CHAPTER 7


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Abstract

While the global financial sector is undergoing reforms of regulation and supervision for an improved financial system in the future, some areas in the Korean financial sector seem to be moving in the opposite direction. This is largely because the existing level of regulation is regarded as being very high compared with that of the developed countries. As a consequence, it is likely that directional discrepancies invite sudden movements of foreign capital in and out of the country possibly giving rise to tremendous shocks such as experienced during 2008-2009.

In order to properly evaluate the situation and hence provide balanced policy recommendations, we set “back to basics” as a vision of the Korean financial sector in the post-crisis era in this paper. Two associated policy issues are discussed.

First, the government should no longer try to manufacture finance for the purpose of achieving some policy goals, say economic growth. It should instead help finance find its own self-sustaining growth path. In this regard, the policy makers must weigh carefully the benefits and costs as manufacturing finance could possibly result in moral hazard on the part of economic agents and systemic risk.

Second, while Korea needs advanced capital markets that are believed to help achieve sustainable growth of the economy, introducing hedge funds must be carefully administered. This is because it could cause some herd behavior on the part of a small number of wealthier investors possibly giving rise to systemic risk. Strengthening supervisory capabilities is desired.
I. Introduction

Korea has been known as one of fast recovering countries from the 2007-2009 global financial crisis (GFC). Largely thanks to growing exports to China and other emerging market economies, Korea recorded a 6.1% growth rate for year 2010, the second highest among OECD countries behind Turkey. However, this blessing may transform itself into a curse if Korea could not learn a lesson from the crisis by way of reforming regulatory and supervisory system.

In some policy issues Korea appears to be moving towards a direction quite opposite to that pursued by the global financial system. The main reason for the directional differences seems to be due to a popular belief in Korea that while she has been very successful in manufacturing and export and import sectors of the economy in the last several decades, her performance in the finance sector has never been up to people's expectation. In this regard, it is likely that most Koreans think that they should be doing equally well in the finance sector, and anything less is not acceptable. They might also think that it is the government's responsibility to enhance the competitiveness of the financial services industry (FSI). In this context, it is argued that the government should deregulate existing rules and regulations more aggressively.

In Korea, one cannot rule out the possibility that the government still considers the domestic financial sector as a handy policy tool that can be used to fulfill senior policy goals such as economic growth. In this respect, it is important to distinguish between deregulation and less intervention by the government. When we say that there should be less of government intervention, this does not necessarily mean something should be deregulated. Rather it means that the government should stop intervening in the markets. The recent debate as to whether the KDB holdings should be allowed to participate in the bidding process for Woori financial group implies a possibility of such government intervention.

In this paper we argue that for the purpose of development of the Korean financial sector in the post-crisis era, it is important that the government reduce its influence on the markets and also its role as a market player. This is because its leading role