When South Korean Finance Minister Yoo Il-ho hurriedly urged the Bank of Korea (BOK) for quantitative easing (QE) without mentioning how much or where to spend, there erupted a series of unexpected controversies and conflict in the political arena, not to mention in the academic field. Most of the opposition argues that the BOK’s QE will invite inflation in the future and take wealth from the financial asset holder to the borrower. Some people at the BOK are especially irked by potential infringement of its autonomy when the country’s QE is not initiated by the Bank but instead pushed by others.

However, neither inflation-worry nor autonomy is the crux of the QE issue. The real matter is how to deal with the chronic troubles in the shipbuilding and shipping industries, as they have been burdened by astronomical debt-service for years, endangering not just a few creditor banks but Korea’s entire banking super structure. Some of these companies have completely wiped out their capital on top of tremendous debt, making its survival almost impossible. To make matters worse, the main creditor banks of such troubled companies, namely KDB and EXIM Banks, also have so significantly eroded their capital that they could hardly save crippling industries in the future. This is exactly why the government is so desperate about the QE from the BOK.

No matter how urgent the matter might be, the QE by the BOK should follow the rules and guidelines set by laws and regulations, but even before this, the exact restructuring of the shipbuilding and shipping industries have to be decided before any kind of QE can be implemented. Some companies may have to be shut down indefinitely, while others merged or sold. At the center is the troubled company Daewoo Shipbuilding and Marine Engineering (DSME), whose debt capital ratio exceeds 7300 percent with a total debt of over KRW 17 trillion (USD 14.3 billion) and borrowing of almost KRW 8 trillion (USD 6.7 billion). Trillions of won are required just to bail out DSME, whose main creditor banks are KDB and EXIM Bank. All these decisions have to be made solely by the creditor banks without any interruptions by an outsider, especially from the political arena. Without prior direction of DSME’s restructuring, along with the restructuring of KDB and EXIM, no legitimate argument can be made for or against QE by the BOK.

The second stage is to figure out the specific role that the special government banks should play in that restructuring process. Having witnessed so many instances of moral hazard, inefficiency and possible corruption in their previous restructuring procedures, their involvement this time also raises serious doubts as to their competence, and this is one of the reasons why the public is against the involvement of government banks or the government itself on the issue of QE. Only when the special banks and the government assure people of their good will and competence of the new restructuring plan can the QE be supported by the general public.

The final stage is that the BOK must decide which course or path is the best on its behalf. In fact there are numerous ways that the BOK can supply money to the economy. One way can be to increase the money stock but another can be to stay away from such an increase. If the supply of base money is absorbed by countervailing issues of the Monetary Stabilization Bond (MSB), for example, the base money’s entire stock could remain unchanged. So, QE isn’t by itself inflationary, even in the long run. Although not clearly mentioned, the Ministry of Strategy and Finance seems to want BOK’s participation in the equity investment for KDB and EXIM Bank, but the BOK explicitly turned down the idea.

At the moment, the BOK seems to have two things in its mind; first, its involvement in this entire process should be “a type of lending”, not capital participation. Second, the BOK wants to partake in only a part of the general rescue plan, not the entire responsibility. It is dubbed the Capital Expansion Fund, whose participation should be taken by both the banking industry and also by interested public investors. The BOK says it is very important to uphold the principle of loss minimization. In other words, it neither wants capital involvement in the business of government banks, nor take sole responsibility in the restructuring of the industry’s problems.

According to the media’s detailed restructuring plan, a special purpose company (SPC) will be created by Intermediate Business Bank (IBK) and Korea Asset Management Corporation (KAMCO), and BOK will lend this SPC with KDB bonds as a government guaranteed collateral. The SPC will then buy contingent convertible (CoCo) bonds or subordinated bonds of KDB and EXIM banks. This fund will then be invested in the purchase of CoCo bonds of KDB and EXIM Bank, which will be able to replenish its capital without degrading their debt-capital ratio.

The total subscription by the BOK is allegedly at about KRW 10 trillion (USD 8.4 billion) at the maximum. As such, the BOK can transfer the risk entirely to SPC and the special governments can enlarge their capital without endangering debt ratio. The size of KRW 10 trillion (USD 8.4 billion) may be or may not be enough, but the tug of war between the BOK and government over QE seems temporarily over for now.

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