# Details of the Revision of the Bank of Korea Act and its Significance

On August 12, 2003, the National Assembly of the Republic of Korea passed the revised Bank of Korea Act (to come into force as of January 1, 2004) that had been tabled by two members of the National Assembly on behalf of a large bipartisan group of legislators on March, 2003.

As a result of this revision, the degree of independence of the Bank of Korea is expected to be considerably enhanced.

## Ⅰ. History of Previous Revisions of the Bank of Korea Act

- Korea undertook six revisions of its central banking act between 1950, when the Bank of Korea Act was first passed, and December 1997, all of which weakened the central bank's independence and functions.

- The most recent revision(7th revision) of the Bank of Korea Act, however, is highly meaningful in that each of the amended items represents a progressive improvement.

## **Key Points of Revisions**

| Date | Contents |
|---|---|
| First revision (May 1962) | The extension of the government's role concerning monetary and credit policy to ensure the financial sector's seamless support for the government-led development plans<br>· A large increase from two members to five members in the number of the Monetary Policy Committee members nominated by the government<br>· Transfer to the government of the Bank of Korea's functions of foreign exchange policy formulation and foreign exchange management<br>· Government given the right to inspect the Bank of Korea's operations and introduction of a system requiring its budget to obtain prior government approval |
| Second through fifth revisions | Technical improvements necessary for monetary and credit policies limited to simple amendments |
| Sixth revision (December 1997) | The Chairmanship of the Monetary Policy Committee was transferred from the Minister of Economy and Finance to the Governor of the Bank of Korea. In this and other ways the degree of independence of the Bank of Korea was increased to a certain extent, but with the introduction of a system of recommendation of members of the Monetary Policy Committee by private sector bodies that were subject to government influence, conditions for the neutrality of monetary and credit policy remained circumscribed.<br>Notably, with the transfer of the bank supervisory functions to new financial supervisory organizations, the Bank of Korea's role in relation to financial stability was reduced and problems were experienced in its acquisition of the information and materials necessary for the efficient conduct of monetary and credit policy. |

## Ⅱ. Main Points of the Revision of the Bank of Korea Act and the Significance of the Individual Amendments

- The principal elements of the current revision of the Bank of Korea Act are that 1) the independence and efficiency of monetary and credit policy are strengthened; 2) the BOK is given heightened responsibility for the operation of payment and settlement systems; and 3) the linkages between policy formulation and implementation are tightened.

**( Participation of the Deputy Governor of the Bank of Korea as an *ex-officio* member of the Monetary Policy Committee )**

| Details of the revision |
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- The Securities Dealers Association loses its right of recommending a member of the Monetary Policy Committee and instead, the Deputy Governor of the Bank of Korea will serve as an *ex officio* member.

- The Deputy Governor of the Bank of Korea, who is currently appointed by the Governor, will be appointed by the President of the Republic of Korea upon the recommendation of the Governor.

| Implications |
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- As the Deputy Governor of the Bank of Korea is to serve as an *ex officio* member of the Monetary Policy Committee, the incorporation of practical judgement and market information acquired in the course of monetary policy implementation into the process of decision-making concerning monetary policy will be facilitated. Not only this, but the linkages will be tightened between policy decision-making and policy implementation

**( Endowment with responsibility and the function of oversight regarding payment and settlement systems )**

| Details of the revision |
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- The Bank of Korea is endowed with the functions of wholistic management and oversight of the payment and settlement systems, whereby 1) it may provide for all necessary matters concerning payment and settlement systems that it itself operates, and demand the submission of data and information from participant institutions; and 2) in the case of other payment and settlement systems, it may require that measures for improvement either be taken by the institutions operating them or instituted by the regulatory institution responsible for them ; it may also require the submission of relevant information.

Implications

- Nowadays, diverse financial transactions are carried out electronically nationwide including the exchange of checks and bills, Giro, the CD/ATM system, the interbank network, Internet banking and e-money. Financial transactions between individuals and financial institutions are cleared in the first instance through the Korea Financial Telecommunications and Clearings Institute and securities transactions through the Korea Securities Depository. Those transactions are finally settled between financial institutions through BOK-Wire. Accordingly, data and information must be gathered to develop the payment and settlement systems nationwide and comprehensive management and oversight are needed concerning the payment and settlement systems to amend failures in breakdown of settlement. These functions are naturally a characteristic duty of the central bank in most countries.

- Explicit endowment of responsibility and function of oversight strengthens the legal foundation for maintaining the safety of the payment and settlement systems.

**( Shift to an intermediate inflation target )**

Details of the revision

- The choice of inflation target is changed from an annual targeting regime to an intermediate targeting system.

Implications

- At present the Bank of Korea establishes an inflation target each year and operates monetary policy in order to attain it, which gives rise to several side effects.

When the central bank pursues the attainment of the inflation target within a brief period of time, it must make use of a more aggressive monetary policy, which may greatly increase the volatility of the real economy and financial markets.

In addition an external shock may cause a deviation from the course of monetary policy to be tolerated, but the short-term inflation target may not then be attained, which can lead to an erosion of public confidence in the central bank's monetary policy.

- In the present revision, the short-term inflation targeting system is changed to an intermediate targeting system in view of the time lag in the transmission effects of monetary policy

**( Enlargement of the Bank of Korea's autonomy in its budget )**

Details of the revision

- Under the existing Bank of Korea Act, the Bank of Korea must obtain the prior consent of the Minister of Finance and Economy to its budget for all operating expenses. The revised legislation calls for his prior consent only to allocations for wages and welfare benefits.

Implications

- The system whereby the Bank of Korea is required to obtain the consent of the Minister of Finance and Economy for its operating budget is open to the criticism that it detracts from the neutrality of monetary and credit policy by making it dependent for the provision of the expenses needed for the running of its organization.

The revised legislation has given the Bank of Korea greater autonomy concerning its budget.

- However, some items of the managerial expenses budget such as wages and welfare benefits remain as before subject to the prior consent of the Minister of Finance and Economy, reflecting the government's opinion concerning the need to restrain, to some extent, the budget of the Bank of Korea, which is the issuer of bank notes.

**( Augmentation of the system for the Bank of Korea's request of joint examination of financial institutions )**

Details of the revision

- Whereas the present Bank of Korea Act stipulates that when the Financial Supervisory Service(FSS) is requested by the Bank of Korea to undertake the joint examination of a financial institution or to examine it itself, the FSS shall "accept", the wording in the revised legislation is changed to "shall promptly accept."

Implications

- The revised legislation is expected to bring about the more practical and efficient operation of the system whereby the Bank of Korea requests joint examination.

**( Strengthened accountability to the National Assembly )**

Details of the revision

- Under the existing Bank of Korea Act, the Bank of Korea is obliged to report on the implementation of monetary and credit policies to the National Assembly at least once a year but this is increased to at least twice a year under the revised legislation.

Implications

- The Bank of Korea's accountability to the National Assembly concerning its policies is heightened.

## Ⅲ. Significance of the Revision of the Bank of Korea Act

- Firstly, in contrast to the past, a genuine improvement has been achieved in terms of the Bank of Korea's independence and functions.

- Secondly, the latest revision of the Bank of Korea Act is historically significant in that it sets the course for an advanced central banking system in keeping with Korea's level of economic development.

Notably, the Deputy Governor of the Bank of Korea is empowered to serve *ex-officio* on the Monetary Policy Committee and the revised legislation stipulates a shift to an intermediate target system as adopted by major advanced countries that have opted for inflation targeting. At the same time, it provides the foundation for the bank of Korea's seamless exercise of its function of oversight of the payment and settlement systems, which have a key bearing on financial stability.

- Thirdly, this revision of the Bank of Korea Act reflects the repeated recommendations of the OECD that officials from the central bank be the members of the Monetary Policy Committee for strengthening of the neutrality and efficiency of monetary policy. It also takes on board the advice of the IMF and World Bank that overall responsibility and the functions of oversight regarding a country's payment and settlement systems as a whole should be given to its central bank in order to secure their seamless operation.

Accordingly, the revised legislation is expected to contribute greatly toward heightening the international credibility of the Korean central banking system.