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Abstract

The purpose of this study is to introduce the postal savings system and FILP (fiscal investment and loan program) in Korea. Korea's postal savings system was introduced, following the success of Japanese experience in terms of raising household savings in rural areas where commercial banks could not reach out.

Korea's postal saving was different from that of Japan in that postal savings in Korea was not as big as in Japan, both in absolute and relative terms, and it was not as the most important financing source of Fiscal and Investment Program as in Japan, even though it used to be one of major financing sources for the program. However, since the economic crisis, postal savings system in Korea has become to attract more special attention both from financial sector and government.

This paper is to explain and analyze what role the fiscal investment and loan program and postal savings system has played respectively in the past, how those two have been changed so far, and in which direction those two are expected to be developed in the future. Additionally empirical analysis shows that the accessible convenience of post office branch and the stability seeking behavior have a positive impact on the growth of postal savings.

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1. Introduction

The postal saving system of the Ministry of Information and Communication and Fiscal Investment and Loan Program (now Fiscal Loan Program since 1997) of the Ministry of Finance and Economy are very similar to those of Japan, in that the government has been involved in financial intermediation through those two. In Korea, the postal savings system was originally introduced in 1962 with enactment of the Postal Savings Law, and then postal banking business was maintained under the control of the Ministry of Communications then up until the law was abolished in 1977. Korea's postal savings system was introduced, following the success of Japanese experience in terms of raising household savings in rural areas where commercial banks could not reach out. But Korea's postal saving was different from that of Japan in that postal savings in Korea was not as big as in Japan, both in absolute and relative terms, and it was not as the most important financing source of Fiscal and Investment Program as in Japan, even though it used to be one of major financing sources for the program.

In 1961 the Ministry of Communications then introduced the postal banking business, but gave up the business mainly because it could not cope with continuing losses from the business. As a result, with abolishment of the law, the business was taken over by the National Agricultural Cooperative Federations along with remaining balances and 2,400 employees. After then, the Ministry of Communication again enacted the Law of Postal Savings and Insurance in 1982 and it began to resume the postal banking business from July 1983.[1] Even after reintroduction, the postal savings was still small and did not account for a fairly large share in financial market, only less than 2 % until late 1990s. But, in the late 1990s, financial crisis shocked the Korea's financial market and damaged financial industry with closing of several commercial banks and a number of financial institutions. As a result, the postal saving's share in saving deposits has increased from less than 2.6% in 1997 to more than 4.2 % in 2001. Since 1983 when the postal savings system was reintroduced until 1996, the year right before the economic crisis broke out, the size of postal saving relative to saving deposits of commercial banks remained at a low level and even decreased. But, the importance of postal saving has increased sharply since the crisis, becoming a safe place of savers' deposits, competing with other financial institutions including commercial banks and consumer credit institutions mainly because

[1] When the Ministry of Information and Communication reintroduced postal saving system, the National Agricultural Cooperatives Federation opposed to and still critical of postal savings system because postal savings system and the banking business of the federation were competitive with each other mainly in agricultural areas. The ministry restarted the postal banking business mainly because it was needed to fill up shortage of financial resources in carrying out postal services businesses. And because the postal saving service was reintroduced for providing jobs for surplus manpower resulting from handover of telegram and telephone service of the ministry to newly established public corporation, Korea Telecom.

saving deposit at post office is fully guaranteed by the government.

Since the economic crisis, postal savings system in Korea has become to attract more special attention both from financial sector and government. On the one hand, since 1997 when its size has been increasing and expanding its business areas related to banking business and has become to be a strong competitor to commercial banks and other types of consumer credit institutions. The postal savings used to be a direct major source for fiscal investment and loan program until 1994 when the new public capital management system was introduced. Even after the reform, postal savings has become an important financial source of public fund management special account that provides financial resources for fiscal loan program.(fiscal investment and loan program until 1996). On the other hand, after the economic crisis, by the agreement with IMF, Korean government has stopped mobilizing financial sources from the National Pension Fund for fiscal loan program and therefore, surplus of postal saving could become a new financial source for the Fiscal Investment and Loan program, not through direct but through indirect channel. Considering the fast growing trend of postal savings in Korea, it will become to be one important but a controversial issue in the near future. This paper is to explain and analyze what role the fiscal investment and loan program and postal savings system has played respectively in the past, how those two have been changed so far, and in which direction those two are expected to be developed in the future.

2. Fiscal Investment and Loan Program (FILP)

2.1 Fiscal Investment and Loan Program

Korean economy has rapidly growing from the ashes of the Korean War since 1953 when the war ended and then it has maintained rapid growth since early 1960s until 1990s. Since then, the government played a leading role in rebuilding shattered national economy and continuing growth of the economy and Fiscal Investment an Loan Program(FLIP) has supported the government role during this long period. FILP of Korea has gone through several major reforms since it was introduced as a major policy arm of fiscal involvement in national economy and is playing an important role of providing financial resources to government-implementing or –supporting projects. During the past five decades, FILP has been in an important position as a major fiscal involvement in development and growth of national economy. (But, it would be difficult to clearly define the range of FILP of the government because the program has been spread among different accounts ranging from general account to a number of special accounts. And Korean government has changed the system through which FILP has been implemented. At the beginning stage, fiscal loan program was implemented within special account of the central government, leaving fiscal investment within the general account.) Then both fiscal loan and fiscal investment program was implemented within one special account for a while, and then went back to the separating system.)

FILP was introduced in 1953 when the Korean economy after the Korean War was badly in need of reconstruction. Right after the war, Korean economy could not mobilize domestic financial resources for fiscal investment then and, therefore, financial resources for fiscal investment for post-war reconstruction mainly depended on economic aid from abroad until early 1960s. Especially FILP played an important role during the economic development period of 1962-1973. In the early 1960s', the new administration planned to drive economic development plan under the government initiative, recognizing the role of fiscal investment and loan and its expansion. But, in the 1950s', fiscal investment and loan was mostly financed by the foreign economic aid and, there was not available domestic sources for it. Therefore, in 1961, the government enacted "Fiscal Fund Management Act" and "Fiscal Fund Management Special Account act' to provide financial sources for fiscal investment and loan program. Revenues of fiscal fund special account came from general account of the central government, deposits from the special account for public employees' pension and revenues of the government's monopoly business. In 1963, the government introduced 'Economic Development Special Account,' and this special account provided financial resources for fiscal investment and loan program. The 'Fiscal Fund Management Special Account' and 'Economic Development Special Account' mainly dealt with fiscal loan and investment program respectively. The revenues of fiscal fund special account came from surplus fund from various special accounts of the central government, while that of economic development special account from transfer of general and special accounts. As expanded the size of fiscal investment and loan program, the government could not meet the fast growing demand for fund. And from 1966 the government began to mobilize financial resources from public foreign loan fund and loan for claim to Japan, expanding the size of fiscal loan. From 1968, financing from counterpart account began to decrease and transfer from general account of central government stopped and instead fiscal investment and loan program became to be heavily dependent on fast expanding public foreign loan fund.

During the period of 1974-1976, financing resources for the fiscal investment and loan program was integrated into the 'Economic Development Special Account' which provided financial resources both for fiscal investment and loan projects under FILP. There were three accounts within the special account, i.e., investment, loan, and counterpart fund account and, among those three accounts, the investment account was for fiscal investment and the other two accounts for fiscal loan program. The government tried to raise efficiency of fiscal investment and loan program by managing the available financial resources within one special account. Three accounts within the economic development special account had sought revenues from different sources. Investment account secured revenues from transfer of general account and some deposits from special accounts, counterpart fund account from withdrawal of counterpart fund, and loan account from payment of fiscal loan and some deposits from special accounts.

During 1977-1987, the role of fiscal investment went back to the function of the general account of

the central government and the remaining fiscal loan program was implemented within the 'Fund Management Special Account' that was introduced in 1977. Through 1977 reform of FILP, the government intended to link available financial sources to the fiscal loan program. FILP was implemented by the two-tier system until 1988 when the Fiscal Investment and Loan Special Account (FILP Special Account) was introduced to carry out both fiscal investment and fiscal loan program within one special account. There have been some important reasons for 1988 reform of the program. First, since 1988, the government tried to change its policy of involvement in national economy from direct to indirect method. Second, as public fund available, from the sale of government-enterprise stocks and surplus fund from government employee pension, expected fund from the newly-fledged national pension system, and postal saving and insurance, expanded, it was needed for government to utilize the growing available public fund in a more efficient way.

FILP Special Account was introduced to provide stable supply of financial resources necessary for FILP for government-related projects. The FILP Special Account is to foster public investment in which the government is directly or indirectly involved. The FILP Special Account has been worked as an effective vehicle for encouraging public investment on important sectors of national economy such as infrastructure and key industrial sectors. FILP Special Account was introduced as a substitute for the already abolished Fund Management Special Account to strengthen consolidated operation and management of fiscal resources and respond effectively to increasing demand for social development and social overhead capital. After its establishment, the special account played a key role in helping capital formation, industrial revitalization, progress of technological innovation, and exerted a significant impact on economic activities of various sectors. The most of the revenues of the special account comes from sale of government stockholding, postal saving, transfer from public funds, and bond issuance. These funds are used for various objects and can be grouped into the following categories: 1) agriculture, forestry and fishery, 2)industry, 3) technology, 4) transportation, 5) energy, 6) housing, 7) others.

Since its introduction, FILP has maintained its basic role and functions, but the vehicle through which it is financially supported within the government budget system has been changed in name and financial sources. Until 1970, due to the lack of financial resources within the public sector, FILP was mainly supported by the counterpart fund coming from the U.S.A. for the purpose of stabilization of fiscal and financial situation in Korea. After then, the major sources for FLIP came from the public loan from international agencies between the early 1970s and mid of 1980s. Only since mid of 1980s, FILP was supported by the general account of government budget and public funds and then the public management fund has became the major financial sources for FILP since 1995.

FILP Special Account consists of three accounts; Fiscal Investment Account, Loan Account, and Foreign Loans Account. Fiscal Investment Account is responsible for investment on government-invested institutions and financed largely by the sale of government stockholdings. Loan Account

makes loans to government and private sector using revenues generated by public funds, postal saving and others. This is primarily designed for making loan redemption and deposits on Loan Account. The special account was consisted of three accounts, investment, loan and foreign loan and the investment account was responsible for investment and contribution of the government. The loan account was responsible for providing loans for agriculture, forestry and fishery industry, regional development, technological development, SOC projects by using the surplus funds from special accounts, public funds, and revenues from bond issuance.

Table1. Areas of Fiscal Loan Program (1985-1993)

(unit: 100 million won, %)

	1985	1986	1987	1988	1989	1990	1991	1992	1993 (budget)
Agriculture Forestry, Fishery	1,343 (27.4)	1,859 (32.8)	2,329 (35.2)	4,341 (34.3)	2,673 (15.3)	2,920 (18.1)	2,747 (20.0)	1,590 (12.9)	1,825 (16.7)
Commerce & Economic Cooperation	150 (3.1)	520 (9.2)	920 (13.9)	3,170 (25.1)	4,130 (23.6)	4,110 (25.5)	5,090 (37.1)	3,375 (27.4)	4,650 (42.7)
Transportation	2,821 (57.5)	2,427 (42.9)	2,252 (34.0)	1,977 (15.6)	6,606 (37.7)	7,453 (46.3)	4,668 (34.0)	5,700 (46.3)	4,165 (29.0)
Mining & Energy	87 (1.8)	284 (5.0)	30 (0.5)	312 (2.5)	-	104 (0.6)	125 (0.9)	157 (1.3)	155 (1.4)
Housing & Sewage	443 (9.0)	520 (9.2)	860 (13.0)	2,419 (19.1)	3,060 (17.5)	720 (4.5)	-	-	-
Environment & Social Welfare	63 (1.3)	50 (0.9)	200 (3.0)	400 (3.2)	889 (5.1)	538 (3.3)	891 (6.5)	1,304 (10.6)	827 (7.6)
Others	-	-	28 (0.4)	30 (0.2)	150 (0.9)	252 (1.6)	192 (1.4)	190 (1.5)	280 (2.6)
Total	4,906 (100)	5,660 (100)	6,619 (100)	12,649 (100)	17,508 (100)	16,099 (100)	13,714 (100)	12,316 (100)	10,902 (100)

Source: Ministry of Finance, *White Paper on Fiscal Investment and Loan Program*, 1993.

2.2 FILP and Postal Savings

Postal savings deposits available had been directly trusted to FILP Special Account as a major financial source until 1994 when Public Management Fund(PMF) was created to provide financial resources to FILP, with revenues coming from a various number of special funds and general revenues. But, since 1994, the surplus fund of the postal saving deposit has been once transferred to the PMF, which in turn provides financial resources to FILP Special Account. In 1994, the surplus resources of the postal saving, up to 80 % of it, was supposed to be transferred to the PMF that is used for fiscal loan program. But, in a broader term, the FILP is implemented not only through FILP Special Account but also through other special accounts and special public funds. In 1988, the total expenditure,

through FILP Special Account and other special public funds, amounts to 36,090 million won and, among the amount, the FILP Special Accounts for 53.1% and other special accounts and public funds does 46.9%. Relative to general budget expenditure, the total expenditure of FILP was 24.2% and that of FILP Special Account was 7.7%. The relative size of fiscal investment and loan through FILP Special Account among the total FILP expenditure increased to more than 68% But, in 1997, the government reformed the FILP Special Account and made the special account only responsible for fiscal loan, changing the name of the account from FILP Special Account to Fiscal Loan Special Account. And the general account again has become responsible for fiscal investment just like before the introduction of FILP Special Account in 1988. And the share of Fiscal Loan Special Account among total fiscal loan program then rapidly increased to 88 % in 1999 and since then the most of the fiscal loan program expenditure has been implemented through Fiscal Loan Special Account.

2.3 Impacts of FILP

In 1950s, the Fiscal Investment and Loan Program was focused on recovery from the war and reconstruction of national economy, while in 1960s, the program was on economic development as the Korean economy launched its economic development plans. But, in 1980s, the program contributed to social welfare development along as economic development. Role of and emphasis of the program have been changed as each period needed different role of the government sector. In 1950s ad 1960s, there was no available domestic resources, the program had to depend on foreign economic aid for economic recovery from the war. In 1960s and 1970s during which economic development was carried out by the government initiative, the program still had to rely on financial resources from foreign public loan, counterpart fund, compensation fund from Japan, and foreign savings due to a very limited availability of domestic resources in private sector. During this period, the government had heavily involved in continuing economic growth with the program mainly focusing on expanding social overhead capital and supporting build up of key industries. In 1983-1987 during which the fifth economic development was implemented, share of economic development, among those areas FILP supported, decreased while that of social development increased. During these periods, the FILP was used as a major policy instrument of the government in the stage of planning and implementing economic development plans and in this sense the program could be acknowledged for its role.

But some problems have been constantly raised related to government's involvement in national economy and economic development process through FILP. One is that there has existed too much diversification of channels for fiscal loan, to a serious degree, which has caused difficulty of mobilizing financial resources in a consistent and efficient way. Second problem related to FILP is absence of flexibility with management of government budget account mainly due to that FILP has not been managed to accommodate economic fluctuations. Third, during the past forty years, special public funds, major fund source for FILP, have been rapidly growing in size and numbers and,

furthermore, they have been managed off budget that has not been under the control of national assembly. And lastly, the surplus fund of public funds used to be deposited, by the law, for financing FILP. Even after the fiscal investment has been reduced to a minimal level within the general account of the central government, fiscal loan program is still implemented within the Fiscal Loan Special Account. But, it has been criticized that the limited financial resources occupied by the government sector have not been used according to economic efficiency criteria, rather allocated according to political ones.

Table2. Fiscal Loan Program(Fiscal Loan Special Account)(1998-1999)
(billion won, %)

	1998	1999
Sources	9,778.9(100.0)	13,339.1(100.0)
1)General account	4,598.9(47.0)	8,539.3(64.0)
2)Pension, special Funds, & special Accounts	5,080.0(51.9)	4,501.5(33.7)
3)Others(including Repayment of loan)	100(1.1)	298.3(2.3)
Disbursements	9,778.9(100.0)	13,339.1(100.0)
1)Restructuring Of financial Market	3,600.0(36.8)	6,851.2(51.36)
2)Assistance to Rural & Fishery Households	2,095.7(21.4)	1,812.9(13.59)
3)Improvement of Transportation of commodities	13.85(0.1)	18.28(1.37)
3)Small business & Industry	1,353.5(13.8)	1,323.1(9.91)
4)Technology & Information	83.3(0.8)	201.5(1.51)
5)Housing & Regional Development	863.5(8.8)	743.4(5.57)
6)Purchase of	1,100.0(11.2)	900.0(6.74)

Municipal Bonds		
7)Social Security	334.6(3.4)	104.0(0.79)
8)Environmental Improvement	58.l0(0.6)	54.0(0.4)
9)Local Education	-	900.0(6.74)
10)Cultural Industry		3.0 (0.02)
11) Others	151.8(1.6)	263.2(1.97)

3. Postal Savings System

3.1 Postal Savings

Postal savings, reintroduced in 1983, remained small in relative size in financial market until 1998 when the economic crisis hit financial market and brought a number of financial institutions including commercial banks into bankruptcy. Since the economic crisis, postal savings deposit has maintained high growth rate and, as a result, has also increased its share in terms of amount of deposits of all financial institutions. Postal savings was only 2,800 billion won in 1990, 7,800 billion won in 1997 but increased to 30,750.5 billion including Repurchase Agreements(RP) in 2002.[2] Amount of postal savings deposit increased 11 times and 3.9 times compared to 1990 and 1997 respectively. Postal saving deposit has increased rapidly since the economic crisis mainly because deposit banks have suffered from non-performing debt and week financial soundness and, therefore, deposits at financial institutions including deposit banks and other consumer credit banks are no longer guaranteed under the protection of the government. While only 20 million won per person of savings deposits at financial institutions has been under protection of deposit insurance since 2001, all the deposit at postal saving system and its interest have been fully guaranteed by the government, according to article 4 of the 'Postal Saving and Insurance Act'. Compared to deposit at other financial institutions, postal saving provides full safety to depositors. And some types of savings at other financial institutions, such as foreign currency saving deposit, CD (certified deposits), development trust at deposit banks and deposits for stock purchasers at stock brokerage and investment companies, are no longer even under the partial protection of deposit insurance system.

Postal savings services can be widely used all around the country because post offices have been maintained almost every corner of the country, especially in remote areas including rural areas where commercial banks cannot maintain their branch offices due to lack of profitability. Even after the economic crisis, the number of post offices has not been decreased, commercial banks, along other

[2] If including postal transfer & postal money order, the amount becomes larger, 31,703.5 billion won in 2002.

financial institutions, have been forced to pull out of the country side due to restructuring process. As a result, the postal saving system has advantage over other financial institutions, especially commercial banks, in network infrastructure. In 1983 when postal saving services was restarted, the number of post offices were 2,184 and then has increased to 2,785 in 2001 and compared to that before the economic crisis post offices just decreased by 88 offices. In 1997, just before economic crisis, branch offices of deposit money banks were 7,546, but it has decreased to 6,109 in 2001 as a result of restructuring of the Postal Services Office. At the same time, post office also has expanded its banking services including postal insurance, credit card, e-banking services, and money order and exchange services by linking its network to banking network. Post banking services has become more competitive threat to deposit money banks. Post office has maintained its offensive marketing strategy after restructuring banking industry following the economic crisis both by offering expanded banking services and emphasizing security of postal savings compared to deposit money banks.

In July 2000, the Ministry of Information and Communication established the Office of Postal Services that is responsible for postal banking services as well as mailing businesses. The office has put banking services together with information technology and has launched aggressive strategy in banking services.

Table3. Ratios of Post Office to Bank Branch Office by Region (1983-2001)

(unit: %)

Ratios(1983)	Ratios(1989)	Changes in Rations(1983-`1989)	
Overall	94.3	70.5	-23.9
Seoul	17.4	15.8	-1.6
Busan	27.2	29.7	2.5
Daegu	30.3	29.7	-0.6
Incheon	32.9	33.3	0.4
Gwangju[1)]	0.0	45.1	45.1
Daejeon[1)]	0.0	44.9	44.9
Ulsan[1)]	0.0	0.0	0.0
Gyeonggi	171.6	92.7	-78.9
Gangwon	176.5	173.1	-3.4
Chungbuk	217.9	180.0	-37.9
Chungnam	207.3	242.4	35.0
Jeonbuk	214.8	184.8	-30.0
Jeonnam	211.8	252.7	40.9
Gyeongbuk	298.0	232.3	-65.6

Gyeongnam	183.3	135.7	-47.6
Jeju	75.5	71.4	-4.1

	Ratios(1990)	Ratios(2001)	Changes in Rations(1990-`2001)
Overall	65.3	45.6	-19.7
Seoul	15.1	11.4	-3.8
Busan	29.4	27.5	-1.9
Daegu	27.8	30.3	2.6
Incheon	30.8	31.6	0.8
Gwangju	41.1	33.5	7.6
Daejeon	44.9	39.1	-5.8
Ulsan[1)]	0.0	35.5	35.5
Gyeonggi	80.5	36.3	-44.2
Gangwon	164.3	125.5	-38.8
Chungbuk	166.3	120.3	-45.9
Chungnam	216.5	145.5	-71.0
Jeonbuk	177.3	123.0	-54.4
Jeonnam	237.2	176.4	-60.8
Gyeongbuk	213.5	138.4	-75.1
Gyeongnam	121.7	98.0	-23.7
Jeju	61.1	52.0	-14.1

[1)] Post offices of Gwangju, Ulsan, Daejeon were included in the region that they belonged to before they became independent metropolitan city. This shows that ratios are zeros in some years.

Table4. Share of Postal Savings to Total Deposit

Year	Postal Savings	Total Deposit[1)]	Share of Postal Savings (%)
1983	289.9	24197.5	1.2%
1984	535.2	28460.3	1.9%
1985	887.8	38486.8	2.3%
1986	1146.5	45624.4	2.5%

1987	1784.6	59197.9	3.0%
1988	2339.2	75223.4	3.1%
1989	2181.8	89270.6	2.4%
1990	2722.0	113941.9	2.4%
1991	3121.1	136950.3	2.3%
1992	3521.1	152455.1	2.3%
1993	4517.8	167281.7	2.7%
1994	5589.4	194716.3	2.9%
1995	5828.6	225063.6	2.6%
1996	6788.3	267259.6	2.5%
1997	7831.1	297419.2	2.6%
1998	15201.1	357360.3	4.3%
1999	15113.2	436714.3	3.5%
2000	20579.5	530994.8	3.9%
2001	25270.0	596067.3	4.2%

1) Total deposit includes life insurance.

3.2 Postal Insurance

The funds seeking stability since the crisis has rushed into postal insurance because the principle in postal insurance is also guaranteed fully by the government.

Table5 shows an increasing trend of postal insurance in size, for example, premium ratio of postal insurance relative to life insurance has increased from 5.8% in 1997 to 11.9% in 2001 and reached at the peak of 16.9% in 2000.

Table5.Postal Insurance and Life Insurance (unit billion won)

	Postal Insurance				Life Insurance	Raio
	(Premium Written)(a)	(Business in Force)	(New Business)	(Total Assets)	(Premium Written)(b)	(a/b)
1997	2,832	13,675	5,743	5,963,	48,955	5.8%
1998	3,520	16,979	9,152	6,649	46,390	7.6%
1999	4,816	28,009	16,462	9,159	46,755	10.3%
2000	8,729	47,913	26,451	14,779	51,653	16.9%
2001	5,648	62,699	22,536	17,739	47,364	11.9%

Source: Korea Life Insurance Association, Korea Post

Comparing management efficiency of postal insurance with life insurance, new business ratio of postal insurance

also has kept increasing faster than that of life insurance. Investment profits of life insurance were bigger than those of postal insurance until 1999 but in 2000 and 2001, investment profits of postal insurance has improved compared with that of life insurance. It is expected that postal savings and insurance has kept growing because of accessible convenience through nation-wide branch and full guaranty by government.

Table 6-1. Management Efficiency of Postal Insurance

(ratio)	New Business	Lapse & Surrender	Claims Paid	Operating Expenses	Investment Profits
1997	49.1	14.2	82.5	5.8	10.7
1998	66.9	18.6	90.1	5.2	10.9
1999	97.0	11.8	58.5	5.1	10.6
2000	94.2	8.8	37.3	4.1	5.9
2001	47.0	7.2	70.6	6.9	8.5

Table 6-2. Management Efficiency of Life Insurance

(ratio)	New Business	Lapse & Surrender	Claims Paid	Operating Expenses	Investment Profits
1997	55.5	28.1	84.1	14.6	11.0
1998	51.0	29.4	98.4	10.5	11.6
1999	42.6	20.5	90.6	9.1	11.0
2000	42.4	15.9	80.1	8.6	4.6
2001	43.2	13.9	72.6	9.4	6.4

Source: Korea Life Insurance Association, Korea Post, Korea Financial Supervisory Service

3.3. Impact of growth of postal savings and financial market

As postal savings system has grown rapidly in size since the economic crisis, its role, as a financial source, has also grown out of rural areas into metropolitan cities and from short-term financial source to stable long-term financial source. The postal savings system has occupied an important position in financial market. As its size has grown, postal savings system has become a strong competitor even to commercial banks as well as other financial institutions such as agricultural cooperative and other consumer credit banks because postal savings are not strictly constrained by profit rate as other financial institutions. As postal savings also is not constrained by cost concept when it does banking business, postal savings usually has shown the pattern of adjusting interest rate for deposit following commercial banks.

Looking at the investment aspect, postal savings have been an important source of government funding. Postal savings used to deposit money to Fiscal Loan Special Account until 1998. Also, funds from postal savings are invested in government bonds and deposited at other financial institutions such as trust accounts of commercial banks. The funds invested in government bonds and Fiscal Loan Special Account are used for government projects such as social infrastructure investment planned within the government programs. And funds deposited at other private financial institutions are used as financial source of industries of private sector, helping funding private projects as well as public projects. The funds of postal savings deposits used to be supporting public welfare purpose, such as revenues source of FILP or Public Fund Management, purchase of government bonds, or financial resources supporting small business. More than 70% of the available funds had been used for public welfare purposes before the economic crisis, but its share has decreased to just more than 40% after the economic crisis. At the same time, fund operation has been trusted to financial institutions for investment in financial market. Before the economic crisis, less than 30% of the total available fund in 1997 was trusted to financial institutions, but its share has increased to more than 50 % in 2002.

Postal savings has been re-deposited a fairly large share of funds available for investment to other financial institutions including commercial banks and investment banks. More than half of the funds available have been re-deposited at other financial institutions since 1998. Office of Postal Services has managed a fairly large amount of through commercial and investment banks, implying that the office does invest, in an indirect way, their funds through those financial institutions. This position of investment of postal savings fund might cause two problems. As the size of postal savings has increased rapidly, postal savings has become the largest depositor for commercial and investment banks and, therefore, its position for fund investment can give great impact on each individual bank, especially investment banks, with its deposit and fund balance. And postal savings fund is also invested in public bonds and bank debenture in primary and transaction market without trusting to investment intermediaries. As a result, postal savings investment in public bonds and financial securities is expected to affect interest rate of those securities if the size of investment increases and accounts for a large share of securities market. Depositing a large share of usable fund at other financial institutions makes higher intermediation fee of financial transaction.

As postal savings increases in size and its influence becomes stronger in financial market, it has caused the trouble for some local area-based small consumer's financial institutions. On the one hand, those small consumers' financial institutions have been weakened their marketing ability due to restructuring of financial market since the economic crisis, on the other hand they have been facing very aggressive marketing of postal savings system. Compared to 1997 before the economic crisis, among those community-based small financial institutions, such as mutual investment bank, mutual credit union, credit cooperative, Saemaul credit union, deposit of postal savings increased from 4.5 % to 9.8% at the end of 2000. During this period, deposit of postal savings increased by 55.6%, far

exceeding other community-based small financial institutions. And, funds from postal savings are usually under the central management of capital city, not locally managed to meet the demand for the loan of the local community, impeding vitalizing local money market. As a result, the local residents and small and medium-sized business firms have been under credit crunch and the demand for credit for those has to be met by commercial banks.

The postal savings becoming large relative to money market has made the monetary policy under the control of the central bank less effective. Postal savings are not subject to minimum reserve requirement unlike commercial banks and are not linked to monetary policy authority both in sources and operations of funds. As a result, postal savings are out of reach of the monetary authority and therefore, out of monetary policy. When its size was small relative to that of financial market, being out of control of the monetary authority was not very serious problem from the perspective of central bank responsible for monetary policy. But, as its size becomes larger, postal savings will be a major factor making the monetary policy less effective. Especially, when the postal savings authority changes its deposit system or fund management position, postal savings system might be able to cause irregularities to financial market. According to the current law, the postal savings are not under control of supervisory authority of banking industries and the authority is not able to bring it under control.

Table 7. Fund Investment of Postal Savings
(1991-2002)

(unit:100 million Won, %)

Classification	1991	1992	1993	1994	1995	1996	1997
○ Public Welfare Purpose	25,176	27,990	31,874	42,756	46,688	57,202	63,880
	(65.97)	(61.77)	(59.67)	(61.39)	(68.61)	(72.66)	(72.40)
i)FILP & PFMF	7,930	10,800	13,600	18,100	21,150	25,406	30,937
	(20.78)	(23.83)	(25.46)	(25.99)	(31.08)	(32.27)	(35.07)
ii) Small Business	0	0	0	5,137	10,279	16,982	16,475
	(0.00)	(0.00)	(0.00)	(7.38)	(15.11)	(21.57)	(18.67)
iii)Government Bonds	14,869	14,377	14,474	15,509	11,159	10,414	11,668
	(38.96)	(31.73)	(27.10)	(22.27)	(16.40)	(13.23)	(13.22)

iv) Trust to Local Post Office	2,377	2,813	3,800	4,010	4,100	4,400	4,800
	(6.23)	(6.21)	(7.11)	(5.76)	(6.03)	(5.59)	(5.44)
○ Financial Institutions	10,643	13,662	19,570	23,179	19,228	19,302	21,891
	(27.89)	(30.15)	(36.64)	(33.28)	(28.26)	(24.52)	(24.81)
○ Others (including Cash)	2,346	3,664	1,972	3,708	2,128	2,225	2,456
	(6.15)	(8.09)	(3.69)	(5.32)	(3.13)	(2.83)	(2.78)
Total	38,165 (100.0)	45,316 (100.0)	53,416 (100.0)	69,643 (100.0)	6,804 (100.0)	78,729 (100.0)	88,227 (100.0)

Classification	1998	1999	2000	2001	2002
○ Public Welfare Purpose	62,358	70,368	90,740	147,475	143,265
	(45.91)	(42.11)	(37.04)	(48.60)	(45.19)
i) FILP	5,600	-	-	-	-
	(4.12)	(0.00)	(0.00)	(0.00)	(0.00)
-ii)PFMF	30,187	45,349	59,287	92,814	99,899
	(22.22)	(27.14)	(24.20)	(30.59)	(31.51)
iii)Government Bonds	21,271	18,819	24,853	48,061	36,766
	(15.66)	(11.26)	(10.15)	(15.84)	(11.60)
iv) Trust to Local Post Office	5,300	6,200	6,600	6,600	6,600

	(3.90)	(3.71)	(2.69)	(2.18)	(2.08)
○ Financial Institutions	64,795	89,673	146,150	147,852	168,025
	(47.70)	(53.66)	(59.66)	(48.73)	(53.00)
○ Others	8,688	7,077	8,073	8,093	5,745
	(6.40)	(4.23)	(3.30)	(2.67)	(1.81)
i)Overdraft for household checking account	794	977	2,096	1,507	874
	(0.58)	(0.58)	(0.86)	(0.50)	(0.28)
ii)Cash	7,894	6,100	5,977	6,586	4,871
	(5.81)	(3.65)	(2.44)	(2.17)	(1.54)
Total	135841 (100.0)	167118 (100.0)	244963 (100.0)	303420 (100.0)	317035 (100.0)

Source: Special Committee of Budget and Accounts, National Assembly of Korea

4. Regional Panel Data Analysis Based on Branching Effects

When households decide to deposit their money at financial institutions, they think high of the convenience of accessibility to each branch. Because branching improves convenience resulting from the increased number of financial facilities, which cut down the transaction cost in obtaining financial services. Most studies show the empirical relationship between branching and convenience. However, this paper sets up a simple model that can explain savings behavior of households in the consideration of two transaction costs, the trip cost and the opportunity cost of holding money. Here the accessible convenience is measured as the branch number of each financial institution. The feature of this model assumes that savings behavior of households depends on the number of branch as well as income and the interest rate as usually theory predicts. More branches can be expected to have a positive impact on the demand for savings.

Looking at the outstanding of individual' financial assets in 2001, financial assets consists of 4.45% cash and transferable deposit, 44.78% time and savings deposit, 27.28% life insurance and pension funds, 13.66% securities, and 10.39% stocks. The share of deposits at financial institutions is almost

50% and life insurance and pension funds also occupy a large share of individual financial assets.

Table8. Individual Financial Assets Outstanding

	Cash(Transferable Deposit)	Time & Savings Deposit	Life Insurance(Pension Funds)	Securities	Stocks
1996	5.64	29.75	31.66	21.77	11.18
1997	4.29	30.69	32.36	21.48	11.19
1998	3.59	31.81	28.14	25.29	11.17
1999	4.55	36.39	27.24	20.34	11.48
2000	4.26	43.93	27.31	14.10	10.39
2001	4.45	44.78	27.28	13.66	9.83

Source: Bank of Korea, Flow of Fund Table

4.1 Savings Behavior with Transaction Costs

Assuming that households maximize their expected utility function considering transaction costs. Here the optimal saving means the one that maximizes the household's consumption. Saving defines the income minus optimized consumption. Suppose that household's preference over consumption in each time is additively separable expected utility function. At the beginning of period, the household gets labor income, and chooses consumption as follows, and saving is determined after households optimize their objective function.

$$Max \quad U = u(C_t) + \beta u(C_{t+1}) \quad \text{---1)}$$
$$s.t. \; A_{t+1} = (1+r_t)(Y_t - C_t) \quad \text{---2)}$$
$$C_{t+1} + TC \le (1+r_t)(Y_t - C_t) + Y_{t+1}$$

Using the optimality condition after solving the above maximization problem, consumption function is obtained as

$$C_t(Y_t, Y_{t+1}, TC, r_{it}) \quad \text{---- 3)}$$

Then saving function is also determined as

$$S_t = Y_t - C_t(Y_t, Y_{t+1}, TC, r_t) = S_t(Y_t, Y_{t+1}, TC, r_t) \quad \text{---- 4)}$$

C_t : consumption at t C_{t+1} : consumption at t+1 Y_t : income at t
r_t : interest rate TC : transaction cost

Simultaneously households minimize the transaction cost in order to maximize their utilities. The transaction cost consists of two parts, time cost of trip to each branch and the foregone interest, that is,

the opportunity cost of holding money for transaction.

$$\min : w\tau + rm \quad \text{---5)}$$

$$s.t : \tau = \frac{1}{m}\frac{1}{BN} \quad \text{---6)}$$

The households optimize their transaction cost function and to choose the optimal real money holdings $m^* = \sqrt{\frac{w}{r \cdot BN}}$ to trade the trip cost against the opportunity cost of holding money instead of interest-bearing assets with the return of r per period. As seen from the budget constraint, transaction time depends negatively on real money holdings and the number of branch. Assuming that money and branching provide the convenience to save on transaction time.

Therefore the minimized transaction cost is obtained as $TC^* = w\tau + rm^* = 2\sqrt{\frac{r \cdot w}{BN}}$

BN：number of branch w ：time cost of transaction(the shadow value of time)
m : real money holdings τ : transaction time

From the above two optimization conditions, finally functional form of savings with transaction costs is expressed as

$$S_t = Y_t - C_t(Y_t, Y_{t+1}, TC, r_t) = S_t(Y_t, Y_{t+1}, r_t, w, BN) \quad \text{---- 7)}$$

Savings depend on the income, the interest rate of deposit, the time cost of transaction and the number of branch.

4.2 Financial Restructuring after 1997 Crisis

Before running the empirical analysis on branching effects, deposit markets in Korea will be briefly reviewed. As a result of financial restructuring since 1997 crisis, many financial institutions were close d and exited and merged. So the number of branch needs to be adjusted to reflect this downsizing of th e financial sector, in order to estimate the effect of branching on savings demand function later. The re sult of this restructuring is summarized in table 9, 10 and 11.

The number of bank branch has substantially declined from 7546 in 1997 to 6109 in 2001. However, the number of the post office has not comparatively affected by the crisis, from 2873 in 1997 to 2785 i n 2001. On the contrary through the nationwide network over the country and the full guaranty of the government, the deposit amount of postal savings has kept increasing.

a) Banks

Banks have been exited and merged and acquired since the crisis. In June 1998, Donghwa, Dongnam, Daedong, Kyounggi, and Chungcheong Bank were exited and acquired by other banks because they are severely financially unsound compared with other banks. In 1999 Commercial Bank of Korea and Hanil Bank merged to Hanvit Bank, and Hana Bank and Boram Bank merged to Hana Bank. Also Chohung Bank merged with Chungbuk Bank and Kangwon Bank and became CHB. Banks in Korea has adopted "branch banking system", which installs and runs branches as well as main office.

b) Post Office

The low social recognition and the rate of return have made the postal saving less popular until 1997. Since the financial crisis, the funds seeking stability have rushed into the postal saving and have kept growing even though the interest rate of postal saving is comparatively low, because the deposit in post office is fully guaranteed by the government directly.

c) Life Insurance Company

Korea had a huge life insurance sector. The life insurance industry also conducts a quasi-banking business with the average maturity of policies much shorter than is conventional in other countries, and with a large proportion of assets invested in commercial lending. But a review in November 1998 judged 18 week and unsound companies that were requested to submit rehabilitation plans. Seven of these companies had negative net worth, four small companies were closed and the rest were merged or sold. The branch number of life-insurance company has kept declining since it peaked at 1995. Especially after 1997 crisis, the branch number dropped sharply.

d) Investment & Trust Company

Among other non-bank financial intermediaries, investment & trust companies might be the weakest and exposed to the significant systemic risk. Shinsegi (1998.2) and Hannam (1999.1) Investment & Trust companies were exited because of the depression of stock market in 1990s and the financial crisis in 1997. Additionally five more companies were repealed and cleared owing to bankruptcy and financial unsoundness.

Table9. The Number of Financial Institutions after the Financial Crisis

	Banks[3]	Life Insurance	Investment Trust
End of 1997 (A)	36	33	30
Exit	5	7	6
Merger	6	5	1
New Entry	N/A	N/A	6
End of 2001 (B)	25	21	29
B-A	-11	-12	-1

Source: Ministry of Finance and Economy, 2002

Table10. The Number of Branch before/after the Crisis

Year	Banks	Post Office	Life Insurance(Salesperson)	Investment Trust
1995	6351	2786	14773(349206)	200
1996	7035	2832	13846(323966)	259
1997	7546	2873	12244 (402458)	350
1998	6614	2807	8955(245894)	234
1999	6282	2808	8160(241429)	209
2000	6148	2812	6889(214793)	27
2001	6109	2785	5853(171505)	30

Source: Bank Management Statistics, 2002, Financial Supervisory Service.

Table11. The Amount of Each Deposit (billion won)

Year	Banks	Post Office	Life Insurance(Salesperson)	Investment Trust
1990	84054.1	2722.0	27165.8	21420.4
1991	98507.9	3121.1	35321.3	25113.0
1992	107246.5	3521.1	41687.5	32275.7
1993	115731.8	4517.8	47032.1	44593.6
1994	135190.0	5589.4	53936.9	52690.9
1995	154136.1	5828.6	65098.9	58454.0
1996	181720.8	6788.3	78750.5	64906.6
1997	198197.4	7831.1	91390.7	81295.2
1998	251794.5	15201.1	90364.7	199125.6

[3] Includes specialized banks

1999	323411.1	15113.2	98190.0	187719.1
2000	404660.9	20579.5	105754.4	140447.0
2001	455630.5	25270.0	115166.8	153942.0

Source: Bank of Korea, Economic Statistic System

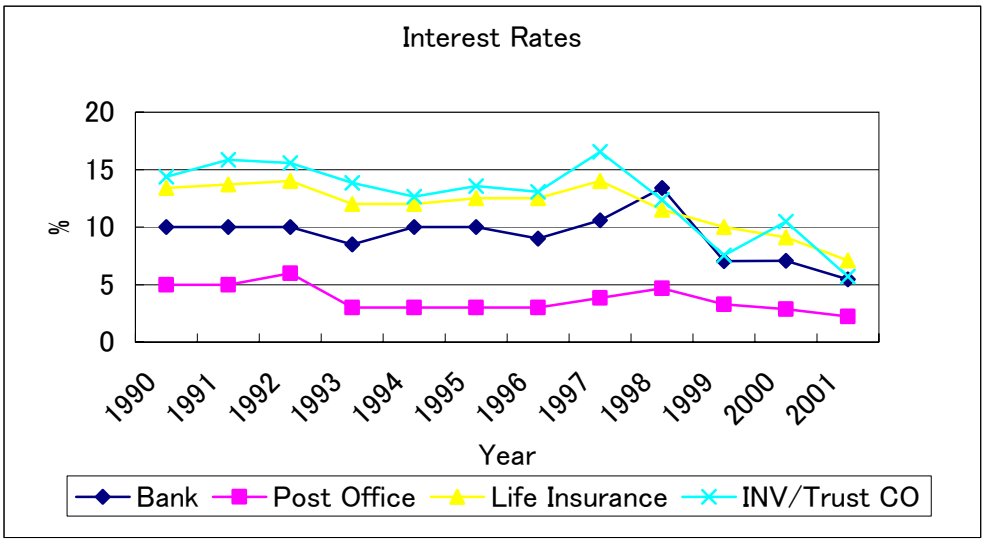
4.3 Deregulation of Interest Rate

The core of financial liberalization, deregulation of the interest rate has started since December 1988. Except the low interest rate offered by government, the ceiling on all lending rates and long-term deposit rate (more than two-year maturity) has been removed. However, the interest rate deregulation actually didn't work so much because the regulation of the interest rate by the window guidance started again due to price instability in 1989.

The Bank of Korea and the government made and announced the four step plan for the interest rate liberalization. This plan has liberalized a short-term interest rate in the lending rate and a long-term & short-term market rate in the deposit rate. Actually most interest rates were liberalized through the three steps from November in 1991 to November in 1995. As a result, most interest rates were liberalized except some short-term market rate and lending rate for the fiscal funds.

Figure 1 shows each interest rate movement and it had been comparatively stable before the crisis. Because of the financial crisis in 1997, IMF advised the high interest rate policy to attract foreign funds and to stabilize the exchange rate. However, there is no evidence for IMF program to have a good effect on the economy. On the contrary, there was a side effect, credit crunch and more bankruptcy. From the 5th agreement with IMF in August 1998, the interest rate kept falling and became stable and low.

Figure 1 Interest Rates of Each Deposit



Source: Bank of Korea, Samsung Life Insurance Co. Asset Management Association of Korea

4.4 Empirical Results

To test whether branching affects savings behavior, the regional panel data analysis is implemented using pooled two stage least squares (2SLS) method in reference to Yoshino and Sano (1997)[4]. As seen from the theoretical consideration in chapter2, the more branches provide the convenience and reduce the transaction cost then households deposit more money at the nearest branch. The convenience of accessibility is measured as the number of each financial institution, bank, post office, life insurance companies, and investment trust companies. This analysis manifests whether savings depends on the accessible convenience to branches, the interests and the income.

The panel data used for this analysis is 16 regions in cross section and 12 years during 1990-2001 in time series. The demand function for each deposit is estimated by two stage least squares method. At the first stage, the number of each branch is estimated with the explanatory variables such as size, population, income, and dummy variable for 97 financial crisis and then exogeneity test[5] is performed and at the second stage, the demand function is estimated.

In table 12, the estimated results of demand function for each savings are summarized. Bank is allocated considering only income and concentrated in Seoul while the post office is allocated considering size, population (POP) and income. A dummy variable for 97 crisis shows that banks were harshly affected by the financial crisis through financial restructuring, but the post office was not influenced so much.

In case of life insurance companies, the convenience is measured as the number of sales persons instead of the branch number. Salespersons play a role of branching because they visit home to home and sell their insurance products and keep relationship with customers. Salespersons are allocated based on size. Investment trust companies are allocated considering income and city dummy variable for Seoul. A dummy for Seoul is used because most branches in other areas were closed and the rest branches are concentrated in Seoul and it is significant. To see whether the financial crisis in 1997 has an impact on financial sectors, the sign of coefficient of dummy variable 97 is negative as expected but is not significant in case of life insurance and investment trust companies.

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[4] They assume the fixed effect model and use two stage least squares method. However I do Hausman test to select the model and also check the exogeneity of the branch number of each financial institution used at the second stage.

[5] Two references about exogeneity test are D. Wu. "Alternative Tests of Independence Between Stochastic Regressors and Disturbances", Econometrica, Vol. 41, 1973, and N.S. Revankar, "Asymptotic Relative Efficiency Analysis of Certain Tests of Independence in Structural Systems", International Economic Review, Vol. 19, 1978.

Table12-1. Estimated Demand Function for Each Savings with Pooled 2SLS

The First Stage: The estimation of the branch number of each deposit institution

Dependent Variable	Explanatory Variables					Hausman Test	R-squared
(Branch Number)	Size	POP	INC	D97	Seoul		
Bank	0.03	0.31	0.20	-30.61	31.10	190.6 *(FE)	0.98
(t-statistics)	(1.15)	(1.69)	(14.51)	(-2.67)	(2.71)		
Post Office	0.03	0.11	0.01	0.84		40.83*(FE)	0.99
(t-statistics)	(14.79)	(7.34)	(8.48)	(46.31)			
Life Insurance	7.63	24.43	-2.17	-33.77		16.97*(FE)	0.8
(t-statistics)	(2.02)	(0.82)	(-1.14)	(-0.96)			
Investment Trust	-0.0004	-0.02	0.005	-2.65	3.67	16.73*(FE)	0.99
(t-statistics)	(-0.10)	(-0.81)	(2.32)	(-1.46)	(2.03)		

* stands for 1% significant level.

After testing the exogeneity of the estimated branch number at the first stage, if the branch number is exgeneous, the actual number of branch is used at the second stage. But in case of life insurance companies, the branch number is endogeneous, so the fitted number of branch is used at the second stage with two stage least squares method with fixed effects model[6]. In order to adjust the effects of financial restructuring on the number of branch, the coefficient dummy is used. Looking at the second stage results, income has a positive effect on the demand function for each deposit. However, the relationship between branching and deposit amounts is complicated. In case of postal savings and life insurance, the number of branches has a positive relationship with deposit amounts. In case of banks, one interpretation is possible, if the number of bank branch is excessive, even though the number of branch has substantially been declined, the deposit amounts keep increasing.

Table12-2] Estimated Demand Function for Each Savings with Pooled 2SLS

The Second Stage: The estimation of the demand for each deposit

Dependent Variable	Explanatory Variables			Hausman Test	R-squared	Exogeneity Test
(Deposit Amount)	NBank	CDNBank	INC			(number of branch)
Bank	-50.89	26.04	21.95	51.92*(FE)	0.9	Exogeneous
(t-statistics)	(-8.70)	(9.31)	(8.74)			
Post Office	-1.67	2.10	0.61	23.60*(FE)	0.69	Exogeneous
(t-statistics)	(-4.47)	(5.98)	(7.64)			
Life Insurance	-0.13	0.14	3.21	2SLS with FE	0.93	Endogeneous

[6] Endogeneity causes inconsistency of the usual OLS estimation and requires instrumental

(t-statistics)	(-1.60)	(9.53)	(5.56)			
Investment Trust	-908.05	898.27	8.31	159.23*(FE)	0.74	Exogeneous
(t-statistics)	(-10.41)	(10.18)	(3.93)			

Including its own interest rate of each deposit, savings demand function is estimated again. All interest rates are insignificant at the 1% statistically significant level while income still has an impact on savings demand. One reason for this is that the interest rate somehow is regulated and is the same at every region.

Table13. Estimation for Savings Demand Function with Interest Rates

Dependent Variable	Explanatory Variables					Hausman Test	R-squared
(Deposit Amount)	NBank	CDNBank	INC	Interest Rate	Seoul		
Bank	-51.29	26.71	20.72	-693.84	703.79	66.69*(FE)	0.9
	(-4.36)	(9.38)	(6.23)	(-1.58)	(1.60)		
Post Office	-0.03	2.15	0.59	-1.72		16.31*(FE)	0.65
	(-0.01)	(5.80)	(5.99)	(-0.45)			
Life Insurance	-2.10	0.06	5.41	-2.59		70.7*(FE)	0.95
	(-3.93)	(5.41)	(16.45)	(-2.12)			
Investment Trust	-886.61	901.17	8.15	-24.05		43.58*(FE)	0.74
	(-7.32)	(10.10)	(3.69)	(-0.26)			

5. Privatization of public enterprise: the case of POSCO

The privatization of postal savings has been discussed since the mid 1990s. The government acted "The special law on the management of postal business" in 1997 and proposed the plans to guaranty the managerial autonomy of postal business. However, in a strict sense, it is pointed out that the autonomy of asset management is not guarantied and the inefficiency of management is accordingly caused. Since the crisis, postal savings and insurance has kept growing fast because of stability seeking behavior and has become to be a strong competitor with commercial banks and life insurance companies. Therefore it is debated that postal savings need to be privatized in order to compete fairly with other private financial institutions. This chapter introduces a successful example of privatization in Korea and derives the implication for the privatization of postal savings.

variable methods like two-stage least squares (2SLS) to obtain consistent estimates.

5.1 Privatization policy in Korea

In Korea privatization of public enterprises has been tried since 1960s. The first noticeable privatization was implemented since 1960s until early 1980s. The major public enterprises that were privatized between 1960s and early 1980s included Korea Transportation, Korea Maritime, Chosun Shipbuilding, Korean Airline, Incheon Steel, Korea Commercial Bank, Korea Fishery Development, Korea Reinsurance, Yukong Oil Refinery, Hanil Bank, Cheil Bank, Seoul Trust Bank, Among those major public enterprises, the commercial banks were not privatized completely because the government still remained a major shareholder until now despite of the fact that some part of shares were sold to private investors. But, in 1987, Korean government changed its privatization policy direction with an idea of selling government-owned stocks to low- and middle-income households, not to big companies or their owners. The government planned to privatize 7 profitable public enterprises, such as POSCO and Korea Electrical Power Company, during the period of 1988-1992. But, this plan was not fully implemented due to bad situation of stock market.

Privatization of public enterprises has been an important economic issue once again during the last decade since Kim Yong Sam government in 1994 announced the plan of privatizing major public enterprises. This plan was originally introduced to bring back efficiency that those major enterprises lost due to their governance structure. Major public enterprises, such as Korean Electric Power Corporation(KEPCO), Korea Telecom(KT), Korea Tobacco and Ginseng Corporation(KT&G), and Pohang Iron and Steel Co(POSCO), were included in the privatization plan.

Related to the idea of privatization of public enterprises of large scale, it was an important issue whether or not the chaebols would be allowed to become major shareholders of the public enterprises. At that time, Korean society was not favorable for the privatization policy of handing over ownership of those despite of the fact that those chaebols were still only possible investors in those large-scale public enterprises. As a result, the government decided to keep ownership of those public enterprises as major shareholder.. Instead of full privatization, in 1997 the government introduced a special act of privatization, acknowledging the need of commercial operation of public enterprises, aiming at privatizing four enterprise, KT&G, KT, Korea General Chemical Co., and Korea Heavy Industries and Construction Co. Two basic spirits of the act was that (i) putting restrictions on the ownership of all four enterprises in order to prevent chabole from acquiring controlling interests and (ii) stipulating that the board of each consisting of civilians, not allowing presence of line ministry and the Ministry of Finance and Economy.

But, the 1997 act did not achieve a successful privatization because it did not succeed in preventing line ministry from being involved in operation as major shareholder and because it did not include the major public enterprises, such as POSCO and KEPCO. As a result, the main objective of privatization policy was not achieved. The Kim Dae Jung that came into power mainly due to outbreak of economic crisis planned another round of privatization. Under this new administration, a newly

established agency, the Budget and Planning Commission(now the Ministry of Planning and Budgeting), made public a new plan of privatizing 108 public enterprises. The 1998 plan is consisted of three groups of public enterprises with different solution applicable to each group; (i) first group to be privatized, (ii) second group to be privatized eventually, but not in the near future, and (iii) third one not to be privatized, but to be restructured. The first group includes POSCO, Korea Heavy Industries and Construction Co., and Korea Chemical, KTB, and Korea Textbook, as well as 12 subsidiaries. The second group includes KT, KT&G, KEPCO, KOGAA, Daehan Oil Pipeline, and Korean District Heating, including 28 subsidiaries of government-operated corporations and government-investment corporations. Those within this group are to be gradually privatized. The third group includes 13 enterprises as well as 14 subsidiaries. For those ones, privatization was not solution, but restructuring for those that needed public ownership, but needed commercial operation, and liquidating those that did not rationale for public ownership.

Looking back the development process of privatization of public enterprises during the last decade, only a small number of public enterprises have been privatized both in terms of ownership and management, such as POSCO, Korea Heavy Industries and Construction Co., and Korea Chemical, KTB, and Korea Textbook. Those except POSCO and Korea Heavy are small scale. POSCO is the most successful case. Korea Heavy Industries and Construction was handed over by Doosan group and changed its name to Doosan Heavy Industries and Construction Co.. But it is too early for us to evaluate how successful privatization of this public enterprise mainly because Doosan Heavy has gone through very harsh management-labor dispute since its privatization. Doosan Heavy is still in the middle of aftermath of privatization and, therefore, it needs more time to be evaluated. Korea Textbook was handed over by private textbook company and was merged into it. Korea. As a result, POSCO is now the only one major public enterprise of large scale for evaluation of privatization.

Table14. Privatization Plan of Public Enterprise of 1998

Solutions	Target Enterprises	Target Subsidiaries
Complete Privatization	POSCO Korea Heavy & Construction Co. Korea General Chemical Co. Korea Technology Banking Corporation National Textbook Co. (5)	12 Subsidiaries including Korea Telecom Card Co, & Hanyang Wood Co.
Korea Telecom	Korea Tobacco & Ginseng Co. Korea Electric Power Co.	28 Subsidiaries including Korea Telecom Powertel Co.

Gradual Privatization	Korea Gas Co. Daehan Oil Pipeline Co. Korea District Heating Co. (6)	Korea LNG Co., & Korea Power Engineering Co.
Restructuring	Agricultural & Fishery Marketing Co. Korea Coal Co. Korea Highway Co. Korea Land Co. Korea National Housing Co. Korea National Oil Co. Korea Resource Co. Korea Security Printing & Minting Co. Korea National Tourist Organization Korea Trade & Investment Promotion Agency Korea Water Resources Co Rural Development Co. Korea Appraisal Board (13)	Restructuring (6 Subsidiaries including Korea Telecom Freetel & Korea Nuclear Fuel Co.) Liquidation or Merger (8 Subsidiaries including Hanyang Co. & Korea Real Estate Trust

Source: Ministry of Planning & Budgeting,
Nam(2001)

5. 2. Privatization of POSCO (Pohang Steel Corporation)

PPOSCO was established, in legal status, as a commercial company based on the Commercial Law, not as a public enterprise to obtain self-management status and to maximize economic efficiency. But, in substance, POSCO used to be treated and considered as the representative public enterprise of the Republic Korea until its full privatization. But POSCO was exceptionally successful in preventing involvement of the government officials in management and contributed tremendously to Korean economic development until its privatization as well as in the early stage of economic development period in 1970s and 1980s. Before 1988 when the administration at that time planned and implemented privatization of POSCO in the first step, the government owned about 70% of the total shares directly and indirectly. Until 1988, the government owned 32.2%, Korea Development Bank 36.8%, and other government –related institutions 30.9% of total shares.

POSCO's privatization was started with political consideration during the 1987 presidential election campaign. The ruling party candidate in the presidential election campaign promised to privatize and sell the government-owned stocks to individual investors, not to chaebols. In April of 1988, the

government sold 34.1% among 69.1% stocks that government and Korean Development Bank owned to individual investors and enlisted the stocks of POSCO in the stock market two months later. But the next administration led by Kim Yong Sam did change the policy direction of privatization of POSCO and decided not to sell government-owned stock to keep it as a government investment enterprise.

But, the Kim Dae Jung administration following the Kim Yong Sam administration listed privatization of public enterprise as a high priority policy in economic policy agenda to implement mainly because of outbreak of the economic crisis. The new administration decided to privatize POSCO because it could clearly characterized as a commercial company. The administration planned to complete privatization of POSCO by the end of 1999. According to this plan, the government sold 3.14% of government-owned stocks
and 2.73% of Korea Development Bank-owned stocks in foreign market in December of 1998 and then sold all the remaining stocks that government and Korea Development owned in two different points in time, July of 1999 and October of 2000. As a result, privatization of POSCO was completed. In the privatization process, among more than 26% that government and Korean Development Bank owned, more than 18% was sold in foreign market and more than 8% was purchased by POSCO as company-owned stocks. At the same time, the government could raise revenue amounting to 290 million won to meet increasing public fund needed for restructuring of financial institutions during the economic crisis period..

5.3 Performance after Privatization of POSCO

As privatization process was under way, POSCO began to make efforts to introduce professional management system and governance system of global standards. By the new governance system, professional management team was to do manage the corporation with accountability to shareholders by their management performance without being intervened by any special shareholder group. POSCO also introduced evaluation system under which professional management is evaluated by and compensated for its performance. Management has been carried out under monitoring and evaluation system of the board. More than half of the board members are consisted of non-standing members in order to establish independent and professional function of the board. Nomination and evaluation committee, finance and operation committee, management committee and auditing committee consisted of non-standing board members have been instituted within the board. According to the new system, function and role of the board and management have been clearly distinguished and, as a result, governance system has been improved.

POSCO's privatization has improved its revenue, business profit and net profit around the period during privatization was carried out except in 2001 when the most of major steel companies in the world marked red ink.

Table15. Revenues and Net Profits (unit: billion won)

Classification	1997	1998	1999,	2000,	2001
Total revenue	9,718	11,138	10,696	11,692	11,086
Operating profit	1,795	1,720	1,820	2,099	1,429
Net profit	729	1,123	1,558	1,637	819

Source: POSRI (2002)

POSCO's privatization also has contributed to improvement of financial situation. Three major indices showing financial status, profitability, stability, and asset utilization have been improved after privatization was completed. Operating profit margin increased from 13.96% in 1998 to 16.74 in 2000. And gross profit margin also increased from 19.4% to 20.7% during same period of time. Assets turnover showing asset utilization increased 0.67 to 0.69 between 1998 and 2000. And percentage of common equity to total asset increased from 38.9% in 1998 to 46.9% between 1998 and 2000. This indicator showing leverage of POSCO has steadily increased since privatization to 52.7% in 2001.

Table16. Finance Indicators of POSCO (1997-2001)

	1997	1998	1999	2000	2001
Operating Profits/ Total Sales(%)	18.5	154.	17.0	18.0	12.9
EVA(billion won)	602	430	428	763	404
Shareholder's Equity (%)	41.4	46.7	52.7	53.1	57.9
Total Asset Turnover	0.61	0.63	0.61	0.67	0.63

Source: POSRI (2002)

Privatization of has also increased market value of its stock. Average stock price increased from 54, 556 won in 1998 to 93,352 in 2000, and then to 95,930 in 2001. This shows that improvement of busin ess performance because privatization has reflected in stock price.

Table17. Change in stock price (unit: won)

	1996	1997	1998	1999	2000	2001
End of year	36,500	45,900	64,500	125,000	76,500	122,000
Yearly average	49,774	51,705	54,556	114,296	93,352	95,930

Source: POSRI(2002)

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