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## Global Forum on Competition

COMPETITION POLICY, INDUSTRIAL POLICY AND NATIONAL CHAMPIONS

Contribution from Korea

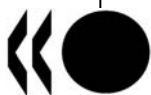
-- Session I --

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## THE RELATIONSHIP BETWEEN COMPETITION POLICY AND INDUSTRIAL POLICY

--Korea--

### 1. Introduction

1. During the 1960s and 1970s, Korea enjoyed a phenomenal economic growth by employing a strategy that aims to nurture certain industries through financial support and protection like tax incentives and safeguard measures. However, during the same period, problems like monopolistic market structure and market distortion were created, which undermined the Korean economy's fundamentals. Today, departing from a government-oriented growth strategy through support and protection, Korea has adopted a market-oriented growth strategy in which promotion of competition, regulatory reform lead to technological innovation and enhanced productivity.

2. This paper will first study Korea's past industrial policies, then explore the conflicts between industrial policy and competition policy and seek possible viable solutions. This is an issue on which much discussion is recently taking place in Korea.

### 2. Thoughts on Korea's industrial policies of the past

#### 2.1. *1960s - 1970s: To nurture strategic industries through selection and concentration*

3. With the first 5-year economic development plan launched in 1962, Korea went about economic development in earnest. At that time, the development strategy was "government-driven export-oriented industrialisation" aiming to overcome unfavourable conditions of small domestic markets and lack of natural resources and thereby to find new growth momentum in exports.

4. In order to develop heavy and chemical industry, the Korean government employed mainly indirect subsidy programs like the provision of low-interest loans, tax breaks and safeguard measures to protect local industry. At the same time, with monopolistic market structure worsening, it enacted the "Price Stabilisation Act," to control prices.

5. Into the 1970s, a high growth of an average of 9.6% continued. However, protectionism and excessive regulations in the form of over-investment in heavy and chemical industry and price controls caused multiple adverse effects, like worsened monopolistic market structure and inefficient resource allocation.

#### 2.2. *1980s: to shift to a system that promotes self-compliance and competition*

6. Going through the second oil shock, the Korean government had a rude awakening over the government-driven economic management system, perceiving the limitation of government intervention. Hence, under the principles of "self-compliance, competition and market opening," Korea embarked upon transforming its economic management style into a market-oriented one.

7. To that end, the Korean government reduced government financial assistance on a large scale, abolished individual laws for industrial development and significantly eased safeguard measures by removing the import prohibition list. Besides, with the view of overhauling the industrial assistance system and carrying out industrial rationalisation effectively, the government introduced the Industrial Development Act. The law confined the role of the government to a "trouble shooter," limiting government intervention only to the case in which market fails to function properly, for example, restructuring of sunset industries. As a result, the 1980s saw regulations on manufacturing industry largely scaled back and market disciplines greatly increased.

8. In the 1990s, Korea proceeded with deregulation in the service sector including finance, telecommunications and transportation in full swing. The purpose of deregulation was to eliminate barriers to entry into the industries and to make it clear when the government should intervene and when it shouldn't, so as to change the framework of the role of the government. Plus, Korea's entry to the WTO in 1995 paved the way for removing trade barriers like tariffs and quantity controls to a level of advanced countries'.

9. Into the 2000s, the policy paradigm of greater market disciplines and market opening was consistently maintained and evolved. Sweeping restructuring of corporate sector and financial industry was carried out, which aimed in the short term, to remove factors that might make the sector and the industry unhealthy and in the long term, to raise transparency, efficiency and fairness of the economy and thereby to strengthen competitiveness through market disciplines.

### **3. Recent development of industrial policy and competition policy of Korea**

10. Currently, Korea's industrial policy takes very measured approaches. The Industrial Development Act as the framework law governing the national industrial policy does not contain major policy tools to nurture national champions, such as sector-specific subsidies, entry restriction, easier access to credit and exemption from antitrust law. The Act, instead, presents long-term-based workforce training assistance, R&D investment in basic science and technology and institutional innovation as primary tools of industrial policy.

11. The Monopoly Regulation and Fair Trade Act (the MRFTA), Korea's competition law, currently applies to all industrial sectors without exception. Exemption from antitrust law is granted only to legitimate exercise of intellectual property rights pursuant to the relevant law or conduct deemed reasonable under other laws and regulations.

12. Therefore, it is fair to say that since the 1980s, Korea has not adopted a national champion promoting strategy and so its leading exporters in shipbuilding, automobiles, and electronics sectors have gotten on their feet without government assistance to survive fierce competition at home and abroad and become the world's leaders. Yet, some regulated industries like finance, telecommunications and energy are keeping anti-competitive regulations for the sake of protecting users' interest and ensuring universal access.

13. In recent years, Korea's competition authority often has conflicted with regulatory authorities mainly for the following two issues. First, undertakings' conduct involving administrative guidance<sup>1</sup> frequently used by regulatory authorities to achieve the purpose of industrial policy like industrial vitalisation and the securing of public interest, often infringes competition law. Second, regulatory authorities' entry restriction or price controls to protect related industry and companies often go against competition advocacy efforts. Accordingly, the Korea Fair Trade Commission is responding to the first issue by establishing principles with which to enforce its law while for the second issue, consulting with the relevant regulatory authorities to improve anti-competitive regulations under their jurisdiction.

- (1) Antitrust infringements involving regulatory authorities' administrative guidance.

In case undertakings' conduct induced by administrative guidance of government agencies in charge of industrial policy is in violation of competition law, the issue comes down to the matter

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<sup>1</sup> The term "administrative guidance" means any administrative action for an administrative agency to guide a specific person in performing or failing to perform any certain act or to recommend or advise him/her to do so or not to do so in order to accomplish administrative purposes within the scope of affairs falling under its jurisdiction.

of whether the conduct can be exempted from application of the MRTFA, deemed as legitimate act pursuant to the relevant law or can be considered legal under the MRFTA. This issue has mainly been relevant in cartel cases.

#### Guidelines for Review of Cartels involving Administrative Guidance

The KFTC established a set of conditions and allowed administrative guidance to be exempted from antitrust law only when those conditions are met. First, the relevant laws should stipulate detailed conditions under which collaboration between competitors is allowed. Second, the relevant laws should explicitly grant administrative agencies authority to issue administrative guidance regarding collaboration between competitors.

Meanwhile, where administrative guidance is involved, the case in which undertakings have made a mutual agreement based on the guidance constitutes a cartel activity, but the case when undertakings follow individually the guidance without the mutual agreement does not.

#### Two local phone companies' cartel involving local call rates

In 2003, two local phone companies KT (market share at about 91% by number of subscribers) and Hanaro Telecom (market share at about 8%) made an agreement in an attempt to bridge the gap in the two's call rates. Under the agreement, KT would maintain its existing call rates but if Hanaro Telecom adjusts its call rates, KT would give its market share in the local phone market by 1.2% on an annual average by 2007. At that time, the examinee KT argued that its conduct should be exempted from competition law, citing that it was inevitable according to administrative guidance of the Ministry of Information and Communication<sup>2</sup>, which tried to prevent the then ailing Hanaro Telecom from being driven out of the market.

The KFTC recognised the existence of the guidance, but concluded that there was no cause-effect relationship<sup>3</sup> between the guidance and the cartel conduct and the guidance was a mere recommendation, thereby imposing a corrective order and 118.4 billion (about 9.1 billion dollars) in surcharge on KT and Hanaro Telecom.

- (2) KFTC's efforts to reform anti-competitive regulations.

#### Korea's competition advocacy system

Pursuant to Article 63 of the MRFTA, the KFTC introduced and has had preliminary consultation on enactment and reinforcement of anti-competitive regulations. Under this system, where regulatory authorities wish to enact or amend laws and regulations that have anti-competitive provisions like the determining of price or transaction terms, restriction in market entry or business activities, or cartels, or to approve of or take actions regarding such anti-competitive laws and regulations, they are required to have consultation with the KFTC in advance or to inform the KFTC of such matters. Then the KFTC suggests recommendations to the relevant authorities, which in turn reflect them in their laws and regulations.

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<sup>2</sup> The Ministry was in charge of promoting and regulating the IT industry, and after governmental reorganisation, is currently named "Korea Communications Commission."

<sup>3</sup> Under the agreement, provisions other than the one related to call rate fixing were not put into practice, and the MIC did not take any action on the specific measures for compliance with the agreements or the part of the agreement which failed to be carried out.

Plus, when it comes to statutory amendment in Korea, all proposals should receive examination by the Regulatory Reform Committee, where the KFTC participates in as the government representative and is actively engaged in competition advocacy efforts. Particularly, from this year, the competition assessment among the Regulatory Impact Analysis items will be carried out solely by the KFTC. This shows that competition authority's role is gradually increasing in the area of regulatory reform in Korea.

#### Accomplishments

As the awareness of and consensus on the preliminary consultation on anti-competitive regulations (Article 63 of the MRFTA) is growing within the government, the number of consultation since 2004 has noticeably increased. In addition, the percentage of accepted KFTC recommendations to the number of the submitted ones is more than 80%, and increasing.

The ongoing efforts to reform anti-competitive regulations launched in 1988 have been successful, with a notable feat in the late 1990s when the Omnibus Cartel Repeal Act enacted to abolish more than 20 cartels from 18 laws. In 2007, based on the survey of the demand side (or those regulated), the KFTC reviewed 52 regulations and agreed with the relevant authorities to improve 23 of them. Since last year, the KFTC has been focusing on anti-competitive regulations like entry and business activity restrictions in major 3 regulated industries that are finance (banks, securities, non-life insurance), broadcasting & telecommunications, and aviation & transportation. Besides, the KFTC is also making efforts to ferret out and improve anti-competitive ordinances and rules of local municipalities.

#### Cases demonstrating economic effect of regulatory reform

In theory, there is no doubt that regulatory reform boosts the economy and brings positive effects on various economic growth indicators. Here are Korea's experiences of regulatory reform in the IT sector introduced.

Since 1990, in concerted efforts with the relevant authority, the KFTC has been spurring efforts to shift the telecommunication market to a competitive one through the easing of entry restriction and price controls. As a result, Korea's telecommunication industry saw new entrants entering to the market one after another after the mid 1990s and the each service sector form a competitive environment, and in 1998, call rating system changed from approval-based to notification-based. As a result, the overall call rates gradually decreased, with distant call and international call rates both plummeting by more than 50%.

#### **4. Conclusion**

14. In hindsight, policy to protect local industry with measures like subsidies, exemption from competition law and entry restriction as seen in Korea seems to be an effective policy at a time when a country with little resources and small domestic market is in its early stage of industrialisation. However, as the economy gets bigger and more complex, a government-oriented strategy that promotes national champions may deepen monopolistic market structure, create inefficiencies and have other adverse side effects. After all, Korea's change in policy paradigm to strengthen market economy in the 1980s amid the oil shocks turned out to be a major contributor to its substantive growth thereafter.

15. In the era of global competition, the key to success lies in creating an environment where companies can develop problem-solving capability themselves and so enhance their productivity. In this light, only policies that create such a pro-competitive microeconomic environment for companies will facilitate productivity growth and efficiency gains and ultimately sustainable economic development.