official English translation.

of the six SOEs and try to determine whether the government ownership and control was the best mechanism to achieve the objectives for each of them. Our conclusion is that it would be difficult to find a justifiable reason for policy objectives that required the government ownership and control of the six SOEs from the characteristics of the industries in which they operated.

<KT&G>

The businesses of KT&G were manufacture and sale of ginseng and tobacco products. Manufacture and sale of ginseng, which was a health supplement food, was a highly commercial activity. It is difficult to find a policy objective that can be better served when an SOE does it than when private firms do it. On the other hand, it is clear that private firms are likely to produce and sell ginseng more efficiently in the sense that their cost of producing and selling any given output of given quality will be lower. Competition between profit seeking firms is more likely to yield a price-quality pair that is closer to a socially optimal price-quality pair than monopoly by a government owned and controlled enterprise that is used as an instrument to achieve policy objectives which are not clear and have weak profit incentives. Manufacture and sale of ginseng is not meant to be a monopoly and does not require large amount of capital to enter the ginseng industry. Thus, we can conclude that maintaining KT&G as a SOE does not have a clear positive effect while privatization and introducing competition are likely to lead to an efficiency gain.

Tobacco, from which KT&G is earning most of the revenues and profits, is a highly addictive and toxic material that not only causes its consumers to pay large amount of costs in various forms in addition to the prices they pay, but generates negative effects on non-smokers. It is difficult to find a single plausible policy objective that can be achieved only by the government, not to mention a monopoly by the government. There were three policy objectives that had been used as the grounds for maintaining KT&G as an SOE; profit from the monopoly of tobacco that directly increased the wealth of the government, promotion of the tobacco leaf producing industry, and subsidies to tobacco growing farmers in Korea.

It is clear that the first of the above three objectives is likely to be better achieved by privatizing the monopoly because the privatized monopoly will be more efficient in marketing and in the production of tobacco products as the tobacco business is a highly commercial one that requires strong profit incentives. The government will be able to generate more money by selling off KT&G to private investors at a price that reflects the expected profit stream in the future of the privatized monopoly than keeping KT&G as a government owned and controlled monopoly. When an entry barrier that allows KT&G to maintain the monopoly in the domestic tobacco manufacturing market is abolished by opening the market for competition, the advantage of privatizing KT&G over maintaining it

as an SOE would probably become larger because a private firm is more likely to compete against its competitors than a SOE that is used as a policy instrument.

Promotion of the tobacco leaf industry, which is an agricultural industry, is also difficult to be justified based upon efficiency criterion. There were a sizable number of tobacco leaf farmers in Korea at the time, who produced very low quality tobacco leaves and sold them to KT&G, which used the leaves purchased from domestic farmers along with higher quality leaves and other ingredients.⁴ KT&G paid prices that were several times higher than the prices for the same quality of leaves that prevailed in the international market at the time to the domestic tobacco farmers. The cost structure of the domestic tobacco farmers was far inferior to that in other countries endowed with environment that had more favorable conditions to grow tobacco leaves, so domestic production would be unprofitable by a large margin without subsidies. For an industry promotion policy to be an efficient one that is worth pursuing, the long run gain from the subsidies and other measures should outweigh the costs that entail the industrial policy. In particular, it is necessary that the target industry should be able to achieve competitiveness in the global market and survive on its own without further subsidies after the nurturing period. However, in the case of domestic production of tobacco leaves, there was little chance that price subsidies to tobacco growing farmers would increase the competitiveness of the tobacco growing industry in Korea significantly as they could not change the endowments in climate, soil or labor costs. Thus, the promotion of the domestic tobacco growing industry was not a plausible policy objective that could justify using KT&G as a policy instrument by maintaining the ownership and governance structure dominated by the government.

From the above discussion on the industry promotion policy argument, it becomes clear that the price subsidies to tobacco growing farmers were not motivated by a policy objective that was based upon economic efficiency criterion but that the nature of the policy was political one. It is not easy to evaluate the effect of a policy that was introduced to solve a political problem using an economic efficiency as a criterion. The reason is that while the cost involved in pursuing such a policy can be measured with some reliability, it is usually very difficult to measure the benefit which is basically the political gain to some. Nevertheless, we can argue that the subsidies to domestic tobacco growing farmers are inefficient in the sense that there is a way that can give domestic tobacco growing farmers the same benefit at a smaller cost to government without hurting anyone else.

4. Production of cigarettes, which is the main tobacco business of KT&G, generally uses many different kinds of tobacco leaves with different quality as well as with other non-tobacco ingredients. Cigarettes sold at higher prices generally use a higher proportion of higher quality tobacco leaves that carry higher prices compared to lower quality leaves.

An alternative way one can easily think of is to sell KT&G to private investors with the condition that the privatized KT&G should provide the farmers with the net gain that they would receive under the existing subsidy program. After privatization, KT&G would stop purchasing tobacco leaves from domestic farmers and would purchase all tobacco leaves from abroad at international prices. If KT&G kept using the same kind of leaves it had purchased from domestic farmers in the international market, it would be able to generate a net gain that is larger than the margins earned by purchasing them from domestic farmers because the cost of production is much lower. KT&G would probably decrease the use of the tobacco leaves which it used to purchase from domestic farmers and would use more of other ingredients after privatization. Such an input substitution would further increase the profit of KT&G, which is due to the privatization effect. KT&G could probably give more net subsidies to domestic farmers while giving its shareholders higher profits at the same time.

From the above discussions on policy objectives relevant to KT&G, we can conclude that none of the policy objectives that has been advanced as grounds for maintaining KT&G as an SOE is plausible enough to keep the government from privatizing KT&G.

<Korea Heavy Industry>

In the case of the Korea Heavy Industry, it was difficult to find a plausible reason to keep it as an SOE considering the characteristics of the generator manufacturing industry. The generator manufacturing is a highly commercial business. It is hard to imagine that the government can do a better job in manufacturing and selling generators than private firms, which are based on strong profit incentives. A SOE monopoly owned and tightly controlled by the government will be significantly inefficient in the competition because profit seeking firms can do much better in terms of efficiency in production as well as in allocation. The Korean market for generators was and still is a part of the world market so that there was no chance that privatization of Korea Heavy Industry would lead to abuse of monopoly power in the domestic market. KEPCO, which was the sole customer of Korea Heavy Industry in Korea, could always choose any of the major generator manufacturers in the world market unless the government ordered it to choose Korea Heavy as the supplier of the generators. Privatization of Korea Heavy would increase the efficiency in the electricity market by freeing KEPCO from the policy of purchasing generators from Korea Heavy Industry, which forced KEPCO to lower some efficiency gain it could have realized by sourcing through competition in the world market.

It was difficult to find a plausible policy objective associated with Korea Heavy Industry that could justify maintaining it as an SOE considering the characteristics of the generator manufacturing industry in Korea.

<POSCO>

The government had two objectives when it established POSCO as an SOE. One was the commercial success of POSCO, that is, making it a successful competitive steel manufacturer in the world market. The other was to promote the industries, such as auto manufacturing, shipbuilding, and general machinery in Korea that used steel as inputs. It is clear that a necessary condition for the first objective is a governance structure that is consistent with profit maximization. Private ownership and control based upon strong profit incentives is obviously a superior solution to government ownership and control.

The second objective is a lot more complex to analyze. The government, using the control it had over POSCO as a dominant shareholder, had forced POSCO to sell steel products to domestic industrial customers at prices that were below the international market prices in order to give the domestic customers an advantage in costs, which would enable them to compete more effectively in their markets both in Korea and abroad. Unlike the first objective we considered above, the achievement of this objective indeed required the government to maintain its dominant shareholder position at POSCO because POSCO would apply the same prices to its customers regardless of the nationality of its customers after privatization.

In order to analyze the effects of the industrial policy of subsidizing domestic firms in other industries using POSCO as a policy incentive, one needs at least to compare the cost which POSCO used to provide such subsidies with the gain to domestic industrial customers of POSCO that benefited from the subsidies. To the first order, the estimated cost of the policy is that the gap between the average price in the international market for steel and the low price POSCO was receiving domestically times the sales volume in the domestic market. This cost is easy to measure and can be used as the lower bound for the real opportunity cost to POSCO, which would be higher than this first order opportunity cost if we consider second order effects of the policy involving investment decisions.

Estimating benefits is difficult. Benefits can be thought of as the sum of increase in the present value of each domestic customer as a result of the subsidy program. The benefits to customers go beyond the difference between the international prices and the domestic ones times the quantities they purchased as they should include the long term gain in competitiveness of the domestic customers in the global market for their respective products, which the price subsidy programs induce. The long term gain is very difficult to estimate. Thus, it is difficult to evaluate the plausibility of the second objective that was possible only because the governance structure of POSCO enabled the government to force POSCO to practice the price discrimination policy.

We can discuss the plausibility of the second policy objective from a different angle more fruitfully. The price subsidy program that Korean government had used for a long time had the problem of subsidizing the shareholders of the firms that purchased steel products from POSCO at the expense of the shareholders of POSCO. If both POSCO and its domestic customers are 100% owned by the government, there would be no problem arising from subsidies between POSCO shareholders and the shareholders of the customer firms. However, a large proportion of POSCO was owned by private investors at the time. Firms purchasing steel products from POSCO were nearly 100% owned by private investors in most cases. The shareholders of POSCO were not the same as those of customer firms. Thus, the subsidy program had the effect of giving increased value for the shares owned by the shareholders of firms that purchased steel products from POSCO and giving decreased value for the shares of POSCO owned by private shareholders and the government. Forcing private shareholders of POSCO to take substantial losses in order to make shareholders of customer firms richer seems to violate the basic principles behind company's related laws. When one takes the view that the shares of POSCO owned by the government is ultimately properties of the general population, the subsidy program is seen to have the effect of sacrificing the money of the general public while making shareholders of customer firms richer. Either way, such misappropriation of assets of POSCO is likely to violate the company's related laws and will be difficult to be justified in a country that is based upon private ownership.

Lastly, it is worth noting that there is a more efficient way to implement a price subsidy program than the one actually used by the government, at least in principle. It is easy to see that the logic we used to argue that privatizing KT&G subject to the constraint that it would give the same net benefit to domestic tobacco farmers would be a more efficient way to provide the same benefit to the farmers will apply to POSCO as well.

In the case of POSCO, we also conclude that there was no policy objective that could be justified based upon an efficiency criterion when we also required that the legal system on the protection of the rights of shareholders of limited liability companies be provided.

We conclude that it was difficult to find plausible policy objectives that could justify maintaining the three firms as SOEs from the characteristics of the relevant industries at least in 1993 when Kim Young-sam administration was studying the possibility of privatizing them.

<KT, KEPCO, KOGAS>

KT, KEPCO, and KOGAS all belong to network industries. Unlike in the cases of the steel, generator manufacturing, and tobacco manufacturing industries, the relevant markets in Korea for these three industries are domestic markets as the networks in Korea are almost

completely disconnected from networks in other countries.⁵ The three network industries had long been regarded as natural monopolies and had been run as vertically integrated SOE monopolies. In 1993, telecom industry in Korea was essentially monopolized by KT in all markets including the markets for local calls, domestic long distance, international long distance, and mobile. Likewise, KEPCO was the monopoly in generation, transmission, distribution, and retail stages of the electricity industry. In the natural gas industry, KOGAS was the monopolist in the import and domestic wholesale stages while in the downstream, retail stage was monopolized by local private monopolies. All three industries had been run based on an approach that was essentially a central economic planning approach similar to a socialist economic system, except for retail stage of the natural gas industry which had been under a rate of return type regulation of private local monopolies. The three SOEs were essentially viewed and used as business units of the line ministries that ran the three industries based upon the command and control approach.

Telecom industry in many OECD countries including U.S. and U.K. was completely privatized and competitive except in local call markets by 1993.⁶ However, restructuring of electricity and natural gas industries was still at a planning stage in most OECD countries in 1993. Thus, telecom was the only major network industry for which arguments for privatization and the introduction of competition could be advanced based on the experience of more advanced countries at the time. Korea was not prepared to privatize KEPCO or KOGAS at the time. However, in the case of telecom, it was difficult to find a policy objective that justified maintaining KT as an SOE tightly controlled by the government. The government had a concrete plan to introduce competition into the international long distance, domestic long distance, mobile, and inter access markets at the time. In fact, entry to all of these markets would be open to any private firm within one to five years from 1993. Even the local call market was open to competition in the late 1990s. In view of this plan, turning KT into a private firm was a natural and optimal solution.

Some of the policy objectives that had been pursued through KT as a policy instrument became irrelevant. The best example of such a policy objective was the construction of the national telecom network, which was the biggest motivation behind the corporatization of KT in the early 1990s. However, by 1993, Korea had already completed the telecom network and did not need an SOE to build a telecom network. It also became clear that private firms could build and operate telecom networks as well as an SOE and they could sometimes do

5. The only exception we can think of is the long distance international telecom lines. This fact does not create a serious problem when we view the markets for telecom services in Korea as the ones whose relevant markets are domestic markets, which are not parts of international markets.

6. U.S. had regulated private monopoly by the old AT&T in most areas even before deregulation. Most other countries including U.K. had had vertically integrated government or SOE monopolies before deregulation and privatizing them.

much better than an SOE could. Controlling abuse of monopoly power was not a plausible policy objective that could justify maintaining KT as an SOE. Competition would yield a more efficient outcome in the long distance and mobile markets while regulation on tariffs by a neutral regulator could do the job as efficiently as the SOE system in local call markets.

In sum, Korea could improve the performance of at least four industries, steel, tobacco manufacturing, generator manufacturing, and telecom, by privatizing the SOEs and introducing competition into the parts of the industries where competition was feasible. If the government would privatize them, a neutral regulatory scheme could be established into the local call market in the telecom industry. But the Korean government faced problems to overcome in selling the shares of the four large SOEs. Sale of the shares of large SOEs needed to be done in ways that meet the following conditions; (1) the selling price must be determined by a competitive procedure which would lead to an efficient price that reflects the value of the firm, and (2) the governance structure of the firm after privatization should be in line with profit maximization.

One of the mechanisms for the sale of the four large SOEs that meet the two conditions would be a competitive bidding open to all investors, including strategic investors who were interested in taking control of the firm and running them, institutional investors who were interested in financial gains, and individual investors, in the world. However, such a mechanism could lead foreign investors to take over some of the SOEs. Selling a controlling interest of a large SOE to a foreign investor was expected to run into a strong opposition for political reasons. Thus, the government had to deal with the problem of whether to allow foreign investors to purchase a controlling interest of large SOEs to be privatized.

The second issue on selling shares had to do with *chaebol* groups. In the mid-1990s, there was virtually no individual who possesses enough money to purchase a controlling interest of one of the six large SOE in Korea. The big four *chaebol* groups at the time, Hyundai, Samsung, LG, and Daewoo each had assets that were larger than the amounts of money needed to purchase the controlling interest of a large SOE. But their assets were mostly in the form of physical assets and debts, and they did not have liquidity to purchase a controlling interest of one of the large SOEs. In fact, most of the *chaebol* companies were in deep financial trouble throughout the 1990s, which ultimately culminated in the largest financial crisis Korea had in 1997, the cause of which could be traced to the *chaebol* system itself. All *chaebol* groups were established essentially by the authoritarian government of Park Chung-hee through heavy borrowing from financial institutions. Many *chaebol* groups kept using borrowed money to expand the sizes of affiliated firms even though these firms did not make any money. Many of them were suffering from high leverage and low profitability in mid 1990s.

Still, many in the government at the time believed that selling a controlling interest to *chaebols* was the most efficient way to privatize because the takeover by *chaebol* chairmen, which was made possible through circular investments by affiliated firms using borrowed money, was the only ownership and governance structure of large firms which they believed had a better chance of not failing. But there were growing concerns over the expansion of *chaebol* groups and there was a strong opposition to the takeover of large SOEs by them. The government had to deal with the question of whether to allow *chaebol* groups to purchase a controlling interest of SOEs or not.

Third, the decision makers in the Korean government wanted to know specific methods they could use to keep *chaebol* groups from taking over large SOEs in case they decided not to allow them to take control of large SOEs. They also wanted to know what other ownership and control models could be used if it decided not to allow *chaebol* groups to take control of SOEs it wanted to privatize. They were concerned about the possibility that scattered ownership structure would lead to serious free-rider problems in the management which in turn would lead to inefficient operations of SOEs after privatization. They were interested in knowing about other arrangements for ownership and control of large firms that could prevent the free-rider problems and lead to an efficient operation after privatization.

U.K. put a 15% ceiling on the ownership of many of the large SOEs that were privatized in the 1980s and 1990s, which had the effect of prohibiting the emergence of a dominant shareholder. It was said that it had been introduced in order to prevent the takeover of large SOEs in infrastructure industries by foreigners. U.K. did not have *chaebol* groups and sold shares of SOEs to be privatized to domestic and foreign investors and placed no additional restrictions on the reselling of the shares after the initial sale by the government was over. U.K. ultimately abolished the golden share provision that was the key instrument behind the 15% share limit in mid 1990s and also removed restrictions on the ownership structure of the privatized former SOEs.

Kim Young-sam administration decided not to allow foreign investors to take a controlling interest of any of the large SOEs to be privatized. We believe that its decision was based more on political factors rather than on economic ones. Kim Young-sam administration also decided not to relax the foreign ownership ceiling of listed firms that had been in effect. Otherwise, it would have the effect of increasing demand for shares of SOEs to be privatized. It also decided not to allow *chaebol* groups to purchase a controlling interest of any of the large SOEs to be privatized. This decision left the government with virtually only one option as a means to sell shares; via the domestic stock market.

But the stock market in Korea at the time was much smaller than that of today and was also inefficient and irregular in many ways. Most of the listed firms had serious problems

with their governance structure which allowed their dominant shareholders and managers to misappropriate large amount of fund from their companies and to tamper with accounting books to hide such illegal or inappropriate activities as well as losses and large debts. Roles of institutional investors were much smaller at that time, too. Private equity funds were also rare. Overall, the stock market was struggling. Many in the government believed that the sale of the shares of even one large SOE would lead to a big drop in the KOSPI index for a prolonged period of time, which would have a serious negative impact on the financial market, so the government was not willing to accommodate it.

In 1996, Kim Young-sam administration concluded that it was not possible to privatize any of the large SOEs without creating a serious damage to the financial market and gave up privatizing them. However, it was believed that the privatization was necessary for four of the six largest SOEs and that they should be privatized by its successors in the near future. It was also convinced that the governance of the large commercial SOEs needed to be changed fundamentally to allow them to run the business based more on profit incentives. It introduced a new set of measures to change the ownership and governance structure of large commercial SOEs and reflected its views by enacting a law in the late 1997. The next section deals with the details of this law generally known as the Special Act on Privatization.

In the remainder of this section, we summarize the main issues on the *chaebol* system that led to the decision not to allow *chaebol* groups to take control of large SOEs and a subsequent legislation against it. As mentioned in the above, there were few *chaebol* groups, if any, which were able to purchase the controlling interest of a large SOE in the mid 1990s without the preferential loans from the banks organized by the government. In other words, the government had to intervene in the financial market to force banks and other financial institutions to make large amount of loans to firms affiliated with a *chaebol* group which it picked so that the group could purchase the controlling interest of a large SOE. This is difficult to be justified in a market economy for various reasons. The *chaebol* chairman will take control of a large firm without investing his own money to acquire the shares. His power to control without real ownership will give him a strong incentive to misappropriate the resources of the firm in order to promote his personal gain.

Even if there is a *chaebol* group that has enough cash reserve of its own or has the ability to borrow money from the lenders on its own without the intervention of the government in order to buy the controlling interest of a large SOE, selling the controlling share of a large SOE to the group raises the question of whether it can be justified. The reason is that the government gave a *chaebol* chairman who initially had little money an opportunity to borrow a huge amount of money to build and operate a multiple number of large firms and a position to mobilize a large amount of money, mostly other people's money, only to give him an exclusive opportunity to acquire control of large SOEs additionally. Thus, allowing

a *chaebol* group to take control of a large SOE meant that the government kept giving it the exclusive right to the access of other people's money so that it could use other people's money to build and operate large firms or take control of large firms.

Allowing *chaebol* to take control of large SOEs was likely to lead to a large scale of misappropriation of the resources in the privatized firm by the *chaebol* chairman, considering their strong control without a real ownership, weak law enforcement on the crimes taking place in *chaebol* companies, and the observed behavior of *chaebols* at the time.

Kim Young-sam administration's decision not to allow *chaebol* to take control of large SOEs was a right one.

1.1. Policy of the Kim Young-sam Administration and its Evaluation

As discussed in the above, Kim Young-sam administration decided not to pursue privatization and instead enacted the Special Act on Privatization which declared three main objectives, (1) fast privatization of the SOEs the act targeted, (2) need to prohibit *chaebol* groups from taking over large SOEs, and (3) need to improve the efficiency of large commercial SOEs even before their full privatization. The act targeted four large SOEs, Korea Telecom, KT&G, KOGAS, and Korea Heavy Industry, and introduced a governance structure in the four SOEs. The main features of the governance structure put in place by the act in the four SOEs are the following:

- 15% ceiling on the ownership of each of the four SOEs by a single party. The definition of a single party covers all corporate investors affiliated with the same conglomerate and all individual investors who are in a special relationship with the same conglomerate.
- Anglo-American style board of directors
- Removal of directors from the line ministry and the Economic Planning Board
- Exemption from the Framework Act on the Management of GIIs
- Stronger role of the CEO and management contract for the CEO that is aligned with long term profits
- Protection of the rights of minority shareholders including the operation of the Key Shareholders Group⁷

The 15% ownership ceiling was included in the act to prevent the *chaebol* groups from purchasing substantial shares of the four large SOEs before full privatization that could lead to the sale of more shares later on leading to the takeover of them. More importantly, the

7. This is the English translation of the term *juju-hyubeu-hoi*.

ownership ceiling was the manifestation of the Kim Young-sam administration that takeover of large SOEs by *chaebol* groups was harmful to Korea. However, the 15% ownership ceiling was effective only when the government remained as a dominant shareholder and it would not work as a legal barrier to takeover by *chaebol* groups once the government sold off its shares. Thus, the ownership ceiling set by the Special Act was much weaker than the golden share U.K. had used whose effects were extended to post-privatization era. The reason that the government at the time decided not to adopt a device like a golden share was due to the possibility that such a device violated a clause in the Constitution on equality. However, the manifestation worked as a political constraint to successive administrations that followed Kim Young-sam administration and had a lasting effect to discourage them from attempting to sell controlling interests of large SOEs in most cases.

The Special Act was based upon the view that politicians and bureaucrats at the line ministries tended to force managers of SOEs to take actions that entailed serious loss of money to promote their political objectives that led to outcomes that were difficult to be justified based on efficiency or other plausible criteria. Therefore, the act attempted to put an arms' length's distance between the line ministries and the four SOEs and to separate policy objectives of the line ministries from the commercial objectives of SOEs significantly. As a practical measure to achieve, the act removed bureaucrats in the line ministry as well as those in the Economic Planning Board from the board of directors. The act attempted to give much of the power, which had been wielded mostly by the line ministry, to the top management and independent directors appointed by shareholders. Independent directors were given the power to play key roles in important affairs of the SOEs, including the selection of the CEO, signing management contract with the CEO, performance evaluation of the CEO and remuneration as in many large listed companies in U.S.

Those who designed the act were aware that politicians and bureaucrats at the line ministries could abuse the shareholder's rights of the government in the SOEs targeted by the Special Act by forcing the government to take actions that would harm the profitability of the SOEs without plausible reasons. They considered such actions of the government similar to those of dominant shareholders of *chaebol* companies that were taken to promote the interests of the dominant shareholders at the expense of the minority shareholders or the companies themselves. They attempted to discourage abuse of shareholding rights by the government that hurt the profitability of SOEs, so that they could protect the rights of the minority shareholders. Key Shareholder Group was a group of large private shareholders, who had the incentive to maximize the firm value and was introduced as a device aimed at checking the wrong incentives of the government officials who exercised shareholding rights of the government.

What led to the decision to select four SOEs as the targets of the Special Act? From the discussion of the previous section, the most natural choice to apply the act among the large SOEs were POSCO, KT&G, Korea Heavy, and KT. For some reason, the list of firms the act was to apply to didn't include POSCO but included KOGAS. We believe that the selection was made as a result of negotiations among the affected ministries. Another question that could be raised was why the act did not include other commercial SOEs including banks. It was ironic that even the most reformative legislation on SOEs in the history of Korea was decided by bargaining among interested parties.

Lastly, it should be noted that the Special Act did not succeed in separating between the line ministries and the SOEs it targeted sufficiently clearly. The act exempted KT, KT&G, and KOGAS from the application of the Framework Act on the Management of GIIs that they had been subject to and removed much of the restrictions that kept them from becoming more efficient. However, it retained an important part of the Framework Act on the Management of GIIs, which was the authority of the line ministries to supervise the operation of the three SOEs. This left the door open for the line ministries to intervene in the management of the SOEs the act covered. Korean government did not take additional actions which aimed at putting an arms' length distance in place between the policy objectives and commercial operation of the SOEs such as establishing a neutral and transparent regulatory scheme.

The Special Act on Privatization was incomplete in many ways because it didn't serve as measures for installing profit oriented efficient governance structure in large commercial SOEs and suffered from inherent instability due to the government ownership. Nonetheless, it was a first big step in the right direction Korea had taken to improve the governance of large commercial enterprises. At the time of its introduction, essentially all the large firms in the private sector were under a governance structure that was far inferior to the one it introduced to four SOEs. It also paved the way for the real privatization of many SOEs by the Kim Dae-jung administration that succeeded it in 1998.

We summarize the important details of the act as follows:

[Composition of the Board of Directors]

The board of directors of SOEs subject to the act consists of executive directors selected from the high ranking managers including the CEO and non-executive directors recruited from civilians outside the company and the government. The proportion of executive directors must not exceed 50%. Thus, it is impossible for executive directors alone to make decisions in the board of directors, and outside directors can provide checks and balances. Each director has a term of 3 years. For outside directors, the term is guaranteed unless he falls in a situation that disqualifies him as a director. But, for executive directors, the term is not guaranteed in practice while the act specifies the 3 year term. Most of the four SOEs

tyed the position of an executive director to an executive position such as CFO or vice president in practice. As a result, when an executive director changed positions from one that was tied to the directorship to another that was not, he had to resign. The first set of directors appointed shortly after the act took effect had different terms. One third of them had the term of 1 year, another one third had 2 years, and the last one third had the 3 year term to prevent a chaotic situation that could arise when all directors were replaced in the same year.

Executive directors were appointed according to a procedure in which the CEO recommended candidates for other executive directors and the board of directors approved them. Executive directors were prohibited from participating in the board meetings that made decisions on the appointment of executive directors, except for the CEO. Non-executive directors were appointed at the general shareholders' meetings by the votes of the shareholders on the candidates recommended by a shareholder or the Key Shareholders Group. The government was also able to recommend candidates for non-executive directors as a shareholder. However, the spirit of the act was that it was not desirable for the government to get involved in the appointment of outside directors. The four SOEs created a procedure that was based on their articles of association, according to which a committee consisted of outside directors and experts recruited from outside the board and the company selected candidates for outside directors.

[Functions of the Board of Directors]

The Special Act allowed the Commercial Law to be applied to the four SOEs on the issues not covered by the act. As a result, the board of directors was the top decision making body next to the general shareholders' meetings. This made it difficult for the line ministries to intervene in the management. The act allowed the non-executive directors to have the power to demand the submission of information on the operation of the SOE where they needed to participate in the decision making process of the board. The CEO must comply with such demands.

[Appointment of the CEO]

The CEO is appointed by the general shareholders' meeting if the shareholders participating in the meeting directly or indirectly approve the candidate recommended by the Committee on the Recommendation of the Candidate for the CEO. The committee consists of non-executive directors, one of former CEOs, and civilian experts selected from outside the board and the company. The number of non-executive directors should be less than 50% of the committee members. Thus, non-executive directors alone cannot make a unilateral decision on the recommendation of the candidate for the CEO. One of the non-executive directors will preside over the meeting as the chairman. The decision

rule is to accept a majority decision. The committee forms the pool of candidates using a combination of application from those interested in the position and recommendation by others for a sufficient period of time. The committee then selects one candidate from the pool and recommends him or her to the general shareholders' meeting.

The process described in the above intended to give outside directors a key role in selecting the CEO while reducing the risk of their power abuse by limiting their power to certain degrees at the same time. Inclusion of one ex-CEO and outside experts in the committee was intended to curb the power of non-executive directors to make decisions unilaterally and to let them use inputs and information from outside members. The participation of the ex-CEO and outside members also had the effect of making the process transparent and open to criticism when inappropriate things occurred during the selection process.

It is true that in spite of all these processes that have been carefully designed, the government can always veto a candidate recommended by the committee and appoint a candidate it prefers as the CEO by casting its vote in the general shareholders' meeting. The committee in practice will take this fact into account in selecting its candidate and will be likely to discuss its intentions on the CEO with the government. However, the very fact that the government enacted the Special Act and designed all these procedures has the effect of the commitment of the government to respect the procedures and to select a candidate from a pool of qualified experts.

The CEO has a term of 3 years. The act prohibits firing the CEO during his term without a valid ground that justifies firing. Thus, the government is tying its hand behind and is careful not to commit to abusing its power to fire the incumbent CEO or to replace him with another because of political considerations. Once a candidate is selected as the CEO, he signs a contract with the board of directors. Performance evaluation and remuneration for the CEO is determined by the board of directors and approved by the general shareholders' meeting. The management contract between the CEO and the board includes the management goals, methodology to be used to measure the performance, and the formula that determines the remuneration for the CEO based on the evaluation of the performance. The board of directors can recommend firing of the CEO to the general shareholders' meeting if the outcome of the performance evaluation of the CEO falls short of the goals. The CEO and the executive directors are prohibited from participating in the board meetings that make decisions on the firing of the CEO. Thus, evaluation, remuneration, and firing of the CEO are entirely in the hands of outside directors.

[Minority Shareholders and Key Shareholders Group]

The crucial weakness of the Special Act is that it will not be in effect if the government decides not to follow the contents of the act in earnest. As we kept saying throughout the

paper, decisions that are ostensibly made by the government are actually made by powerful politicians and the bureaucrats who take orders from the politicians and execute them in Korea. Powerful politicians keep changing, and so do the bureaucrats in charge of the affairs of SOEs. The administration itself changes every five years. Politicians and bureaucrats usually have incentives to use the resources of SOEs in pursuing objectives they favor by forcing SOEs to get involved in the business which is necessary to achieve their objectives even though they know it would result in losing money for SOEs. It is possible that they can decide to take actions that are against the act or the spirit of the act if powerful politicians of a new administration do not like the governance structure of large commercial SOEs set by the Special Act.

The provisions of the act such as the guaranteed term of the CEO and the directors, appointment procedures for the CEO and directors, and application of the Commercial in most cases were introduced to make it difficult and costly for politicians and bureaucrats to take actions that are against the goals and the spirit of the act. Nonetheless, powerful politicians can always force the bureaucrats at the shareholding ministries to use the position of the dominant shareholder of an SOE to make decisions at the general shareholders' meeting that are against the goals of the act. For instance, it is possible that powerful politicians do not like the candidate which the Committee on Recommendation of the CEO recommends and order bureaucrats to vote against the recommended candidate and vote for another one who is less qualified based on political considerations. After electing the candidate they favor, they try to use him later on in forcing the SOE to get involved in activities that would promote the political objectives they pursue.

The nature and the effect of such actions by the politicians and bureaucrats are similar to the actions taken by dominant shareholders of *chaebol* affiliated firms that promote the interests of dominant shareholders at the expense of other shareholders. In the case of *chaebol companies*, a dominant shareholder is a minority shareholder with less than 5% of the shares. In the case of SOEs, politicians and bureaucrats have no share at all. In both cases, those in control of a firm in which he owns a minority share or no share at all sacrifice the money belonging to other shareholders in order to promote the interests they pursue. In private companies, shareholders other than the dominant shareholder can attempt to seek to revoke the decisions of the board of directors by the vote of the general shareholders, criminal prosecution, or civil suits to force the dominant shareholder and other executives involved to pay for the damage they cause to the company. The act allowed the avenue for the protection of minority shareholders, too. However, it is not easy for minority shareholders to take such measures due to the high costs involved and the low probability of winning in the general shareholders' meeting and in court, especially when the dominant shareholder is the government.

The act attempted to deal with this problem further by introducing the Key Shareholder Group consisting of shareholders other than the government who own substantially large shares and giving them a role in checking the government as a shareholder. However, the act is vague in prescribing the precise functions and roles of the Key Shareholder Group, and as a consequence it has not been used much.

1.2. SOE Policy of the Kim Young-sam Administration and its Evaluation

As explained above, Kim Young-sam administration intended to distinguish SOEs that should be and are able to be privatized among the six major SOEs, and tried to privatize them. Pohang Iron and Steel Corporation, Korea Heavy Industries, KT&G, and KT were classified as privatization targets and were under detailed investigation. As for the divestment method, SOEs mentioned above were assessed and the results were as follows:

- They did not relieve the foreign ownership regulations the stock market had at the time of SOE privatization.
- They decided not to privatize a firm by having a foreign controlling shareholder.
- They decided not to privatize a firm by selling substantial amount of shares to *chaebols* and not to allow them to run the privatized firm.
- The last alternative which was to sell the SOE shares within the domestic stock market was considered to have a slim chance of success in view of Korean economy and stock market situation of those days and was not put into practice.⁸

In the end, Kim Young-sam administration decided to exclude *chaebols* from the privatization process of large-scale SOEs and maintain its original limit on foreign ownership. Moreover, taking the domestic stock market and the capital market situation at that time into consideration, selling all the shares to domestic investors within relatively short period of time was deemed to be impossible. Failure in the privatization of the four SOEs was not due to any particular characteristics of the SOEs or the industries, but was due to relatively underdeveloped domestic capital market and irregular governance and ownership structure of large-scale private enterprises. Such underdeveloped domestic capital market and irregular governance and ownership structure of large-scale private enterprises stemmed from the use of the *chaebol* system, illegal market intervention by political force of the time, and ineffective enforcement of laws concerning governance structure and financial regulations within large-scale enterprises and financial institutions.

8. In retrospect, the financial crisis that would hit Korea in less than two years was under way in 1996, and the financial market situation in Korea was deteriorating at the time. Even if the Korean government had decided to privatize some of the large SOEs in the mid-1990s, the probability of success would have been very slim.

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Chapter 5

Privatization of SOEs and Changes in the Governance of Government-invested Institutions (GIs) under Kim Dae-jung Administration

Privatization of SOEs and Changes in the Governance of Government-invested Institutions (GIIs) under Kim Dae-jung Administration

The Special Act on Privatization became effective on November, 1997. By then, Korea was well on its way to a huge financial crisis that the country had not experienced, which would eventually make more than half of the large firms belonging to *chaebol* groups go into bankruptcy or deep financial crises. Amid the financial crisis, the main opposition party won the presidential election and took over in early 1998. The Kim Dae-jung administration implemented sweeping economic reforms in corporate and in financial sectors. At the same time, it pursued large scale privatization of SOEs and restructuring of many SOEs that were to remain as SOEs. Following <Table 5-1> summarizes key information on the large SOEs in non-financial sectors that had existed by the time Kim Dae-jung administration took over. There were 13 GIIs and 13 non-GII SOEs as well as their subsidiaries.⁹ Note that the size of the SOEs was larger than that of private firms at the time. In particular, KEPCO, KOGAS, KT&G, KT, and POSCO were among the largest firms that existed at that time, when such large private firms as Samsung Electronics or Hyundai Motors were larger or comparable to them.

Kim Dae-jung administration privatized many SOEs including KT, KT&G, POSCO, and Korea Heavy Industry. It also sought to introduce competition into the industries dominated by SOEs that it wanted to privatize. Telecom industry was the best example of this effort. Telecom industry had been liberalized substantially by 1998, but the local loop part of the industry had been still under KT monopoly. Kim Dae-jung administration introduced competition into the local market by allowing entry and then completed the introduction of competition into all parts of the telecom industry. It also abolished the monopoly of KT&G on the manufacture of tobacco products by relaxing restrictions on manufacturing and introduced a program to phase out subsidies to domestic farmers growing tobacco leaves gradually while it was preparing for the full privatization of KT&G.

9. Note that KT, KT&G, and KOGAS are classified as non-GII SOEs as they were subject to the Special Act on Privatization in November 1997.

Table 5-1 | Current Status of GIs and Non-GII SOEs (1998. 3. 31)

(Unit: one hundred million won / persons)

GIs	Organization Name	Capacity	Capital	Balance Account of 1997		Budget in 1998	Affiliated Companies
				Sales	Current net profit		
GIs	Korea Minting and Security Printing Corp	2,634	66(100)	1,967	158	3,014	-
	Korea Tourism Corp	984	324(56.1)	2,118	134	2,433	Kyeongju Tourism Development Corp
	Korea Rural Community Corp	2,478	1,265(100)	7,947	272	11,139	-
	Korea Agro-Fisheries and Food Trade Corporation	948	532(100)	1,825	6	2,168	7 including Korea Refrigerator
	KEPCO	39,454	31,411(69.8)	131,162	5,606	233,340	7 including KEPCO Plant Service and Engineering
	Petroleum Development Corp	949	13,058(100)	3,841	150	885	2 including KCCL (Korea Captain Company Ltd.)
	Korea Coal Corp	4,072	2,983(98.3)	2,110	-833	3,330	-
	Korea Resource Corp	431	1,443(98.1)	550	-23	1,775	-
	KOTRA	649	5(100)	784	-	1,149	-
	Korea Housing Corp	5,914	34,627(98.1)	38,224	733	46,668	6 including Hanyang
	Korea Water Corp	4,162	18,891(91.8)	16,169	450	12,622	2 including Korea Water Inspection Corp
	Korea Expressway Corp	5,178	48,233(89.5)	14,778	448	46,769	3 including Expressway Inspection Corp
	Korea Land Corp	2,490	16,640(92.9)	32,706	5,207	35,045	2 including Korea Real Estate Investment & Trust Co
	GIs (13 in total)	70,343	169,478	254,181	12,308	400,337	30 in total

GIs	Organization Name	Capacity	Capital	Balance Account of 1997		Budget in 1998	Affiliated Companies
				Sales	Current net profit		
Non-GII SOEs	KT&G	7,680	9,550(89.2)	42,434	2,258	45,262	1
	National Textbook Korea	739	82(40.0)	517	38	594	-
	Technology Banking Corporation	163	912(10.2)	4,384	24	283	Technology Lottery Sales Inc.
	Seoul Daily Korea	1,077	544(49.9)	1,840	-173	2,038	-
	Broadcasting System	5,741	1,512(100)	9,999	686	10,511	6 including KBS Production
	KOGAS	2,891	2,664(50.2)	29,266	-3,355	53,854	5 subsidiaries including Kogas Tech
	Pohang Iron and Steel	19,294	4,695(19.6)	97,181	7,290	131,736	16 including Posteel
	Korea District Heating Corp	1,015	217(46.1)	2,026	7	5,929	3 including KDH Tech
	Korea Heavy Industries	7,851	5,210(-)	30,070	453	39,974	3 including Korea-Ch
	Daehan Oil Pipeline Corporation	386	2,141(52.7)	336	-443	1,967	2 including Korea Oil Pipeline Corporation
	General Chemical	263	878(-)	150	-566	735	Namhae Chemistry
	KT	59,491	14,396(71.2)	77,852	797	91,866	13 including KT
	Korea Appraisal Board	1,120	60(49.3)	816	22	899	한국부동산신탁
	Non-GII SOEs (13 in total)	107,711	42,861	296,871	7,038	385,648	52 in total
Subsidiaries	GII-invested companies (30 in total)	23,029	5,136(4,285)	35,211	286	39,773	
	Non GII SOEs-invested companies (52 in total)	22,483	20,382(14,590)	121,257	-2,266	163,365	
Total		223,566	237,857	707,520	17,366	989,123	

Source: Budget Planning Committee (1998)

On the governance of SOEs, Kim Dae-jung administration allowed more autonomy to the management of GIIs by adopting some of the key features of the Special Act on Privatization. The main elements of the 1999 Amendment of the Framework Act on the Management of GIIs are as follows:

- Exclusion of the government agencies from the board of directors, which prevented line ministries and the Ministry of Finance and Economics from participating in board meetings
- Anglo-American board structure consisting of independent directors and executive directors
- CEO Recommendation Committee consisting of independent directors and outside experts from outside the government and SOEs
- Management contract between CEOs and independent directors
- Remuneration of the CEOs based on performance evaluation
- Appointment of the auditor by the president of Korea

The policy of Kim Dae-jung administration on SOEs was more systematic and more active in adopting market economic principles. Unlike its predecessors, none of which even attempted to identify all SOEs that needed to be privatized, Kim Dae-jung administration tried to identify the SOEs from the pool of all GIIs, non-GII SOEs, as well as their subsidiaries whose optimal ownership and governance structure was that of a private enterprise. The selection was done reasonably well based on the nature of the businesses of SOEs. Most of the commercial SOEs were selected as the ones to be privatized.

Kim Dae-jung administration adopted the spirit behind the Special Act on Privatization on *chaebol* issues and decided not to allow *chaebols* to participate in the privatization of large commercial SOEs, except in the case of Korea Heavy Industry, whose controlling interest was sold to Doosan group, a mid-sized *chaebol* group, whose main business had been beer manufacturing. The other large SOEs were privatized based on dispersed ownership and a governance structure specified by the Special Act on Privatization. It is worth noting that even after the privatization of the commercial SOEs in this way, no *chaebol* group attempted to acquire a controlling interest of them even though there was no law prohibiting them from trying to buy a controlling interest of a privatized former SOE in Korea.

This strongly suggests two important facts about Korea. First, the administrative branch of the government, headed by the president, was still very powerful in Korea so that *chaebol* groups did not dare to confront the government which did not want *chaebol* groups to take over large former SOEs even though there was no law that prevented them from attempting to do so. Second, *chaebol* issues were such crucial issues in Korea, at least politically, that

the administrative branch of the government had a strong incentive to prevent *chaebol* from taking over large former SOEs even though there was no law that prohibited it.

All large SOEs, except Korea Heavy Industry, were privatized through general sales of shares to domestic and foreign investors. Foreign ownership ceiling, which had been in effect before the financial crisis, was abolished by Kim Dae-jung administration that wanted to attract foreign capital in the aftermath of the crisis. As a result, many foreign investors participated in the privatization process, which led to the successful privatization of the commercial SOEs.

The sale of Korea Heavy Industry to a *chaebol* group was inconsistent with the policies of Kim Dae-jung administration on *chaebol* issues and contributed to the expansion of the *chaebols* and aggravated the problems that are rooted in the *chaebol* system in Korea. Policies of Kim Dae-jung administration had some other flaws, too. It initially excluded KT from the list of SOEs to be privatized even though private firms including several *chaebol* firms were effectively competing in many parts of the telecom industry. Although KT was added to the list of SOEs to be privatized and ended up privatized completely by 2002, its exclusion from the list of SOEs to be privatized in early years of Kim Dae-jung administration delayed the privatization of KT, which in turn prevented it from competing effectively against *chaebol* firms operating in the telecom sector.

It should be noted that while Kim Dae-jung administration adopted some of the key features of the Special Act on Privatization in the governance structure of GIIs that were subject to the Framework Act on the Management of GIIs, the spirit behind the measures taken by Kim Dae-jung administration was quite different from that of the Special Act on Privatization. The Special Act on Privatization envisaged SOEs subject to it as commercial firms that should be owned and controlled by private investors but that had the government as a dominant shareholder temporarily due to the under-development of the capital market in Korea. It regarded the government as a necessary evil that was the only feasible dominant shareholder and that could only lead to sub-optimal performance if it wielded control of them based on its ownership.

On the other hand, the GIIs subject to the 1999 Framework Act on the Management of GIIs, were regarded as institutions that were closer to the government itself than commercial enterprises and that should be used as policy instruments of the line ministries. The line ministry and the Ministry of Finance and Economics were excluded from the board of directors. The board of directors consisted of outside directors and executive directors and the majority were outside directors, which intended to increase their efficiency as public institutions. Somehow, the designers within the Kim Dae-jung administration who designed the new governance structure for GIIs believed that the presence of the line ministry and

the Ministry of Finance and Economics in the board of directors and their subsequent direct intervention in the management of GIIs led to inefficiency, so GIIs could increase the efficiency only by removing them from the board of directors and replacing them with professors, lawyers, and accountants brought from outside. But the GIIs were not to be privatized as they were public institutions unlike the SOEs subject to the Special Act. The primary goal of the board of directors was different between GIIs and the SOEs subject to the Special Act. Profit incentives were not an important part of the amendment of the Framework Act.

If it were true that the intervention of the line ministry and the Ministry of Finance and Economics resulted in inefficiency in achieving the goals of GIIs set by the line ministries, then replacing government officials from the two ministries with civilian experts should increase the efficiency in principle. But for this scheme to work, it is necessary that the government should appoint appropriate people as directors and give them sufficient incentives to increase the efficiency of the GIIs given the objectives set by the line ministries. However, incentives given to the outside directors were not sufficient enough to make them put meaningful efforts. Whether the selection process, which is believed to have been heavily influenced by politicians and bureaucrats, was effective in appointing those with required expertise as directors was not clear, either. It is possible that appointment of directors was made based more on political considerations.

Kim Dae-jung administration also prepared a restructuring plan, which would take at least 7 to 8 years to complete, well beyond its tenure, in 2001, and implemented the first stage of the plan. The first part of the restructuring plan consisted of the separation of the generation stage from the rest of the industry that had been operated as a vertically integrated monopoly by KEPCO and the introduction of competition into the industry. It forced KEPCO to set up 6 generation companies as legally separate entities and gave all power plants that it had owned before to the 6 companies. It also allowed entry into the generation stage and established a wholesale spot market in which the 6 generation companies that were subsidiaries of KEPCO would compete with new entrants. KEPCO's businesses were reduced to transmission, distribution, and retail, and KEPCO became the monopolist in the three stages as well as the holding company for the 6 generation companies. The restructuring plan drafted by Kim Dae-jung administration also sought to force KEPCO to sell one or two of the 6 generation companies to investors during its tenure and sell some more in later years. The plan also included the separation of the distribution and the retail unit of KEPCO into several local monopolies and the introduction of competition into the retail stage in mid 2000s.

The restructuring plan clearly tried to imitate the U.K. model of restructuring of the electricity industry, which focused on competition between purely profit seeking firms

in the wholesale market and incentive regulation of purely profit seeking monopolists in transmission and distribution stages of the industry. For the restructuring plan to work in Korea, the government needed to privatize KEPCO and its subsidiary generation companies or at least install a governance structure in them that is comparable to that of purely profit seeking private enterprises. However, Kim Dae-jung administration did not install such a governance structure in KEPCO and continued to run KEPCO as a GII, a direct policy instrument of the line ministry.

The governance structure of KEPCO and its subsidiary generation companies deprived the subsidiaries of a chance to become effective competitors in the competitive wholesale market and deprived KEPCO of a chance to become an efficient holding company of them. The governance structure of KEPCO also deprived KEPCO of a chance to become a more efficient firm in the transmission, distribution, and retail stages. It also made it impossible to regulate KEPCO efficiently for its monopolistic service in the transmission, distribution, and retail stages. It is also worth mentioning that the regulatory scheme for the transmission, distribution, and retail services did not change much from the scheme that had been used before 2001.

Thus, there was inconsistency between the policy on the market structure and competition on the one hand and the policy on the corporate governance of KEPCO and its subsidiary generation companies and the regulatory scheme on the other. Naturally, there was a high degree of uncertainty as to the eventual success of the restructuring plan even from the beginning of the restructuring. Kim Dae-jung administration failed to sell a couple of generation companies owned by KEPCO as the market participants did not see a clear picture of its industrial structure and the regulatory scheme, which were to determine the valuation of the generation companies up for sale. The restructuring plan also had a set of serious flaws in market rules, which made effective competition very difficult even if all participants including KEPCO's subsidiary generation companies had efficient governance structure. In the end, the restructuring produced an outcome that was consistent with all these structural problems. While the restructuring led to the entry of private generation companies that found it not so difficult to make profits, KEPCO's subsidiary generation companies recorded much lower profitability. KEPCO suffered financially as well.

The second part of the restructuring plan, which was scheduled to be completed by subsequent administrations, did not materialize as Roh Mu-Hyun administration which succeeded Kim Dae-jung administration decided to stop the implementation of the second part of the restructuring plan during its tenure and the Lee Myung-bak administration that succeeded Roh administration followed the same step. As a result, the structure of the electricity industry in Korea did not change much from that in 2001.

Kim Dae-jung administration should have chosen a more comprehensive approach to the electricity industry. It should have prepared a detailed plan for the ultimate ownership structure of KEPCO and its subsidiaries, the generation companies that were supposed to pursue pure profit maximization, and the governance structure that should be used during the transient period before their full privatization that was also consistent with pure profit incentives. It should have adopted not only a set of market rules that would induce effective competition in the wholesale market and but also a regulatory scheme for the transmission, distribution, and retail stages that were fundamentally different from the schemes that had been used before 2001 and consistent with profit incentives of KEPCO. It should also have changed the roles of the line ministry and reassigned appropriate roles to the line ministry and the newly created regulatory authority. It should have published a clear time table for all those changes to be made along with the measures that would implement the plan according to the announced time table.

Kim Dae-jung administration attempted to restructure the natural gas industry in a way that was as incomplete and inconsistent as its restructuring plan for the electricity industry. It attempted to introduce competition into the importing stage of the natural gas industry that had been nearly monopolized by KOGAS without even trying to make necessary changes in the governance structure of KOGAS or regulatory scheme for regulation of wholesale and retail tariffs. Its plan to introduce competition into the importing stage was actually very unusual. It wanted to force KOGAS to divide all of the long term gas purchase contracts that had been in effect at the time into three roughly equal sets of contracts and to sell two of them to private investors. It did not succeed in implementing this plan.

But it is important to note that Kim Dae-jung administration did not even consider changing various policies that should accompany the fundamental change in the structure of the industry it sought after. It should have considered changing regulations of wholesale and retail tariffs, introducing competition into the retail stage, changing the policy on various cross subsidies that had been going on in natural gas, electricity, and other energy industries. This is strong evidence that politicians and the bureaucrats in the relevant ministries do not understand what restructuring means and what measures need to be taken.

In spite of all these shortcomings, there is no question that Kim Dae-jung administration was more active in implementing market oriented policies in the industries that had been dominated by SOEs than any other administration that preceded it or that succeeded it. The flaws in its approach and the mistakes it made simply confirm the fact that the idea of market economy and the rule of law is still very much a foreign one in Korea.

Current SOE Policy Adopted by Roh Moo-hyun Administration and its Evaluation

1. Framework Act on the Management of Government-affiliated Institutions
2. Act on the Management of Public Institutions
3. Details of the Governance Structure of SOEs and Public Institutions Adopted by Roh Moo-hyun Administration
4. Management Evaluation System
5. Bonus
6. Public Disclosure
7. Evaluation of SOE Policy Adopted by Roh Moo-hyun Administration

Current SOE Policy Adopted by Roh Moo-hyun Administration and its Evaluation

1. Framework Act on the Management of Government-affiliated Institutions

Until 2005, the governance system of large SOEs in Korea had been incomplete in that there was no law that governed the governance of non-GII SOEs. The governance of SOEs also lacked consistency in the sense that SOEs whose nature of businesses seemed quite similar were subject to different governance structures depending on whether an SOE was classified as a GII or not. The criterion that defined GIIs was also unclear. While the principle behind the classification was whether the government ownership was 50% or more, there were exceptions. For instance, KBS was classified as non-GII SOE even though it was 100% owned by the government. The governance of subsidiaries of GIIs was unclear, too, as they were treated as non-GII SOEs even though their mother company was classified as a GII.

The uncertainty over the governance structure of non-GII SOEs and the practice of the past administrations to allow less stringent regulations on the management of non-GIIs made the management of GIIs and the bureaucracy of the line ministries have a strong incentive to establish subsidiaries as it was much easier to create high paying jobs in subsidiaries, which were not subject to the Framework Act and the regulations of the ministry in charge of the budget, than in GIIs themselves. Many subsidiaries of GIIs are believed to have been created to serve the interests of the executives of GIIs and the bureaucrats at the line ministries even though there was no compelling reason to establish them, resulting in significant inefficiency.

Roh Moo-hyun administration, which came to power in 2003, saw the incompleteness and inconsistency in the governance of SOEs described above as a serious flaw of the

system on the governance of SOEs. In addition, it also became aware that there were a large number of public institutions, which were owned wholly or substantially by the government or whose budgets were largely provided by the government but their governance structure was unclear. It was decided to introduce a completely new system of governance for all SOEs and public institutions. In 2005, Roh administration identified 537 SOEs and public institutions which were GIIs or non-GII SOEs and enacted the Framework Act for the Management of Government Affiliated Institutions (FAMGAI and GAIs respectively henceforth) which defined the governance structures for 88 of them. The SOEs and public institutions that were targeted by the FAMGAI were the ones that met the following three conditions:

- (i) institutions that were receiving more than KRW 5 billion a year from the government,
- (ii) SOEs in which the government was the largest shareholder,
- (iii) Public institutions which were receiving more than KRW 5 billion a year and for which the proportion of the money provided by the government exceeded 50% in their budgets

The following <Table 6-1> is the list of names and classifications of 321 SOEs and public institutions Roh administration identified as of August, 2005.

Table 6-1 | Public Institutions identified by Roh Administration as of August, 2005

Category	Institution Name
Institutions whose yearly government investment is greater than 5 billion won (The Framework Act on the Management of Government-Affiliated Institutions §3①3)	Korea Transportation Safety Authority, Korea Infrastructure Safety Corporation, Korea Railway Network Authority, Road Traffic Authority, Korea Science and Engineering Foundation, Korea Institute of Nuclear Safety, Korea Education & Research Information Service, Korea Research Foundation, Korea Workers' Compensation & Welfare Service, Workers' Accident Medical Corporation, Employment & Labor Training Institute, Korea Occupational Safety & Health Agency, Human Resources Development Service of Korea, Korea Employment Agency for the Disabled, Korea Film Council, Korea Health Industry Development Institute, Korea Testing Laboratory, Coal Industry Promotion Board, Korea Energy Management Corporation, Korea Institute of Ceramic Engineering and Technology, Korea Export Insurance Corporation, Korea Nuclear Energy Promotion Agency, Korea Technology Finance Corporation, Korea Credit Guarantee Fund, Korea Consumer Agency, Korea Housing-Finance Corporation, Institute for Information Technology Advancement, Korea IT Industry Promotion Agency, National Computerization Agency, Korea Agency for Digital Opportunity and Promotion, Korea Information Security Agency, Korea Federation of Credit Guarantee Foundations, Korea Container Terminal Authority, Korea National Parks Authority, Korea Environment Corp, Korea Environment Management Corp

Category	Institution Name
<p>Institutions whose maximum number of shares are owned by the government (The Framework Act on the Management of Government-Affiliated Institutions §3①2)</p>	<p>Korea Housing Guarantee, Korea Appraisal Board, The First Club 88, Korea Asset Management Corp, Korea District Heating Corp, Pusan Port Authority</p>
<p>Institutions whose sum of government investment and subsidy is greater than 50% of the budget or 5 billion won (The Framework Act on the Management of Government-Affiliated Institutions §3①3)</p>	<p>Pusan Transportation Authority, Jeju Free International City Development Center, Korea Foundation for the Advancement of Science and Creativity, Korea Teachers Pension, Korea Foundation for the Promotion of Private School, Korea Veterans Welfare and Healthcare Corporate, Livestock Health Control Association, Korea Institute for Animal Products Quality Evaluation, Agriculture Forestry Fisheries Information Service, Korea Racing Authority, Korea Creative Content Agency, Government Employees Pension Service, National Council of Sport for All, Korea International Broadcasting Foundation, Korea Sports Council, Independence Hall of Korea, Korea Cadastral Survey Corp, Korea Game Development and Promotion Institute, Korea Culture Content Agency, Korean Federation of Film Archives, Korea Sports Promotion Foundation, Korea Arts and Culture Education Service, Korea Broadcast Advertising Corporation, National Youth Center, Health Insurance Review & Assessment Service, National Health Insurance Corporation, National Pension Corporation, Korea Gas Safety Corporation, Korea Democracy Foundation, Korea Photonics Technology Institute, Korea-Japan Cooperation Foundation for Industry and Technology, Korea Industrial Complex Corp, Korea Elevator Safety Institute, Korea Power Exchange, Korea Petroleum Quality Inspection Institute, Korea Institute of Design Promotion, Korea Institute of Industrial Technology Evaluation and Planning, Korea Fire Equipment Inspection Corporation, Korea Deposit Insurance Corp, Korea Securities Depository, Association of Specific Post Office, Korea Electrical Safety Corp, Korea Radio Station Management Agency, Korea Internet & Security Agency, Korean Society of Ship Inspection & Technology, Korea Institute of Maritime and Fisheries Technology</p>
<p>Institutions whose yearly government investment is less than 5 billion won</p>	<p>Korean Federation of Science and Technology Societies, University of Science and Technology, Korea Institute for Military Affairs, Fashion Center Korea, Agricultural Research & Development Promotion Center, Korea Public Health Association, International Korean Adoptees Service, Korea Specialty Chemical Industry Association, Korea Information and Communication Contractors Association, Korea Software Finance Cooperative, Korea Local Authorities Foundation for International Relations, Korea Local Information Research and Development Institute, Korea Scientists & Engineers Mutual-aid Association, Telecommunication Technology Association</p>

Category	Institution Name
Auxiliary institutions whose yearly government investment is less than 50% of the total profit & 5 billion won	Korea Technology and Information Promotion Agency for Small and Medium Enterprises, Korea Small Business Institute, Korea Venture Business Women's Association, Korea Association of Business Incubator, Korean Classics Research Institute, Korea Military Merit Awardees Association, Korea Disabled Veterans Organization, Korea War Widows Association, Korea War Veterans Bereaved Families Association, Seoul Performing Arts Company, Korea National Ballet, National Opera Company of Korea, National Chorus of Korea, Copyright Commission for Deliberation and Conciliation, Korea Youth Counseling Institute, Chungdong Theatre, Korea Publication Ethics Commission, Korea Culture and Tourism Institute, Press Arbitration Commission, Korea Association of Rehabilitation Welfare Centers, Korean Apparel Industry Association, Korea Silk Research Institute, Korea Salt Manufacture Association, Korea Association of School Invention, Korea Maritime Foundation, Korea Fisheries Infrastructure Promotion Association.
Government-commissioned institutions whose yearly government investment is less than 50% of the total profit & 5 billion won	Investment Banks Association of Korea, Korea Futures Association, Korea Insurance Institute, Credit Finance Association, Component Material Research, Korean Institute of Certified Public Accountants
GIs	Korea Housing Corp, Korea Expressway Corp, Korea Water Corp, Korea Railroad Corp, Korea Land Corp, Korea Agricultural and Rural Infrastructure Corporation, Korea Agro-Fisheries and Food Trade Corp, Korea Tourism Corp, Korea Resources Corp, KOTRA, Korea Coal Corp, Korea National Oil Corp, KEPCO, Korea Minting and Security Printing Corporation
KBS, etc	KBS, EBS, IBK, KDB, Export-Import Bank of Korea
Bank of Korea, etc	Bank of Korea, Financial Supervisory Service

Table 6-2 | Current Status of Public Institutions (in August, 2005) (Continued)

Category	Institution Name
Government-funded research institutes	Korea Research Council of Public Science Technology, Korea Research Council of Fundamental Science Technology, Korea Research Council for Industrial Science and Technology, Korea Institute of Construction Technology, Korea Institute of Science and Technology, Korea Institute of Science and Technology Information, Korea Institute of Machinery & Materials, Korea Legislation Research Institute, Korea Basic Science Institute, Korea Research Institute of Bioscience and Biotechnology, Korea Institute of Industrial Technology, Korea Food Research Institute, Korea Institute of Energy Research, Korea Electro-technology Research Institute, Electronics and Telecommunications Research Institute, Korea Institute of Geoscience and Mineral Resources, Korea Astronomy and Space Science Institute, Korea Railroad Research Institute, Korea Research Institute of Standards and Science, Korea Institute of Oriental Medicine, Korea Aerospace Research Institute, Korea Ocean Research & Development Institute, Korea Research Institute of Chemical Technology, National Research Council for Economic, Humanities, and Social Sciences, Science & Technology Policy Institute, Korea Transport Institute, Korea Research Institute for Human Settlements, Korea Institute for International Economic Policy, Korea Institute for Industrial Economics & Trade, Korea Energy Economics Institute, Korea Information Society Development Institute, Korea Institute for National Unification, Korea Development Institute, Korean Educational Development Institute, Korea Institute for Curriculum and Evaluation, Korea Labor Institute, Korea Rural Economic Institute, Korean Institute of Criminology, Korea Institute for Health and Social Affairs, Korean Women's Development Institute, Korea Institute of Public Finance, Korea Research Institute for Vocational Education & Training, Korea Institute for Youth Development, Korea Maritime Institute, Korea Institute of Public Administration, Korea Environment Institute
Institutions subsidized by the Small and Medium Business Administration	Korea Productivity Center, Korean Standards Association, Korea Federation of Small and Medium Business, Small and medium Business Corporation
Companies invested by KORAIL	Daegu Cargo Terminal, V Cash, International Pass & Commerce, Rail Development Inc., Rail Advertisement Inc. KORAIL Retail, KORAIL LoGIIs, KORAIL Service net, KORAIL Engineering, Pabalma, KORAIL Facility Industry Inc., KORAIL Retail, Korea Railroad Electricity System, KORAIL General Service Inc., KORAIL Unified Support Center Inc. KTX Tourism & Leisure Inc., KORAIL Tourism Development, Kyeongin ICD

Category	Institution Name
University hospitals	GWNH Dental Hospital, KNU Hospital, KPNU Hospital, KSNU Hospital, PNU Hospital, SNU Hospital, SNU Dental Hospital, CNU Hospital, CPNU Hospital, JNU Hospital, CNU Hospital, CPNU Hospital
Targets of privatization law	Incheon International Airport Corp, Korea Airport Corp, KOGAS
Institutions related to foreign affairs and national security, academic research or quasi-judicial power (The Framework Act on the Management of Government-Affiliated Institutions §3②③)	Korea Academy of Science and Technology, Daegu Gyeongbuk Institute of Science & Technology, Gwangju Institute of Science & Technology, National Cancer Center, Korea Institute of Science & Technology Evaluation and Planning, Korea Advanced Institute of Science and Technology, Korea Atomic Energy Research Institute, Academy of Korean Studies, Korean Legal Aid Corporation, Korea Rehabilitation Agency, Korea Internet Safety Commission, Program Deliberation & Mediation Committee, Korea Foundation, Korea International Cooperation Agency, Overseas Koreans Foundation, Agency for Defense Development, Korea Institute for Defense Analyses
Subsidiaries in addition to the companies invested by KORAIL	Korea Construction Management Corp, Korea Housing Management, Korea Real Estate Investment & Trust, Korea Foundation of Polytechnic Colleges, Korea University of Technology and Education, Korea Culture Promotion, KSPO and CO, Korea South-East Power, KDB Capital, IBK Capital, Korea Southern Power, Gyeongsangbuk-do Tourism Corporation, Korea East-West Power, Korea Hydro & Nuclear Power, KEPCO Engineering & Construction Company, Korea Midland Power, Korea Plant Service & Engineering, KEPCO Nuclear Fuel, Korea Electric Power Data Network, Ansan Urban Development, KOGAS Tech, Korea District Heating Engineering, Korea Western Power, IBK Credit Information, Korea Asset In Trust, KDB Asset Management, KDB Infra Asset Management, IBK Tech, IBK SG Asset Management, Kexim Bank (UK), KOEXIM MANDIRI FINANCE, KEXIM Vietnam Leasing, KEXIM Asia, Credit Guarantee Venture Investment, Korea Enterprise Data, Aju IB Investment, Resolution Finance Corp, Yegaram Savings Bank, Arirang TV, Farmland Improvement, KOGAS Tech, KORAS, KOLNG, Incheon Total Energy, Small Business Certification Center, Korea Venture Investment, Small Business Distribution Center, KL-Net Corp
Institutions affiliated with government-funded institutions	Korea Institute for Advanced Study, Korea Institute of Radiological and Medical Science, National Security Research Institute, Korea Polar Research Institute, Korea Institute of Toxicology, Korea Institute of Nuclear Nonproliferation and Control, Defense Quality Assurance Agency

Category	Institution Name
Miscellaneous 11)	Taedok Science Town, War Commemoration Service Society, Korea Media Rating Board, Korea Press Foundation, Korea Cultural Heritage Foundation, Korea Fire Safety Association, Public Officials Benefit Association, Korea Local Finance Association, Korea Research Institute for Local Administration, Seoul Arts Center, The Korea Chamber of Commerce & Industry
Miscellaneous 22)	Korea Investment Corp

Comments: 1) Institutions that do not fall under any specific categories but that are managed as management innovation targets

2) Both the Framework Act on the Management of Government-affiliated Institutions and the Framework Act on the Management of GIIs do not apply to this institution by a special law

Source: Sul Kwang Un and others (2005), 「A Research on the Policy on the Management of Government-affiliated Institutions」, KDI, p.29 ~ 30

The governance structure of GAIs defined by the FAMGAC was similar to that of GIIs defined by the FAMGII and could be summarized as follows:

- FAMGAI declared management autonomy for GAIs. However, the precise meaning of management autonomy was not clear even though the law was intended to achieve the objectives by allowing management autonomy.
- There was no clear mechanism that could be used to ensure management autonomy in practice. As a result, it was not clear how the management of the GAIs would act in an autonomous way.
- FAMGAI allowed diverse governance structures for GAIs and allowed a GAI to have one or more outside directors. However, it did not require that the outside directors should comprise a large majority in the board of directors. As a result, the law continued to allow the line ministries to wield control of the GAIs that had been under their control before.
- The roles of the board of directors were not clearly defined.
- The CEO of an SOE or the head of a public institution that was subject to the FAMGAI was to be selected by the Recommendation Committee for the CEO or Head. The committee was required to include a majority of civilian members.
- Management objectives of a GAI were to be determined by the CEO or the head of a GAI, who must consult with the line minister to determine the objectives. The CEO or the head of a GAI must submit the management objectives as well as the report on the performance of the GAI to the minister.

- Performance evaluation was to be conducted by the line minister, who might organize an evaluation team if needed.
- FAMGAI also established the Committee on the Management of GAIs, consisting of the Minister of Planning and Budget, vice ministers of line ministers of relevant ministries, other relevant vice minister level bureaucrats, and civilians. The Minister of the Planning and Budget was also the head of the committee.
- Roles of the Committee on the Management of GAIs: The committee was responsible for making decisions on the evaluation of GAIs, methods used in evaluations, important personnel and budgetary issues, and criterion for budget management. It was also given the authority to finalize the results of outside audits of GAIs.
- The line minister must submit the results of the evaluation on the performance of GAIs under its control to the Committee on the Management of GAIs. If the committee determines that the outcome of the evaluation of a GAI is not fair or objective, it can order re-evaluation of the performance of the GAI by a different evaluation team or by a different method.

Roh administration attempted to identify all SOEs and public institutions that had been loosely managed in the past without governance structures clearly defined by laws, and tried to subject them to governance structures that were clearly defined by a law, which produced sizable positive effects. Many SOEs and public institutions that had been left to the arbitrary control of the line ministries were identified. The FAMGAI reduced uncertainty about the governance of GAIs by specifying a set of alternatives for their governance structures while it also established the Committee on the Management of GAIs as the supreme decision making body in the governance of GAIs regardless of their governance structure. The inclusion of the Committee on the Management of GAIs in the governance structures of GAIs had the effect of increasing the accountability of the governance of GAIs. However, it failed to differentiate between commercial SOEs and public institutions whose nature is closer to the government itself than commercial enterprises clearly, and to prescribe different governance structures based on the nature of their businesses. FAMGAI did not have a chance to produce significant effects as it was abolished only three years after its introduction and replaced by the Act on the Management of Public Institutions.

2. Act on the Management of Public Institutions

Shortly after enacting FAMGAI, Roh administration began to design a new system of governance for nearly all SOEs and public institutions. The outcome of its effort was a new law which defined the governance structures of nearly all SOEs and public institutions, called

the Act on the Management of Public Institutions. Note that despite its name, this law targets not only public institutions, whose nature is closer to that of the government than commercial enterprises, but also SOEs whose nature of businesses are highly commercial. SOEs that had been classified as GIIs or non-GII SOEs before were included in the list of SOEs and public institutions to be subject to AMPI as most of the SOEs and public institutions had been subject to FAMGAI. Consequently, the Framework Act on the Management of GIIs and the FAMGAI were abolished as the new law became effective. Many SOEs and public institutions that had not been subject to FAMGAI or FAMGII became targets of AMPI, and the laws that had governed their governance before were also abolished. The Special Act on Privatization was not abolished, but became ineffective as SOEs that were subject to the Special Act were also required to meet all the requirements set by the AMPI.

The governance structures specified by the AMPI were close to those of GIIs under the Framework Act before 2006. Main contents of the AMPI are as follows:

- AMPI divides the SOEs and public institutions subject to it into 3 types and prescribes a governance structure for each type.
- AMPI does not give the line ministry the general supervision right to intervene in the management of an SOE or a public institution in an arbitrary way and limits the issues on which it can intervene in the management of the ones included in the list provided by the act.
- AMPI establishes the Committee on the Management of Public Institutions, which is similar to the Committee on the Management of Government Affiliated Institutions in composition and roles, and gives the Ministry of Strategy and Finance a pivotal role in the committee.
- The functions of the government in the affairs of an SOE or a public institution are divided into the policy functions in the relevant industry and the ownership functions. The line ministry exercises the policy functions unilaterally. But it shares the ownership functions with the Ministry of Strategy and Finance. As a result, the roles of the line ministries become smaller while those of the Ministry of Strategy and Finance become bigger on issues related to the management efficiency of an SOE or a public institution.
- The structure of the board of directors follows that of the SOEs prescribed by the Revised Framework Act on the Management of GIIs of 1999, which in turn is modeled after the structure of the board of directors of SOEs subject to the Special Act on Privatization of 1997. Thus, the board of directors is composed of a majority of outside directors and a minority of executive directors and has an Audit Committee in it. The board of directors also signs a management contract with the CEO of an SOE or the head of a public institution.

- Executives are liable for the damages they cause to their firm or institution if they are involved in acts of a breach of trust.
- AMPI divides the SOEs and public institutions subject to AMPI into three groups, SOEs, quasi-government institutions, and other public institutions, and prescribes their governance structures that are slightly different among the groups.
- The authority to appoint a director of an SOE is given to the Ministry of Strategy and Finance and the Committee on the Management of Public Institutions while the authority to appoint a director of a quasi-government institution is given to the minister of its line ministry.
- The CEO of an SOE is appointed by the President after the Committee on the Management of Public Institutions selects a candidate and recommends him or her to the President. However, in the case of a quasi-government institution, the head of an institution is appointed by the minister of the line ministry after the Committee on the Recommendation of Executives of the institution selects the candidate and recommends him or her to the minister of the line ministry.
- Auditor of an SOE is appointed by the President while the auditor of a quasi-government institution is appointed by the Minister of Strategy and Finance.
- AMPI attempts to allow SOEs greater autonomy in management compared to quasi-government institutions. However, the gap does not seem to be sufficiently large enough to make a difference between them.

3. Details of the Governance Structure of SOEs and Public Institutions Adopted by Roh Moo-hyun Administration

3.1. Target Enterprises and Institutions and their Classifications

AMPI targeted a wide range of SOEs and public institutions. The list of SOEs and public institutions to be covered by this act included those that had formerly been classified as GIIs and the SOEs that had been subject to the Special Act on Privatization, and most of the SOEs that had previously been classified informally as non-GII SOEs or *choolja-gigwan* in Korean including subsidiaries of GIIs and SOEs subject to the Special Act. The list also included the institutions that managed various funds whose nature of businesses was highly commercial. These institutions had been treated as separate entities from GIIs or non-GII SOEs and had been managed by the line ministries without allowing the intervention by other government agencies in the past. Lastly, the list included a large number of public institutions that had no or little commercial elements and that performed functions which

were close to the functions of the government itself, including all government funded research institutes. Officially, AMPI covered any SOE or a public institution that met one of the following three conditions if the Minister of Strategy and Finance designated it as a target of the act:

- ① An institution that has been established by a law
- ② An institution whose businesses have been delegated by the government or that has been given a monopoly right to provide some services by the government, and its revenue from the businesses delegated or given the exclusive right by the government accounts for 50% or more of the total revenue.
- ③ An institution that has been established by the government or of which the government takes effective control

Thus, even if an institution was not founded by the government or the government was not its shareholder, any institution that was commissioned or given a franchise by the government could be designated as a target of AMPI as long as the proportion of the revenue from the businesses commissioned by the government or from the franchise monopoly given by the government exceeded 50% of the total revenue. There was some ambiguity in what the precise meaning of the effective control by the government was. The criterion for an effective control used in practice was 50% ownership by the government, or 30% or a higher ownership by the government that was larger than the share of any other shareholder. While 50% ownership of an SOE or of an institution clearly implied an effective control, it was possible that the government was not in control of a firm or an institution even if it was the largest shareholder with a share between 30% and 50%.

This law classifies all target public institutions into three types, SOEs, quasi government agencies, and other public institutions. It also classifies SOEs and quasi-government agencies further into two sub-types each. SOEs are divided into the market type SOEs and the quasi-market type SOEs. Quasi-government agencies are divided into the fund management type agencies and the business delegation type agencies. The law differentiates between the governance structure of an SOE or that of a public institution based on the sub type. The criterion that distinguishes SOEs from the other two types is the proportion of the revenue it generates on its own to the total revenue. The revenue an institution generates on its own is defined to be revenues that are not from the businesses delegated by the government or from a franchise monopoly business given by the government or government subsidies. If the revenue an institution generates on its own exceeds 50% of the total revenue, it is classified as an SOE. If this proportion falls below 50%, an institution is a quasi-government agency or another public institution.

The criterion of distinguishing between market type and quasi-market type SOEs is the size of the assets and the proportion of the revenue an SOE generates on its own. An SOE is a market type if its asset exceeds KRW 2 trillion and the proportion of the revenue it generates on its own is 85% or higher. The rest are quasi-market type SOEs. Quasi-government agencies are divided into two groups; those whose main business is the management of some funds delegated by the government and the rest. The former is called the fund management type and the latter is called the executor of delegated business type.

Public institutions which have less than 50 employees are classified as other public institutions. But other public institutions also include some firms and institutions that have more than 50 employees which are not classified as SOEs or quasi-government institutions.

The following <Table 6-2> displays the number of organizations designated as public institutions and their classifications from 2007 to 2010. The following <Table 6-3> summarizes the outcome of the classification of the SOEs and public institutions that are subject to AMPI in 2010, and identifies the relevant government agencies that are given the authority to exercise control over them in order to meet some policy objectives in the relevant industries.

Table 6-3 | Numbers and Types of SOEs and Public Institutions from 2007 to 2010

Classification	2007	2008	2009	2010	Fluctuation from 2007
① SOE	24	24	24	22	Δ2
• Market type	6	6	6	8	2
• Quasi market type	18	18	18	14	Δ4
② Quasi government agencies	77	77	80	79	2
• Fund management type	13	13	16	16	3
• Business delegation type	64	64	64	63	Δ1
③ Other public institutions	197	204	193	185	Δ12
Total	298	305	297	286	Δ12

Source: Appointment of SOEs, quasi government agencies, and other public institutions during (2007 ~ 2010), Ministry of Strategy and Finance

Table 6-4 | Numbers and Types of SOEs and Public Institutions in 2012

Ministry in Charge	SOE		Quasi Government Agencies		Other Public Institutions(177)
	Market Type(14)	Quasi market type (14)	Fund Management Type (17)	Business Delegation Type (66)	
Ministry of Strategy and Finance (3)		Korea Minting and Security Printing Corporation (1)			Korea Exim Bank, Korea Investment Corp(2)
Ministry of Education, Science, and Technology (39)			Korea Teachers Pension (1)	Korea Education & Research Information Service, The Korea Foundation for the Advancement of Science and Creativity, National Research Foundation of Korea, Korea Student Aid Foundation (4)	GWNU Dental Hospital, KNU Hospital, KPNU Hospital, KSNU Hospital, PNU Hospital, SNU Hospital, SNU Dental Hospital, CNU Hospital, CPNU Hospital, JNU Hospital, CNU Hospital, CPNU Hospital, Korea Research Council of Fundamental Science Technology, Korea Institute of Science and Technology Information, Korea Basic Science Institute, Korea Research Institute of Bioscience and Biotechnology, Korea Astronomy and Space Science Institute, Korea Research Institute of Standards and Science, Korea Institute of Oriental Medicine, Korea Aerospace Research Institute, Korea Ocean Research & Development Institute, Korea Institute of Science and Technology, Korea Atomic Energy Research Institute, Korea Advanced Institute of Science and Technology, Gwangju Institute of Science & Technology, Daegu Gyeongbuk Institute of Science & Technology, Korea Institute of Radiological and Medical Science,, Korea Foundation for the Promotion of Private School, Academy of Korean Studies, Northeast Asian History Foundation, Institute for Translation of Korean Classics, National Institute for Lifelong Education, PNU Dental Hospital, Institute for Basic Science (34)
Science and Technology Commission (1)					Korea Institute of Science & Technology Evaluation and Planning(1)

Ministry in Charge	SOE		Quasi Government Agencies		Other Public Institutions(177)
	Market Type(14)	Quasi market type (14)	Fund Management Type (17)	Business Delegation Type (66)	
Nuclear Safety and Security Commission [2]				Korea Institute of Nuclear Safety(1)	Korea Institute of Nuclear Nonproliferation and Control(1)
Ministry of Foreign Affairs and Trade (3)					Overseas Koreans Foundation, Korea Foundation, KOICA(3)
Ministry of Justice (3)					Korean Legal Aid Corporation, Korea Government Legal Service, Korea Rehabilitation Agency(3)
Ministry of National Defense (3)					War Commemoration Service Society, Korea Institute for Defense Analyses, Hoguk Foundation(3)
Ministry of Public Administration and Security (4)			Government Employees Pension Service (1)	National Information Society Agency, Korea Elevator Safety Institute (2)	Korea Democracy Foundation(1)
Ministry of Culture, Sports and Tourism (32)		Korea Tourism Corp (1)	Korea Sports Promotion Foundation Art Council Korea, Movie Promotion Committee, Korea Press Foundation (4)	Korea International Broadcasting Foundation, Korea Creative Content Agency (2)	Korea Cultural and Arts Centers Association, Gyeongsangbuk-do Tourism Corporation, Culture Foundation of National Museum, National Council of Sport for All, Grand Korea Leisure, Sports Association for Disabled, Korea Media Rating Board, Seoul Arts Center, Chungdong Theater, Publication Industry Promotion Agency of Korea, Literature Translation Institute of Korea, Korea Sports Council, Korea Culture and Tourism Institute, Korea Arts and Culture Education Service, Korea Agency for Digital Opportunity and Promotion, Korean Federation of Film Archives, Korea Sports Industry Development, Korea Foundation for the Next Generation Sports Talent, Game Rating Board, Gugak FM Broadcasting System, Taekwondo Promotion Foundation, Korea Copyright Commission, Korea Craft and Design Foundation, Hanguk Performing Arts Center, Korea Art Management Service(25)

Ministry in Charge	SOE		Quasi Government Agencies		Other Public Institutions(177)
	Market Type(14)	Quasi market type (14)	Fund Management Type (17)	Business Delegation Type (66)	
Ministry for Food, Agriculture, Forestry and Fisheries (10)		Korea Racing Corp (1)		Korea Agro-Fisheries and Food Trade Corporation, Korea Institute for Animal Products Quality Evaluation, Korea Rural Community Corp, Fisheries Resources Agency, Korea Livestock Products HACCP Accreditation Service, Korea Institute of Planning and Evaluation for Technology of Food, Agriculture, Forestry and Fisheries (6)	Livestock Health Control Association, Agriculture Forestry Fisheries Information Service, Korea Fisheries Infrastructure Promotion Association(3)
Ministry of Knowledge Economy (60)	KNOC, KOGAS, KEPCO, Korea District Heating, Korea Hydro and Nuclear Power, Korea South-West Power, Korea Southern Power, Korea East-West Power, Korea Western Power, Korea Mid-land Power (10)	Korea Resources Corp, Korea Coal Corp (2)	Korea Trade Insurance Corp, Korea Radioactive-waste Management Corporation (2)	Korea Institute of Petroleum Management, KOTRA, Korea Energy Management Corporation, Korea Institute of Ceramic Engineering and Technology, Korea Postal Logistics Agency, Postal Savings and Insurance Development Institute, Korea Gas Safety Corporation, Korea Mine Reclamation Corp, Korea Institute of Design Promotion, Korea Testing Laboratory, Korea Institute of Advancement of Technology, Korea Institute of Industrial Technology Evaluation and Planning, Korea Industrial Complex Corp, Korea Institute of Energy Technology Evaluation and Planning, Korea Postal Service Agency, Korea Electrical Safety Corp, Korea Power Exchange, National IT Industry Promotion Agency (18)	Korea Electrical Engineering and Science Research Institute, Incheon Total Energy, Kangwon Land, KOGAS Tech, Korea Productivity Center, KEPCO Engineering & Construction Company, Korean Standards Association, Korea-Japan Cooperation Foundation for Industry and Technology, KEPCO Data Network, Korea Plant Service & Engineering, KEPCO Nuclear Fuel, Korea Nuclear Energy Promotion Agency, Specific Post Office Pension Service Agency, INNOPOLIS Foundation, Korea Research Council for Industrial Science and Technology, Korea Institute of Construction Technology, Korea Institute of Machinery & Materials, Korea Institute of Industrial Technology, Korea Food Research Institute, Korea Institute of Energy Research, Korea Electro-technology Research Institute, Electronics and Telecommunications Research Institute, Korea Institute of Geoscience and Mineral Resources, Korea Railroad Research Institute, Korea Research Institute of Chemical Technology, Korea StrateGII Trade Institute, Postal Facility Management Agency, Korea Institute for Robot Industry Advancement(28)

Ministry in Charge	SOE		Quasi Government Agencies		Other Public Institutions(177)
	Market Type(14)	Quasi market type (14)	Fund Management Type (17)	Business Delegation Type (66)	
Korea Communications Commission (3)		Korea Broadcast Advertising Corporation(1)	Korea Communications Agency(1)	Korea Internet & Security Agency (1)	
Ministry of Health and Welfare (16)			National Pension Corporation (1)	Health Insurance Review & Assessment Service,, National Health Insurance Corporation, Health Industry Development Institute, Korea Labor Force Development Institute for the Aged, Health and Welfare Information Service(5)	National Cancer Center, Korea Red Cross, Korea Human Resource Development Institute for Health and Welfare, National Health Personnel Licensing Examination Board , Korea Disabled People's Development Institute, Korea Foundation for International Healthcare, Korea National Council on Social Welfare, National Medical Center, National Childcare Promotion Institute, Korea Health Promotion Foundation (10)
Ministry of Gender Equality and Family (2)				Korea Youth Counseling and Welfare Institute, Korea Youth Work Agency (2)	
Ministry of Environment (4)				Korea National Parks Authority, Korea Environment Corp, Korea Environmental Industry and Technology Institute(3)	Sudokwon Landfil Site Management Corp(1)
Ministry of Employment and Labor (10)			Korea Workers' Compensation & Welfare Service(1)	Korea Employment Information Service, Korea Occupational Safety & Health Agency, Human Resources Development Service of Korea, Korea Employment Agency for the Disabled (4)	Korea Politech, Korea Labor Foundation, Korea University of Technology and Education, Korea Elevator Safety Technology Institute, Social Enterprise Promotion Agency(5)

Ministry in Charge	SOE		Quasi Government Agencies		Other Public Institutions(177)
	Market Type(14)	Quasi market type (14)	Fund Management Type (17)	Business Delegation Type (66)	
Ministry of Land, Transport and Maritime Affairs (32)	Incheon International Airport Corp, Korea Airport Corp, Pusan Port Authority, Incheon Port Authority (4)	Korea Land and Housing Corp, Korea Housing Guarantee, Jeju Free International City Development Center, Korea Appraisal Board., Korea Expressway Corp, Korea Water Corp, KORAIL, Yeosu Port Authority (8)		Korea Transportation Safety Authority, Korea Institute of Construction and Transportation Technology Evaluation and Planning, Korea Infrastructure Safety Corporation, Korea Railway Network Authority, Korea Ship Safety Technology Authority, Korea Institute of Maritime and Fisheries Technology, Korea Cadastral Survey Corp(7)	KORAIL Tech, KORAIL Retail, KORAIL Tourism Development , Korea Construction Management Corp, Korea Housing Management, KORAIL Networks, KORAIL LoGILs, Ulsan Port Authority, Incheon Port Security, Pusan Port Security, Korea Institute of Marine Science & Technology Promotion, Korea Association of Aids to Navigation, Korea Marine Environment Management Corp (13)
Office of the Prime Minister (24)					National Research Council for Economic, Humanities, and Social Sciences, Science & Technology Policy Institute, Korea Research Institute for Human Settlements, Korea Institute for International Economic Policy, Korea Institute for Industrial Economics & Trade, Korea Energy Economics Institute., Korea Information Society Development Institute, Korea Institute for National Unification, Korea Development Institute, Korean Educational Development Institute, Korea Institute for Curriculum and Evaluation, Korea Transport Institute, Korea Labor Institute, Korea Rural Economic Institute, Korea Institute for Health and Social Affairs, Korean Women's Development Institute, Korea Institute of Public Finance, Korea Research Institute for Vocational Education & Training, National Youth Policy Institute, Korea Maritime Institute, Korea Institute of Public Administration, Korean Institute of Criminology, Korea Environment Institute (24)

Source: Information on public institutions (<http://www.alio.go.kr>)

As of Dec. 2012, there were 288 public institutions in total which were subject to AMPI, out of which 28 were SOEs, 83 were quasi-government agencies and 177 were other public institutions. Of the 28 SOEs, 14 were market type and the other 14 were quasi-market type. Of the quasi-government agencies, 13 were a fund management type and 64 were a business delegation type. The total number of institutions subject to AMPI and the number of institutions belonging to each type and sub-type changed only slightly over the last several years. Between 2007 and 2010, the total number of institutions subject to AMPI decreased only by 10. During this period, the number of SOEs increased from 24 to 28 while the number of quasi-government agencies also increased from 77 to 83. The most significant change was the inclusion of 6 large generation companies owned 100% by KEPCO in the list of market type SOEs. As a result of this, KEPCO lost control over the 6 subsidiaries even though it had 100% ownership of them because the Ministry of Strategy and Finance and the Ministry of Knowledge Economy were given the authority to control them. On the other hand, the number of SOEs of the quasi market type fell by 4 due to re-classification of Korea National Oil Corp and Korea District Heating Corp as SOEs of the market type, dissolution of Workers' Accident Medical Corporation, and the merger between Korea Housing Corp. and Korea Land Corp.

Among quasi government agencies, the number of fund management type increased by 4, as Korea Film Council, Korea Radioactive-waste Management Corporation and Small and Medium Business Corporation were added to the list. The number of the business delegation type increased by 2 as a result of adding Korea Exchange and Small Enterprise Development Agency to the list of business delegation type quasi-government agencies. The number of other public institutions decreased from 197 to 177.

AMPI requires that when a government agency wants to establish a new SOE or a public institution, it must propose its plan for the new institution along with the following information to the Minister of Strategy and Finance, and must request the MSF to evaluate its proposal:

- Goods or Services that will be produced by the institution
- The scope and contents of its business
- Estimated income and required government budget for the next five years
- Personnel and organization management plan for the next five years
- Current situation of existing interagency

If a new capital investment or an increase in existing capital investment is necessary to establish the new institution, the Minister of Strategy and Finance shall decide the time and the method to invest.

3.2. Committee on the Management of Public Institutions

The mechanism by which the government exercises its control over SOEs and public institution subject to AMPI takes several different forms. On the highest level, the president, the Committee on the Management of Public Institutions, the Minister of Strategy and Finance, and the ministers of various line ministries make decisions on key issues. The Committee consists of vice-ministers or vice minister-level officials from various line ministries and other relevant government agencies including vice ministers from the Ministry of Strategy of Strategy and Finance, Ministry of Home Affairs and Security, a vice-minister level official designated by the Head of the Committee on the Rights of Citizens, and vice minister level officials from the Prime Minister's Office and line ministries of some institutions as well as civilians.

The total number of the committee members cannot exceed 20, and the total number of civilians cannot exceed 11. The Commission makes decisions according to the rule of the approval by 50% or more of those attending a meeting, which is valid only if 50% or more of the total members are present at the meeting. Main roles the Commission plays are summarized as follows:

- New designation of a public institution, cancellation of a designation, classification of SOEs, quasi-government agencies, and other public institutions.
- Making public disclosure on the management of the public institution
- Punishment of those who violate the public institution laws
- Change in the functions or businesses of SOEs or public institutions
- Support for the innovation of public institutions
- Appointment of the senior non-executive board members of SOEs of the market type and of the quasi-market type
- Dismissal or request for dismissal of executives of SOEs and quasi-government agencies
- Providing guidelines on wages
- Preparing the management guidelines for SOEs and quasi-government agencies
- Examine whether the supervision over SOEs and quasi-government agencies by the line ministries is appropriate and make necessary measures to correct inappropriate supervision.

The act attempted to provide checks and balances to the management of SOEs and public institutions that had been dominated by the line ministries and the management, who had incentives to expand the size of the organization and assets and had little incentives to care about the efficiency of operations or investment by allowing the Committee on the Management of Public Institutions to represent the government in making key decisions on issues that did not belong to business supervision of the line ministries. However, it was not clear whether the committee was effective in making key decisions in ways that were consistent with economic efficiency. Vice ministers from line ministries had little incentive to work against the interests of their own ministries or to meddle in the affairs of other ministries. Bureaucrats at the Ministry of Strategy and Finance in charge of SOEs and public institutions might have had incentive to try to enhance the efficiency of investment and operations of SOEs and public institutions. But, they lacked the expertise needed to make appropriate decisions. Civilian members generally lacked pecuniary incentives to work hard to make decisions that would lead to increased efficiency. Nor did they have the necessary expertise to make appropriate decisions. Another barrier to efficient decision making was the lack of independence of the committee from the political power.

3.3. Setting Management Goals and Management Guidelines for Public Institutions

CEO or head of an SOE or a public institution is required to set long-term management goals for the subsequent five years every year, get it approved by the board of directors by a majority vote, and submit it to the Minister of Strategy and Finance and the minister of the line ministry. Newly established SOEs or quasi-government agencies must submit management goals for the subsequent three years. If there is a need to modify the goals that have been submitted, the CEO of an SOE can request the Minister of Strategy and Finance to revise them. In the case of a quasi-government agency, the head of a quasi-government agency can require the minister of the line ministry to revise them if there is a need to change the goals. The Minister of Strategy and Finance prepares a set of guidelines after the review and the approval of the draft guidelines by the committee and notifies the CEO of an SOE or the head of a public institution of them. The guidelines are aimed at reducing unnecessary costs as well as ensuring the fairness in personnel management and maintaining a high standard of ethics in management. Following are the list of items that the guidelines focus on:

- Organizational form, quota on the number of employees, personnel management
- Budget and fund management
- Measures to ensure financial soundness

The guidelines reveal that the objectives behind the current governance structure of SOEs and public institutions are not much different from those behind the governance structure of GIIs envisaged by the 1999 revision of the Framework Act for the Management of GIIs. The current governance structure is based upon the idea that SOEs and public institutions are all direct policy instruments of the government that it runs to achieve some policy objectives just as the governance structure of GIIs in the past was based upon the idea that GIIs were direct policy instruments of the government. The role of the Ministry of Strategy and Finance in the governance of commercial SOEs has little to do with economic value maximization. Its role is limited to provide checks and balances to reduce waste of money in using SOEs and public institutions as policy instruments of the line ministries. Thus, the nature of the governance of commercial SOEs in Korea is significantly different from that in most other OECD countries.

3.4. Performance Report, Performance Evaluation, and Remuneration of Executives

In the beginning of every year, each public institution submits a report on its performance, including the balance sheet in the previous year to the Minister of Strategy and Finance and the minister of the line ministry. The Minister of Strategy and Finance evaluates the performance of a public institution on the basis of management goals, a report on the performance, and a report on the management contract between the head of the institution and the board of directors and the fulfillment of the contract. The criteria and the method to be used to evaluate the performance of an institution are determined by the Minister of Strategy and Finance.

The minister organizes and runs an evaluation team, which is going to do the evaluation on SOEs and public institutions, and takes the result of the evaluation by this team into account when evaluating the performance of SOEs and public institutions officially. The evaluation team consists of professors, research fellows at government funded research institutes with Ph.D. degrees, CPAs with 5 years or more experience, lawyers, consultants, and other qualified experts.

For SOEs and public institutions that are evaluated separately according to other laws as well, the minister takes the result of the evaluation into account according to other laws when he evaluates the performance of such SOEs or public institutions. For instance, quasi-government agencies of fund management type are evaluated separately according to the National Finance Act. Some research institutes funded by the government are also evaluated according to the clauses of the Framework Act on Science and Technology on the promotion of government funded research institutes.

If an SOE or a public institution is found to have submitted false reports on performance, the fulfillment of management contract, or other relevant documents, the committee can punish its executives and employees by lowering the evaluation results or reducing performance based bonuses and can also give a warning to the institution. The committee must also request the minister of the line ministry or the head of the institution to punish those who are responsible for falsified reports and documents. If it is found that the auditor or a member of the audit committee neglected to perform their duties properly, the committee can request the dismissal of the auditor or the audit committee member.

The result of the performance evaluation of an institution is linked to the remuneration for the head of the institution. The committee can recommend or demand the firing of the head of an institution according to his performance. If a poor performance of an institution is caused by violations of the guidelines from the management or by paying too much money as salaries and bonuses of the employees, the committee can also take measures to reduce the budget or put the ceiling for its employees' salaries and bonuses.

All audit results, including the results of audits by the auditors, audit committee, and the Board of Audit and Inspection, must be reported to the National Assembly.

3.5. Supervision over Public Institutions

Both the Minister of Strategy and Finance and the minister of the line ministry have the authority to supervise public institutions. However, the nature of their supervision differs. The Minister of Strategy and Finance supervises public institutions on issues related to the implementation of the guidelines. On the other hand, the ministers of the line ministries supervise SOEs under their jurisdiction on all issues related to their businesses and operations and also supervise a quasi-government agency on issues related to the implementation of guidelines as well as on all the issues related to their businesses and operations.

The subjects of the supervision by the minister of the line ministry on businesses and operations include the businesses that the line ministry delegates to the SOE or a quasi-government agency and issues that are relevant to the businesses of the line ministry and usually cover nearly all aspects of the businesses of an SOE or a quasi-government agency. As a consequence, the line ministries have much more room to intervene in the management than the Ministry of Strategy and Finance.

3.6. Composition of the Board of Directors and its Roles

Although the government established most of the institutions subject to AMPI as policy instruments to be used to achieve some policy objectives, it did not manage them directly and let the board of directors manage them. Thus, it is imperative that the board of directors should manage an institution in ways that are consistent with the policy objectives behind their establishment. The board of directors is the supreme decision making body and makes decisions on the following:

- Setting management goals, preparing management plans and long-term financial management plans
- Balance accounts
- Acquisition and management of asset
- Loans, issuing of bonds, repayment of debts
- Disposal of surpluses
- Investment in other enterprises
- Debt guarantee for other enterprises
- Pricing of the goods and services produced by the institution
- Modify the articles of association
- Establishment and modification of the internal rules and guidelines
- Decisions on the wages of the executives
- Deliberation and voting on the proposals prepared and submitted by the head of the institution to the board
- Review reports by the head of the institution on important issues and request or demand information from the management of the institution that the board judges to be important.
- In case the head of the institution neglects his duty or violates the law or the articles of association, vote on requesting the firing of the head to the line minister and then request it if the board votes for dismissal.

The board of directors usually consists of less than fifteen members, including the head of the institution. Details on the composition of the board of directors are as follows:

- The board consists of executive directors and outside directors. In case of SOEs and quasi-government agencies that are greater than a certain size, the number of executive

directors including the head of the institution should be less than 50% of the total number, allowing non-executive directors to be the majority. The rest of the quasi-government agencies generally allow higher proportion of executive directors as long as it is lower than 2/3.

- SOEs and quasi-government agencies shall have one senior non-executive director among non-executive directors. The senior non-executive director of an SOE of the market type and a quasi-government agency with assets greater than KRW two trillion is appointed by the Minister of Strategy and Finance among non-executive directors. The senior non-executive director of an SOE and a quasi-government agency with assets less than KRW 2 trillion is selected by non-executive directors' vote.
- The senior non-executive director has the authority to convene meetings attended by non-executive directors and preside over them. The senior non-executive director is expected to play a pivotal role among non-executive directors in providing checks and balances effectively against executive directors.
- The senior non-executive director of an SOE of the market type or a quasi-market type with an asset greater than KRW two trillion serves as the chairman of the board. As a consequence, there will be a clear separation between the CEO and the chairman of the board of directors for SOEs.
- CEO of an SOE of the quasi-market type with an asset smaller than KRW 2 trillion and the head of a quasi-government agency will also serve as the chairman of the board of directors.
- The board of directors makes decisions on an agenda by a simple majority vote by those who attend a board meeting. More than half of the board members must be present at the meeting to vote on an agenda.
- Establishing committees within the board of an SOE follows the relevant part of commercial law.
- Market type SOEs and quasi-market type SOEs with assets greater than KRW two trillion shall have an audit committee instead of an auditor.
- Composition and operation of the audit committee follows the relevant part of the commercial law.

The current governance structure of public institutions expects non-executive directors to provide checks and balances against the management and gives non-executive directors the following authorities:

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- When necessary, two or more non-executive directors can jointly request audits by the auditor or the audit committee on issues they choose. The auditor or the audit committee must conduct audits if there is such a request by non-executive directors unless there is a strong ground for rejecting the request.
 - The audit committee conducts audits on the operations and the accounting of the institution and reports the results to the board of directors.
 - Non-executive directors can request the head of their institution to provide them with information necessary for conducting their duties. The head of an institution should accommodate such requests unless there is a strong ground for rejecting them.

The head of the institution ought to respect such requests if there is no particular reason to reject them.

3.7. Appointment of the CEO, Board of Director Members, and Auditor of an SOE

Appointment of the CEO of an SOE proceeds with the following procedure:

- (a) Committee for recommending executives of an SOE selects two candidates and recommends them to the Committee on the Management of Public Institutions.
- (b) The committee selects one of them and notifies the minister of the line ministry, who in turn requests the President to appoint the person.
- (c) The President appoints the person as the CEO.

Appointment of the CEO of a small SOE is done according to the following procedure:

- (a) Committee for recommending executives of an SOE selects two candidates and recommends them to the Committee on the Management of Public Institutions.
- (b) The committee selects one of them and notifies the minister of the line ministry.
- (c) The minister appoints the person as the CEO.

Executive directors of an SOE are appointed by the CEO, except for the executive director who also serves as a permanent audit committee member, who is appointed by the President or the Minister of Strategy and Finance. A non-executive director of an SOE is appointed by the Minister of Strategy and Finance after the Committee on the Management of Public Institutions selects one of the two candidates recommended by the Committee for Recommending Board members of the SOE.

The auditor of an SOE whose size is comparably small is appointed by the Minister of Strategy and Finance between the two candidates recommended by the Committee for Recommending Directors of the SOE. However, the auditors of large SOEs are appointed by the President.

3.8. Appointment of a Head, Board of Director Members, and Auditors of a Quasi-government Agency

Heads of most quasi-government agencies are appointed by the minister of the line ministry between the two candidates recommended by the Committee for Recommending directors of an institution. However, the head of a large quasi-government agency is appointed by the President at the request of the minister of the line ministry. Even if a quasi-government agency is not large, the head of an agency may be appointed by the President at the request of the minister of the line ministry if there exist special reasons for such a procedure. Executive directors are appointed by the head of the agency. But, the executive director who is also a member of the audit committee is appointed by the President at the request of the Minister of Strategy and Finance. The auditor of an agency is usually appointed by the Minister of Strategy and Finance after the minister selects one out of the two candidates recommended by the Committee for Recommending Directors of the agency. But the auditors of large agencies are appointed by the President at the request of the Minister of Strategy and Finance after the Committee on the Management of Public Institutions selects a candidate. Non-executive directors are usually appointed by the minister of the line ministry. But under special circumstances, the minister selects one out of the two candidates recommended by the Committee for Recommending Directors and appoints the person as a non-executive director.

3.9. Committee for Recommending Executives

This committee consists of five to fifteen members, including some non-executive directors and outside members recommended by the board of directors. The number of outside members of the committee should be less than 50% of the total number of committee members. The head of the committee is selected among the non-executive directors in the committee by vote. The committee makes decisions based on a majority vote.

3.10. Management Contract

When a candidate is appointed as the head of an institution, the board of directors of the institution prepares the draft contract and sends it to the Committee for Recommending Directors, which negotiates with the appointee based on the draft contract and may revise

some parts of the draft contract during negotiations. The finalized contract will be sent to the minister of the line ministry, who signs it with the appointee. The minister of the line ministry is required to consult with the Minister of Strategy and Finance before signing the contract with the new CEO of an SOE. The terms of the contract may change as a result of this consultation.

The head of an institution signs a performance based contract with executive directors, evaluates their performance, and determines their bonuses based on their performance. Executive directors can be dismissed if their performance is poor.

3.11. Term of Office

The term for the head of an institution is three years. The term for members of board of directors and auditors is two years. An executive director can be reappointed on a yearly basis. Reappointment of executive directors and the head of an institution is determined on the basis of performance of the institution, fulfillment record of their individual management contract, and their performance as executive directors or as the head on various tasks. For non-executive directors and auditors, reappointment is determined based upon the record of their performance as non-executive directors and auditors.

3.12. Public Disclosure of Management

In order to ensure transparency of management in public institutions, the following information is disclosed via internet and is to be kept for 5 years and is made available for reading or photocopying to anyone who wants to have access to it.

- Management goals, budget and management plans, balance accounts
- Names of executives and employees currently hired by the institution
- Budget for labor costs and its current state
- Record of transactions with subsidiaries as well as the record of the movement of employees between the institution and its subsidiaries.
- Customer satisfaction ratings
- Performance evaluation by auditors or members of the audit committee
- Management evaluation result
- Articles of association, the minutes of the board meetings¹⁰

10. Minutes that contain information which can hurt the business of an SOE or a public institution may not be disclosed according to the Act on the Information Revelation of Public Institutions.

- Audit report of an auditor or the audit committee, decisions or actions of the institution or its employees that have been cited as inappropriate in the audit report, corrective measures demanded by the audit report, measures actually taken by the institution in response to audit reports
- Audit results by the minister of the line ministry, decisions or actions of the institution or its employees that have been cited as inappropriate in the audit report by the minister, corrective measures demanded by the audit report, measures actually taken by the institution in response to audit reports
- If there were requests regarding compensation, punishment, or correction after an audit, there should be contents of the requests as well as the corrective actions taken by the institution in response to the requests

The Minister of Strategy and Finance determines the common list of items that all public institutions must disclose to the general public in a standardized way. The list of information items to be disclosed in this consolidated way is finalized by the Committee on the Management of Public Institutions and sent to the Minister of Strategy and Finance, who in turn notifies it to heads of public institutions. The head of each institution is required to disclose the information in the internet site designated by the Minister of Strategy and Finance.

3.13. Official Disclosure of Surveys on Current Customers and Customer Satisfaction Ratings

Each public institution is required to disclose information on its basic duty, contents of the services it provides, the desirable level of service quality, procedures through which complaints about its services are filed and handled, responsibility for damage compensation, efforts to improve the quality of the service, and plans for improving the quality of service. It is also required to conduct a survey on customer satisfaction at least once a year and to disclose the outcome of the survey via the internet site designated by the Minister of Strategy and Finance.

3.14. Adjustment of the Functions of SOEs and Public Institutions

The Minister of the Strategy and Finance is required to consult with ministers of the line ministries to review the appropriateness of the functions that public institutions perform and to submit a plan to (1) remove the functions which are no longer desirable for an institution to perform from the list of functions the institution performs, (2) merge similar functions performed by multiple number of institutions, (3) adjust functions of institutions, and (4) privatize institutions for which privatization is desirable. The plan must be reviewed and approved by the Committee on the Management of Public Institutions.

Ministers of the line ministries are required to implement the plan and to submit reports on the implementation result of the plan to the Minister of Strategy and Finance. The Minister of Strategy Finance reviews the report submitted by ministers and can demand them to take extra measures if it is necessary to implement the plan after the approval of such measures by the Committee on the Management of Public Institutions.

If there is a need to dispose of the assets of an SOE or a public institution in order to implement a plan for adjustment of functions of some SOEs or public institutions, the Minister of Strategy and Finance may demand the minister of the line ministry to request KAMCO to sell the assets. The minister of the line ministry must sign a contract on the delegation of the sale of the assets with KAMCO if he or she accommodates the demand by the Ministry of Strategy and Finance and decides to dispose of the asset of an SOE or a public institution under his or her control.

3.15. Budget, Settlement of Account, Accounting Audit, Audit by the Board of Audit and Inspection

Every year, SOEs and quasi-government agencies with assets greater than KRW two trillion are required to submit a long-term financial management plan for subsequent five years to the ministry of Strategy and Finance and the minister of the line ministry. The plan must include the following:

- Management goals
- Business plans and investment plans
- Financial prospects and grounds for them, financial management plans
- Forecast on debts and its grounds, debt management plans
- Comparison between the financial plan for the current year prepared in the previous year and the actual financial outcome in the current year, analysis and evaluation of the discrepancy between the plan and the actual outcome, and plans for financial management in response to the discrepancy

Every year, the board of directors finalizes the budget which is submitted by the head of the institution and reports it to the Minister of Strategy and Finance, the minister of the ministry in charge, and the head of the Board of Audit and Inspection. At the end of the year, the board of directors settles the account and submits the result to an accounting auditor for it to be audited. The audit is conducted by the same procedures as those used in the audit of joint stock companies by outside auditors according to the laws and regulations on the audit of joint stock companies.

SOEs and quasi-government agencies are subject to the accounting audit and audit of their operations by the Board of Audit and Inspection, separate from the outside audit by accounting firms. The Board of Audit and Inspection may allow the line ministry to audit an SOE or a quasi-government agency on its behalf.

3.16. Procurement

Except under special circumstances, a public institution must procure goods and services according to the public procurement system specified by the Act on Contracts in Which the State is a Party, the Government Procurement Act, and the Act on the Promotion of Procurement from Small and Medium Sized Firms. Competitive and single source bidding that public institutions use in procurement must follow these laws. In practice, many SOEs and quasi-government institutions purchase goods and services through the Office of Supply of the Republic of Korea (OSROK).

3.17. Punishment

Employees and executives of SOEs and quasi-government agencies will be treated in the same way as the government officials in applying the criminal law for taking bribes.

3.18. Minority Shareholders' Rights

Minority shareholders of unlisted SOEs and quasi-government agencies can not only exercise their rights but also make proposals to the general shareholders' meetings according to the relevant clauses of the Commercial Code.

4. Management Evaluation System

The effects of the current governance structure of SOEs and public institutions depend crucially on the effectiveness of the system of performance evaluation and remuneration. In this section, we focus on the system of performance evaluation and remuneration that has been applied to the SOEs and public institutions subject to the act. It is virtually impossible that the Committee on the Management of Public Institutions conducts performance evaluation and determines remuneration directly. It is also impossible for the Minister of Strategy and Finance to conduct evaluation and remuneration directly. In practice, most of the decisions on performance evaluation and remuneration are made effectively by a unit within the Ministry of Strategy and Finance and an evaluation team that it organizes and runs.

This unit organizes a team that is going to evaluate the performance of SOEs, public institutions, and their CEOs or heads each year by selecting team members from a pool of experts outside the government. This system is rooted in the system of performance evaluation under the Framework Act on the Management of GIIs that has been in use since 1983, and maintains most of the features of the old system. Most of the team members have been professors, researchers at government funded research institutes, and accountants. Most of the members who are not accountants have backgrounds in economics, management, or public policy.

It is interesting to note that the proportion of professors, research fellows, and accountants in an evaluation team has been stable over the last 3 decades. The proportion of professors, research fellows, and accountants is 60 ~ 75%, 5 ~ 10%, and 15 ~ 25% respectively. Each year, the evaluation team consists of three subgroups, a quantitative evaluation subgroup, a non-quantitative evaluation subgroup, and a coordination subgroup. The roles of each subgroup can be summarized as follows:

- The coordination group consists of the head of the entire evaluation team and a coordinator who assists the head. It is in charge of the designing of the evaluation plan, coordination of the evaluation by the other two subgroups, and a review of the appropriateness of the indices and criteria used in evaluation. It also reviews the evaluation results of the other two subgroups, makes necessary adjustments to the outcome of evaluation, and prepares the report on evaluation. Both quantitative group and non-quantitative group each have their own coordinators, too.
- The quantitative group applies quantitative indices designed to evaluate the performance of each type of SOEs and public institutions and produces the results of evaluation. This group usually consists of accountants and accounting professors.
- Non-measurement team makes qualitative and subjective judgments on the performance of SOEs and public institutions using non-quantitative evaluation indices designed for each type of SOEs and public institutions.

The evaluation is done by classifying SOEs and public institutions into several subgroups and applying different indices to different groups. For instance, in 2010, the evaluation team classified institutions, pension fund managing institutions, and small institutions – and created four evaluation units, one for each group, and assigned 5 to 10 members for each unit. Each unit evaluated the performance of SOEs and public institutions it was designated to evaluate between mid-March and the end of May according to the procedures described below. The evaluation results were finalized by the end of June and were submitted to the Commission. The evaluation report was completed in July, and became publicly available in August. Other relevant information on the details of evaluation is given below:

- Adjustment of the evaluation guidebook that will be used for management evaluation
- Submission of the management report from the previous year
- Management evaluation conducted by teams organized according to the types and divisions for approximately two months: Evaluation on the submitted report, in-site survey, interviews, etc.
- Evaluation of all institutions using the management indices, computation of final marks, preparation of the report

The evaluation team not only evaluates the performance of the current year, but also prepares for the evaluation of the following year. If there is an institution that becomes subject to the Act on the Management of Public Institutions newly, the team develops evaluation indices for this institution. For institutions that have been in existence, the committee prepares new guidelines on evaluation that will be used to evaluate the performance in the following year, based upon the review of the guidelines on evaluation that were used to evaluate the performance in the current year.¹¹

The size of the evaluation team is around 150 each year. This may seem too big. But we think that this is actually too small to evaluate nearly 300 SOEs and public institutions, some of which are large and complex, within a short period of time accurately. Considering that the members of the evaluation team have regular jobs and conduct evaluation as a part time job in their spare time and that they receive only nominal compensation for their services, 150 is probably way below the necessary number for accurate evaluations. The annual budget assigned to support the evaluation is around KRW 2 billion and is too small to attract the participation of qualified experts.

Indices used for evaluation of each of the subgroups of SOEs and public institutions, are composed of common indices and individual indices. Common indices apply to all SOEs or institutions belonging to the same subgroup, and individual indices apply to each SOE or public institution. Both common and individual indices are composed of quantitative and non-quantitative indices. The indices that are currently in use were introduced in 2008. We take a close look at the indices currently in use as well as the indices that had been used before 2008 below.

The evaluation system that was used to evaluate the performance of GIIs under the Framework Act during the 1993 ~ 1999 before the law was amended in 1999 can be described as follows. The evaluation items were divided into four parts – overall management, major business, management efficiency, and business management. Each part had the following indices for evaluation.

11. Yoon et. al. [2012].

- Overall management part used two common non-quantitative indices, which were accountability of the management and public contribution on the one hand and effectiveness of the operation of the board of directors, and one or two individual quantitative indices.
- Major business part selected three to five major businesses of a GII and used a multiple number of quantitative indices and up to five non-quantitative indices to evaluate each business.
- Management efficiency area used three to five quantitative indices to evaluate the efficiency of a GII on managing operating costs, labor costs, fund management, and financial costs. The number of indices used varied according to GIIs.
- Business management part was subcategorized into strategy, management system, internal evaluation system, and R&D and used non-quantitative indices for each of them before 1995. In 1996, the government stopped using sub-categorization and used the non-quantitative indices that were similar to those that had been used till 1995 to evaluate the performance of a GII in the business management part. There was no change in the evaluation indices between 1996 and 1999. Thus, the same indices were used during 1993 ~ 1999 because the change that took place in 1996 was only nominal and did not involve any change in indices.

From the amendment of the Framework Act on the Management of GIIs in 1999 till 2000, the same indices were used for evaluation. In 2001, there were some changes in the indices. Of the four parts that had been used before 2000, the management efficiency part was merged into the business management part, resulting in three parts. There were some changes in the indices belonging to each of the three parts, too. There were few changes after 2001 in the indices until the Framework Act was abolished in 2007. Detailed information on the indices that had been used between 2001 and 2007 is given below:

- Overall management part used four common, non-quantitative indices, which were accountability in management and public contribution, effectiveness of the operation of the board of directors, efforts on increasing customer satisfaction, and efforts on the innovation and restructuring, and two to four individual quantitative indices on labor productivity, improvement in customer satisfaction, management of marketing expenses, and productivity of fixed assets. The number of individual quantitative indices used for the evaluation of a GII varied from one GII to another.
- Major business part selected three to five major businesses of a GII and used a multiple number of quantitative indices and up to five non-quantitative indices to evaluate each business. Thus, there was no change in indices used in this part from those used before 2001.

- Business management part consisted of several indices on the organization/personnel management, compensation/labor management, internal evaluation system, financial and budget management.

In 2007, the year the Act on the Management of Public Institutions was introduced, the evaluation team classified SOEs and public institutions subject to the newly introduced law into four groups; SOE type 1 consisting of the institutions that had been classified as GIIs before 2007 and 10 institutions that had been classified as GAIs before 2007; SOE type 2 consisting of another 10 institutions that had been classified as GAIs; quasi-public agencies consisting of 3 institutions that had been classified as GIIs before 2007 and the other 77 public institutions, and the rest; the last group which was not subject to evaluation. For each of the other three groups, the evaluation team applied three sets of indices, each of which was used to evaluate the performances in the areas of overall management, main businesses, and business management. Each set of indices had several indices, each of which led to a numerical value as the outcome of an evaluation. Finally, the evaluation team applied weights to the indices and calculated the weighted average of the numbers, which were outcomes of evaluation using the indices. The following lists the indices of each area:

- Overall management part consisted of four common, quantitative indices, accountability in management, public contribution, effectiveness of the board of directors, and efforts on increasing customer satisfaction, and two to four individual non-quantitative indices on labor management, improvement in customer satisfaction, management of marketing expenses, and productivity of fixed assets.
- Main business part used only individual indices. The evaluation team selected three to five major businesses from each institution, applied a multiple number of quantitative indices and two to four non-quantitative indices to each of the selected businesses. We could not obtain information on details of the indices.
- Business management part consisted of three sub-parts, personnel management, financial and budget management, and the rest. Each sub-part had one or more indices. But we could not obtain information on them.

The evaluation team applied slightly different indices to four groups of institutions. It also applied slightly different weights to four groups. However, upon examining the indices and weights applied to four different groups in 2007, we found out that the differences in the chosen indices and weights were insignificant. Indices that were used to evaluate type 1 SOEs were very similar to those used to evaluate type 2 SOEs. Indices that were used to evaluate type 2 SOEs differed only in inclusion/exclusion of the main business area. The weight given to each index was also almost identical. Therefore, we concluded that even though there was sufficient difference in the characteristics of SOEs belonging to type 1

and type 2 groups, the evaluation system was unlikely to be effective in evaluating them because they didn't take the differences in the characteristics of SOEs belonging to different groups into account.

The indices that were used to evaluate the performance of quasi-government agencies had the same two parts, an overall management part and a business management part, which were used for type 2 SOEs. Indices belonging to each of the two parts used to evaluate quasi-government agencies were similar to those used to evaluate type 2 SOEs. We concluded that there was little difference in the evaluation methods between the type 2 SOEs and quasi-government agencies.

The evaluation methods that were used to evaluate the performance of quasi-government agencies were important in that they provided information on the difference in the governance structure between SOEs and quasi-government agencies prescribed by the new system. Surprisingly, the methods used to evaluate the performance of SOEs of type 2 were not much different from those for quasi-government agencies.

There were small changes in the indices in 2008. Common indices, which had consisted of overall management part and business management part before, changed to have 3 parts, leadership/strategy, management system, and management results. Indices belonging to each part also changed. In addition, common indices for SOEs and quasi-government agencies were united and applied to all SOEs and quasi-government agencies. Details on the indices belonging to each part are summarized below:

- Leadership/strategy part: Implementation of vision, goal, and strategy, leadership
- Management system part: Efficiency in business projects, efficiency in organizational structure
- Management results part: Results from major businesses, customer satisfaction

Most of the indices belonging to the management system part and the management results part that were used in 2008 coincided with the indices that had been used before 2008, although their names changed and the names of the indices changed. The leadership/strategy part included some indices that had not been used before, including vision, developing strategy, implementation plan for major businesses, ethics and transparency, and implementation of the businesses recommended by the government. Another important fact about the evaluation system that was used in 2008 was that the weights given to various indices were almost the same between SOEs and quasi-government agencies except for productivity of capital.

Evaluation indices changed slightly again in 2009 and 2010, although the indices used in 2009 and 2010 were almost identical. The difference between the evaluation system used in 2008 and 2010 was not great. The parts and the indices in each part remained the same. The

main differences in the evaluation system between 2008 and 2010 are two. First, evaluation methods for type 1 and type 2 SOEs were unified. In other words, the same indices and weights were used for both types of SOEs. Second, indices used for SOEs and quasi-government agencies became very similar to each other. The only meaningful difference in the evaluation methods between SOEs and quasi-government agencies appeared to be that the evaluation team applied different weights to the indices depending on whether an institution was an SOE or a quasi-government agency. There was little change in the criteria to be used for each index when we compared the criteria used in 2008 and 2010 respectively. However, the weights given to quantitative indices appeared to be rising under AMPI. The evaluation system used for GAIs under FAMGAI generally gave 60 ~ 70% weights to quantitative indices. But, the evaluation system for institutions subject to AMPI has given increasingly larger weights to quantitative indices since 2008.

From the above discussions, we can draw a conclusion that there have been few meaningful changes in the evaluation system under AMPI from the one used prior to 2008 although details on indices and weights kept changing every year. The changes in the evaluation methods made in 2010 in response to a sharp increase in debts and debt/equity ratios of some institutions subject to SOE are a good example that supports this conclusion. Debts incurred by some SOEs and quasi-government agencies have increased sharply since 2008 as a result of the policy of the Lee Myung-bak administration to force them to invest a large amount of money in many large scale infrastructure projects coupled with the policy of Lee administration to maintain tariffs of the services provided by those institutions at levels that are significantly lower than the cost recovery levels. By the end of 2009, it became clear that the size of the debts and the high debt/equity ratios of several institutions posed a serious problem to the government and the institutions.

In 2010, the government changed one of the evaluation indices in order to give the institutions a stronger incentive to manage their debts in a responsible way. Specifically, the government explicitly specified that the evaluation team should take into account the efforts an institution took in order to maintain a sound financial structure, forecasting future risks and diversification of risks, the adequacy in financing and liquidity management, and efforts to improve the financial structure in evaluating an index on the financial and budget management. However, the index on the financial and budget management was given only 2 points out of 60 points assigned to the common indices. As a result, the change had only a limited effect on the incentive of the institutions. The change had no chance of inducing a significant improvement in the situation of the institutions that had serious debt problems because it was impossible for them to reduce debts or lower the debt/equity ratios as the debt problem was caused by the Lee administration's policy of forcing them to invest in mega projects it pursued, which resulted in large debts.

5. Bonus

The outcome of evaluation on the institutions subject to AMPI is reported to the National Assembly and the President. It is also used as a basis to determine the performance based bonuses of the institutions. Performance based bonuses for employees and executives of SOEs have been used at least since 1973. According to Song (1983), employees and executives of GIIs subject to the Framework Act on the Management of Government Invested Corporation received roughly 200% of the annual fixed salaries as bonuses. The intention of the government when it introduced the bonuses was to give the bonuses according to their performances. However, the government allowed GIIs to pay 200% of the annual fixed salaries as bonuses in practice in most cases as it did not have a reliable way to measure the performance of GIIs accurately and to link bonuses to measured performances fairly.

The government gradually increased the linkage between the bonuses and the outcomes of evaluations over the last 30 years. As a consequence, the remuneration system on determining bonuses evolved into a fairly sophisticated one, and the variation in the bonuses that employees of SOEs and public institutions received has increased over the years. The <Table 6-5> below summarizes the key aspects of the bonus system applied to GIIs during 1983 ~ 2006.

Table 6-5 | GII Evaluation Incentives from 1983 to 2006

(Unit: %)

Year of Evaluation	Bonus Rates as Proportions of Monthly Salaries		Range of Bonus Rate (actual bonus rate)			
	Formulas for determining bonus rates	Important facts	Average	Highest	Lowest	Difference
1983	A(300%) B(250%)	· Within the same grade, the same bonus rate applies regardless of the total points · 50% gap between adjacent grades	240	300 (300)	100 (200)	200 (100)
1984	C(200%) D(150%) E(100%)		232	300 (250)	100 (150)	200 (100)
1985	100%+[(Total points -75)×10%]	· If the total points exceed 95, maximum bonus rate of 300% applies	243	300 (280)	100 (170)	200 (110)
1986			256	300 (290)	100 (190)	200 (100)
1987			250	300 (290)	100 (190)	200 (100)
1988			247	300 (300)	100 (200)	200 (100)
1989			241	300 (275)	100 (215)	200 (60)
1990			246	300 (280)	100 (190)	200 (90)
1991	125%+[(Total points -75)×10%]	· Increase in the basic bonus rate by 25% · If the total points exceed 95, maximum bonus rate applies · Additional bonus for early settlement of wage negotiation existed separately	266	325 (295)	125 (225)	200 (70)
1992			267	325 (295)	125 (215)	200 (80)
1993			263	325 (305)	125 (195)	200 (110)
1994	165%+[(Total points -75)×10%]	· Increase in the basic bonus rate by 40% · If the total points exceed 95, maximum bonus rate of 365% applies	303	365 (335)	165 (275)	200 (60)
1995	125%+[(Total points -75)×20%]	· Increase in the maximum bonus rate(60%), decrease in the minimum bonus rate(40%) · Greater gap between maximum bonus rate and minimum bonus rate	352	425 (395)	125 (265)	300 (130)

Year of Evaluation	Bonus Rates as Proportions of Monthly Salaries		Range of Bonus Rate (actual bonus rate)			
	Formulas for determining bonus rates	Important facts	Average	Highest	Lowest	Difference
1996	N/A	<ul style="list-style-type: none"> · If the total points exceed 95, maximum 425% bonus rate · If the total points are below 80, 0 bonus rate applies 	350	425 (395)	125 (277)	300 (118)
1997	$[(\text{Total points}-80)/20] \times 500\%$	<ul style="list-style-type: none"> · Increase in the maximum bonus rate(75%), decrease in the minimum bonus rate · If the total points are below 85, 0 bonus rate · Greater gap between the bonus rates 	274	500 (325)	0 (175)	500 (150)
1998	$100\% + [(\text{Evaluation points} - 50)/50] \times 400\%$	<ul style="list-style-type: none"> · Each point counts for 8% increase in the bonus rate · Introduction of 100% basic bonus rate. 	268	500 (357)	100 (67)	400 (290)
1999			284	500 (357)	100 (208)	400 (149)
2000			326	500 (358)	100 (265)	400 (93)
2001			282	500 (343)	100 (186)	400 (157)
2002			307	500 (376)	100 (234)	400 (142)
2003	$180\% + [(\text{Evaluation points} - 62.5)/25] \times 320\%$	<ul style="list-style-type: none"> · Each point counts for 3.2% increase in the bonus rate · Increase in the basic bonus rate(80%) 	342	500 (500)	180 (218)	320 (282)
2004	$200\% + [(\text{Evaluation points} - \text{The lowest point}) / (\text{The highest point} - \text{The lowest point})] \times 300\%$	Bonus rates depend on the relative scores of the highest and the lowest performers	378	500 (500)	200 (200)	300 (300)
2005			352	500 (500)	200 (200)	300 (300)
2006			380	500 (500)	200 (200)	300 (300)

Comment 1: Bonus = Monthly wage × Bonus rate

Comment 2: Actual bonus rates are within the parenthesis

Source: Ministry of Strategy and Finance (1999 ~ 2006), 『Guideline on the Management Evaluation of Government-affiliated Institutions』, Government-affiliated Institutions Management Committee (2004 ~ 2006), 『Guideline on the Management Evaluation of Government-affiliated Institutions』, Ministry of Strategy and Finance (2007 ~ 2010), 『Guideline on the Evaluation of Management Results of SOEs and Quasi Government Institutions』, Yoon Tae Bum and others, 『A Research on the Changing Process of the Management Evaluation System of Public Institutions』, Korea Institute of Public Finance (2012), p.96 ~ 97

In the bonus system used from 2004, each employee of a GII subject to the Framework Act on GIIs amended in 1999 received 200% of the monthly salary as a basic bonus. In addition to the fixed bonuses, employees of public institutions received performance based bonuses determined by the formula, $(\text{the evaluation point of the institution} - \text{the lowest evaluation point among the institutions}) / (\text{difference between the highest point} - \text{the lowest point}) \times 300\%$. As a result, each employee of a public institution received a performance based bonus of 0% ~ 300% of the monthly salary depending on the outcome of performance evaluation of his or her institution. In 2004, 2005, and 2006, the average performance based bonus as a percentage of the monthly salary of GIIs was 178%, 152%, and 180%, respectively.

Bonuses to the CEOs of GIIs were determined separately from those of the employees based on the evaluation of the performance of the CEO and bonuses of the CEOs of other GIIs. The formula that was used to determine the bonus of the CEO of a GII was $(\text{evaluation point of the CEO} - \text{the lowest CEO evaluation point}) / (\text{the highest CEO evaluation point} - \text{the lowest CEO evaluation point}) \times 200\%$. The CEO with the highest evaluation point received 200% of his monthly wage as a bonus while the one with the lowest evaluation point received none. A CEO with the evaluation point between the two extreme outcomes received a bonus between 0% and 200% of his monthly wage according to the evaluation results. Each year during this period, average bonus GII CEOs received was 121%, 96%, and 114%.

During the same period, the bonus rate of employees and the heads of government-affiliated institutions under the Framework Act on the Management of Government-Affiliated Institutions was determined by a formula that gave 50% of the weight to the absolute score of the CEO of a GAI and the other 50% to the relative performance of the CEO in comparison with the performances of the CEOs of other GAIs. The bonus rates for the employees of GAIs ranged from 100% to 200%. The bonus rate for CEOs ranged from 21% to 88% in 2004, from 20% to 90% in 2005, and from 22% to 85% in 2006. The average bonus rate for employees in each of 2004, 2005, and 2006 was 143%, 145%, and 147%, respectively while the average bonus rate for CEOs was 54%, 55%, and 58% respectively.

After the introduction of the Act on the Management of Public Institutions, bonus rates were determined by the following method using the evaluation results. For employees who were not executives, a fixed bonus of 200% of monthly salaries were given. In addition, a performance based bonus was determined by the formula $(\text{the evaluation point of the institution} - \text{the lowest evaluation point among the institutions}) / (\text{difference between the highest point} - \text{the lowest point}) \times A\%$, where A varied according to the class and type of an institution. Details on the bonuses are summarized below. Note that below, bonus rates were based on monthly salaries for employees while they were based on annual salaries for executive directors and CEOs.

Employees (In terms of monthly salary)

- SOE type 1: Maximum 300%, minimum 0%, average 218%, fixed bonus 200%.
- SOE type 2: Maximum 250%, minimum 0%, average 115%, fixed bonus 250%.
- Quasi government agency type I: Maximum 100%, minimum 0%, average 53%, fixed bonus 100%.

Executive directors (In terms of annual salary)

- SOE type 1: Maximum 100%, minimum 0%, average 73%, fixed bonus 0%.
- SOE type 2: Maximum 100%, minimum 0%, average 46%, fixed bonus 0%.
- Quasi government agency type I: Maximum 80%, minimum 0%, average 42%, fixed bonus 20%.

Bonuses for CEOs or heads (In terms of yearly wage)

- SOE type 1: Maximum 200%, minimum 0%, average 119%, fixed bonus 0%.
- SOE type 2: Maximum 200%, minimum 0%, average 105%, fixed bonus 0%.
- Quasi government agency type I: Maximum 80%, minimum 0%, average 41%, fixed bonus 20%.

Since 2008, all SOEs and quasi-government agencies have been given one of 6 grades according to the result of the evaluation of their performances. Bonus rates for employees are differentiated according to the following factors; (1) class, that is, whether an institution is an SOE or a quasi-government agency, (2) among SOEs, whether an SOE was classified as a GII before 2008, (3) among quasi-government agencies, whether an agency was classified as a GII before 2008. Bonuses of executive directors and CEOs of SOEs depend only on the performance results and do not depend on whether an SOE was classified as a GII before. CEOs bonus rate of an SOE is double the bonus rate of executives of the same firm. For executive directors and the heads of quasi-government agencies, different bonus rates apply depending on whether an agency is a financial institution. Executives and heads receive the same bonus rates. There is no fixed bonus rate for executive directors, CEOs, and heads. Information on the bonuses of employees and executives of SOEs and quasi-government agencies are given below:

Employees

- SOEs that were formerly GIIs: S(300%), A(240%), B(180%), C(120%), D(60%), E(0%), in addition to 200% fixed bonus

- The rest of SOEs: S(250%), A(200%), B(150%), C(99%), D(50%), E(0%), in addition to 250% fixed bonus
- Quasi-government agencies that were formerly GIIs: S(300%), A(240%), B(180%), C(120%), D(60%), E(0%), in addition to 200% fixed bonus
- The rest of the quasi-government agencies: S(100%), A(80%), B(60%), C(40%), D(20%), E(0%), in addition to 100% fixed bonus

Executive directors (In terms of yearly salary)

- SOEs: bonus of 100%, 80%, 60%, 40%, 20%, 0% according to their grades without a fixed bonus
- Quasi-government agencies that are financial institutions: 100%, 80%, 60%, 40%, 20%, 0% according to their grades without a fixed bonus
- Other quasi-government agencies: 60%, 48%, 36%, 24%, 12%, 0% according to their grades without a fixed bonus

CEOs heads (In terms of yearly salary)

- SOEs: bonus of 200%, 160%, 120%, 80%, 40%, 0% according to their grades without a fixed bonus
- Quasi-government agencies that are financial institutions: 100%, 80%, 60%, 40%, 20%, 0% according to their grades without a fixed bonus
- Other quasi-government agencies: 60%, 48%, 36%, 24%, 12%, 0% according to their grades without a fixed bonus

In 2009, a bonus system changed slightly from that used in 2008. Bonus rates for employees and executives were tentatively determined by the formulas used in 2008, and then adjusted by the outcome of the evaluation of the performances of CEOs of SOEs or heads of quasi-government institutions as follows:

- No adjustment or increase in bonus rates if the outcome of the performance evaluation of the CEO of an SOE or the head of a quasi-government agency is B.
- Increase in bonus rates if the outcome of the performance evaluation of the CEO of an SOE or the head of a quasi-government agency is A.
- Decrease the bonus rates if the outcome of the performance evaluation of the CEO of an SOE or the head of a quasi-government agency is C or D.

Bonus rates for the CEO of an SOE or the head of an agency were determined 50% by the evaluation result of their institution and 50% by the evaluation results of themselves. Their bonuses were to fall to zero if their institutions received an E in the evaluation and were to be reduced by 50% if their institution received a warning for two consecutive years.

The government also selected institutions which it considered excellent or inferior in performance. Institutions that were selected as excellent performers were given rewards such as increase in the budget for the following year as well as promotion or commendation for employees who were credited with the high performance. Institutions that were deemed inferior were those that received low evaluation results or whose performance results fell significantly lower than those in the previous year. They are subject to warnings by the government and additional reduction in bonuses. They are also required to submit a plan to improve performances.

6. Public Disclosure

A public disclosure system is one of the most essential means to improve the efficiency of SOEs and public institutions. Naturally, all key decisions are made by the government officials and the managers and executives of SOEs and public institutions. This brings the result that key information about the management or institutions themselves is monopolized by them. They have a strong incentive to reveal the information that will work in their interests and to hide the information that is likely to work against their interests. Therefore, it is crucial to put a system in place that allows the general public to have access to key information about public institutions and their management. Official Information Disclosure Act, which became effective in January 1998, requires that information on the operation of the government agencies, SOEs, and public institutions be disclosed.

In addition, AMPI requires the public institutions subject to it to disclose important information on them in their internet home pages. It further requires that information on important items that are included in the list of items for public notice should be disclosed in a standardized manner determined by the Ministry of Strategy and Finance. Currently, 33 items are required to be disclosed in the standardized manner called the unified public disclosure. The following table provides information on the unified public disclosure.

Table 6-6 | Standardized Disclosure Items of Public Institutions

Classifications	Items	Criteria	Frequency of Public Disclosure
I. General information	1. General introduction	<ul style="list-style-type: none"> • Introduction, main functions, management goals and strategies, location, purpose of foundation, government ministry in charge 	- Yearly disclosure (End of April)
	2. Number of employees	<ul style="list-style-type: none"> • Number of executives • Number of employees (Capacity, Permanent/ Temporary) • Number of employees in each position 	- Scheduled disclosure: Four times a year (Quarterly)
	3. Executives	<ul style="list-style-type: none"> • Name, position, term of office, career, appointment process 	- Frequent disclosure
	4. Recruitment status	<ul style="list-style-type: none"> • Recruitment records • Recruitment status of woman, the disabled, and engineers • Recruitment status of youth interns 	- Scheduled disclosure: Four times a year (Quarterly)
	5. Average wage of executives	<ul style="list-style-type: none"> • Average wage of executives, benefits, welfare cost, management evaluation bonus, other bonuses 	- Yearly disclosure (End of April)
	6. Average wage of employees	<ul style="list-style-type: none"> • Average wage of employees, benefits, management evaluation bonus, other bonuses • Average number of years worked • Average wage of new employees 	- Yearly disclosure (End of April)
	7. Official expenses used by the head of the institution	<ul style="list-style-type: none"> • Details on official expenses 	- Yearly disclosure (End of April)
	8. Welfare cost	<ul style="list-style-type: none"> • Current status of welfare cost, guidelines on welfare cost 	- Yearly disclosure (End of April)
	9. Business trip details	<ul style="list-style-type: none"> • Overseas business trip details, business trip reports 	- Frequent disclosure
	10. Labor union related information	<ul style="list-style-type: none"> • Range of the labor union, participation rate, the number of union officers, upper-level labor unions 	- Scheduled disclosure: Four times a year (Quarterly)
		<ul style="list-style-type: none"> • Collective agreement, any contracts between the labor union and the management 	- Frequent disclosure
11. Employment regulations	<ul style="list-style-type: none"> • Regulations on personnel affairs, code of conduct, rewards, overall organization, etc. 	- Frequent disclosure	

Classifications	Items	Criteria	Frequency of Public Disclosure
II . Management results	12. Summary of balance sheet	<ul style="list-style-type: none"> Major items in balance sheet 	- Yearly disclosure (End of April)
	13. Summary of income statement	<ul style="list-style-type: none"> Major items in the income statement 	- Yearly disclosure (End of April)
	14. Income and expenditure	<ul style="list-style-type: none"> Income: Government subsidy, net profit, etc. Expenditure: business expenses, labor costs, operating costs, etc. 	- Yearly disclosure (End of April)
	15. Main businesses	<ul style="list-style-type: none"> Title for the businesses Budget for the businesses 	- Yearly disclosure (End of April)
	16. Investment details	<ul style="list-style-type: none"> Investment details 	- Yearly disclosure (End of April)
III . Management performance and major business contents	17. Capital and shareholding status	<ul style="list-style-type: none"> Shareholders' names, paid in capital, shareholding ratio 	- Yearly disclosure (End of April)
	18. Debt status	<ul style="list-style-type: none"> long-term debt, short-term debt 	- Scheduled disclosure: Twice a year(End of April, October)
	19. Investment status	<ul style="list-style-type: none"> Investment information 	- Yearly disclosure (End of April)
		<ul style="list-style-type: none"> Information on affiliated companies - Employment information of the retirees from the public institution, transactional information, debt guarantee status, etc. 	- Frequent disclosure & Yearly disclosure (End of April)
		<ul style="list-style-type: none"> Investment on new facilities 	- Frequent disclosure
	20. Yearly investment and donations	<ul style="list-style-type: none"> Amount, recipient or investee, main contents, details 	- Yearly disclosure (End of April)
	21. Liability management	<ul style="list-style-type: none"> Provision of security status 	- Yearly disclosure (End of April)
<ul style="list-style-type: none"> Debt guarantee status 		- Yearly disclosure (End of April)	
<ul style="list-style-type: none"> Other liabilities 		- Frequent disclosure	

Classifications	Items	Criteria	Frequency of Public Disclosure
IV. External and internal evaluation	22. Suggestions from National Assembly	<ul style="list-style-type: none"> Suggestions from National Assembly and corresponding corrective actions 	- Frequent disclosure
	23. Suggestions from auditing committee and the ministry in charge	<ul style="list-style-type: none"> Suggestions from the audit results of the past three years and corresponding corrective actions 	- Frequent disclosure
	24. Management results evaluation	<ul style="list-style-type: none"> Reported by the Ministry of Strategy and Finance 	-
	25. Suggestions from management evaluation	<ul style="list-style-type: none"> Suggestions from the management evaluation from the previous year (if the evaluation grade is D) and corresponding corrective actions 	- Scheduled disclosure: Twice a year(End of April, October)
	26. Survey on customer satisfaction rate	<ul style="list-style-type: none"> Reported by the Ministry of Strategy and Finance 	-
	27. Audit results	<ul style="list-style-type: none"> Reported by the Ministry of Strategy and Finance 	-
	28. Internal audit results on board of directors meeting minutes	<ul style="list-style-type: none"> Board of directors meeting minutes, external and internal audit results, etc. 	- Frequent disclosure
V. Announcements	29. Management case study	<ul style="list-style-type: none"> Case studies on successful personnel affairs and relationship with the labor union, increase in customer satisfaction rate etc. 	- Frequent disclosure
	30. Recruitment information	<ul style="list-style-type: none"> Recruitment information 	- Frequent disclosure
	31. Bidding information	<ul style="list-style-type: none"> Open bidding information such as services provided by each institution 	- Frequent disclosure
	32. Reports	<ul style="list-style-type: none"> Reports on management and activities of public institutions 	- Frequent disclosure
	33. Others	<ul style="list-style-type: none"> Necessary announcements related to management and community services 	- Frequent disclosure

Source: 『Rules on Standardized Disclosure of Information of Public Institutions』 (2012. 3. 7.)

In order to avoid false or insufficient disclosure, there are designated reporter, supervisor, and reviewer for each disclosure item whose names, affiliated ministry, and contacts are also disclosed. When negligence of duty or false information is found, the institution and its employees responsible for it could be punished with some penalties. In cases of failure to disclose an item that is included in the <Table 6-6>, disclosure behind the schedule, or incorrect disclosure, the government imposes penalty points to the institution. When the penalty points exceed a certain level, the government imposes penalties on the institution and people that are responsible for it. The institution is also required to submit plans to correct the problems that led to the negligence in disclosure.

An important item to be disclosed through the unified disclosure system is the information on the subsidiaries that an institution controls and the firms in which it has shares but does not control. The former are called subsidiaries (ja-hoi-sa in Korean) while the latter is called non-subsidiary invested firms (chool-ja-hoi-sa in Korean). The official definition of a subsidiary of an institution is a firm in which the institution has a 50% or more ownership or 30% or more ownership with an effective control. The official definition of a non-subsidiary invested firm of an institution is a firm in which the institution owns 1% or more of the shares but is not a ja-hoi-sa according to the definition given in the preceding sentence. Non-financial SOEs and quasi-government agencies are required to disclose their 15 largest subsidiaries while SOEs and quasi-government agencies that are financial institutions are required to disclose all the subsidiaries and the non-subsidiary invested firms in which their share is 20% or larger or in which they invested more than KRW 100 billion. However, investment associations, paper companies, SPCs, AMCs, and PFVs do not need to be disclosed.

Institutions subject to AMPI are also required to disclose transactions with subsidiaries and non-subsidiary invested firms. An institution that is not a financial institution is required to disclose information on transactions with subsidiaries and non-subsidiary invested firms, which involved an amount that exceeds 5% of the revenue of the institution. A financial institution subject to AMPI is required to disclose information on transactions with subsidiaries and non-subsidiary invested firms, which involved an amount that exceeds 10% of the revenue of the institution. The information to be disclosed includes the name of the subsidiary or non-subsidiary invested firm, relationship with the institution, types of transaction, amount of money involved in the transaction, and the proportion of the amount of money involved in the revenue of the institution. Information on loan guarantees is also required to be disclosed, including debtor, creditor, the relationship between them, amount of the loans guaranteed, and the proportion of the loans guaranteed to the loan amount.

Another important item to be disclosed is the information on the employment of a former employee of an institution by a subsidiary or a non-subsidiary invested firm of the

institution. This is important in Korea because it is common for executives and managers of SOEs and quasi-government agencies in Korea to get jobs in firms their institutions have invested in even after they retire from their institutions. Often, it is likely that they work to generate revenues for their new employers from the institutions they used to work for, which distorts competition and frequently leads to transactions that are difficult to be justified on efficiency grounds. Further, executives and managers of SOEs and quasi-government agencies frequently try to lead their institutions to set up new subsidiaries and to invest money in other firms in order to increase the chance of getting a new job after retiring from the current job, and it often works. Such behaviors of executives and managers of institutions naturally lead to inefficiency. In order to mitigate the problems associated with the distortion in incentives of the executives and managers explained above, AMPI requires each SOE and quasi-government agency to disclose information on the hiring of ex-employees and ex-executives by subsidiaries, and non-subsidiary invested firms. AMPI also requires the disclosure of information on the employment of former employees and executives by other firms that have significant business transactions with an SOE or a quasi-government agency.

Lastly, let us discuss the disclosure requirement on the investment made by public institutions. Currently, the disclosure system is required for 24 SOEs and quasi-government agencies that are designated as institutions that are subject to investment guidelines of the government. The 24 SOEs and quasi-government agencies are the institutions that are often under a strong pressure by the government to invest certain amount of money in projects that the government wants in order to achieve various political and other objectives. The disclosure requirement for 24 institutions on investment is used as an instrument that the government uses in forcing them to invest a certain amount of money in projects according to a timetable that the government wants. Following is the list of 24 institutions:

- 6 SOEs related to SOC: LH Corp, Korea Water Corp, Incheon International Airport Corp, Korea Railway Network, KORAIL, Korea Expressway Corp
- 13 SOEs related to energy industry: KEPCO, Korea National Oil Corp, Korea Coal Corp, Korea Resources Corp, KOGAS, Korea District Heating Corp, Korea Energy Management Corporation, Korea South-East Power, Korea Midland Power, Korea Western Power, Korea Southern Power, Korea East-West Power, Korea Hydro & Nuclear Power
- Others: Korea Minting and Security Printing Corp, Korea Tourism Corp, Korea Rural Community Corp, Korea Racing Authority, Korea Agro-Fisheries and Food Trade Corp

7. Evaluation of SOE Policy Adopted by Roh Moo-hyun Administration

While Kim Young-sam and Kim Dae-jung administration focused on the privatization of SOEs with high market potentials, the improvement in governance structures of the target SOEs, and the separation of their roles as a policy tool and as a commercial enterprise, Roh Moo-hyun administration focused on the completion of privatization and the introduction of market competition as well as the standardization of governance structures of SOEs and public institutions. Roh Moo-hyun administration attempted an appropriate systematic approach on many public institutions previously managed in disorganized fashion. However, it was unproductive because many SOEs and public institutions had different governance structures. In particular, Roh Moo-hyun administration's policy on SOEs with high market potentials hardly increased their efficiency. In regards to the restructuring of electric power industry initiated by Kim Dae-jung administration, Roh Moo-hyun administration did not introduce competition in the sales stage and did not privatized electric power subsidiaries. It also decided to retain the industry structure as it was at the time of Kim Dae-jung administration. It also did not attempt the privatization of other SOEs. Furthermore, Roh Moo-hyun administration removed any distinction between GIIs and government-affiliated institutions through the Act on the Management of Public Institutions, and implemented a standardized governance structure in SOEs and public institutions with the exception of GII management institutions through the Framework Act on the Management of Government-Affiliated Institutions. This reflects that Roh Moo-hyun administration neglected the distinction between SOEs and public institutions, considered both SOEs and public institutions primarily as policy tools of the government, and allocated resources through direct government control rather than through market competition led by profit motives. In this regard, SOE policy of Roh Moo-hyun administration on all SOEs and public institutions took fundamentally the same approach with GII policy prior to 1999.

Act on the Management of Public Institutions system does not adequately distinguish a governance structure of SOEs with high market potentials from that of public institutions that perform government-commissioned public service which can cause low management efficiency of the SOEs and hinder optimal allocation of resources within the corresponding industries. Potential problems related to the current governance structure of SOEs with high market potential are as follows:

- Current system defines institutions with high market potentials as SOEs, and institutions that perform government-commissioned public services as quasi government agencies. The criterion used for such classification is whether the profit earned through the market or government-commissioned public services accounts for more than half of

the total profit but it may not be reasonable enough to properly distinguish SOEs from public institutions. A better criterion will be the nature of the tasks performed by the institution. For example, the tasks which involve purchase of non-performing loans and insolvent companies and its disposal are a business area with high market potentials and investment banks in the advanced countries are involved with this kind of business. Businesses in Credit guarantee or deposit insurance are also highly commercial. Therefore, it is appropriate to classify institutions in these fields as SOEs.

- Classification of SOEs into the market type and the quasi market type is also hardly related to the market potentials of the SOEs. Racecourse management, coal mining and distribution, advertisement, hotel management, duty-free shop management, golf course management, transportation business, real estate management and valuation, etc are highly commercial in their nature. SOEs of the quasi market type in these fields often have higher market potentials than market-type SOEs such as KEPCO.
- A large number of institutions with high market potentials are classified as “other institutions.” For example, Export-Import Bank of Korea, Korea Investment Corp, subsidiaries of KEPCO and KOGAS, Kangwon Land, The First Club 88, etc. are highly market-oriented.
- It is not reasonable to classify SOE subsidiaries into SOEs, quasi government agencies, and other institutions. A logical approach is to recognize subsidiaries of a SOE as a part of the SOE under its control so that only the SOE will be a management target.
- The difference between the governance structure of SOEs and that of quasi government agencies is unclear. The appointment process of CEO in a SOE involves multiple candidates recommended by the executive recommendation committee, the selection of a candidate by committee for management of public institutions, the appointment request placed by the minister of the ministry in charge, and the official appointment by the president. On the other hand, the appointment process of the head of a quasi government agency involves the recommendation of multiple candidates by the executive recommendation committee and the selection and appointment of a candidate by the minister of the ministry in charge. Considering the fact that CEO appointment process also requires the appointment request by the minister of the ministry in charge which will eventually serve to reflect the interests of the ministry in charge, there are no clear differences between these two appointment processes. Since the president or the minister of Strategy and Finance were empowered to appoint standing members of an auditing committee, auditors, and non-executive directors of SOEs, politicians in power are likely to control the personnel affairs of SOEs and eventually lower management efficiency of the SOEs with high market potentials.

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- The board of directors' management system and management evaluation system are similar in SOEs and quasi government agencies.
 - Giving the ministry in charge the supervisory authority may result in lower management efficiency of SOEs and hinder optimal allocation of resources through increased uncertainty of the opportunity cost involved with the policy promoted by the ministry in charge.

Such shortcomings of current SOE system emerge from the idea that SOEs are not enterprises, but merely policy tools of the government, especially of the ministries in charge. Despite a temporary success in the market-friendly SOE reform achieved by Kim Young-sam and Kim Dae-jung administrations, Korea's approach on SOEs hasn't almost changed from that of the Framework Act on the Management of GIIs in 1980s. The approach is ineffective in the establishment of a proper governance structure as well as in the introduction of competition and regulations of a broader scale. SOE policy in definition not only involves the board of directors, the appointment of CEO and board members, and management evaluation and rewards, but also includes rules on competition and regulations of the industries these SOEs are in. Therefore, it is essential to develop an optimal system in consideration of the market structure of the industry each SOE belongs to, the competition type, regulations on the industry with high entry barrier, as well as the governance structure of each SOE. However, Korea's SOE policy presumes that the government, more specifically the ministry in charge, needs to control production and distribution of goods and services. In this regard, current SOE policy is very similar to the SOE policy of mid-1980s in its foundation.

Current governance structure of quasi government agencies generally promotes higher efficiency in the public service operated by the government. However, policies on quasi government agencies are considered ineffective as in the case of those on SOEs because they failed to comprehensively consider governance structure as well as the characteristics of the industries in setting the most efficient plan to accomplish the policy goals. Besides, there are additional problems in the current system regarding quasi government agencies and other institutions.

- It often includes institutions that ought to be classified as SOEs because of its high market potentials such as subsidiaries of SOEs.
- Even in the case of institutions with strong public nature, classifying these various institutions as the same type, that is, quasi government agencies and imposing identical governance structure fail to reflect the characteristics of the tasks performed by each institution and thus lower the effectiveness of these institutions.
- Allowing the president to appoint standing members of auditing committee and auditors may cause abuse of political influence and management inefficiency.

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Chapter 7

Conclusion

Conclusion

The proportion of SOEs in the corporate sector has been far lower in Korea than that in most developing countries since the early years of industrialization, as Korea has never been under a socialist economic system and also the industrialization has been achieved primarily through the *chaebol* system in most industries. Nevertheless, Korea ended up building a sizable number SOEs in several industries including network industries and financial industries. In addition, the government became the dominant shareholder of many large firms that had been privately owned and went bankrupt in the last half a century. The usual way to handle large bankrupt firms in Korea was that the government took over the ownership and control of them through rationalization measures or more voluntary debt equity swaps between state-owned banks and bankrupt debtor firms.

Before Kim Young-sam administration changed the policy toward commercial SOEs, all administrations regarded SOEs as policy instruments that the government could use to pursue policy objectives and not as commercial firms. In a sense, the nature of the system of running SOEs was quite similar to that of the central planning system of socialist countries. The Framework Act on Management of GIIs introduced in 1983 allowed the management of SOEs a larger degree of autonomy from the line ministries, but was still based on the same command and control approach. The GIIs that were subject to this act included both commercial SOEs and public institutions that were closer to the government than commercial SOEs in the nature of their businesses. Kim Young-sam administration acknowledged for the first time in the history of Korea that commercial SOEs were commercial firms rather than policy instruments of the line ministries and attempted to privatize them and to install a profit oriented governance structure in them even before full privatization. Kim Dae-jung administration adopted the ideas embodied in the Special Act on Privatization and continued to implement them.

However, Roh Moo-hyun administration reversed the policy of the two predecessors and began applying governance structures that were not much different from each other to commercial SOEs and public institutions. By treating commercial SOEs essentially in the same way with public institutions, it made it difficult, if not impossible, to differentiate between the governance structure of highly commercial SOEs which were competing with private firms and that of public institutions which had little or no commercial elements. The Act on the Management of Public Institutions installed a governance structure in commercial SOEs that was not consistent with successful commercial operations. The governance structure of SOEs and public institutions have not changed since 2008 as Lee Myung-bak administration did not amend the Act on the Management of Public Institutions.

On privatization, no administration before Kim Young-sam administration attempted to establish a set of criteria to identify the SOEs that should be privatized and the SOEs that should be kept under the government ownership and control. SOEs that had been privatized by Park and Chun administrations were commercial enterprises and commercial banks to which it was difficult to attach plausible policy objectives that would require continued government ownership and control.¹² However, the privatization of banks by Chun administration was accompanied by a governance structure that was vulnerable to the interference by powerful politicians in the ruling party and the bureaucrats working for them. Misappropriation of the money in the privatized banks by the bank managers forced by the politicians continued in a large scale until most of the banks went bankrupt during the financial crisis, which hit Korea in 1998.

Privatization of SOEs by Kim Dae-jung administration, including four out of the six largest SOEs that existed at the time, was the first large scale privatization in the history of Korea. It was conducted in a more organized manner than previous privations, too. The Kim Dae-jung administration analyzed the businesses of each SOE to distinguish the SOEs that should be privatized from those that needed to be maintained as SOEs. It is worth noting that Kim Dae-jung administration was not only the first but also the last administration in Korea which privatized a large SOE without involving *chaebol* groups. In fact, it privatized four large SOEs - KT, POSCO, KT&G, and Kookmin Bank – without handing over a controlling interest to *chaebols*. By doing so, it opened the door to a new ownership and governance structure for large firms in Korea, which was dominated by neither a *chaebol* family nor the government. The new ownership and governance structure of privatized former SOEs could

12. Nam and Kang [1998] was the first paper in Korea that reviewed the policy objectives associated with each of the large SOEs which existed in 1998, asked whether each policy objective was still plausible in 1998 and how the government could pursue a policy objective which survived this test by using the ownership and control, and also asked whether privatization combined with additional measures such as competition and regulation of bottleneck facilities would be a more efficient way than the government ownership and control to achieve the same objective.

have far-reaching implications to the ownership and governance structure of large firms in Korea in the long run.

All administrations, including Kim Young-sam and Kim Dae-jung administrations failed to recognize that the policy on the ownership and governance of an SOE had to be implemented along with competition policy, industrial policy, and regulatory policy as a package. Kim Dae-jung administration also failed to give a proper profit incentive to KEPCO and its subsidiary generation companies when it restructured the electricity industry. Nor did it change the regulatory scheme for transmission, distribution, and retail stages which were to remain monopolies from the regulatory scheme that had been used to regulate old KEPCO that monopolized all stages of the industry including the generation stage.

The evolution of the governance structure of SOEs in Korea reflects the changes in the political system and the economic development of Korea that took place in the last half a century. The Korean government was unable to distinguish SOEs from the government itself in the early years as Korea was one of the poorest countries in the world that had little experience with the market economy. However, since the early 1960s, the government separated SOEs from the government gradually and installed a governance structure in them, separate from the governance of the bureaucracy of the government. In the early 1980s, Chun administration introduced a well- defined governance structure in large SOEs backed by a law, the Framework Act on the Management of Government Invested Institutions, to allow more management autonomy needed for commercial operations while continuing to maintain them as policy instruments.

The mass privatization of commercial SOEs was probably not an optimal policy in the early 1980s considering that Korea was under a military dictatorship which dominated the economy as well as politics, when there were few large private firms that had normal ownership and governance structure and the private sector was generally suffering from the lack of capital and managerial human resources. In addition, law enforcement on misappropriation of money in private firms was very weak. Considering these factors, the governance structure Chun administration installed in GIIs might have been a reasonably good alternative.

The political and economic environments changed in a fundamental way after the democratization that took place in 1997. As the military dictatorship that had prevailed for nearly three decades collapsed, so did the old system of the governance structure of large firms, both in the private and the public sectors. By 1987, the private sector in Korea had accumulated substantial capital and managerial resources. Several SOEs also accumulated capital, technology, and human resources sufficient enough to sustain profitable operation

and growth. Korea was in need of a new ownership and governance structure for large firms in the private sector that would replace the old ones dominated by *chaebols* and military dictators. We also believe that Korea could have increased the efficiency of SOEs significantly by installing a governance structure in them that was based more on economic efficiency and that drew a distinct line between policy functions and commercial operations. In financial and network industries, it was necessary to separate policy functions from the operation of commercial SOEs so as to increase the internal efficiency of SOEs as well as the allocation efficiency in relevant markets.

However, Roh Tae-woo administration did not even consider the possibility of installing new governance structures in private firms or SOEs and continued to do business in the old way that passed down from the military dictatorship. Neither Kim Young-sam nor Kim Dae-jung administration attempted to change the governance structure of large firms in the private sector, either, although they took substantial measures to privatize SOEs or to improve the governance structure of SOEs. Roh Moo-hyun and Lee Myung-bak administrations did not attempt to improve the governance structure of large firms in the private sector and reversed much of the changes that took place under Kim Young-sam and Kim Dae-jung administrations in the governance of SOEs.

Except for a brief period of around 7 years during 1996 -2003, the governance structure of large firms in Korea maintained a remarkable stability in both the private and the public sectors. We believe that this stability was due mainly to the fact that the power to make decisions on the governance structures of SOEs and large private firms was by and large in the hands of those who had interests in maintaining the old governance structure. Ultimately, it was the voters' indifference to the issues of governance that was responsible for the persistence of inefficient governance structures as it didn't give politicians a strong incentive to install more efficient structure. The Special Act on Privatization was an exception in the sense that Kim Young-sam administration attempted to make fundamental changes in the governance of large private firms and SOEs even though the general public showed little interest. It was also an example that it was possible to implement a policy that could lead to a long term gain in efficiency even if it was not popular and politically profitable in the short run. On the other hand, the reversal of the policy on the governance of SOEs that occurred under the last two administrations was an evidence that a good policy introduced by an administration could be nullified easily by successive administrations.

The reason that each administration failed to separate the policy functions of the line ministry from the operation of SOEs, which would not only increase the internal efficiency but also allocation efficiency, was mainly due to the opposition from the bureaucracy of the relevant ministries, especially the line ministries. Moreover, the politicians who would make ultimate decisions didn't fully understand the relevant issues. Private firms that had

business interests in SOEs or that competed with SOEs in partially privatized industries also had a keen interest in maintaining the tight control of the government in the industry as they could take advantage of it to their interest.

We believe that Korea needs to change the policies on SOEs as follows:

First, the SOEs and public institutions subject to the Act on the Management of Public Institutions need to be classified differently according to the nature of their businesses.

Second, the SOEs that are classified as commercial enterprises should be subject to the Special Act on Privatization and not the Act on the Management of Public Institutions. The Special Act on Privatization must be amended to install a governance structure in commercial SOEs primarily based on profit incentives and to prohibit the government agencies to use them as policy instruments directly. In particular, the authority of the current line ministry of an SOE, which supervises it, should be abolished. In case the government wants to use an SOE to perform a function that involves loss of money, the government should be required to disclose the policy objective behind the money-losing function to be performed by an SOE, specific actions needed to be taken by the SOE to perform the function, the costs to be incurred by the SOE, and the benefits to the general public as a result of the function performed by the SOE.

Third, SOEs whose shares are partially owned by private investors must have a governance structure prescribed by the company laws, except for ownership ceilings and other measures that are deemed necessary.

Fourth, the agency representing the government as a shareholder of a commercial SOE should not coincide with the line ministry or the ministry which pursues policy objectives that are in serious conflicts with the profitability of the SOE or with efficiency in allocation of the relevant industry. It is also necessary to make it illegal for government officials to intervene in the management of an SOE in order to achieve an objective of their ministry that is not explicitly allowed by laws. It is worth considering establishing a holding company that will own the shares of SOEs currently owned by the government and other SOEs and exercise the shareholding rights. The holding company should be allowed to exercise the shareholding rights exclusively for economic value maximization.

Fifth, policies on competition and regulation of network industries, including electricity, natural gas, water, and railroad, should be changed fundamentally. Governance of SOEs in these industries must be compatible with profit maximization. In particular, SOEs that are competing with private firms directly or through affiliated firms should be allowed to have a similar degree of profit incentive and management autonomy like their competitors. Regulations on tariffs in the monopolistic parts of an industry dominated by an SOE also need to be modified fundamentally based upon fair return and incentive to lower costs.

Lastly, there is a need to form a consensus on the desirable ownership and governance structure of large firms, both in the private and the public sectors, which future administrations should take sustained efforts to install and maintain in large firms that would replace anomalous structures that have dominated large firms in the last half a century. It should be realized that a *chaebol* chairman is only one of minority shareholders who is also a professional manager, and not in the least the owner of affiliated firms. Similarly, it should be understood that the line ministry is not the owner of an SOE. Governance structure of both private firms and large SOEs should be based on the same principle of shareholder value maximization.

There is some room for improvement in the current governance structure of public institutions because they virtually have the same governance structure even though they are quite different in the nature of their functions. For instance, it is difficult to imagine that the same governance structure and performance evaluation mechanism that work well for hospitals will work well for research institutes which develop economic policies. Even for a group of public institutions that perform similar functions, applying the same governance structure can lead to an inefficient outcome by failing to reflect the differences in the quality of work required by different institutions that perform different functions. Therefore, there is a need to classify public institutions further and apply different governance structures that are tailored to each sub group.

The past and current policies that Korea has adopted in the last half a century have following implications for developing countries, especially those in Asia:

First, it is crucial to distinguish the goods and services whose production and sale can be done better when private firms do from the goods and services for which production by the government is more efficient, and to realize that the first group of goods and services should be produced by profit seeking firms as soon as possible. The government businesses or SOEs that produce the goods and services belonging to the first group should be regarded as commercial firms in which the government accidentally owns the shares that would be turned over to private investors when privatization becomes a feasible option. These entities should be allowed to operate based on profit incentives as much as possible without the interference of policy functions.

Second, the government should try to privatize commercial SOEs as early as possible if the privatization doesn't bring any significant side effects. Smaller SOEs should be privatized as soon as possible, too.

Third, it is important to understand that successful privatization of large SOEs requires many conditions such as the development of the capital market including the stock market, the establishment of an efficient governance structure for large firms in the private sector as

well as in banks and financial institutions, and effective regulation on financial institutions, and effective law enforcement, which takes a long time. The government must have a well-organized plan to achieve these conditions before privatizing large SOEs. Moreover, it is crucial to assign appropriate roles to various ministries and government agencies that are in line with achieving these conditions. Maintaining the balance of power among other stakeholders, including labor and new industrial capital, is also important. More fundamentally, establishing a political structure that is compatible with a market based economic system is needed to establish an efficient governance structure in SOEs.

Fourth, it is important for the decision makers within the government to understand that scattered ownership is an inescapable fact of life when it comes to large private firms, except in exceptional cases. In other words, they need to focus on a set of governance structures that are based on scattered ownership structure in trying to design an optimal governance structure for large firms. The Special Act on Privatization, which envisaged such a governance structure in large commercial firms for the first time in Korea, can serve as a good model for developing countries. Golden share used by U.K. could be another good model.

Fifth, it is important to establish a profit-oriented governance structure in commercial SOEs whose privatization is desirable but takes time due to constraints, such as the weak financial market, prior to privatization. Holding company system, such as Temasec in Singapore, can be a good model for this. The Special Act on Privatization is less effective in inducing efficiency of SOEs than the Temasec system, but can still be used as a good model for countries that have problems with holding company approaches.

Sixth, it is important to design a policy on the ownership and governance of SOEs along with competition policy, industrial policy, and regulatory policy as a package to ensure that they are compatible with one another in order to induce an efficient outcome. In particular, allowing private firms to enter an industry that has been an SOE monopoly should be accompanied by privatization of the SOE. If privatization of a large SOE is not feasible for some reasons at the time of introducing competition into the relevant market, the government should install a governance structure in the SOE that is comparable with that of private firms. Allowing entry by private firms without privatization or establishing a governance structure based on strong profit incentives is likely to result in inefficient outcomes. Failure to establish a regulatory scheme that is based on fair return on investment and incentives to lower costs will also lead to large inefficiency and a large fiscal burden on the government. Korea's experience with the telecom and electricity industries can be a good example that should be avoided in developing countries.

Seventh, developing countries that are in the infant stage after giving up the socialist system could benefit from adopting a governance structure given by the Framework Act on the Management of GIIS Korea introduced in 1983.

Lastly, for public institutions which supply services that have few commercial elements and that are closer to the services provided by the government itself, the governance structure prescribed by the Act on the Management of Public Institutions Korea introduced in 2007 can be a reasonably good model, although it should be taken with a grain of salt.

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