

Analysis and Evaluation of the Korean Local Government Borrowing Decision Making System

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<Abstract>

Local government borrowing is a part of budgeting in local government and borrowing is a useful resource to meet local finance demand. Local government borrowing is a process of policy making, it can be analyzed in viewpoint of the systems approach. For the analyzing local government borrowing decision making system, there were decided three factors (institutional structure, borrowing criteria, and personnel capability) and the three values (local democracy, economic efficiency, and financial security) in this research. Korean local government borrowing decision making system was analyzed and evaluated in terms of the three factors and three values.

As for the findings, these indicate that the present Korean local government borrowing decision making system is not appropriate to obtain the three values because of problems such as the central government's strong but formal control; the use of impractical criteria; and the insufficient capabilities of policy makers. Under the above diverse problems of the present system, it is possible for a local authority to experience either extremes in local borrowing policy such as too little borrowing or too much borrowing and both can provoke the traps of the vicious circle and the dilemma.

The problems of the system may continue in the future if there is not fundamental and comprehensive reform in Korea. Therefore, some of the reforms are needed for a more desirable system to increase the three values.

I. Introduction

Some trends entailing a number of different types of reform and movement in government can be identified recently in Korea. Broadly speaking, the trends can be divided into three: increasing democratization and local autonomy; more globalization and unlimited competition; and recovery from the financial crisis and the need for more sustainable development. These are rooted in the needs of the Korean people but many of them are triggered by changes in worldwide circumstances.

In many cases, the Korean government's policies and systems are being changed, reformed and modernized responding to the above pressures. Most researchers agree that the local government borrowing system of Korea is one of the public systems needing to be reformed (Lee, H. 1998; Lim, S. I., 1997; KRILA, 2000; MOGAHA, 2001a.). However, it is a difficult problem to decide which is the right direction for this reform and which aspects should be reformed. The above three trends may imply some suggestions. It is therefore the intention of this research to examine the present

system and to justify and propose reforms.

Local government borrowing is a part of budgeting in local government and, in general, the process of public budgeting is a process of policy making (Lynch, 1979, pp. 58-59; Steiss, 1975, p. 24 quoting Mosher, 1954, p. 5). As Golembiewski and Rabin (1983, p. 4) maintained, budgeting is a critical activity in decision making. So deciding local government borrowing can be said to be an activity of decision making and, in particular, a kind of policy making because it is done in a public authority the result of which appears in the shape of public finance policy.

Policy making needs to be analyzed to see its problems and to look for better resolutions. The analysis of policy making can be carried out largely on the basis of the systems approach (Dror, 1971, p. 3; Quade, 1989, pp. 4-6). So the local borrowing decision making system can be analyzed in viewpoint of policy science, in particular systems approach. According to Mikesell (1986, p. 25), an effectively operating system that includes incentives for officials to respond to public demands is more likely to produce consistently good decisions. So it can be said that good (or better) decisions are produced from a good decision making system. For more satisfactory or desirable decisions on local borrowing, the decision making system needs to be good. To know the ability of a policy making system in a society, the system should have cannot avoid being evaluated by measures such as societal values.

The aim of this research is to provide the knowledge about the local government borrowing decision making system of Korea by analyzing and evaluating the system from the viewpoint of some main societal values and factors. For this, next section discusses some values as the measure of evaluating the system and some factors in the local government borrowing system as the objects to be evaluated before the analysis and evaluation of the Korean system.

II. What should be considered in the Course of Analyzing and Evaluating the Local Government Borrowing Decision Making System?

According to Churchman (1968, p. 11), systems are made up of sets of components that work together for the overall objective of the whole. Sztompka (1974, pp. 71-72) mentioned that a system is a complex set of interrelated elements making up a separate total and standing in a specific relationship with the environment. So, in order to analyze the local government borrowing decision making system, factors, the objectives (goal or value accomplishment), and environment of the system should be investigated. However, all the facets of the environment, which is broad and diverse and includes the fields of: policy, the economy, society, culture, and administration in Korea, are impossible to examine in this limited space. So, In this paper, the factors and values of the local government borrowing decision making system are discussed mainly as follows.

1. Analysis Component of the System : Three Factors

As said before, the local government borrowing decision making system can be analyzed and evaluated in viewpoint of the systems approach. The systems approach is a way of thinking about the whole, namely the whole system to which the parts belong (Churchman, 1968, p. 11; Daellenbach, 1995, p. 18). Something to be explained is viewed as part of a larger total, a system, and is explained in terms of its role in that system (Daellenbach, 1995, p. 18). Therefore, it can be said that the local

government borrowing decision making system studied is made up of sets of components or factors that work together for the overall objective of the whole.

This research has chosen three factors- institutional structure, borrowing criteria and personnel capability, as the main components of the decision making system and as the factors affecting the system according to the view of policy science researchers and the character of local government borrowing. The justification for this choice and definition of each factor is now presented.

First, There are diverse views on the factors or variables which affect policy making. Robinson and Majak (1967, p. 178) stressed situation, participants, organization, process, and outcome. Nigro (1965, pp. 178-180) emphasised information, personalities and the prior backgrounds of executives, values, individuals' previous training, individuals' previous work history, choosing the members of the work team, and community mores. Sharkansky (1978, p. 57) suggested attention be paid to: (a) public administrators in their political culture and citizens' attitudes; (b) demands, resources, and political support from individual citizens, political parties, and interest groups; (c) demands, resources, and political support from government; (d) demands, resources, and political support from individuals, government institutions, and intergovernmental relations; (e) social backgrounds, skills and values of the administrators; (f) and structure, procedures, and precedents of administrative units. Kyu Jung Kim (1986, pp. 155-156) focused on environment, policy makers, organization features, goals, and information. Dong Suh Park (1986, p. 131) mentioned officials or policy makers, government structure, and environment as important in shaping policy. Therefore, it can be said that policy making can be affected by factors internal to the public sector (government structure, procedures, relationships between organizations, policy makers' character, experience, values, institutions, rules, etc.) and external factors (policy, the economy, community mores, culture, environment, etc.).

On the other hand, some researchers point out some major reasons for policy failure which can be classified into four groups of factors: (1) structural factors: autocratic and centralized power, problems of bureaucracy, and insufficient information; (2) methodological and criteria factors: irrational precedents or rules, the unchangeable methods often used by public authorities in seeking solutions, and incompatible goals; (3) human factors in the personnel and clients involved: irrational consciousness or attention, insufficient perception and knowledge, and official resistance; and (4) environmental factors: changing technology and events, weak demand and support, and an undeveloped society and social norms (Quade, 1989, pp. 3-4; Anderson, 1975, 138-153; Ahn, H. G., 1990, pp. 409-412). So, in this research, the three factors mentioned above, structure, criteria, and capability, are chosen as the main factors to be studied in the local borrowing decision making system, with less focus on the environment factor because of research limitations. Values are included as the measures of the system evaluation as explained before.

Second, these factors are important in the practice of local government borrowing decision making. In practical affairs, local borrowing is not only an issue for the local authority but is also of interest to central government. So, the overall government *structure* engaged in the local borrowing decision making affects local borrowing policy. The content of local borrowing decision making can be changed by the *criteria* used in the course of deciding local borrowing. On the other hand, in practice, as local borrowing is decided by officials and politicians, their *capabilities* affect the shape of local borrowing decisions. So it can be said that this three factors, institutional structure, borrowing criteria and personnel capability, are the main factors directly affecting local borrowing decision making.

Of the three factors that comprise the local borrowing system, the first, the institutional structure (briefly structure) for deciding local borrowing has been seen as having two main components, namely the decision making process and the relationships between central and local governments. Secondly, the borrowing criteria (briefly criteria) used in the decision making comprise both project criteria and quantity criteria. Thirdly, personnel capability (briefly capability) was defined to include policy makers' awareness, knowledge and ability, the policy makers being the local officials, central officials, and politicians in the system.

2. Evaluation Measure of the System : Three Values

Generally speaking, the objectives or goals of the system in a society are based on societal values (Kast and Rosenzweig, 1985, pp. 23-24; Schwarz et al. 1995, p. 234; Dunn, 1994, 131). According to Schwarz et al. (1995, p. 234), the values and beliefs held by individuals and organizations affect analysis at all stages, from problem formulation to decision and implementation. Kast and Rosenzweig (1985, pp. 23-24) claimed that values are a primary basis for guiding decision making and other actions and therefore set the basic framework for the development of organization theory and management practice. As the values inherent or desirable in public administration can be understood as providing standards for the evaluation of policy making or as the goals of the policy process, the values relevant to local government borrowing can be said to be not only the goals or ideals at which the public organization aims but also measures for evaluating local borrowing decision making system. Such values are related to the philosophy or vision of the public administration or system of a country. In this research, the three values, local democracy, economic efficiency and financial security, have been chosen after consideration of the literature and the special character of local borrowing.

First, many researchers, each with their own terms and preferences but with considerable overlap, suggest some values as standards of policy evaluation or forming the ideology of public administration. Nakamura and Smallwood (1980, p. 45) suggested such standards of policy evaluation as goal attainment, efficiency, constituency satisfaction, clientele responsiveness, and system maintenance. Suchman (1967, pp. 61-68) mentioned effort, performance, adequacy, and efficiency as standards. Going deep into philosophy, Schwan (1981, pp. 7-8) named the fundamental values as dignity of man, liberty, life, equality, justice, solidarity, and plurality. Rather more practically, Dunn (1994, p. 326) urged such decision criteria as policy effectiveness, efficiency, adequacy, equity, responsiveness, and appropriateness. Barbash (1981, pp. 274-275) suggested accountability, dignity, power, price, participative management, efficiency, equity, industrial democracy, security, social justice, and social responsibility. Park, D. S. (1986, pp. 96-106) urged such evaluation values as legality, efficiency, democracy, effectiveness, and trustworthiness.

As can be seen in the above theories and views in policy science, the same or similar values as these were suggested by the literature; namely *democracy* - clientele responsiveness (Nakamura and Smallwood, 1980, p. 326), liberty, equality (Schwan, 1981, pp. 7-8), equity, responsiveness (Dunn, 1994, p. 326), participative management, industrial democracy (Barbash, 1981, pp. 274-275) and democracy (Park, D. S. 1986, pp. 96-106); *efficiency* - efficiency (Nakamura and Smallwood, 1980, p. 45; Suchman, 1967, pp. 61-68; Dunn, 1994, p. 326; Barbash, 1981, pp. 274-275; Park, D. S. 1986, pp. 96-106); *security* - systems maintenance (Nakamura and Smallwood, 1980, p. 45), appropriateness (Dunn, 1994, p. 326), security (Barbash,

1981, pp. 274-275) and trustworthiness (Park, D. S. 1986, pp. 96-106). Considering the recent Korean reform trends: increasing democratization and local autonomy; more globalization and unlimited competition; and recovery from the financial crisis and the need for more sustainable development, the three values - democracy, efficiency and security are matched with above Korean reform trends.

Second, in terms of the special character of local borrowing, these three values are thought to be essential. Local government borrowing is a part of local public budgeting which may impose a financial burden (or financial risk) on all residents as the debt must be redeemed by their resources in the future. Furthermore projects funded by borrowing are mostly capital or infrastructure projects in the society which may affect the life of residents such as the building of roads, subways and housing. So, the value local democracy which needs the opinion of residents to be taken into account cannot but be one basis of policy making about local government borrowing and its evaluation. The value local democracy (briefly democracy) in local borrowing can be defined as local borrowing being decided by residents directly or by their representatives through the local democratic system. In practice, the value local democracy can be obtained by such action in the local government borrowing decision making system as 'reflecting residents' opinions well'.

Most money borrowed by local government is used to conduct projects which produce economic or social benefits, and the cost of borrowing comprises the principal and interest. Therefore policy makers cannot help but consider economically efficient choice in the course of deciding borrowing quantity and projects. The value economic efficiency (briefly efficiency) in local borrowing can be defined as meaning the ratio between cost and benefit or effect. In practice, the value economic efficiency can be obtained by such action in the local government borrowing decision making system as 'analyzing cost and benefit or effect of local borrowing'.

On the other hand, local government can meet financial difficulties or crises by over-borrowing or mis-investing. Then a control system to prevent such danger is needed in deciding local borrowing process. The value of financial security is thought more important in the borrowing area than in any other parts of budgeting. The value of financial security (briefly security) in local borrowing can be defined as the condition of not being exposed to financial risk such as bankruptcy, but keeping financial soundness. In practice, it can be said that the value financial security is obtained by such action of the local government borrowing decision making system as 'checking and controlling excessive borrowing which may bring financial risk'.

So the three values are useful and indispensable to analyze and evaluate the local government borrowing decision making system. Now, it is necessary to analyze and evaluate the Korean local government borrowing system in viewpoints of the three factors and three values. This occurs in the next sections.

III. Analysis of the Korean Local Government Borrowing Decision Making System

The object of this section is to investigate the local government borrowing decision making system of Korea and to evaluate the system in terms of the three factors - institutional structure, borrowing criteria and personnel capability and three values - local democracy, economic efficiency and financial security identified before. The Korean local government borrowing decision making system is analysed on the bases of the results of literature investigation, survey analysis and interview survey.

1. The Institutional Structure of the System

Korea has a local government borrowing approval system in which central government approves every borrowing project of every local authority though the local authority has the right and responsibility to plan and decide its own borrowing within this process. Therefore, it is necessary to investigate not only the process for deciding local borrowing, but also the mechanical relationships between the levels of government and between the organizations involved.

1) The Process of Deciding Local Borrowing

The Local Autonomy Law (Article 115), the Local Autonomy Decree (Article 45) and the guidance of the Ministry of Government Administration and Home Affairs (MOGAHA) prescribe the detailed process of local government. This annual regular local borrowing decision making process can be broadly divided into four parts: (1) local borrowing guidance deliverance; (2) local borrowing plan preparation; (3) application and approval; (4) budgeting and decision. The process is, in principle, carried out annually, but the Local Autonomy Decree (Article 45) prescribes the exception that local government can issue additional borrowing with the separate approval of the MOGAHA when such borrowing is needed during the year or at other times due to unavoidable circumstances such as a natural disaster. In practice, the number of what are called 'irregular' borrowing project applications is almost same as the number of 'regular' ones decided under the annual procedures.

(1) Local Borrowing Guidance Deliverance

The Finance and Economy Division of the Local Finance and Tax Bureau of the MOGAHA starts to prepare local government borrowing guidance early every year. After that, the division calls together all local officials in charge of local borrowing to deliver the guidance and to instruct them about local borrowing in late-May or early-June. The content of the guidance consists of keynotes, referential criteria, borrowing plan items and processes, the borrowing application and approval procedure, the direction of central government borrowing policy, and other matters.

(2) Local Borrowing Plan Preparation

Each department of the local authority prepares a borrowing plan for any project for which borrowing is needed in the course of its budgeting. Then the budget department collects all the departmental borrowing plans together and makes the overall borrowing plan of the authority. In particular, the budget department of the upper-level local authority prepares the comprehensive local borrowing plan which includes the plans of the lower-level local authorities within its jurisdiction.

(3) Application and Approval

As said before, these comprehensive local borrowing plan applications for the next year are sent to MOGAHA by 31st July. MOGAHA proceeds with consideration of these applications, consulting with other ministries until 31st October. The number of borrowing projects applied for by local authorities for which ministerial approval is sought in this time under the annual regular procedure is in general over 300. So MOGAHA operates a 'local borrowing examination program' to examine each local borrowing plan more exactly. All borrowing projects are reviewed by official examination, but big borrowing projects over a certain size, for example in general, 5 billion Won in 1999, are judged by the 'Local Borrowing Examination Committee' on the basis of the examination by officials.

The examination is carried out by investigating the papers submitted by each local authority for each application, the opinions of local officials and the opinions of central government ministries including MOGAHA. After the examination, the Director General of the Local Finance & Tax Division makes the proposal for local borrowing approval (or rejection) and then the approval (or rejection) is settled by the sanction of the Minister of Government Administration and Home Affairs by 31st October and sent off to the local authority concerned.

(4) Budgeting and Decision

After making the draft budget including the local borrowing plan, the local authority presents the draft budget to the local council 40~50 days (50 days in an upper-level authority, 40 days in a lower-level authority) and the local council decides the local borrowing along with other parts of the budget at least 15~10 days before the beginning of the fiscal year.

2) Relationships Involved in Deciding Local Borrowing

As can be seen from the local borrowing process, These organizations, which have the main roles in deciding and conducting local borrowing, are central government (particularly MOGAHA), lower-level local authorities, upper-level local authorities, and the local councils in these latter authorities where borrowing is involved. Therefore, the relationships involved in local government borrowing can be classified as the relationships between local and central government; the relationships between lower-level and upper-level local authorities; and the relationships between each local executive and its local council.

(1) The Relationships between Local and Central Government

The relationships between local and central government can be said to involve control relationships (guiding the local borrowing plan, approving local borrowing, inspecting local debt conditions, etc.) and support relationships (loaning from the government fund, delivering information about the capital market, training the local officials charged with local borrowing, etc.) in local borrowing. Recently, there have been many arguments about the relationships between central and local government over local borrowing. Most researchers assert that the main relationship between central and local government in local borrowing is one of control because the guidance and the approval of central government determines the direction and content of local borrowing (Cho, K. H., 1996, pp. 55-61; Lim, S. I., 1997, pp. 537-540; Kim, J. S., 1997, pp. 555-556; Lee, H., 1998, pp. 82-83).

(2) The Relationships between Lower-level and Upper-level Local Government

Korean laws and decrees give upper-level local authorities the power to examine and coordinate their lower-level local authorities' borrowings. In actual practice, almost all official documents and public policies between central government and lower-level local government are conducted via upper-level local government. However, recently, there has been criticism that the role and status of upper-level local authorities in this process is vague and weak because the upper-level local authorities have no coercive power to effect their lower-level local authorities' borrowing lacking the right to approve or reject it (Kim, I. S., 1995, p. 548).

(3) The Relationships between the Local Executive and Local Council

As said before, local borrowing is planned and conducted by the executive (i.e. the

elected chief executive and his/her non-elected officials) of the local authority, but their conduct has to be approved by the elected local council. So it can be said that the power relations of the executive and the council are maintained by a system of checks and balances in deciding local government borrowing. However, in practice, the local executive leads local borrowing policy because the local executive has more information, knowledge and officials to deal with the complicated local borrowing affairs than the local council. Furthermore, the power of local council is limited by the power of the chief executive of the local authority. It has been said that Korea has the system of a 'strong local chief executive and weak local council' because the local chief executive can ask the local council to reconsider its decisions (Local Autonomy Law, Article 98) and can call for a residents' vote about local affairs thought to be important (the law, Article 13) (Ahn, S. C., 1995, p. 409; Kim, B. Y., 1995, p. 397).

3) Implications of the Institutional Structure for the Three Values

Firstly, the structure as it is likely to cover *local democracy* is undeveloped. In the course of deciding local borrowing, there are not many opportunities for reflecting residents' opinions and residents' concern is lack. The intervention and authority of the MOGAHA seem be too large in the decisions on local borrowing without the opportunity to contact and reflect local residents' opinions from the local authority area concerned. In the questionnaire survey(Lee, H. B., 2002, ch. 7), a great number of local officials (60.4% of local officials) insisted that there was too much central government control in the course of deciding local government borrowing. In the interview survey(Lee, H. B., 2002, ch. 8), almost all interviewees (87.5%) thought the central government's role in approving all borrowing excessive and in conflict with democracy.

Secondly, the present structure leaves little room for any *economic efficiency* analysis. There is no legal requirement for any efficiency analysis of local government borrowing in the local borrowing decision making process. Yet there is not much time to analyze exactly the cost and effect of each local borrowing project; lack of time may cause the loss of the opportunity to do sufficient analysis and to ensure efficiency and proper policy timing. As already mentioned, central government approves almost all of the 300 or so local borrowing project applications within just two months without sufficient expert participation, this implies difficulty in under taking much efficiency analysis. In the above questionnaire survey, a large number of local officials (54.4% of local officials) insisted that the process of applying and approving local borrowing already took too long without an efficiency analysis. In the above interview survey, almost all interviewees (92.2% of total) thought that the present structure of deciding local borrowing does not include or permit an efficiency analysis.

Thirdly, the structure, while providing the opportunity for government control, pays limited attention to *financial security*. Multi-stages checks in the process of deciding local government borrowing (e.g. lower-level local authority borrowing is checked by the upper-level local authority, by central government and by the local councils) increases the financial security of local borrowing, but at no stage is the security of local borrowing analyzed profoundly with enough time and expert ability to do the analysis adequately. Central government approves and controls almost all the local borrowing of all local authorities with much officials' discretion, both through the regular and irregular process. This system may help the security of local borrowing decisions, but it may constitute excess control of local borrowing and lead local authorities to be apt to shuffle off the responsibility of ensuring security to central government rather than analyzing the security of their own finance and local borrowing. In the above questionnaire survey, three quarters of the officials

recognized the possibility of local authorities going bankrupt through over-borrowing. In the above interview survey, about two thirds of interviewees (67.2% of total) thought that the present structure of deciding local borrowing is inadequate to check and resist excessive borrowing.

So, it can be suggested at first sight that the structure of the Korean system, which has many stages for deciding local borrowing and what seems excess control by central government, may help to increase each authority's financial security to some degree. However, the structure may be an important cause weakening local democracy, economic efficiency and real security of the local government borrowing decision making system in Korea.

2. Borrowing Criteria used in the System

Turning from the structure to the criteria used in the system to decide local borrowing, the criteria used in Korea are of two kinds, first the project criteria of deciding on local borrowing projects and second the quantity criteria for deciding the quantity of local borrowing on each project and overall for each authority.

1) Project Criteria

As already mentioned, the Local Autonomy Law (Article 115) prescribes that the chief executive of the local authority can issue borrowing for the permanent interest of the local authority or for emergency relief in the case of a natural disaster. And the Local Finance Decree (Article 6-2) prescribes the projects which can be financed with borrowing. These comprise: (1) the construction of public facilities; (2) enterprises whose revenue can be used to repay their debt; (3) any unexpected deficit compensation resulting from a natural disaster; (4) disaster prevention and restoration projects; (5) renewal of existing borrowing; and (6) other enterprises considered specifically to enhance the welfare of residents.

Therefore, as most projects can be included in the above category, then they can be financed with local borrowing. Some researchers argued that the projects financed by local borrowing should be divided by their types for more efficient management (Lim, S. I., 1997, pp. 543-544, Lee, H., 1998, pp. 83-84).

On the other hand, MOGAHA's local borrowing guidance indicates some items for local authority consideration on projects such as: (1) residents' opinions; (2) project's urgency and necessity; (3) lawfulness; (4) propriety of the construction term; and (5) the condition of previous facilities. The guidance also lists the projects that are *not* considered suitable for local borrowing such as (1) meeting wear and tear expenses (e.g. current maintenance or repair expenses, general investigation expenses, consumable tools and materials expenses, the expenses of short-term durability facilities); (2) small cost projects (e.g. those below 3 billion Won in a metropolitan city or province; below 1.5 billion Won in a city having the population of over 300,000; below 1 billion Won in a city having the population of below 300,000; 0.7 billion Won in county or district); and (3) other expenses that can be met from general resources.

These items from the guidance are necessary to decide the proper projects to be financed with local borrowing but, there is no more detailed guidance or criteria to examine the project items. So there is room for discretion of policy makers in applying the criteria.

2) Quantity Criteria

In Korea, there are no laws or decrees which directly prescribe the proper quantity of a local authority's borrowing. However, there are some prescriptions which control

over-borrowing quantity indirectly.

The Local Finance Decree (Article 6-2) prescribes some conditions that restrict local borrowing; approval is not to be given to a local authority to borrow (1) when the repayment of existing debt is delayed; (2) when financial conditions are difficult due to the heavy burden of existing debt; and (3) when a borrowing plan was approved on the basis of an earlier false application or local borrowing was issued without central government's approval.

On the other hand, the MOGAHA guidance indicates some criteria for the authority which can issue borrowing. It can do so and expect approval in the following cases: (1) the authority has no delayed repayment of debt; (2) the authority has had an average Debt Redemption Ratio (DRR) below 20% for the last 4 years (DRR is the average ratio of the amount of debt due to be repaid to the general resources amount (tax revenue + non-tax revenue + local shared tax)); (3) the authority's ratio of its overall surplus to its expenditure is more than -10% (i.e. deficit is less than 10% of expenditure); (4) the authority's ratio of its expected tax revenue for the present year to the one for the previous year is over 90%; (5) when there is no evidence that the authority's borrowing plan as approved was based on false claims or its local borrowing was issued without approval.

The above five items comprising the 'necessary conditions for local borrowing' are important to the planning and approval of local borrowing, but they are unrealistic or irrational to be used as criteria for borrowing (Cho, K. H., 1996, p. 59; Lim, S. I., 1997, p. 538). In practice, very few authorities until now have broken the conditions. For example, apart from eight authorities which delayed repayment in 1998, there were no authorities breaking the four items, "delayed repayment of debt", or proportions outside the rule for "surplus to expenses ratio", or "tax revenue ratio" and making "false application or borrowing without approval".

On the other hand, the DRR has some shortcomings as a criterion for deciding the proper quantity of local borrowing for the following reasons. One reason is that the DRR is focused not on borrowing or debt, but only on the repayment over the four years. The current level of borrowing and total debt cannot be reflected strongly enough in deciding local borrowing. So it can be said that the DRR is only an indirect limit on local borrowing. Another reason is that the 20% standard used in the DRR has not been tested as to its validity and, in practice, there are almost no authorities exceeding that limit. For instance, in 2000, only three out of the 248 authorities exceeded the 20%; only four authorities had DRR of 15-20%, with 241 authorities below 10%.

The guidance also indicates some items to be considered: (1) the financial condition and repayment ability of the local authority; (2) the conditions attached to the borrowing such as borrowing type, interest rate, repayment term and repayment resources; and (3) the borrowing situation. However, most items from the guidance are necessary but obscure. So, the utility of the criteria may be reduced and that can enlarge the discretion of the officials in charge of local borrowing.

The guidance, in addition, prescribes the Borrowing Appropriation Ratio (BAR) as the criteria for water supply and sewerage projects. BAR is estimated from such indices as liabilities ratio, average fee to prime cost ratio, personnel expense to revenue ratio, and so on (MOGAHA, 2000b, pp. 9-10). However, the BAR 'criteria for water supply & sewage projects' is only applicable to those particular projects and the applicability of the criterion has not yet been examined by MOGAHA.

Anyway, among the quantity criteria, the five items that comprise the conditions necessary for borrowing are mainly used in the course of deciding local borrowing. In

particular, the Debt Redemption Ratio (DRR) has until now been the most important criterion to control the quantity of local borrowing in Korea.

3) Implications of the Borrowing Criteria for the Three Values

Firstly, the implications of the borrowing criteria used in deciding borrowing in Korea are that *local democracy* is emasculated by the control and official discretion. In Korea, there is no exact and detailed criteria for deciding the project or quantity of local government borrowing taking into consideration of the financial and regional circumstances of the local authority seeking permission to borrow nor the opinions of residents. This means that the criteria are better fitted for the control strategy aim of the central government rather than for regional conditions and residents' opinions. In the above questionnaire survey, less than a third of respondents (30.9% of total) thought the criterion DRR reflected well the situation of local authorities. In the above interviews, almost all interviewees (90.6% of total on project criteria, 93.8% of total on quantity criteria) thought that the project and quantity criteria did not reflect residents' opinions.

Secondly, the criteria for deciding local borrowing are hardly helpful to considering *economic efficiency* either in choosing proper local borrowing projects or in deciding borrowing quantity. Considering the project criteria first, almost all project criteria for deciding local government borrowing projects show the range of projects on which local borrowing is permitted, but there are no criteria that help to choose the best projects for local borrowing nor are there detailed criteria requiring any efficiency analysis. These criteria are abstract and broad; almost all likely local authority projects are contained within the range of one of the criteria. This leaves discretion to officials or allows political bargaining rather than an analysis of efficiency (Cho, K. H., 1996, pp. 58-60; Lim, S. I., 1997, pp. 538-539). Turning to the quantity criteria, none of the criteria for deciding the quantity of local government borrowing reflect any efficiency analysis for determining the proper quantity of local borrowing. Most criteria are obscure and impractical as indicated before. In the above interview, most interviewees (96.9% of total on project criteria, 93.8% of total on quantity criteria) thought that the project and quantity criteria were not enough to constitute an efficiency analysis of borrowing as they were too abstract, broad and uniform with room for officials' discretion.

Thirdly, there are not enough criteria with which to conduct a detailed *security* analysis in deciding local borrowing. As said before, the project criteria are broad and obscure; almost any projects can be planned and approved by policy makers. There is no detailed borrowing project criteria that considers financial security. On the other hand, the quantity criteria are used in ways that allow central government to control local borrowing rather than involving an analysis of the security of local borrowing and finance in the long term. Furthermore, the present quantity criteria are too abstract and impractical to act as a control. In the above interviews, many interviewees (78.1% of total) thought that the project or quantity criteria were not enough to check and resist excessive borrowing because they were too abstract, obscure and uniform

Therefore, it can be said that the present criteria used in deciding local borrowing in Korea are too broad and abstract to reflect local conditions and to conduct an exact analysis. The shortcomings of the criteria depreciate the value local democracy, economic efficiency and financial security in the local government borrowing decision making system in Korea.

3. Officials' and Politicians' Capabilities in the System

As said before, the term personnel capability is used to reflect the policy makers' understanding, awareness and ability for deciding reasonable local borrowing. Policy makers are divided into three groups, local government officials, central government officials and elected representatives. In particular, the capabilities of policy makers are investigated in terms of the personnel system and political culture.

1) Local Government Officials

Korean personnel administration is based on the 'career corps system' where members of a corps are classified into a rank in consideration of their career and abilities (Kim, K. J., 1986, p. 532; Park, D. S., 1986, p. 309). Here promotion is highly dependent on length of service.

In practice, Korean local officials are recruited through competitive examinations. However, there is no "finance class" as it is included in a "general administration class" in the examinations. So official policy makers when they are first concerned with local finance have little understanding of finance and, in particular, of borrowing affairs. They can get some capabilities of conducting local finance and borrowing affairs in the course of their work in local - finance and borrowing by on the job training and education. However, in general, the practice is to move them on to another part of local administration within two years. It is therefore difficult for them to become specialists in local borrowing affairs.

Moreover, until recently, Korean public administration financial resources were centralized and local borrowing affairs controlled entirely by central government. This limits the discretion and experience of current local officials. Again, officials are still little affected by residents' influence under the ongoing bureaucratic system and as yet undeveloped democracy. Local officials are apt to depend on the decisions of central government or on precedents. They have difficulty in getting expert knowledge and ability in local borrowing, and their capabilities have not been so important an issue in this area.

2) Central Government Officials

In Korea, local borrowing affairs in central government are mainly dealt with by the officials of the Finance and Economy Division of the Local Finance and Tax Bureau of the MOGAHA. These officials, who also work under the 'career corps system', are generalists too. So the problems of local government officials' capabilities in the course of carrying out local borrowing affairs applies similarly to central government officials. In general, central officials in MOGAHA can get knowledge about local borrowing from their predecessors, their own studies and the files of previous decisions. However, they are also in general moved on to another part of government within two years. So it is also difficult for central officials to have high capabilities in deciding local borrowing policy.

In particular, the three of them have to assess about 300 projects and decide the draft approval on each within two months as mentioned before. Moreover, they have other responsibilities as well such as preparing the guidance on local borrowing, educating local officials, assessing additional 'irregular' local borrowing applications which can involve over 200 projects during the year, supervising local authorities on local borrowing, reporting the local borrowing situation to their Minister, the President, the Prime Minister, etc. So they seem to have too high a workload to analyze applications exactly and to assess local borrowing reasonably. Therefore, it is doubtful that central officials have capabilities and, especially, the time to decide local borrowing rationally or in any way thoroughly.

3) Politicians

As mentioned before, the Local Autonomy Law (Article 115) endows the *chief executive* with the power to issue local borrowing. So, as has been said above, in general, the chief executives lead the local borrowing policy in each authority. However, it is doubtful, in the short experience of local autonomy in Korea, that the chief executives have enough responsibility and ability in local borrowing policy to do the job properly. In general, they cannot but be assisted by local officials about the difficult and complicated borrowing affairs involved. But, in turn, as suggested above, the capabilities of local officials are limited. Hence, local borrowing policy may therefore be decided without proper consideration and irrationally.

According to the Local Autonomy Law, the local councilor has duties such as regulating bylaws, deciding local budgets, assessing the main policies of the local authority, inspecting the local administration and accepting any residents' appeals. So the local councilor has an important role in the process of deciding local borrowing because he or she can recommend, check, assess and control local borrowing much undertaken in the few days allowed. However, it is doubtful, once again, if local councilors' capabilities are enough to conduct the above roles under the present conditions in Korea's undeveloped democracy and, indeed, more generally (Ahn, S. C., 1995, pp. 406-425; Roh, M. H., 1995, pp. 434-437). Furthermore, the local council has limited power to control the executive branch under the strong chief executive system as highlighted in Korea.

4) Implications of the Personnel Capability

Firstly, it is suggested that policy makers' capabilities to *reflect residents' opinions* on local borrowing policy are inadequate and immature. Local officials seem often to focus on the orders of senior officials, the chief executive and central government rather than on residents' opinions under the Korean culture of strong authoritarianism and bureaucracy. Moreover, central officials have less information than local officials about the real situation of a region and they are little affected directly by the opinions of the residents. Though, politicians reflect residents' opinions better than local and central officials, their capabilities are limited structurally as has been seen before. In the interviews, almost all interviewees (93.7% of total) thought that the capabilities of policy makers were not enough to enable them to reflect residents' opinions.

Secondly, it does not seem that any policy makers among local officials, central officials and politicians have enough capabilities to conduct an *economic efficiency* analysis into local borrowing. Almost all local and central officials who are in charge of deciding local borrowing have very limited experience of borrowing affairs and have been generalists. It is difficult for them to have enough knowledge to analyze the cost and economic effects of local borrowing efficiently in the condition of nonexistence of reasonable analysis model or frame. The capabilities of politicians to analyze local borrowing efficiently seem still to be low as said before. In the above interview, all interviewees thought that the capabilities of officials and politicians were inadequate to do an efficiency analysis of borrowing. The limited capabilities of politicians may generate extravagance in local finance.

Thirdly, the insufficient capabilities of policy makers to analyze local borrowing may be serious problems in ensuring *financial security* in deciding local borrowing. As mentioned before, the limited capabilities of local and central officials, who are generalists, in deciding local borrowing means that they cannot adequately analyze local financial conditions. This adversely affects the sound operation of local government finance. Furthermore, local officials may shuffle off their security

responsibilities to central government's rather than try to develop the necessary capabilities themselves to ensure security through detailed financial analysis. Central officials are apt to rely on restraining local borrowing as the way to obtain security without considering the local financial situation. As local councils have limited control over the executive under the strong chief executive system in Korea as mentioned before, the real security of local authority finance through a local authority's self control may be ineffective. Most interviewees (78.1% of total interviewees) thought that the capabilities of officials and politicians were not enough to check and resist excessive borrowing because of problems which included their insufficient expert knowledge and their deficient awareness of their responsibility for this.

In conclusion, the insufficient capabilities of policy makers to reflect residents' opinions and analyze local borrowing in detail can menace accomplishing the three values, local democracy, economic efficiency and real security of local finance in Korea.

III) IV. Comprehensive Evaluation of the Present Local Government Borrowing Decision Making System in Korea

A comprehensive evaluation is now undertaken. The present local government borrowing decision making system which is evaluated comprehensively in terms of the three values by synthesizing the evaluations of the three factors, structure, criteria and capability in the previous sections. And the present system can be pictured through the relations between the three factors and the three values as can be seen in follow Table 1.

First, the present local government borrowing decision making system does not meet the requirements of the value *democracy*. This is *inter alia* because the three factors, structure, criteria and capability, have considerable problems in reflecting residents' opinions. In terms of democracy, the *structure* of the present system presents problems such as the strong central government combined with the weak local authority and the strong executive branch in the local authority combined with the weak local council in power and role; and the insufficient residents' participation in and concern with local borrowing. The *criteria* used in the present system also deliver problems as they are too abstract, obscure and broad; leave too much room for officials' discretion in applying the criteria; and do not reflect residents' opinions. The *capabilities* of officials and politicians in the present system also contribute problems such as the policy makers' lack of expert knowledge and responsibility for borrowing; officials' administrative opportunism or bureaucracy; and the weak role of the local council.

Second, the present local government borrowing decision making system certainly does not meet the requirements of the value *efficiency*. All the three factors, structure, criteria and capability, present problems in ensuring the analysis of the cost and effect of local borrowing applications and the projects involved. The *structure* of the present system lacks any provision for an efficiency analysis; the application process is too long but the analysis time too short; the role of central government is too large but without sufficient time for the local borrowing aspect to be analyzed efficiently; and little opportunity is provided for expert participation and advice. The *criteria* in the present system constitute problems in that they are too abstract, broad and uniform; and there is no requirement in the present system for the legal process or the criteria to analyze quantity and project priority properly. The *capabilities* of officials and

politicians in the present system present problems through the lack of official expertise due to the ‘rotation-working system’; the deficient awareness of officials and the unconcern of politicians with any efficiency analysis; and the absence of any efficiency analysis model or frame to follow.

Third, with regard to security, the present local government borrowing decision making system focuses on limiting local borrowing. Consequently, the system offers the security of local borrowing to some degree, but not enough to ensure it. This is because the three factors, structure, criteria and capability, meet problems in checking and controlling excessive borrowing which may bring financial risk to the local authority concerned. The *structure* in the present system presents problems in that the central control is too formal and uniform without consideration of local conditions. Other problems include officials’ self-righteousness and discretion; and the weak function of the local council. The *criteria* in the present system constitute problems for security because they are too abstract, broad and uniform; because the decisions made by central government are made without reflecting local conditions and without considering the future repayment ability of the local authority; and because there is too much room for officials’ discretion in applying the criteria. The *capabilities* of officials and politicians in the present system give rise to security problems because of insufficient expert knowledge; use of the uniform and excessive control of central government without consideration of the local situation; officials’ and politicians’ deficient awareness and weak sense of responsibility about the need for security.

Table 1 The Evaluation of the Present System in Korea

Factor	Value	Structure	Criteria	Capability	Whole
Democracy		Main Problem	•strong central government •too abstract, broad, uniform	•strong executive •much room for discretion	
		•lack residents’ concern •insufficient residents’ opinions •administrative opportunism	•weak role of local council	•lack of expert knowledge many fundamental problems	
	Evaluation		Inadequate (89.1%)		
		Inadequate (92.2%)	Not enough (93.7%)		
		Inadequate (91.7%)			
Efficiency		Main Problem	•long process, short analysis •too abstract, broad, uniform	•too large role of central gov. •no criterion for proper quantity and project priority	
		•lack of expert participation •lack of analysis model, frame	•lack of expert knowledge	•deficient awareness many fundamental problems	
	Evaluation		Inadequate (92.2%)		
		Inadequate (95.3%)	Inadequate (100%)		
		Inadequate (95.8%)			
Security		Main Problem	•central control is too formal •too abstract, broad, uniform	•officials’ discretion •central control not reflecting local conditions	
		•weak role of local council •much room for discretion •irresponsibility	•lack of expert knowledge	•central control not reflecting local conditions many fundamental problems	
	Evaluation		Inadequate (67.2%)		
		Inadequate (78.1%)	Not enough (78.1%)		
		Inadequate (74.5%)			
Whole		Comm- on Problem	•strong central government, weak local role	•lack of expert knowledge	
		•too abstract, broad, uniform many fundamental problems			
	Evaluation		Inadequate (82.8%)		
		Inadequate (88.5%)	Not enough (90.6%)		

Inadequate (87.3%)

N.B.: The percentage in the bracket is the interviewees' responses i.e. who answered that any factor of the present system was inappropriate or not enough to meet each value, and the percentage for whole column or row is the average percentage for each column or row.

Therefore, it can be said that the present local government borrowing decision making system in Korea is inadequate to obtain the three values, local democracy, economic efficiency, and financial security, because of fundamental problems in the three factors, institutional structure, borrowing criteria, and personnel capability, that make up the system.

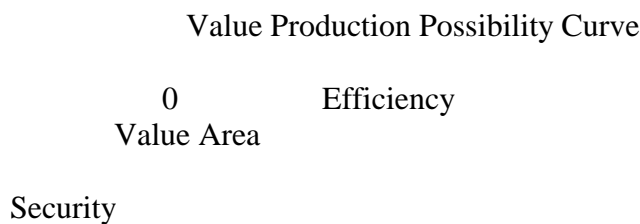
In particular, it is significant that the three values share several common problems in the three factors such as the strong, but formal and uniform checks and controls of central government without consideration of local conditions; the over abstract, broad and uniform criteria; and insufficient expert knowledge and responsibility of policy makers. Furthermore, almost all the problems in the three factors are connected with each other, for example, central government's strong and extensive control structure, in which central government approves every local authorities' local borrowing projects, makes it difficult to carry out the detailed and exact analysis needed in a short time. So the criteria for deciding local borrowing are apt to be obscure, broad and uniform. The reverse is also true.

Therefore, in summary, it can be said that the main problems of the three factors are closely connected and reinforce each other and will do so as long as there is no fundamental reform in the present system. If the three factors are evaluated with the degree of interviewees' responses in a thesis (Lee, H. B., 2002, ch 8), the factor relating to the capabilities of officials and politicians is the most inadequate to meet the three values (90.6% of total interviewees think capabilities inadequate), the factor criteria is the second (88.5% of total), and the factor structure is the third (82.8% of total) (see Table 1). However this 'inadequate factor order' could change in other circumstances because the above views and measures were drawn from only a qualitative interview and the three factors are connected each other as said before.

On the other hand, if the present system is evaluated in terms of the three values by the degree of interviewees' responses (Lee, H. B., *ibid.*), the present system is the most inadequate in meeting the value efficiency (95.8% of total interviewees think that the present system is inadequate to meet the value efficiency), the second most inadequate is democracy (91.7% of total), and the least inadequate is security (74.5% of total) (see Table 1). This 'inadequate value order' accords with the response to another question in the interview which asked whether more of each value was desirable (Lee, H. B., *ibid.*). More efficiency was considered to be desirable by all 32 interviewees (100% of total), more democracy by 30 interviewees (93.8% of total), and more security by 25 interviewees (78.1% of total).

In reality, there is little room for any efficiency analysis in the present Korean system which has the above fundamental problems in the structure, criteria, and capabilities of policy makers. The value democracy seems to be increasing as local autonomy is established, but not enough to reflect residents' opinions at all well. The value security has been obtained to some degree by the strong control of central government, but the present system, focusing on formal control, is weak in meeting financial crises. Taking all the literature, data analysis and fieldwork into account, it can be said that the most insufficient value in the present system in order are first efficiency, second democracy and, then security. Therefore, the present local government borrowing decision making system in Korea can be pictured as having the shape of the central space of the three values' coordinate axis as below in Figure 1.

Figure 1 The Ability of the Present System to meet the Three Values
Democracy



In the figure, the system is short in meeting each of the three values but, particularly short in relation to the value efficiency with democracy the second shortest and with security met more than former two values. The curved line between values can be called the 'value production possibility curve' which indicates the possibility range of the values to be obtained from the present system. The curve has a convex shape. This implies that the 'marginal rate of transformation' is increasing because obtaining a unit of a value from the system will become more difficult as the ability of the system approaches its maximum level. So more units of other values need to be forgone to add a unit of the first value under the limited ability of a system. The point zero "0" is premised that here the local borrowing decision making system is inoperative, so it provides none of the three values. In any case, the value production possibility area (or value area inside the value production possibility curve) in the present system is small.

V. Conclusion

This research has aimed at producing knowledge about the local government borrowing decision making system through analyzing and evaluating the Korean system from the viewpoint of policy science. In the process, some elements needed to be analyzed such as the factors that together comprise the system and the values that should underpin the system. The factors and values of the system were decided after consideration of the literature and local borrowing's character. The three factors are institutional structure, borrowing criteria, and personnel capability and the three values are local democracy, economic efficiency, and financial security.

On the whole, it is apparent that the Korean local government borrowing decision making system has many problems in its structure, criteria and capabilities of policy makers such as the strong but formal and uniform checks and controls of central government without consideration of local conditions, the use of too abstract, broad and uniform criteria, and the insufficient expert capabilities of policy makers. These problems of the three factors in the system are connected and reinforce each other. As for the findings, these indicate that though the present system focuses on controlling local borrowing, it is not yet enough to obtain the three values, democracy, efficiency and security. Based on the analyses of this research, it can be said that the most insufficient value in the present system in order is first efficiency, second democracy and third security.

Under the above diverse problems of the present system, it is possible for a local authority to experience either extremes in local borrowing policy such as too little borrowing or too much borrowing and both can provoke the traps of the vicious circle of under-investment and the second to a dilemma of over-investment. On the one hand, the situation and policy focused on the public fund and the control of local

borrowing shrinks the investment in a region, the low investment resulting in under development of the region, and then the undeveloped region can induce only low investment. So the region may drop into the trap of a vicious circle. On the other hand, under the present system in which central government approves each local borrowing projects of all local authorities without the sufficient market checking system, there may be formal and uniform checks and controls of local borrowings. Some authorities take on too much borrowing in spite of their difficult financial conditions without profound analysis. However, the local authority who took on too much borrowing and conducted too much development could meet a dilemma. This dilemma arises when the local authority chooses the policy of continuing development, needs more borrowing and imposes an increasing financial burden on its residents; and, then, has to change to either a policy of stopping development or adding more borrowing. Ultimately, these mean that the present system's ability to meet democracy, efficiency and security is weak now and in the future. This aspect may well be strengthened under the conditions of increasing residents' demands for regional development with the increasing urbanization and advancing local autonomy in the future in Korea.

Therefore, some of the reforms are needed for a more desirable system in which the shape of the three factors is amended to increase the three values, for example, lessening the central government's power and role; opening up the local borrowing process to the public; developing and prescribing more practical and detailed criteria; reforming the present personnel system with its rotation-working system; and many others. However, there may be considerable difficulties in introducing the reforms not least the considerable expense and resistance. Certainly more time and human resources will be absorbed in any satisfactory new system. A staged introduction is proposed to proceed in parallel with the advance in local autonomy practices.

Anyway, the principal contribution to knowledge considered to be made by this research is its comprehensive investigation of the operation of the Korean local government borrowing decision making system. This research tried to pioneer new field, the decision making system in local borrowing by analyzing local borrowing decision making through connecting the special character of local borrowing with the policy making process in government. So it is hoped some findings of this research seem be fresh and profound to local borrowing researchers and policy makers. However, this research has focused on the system and the analyses have been carried out from the systems approach viewpoint. Thus, the range of the analyses became broad; more technical and complicated information has not been applied. These issues could be discussed in further research on the basis of the implications of this research and taking account of its limitations.

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