



Economic Survey of Korea, 2000

Summary

Korea has achieved a remarkably quick and strong recovery from the financial crisis at the end of 1997, thanks to supportive fiscal and monetary policies and progress in structural reform. Growth appears likely to continue at a buoyant pace in 2000 and 2001. In the context of the strong expansion, the newly independent Bank of Korea should ensure that its inflation target is achieved, while fiscal policy should meet the new goal of accelerating the achievement of a balanced budget and limiting public debt. Given the need to increase tax revenue to meet medium-term spending pressures associated with the ageing of the population and co-operation with the North, it is important to remove remaining distortions in the tax system and to pursue reforms in the pension system. There are remaining concerns, particularly in the financial and corporate sectors. Given the strong recovery, it is crucial to avoid complacency in implementing reforms to establish a more market-oriented economy, with appropriate prudential control and governance mechanisms. Progress in this regard is the key to sustaining high growth and reducing financial vulnerability. Competition needs to be strengthened through further market opening, regulatory reform, competition policy and privatisation and, more generally, by limiting government intervention in the economy. Ensuring an open environment for foreign direct investment is also important to boost competition, as well as to introduce new technology and management practices. Serious problems that remain in the non-bank financial sector should be promptly addressed, building on the considerable progress that has been made in rehabilitating the banking system. These efforts should be accompanied by a further strengthening of the corporate governance system. In short, having launched an ambitious programme to transform its economic system, Korea needs to follow through on the implementation of these reforms. Such reforms, together with appropriate macroeconomic policies, will boost the supply potential and reduce vulnerability to shocks, thereby sustaining rapid economic growth in the years to come. ■

How strongly has the Korean economy rebounded from the 1997-98 financial crisis?

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This Policy Brief presents the assessment and recommendations of the 2000 OECD Economic Survey of Korea. The Economic and Development Review Committee, which is made up of the 29 Member countries and the European Commission, reviewed this Survey. The starting point for the Survey is a draft prepared by the Economics Department which is then modified following the Committee's discussions, and issued under the responsibility of the Committee.

How strongly has the Korean economy rebounded from the 1997-98 financial crisis?

Following the financial crisis of 1997, a recovery began in the second half of 1998 and gathered momentum in 1999. The recession – Korea's worst in the post-war era – resulted in an output fall of almost 7 per cent in 1998, a tripling of unemployment and a current account surplus of almost 13 per cent of GDP, primarily due to a sharp contraction in imports. By the latter part of 1998, however, an improvement in a broad range of indicators signalled an economic turnaround. The recovery in 1999 and the first half of 2000 was led by private consumption, which was fuelled by pent-up demand and rising overtime payments. The corporate sector, having slashed employment and wages and reduced its debt burden, recorded profit gains, leading to a rise in fixed investment. Another important factor was a deceleration of inventory destocking, which made a large positive contribution to growth. Export growth also picked up, reflecting the increased competitiveness of Korea following the depreciation of the won. Output increased almost 11 per cent for the year in 1999, despite the problems resulting from the collapse at mid-year of Daewoo, the second-largest chaebol, and continued to expand at a robust pace into the early part of 2000. The consumer price increase in 1999 was 0.8 per cent, a record low. During the first four months of 2000, it picked up to 1½ per cent (year-on-year), although core inflation (excluding energy and most agricultural products) remained less than 1 per cent.

Korea's early and strong rebound was due, in part, to a recovery in confidence resulting from the sharp increase in foreign exchange

reserves related to the huge current account surplus. In addition, a wide range of structural reforms was introduced to establish a more market-oriented economy, thereby addressing the weaknesses that had made Korea vulnerable to a crisis. The reforms, which are discussed below, included significant changes in the financial system, the corporate sector, the labour market and government regulation. While the reform process is still not complete by any means, it has had a positive impact on confidence, both within Korea and abroad, concerning the country's prospects. Increased confidence boosted capital inflows, notably in the form of direct investment, which rose from \$8.8 billion in 1998 to an all-time high \$15.5 billion in 1999, thus further increasing foreign exchange reserves. These factors resulted in an upgrading in Korea's sovereign credit rating, a fall in its risk premium from 1 000 basis points in the wake of the crisis to around 150 at present and a rise in the exchange rate from the very low levels recorded in early 1998.

The recovery in the won facilitated the easing of monetary policy. Short-term interest rates, which had been over 30 per cent at the beginning of 1998, continued to fall to under 5 per cent in 1999, while the long-term bond rate remained in single digits during most of the year. The impact of lower interest rates was extremely positive for Korea's highly indebted corporate sector and also promoted a recovery in bank operating profits. The easing of monetary policy was accompanied by an activist fiscal policy to attenuate the economic downturn. Increased outlays, focused on assisting the unemployed and small and medium-sized enterprises (SMEs), boosted Korea's government spending by 15 per cent in nominal terms in 1998. Consequently, the consolidated central government budget, which had typi-

cally been kept in balance prior to the crisis, recorded a deficit equal to 4 per cent of GDP. ■

What is the outlook through 2001?

The upturn appears likely to continue at a buoyant, though slowing pace, through 2001. The boom in the information and telecommunications sector and the large number of new venture businesses are expected to sustain investment growth. Further gains in employment and wages are likely, boosting private consumption and lowering the unemployment rate from a peak of 8½ per cent in early 1999 to around 4 per cent. Export growth may pick up further, given stronger demand in overseas markets and Korea's still strong competitive position. Nevertheless, there are factors that are likely to slow growth gradually from its double-digit pace to more sustainable rates. *First*, the exceptionally large contribution from stockbuilding that was recorded in 1999 will wane during the next few years. *Second*, buoyant import growth will narrow Korea's current account surplus from 6 per cent of GDP to around 2 per cent, and make the external sector a drag on growth in 2000. *Third*, the satiation of pent-up demand will restrain the rise of private consumption. *Fourth*, fiscal consolidation will have a negative impact on demand. As a result, growth is projected to slow to 8½ per cent in 2000 and 6 per cent in 2001. Seasonally-adjusted economic indicators suggest that growth had already decelerated in early 2000 from its peak in mid-1999. Inflation is expected to be limited to under 3 per cent by remaining slack in the labour market, a capacity utilisation rate that remains below its peaks recorded during past expansions and the renewed appreciation of the won since the autumn of 1999.

There are risks, both domestic and external, attached to this projection of a continued expansion through 2001. On the domestic side, the major risk would appear to be financial market turbulence, perhaps related to possible bankruptcies of other large companies triggering difficulties in financial institutions. On the external side, there is a risk of potentially destabilising flows of portfolio investment. Realising the benefits of opening the equity and bond markets, which offers considerable advantages, requires policies that maintain the confidence of foreign investors. However, the stock market in Korea has shown a close correlation with that in the United States in recent months. Consequently, a sharp correction in US share prices could lead to a further decline in the Korean market, which has fallen around 20 per cent from its peak at the end of 1999. Such a correction could reduce growth in Korea, to a limited extent through a negative wealth effect, as well as through slower growth in Korea's major export markets. Finally, a depreciation of key Asian currencies might also undermine Korea's export growth. ■

What is required of monetary policy?

If the expansion continues at a rapid pace, as projected, and remaining slack is used up, it will be important that the Bank of Korea adjust monetary policy in a timely manner in order to achieve its inflation target. The Bank, which was made independent in 1998 and given full responsibility for monetary policy, has set an objective of limiting core inflation in 2000 to 2.5 per cent, plus or minus one percentage point. Having raised the overnight interest rate by 25 basis points in February, the Bank of Korea is closely monitoring economic conditions to determine

whether further rate increases may be necessary to contain inflationary pressures in line with the medium-term target of 2.5 per cent. It is essential that the central bank effectively use its independence to establish its credibility and demonstrate that price stability is its primary objective. Completing the shift to an interest-rate-based policy, in part by phasing out the use of aggregate credit ceilings, would enhance the effectiveness of monetary policy.

The need for higher interest rates will depend, in part, on exchange rate developments. The won has appreciated about 13 per cent since September 1999 on a trade-weighted basis, driven by the current account surplus and capital inflows. These factors may put further upward pressure on the exchange rate, which currently is still about 13 per cent below its pre-crisis level. The government, however, is concerned by the pace of the won's appreciation, as it is a factor in the significant narrowing of the current account surplus in early 2000, thus putting its objective of a \$10 to 12 billion surplus for the year at risk. Consequently, it has implemented a package of measures, including foreign-exchange market intervention, aimed at smoothing the appreciation of the won. However, a stronger currency helps contain inflation, thereby limiting the need for higher interest rates in the context of continued restructuring in the corporate and financial sectors. It is important that monetary policy focus on the objective of price stability, taking into account the impact of exchange rate developments on inflation, rather than on secondary considerations. Experience in some other OECD countries shows that the pursuit of multiple objectives, such as alleviating the interest burden or improving the current account, by central banks has undermined price stability, the primary objective of monetary policy. ■

How important is the behaviour of the current account?

The current account surplus was substantially reduced in the first half of 2000. The government is planning to take some measures, including the adjustment of taxes on energy, which are intended to have the indirect effect of reducing imports. The government's sensitivity to the external balance is understandable in light of the recent financial crisis but should not be over-emphasised at this stage. In any case, the measures introduced are unlikely to influence significantly the external balance, which is determined by the domestic saving and investment balance. Indeed, the large current account surpluses in 1998 and 1999 primarily reflected the sharp fall in domestic investment as a share of GDP. Korea's current account may tend to remain in surplus to the extent that investment remains below its pre-crisis peaks, government budget deficits decline and household savings remain high. However, failure to achieve a \$10 to 12 billion surplus – or indeed any level of surplus – would hardly seem important in the present context. *First*, current account deficits in the pre-crisis era reflected excessive investment, which failed to generate sufficient return. In the wake of the reforms to the financial and corporate sectors, investment is to be guided by profitability. *Second*, Korea's vulnerability to a foreign exchange crisis has been sharply reduced by its high level of reserves, which at \$90 billion are the second-highest level in the OECD area and double its short-term debt. Moreover, the large inflows of foreign direct investment and Korea's status as a net creditor nation are positive factors in this regard. ■

Is further budget restraint needed?

A declining current account balance would be a concern to the extent that it reflected overheated domestic demand boosting imports. At this stage, however, achieving any necessary restraint in domestic demand would best be accomplished by accelerating the ongoing reduction of the government budget deficit rather than through higher interest rates. Under the revised medium-term fiscal plan, the budget is to be balanced by 2003, rather than 2004 under the previous plan and 2006 under the initial plan. This is to be accomplished by limiting the growth of expenditures to about two percentage points below nominal output growth. A significant first step in meeting this objective was achieved in 1999, thanks largely to the strength of the expansion. Although a deficit of 5 per cent of GDP was initially targeted to support the economic recovery in its early stages, higher-than-expected tax revenues and a scaling-back of social welfare expenditures as unemployment fell reduced the deficit to 2.7 per cent. Including the supplementary budget, spending is to increase 7½ per cent in 2000, while nominal output is projected to rise 10 to 11 per cent. Consequently, the deficit is expected to fall to between 2.5 and 2 per cent of GDP. Fiscal consolidation should be accompanied by efforts to simplify the complex structure of the budget and increase transparency, which would increase efficiency of budgetary operations.

Achieving the medium-term objective for eliminating the budget deficit is important in the context of the rapid increase in government debt and future spending pressures. Between 1996 and 1999, central government gross debt more than doubled from 8 per cent of GDP to

19 per cent, though still substantially below the OECD average of about 70 per cent of GDP. However, government-guaranteed debt also increased rapidly, from 3 to 17 per cent of GDP between 1996 and 1999, largely due to the cost of financial-sector restructuring. Taking into account local government debt and government-guaranteed debt, the overall debt ratio reached nearly 40 per cent of GDP at the end of last year. The impact of expanding government indebtedness on the budget is reflected in the sharp increase in interest payments, including those for financial restructuring, from 2½ per cent of total expenditures in 1996 to a projected 6½ per cent in 2000. Limiting the rise in government debt is important, given uncertainty about the costs of closer ties with North Korea, the pressures for increased social welfare spending and the need for further resources for financial-sector restructuring. ■

How has financial restructuring progressed?

Indeed, the 64 trillion won (13 per cent of GDP) of government-guaranteed borrowing originally authorised to support the restructuring of the financial sector has been fully committed. These funds have been used primarily to rehabilitate the banking sector through injections of capital and deposit reimbursement by the Korea Deposit Insurance Corporation (KDIC) and the purchase of impaired assets by the Korea Asset Management Corporation (KAMCO). The number of banks has been reduced from 27 to 17 and the surviving banks have implemented serious restructuring measures. In addition, a new regulatory system has been put in place to bring supervisory standards closer to

international norms, including the introduction of “forward-looking criteria” for loan classification and provisioning at the end of 1999. As a result of these efforts, Korea now has a core of privately owned banks with good balance sheets and strong incentives to remain profitable. Several major banks have significant foreign ownership, which is important as a means of bringing new management skills into this sector and improving monitoring by shareholders. However, there is a clear divergence between these strong banks and a set of weaker banks burdened by bad debt inherited from the past. Rising non-performing loans, due to the collapse of Daewoo and the introduction of new loan classification criteria, have put increasing pressure on these institutions. A second phase of bank rehabilitation is to begin in the second half of 2000.

The government announced in May 2000 that another 30 trillion won of spending, financed by funds recovered by KAMCO and KDIC and additional borrowing would be necessary for financial restructuring. The remaining problems are primarily in the large government-owned banks and in the non-bank sector. It is important to accelerate reforms in the non-bank sector, along the lines followed in the banking sector, by providing adequate funds up front while imposing strict rules for financial soundness and closing non-viable institutions. Some of the most serious problems are in *investment trust institutions*, which were seriously affected by the collapse of Daewoo and the abrupt withdrawal of funds from their accounts. Unwilling to let individual investors bear the losses, the government has allowed them to redeem their investments at up to 95 per cent of face value. In June, an additional 4.9 trillion won of public money, on top of the 3 trillion won already provided, was invested in two ailing invest-

ment trust companies. While the government's handling of the Dae-woo crisis avoided systemic consequences and a negative effect on the real economy, it has failed to address the underlying structural distortions in this sector, which limit its role as a source of financing and make the financial sector vulnerable to crisis. It is essential to upgrade the investment trust sector in line with best international practices by addressing serious problems in portfolio valuation methods, disclosure standards and in mechanisms to resolve conflicts of interest. There are also major weaknesses in the *life insurance industry*, with about half of the 29 companies insolvent in 1999. This is due to its legacy of over-regulation, inadequate prudential supervision, conflicts of interest and poor risk management. Since the second half of 1998, however, prudential standards have been tightened and public money has been injected into 11 companies as part of restructuring, including mergers and closure of bankrupt firms. Maintaining pressure on the remaining companies to meet the new solvency requirements would be the best way to promote continued restructuring and consolidation in this sector. ■

What budgetary pressures does Korea face?

While the sums committed to financial restructuring are extremely large, the final cost can be substantially reduced by sales of impaired assets on secondary markets. Thus, it is important that KAMCO press ahead with its programme of asset sales, in which it hopes to recoup by 2003 most of the funds it has spent acquiring bad loans. In addition, successful restructuring of the banks with large government ownership would reduce the final cost of the

financial rehabilitation programme by allowing the sale of the government equity positions to private investors.

A second area where there is rising demand for increased expenditure is the social safety net, which is an essential part of a well-functioning market economy. Outlays in this area are likely to rise following the introduction later this year of the National Basic Livelihood Protection Law, which is based on the concept of "productive welfare" and makes social assistance a right for low-income citizens. The level of total assistance is to be set so as to ensure that the recipient's total income meets the minimum cost of living as calculated by the government.

The public pension programme is another area of rising outlays. With the maturation of the system, established in 1988, and the ageing of the population, the number of beneficiaries is projected to increase by a factor of 12 over the next decade. Certain measures, such as lowering the replacement rate and raising the retirement age, have recently been adopted to contain spending. But the contribution rate would have to double from the current 9 per cent of wages to 18 per cent to maintain the actuarial balance under the current programme, which would likely have adverse effects on Korea's growth potential. Given the relatively young population and the still immature public pension programme, Korea has a window of opportunity to adopt systemic reforms that would promote the long-run viability of the public pension system. One option that could be considered would be to transform the separation allowances that firms are required to provide for departing employees into an occupational pension system based on defined contributions that are managed by private institutions. Such an approach has

been adopted in some other OECD countries. ■

Is tax reform needed to raise additional revenue?

In sum, the prospects for increased outlays on financial restructuring and the social safety net, as well as the uncertain cost of economic cooperation with North Korea, will necessitate higher tax revenues over the medium term. While a rationalisation of spending in many areas would be welcome, it is unlikely to be sufficient. At present, the tax burden in Korea is among the lowest in the OECD, mainly reflecting the fact that its social safety net is at an early stage of development. A number of weaknesses, nevertheless, continue to undermine tax bases, efficiency and the fairness of the system. These include generous allowances and loopholes for individuals, large-scale and wide-ranging tax preferences for enterprises and an inappropriate taxation of property. Moreover, there is a lack of strong and uniform tax enforcement, especially towards the self-employed. With the low tax burden at present, however, the economic distortions created by the tax system are relatively limited, particularly with respect to labour market participation and labour demand. Given that the pre-tax income distribution is already quite even, the tax system has a relatively neutral effect on income distribution.

As the tax burden will need to increase in the future, it will be important to minimise existing tax-related distortions in order to avoid magnifying their negative effects. Korea has, in fact, made some progress over the past decades in reducing such distortions, in particular by broadening some tax bases and lowering tax rates along the lines followed in many other OECD countries. It is imperative to con-

tinue the movement towards still more neutrality in the personal income tax system and to avoid excessive use of taxes as instruments of industrial policy. The priority should be to broaden further tax bases for the personal and corporate income tax systems, as well as the VAT system. Allowances and exemptions in the personal tax system should be reduced or at least consolidated into a simpler structure, perhaps initially by limiting indexation. Any reduction in personal tax reliefs should be accompanied by stricter tax enforcement of the self-employed in order to avoid exacerbating the prevailing sense of unfairness among wage and salary earners. Enforcement could be improved by better targeting of audits and more systematic sharing of information from other government bodies as well as from financial institutions. The number of audits and the penalties for tax evasion should also be increased. Regarding the *corporate tax* system, tax incentives should be reduced substantially, including those given to SMEs, R&D and overall investment. Finally, the *VAT base* should be expanded by eliminating the special tax regime, leaving only a minimum VAT-exempt threshold for very small retailers.

Equity could also be enhanced in several other areas. *First*, personal capital income should be taxed more evenly across sources, though not necessarily included in the progressive global income schedule. *Second*, a tax on fringe benefits should be introduced, perhaps at the company level to facilitate implementation. *Third*, public pension contribution rates should be equalised across sources of income and such payments excluded from taxable income. In addition, retirement income from all sources – public pensions, company separation allowances and private pension accounts – should be taxed as ordi-

nary global income. Such a reform would improve equity across generations as well.

Efficiency of resource allocation should also be promoted through tax reform. In the area of property taxation, the tax mix should be changed so as to encourage development and a more efficient use of land. This would require higher holding taxes, through valuation closer to market levels, and lower transaction taxes. The capital gains tax structure should be independent of the holding period in order to reduce lock-in effects. Ongoing restructuring in the corporate sector should be encouraged by introducing a consolidated tax treatment of holding companies and by making permanent the tax deferral offered in 1998 in the case of assets and equity swaps, mergers, acquisitions and divisions, subject to appropriate tests for continuation of business and ownership. Simplicity should be increased by streamlining the special consumption tax into a few excise taxes and by eliminating the various earmarked taxes and quasi-taxes. ■

What must be done to sustain Korea's long-run growth potential?

Greater economic efficiency should also be promoted by accelerating the implementation of a wide range of structural reforms. While the restructuring of the financial system along market-oriented lines is essential, it needs to be complemented by measures to enhance competition and to accelerate the restructuring of the corporate sector. The rapid pace of the economic expansion should not lead to complacency about moving ahead with the objective established in the wake of the crisis of building a more market-oriented economy. Progress on this front would have two important benefits.

First, it would sustain the growth potential, thus promoting the convergence of income levels in Korea, which are currently about 60 per cent of the OECD average, to the norms of Member countries. *Second*, it would make Korea less vulnerable to future crises in a world of increasing global competition.

Restructuring of the corporate sector remains a key concern in this regard. Previous governments have relied on regulation and intervention, including controls on investment and financing, to limit the role of the chaebols in the economy. Such an approach, however, proved to be inadequate, given that the serious problems in the corporate sector were a major factor behind the 1997 crisis. In some sense, government involvement in the corporate sector actually increased in the wake of the crisis, reflecting the need for decisive restructuring measures to boost investor confidence. Moreover, the weak financial sector was incapable of guiding the process. The government, as the major owner of the banks and responsible for prudential supervision, thus had an important role to play in corporate restructuring. Examples of the government's involvement include the agreement on five basic principles of chaebol reform and the Capital Structural Investment Plans, of which the so-called Big Deals and the across-the-board 200 per cent debt to equity targets were well-known elements. However, in a market-based system, pressure from stockholders, together with competition, both domestic and international, and the threat of bankruptcy, should discipline the behaviour of the conglomerates. There has been considerable progress, in fact, in establishing the key elements of such a system, notably the rehabilitation of the banking sector, the improvement in the exit mechanism, the increase in competition through

a reduction in barriers to trade and direct investment and the establishment of a more effective corporate governance framework. Given such progress in the institutional framework, it is important for the government to try to shift from the use of direct intervention to reliance on market forces.

Moreover, there is further scope for improving the market-based framework. The reform in the corporate governance system – by increasing shareholder rights, requiring the use of outside directors and clarifying the responsibility of directors – has created a solid basis for corporate restructuring. In 1999, a private-sector committee developed a “Code of Best Practices”, which draws on OECD principles for corporate governance. The Code contains useful elements to further improve the rights of small shareholders, increase the use of independent directors and give them specific responsibilities, and to strengthen audit procedures. Compliance with this Code is not mandatory, but the Korea Stock Exchange requires listed companies to disclose detailed information on their progress in implementing the Code. It is hoped that this step will help develop a business culture in which good corporate governance practices are reflected in the value of a company’s shares. However, it is clear that activating the new corporate governance framework will be difficult given the lack of a tradition of shareholder activism and the limited role played by boards of directors, as well as the entrenched power of the chaebols. This suggests the need for very detailed rules that in some cases go beyond practices in other OECD countries. For example, it would be useful to specify which corporate decisions require approval of the board of directors and to strengthen monitoring by shareholders and the board of related party transactions. Finally, removing

the obstacles that impede the formation of holding companies would promote corporate restructuring and transparency.

Increased competition is also an important driving force of corporate restructuring. The elimination of the Import Diversification Programme, which had limited imports from Japan, and the removal of all remaining quota restrictions except that on rice, are important steps to lowering trade barriers. The key to further progress in opening the domestic market is to ensure that regulations, such as those aimed at protecting safety and health, do not act as barriers to imports. The surge in foreign direct investment during the past few years is another positive development for competition. The increase in such inflows, though, is partially due to exceptional circumstances in the wake of the crisis. Sustaining high levels of foreign direct investment in the future will require continued efforts to improve further the investment climate and to avoid a resurgence of sentiments against such inflows. Strengthening competition policy by expanding the Fair Trade Commission’s resources and investigative powers would be beneficial, and it would be desirable to shift its emphasis to violations of competition policy and away from regulation of chaebol activities once the enhanced corporate governance framework and the more market-oriented financial sector operate to effectively discipline chaebol behaviour. In addition, moving ahead with the 1998 privatisation programme would reduce the role of the government in the economy and extend competition to new areas. Concerns about employment and exchange rate effects should not derail progress in this field.

Flexible factor markets for land, labour and capital are important to allow a smooth reallocation of

resources to higher-productivity activities. Regarding land, government controls should be further eased, along with the reform of property taxes, to promote greater flexibility in land use. Labour market flexibility has been enhanced by the decision to allow temporary workers in certain occupations. However, the conditions for dismissing permanent workers are quite stringent, despite some easing in 1998, compared to other OECD countries. A further relaxation of these regulations might enhance labour mobility while reversing the growing use of non-regular workers, who now account for more than half of all employees. Factor market flexibility is also important to developing a vibrant venture business sector. The strong growth of young companies, particularly in such areas as information and telecommunications, is challenging established chaebol affiliates. The development of a dynamic small company sector would be enhanced by accelerating the shift away from SME policies that have tended to make small companies dependent on government assistance. This will be an essential aspect of achieving the government’s goal of building a knowledge-based economy.

Regulatory reform is another aspect of increasing both flexibility and competition. The government has made rapid progress in this area, as discussed in the OECD’s review of *Regulatory Reform in Korea*, by reducing the number of regulations by half during a one-year period and attempting to eliminate the use of administrative guidance that is not based on laws. While the quantitative progress is indeed impressive, it is important to focus now on changes that will enhance competition in key sectors. One such sector is electricity, where the government has announced a ten-year plan to introduce competition. Accelerating

the implementation of the plan, which includes the privatisation of the Korea Electric Power Company's generating facilities, is desirable, as most consumers would not benefit from competition and lower electricity prices until after 2009. Promoting competition in the telecommunications sector, a key knowledge-intensive industry, is also important. Korea Telecom, which is 59 per cent-owned by the government, has a dominant share in the local, long-distance and international markets. Reducing government intervention in the business and investment plans of telecom firms and introducing an independ-

ent regulatory authority are priorities. Finally, there is great scope for efficiency gains in the agricultural sector. Although price support levels have been decreased substantially to meet Uruguay Round commitments, food prices remain well above world levels, imposing considerable burdens on consumers. The new Agriculture and Rural Communities Basic Act established the objective of shifting to a system of direct payments to farmers. Such an approach, to the extent that it is decoupled from production decisions, would be a more efficient and transparent means of providing the intended

level of income support. Moreover, it would reduce distortions to resource allocation and trade. Market access for rice, which will rise to 4 per cent of domestic consumption in 2004, should be further increased. Finally, increasing the average farm size, which is the key to increasing agricultural productivity, is essential. ■

For further information

More information about the Survey can be obtained from Randall Jones (Email: randall.jones@oecd.org, tel.: (33-1) 45 24 79 28). ■

For further reading

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They are published under the responsibility of the Secretary-General.

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