Regulatory Reform in Korea

Enhancing Market Openness through Regulatory Reform

OECD

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *Enhancing Market Openness through Regulatory Reform* analyses the institutional set-up and use of policy instruments in Korea. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Korea* published in 2000. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform.*

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was prepared by DoHoon Kim, with the participation of Sophie Bismut, and Keiya Iida, of the Trade Directorate of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Korea. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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ABBREVIATIONS AND ACRONYMS

AMCHAM	American Chamber of Commerce
APEC	Asia-Pacific Economic Co-operation forum
APLAC	Asia-Pacific Laboratory Accreditation Co-operation
CEN	European Committee for Standardisation
CENELEC	European Committee for Electro-technical Standardisation
CIF	Cost Insurance Freight
EC	Commission of the European Communities
EDI	Electronic Data Interchange
EPA	United States Environmental Protection Agency
ESCAP	Economic and Social Commission for Asia and the Pacific
ETSI	European Telecommunication Standards Institute
EUCCK	European Union Chamber of Commerce in Korea
FDI	Foreign Direct Investment
FIPA	Foreign Investment Promotion Act
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GPA	WTO Agreement on Government Procurement
GSTP	Global System of Trade Preferences
HANJUNG	Korea Heavy Industries and Construction Co. Ltd.
IEC	International Electro-technical Commission
IMF	International Monetary Fund
ISO	International Organisation for Standardisation
KAIT	Korea Association of Information and Telecommunications
KAMA	Korean Automobile Manufacturers' Association
KATS	Korean Agency for Technology and Standards
KCMA	Korea Chemicals Management Association
KCS	Korea Customs Service
KEPCO	Korea Electric Power Corporation

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KFDA	Korea Food and Drug Administration
KFTC	Korean Fair Trade Commission
KISC	Korea Investment Service Centre
KOGAS	Korea Gas Corporation
KOLAS	Korea Laboratory Accreditation System
KOTRA	Korea Trade-Investment Promotion Agency
KS	Korea Industrial Standard
KT	Korea Telecom Corporation
KT&G	Korea Tobacco and Ginseng Corporation
MFN	Most-Favoured Nation
MIP	Medical Insurance Reimbursement Price
MOCIE	Korean Ministry of Commerce Industry and Energy
MOE	Korean Ministry of Environment
MOFAT	Korean Ministry of Foreign Affairs and Trade
MOHW	Korean Ministry of Health and Welfare
MOU	Memorandum of Understanding
MRA	Mutual Recognition Agreement
NGO	Non-Governmental Organisation
POSCO	Pohang Steel and Iron Corporation
SAROK	Supply Administration of the Republic of Korea
SDR	Special Drawing Rights
SME	Small-and-Medium Enterprise
TBT	WTO Agreement on Technical Barriers to Trade
TNDC	Protocol Relating to Trade Negotiations among Developing Countries
UNCTAD	United Nations Conference for Trade and Development
UN-ECE	United Nations- Economic Commission for Europe
USTR	United States Trade Representative
WTO	World Trade Organisation

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Executive Summary

Background Report on Enhancing Market Openness through Regulatory Reform

Does the national regulatory system allow market participants to take full advantage of competitive markets? Reducing regulatory barriers to trade and investment enables countries in an expanding global economy to benefit more fully from comparative advantages and innovation. This means that more market openness increases the benefits that consumers and producers can draw from regulatory reform. Maintaining an open world trading system requires regulatory styles and content that promote global competition and economic integration, avoid trade disputes, and improve trust and mutual confidence across borders.

The outward-oriented development of the economy and participation in multilateral organisations have driven a reduction in tariff and non-tariff barriers in Korea. Under pressure of the financial crisis at the end of 1997 and the recession in 1998, the Korean authorities have taken further action to promote foreign direct investment and improve the national regulatory system, so that it does not unnecessarily compromise foreign competition in the market. Despite progress, the Korean regulatory system is still perceived to some extent as little favourable to the entry of new competitors in the market, in particular to the entry of foreign competitors.

When considering the six efficient regulation principles for market openness defined by the OECD, unnecessary trade restrictiveness and lack of transparency appear as the main weaknesses of the Korean regulatory system. Major trading partners point to cumbersome or slow administrative procedures imposed on importers and, despite some recent progress in making information on regulations available, the Korean regulatory system is still often perceived as non-transparent vis-à-vis new entrants in the market, especially foreign firms. Non-discrimination principles are well promoted in Korean legislation, but there is some concern about *de facto* discriminations resulting from some regulations, especially subordinate statutes or regulatory actions of industrial associations. The Korean government recently took some steps towards increased use of internationally harmonised standards and recognition of foreign countries' regulatory measures, an area of major concern to Korea's trading partners. Time is needed to assess whether the efforts will lead to tangible improvements. There is also evidence of significant progress in the application of competition principles from an international perspective. In recent years, the Korean Fair Trade Commission has taken relatively strong action against anti-competitive practices in Korea. Still, a market openness perspective should be further integrated into competition policy in order to enhance effective competition in many domestic sectors.

Some factors can contribute to making the Korean regulatory system more trade-and-investment-friendly: Korea's determination to integrate in the global economy, a strong commitment of the political leadership to market openness-oriented reforms, a comprehensive reform action programme, and the active interaction between trade policy bodies and other regulatory bodies. However, the following issues need to be tackled. First, after a long period when the wealth of the Korean economy was considered to lie on exports, the public is still relatively unaware of the benefits of opening the market to global competition. Second, there is a large gap between sectors open to competition and those, mainly services and agriculture, relatively sheltered. Third, a large number of regulations have been created or modified in favour of market openness, but their implementation is slow. Finally, despite some progress in opening up the regulatory making process to the public, foreign firms are still largely excluded from consultation processes.

To pursue further regulatory reform from a market openness perspective, the Korean government should concentrate its efforts in the following areas:

- Strengthen efforts to harmonise Korean technical regulations and standards with international standards and to recognise the equivalence of other countries' regulatory measures.
- Enlarge the scope of consultation with foreign parties, so that they are consulted not only on directly trade-related regulations, but also on other domestic regulations.
- Speed up regulatory reform, deregulation and market opening in traditionally highly regulated sectors such as services and agriculture.
- Engage efforts to change the bad image of imports and foreign firms among the Korean public.
- Strengthen the government's efforts to eliminate regulations that have *de facto* discriminatory effects against foreign competitors.
- Enhance co-operation between trade policy bodies and other government bodies in charge of domestic regulations in order to reduce restrictions on trade resulting from regulatory measures.
- Strengthen the enforcement of competition policy regarding practices that impair international market openness.

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1. MARKET OPENNESS AND REGULATION: THE POLICY ENVIRONMENT IN KOREA

Since the initiation of ambitious economic development efforts in the early 1960s, successive Korean governments have pursued an outward-oriented economic policy. Due to a low endowment in natural resources, the economy has been dependent on imports of raw materials, while industrial growth has largely been driven by exports. Consequently, foreign trade has played a key role in the Korean economy. Exports and imports currently account for nearly 40% of GDP, a ratio comparable to other OECD Member countries of similar size, as seen in Figure 1. However, the development process followed by Korea has contributed to building a mercantilist approach among government officials, in which the aim of economic policy is considered to be maximising exports and targeting imports that are considered necessary for the export-oriented manufacturing sectors. Development strategy in Korea has indeed been based on protecting infant industries from competition and discouraging what were considered as unnecessary imports. Successive governments have also favoured developing the domestic industry by borrowing on foreign markets rather than attracting foreign investors. As the Korean economy developed to reach the level of an industrialised economy, this policy has brought increasing criticism from Korea's trading partners.

Over the past decade, there has however been a move towards opening the Korean market to global competition. The participation of Korea in regional and international organisations such as WTO, OECD and APEC has been a driving force behind the liberalisation of the trade regime. As a result of the Uruguay Round, the general tariff rates have declined in Korea. Since 1994, the average tariff rate has stood at less than 8%, down from 20% in 1988, and for manufacturing products at 6.2%, down from 16.9% in 1988.[1] Non-tariff barriers have declined too with the elimination of some import licenses and quantitative restrictions. One of the liberalisation measures consisted in the phasing out of the "Import Diversification System" established in 1978, which had introduced a ban on imports from Japan of over 260 items, in reaction to the fast growing deficit with Japan. As required by the accession procedure to the OECD, Korea gradually reduced the number of products subject to the ban, and eventually abolished the system on 30 June 1999.

Liberalisation has recently accelerated as the financial crisis of 1997 and the following recession put pressure on the government to radically modify its policy towards foreign investment. Foreign capital was badly needed to rebuild foreign reserves, which had nearly disappeared at the end of 1997, and to support firms hit by the recession. Foreign direct investment (FDI) was also considered as a way to bring in advanced management expertise. The government has endeavoured to attract foreign investors in Korea by relaxing the investment regime and creating a more favourable business environment for foreign firms. In addition to specific incentives, the government lifted some restrictions on foreign investment, introduced structural reforms in the financial sector and took measures to increase protection of intellectual property rights. This turnaround was welcomed by the foreign business community, which in 1999 noted progress in the business environment in Korea.[2] Since 1997, FDI inflows have grown significantly as foreign firms have been attracted by opportunities resulting from the devaluation, the fall in stock market prices and liberalisation measures. Combined with a shrink in GDP in 1998, this has resulted in a surge of FDI flows as a percentage of GDP. Inflows of FDI accounted for 1.7% of GDP in 1998, up from less than 0.5% in 1996. As seen in Table 1, this is still well below the three European Central and Eastern European countries that joined OECD recently, but closer to OECD Member countries of similar size (Mexico, Spain).

Despite recent progress, much remains to be done to open the economy to global competition. First a large part of the economy has not benefited from the liberalisation process. Some sectors (mainly manufacturing sectors) have been significantly liberalised, even though further progress is still needed to compare with other OECD Member countries. But other sectors (mainly services and agriculture) remain

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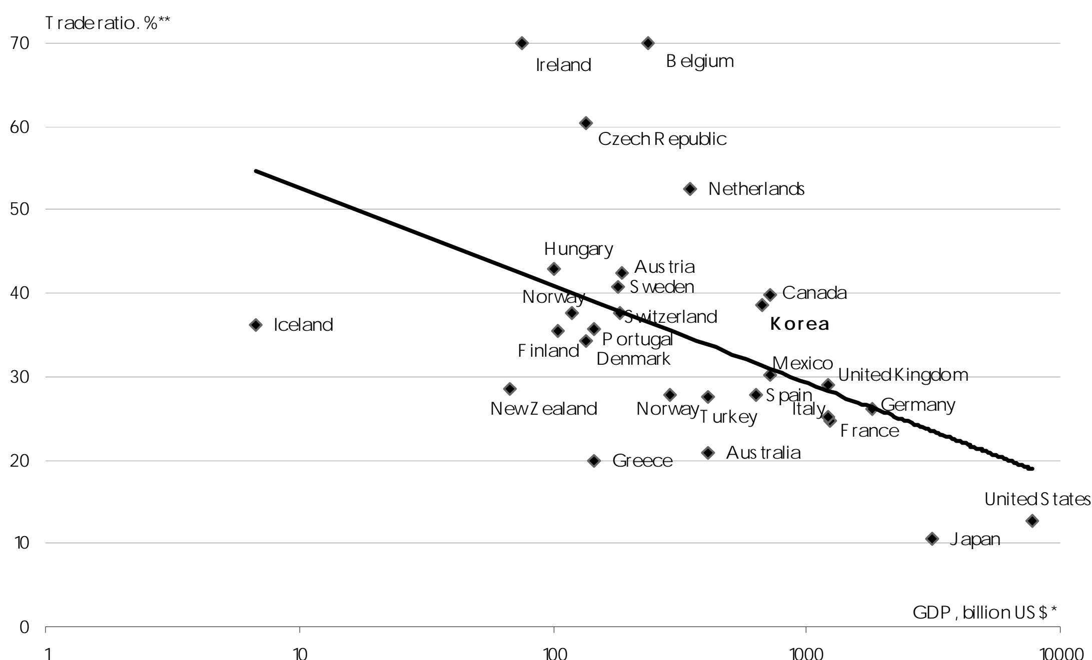
relatively protected from international competition. Other reforms, including in the financial sector and in the field of corporate governance, are also important for market openness (for more details on structural reforms, see Chapter 1). In addition, reforms need not only to be formulated, but also implemented. Some trading partners have raised concerns about the slow pace in implementing the reforms. They also claim that government officials, particularly those in local governments, are not trained quickly enough and tend to stick to old regulatory practices.[3]

Figure 1. **Share of trade in OECD Member countries' economies, 1997**



Foreign trade of the Czech Republic includes trade with Slovakia.
* GDP measured at current prices and current PPS in billion US$.
** Average of exports and imports of goods and services relative to GDP.
Source: *OECD National Accounts*, Vol. 1, *Main Aggregates, 1990-97*.

Table 1. **FDI as a share of GDP (%)**

	1996	1997	1998*
Korea	0.48	0.64	1.73
Czech Republic	2.53	2.50	4.62
Hungary	4.43	4.60	4.08
Poland	3.34	3.62	3.41
Mexico	2.79	3.10	2.46
Spain	1.11	1.04	1.57

*: provisional.
Source : *ECD Financial Market Trends*, No. 73, June 1999; *OECD National Accounts,* Vol.1, *Main Aggregates*, 1990-97; http://interprod.oecd.org/std/gdp.htm.

A major obstacle to market openness comes from the unfavourable perception of imported products and foreign companies in Korea. On several occasions, consumer organisations launched "frugality campaigns" that included the boycott of imported products. There is a widespread idea that

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"imported goods are in general luxury goods and only the rich can afford them", which goes back to the long period when the Korean consumer goods market was closed to global competition. The Korean government took a number of measures in 1998 and 1999 to correct this perception. For example, the National Tax Service committed that it would not conduct the alleged "tax audits on individual owners of expensive imported goods", and President Kim Dae-Jung held several live broadcast meetings with citizens during which he stressed the importance of non-discrimination between domestic and foreign products or companies. However, this perception can still be seen among the media and the public.

2. THE POLICY FRAMEWORK FOR MARKET OPENNESS: THE SIX "EFFICIENT REGULATION PRINCIPLES"

An important step in ensuring that regulations do not unnecessarily reduce market openness is to build the "efficient regulation principles" into the domestic regulatory process for social and economic regulations, as well as for administrative practices. "Market openness" here refers to the ability of foreign suppliers to compete in a national market without encountering discriminatory or excessively burdensome or restrictive conditions. These principles, which were described in the 1997 OECD report on regulatory reform (OECD, 1997, Chapter 5) and developed further in the Trade Committee, are:

- Transparency and openness of decision-making.
- Non-discrimination.
- Avoidance of unnecessary trade restrictiveness.
- Use of internationally harmonised measures.
- Recognition of equivalence of other countries' regulatory measures.
- Application of competition principles from an international perspective.

These principles were identified by trade policy makers as key to market-oriented and trade-and-investment-friendly regulations. They reflect the basic principles underpinning the multilateral trading system. The intention of this review is not to judge the extent to which Korea may have undertaken and lived up to international commitments relating directly or indirectly to these principles; but rather to assess whether and how domestic instruments, procedures and practices give effect to the principles and successfully contribute to market openness. Similarly, the review does not assess trade policies and practices in Korea.

This report considers whether and how Korea's regulatory procedures and content affect the quality of market access and presence in Korea. An important reverse scenario -- whether and how inward trade and investment affect the fulfilment of legitimate policy objectives reflected in social regulation -- is beyond the scope of the present discussion. This latter issue has been extensively debated inside and outside the OECD from a range of policy perspectives. To date, however, OECD deliberations have found no evidence to suggest that trade and investment *per se* impact negatively on the pursuit and attainment of domestic policy goals through regulation or other means (OECD, 1998; OECD 1994).

2.1. Transparency, openness of decision making and of appeal procedures

To ensure international market openness, foreign firms and individuals seeking access to a market (or expanding activities in a given market) must have adequate information on new or revised

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regulations so that they can base their decisions on an accurate assessment of potential costs, risks and market opportunities. Regulations need to be transparent to foreign traders and investors. Regulatory transparency at both domestic and international levels can be achieved through a variety of means, including systematic publication of proposed rules prior to entry into force, use of electronic means to share information (such as the Internet), well-timed opportunities for public comment, and rigorous mechanisms for ensuring that comments are given due consideration prior to the adoption of a final regulation (OECD, 1997, Chapter 2). Market participants wishing to voice concerns about the application of existing regulations should have appropriate access to appeal procedures. This sub-section discusses the extent to which these objectives are met in Korea and how. The general regulatory system and consultation procedures in Korea are analysed in the background report to Chapter 2.

2.1.1. Access to information

Korean law requires that all laws and regulations be made public before their entry into force and that an interval be set between publication and entry into force. The 1996 Administrative Procedure Act that took effect on 1 January 1998 set a 20-day interval.[4] Information on laws, presidential decrees and ministerial orders is published in the official gazette and the consolidated statute books. Draft regulations are usually not available to the public. However, according to the Administrative Procedure Act, the objective and main contents of proposals of new or modified laws and regulations must be made public through media, such as the official government gazette and also public bulletin boards, newspapers, broadcast media or the Internet. This has given rise to an increased use of newsletters, magazines and information networks such as the network of the Ministry of Foreign Affairs and Trade (MOFAT)[5] to provide information on regulatory activities.

The Korean authorities have undertaken specific efforts to facilitate the access of foreign businesses to the Korean legal system. The content of regulations related to foreign trade can be found in the "Consolidated Public Notice on Guidelines of Exports and Imports" published and updated twice a year by the Ministry of Commerce, Industry and Energy (MOCIE) (for the respective role of MOCIE and MOFAT in trade policy, see Box 1). All laws and major presidential decrees, as well as most of the statute books, are now available in English, although the translation is not considered as official.[6] In addition, all laws and subordinate regulations are displayed on governmental Internet sites.[7] The Internet is also used in the field of government procurement as information on government contracts is published not only in the official gazette and daily newspapers, but also increasingly on the Internet.[8] A summary in English is attached to the public notice on invitation to bid for the delivery of products and services (including construction) that are covered by the WTO Agreement on Government Procurement (GPA). In addition, bid results are published in the official gazette.

Box 1. **The role of MOCIE and MOFAT in trade policy**

Until 1998, trade policy issues were shared by MOFAT (then called MOFA, Ministry of Foreign Affairs) and MOCIE (then called MOTIE, Ministry of Trade, Industry and Energy). MOFAT was responsible for trade talks and negotiations, while MOCIE was in charge of trade promotion. However, both ministries were involved in almost all trade policy related issues. Both wanted to send their representatives to trade negotiations, which sometimes resulted in confusion and inefficiency.

As part of the government restructuring in March 1998, MOFAT was given full responsibility for trade negotiations. As a consequence, only MOFAT can now send representatives to trade talks and negotiations. It can ask other ministries to send specialists to accompany MOFAT's representatives. In case domestic regulations need to be changed as a result of trade agreements, MOFAT should ask other ministries in charge of those regulations to implement the changes, and should monitor and supervise the changes. However, according to the Foreign Trade Act, MOCIE is still responsible for publishing the "Consolidated Public Notice on Guidelines of Exports and Imports".

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In spite of this series of measures to provide information on established and proposed regulations, the lack of transparency in regulatory and administrative processes is still perceived as a major weakness of Korea's domestic regulatory system. Foreign firms have often pointed to the lack of transparency in the decisions taken by Korean officials as a major obstacle to making business in Korea. Korea's trading partners have for example reported the opaque handling of applications for patents, licenses or spectrum or the absence of clear procedures for tax probes related to transfer prices or public construction projects tenders (Government of the United States of America, 1999; Commission of the European Communities, 1999, Government of Canada, 1999, AMCHAM, 1999, EUCCK, 1999).

In 1996, the adoption of the Information Disclosure Act came in response to demand for more transparency of the administration. The law requires the release of information to the public upon request, with a list of exceptions, including reasons related to national security, reunification, privacy protection and commercially sensitive material. The law represents a move from a type of administrative governance, in which access to information was difficult, to a more open type of administration, in which officials are accountable for their actions. Its implementation requires that officials change their practices, and its success at enhancing transparency will also depend on how exceptions will be handled.

The recent efforts undertaken by the Korea Food and Drug Administration (KFDA) to rewrite the food-related codes represent encouraging steps towards a more transparent and open regulatory environment. As in other sectors, many regulations lacked clarity so that officials were given large discretionary power in their application. This had given rise to numerous complaints about inconsistent applications of the codes and lengthy customs procedures. In 1998, the KFDA launched a programme to review the codes, specify the rules and provide clear guidance to customs inspectors. In the process, an extended comment period was provided to solicit inputs from both domestic and foreign firms. Many government bodies have undertaken similar efforts to enhance the transparency of regulations.

2.1.2. Public consultation

Recent reforms have opened the regulatory making process to the public and given interested parties, including foreign parties, the possibility to make their comments on new or revised draft regulations. The 1997 Basic Act on Administrative Regulations stipulates that when the head of a central administrative agency wishes to set up or modify a regulation, he/she shall sufficiently hear the opinion of other administrative agencies, civic groups, interested parties, research institutes, experts, etc., through "public hearings, notice of legislation or any other means". The Administrative Procedure Act requires government agencies to "respect the arguments and process accordingly", except in "special circumstances". It also requires them to notify the person who submitted the comments of the results of the review. The law provides wide exemptions, which can in effect limit the impact of the law (for details, see background report to Chapter 2). Some recent initiatives taken by ministries to use the Internet as a tool of public consultation indicate some progress in opening the regulatory process (see Box 2).

However, ministries and governmental bodies still widely rely on advisory councils and discussion groups to collect views on specific measures or general policy orientations. These groups, which include academics, journalists, technical experts and business leaders, are often called upon when ministries or agencies need to get the views of specialists before they make an important decision. The regulatory authorities also use official communication notes to consult the private sector or experts on specific issues. When making regulations or before engaging in international negotiations, the government sends a communication note to interested parties or to experts asking for their reactions. Advisory councils and communication notes have proved a quick way to collect views, but they have favoured discretion over openness in the elaboration process of regulations. Members of advisory councils and people interviewed through communication notes are usually selected by government officials. The consultation process has

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actually mostly involved business sectors selected by the government rather than civil society groups such as consumers' organisations or environmental non-governmental organisations (NGO). It has privileged incumbent firms, part of an "inner circle" with close relations to the government, and in most cases, it has excluded foreign firms. An encouraging step towards a better integration of foreign firms in the consultation process was taken by the Ministry of Health and Welfare (MOHW), which, in 1999, designated two foreign firms as members of an advisory council for the review of new pricing standards for medical reimbursement schedules.

Box 2. **Public views and policy-making: MOFAT's web site**

Many ministries and government bodies in Korea make an active use of the Internet to disseminate information about regulations and collect the views of the public. A recent example is provided by the handling of the screen quota issue by the Ministry of Foreign Affairs and Trade (MOFAT). As part of a policy to promote the domestic movie industry, the Korean regulatory authorities set up a regulation according to which movie theatres in Korea must feature Korean movies during a pre-determined number of days per year. The United States objected to this quota system and asked Korea to abolish it. The Korean authorities were caught between foreign pressure and strong opposition from the domestic movie industry to any change to the screen quota system. The MOFAT decided to put the issue for public discussion on the Internet. Opportunities for comment were opened on the web site of the MOFAT from December 1998 to June 1999, and 77 comments were received.

The experience gave mixed results. On the one hand, it provided the Korean and foreign movie industries, as well as the public, an opportunity to give their opinion in a transparent way. Indeed, comments received included a large number of frank opinions. On the other hand, the MOFAT did not use the comments to elaborate its policy. The case shows that the Internet can be a powerful tool in enhancing the transparency of regulatory processes, but that the ultimate responsibility for taking advantage of this possibility lies with affected parties using the system, and with regulatory authorities making use of the comments.

As part of its policy to attract foreign investment, the Korean government has recently undertaken to consult foreign firms on trade and investment issues. In 1998, it set up the Advisory Council for Foreign Investment, a body composed exclusively of foreign businesses established in Korea (four American, four European and two Japanese firms). Its role is (1) to advise the government on foreign investment policy, in particular on how to improve regulations on foreign investment; (2) to attract foreign investment in Korea through the organisation of seminars and promotion events; and (3) to give conferences to government officials, in particular those in charge of investment-related affairs. In addition, since 1998, the government has organised several "Enlarged Meetings to Promote Trade and Investment" to consult the private sector, including foreign firms, on trade and investment policy.[9] The consultation of foreign firms represents an improvement over the past exclusion of foreign parties. However, it tends to separate foreign firms from local firms in the consultation process and to limit their involvement to specific trade and investment issues, while many market access issues lie with other domestic regulations.

2.1.3. Appeal procedures

According to the Administrative Appeals Act, when market participants voice concerns about a measure taken by the administration, this measure should first be reviewed by the government body directly superior to the administrative office responsible for it. If the decision is not found satisfactory, it is possible to appeal to the Administrative Appeals Commission. The period for handling a case is limited to 60 days. For special situations, the chairman has the authority to extend the limit by 30 days. The appeal procedures is open to any party, regardless of nationality, and it does not require the party to be established in Korea.[10]

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2.2. Measures to ensure non-discrimination

Application of the non-discrimination principle aims to provide effective equality of competitive opportunities between like products and services, irrespective of the country of origin. Thus, the extent to which respect for two core principles of the multilateral trading system -- most-favoured-nation (MFN) and national treatment -- is actively promoted when a country develops and applies regulations is a gauge of its overall efforts to promote trade-and-investment-friendly regulations.

2.2.1. Non-discrimination in domestic regulations

According to Article 6(1) of the Korean Constitution, treaties duly concluded and promulgated have the same effect as the domestic laws of the Republic of Korea. Therefore, the principles of MFN and national treatment apply in all areas covered by Korea's international commitments, notably in the context of its membership in the WTO. The MOCIE and the MOFAT are co-responsible for checking the conformity of draft regulations to international treaties, and in particular the observance of MFN or national treatment principles required under these treaties.

However, a survey of foreign-controlled firms undertaken in 1998 by the Korea Trade-Investment Promotion Agency (KOTRA), a body under the supervision of the MOCIE, showed that foreign firms still consider as key issues the lack of fair and non-discriminatory practices in a wide range of regulations affecting business, including foreign exchange and financial controls, corporate tax levies and import duties, employer-employee relationships, access to plant sites and social infrastructure, and bidding procedures for public and private contracts (Government of Korea, 1999*c*). Regulations that deviate from the non-discrimination principle or whose implementation results in *de facto* discrimination can be found in various fields. For example, the Liquor Tax Law and the Education Tax Law applied different tax rates to imported liquors such as whisky or cognac and to *soju*, the domestic liquor. Following recommendations by the WTO Dispute Settlement Body, the government has undertaken to equalise the tax rates for soju and whisky. In the financial sector, the discriminatory content of some regulations is a significant impediment to foreign participation. For example, foreign banks are not allowed to issue corporate bonds. Some prudential regulations created to protect customers, such as the single customer loan limit or the single customer guarantee, do not apply to local and foreign banks similarly. As the limits are based on the capital of the local branch rather than on the capital of the parent company, these prudential regulations result in *de facto* discrimination against foreign banks. In the entertainment sector, the Korean authorities took some measures in October 1998 and in September 1999, which broke up the long-standing control of imports of some Japanese products such as movies and live performances by Japanese singers. This move was welcomed by the Japanese authorities that however still express some concern about remaining discriminatory treatment of some Japanese products, such as the ban on Japanese compact disks.[11]

Some trading partners have alleged that the management of the government-controlled medical insurance scheme has given rise to discrimination against foreign pharmaceutical products (AMCHAM, 1999; EUCCK, 1999). In October 1998, the MOHW decided that, from July 1999, the medical insurance scheme would reimburse imported medicine on the same basis as domestically produced medicine.[12] Korea's trading partners welcomed the move but claimed that the measure alone could not guarantee an equal treatment between imported and domestic pharmaceutical products. They pointed to the fact that domestic producers can offer their products to hospitals at much lower prices than the Medical Insurance Reimbursement Price (MIP) set by the MOHW, which increases the net margins of hospitals. However, if a foreign firm offers a similar discount, the MOHW may reduce the MIP. Therefore, hospitals prefer to buy domestic pharmaceuticals. Some major trading partners also point to the lack of distinction made by the MOHW between innovative products and generic products, and as a consequence, to the fact that the

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MOHW does not make any difference between innovative products and generic products in setting up their MIPs, despite the lower cost of production of the latter. They claim that this has distorted competition because generic products, mainly domestic ones, have benefited from higher MIPs relatively to their cost of production, compared to innovative products.

2.2.2. Restrictions on foreign ownership

As part of the current government policy to create a more favourable investment climate in Korea, restrictions on foreign ownership have been recently reduced. The Korean government can reject the investment notification of a foreign investor when the activity jeopardises national security, public order, public health, environmental preservation, or morality, or when it is a business specified in a "negative list", for which foreign direct investment is prohibited or restricted. The revised Foreign Investment Promotion Act (FIPA) that took effect in 1998, lifted restrictions completely or partially for 29 categories of business. Major activities such as stock exchange operations, futures trading, loan banking, oil refining and oil distribution, power generation, tap water supply, tobacco manufacturing were opened to foreign investment. Currently, out of a total of 1 058 business sectors, only 4 remain completely closed to foreign direct investment, while 24 are partially restricted (these are summarised in Table 2).

Other recent structural reforms have also led to reducing restrictions on foreign investment. The liberalisation of the financial sector, which was introduced in 1998, included the removal of ceilings or restrictions on foreign purchase and ownership of equity, bonds and short-term money market instruments. The approval of the Ministry of Finance and Economy is still required to take over a Korean company, but requirements for getting the approval have been substantially relaxed (Government of Korea, 1999*b*). Some restrictions on the acquisition of state-owned enterprises have also been removed. However, in some cases, foreign equity ownership is still limited. For example it cannot exceed 25% in Korea Tobacco & Ginseng Company (KT&G), 33% in Korea Telecom Corp. (KT) and 30% in Pohang Steel and Iron Corp. (POSCO). Another important liberalisation measure is the removal of the strict controls on foreign ownership of land. Foreign firms or individuals no longer need the approval of the government to purchase land, and need only make a notification.

2.2.3. The case of government procurement

In 1997, as Korea implemented the WTO GPA, the government opened part of its procurement market to international competition. A specific government body, the Supply Administration of the Republic of Korea (SAROK), is responsible for part of the procurement of central and sub-central entities of the government. However, procurement of state-owned enterprises and of some central and sub-central entities of the government is handled in-house. Procurement conducted by SAROK accounts for around 25 to 30% of total government procurement. According to SAROK, 52% of government procurement contracts managed by SAROK in 1998 were awarded through open tendering procedures in which foreign firms could participate, although the share of contracts awarded to foreign companies was much lower. Most of the other remaining contracts were awarded following selected or single tendering. A large share of procurement of goods is reserved for domestic small-and-medium enterprises (SME). The relatively large number of exceptions to the coverage of the GPA, preferential conditions for domestic SMEs as well as the large share of contracts awarded by single tendering have given rise to claims by Korea's trading partners that the Korean government procurement market remains relatively closed to international competition.

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Table 2. **Sectoral restrictions on FDI in Korea**

As of December 1999

Sector	Current situation	Future liberalisation
Wholly closed sectors		
Cattle raising		Partially liberalised on 1 January 2000 (foreign equity ratio limited to less than 50%).
Wholesale of meat		Partially liberalised on 1 January 2000 (foreign equity ratio limited to less than 50%).
Inshore and coastal fishing		
Television and radio broadcasting		
News agency activities		Partially liberalised on 1 January 2000 (foreign equity ratio limited to less than 25%).
Partially closed sectors		
Cereal growing	Allowed except for growing of rice and barley.	
Electric power generation	Open to foreign investment, except that foreign investment in public power generation facilities is limited to 50% of the capital. The largest stockholder and the representative director must be Korean nationals.	
Coastal water transport	Allowed only for passenger or freight transportation between South and North Korea. Foreign firms can establish only through joint ventures with local firms, and their share is limited to less than 50%.	
Air transport (scheduled and non scheduled)	Foreign equity ratio limited to less than 50%.	
Wired and wireless telegraph, telephone	Foreign equity ratio limited to 49% (in the case of KT, to 33%).	
Other telecomm-unications	Foreign equity ratio limited to 49% (in the case of KT, 33%) of the total stocks of share with voting rights.	
Publishing	Foreign equity ratio limited to less than 30% for newspapers and 50% for periodicals.	
Cable TV broadcasting	Allowed for programme providers, system operators in cable TV industry and transmission network business provided that the foreign investment ratio does not exceed 33%.	
Domestic banking	Allowed only for commercial banking.	
Trusts and trust companies	No restriction on FDI in the security investment trust business. In other industries, only money trust business is allowed provided that the commercial or chartered bank engages in the money trust business together with its original business.	

Source : Government of Korea (1999*b*).

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2.2.4. *Preferential agreements*

Preferential agreements give more favourable treatment to specified countries and are thus inherent departures from the MFN principle. The extent of a country's participation in preferential agreements (which overall can be trade-creating or trade-diverting) is not in itself indicative of a lack of commitment to the principle of non-discrimination. However, in assessing such commitment, it is relevant to consider the attitudes of participating countries towards non-members in respect of transparency and the potential for discriminatory effects. Third countries need access to information about the content and operation of preferential agreements in order to make informed assessments of any impact on their own commercial interests. In addition, approaches to regulatory issues such as standards and conformity assessment can introduce potential for discriminatory treatment of third countries (if, for example, standards recognised by partners in a preferential agreement would be difficult to meet by third countries).

Korea's participation in preferential agreements has remained limited. Korea ratified three preferential trade agreements with developing countries: the Protocol Relating to Trade Negotiations among Developing Countries (TNDC), the Bangkok Agreement, and the Global System of Trade Preferences (GSTP).[13] These preferential agreements were established among developing countries, and the exceptions to the MFN principle which they included were based on waivers granted by the GATT Council or allowed under the GATT Enabling Clause. Recently, the Korean government has departed from its long preference for negotiating trade liberalisation at the multilateral level to engage free trade negotiations with some trading partners. It has undertaken negotiations on a Free Trade Agreement (FTA) with Chile and initiated a co-study project with Japan to look into the possibility of a Korea-Japan FTA.

2.3. *Measures to avoid unnecessary trade restrictiveness*

To attain a particular regulatory objective, policy makers should seek regulations that are not more trade restrictive than necessary to fulfil a legitimate objective, taking account of the risks that non-fulfilment would create. Examples of this approach would be to use performance-based rather than design standards as the basis of technical regulations, or to consider taxes or tradable permits in lieu of regulations to achieve the same legitimate policy goal. At the procedural level, effective adherence to this principle entails consideration of the extent to which specific provisions require or encourage regulators to avoid unnecessary trade restrictiveness (and consideration of the rationale for any exceptions), how the impact of new regulations on international trade and investment is assessed, and the extent to which trade policy bodies as well as foreign traders and investors are consulted in the regulatory process.

2.3.1. *General assessment*

The Korean authorities have expressed a strong stance in favour of building a trade-and-investment-friendly regulatory environment. Indeed, the Foreign Trade Act specifically requires administrative procedures to be trade-and-investment-friendly. It stipulates that the MOCIE must be consulted before the enactment or amendment of acts and subordinate statutes, directives or public notices that may restrict trade. Moreover, if there are any changes in the domestic regulations that can affect fulfilment of international trade obligations, the concerned regulatory authority must inform the MOCIE of such changes in writing prior to implementation. After the notification, the MOCIE, if necessary, may request the relevant regulatory authorities to provide additional information or revise the regulations that unnecessarily or excessively restrict trade and investment (*i.e.*, remove or ease unnecessary or excessive trade restrictions). Some other laws include provisions to avoid unnecessary restrictions on trade in specific sectors. For example, according to the Regulation on the Procedures of Legislative Activities, the Ministry of Information and Communication must consult the relevant ministries when it intends to enact or amend rules that restrict exports and imports of communication equipment.

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In recent years, there have been cases in which the consultation of other government bodies by the MOCIE, as defined by the Foreign Trade Act, helped avoid unnecessary restrictions on trade. For example, products made of processed sterilised animal fur or hair previously had to go through a quarantine inspection procedure handled by the National Quarantine Office prior to importation. The MOCIE consulted with the MOHW, the ministry in charge of regulating the sector, and concluded that the quarantine inspection requirement was redundant since the fur had already been sterilised. The regulation was eliminated at the end of 1998. Another example relates to the inspection of imported food sanitation. The lengthy procedure had given rise to trade frictions. After the MOCIE consulted with the relevant authority, namely the KFDA, the inspection period was shortened from 18 to 3 days at the end of 1998.

In addition to inter-ministerial consultation, the recently modified procedures for making or amending regulations could help avoid unnecessary trade restrictiveness in future. The Basic Act on Administrative Regulations provides for an assessment of the impact of new regulations, including an analysis of the costs and benefits of the regulations for affected parties and the public in general. The Regulatory Reform Committee has also undertaken to review all regulations with a view to reducing their number. The streamlining is likely to result in a simplified regulatory framework, more favourable to open competition, including international competition. In addition, regulations that explicitly mention export- or import-related procedures go through a thorough review by the MOCIE before their inclusion in the Consolidated Public Notice on Guidelines of Exports and Imports.[14] The MOCIE examines the need for the regulation, the scope of its application and its potential unnecessary restrictive effects on trade. Unless regulations relate directly to trade and investment, their potential impact on trade and investment is unlikely to be examined. This limits the capacity of the current system for reviewing regulation to enhance the trade-friendly character of the regulatory framework, as many restrictions on trade and investment actually stem from sector specific domestic regulations.

Unnecessary restrictiveness on trade should be addressed when regulations are implemented. Korea’s trading partners have pointed to a large number of procedures that restrict trade (see Box 3). Some cases have stemmed from an over-strict enforcement of regulations. For example, some foreign firms find it difficult to do business in Korea because government officials, particularly those of provincial and local governments, frequently ask more documents than required by laws or government orders, and sometimes refuse to issue required permits on grounds of insufficient documents. According to the government, these authorities are afraid that the government audit office could accuse them of giving preferential treatment, and thus tend to ask for as many supporting documents as possible to prove the reason why they granted the permission. To attract foreign investors, the central government and local governments have recently started to tackle this issue through deregulation and monitoring by central authorities.

Again, as part of a policy to attract foreign investors, the Korean authorities established a specific task force centre in 1998 to help foreign firms in their relation with the Korean administration. The Korea Investment Service Center (KISC), an arm of KOTRA, is made up of experts and high-level officials from various ministries and government agencies. The centre provides assistance to foreign firms investing in Korea in a wide range of areas, such as visa-related issues, establishment of legal entities, investment notifications, etc. KISC has proved helpful in smoothing and speeding up administrative procedures. However, its capacity to reduce the potential restrictions on trade created by regulations is limited as it cannot change the regulatory system.

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Box 3. **Avoiding unnecessary trade restrictiveness of regulations: Some cases raised by Korea's trading partners**

(AMCHAM, 1999; EUCCK, 1999)

As traditional barriers to trade have fallen, "behind the border" measures created by domestic regulations are falling under increased international scrutiny by trading partners. A range of measures can be taken, from standards and conformity assessment to sanitary and phytosanitary systems, in support of legitimate policy objectives relating to product quality, safety, health and environmental protection. Korea's trading partners have pointed out some Korean domestic regulations as cases of measures creating unnecessary obstacles to trade. What is called into question is not a given domestic policy or its underlying objectives, but the fact that these policies could have been achieved as efficiently by using less trade-restrictive means. The following examples illustrate such unnecessary trade restrictiveness as seen by Korea's trading partners, and how some reforms have reduced it in some cases.

Labelling requirements

- In January 1998, the KFDA introduced a new regulation requiring that the date of bottling and the batch code should be shown on the bottle of spirit drinks. Some trading partners argued that this could have a severe impact on smaller domestic spirits manufacturers and importers.

- The regulation stipulating that all imported cosmetics, including samples and testers, should contain Korean labelling is considered too burdensome since samples and testers are not for sale.

Restrictions on advertisement

- TV advertisements are subject to control by the Korean Broadcasting Commission. Despite recent easing of the related regulations, concerns remain about the lack of transparency and unpredictability of the content control procedure.

Import licenses

- Trading partners argue that the Medical Device Regulations (revised in 1997) require excessive documentation formalities to obtain import approval for medical devices.

- When new chemical products are imported, they should be notified separately to the Ministry of Environment and to the Ministry of Labour. This is a case of duplicative requirement.

Testing and certification

- According to some trading partners, repetitive self-inspection tests are applied to each batch of imported cosmetics before they are put on sale. From January 2000 on, as the government adopts an "in-market surveillance system" in lieu of the old "pre-market testing system", the issue will be resolved.

Bidding procedures

- Three different licences used to be required to be allowed to submit bids for construction and engineering projects (a construction licence, a construction supervision licence and a design licence). Foreign companies considered these procedures too burdensome, arguing that each license was obtained through a long procedure. The Framework Act on the Construction Industry was revised on 15 April 1999, and changed the licensing system into a registration system.

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Lack of protection of confidential information

- Documents submitted for import approval or import certificates may contain confidential business information (*e.g.* description of manufacturing processes or content specifications). Some trading partners argue that, for some imports, the confidentiality is insufficiently secure, and that this can give rise to misuse of information submitted by competitors. For example, no confidentiality was guaranteed by the Toxic Chemicals Control Act for the data submitted to Korea Chemicals Management Association (KCMA) when applying for an import certificate of chemical products. The regulation was modified recently, and from 30 September 1999, importers of chemical products can submit self-certification to the KCMA.

In order to reinforce KISC, the Korean authorities established the Office of the Investment Ombudsman in October 1999. Staffed with 30 so-called "Home Doctors", who are specialists of finance, tax, customs clearance, labour issues, etc., the Office of the Investment Ombudsman surveys difficulties encountered by foreign investors doing business in Korea and consults government agencies in order to solve them. When a government agency receives a request for information from the Investment Ombudsman, it must provide a reply within seven days. The Office of the Investment Ombudsman plays a different role from the KISC and from the Administrative Appeals Committee. Whereas the KISC assists foreign investors at the establishment stage, the Office of the Investment Ombudsman assists them after they have established. And while the Administrative Appeals Commission can take legal decisions that override measures taken by government agencies, the Office of the Investment Ombudsman is only entitled to discuss with government agencies of difficulties met by foreign firms. Only government agencies themselves can take a decision on cases raised by the Office of the Investment Ombudsman.

2.3.2. The case of customs procedures

Customs procedures encompass formalities and procedures in collecting, presenting, communicating and processing data requested by customs for and related to the movement of goods in international trade. As tariff levels have declined through GATT rounds, the costs incurred by such procedures have attracted growing attention from businesses. Costs are generated by compliance with documentary requirements (acquiring and completing the documents and paying for their processing) and by delays of cargo processing at borders. The aims of customs procedures (to collect revenue, to compile statistics, to ensure that trade occurs in accordance with applicable regulations, such as those aiming at protection of human safety and health, protection of animal and plant life, environmental protection, prevention of deceptive practices, etc.) should be pursued so as to ensure that the procedures do not create unnecessary obstacles to international trade. In other words, the lowering of trade barriers may not fully achieve the efficiency gains of liberalisation without harmonised, simplified, fast and secured customs procedures. The issue is particularly acute in Korea where slow and cumbersome customs clearance procedures have often been pointed out as a significant impediment to trade.

In recent years, the Korean authorities have endeavoured to simplify customs procedures. These procedures are currently handled by four major government bodies, namely the Korea Customs Service (KCS), the MOCIE, the KFDA and the MOHW. The KCS is responsible for conducting customs clearance procedures while the MOCIE delivers import and export licences. The KFDA is in charge of making health safety inspection of imports of agricultural and forest products, basic and processed food products, food additives and food containers. Finally, the MOHW manages the quarantine procedures. In 1995, the Customs Duties Act was modified to reduce the costs induced by customs clearance and to adapt the customs procedures along international standards. Following the entry into force of the new Act in July 1996, a certain number of procedures were simplified. For example, in the previous procedures, goods could not enter Korea unless the customs authorities gave the importer permission to do so, which could result in long delays at the border. Under the new procedure, goods can enter freely Korea provided the importer submits the required information. If the customs authorities delay the processing, they must

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provide tangible evidence that there is a risk that the good may not comply with relevant requirements. It also became possible to make a pre-arrival import declaration and to defer payment with limited or no deposit, and some transit procedures were relaxed or eliminated.

The Electronic Data Interchange (EDI) customs system developed by the KCS since 1993 has also reduced paperwork and increased the efficiency of the Korean customs system.[15] The EDI system now covers over 70% of import/export clearance procedures and customs duty drawback transactions. According to the Korean government, the introduction of the EDI system cut the clearance time from 8.5 hours to 3.5 hours for imports, and from 4 hours to 4 minutes for exports. In May 1998, the computer networks of the KCS and the MOHW were linked, and the KCS is currently examining the possibility of an interface with the systems of other border control agencies responsible for import approval, import recommendation or quality inspection. However, the system is not interfaced with the import/export licence delivery network, which reduces the efficiency of the Korean EDI system.

Despite the streamlining of customs procedures undertaken in 1998 as part of the government-wide regulatory reform, many complaints remain about Korean customs procedures. Many of these complaints relate to the slowness of the inspection and quarantine procedures, in particular for agricultural products. According to trading partners, it can take up four to five weeks when checking processed foods through border controls when the product is imported for the first time, and it can take up one to two weeks when the product is imported on an on-going basis. The Korean government has objected to these estimates, arguing that all inspections except laboratory inspection are carried within a week. Inspections require 3 days for document review, 5 days for organoleptic review and 18 days for laboratory inspection. The government is planning to reduce these periods to 2, 3 and 10 days respectively in 1999. Another source of concern stems from some arbitrary decisions or sudden changes made by the KCS in classifying goods (and consequently in applying different tariff levels). In addition, some importers of products subject to high tariff and tax rates incur costs due to the insufficient availability of bond warehouses and their high service charges.

2.4. Measures to encourage use of internationally harmonised measures

Compliance with different standards and regulations for like products often presents firms wishing to engage in international trade with significant and sometimes prohibitive costs. Thus, when appropriate and feasible, reliance on internationally harmonised measures (such as international standards) as the basis of domestic regulations can readily facilitate expanded trade flows. National efforts to encourage the adoption of regulations based on harmonised measures, procedures for monitoring progress in the development and adoption of international standards, and incentives for regulatory authorities to seek out and apply appropriate international standards are thus important indicators of a country's commitment to efficient regulation.

As Korean tariff rates have declined, trading partners have increasingly raised the cumbersome Korean system of standards and conformity certification as a source of obstacles to trade (for an overview of the Korean standardisation system, see Box 4). For example, AMCHAM mentions the Korean Food and Food Additives Code, which includes specific standards and conformity assessment procedures; labelling requirements set by various ministries, which differ from international standards defined by the Codex Alimentarius Commission; and duplicative testing such as the requirement that imported vaccines go through a certification procedure to check their conformity with Korean standards, even though those vaccines are already in conformity with internationally recognised good manufacturing practices standards.[16] In addition, lack of transparency and insufficient co-ordination have given rise to a complex standardisation and certification system. Several ministries or governmental agencies can have overlapping competencies for the definition and enforcement of standards for the same category of products, which is a serious source of inconsistency and difficulties for entering the market (Commission of the European Communities, 1999).

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The Korean government has engaged an active policy in favour of enhanced transparency of the the standardisation and certification system, and of increased use of internationally harmonised standards. The move has been driven by trade talks, such as discussions with the United States or the European Union, but also by the need to improve the business environment for local firms. Reducing costs associated with complying with various and complex technical requirements could indeed improve the competitiveness of the Korean industry. A first step was completed in 1998 with the review of Korean standards (KS standards) undertaken by the MOCIE to identify which standards were identical or equivalent to ISO or IEC standards, and could be harmonised with them.[17] The MOCIE excluded some standards from possible harmonisation on grounds that they had been designed for local products, which cannot be found in other countries and for which there are no corresponding international standards. Out of the 3 423 KS standards considered as relevant, 495 were found identical to ISO or IEC standards, and 1 147 were found equivalent. As the MOCIE reviews all KS standards every five years, it expects to complete the harmonisation of KS standards with ISO and IEC standards over the next five years.[18]

Box 4. **The Korean standardisation system**

The Korean standardisation system has a dual structure. Technical regulations (mandatory standards) are developed by ministries and government agencies. Voluntary standards, called Korea Industrial Standard (KS standards), are elaborated by the Korean Agency of Technology and Standards (KATS), a government agency under the supervision of the MOCIE.

Technical regulations: Eighteen categories of manufactured goods are subject to technical regulations, which are defined by 19 laws. Technical regulations are elaborated by the ministry or agency in charge of regulating the sector (for details, see Table 3). Any product subject to technical regulations cannot be sold in Korea unless it is certified to conform to the relevant technical requirements. Certification is processed by the relevant regulatory authorities based on test reports issued by government designated laboratories. When a product is subject to several technical regulations, conformity is checked for each of the regulations by the relevant authorities.

Voluntary standard: According to the Industrial Standardisation Act, the KATS is responsible for elaborating KS standards. The MOCIE is responsible for delivering the authorisation to affix KS marks that certify conformity of products with KS standards. There are currently 10 939 KS standards and 10 600 authorisations to affix KS mark.

The Basic Act on National Standardisation that was enacted in February 1999 and entered into force in July 1999 has confirmed the focus on harmonising Korean standards with international standards. It recommends that regulatory authorities adopt relevant international standards when drawing up or modifying technical regulations and voluntary standards. The reform, which has attracted high political attention, has also endeavoured to streamline the Korean standardisation and certification system. The new standardisation law builds the foundation of a comprehensive framework that provides for better co-ordination between the various voluntary and mandatory standards. It sets up a co-ordination body called the National Standards Council, composed of the Ministers of the government and chaired by the Prime Minister. The mission of the Council is to review all standards with a view to promoting co-ordination of different standards and international standards. As the review encompasses all mandatory standards, including those on materials, legal metrology and calibration, the initiative could result in a streamlined system and facilitate certification procedures at the border. The composition of the Council demonstrates the priority given to the reform of the standardisation system and sends a strong signal to the various ministries and agencies.

As the reform is very recent, it remains to be seen how it will be implemented and what strategy the government will choose in the future. Some recent developments, however, may indicate that the Korean authorities are moving towards the approach to standardisation chosen by the European Union.[19] This would involve limiting the mandatory requirements to the definition of essential requirements and leaving the Korean Agency for Technology and Standards (KATS) the responsibility for elaborating standards that permit firms to meet these requirements. If this direction is chosen in Korea, it cannot make

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the system smoother and lead to a more trade-friendly business environment unless the KATS makes an active use of international standards in making or modifying KS standards, and has enough skilled resources available to prepare standards.

Table 3. **Mandatory certification procedures**

Product	Certification procedure	Ministry	Law
Consumer products	Safety inspection	MOCIE	Quality Management Promotion Act
Electric appliances	Type approval	MOCIE	Electric Appliances Safety Control Act
Gas appliances	Safety inspection	MOCIE	Liquefied Petroleum Gas Safety and Business Management Act
Pressure equipment	Safety inspection	MOCIE	High Pressure Gas Safety Control Act
Aircraft	Product certification	MOCIE	Aircraft Industry Promotion Act
	Type certification	Ministry of Construction and Transportation	Aviation Act
Construction machines	Type approval	Ministry of Construction and Transportation	Construction Machines Control Act
Motor vehicles	Type approval	Ministry of Construction and Transportation	Motor Vehicles Control Act
	Authentication	Ministry of Environment	Atmospheric Environment Preservation Act; Noise and Vibration Regulation Act
Environmental measurement equipment	Type approval	Ministry of Environment	Development of Environmental Technology Act
Water appliances	Quality inspection	Ministry of Environment	Drinking Water Management Act
Ships and ship equipment	Type approval	Ministry of Marine Affairs & Fisheries	Ship Safety Act
Sea pollution prevention equipment	Type approval	Ministry of Marine Affairs & Fisheries	Marine Pollution Prevention Act
Medical devices	Safety inspection	Korea Food and Drug Administration	Pharmaceutical Act
Telecommunications equipment	Type approval	Ministry of Information and Communication	Telecommunications Basic Act
Radio equipment	Type inspection	Ministry of Information and Communication	Radio Waves Act
EMI.EMC equipment	Authentication	Ministry of Information and Communication	Radio Waves Act
Fire extinguishing equipment	Type approval	Ministry of Government Administration and Home Affairs	Fire Service Act
Safety devices attached to machinery	Quality inspection	Ministry of Labour	Industrial Safety and Health Act
Harmful or hazardous equipment	Design test for safety	Ministry of Labour	Industrial Safety and Health Act

Source : MOCIE.

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2.5. Recognition of equivalence of other countries' regulatory measures

When the harmonisation of regulatory measures is not considered feasible or necessary, the recognition of equivalence of other countries' regulatory measures in attaining the same regulatory objective may be the most appropriate avenue for reducing technical barriers related to regulatory divergence. Despite the development of global standards, there are still many areas in which specific national regulations prevail, preventing manufacturers from selling their products in different countries and from enjoying full economies of scale. Additional costs are also raised by the need to demonstrate the compliance of imported products with applicable regulations in the import country through testing and certification accepted in that country. Recognising the equivalence of standards applicable in other markets or the equivalence of the results of conformity assessment performed elsewhere can greatly contribute to reducing their costs.

There has been a recent move in Korea in favour of mutual recognition agreements (MRA), partly in response to concerns raised by trading partners about Korean certification procedures. Trading partners have for example objected to the long and duplicative tests required to import pharmaceuticals (specific testing of biological vaccines, antibiotics or medical devices) (EUCCK, 1999). While the recognition of tests performed abroad is still limited, the Korean authorities have made recent steps in favour of mutual recognition. The 1999 Basic Act on National Standardisation encourages domestic certification authorities to negotiate MRAs with foreign certification authorities. It requires that the MOCIE issues recommendations to the relevant government bodies to make sure that MRAs are in harmony with the WTO Agreement on Technical Barriers to Trade (TBT) as well as the fair practice codes in relevant international standards. The 1997 Basic Act on Telecommunications allowed the government to sign MRAs on type approval certification of telecommunications. Following the adoption of the law, Korea concluded a MRA with Canada in the field of telecommunications equipment and electromagnetic compatibility. Korea and Canada are about to launch new negotiations for a broader-based MRA. In addition, Korea is currently negotiating another MRA with other member countries of APEC (for details of the MRAs, see table 4). In the area of animal health, the Ministry of Agriculture is considering mutual agreements to recognise tests performed in foreign countries. In addition, specific acts, such as the Electric Appliances Safety Control Act, provide for some possibility to admit conformity assessments performed by foreign certification bodies.

Table 4. **Mutual Recognition Agreements concluded or negotiated by Korea**

Partner country	Sectors covered by the MRA	Type of mutual recognition	Status of negotiation	Date
Canada	• Telecommunications equipment • EMC related equipment • Electrical safety related equipment	Mutual recognition of test results	Completed	Signed in January 1997; effective since July 1998
APEC member countries	• Wireless telecommunications equipment • Terminal equipment for land-based or satellite-based network • Electrical safety related equipment	Mutual recognition of test certificates	Under negotiation	Not yet decided

Source: Communication from the Government of Korea to the OECD, July 1999.

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Recognition of equivalence cannot produce benefits without confidence in the accreditation systems in the various countries involved in the MRA. Accreditation is the procedure by which regulatory authorities assess the qualification of public or private bodies to perform testing or certification. The MOCIE has undertaken to organise the Korean accreditation system on the basis of international standards. The Korea Laboratory Accreditation System (KOLAS) was thus established in 1994 according to the guidelines defined by ISO and IEC. In 1998, KOLAS was accepted in the MRAs of the Asia-Pacific Laboratory Accreditation Co-operation (APLAC). The capacity of the reform to improve the Korean certification system, however, depends on whether all ministries and agencies designate laboratories and certification bodies based on internationally harmonised accreditation systems such as KOLAS.

The Korean government has shown a clear stance in favour of recognition of equivalence of other countries' regulatory measures. It is too early to assess whether the implementation of the new Standardisation Act will produce tangible improvements. However, in order to sustain momentum and try to speed up the process, the issue is again whether the cross-cutting efforts undertaken by the Korean authorities can effectively result in better co-ordination between the different authorities responsible for technical regulations.

2.6. Application of competition principles from an international perspective

The benefits of market access may be reduced by regulatory action condoning anti-competitive conduct or by failure to correct anti-competitive private actions that have the same effect. It is therefore important that regulatory institutions make it possible for both domestic and foreign firms affected by anti-competitive practices to bring complaints. The existence of procedures for hearing and deciding complaints about regulatory or private actions that impair market access and effective competition by foreign firms, the nature of the institutions that hear the complaints, and adherence to deadlines (if they exist) are thus key issues from an international market openness perspective. These issues will be the focus of this sub-section, while a more detailed discussion of the application of competition principles in the context of regulatory reform in Korea can be found in the background report to Chapter 3.

Korean legislation provides several ways of lodging complaints against anti-competitive regulatory or private actions. Firms can first take their complaints to the regulatory authorities. The Civil Petition Treatment Act and the Basic Act on Administrative Regulations provide that any affected party can submit an official opinion to the minister responsible for the regulatory action that allegedly undermines market access or fair competition. The minister is required to give a response within a given period (which can vary depending on the case). In addition, under the Monopoly Regulation and Fair Trade Act, complaints about restrictive agreements, unfair practices or abuses of market dominant positions can be brought to the Korean Fair Trade Commission (KFTC) (for a detailed analysis of the role and resources of the KFTC, see the background report to Chapter 3). When a complainant is not satisfied with the decision of the KFTC, it can appeal to the Administrative Court. Complaints can also be brought to the National Grievance Settlement Committee, which acts as an ombudsman. In case the Committee concludes there is evidence of anti-competitive actions, it can make recommendations, but its decision is not legally binding. As the Korean legislation on competition gives foreign firms national treatment, foreign firms have the same rights as domestic firms to make requests.

Many competition-related issues raised by foreign partners have been related to *chaebols*.[20] For example, where *chaebols* have established their own distribution network for their major products, they have hampered the access of goods produced by competitors to the distribution system. This has made the access of foreign competitors to the Korean market particularly difficult, and the situation has often been denounced as a significant obstacle to trade by Korean trading partners. A recent case was raised by a

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foreign firm that tried to enter the Korean market of information technology products. Entry in the market was nearly impossible as *chaebols* had set up systems integration companies that have a near-monopoly in the provision of information technology products and services to *chaebol*-affiliated firms.

The reforms undertaken by the Korean government in the wake of the financial crisis to improve the corporate governance of the *chaebols* are expected to contribute to resolving the problem. The *chaebol* reform is based on five objectives: enhancing financial transparency, eliminating cross debt guarantees between firms affiliated with the same *chaebol*, strengthening the accountability of shareholders and managers, improving the capital structure of firms, and focusing the activities of *chaebols* on their core business. Increased managerial transparency may make it easier for foreign investors to take shares in the *chaebols*, while the prohibition of financial support between subsidiaries may eliminate unfair competition. However, there is a risk that the *chaebol* reform, in particular "Big Deals", swapping major business divisions among *chaebols*, may on the contrary strengthen the position of some subsidiaries of the *chaebols*. In addition, some trading partners have objected that the financial support of the government to *chaebols* engaged in swap operations does not conform to the WTO principle regarding government subsidies.[21]

The delegation of some regulatory powers to industrial associations, such as the authority to issue letters of recommendations for imports, has been another major source of potential discriminatory and anti-competitive practices. Foreign firms, in particular, have complained about industrial associations using their regulatory power to prevent non-member firms from entering the market. For example, some foreign carmakers decided to boycott the Seoul Motor Show, alleging that the Korean Automobile Manufacturers' Association (KAMA) limited the access of imported vehicles through higher rental fees for non-members and booth allocation. In the fields of pharmaceuticals and cosmetics, the MOWH requires that the Korean manufacturers' association approve advertisements before their publication or airing, which gives incumbent firms power over the marketing of competitors' products. Producers' associations are also very active in the field of agricultural products. Many associations were created to implement the import quota set by WTO agreements for various categories. Most of their members are companies that produce, process, distribute or sell the products for which they are given regulatory powers. As they have a conflict of interest, they may delay the processing of imports, for example by asking the importing company to submit unnecessary and even confidential information. The risk of industrial associations using their regulatory powers to distort competition has been enhanced by the difficulty for new firms, in particular foreign firms, to take part in their activities.[22]

The KFTC recently took some initiatives against anti-competitive practices of firms with dominant position or industrial associations. In July 1999, the KFTC carried out a survey of over 1 000 foreign firms about anti-competitive practices. The survey focused on the problems encountered by foreign firms in becoming members of industrial associations, including their exclusion from regular membership, the excessive membership fees applied to them and the requirement to provide confidential business information. It showed that some government bodies often disseminate information through industrial organisations.[23] There have also been specific cases in which the KFTC acted against anti-competitive business practices affecting importers. For example, in March 1998, it conducted an investigation following a complaint by foreign tobacco companies, according to which some employees of a branch office of the Korea Tobacco and Ginseng Corp. (KT&G) had sabotaged the business activity of a retailer who was selling foreign cigarettes. Following the investigation, the KFTC ordered KT&G to take corrective measures.

The KFTC has also taken some action against bid rigging, a practice frequently used by companies when government entities invite tenders for public construction projects. Be they a large project ordered by a central government agency or a small project from local governments, a pre-discussion often takes place among major candidates in order to decide which company will receive the contract and which

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price it will propose. If an outsider firm tries to go up against this system, then other competitors will try to exclude this newcomer from the market. This practice may have created a major barrier to the entry of foreign companies in the Korean construction market. In August 1998, the KFTC announced that it would strengthen its investigations and penalties against bid rigging, and it made government agencies some recommendations for changes in their procurement procedures. However, with six actions in 1996, one action in 1997 and two actions in 1999, the number of actions taken so far by the KFTC looks quite limited in view of the alleged frequency of this practice.

The Korean procedures for advancing complaints about anti-competitive regulatory or private actions offer equal opportunities to foreign and domestic firms. The increasingly active role of the KFTC in enforcing competition rules also runs in favour of greater exposure to global competition. However, it remains to be seen whether the KFTC will effectively integrate the perspective of international market openness into its action against the practices of *chaebols* or industrial associations that have hampered access to the Korean market.

3. ASSESSING RESULTS IN SELECTED SECTORS

This section examines the implications for international market openness arising from Korean regulations in the sectors of automobile and components, telecommunications equipment and services, and electricity. For each sector, an attempt has been made to draw out the effects of sector-specific regulations on international trade and investment and the extent to which the six efficient regulation principles are explicitly or implicitly applied. Particular attention is paid to product standards and conformity assessment procedures, where relevant. Other issues addressed here include efforts to adopt internationally harmonised product standards, use of voluntary product standards by regulatory authorities, and openness and flexibility of conformity assessment systems. In many respects, multilateral disciplines, notably the WTO TBT Agreement, provide a sound basis for reducing trade tensions by encouraging respect for fundamental principles of efficient regulation such as transparency, non-discrimination, and avoidance of unnecessary trade restrictiveness.

3.1. Automobiles and components

Despite a reduction of general tariff rates levied on motor vehicles to a level comparable to OECD countries (8%) and the elimination of the prohibition on imports of cars from Japan in July 1999, the foreign penetration rate of the Korean motor vehicle market remains very low. It has stayed around 1% over the years, compared to roughly 6% in Japan, 25% in the European Union and 30% in the United States. In 1998, the collapse of the demand for cars following the recession hit importers more severely than domestic producers. Domestic sales decreased by 48% and domestic production by 30%, while imports fell by 85%. The low level of imports has come in sharp contrast with the dynamic exports of cars. In 1997, Korea was the fifth largest motor vehicle manufacturer in the world, producing over 2.8 million units, 47% of which were exported. In 1998, the ratio reached nearly 70%, as exports remained stable while production decreased (see Table 5).

In response to some trading partners' concerns about the development of anti-import campaigns in Korea, the Korean government has publicly committed to remedy the bad image of imports in Korea, particularly of imported cars. It has lifted the application of a tax audit by the National Tax Service on the sole basis of ownership of a foreign car. However, there is no sign of any take-off in domestic sales of foreign cars, and social pressure against purchasing foreign cars seems to remain in companies and government offices.

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Table 5. **The Korean automobile market**

(1 000 units)

	Production	Domestic sales	Exports	Imports	Registration
1994	2 312	1 556	737.9	13.9	7 404
1995	2 526	1 556	978.7	18.6	8 469
1996	2 813	1 644	1 210.2	25.1	9 553
1997	2 818	1 513	1 316.9	20.1	10 413
1998	1 954	780	1 362.2	3.0	10 470
1998. 1-6	922	361	618.7	1.9	10 394
1999. 1-6	1 279	540	681.2	2.4	10 734

Source: KAMA (1999).

Trading partners complain about the numerous obstacles to trade related to Korean automobile standards and certification procedures. According to the Korean government, the requirements set by the Automobile Management Act, which provides for a safety-check system, and by the Atmospheric Environment Preservation Act, which requires emissions certification, are in line with the principles of MFN and national treatment. In the field of safety standards, some progress has been made in the recognition of conformity assessment performed abroad. Korea recognises conformity assessments performed in the United States for 32 out of the 41 safety test items required; and in the case of the European Union for 25 out of 41. However, the US authorities still contend that for nine safety standards, for which Korea does not recognise the equivalence of the US standards, the US regulatory requirements exceed those in Korea. Many complaints have also been raised about the Korean standards related to emission and noise testing. The European Union argues that the European noise test standards and the European standards on emission are not recognised in Korea even though they are more stringent than the Korean standard. The EU also complains that Korea does not accept the UN-ECE safety crash test although it is as stringent as the US test, which Korea recognises. Korea responds that it will recognise some of these standards only if they are in conformity with internationally harmonised standards and claims that there are many country-specific elements that make the recognition of equivalence difficult.

In addition, Korean certification procedures can be lengthy and cumbersome. The European Union for example argues that the amount of documents required for the certification of emission and noise is still excessive compared with EU or EPA requirements, in spite of its recent reduction by half. The Korean government objects that the system is similar to the US system. Moreover, some trading partners consider the monopoly of the National Institute for Environmental Research in making certification as a restriction on trade. According to the Korean Ministry of Environment (MOE), the results of tests conducted by manufacturers in their own test facilities, including in foreign countries, are accepted if they are certified by the MOE after an on-the-spot inspection.

As many domestic taxes are levied on the CIF price plus the tariff levied at the border, imported cars suffer from a price disadvantage compared to domestic ones, of around 20% according to trading partners and 11% according to the Korean government (see Table 6).[24] The Korean government applies different tax rates based on engine size for some of these taxes, such as the special consumption tax and the automobile tax. The system was adopted to promote the purchase of small cars, with a view to reducing gas consumption and preserving the environment. Although this taxation system applies equally to domestic and foreign cars, trading partners consider that it creates *de facto* discrimination. They argue that the system applies more heavily on imports, as most imported cars are large cars. The underlying objective of the policy, which is preserving the environment, is not called into question. However, the potential restrictive effects on trade of the regulation could be avoided if taxation was based on actual performance in terms of environment, *i.e.* gas emissions, rather than on engine size.

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Following bilateral discussions and involvement in multilateral organisations, the Korean government has taken significant initiatives to open its automobile market. In 1996, Korea joined the UN-ECE Working Party 29, which works at establishing international standards in the automobile manufacturing sector. In 1998, it committed to sign the Global Agreement (currently signed only by the US) on internationally harmonised standards for automobile manufacturing, which was devised by the UN-ECE Working Party. In addition, as a result of the Memorandum of Understanding (MOU) concluded with the United States in 1995, the Korean government took specific commitments in October 1998 in favour of increased openness. These commitments include:

- Maintaining a reduction by 30% of the Special Consumption Tax through July 2005.
- Reducing the annual Vehicle Registration Tax by 40%.
- Narrowing tax differentials between categories and simplifying the tax structure.
- Eliminating entirely two taxes, the Education Tax levied on the Registration Tax, and the Rural Development Tax levied on the Acquisition Tax.
- Instituting a self-certification system by 2002.
- Significantly streamlining the safety standard certification system.
- Introducing a collateralisation system for the purchase of motor vehicles.
- Improving consumers' perception of imported automobiles.

Table 6. **Taxes applied to automobile sales in Korea**

Engine size of 2 000 cc

Tax	**Imported cars**	**Domestic cars**
Producer price	100.0	100.0
Tariff	8.0	-
Total taxes, including:	50.3	46.7
- Special excise tax	*11.3*	*10.5*
- Education tax	*3.4*	*3.2*
- Value added tax	*12.3*	*11.4*
- Acquisition tax	*2.5*	*2.3*
- Rural development tax 1/	*0.0*	*0.0*
- Vehicle registration tax	*6.1*	*5.7*
- Education tax 1/	*0.0*	*0.0*
- Purchase of subway bond	*14.7*	*13.6*
Total price	158.3	146.7

1/ Abolished in 1998 following the MOU with the United States.
Source: Government of Korea, 1999*d*.

Some progress, even though limited, has already been made in reducing the trade restrictiveness of the automobile standards and certification system. For example, the Korean authorities have reduced a significant portion of the documentation requirements, eliminated five safety standards and increased the threshold for full volume certification from 100 to 1 000 units per vehicle line since the MOU with the

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United States. Korea has committed to raise the threshold to 2 000 units on 1 January 2000 and to 2 500 units on 1 January 2001. The Korean government's commitment to introduce a self-certification system no later than 2002 should also considerably ease customs procedures.

As a result of the bilateral talks with the US, Korea simplified the taxation structure for automobiles. The rate applied to engines over 2 000 cc was made uniform. The government extended the 30% reduction of the special consumption tax, which was applied for one year in 1999, for another five years, *i.e.* until 2005. In addition, the overall tax rate was reduced by 9 to 40% depending on the size of the engine. Despite this progress, trading partners are still concerned that the total amount of taxes levied on automobiles is too burdensome compared to other OECD countries and that the progressive taxation structure of two taxes tends to discourage the purchase of large cars.

3.2. Telecommunications equipment and services

Following impressive development of the telecommunications infrastructure and industry in the 1980s in Korea, the Korean authorities have undertaken to introduce competition in the sector, with a view to increasing the quality of Korean telecommunications equipment and services. In the early 1990s, Korea allowed a duopoly for the provision of international call services. This was extended to domestic long-distance services and cellular phone services. In 1998, the local telecommunications market was opened to full competition (for more on reforms in the telecommunication sector, see the background report to Chapter 6).

As the demand for telecommunications equipment and services has grown in Korea and liberalisation of the sector has expanded business opportunities, Korea's trading partners have urged Korea to remove obstacles to trade and investment. Their concerns have included the "localisation" programme, which encourages domestic production of some imported goods to strengthen the Korean industry, the lack of transparency in licensing procedures, non-availability of information about technical regulations sufficiently prior to their entry into force, insufficient transparency of standards and type approval certification procedures, and the discriminatory procurement policy of Korea Telecom Corp. (KT), the incumbent telecommunications operator in Korea (AMCHAM, 1999).

Korea's commitments under the WTO Agreement on Basic Telecommunication Service and bilateral trade talks with the United States and the European Union have largely contributed to the liberalisation of the Korean telecommunications services sector. The authorisation of the Ministry of Information and Communication is still required to provide facilities-based telecommunications services. However, the procedure to enter the market is limited to registration or notification for all other categories of service. The prior approval system for telecommunications tariffs was abolished in 1996, but it was maintained for local services provided by KT and SK Telecom, the market leader in cellular services. Despite strong opposition in the National Assembly, restrictions on foreign ownership have been reduced, ahead of the schedule for market opening measures agreed under the WTO agreement. Restrictions are still maintained for facilities-based service providers but have been significantly reduced since 1998. Foreign equity ownership cannot exceed 49% from 1999, except in the case of KT where it is limited to 33% from 1999. For the resale of leased lines, which is a non facilities-based service, foreign ownership is restricted to 49% from 1999 and complete foreign ownership will be allowed from 2001.

Some progress has been made in the field of transparency and non-discrimination, even though it is difficult to assess precisely, particularly about procurement. There have been many claims that the procurement policy of KT has led to discrimination against foreign products and that the government has encouraged private telecommunications operators to buy local. In 1997, the Korean government committed publicly to refrain from interfering in the procurement process of telecommunications operators

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(Government of Korea, 1999-d). It confirmed that private telecommunications operators are free to make procurement decisions independently and that no government regulation should require the purchase of goods or services of any particular origin. Although it is difficult to measure precisely the effects of the announcement, the import of telecommunications equipment has increased steadily in recent years (see Table 7) and frictions with trading partners on the issue of telecommunications have decreased.

Table 7. **The Korean market for telecommunications equipment**

	1992	1993	1994	1995	1996	1997	1998
Total domestic sales (billion US$)	15.4	16.5	22.6	34.7	44.8	48.8	34.5
Total imports (billion US$)	9.2	9.3	12.1	16.3	19.2	21.5	18.0
Import / domestic sales (%)	59.7	56.4	53.5	47.0	42.9	44.1	52.2

In this table, the market for telecommunications equipment includes telecommunications equipment as such, information equipment, broadcasting equipment and electronic components.
Source: KAIT (1999).

3.3. Electricity

In Korea, power generation, transmission and distribution are dominated by Korea Electric Power Corporation (KEPCO), a state-owned enterprise. It controls 100% of transmission and distribution services, and it owns 94% of the total domestic generating capacities. The remaining 6% are split between a small number of independent producers that supply power to KEPCO under long-term contracts. The industry is regulated by the MOCIE, which has established its policy in very close co-operation with KEPCO. Korea does not trade electricity with foreign countries, as there are no interconnections with other countries.

In 1997, the Korean government decided to restructure the electric power sector, as part of the general economy-wide deregulation and privatisation programme, to introduce more competition. In January 1999, the MOCIE presented a “Basic Plan for Restructuring the Electricity Supply Industry”. The main elements of the Basic Plan are the following: (1) to split KEPCO’s generation capacities into several power generation companies and to introduce competition in the power generation sector; (2) to privatise the new power generation companies step by step; (3) to split KEPCO’s distribution sector into several power distribution companies and to introduce competition in the wholesale and retail sectors; and (4) to open up the transmission network to introduce customer choice of the distributor, starting with large end-users. The Basic Plan also provides for the transfer of regulatory power to a new independent body (for more on reforms in the electricity sector, see the background report to Chapter 5).

The reform of the sector will reduce restrictions on FDI in the Korean electric power sector. Foreign investment is currently prohibited in the following areas: electricity transmission and distribution, nuclear power generation, nuclear fuel recycling, and radioactive waste treatment and related businesses.[25] The restriction is based on the exception clause provided by the FIPA, which stipulates that the national treatment principle may be waived in case foreign investment could adversely affect national safety and public order. Investment in state-funded power generation companies is allowed under the following conditions:[26] (1) foreign equity share must remain under 50%; (2) it must be less than the equity share of the largest national shareholder; (3) the executive director of the corporation must be a Korean national. The revised Electricity Business Act that took effect in July 1999 provides for the removal of restrictions on foreign investment in power generation and distribution. As foreign investors will be allowed to bid, the Korean electricity market is expected to open for the first time to foreign participation.

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The procurement of KEPCO has been open to foreign participation since 1997 when Korea began to implement the WTO GPA. It includes construction, equipment for generation plants, fuel and other electricity equipment. According to its commitment to the GPA, KEPCO's tendering procedures are open to foreign suppliers when the amount of the contract exceeds 15 million SDR in the case of construction projects, and 450 000 SDR in the case of goods. Some items related to transmission and transformation are bought exclusively from domestic suppliers, as they were not included in the concession list submitted by Korea. In order to enhance the transparency of its procurement procedures and introduce effective competition, KEPCO displays all the information about its procurement programme in its website.[27] English summary notices are attached when the value of the contract exceeds the threshold defined in the GPA.

Although the procurement procedures of KEPCO are fairly open and transparent, including in an international perspective, the proportion of contracts awarded to foreign suppliers remains low. In 1998, over 70% of the total value of KEPCO's procurement contracts were awarded through open tendering procedures opened to international competition. However, only 3% were awarded to foreign firms (see Table 8). KEPCO attributes this low level to a lack of interest or competitiveness of foreign firms.[28] It may also take time to change the practices set by the use in the past of long-standing contracts. Among the four major items procured by KEPCO, two items, namely generating equipment and gas, were under special long-term preferential schemes with two specific partners. Until 1995, the government forced KEPCO to buy generating equipment from Korea Heavy Industries & Construction Co. Ltd (HANJUNG), another state-owned enterprise, as part of its "unification scheme for generating equipment". This excluded any kind of competition from both domestic and foreign firms. This procurement market was liberalised in 1996, just one year before its opening to global competition according to the GPA. Since 1997, several foreign companies have entered the Korean market. The government still requires that KEPCO buys gas from Korea Gas Corp. (KOGAS), a state-owned company. KOGAS charges KEPCO higher prices than world market, but the government has so far maintained this scheme in order for KOGAS to keep its bargaining power in the international natural gas market. However, it plans to restructure and open the gas industry to competition, which would imply the end of long-term contracts between KEPCO and KOGAS.

Table 8. **KEPCO's procurement in 1998**

	Total contracts	**Tender limited to domestic suppliers**	**Tender open to foreign suppliers**	**Contracts awarded to foreign suppliers**
Value (in billion won)	6 554	1 889	4 665	196
Share	100.0	28.8	71.2	3.0

Source: KEPCO.

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4. CONCLUSIONS AND POLICY OPTIONS FOR REFORM

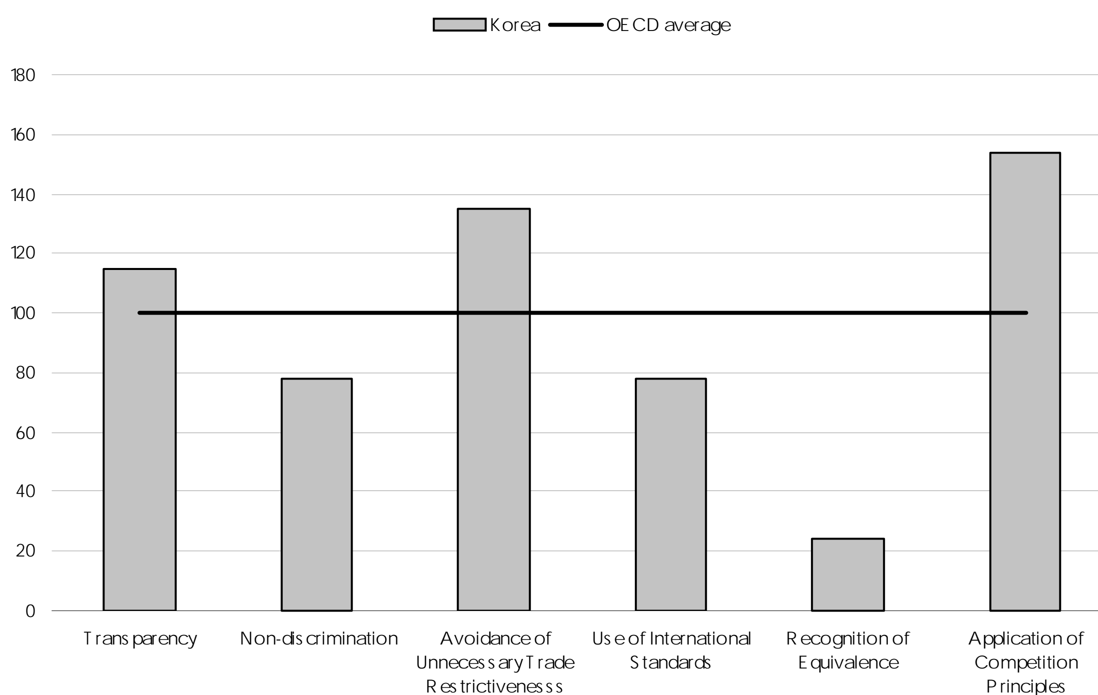
4.1. General assessment of current strengths and weaknesses

The Korean government has undertaken a broad-ranging structural reform based on market-oriented lines. The decision to sell two troubled domestic banks to foreign investors in the framework of the financial sector restructuring is a good example of the government's determination to introduce more competition in the Korean economy. As regulatory reform strengthens market principles, conditions for trading with and investing in Korea will improve and the Korean economy will reap the benefits of global competition. The regulatory reform undertaken so far has already produced tangible results in areas such as investment-related regulations, customs clearance or distribution.

Box 5. **Indicators of application of trade-friendly principles in Korean regulations**

The OECD indicators on regulatory reform and market openness are based on self-evaluation by Member countries of their domestic application of the efficient regulation principles. The results concerning Korea show a relatively high score for the application of transparency, avoidance of unnecessary trade restriction and application of competition principles. Results suggest progress in these areas, and relatively weaker efforts at eliminating non-discriminatory measures, using internationally harmonised standards and recognising the equivalence of other countries' regulatory measures. It should be recalled that the indicators on regulatory reform put the emphasis on dynamic assessment. They give more weight to relative improvement rather then regulatory quality in absolute terms. In addition, they focus on specific provisions, and relatively less on implementation and enforcement of regulations.

Figure 2. Figure 2. **Korea's trade-friendly index by principle**



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A first major strength of the Korean regulatory reform process is the government's determination to integrate Korea in the global economy. Since the 1960s, Korea has continuously pursued an outward-oriented strategy, but its policy has long focused on exports. The Korean government now acknowledges the need for Korea to open its economy to importers and gain the benefits of increased competition.

A second strength is the strong commitment by the political leadership for regulatory reform and market openness. President Kim Dae-Jung's motto "a business-friendly country, a people-friendly country" has led the government's strong policy in favour of regulatory reform, market openness and FDI promotion (Government of Korea, 1999-a). Pressure imposed by the financial crisis combined with a strong leadership have helped overcome reluctance from interest groups and from some government officials to change the system.

A third strength is the large scope of the reform process. In 1998, almost all the laws were changed; 23 of them were abolished; out of a total of around 11 000 regulations, over 5 000 were eliminated and 2 500 modified. Such broad, fast action has resulted from the pressure of the IMF package and from the urgent need to take the economy out of recession.

A fourth strength is the emphasis on building a better environment to attract foreign investment. Many long-standing barriers to foreign investment have been removed while deregulation of sectors such as telecommunications have created more business opportunities.

A fifth strength is the active role played by trade policy bodies in the elaboration of domestic regulations. The provisions of the Foreign Trade Act and the use of inter-governmental consultative meetings give Korean trade policy bodies the opportunity to intervene in the regulatory making process, to suggest some modifications if necessary, and eventually to promote trade-and-investment-friendly regulations.

However, there are still significant weaknesses in terms of international market openness in the Korean regulatory system.

First, the view has persisted and sometimes intensified that Korea's wealth lies in export growth and import substitution. The campaign of non-government organisations against the consumption of luxury goods can easily give way to social pressure not to buy imported products.

Second, there is a significant gap between sectors open to and sectors protected from international competition. As the former sectors (in general manufacturing sectors) have gained competitiveness, there is less resistance to opening the market to full foreign competition. This was the case when domestic manufacturers showed weak opposition to the abolishment of the Import Diversification System and the opening of cars and electronic sectors to Japanese competition. In these sectors, businesses are generally in favour of regulatory reform and increased market openness as they consider that more competition in protected sectors will help them become more competitive. However, traditionally protected sectors (in general services and agriculture) are still highly regulated and not enough progress has been made to open them to global competition. Since ministries and agencies in charge of the two groups of sectors are separated and independent from each other, it is difficult to make across-government regulatory reforms that introduce global competition.

Third, the speed of modifying and formulating new regulations has not been complemented with a similar speed in implementation. At the stage of elaboration, strong political leadership can be very efficient at pushing forward changes. However, reluctance to change is much more difficult to overcome at the stage of implementation. Politicians or officials who oppose changes can slow down the process by delaying the adoption of subordinate rules. Moreover, all levels of government must be accurately informed and trained to put reform in practice.

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Fourth, some regulatory authorities still make an active use of the traditional "inner circle"-oriented consultations. When these authorities need to collect views of the private sector in the process of formulating, changing or implementing regulations, they tend to go to regulated firms. When they extend the consultation by convening advisory councils, the composition of the councils excludes consumers and citizens. In spite of recent progress, foreign parties are still almost always excluded from those consultation processes.

4.2. The dynamic view: the pace and direction of change

After severely suffering from the financial crisis at the end of 1997 and the subsequent economic recession in 1998, the Korean economy is on the way to recovery. The government has not deviated from its commitment to reform and open the economy. Indeed, structural reforms combined with increased openness to international competition are needed to sustain the growth path (OECD, 1999). Imports, which had collapsed during the recession, are now on the rise, and some media have started to talk about the adverse effects of the increase in imports on the Korean economy. As the economy picks up and the crisis seems over, it is necessary for the government to resist pressures against further reforms, particularly against further reforms in favour of increased market openness.

In 1998, when the government launched a massive reform programme, no policy priorities were clearly selected. As the objectives for the government in general as well as for each ministry were then set by defining the number of issues rather than selecting the sectors, efforts have been spread out all over the whole economy. Sectors that needed urgent and drastic reform have been treated in the same way as sectors that were already fairly deregulated. It is therefore crucial that priorities be given to sectors where reform is needed, such as services and agriculture. The decision of the Regulatory Reform Committee to target specific issues in the 1999 annual reform plan is a step in the right direction.

4.3. Potential benefits and costs of further regulatory reform

Further regulatory reform in a market openness perspective could produce large benefits for the Korean economy as they could promote trade and make Korea more attractive for foreign investors. According to the Korean government (Government of Korea, 1999*a*), "foreign capital inflows are of crucial importance to the Korean economy. Foreign capital contributes to stabilising the foreign exchange market, restructuring the economy, creating jobs, increasing economic efficiency, and ensuring long-term sustainable growth. The free flow of imports also helps enhance domestic competition".

According to a recent study on the economic effects of FDI in Korea (Kwon and Ha, 1999), the recent regulatory reform programme can give rise to an increase in foreign investment inflows, up to 7 billion US$ and an increase in employment of 100 000 people each year during 1999 – 2003. In addition, FDI is expected to have various spill-over effects: providing technical guidance to subcontractors, bringing in new capital goods and technology, introducing advanced management know-how, promoting in-house R&D, and enhancing competition. There is some evidence of these effects in several sectors, including electronics, chemicals, pharmaceuticals, machinery and retailing (Kim, 1999).

4.4. Policy options for consideration

The following recommendations are based on the assessment presented above and the policy recommendations set out in the 1997 OECD report on regulatory reform (OECD, 1997, Chapter 5). Considering the potential benefits of market openness that could be induced by further regulatory reform, the Korean government is encouraged to consider the following seven policy options:

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- *Strengthen efforts to harmonise technical regulations and standards with international standards and to recognise the equivalence of other countries' regulatory measures:*

    - Reinforce the technical capacities of standards-related bodies, such as standards institutions, laboratories and certification bodies, so that they can effectively engage in aligning technical regulations and standards to internationally harmonised ones and accepting other countries' standards or certification procedures.

    - Co-ordinate efforts of international co-operation conducted by different ministries.

    - Engage more actively in the negotiation of MRAs.

- *Enlarge the scope of consultation with foreign parties, so that they are consulted not only on directly trade-related regulations, but also on other domestic regulations.*

    - Apply the transparency-enhancing approach developed by trade policy bodies, according to which foreign participants are invited at consultative meetings on trade policies, to other domestic policy areas.

    - Induce all government bodies to put more information about their policy agenda and major current issues on their Internet sites, if possible in foreign languages as well.

    - Open advisory councils to all interested parties, including consumers, environmental or other NGOs and foreign firms.

- *Speed up regulatory reform, deregulation and market opening in the traditionally highly regulated sectors such as services and agriculture.*

- *Engage public efforts to change the bad image of imports and foreign firms among the Korean public.*

    - Enlarge chances for consumers to have contact with imported goods by organising imported fairs, exhibitions, etc.

    - Give more opportunities to foreign producers to participate in fairs such as the Seoul Motor Show, machine fairs, electronic goods fairs, computer fairs, etc.

    - Publicise the objectives of the government's market opening policies by using mass media, open seminars, etc.

- *Strengthen the government's efforts to eliminate regulations that have de facto discriminatory effects against foreign competitors.*

- *Enhance co-operation between trade policy bodies and other government bodies in charge of domestic regulations in order to reduce trade restrictiveness of their regulatory measures.*

    - Strengthen the supervisory role of trade policy bodies over the regulatory decision making processes of other ministries and agencies: use actively the articles of the Foreign Trade Act that give trade policy bodies the right to intervene in the regulatory making process.

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    - Enhance officials' understanding of trade and investment issues, for example through exchange of views with trade policy officials. Make special efforts for officials of local governments.

    - Strengthen the role of cabinet level meetings for co-ordination of international economic affairs.

    - Require explicit assessments of the effects of proposed rules on trade and investment as part of the regulatory impact analysis.

- *Strengthen competition policy enforcement regarding anti-competitive practices that impair market openness.*

    - Keep vigilant that the *chaebol* reform does not give rise to anti-competitive or discriminatory effects against foreign firms.

    - Integrate the international market openness perspective into the action of the KFTC against the anti-competitive practices of *chaebols* or industrial associations. For example, as part of the *chaebol* reform programme, enlarge chances for foreign companies to participate in mergers and acquisitions.

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NOTES

1. For more details, see Kim (1997).

2. The progress was identified by businesses from the European Union (EUCCK, 1999) and the United States. “The new government did a great job in terms of market opening and foreign investment promotion during the recent two years”, representatives from the American Chamber of Commerce (AMCHAM) declared during an interview in Seoul in July 1999.

3. Communication from the European Union Chamber of Commerce in Korea (EUCCK) and the American Chamber of Commerce in Seoul (AMCHAM), to the OECD, July 1999.

4. During a discussion of the Working Group of the OECD Trade Committee in November 1999, a delegation expressed concerns that the interval was too short to enable foreign parties to lodge comments effectively. The Korean delegation considered, however, that foreign parties have time to provide comments as they have access to public hearings and other public comment procedures during the making process of regulations.

5. MOFAT recently established a list of people to whom they intend to disseminate trade-related information more quickly (by means of Internet mail or facsimile). The list includes the members of MOFAT advisory council and those of its sub-councils, the members of the Economic Co-operation Committee at the Private Level, deans of graduate schools specialised in trade, MOFAT advisory group on regional issues, research fellows from public and private research centres specialised in trade, mass media representatives, members of the Committee on Foreign Affairs and Trade at the Congress and political parties.

6. According to the Korean government, the English versions are not regarded as official because the translation was conducted by a private research centre and not by the government itself.

7. Laws and subordinate regulations are available on the Internet site of the Ministry of Legislation at the following address: http://www.moleg.go.kr/law/l.html. In addition, some laws related to foreign direct investment and international trade can be found on the Internet site of the Korean Investment Service Center at the following address: http://www.kisc.org/.

8. Information on public procurement is available on the Internet site of the Supply Administration of the Republic of Korea at the following address: http://www.sarok.go.kr.

9. Three meetings inviting foreign representatives have been called on since 1998. The meetings of March 1998, July 1998 and January 1999 were attended respectively by 115 people (including 13 representatives of foreign companies), 125 people (including 15 representatives of foreign companies) and 195 people (including 19 representatives of foreign companies).

10. According to the Korean Ministry of Government Administration and Home Affairs, which serves as a secretariat for the Administrative Appeals Commission, foreign parties have scarcely brought issues to the Commission. A recent example is the case raised by a Japanese company in Autumn 1999, concerning a decision made by the Korean Ministry of Construction and Transportation based on the Construction Technology Management Act.

11. Communication of the Japanese government to the OECD, November 1999.

12. Ordinance of the Ministry of Health and Welfare No. 98-67 of 10 October 1998.

13. Korea is part of the Protocol Relating to Trade Negotiations among Developing Countries (TNDC) with twelve other countries. The TNDC was founded on the GATT Enabling Clause and took effect in 1973.

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Under this agreement, Korea has granted concessions for 12 items. Korea also concluded an agreement with five other countries of the UN Economic and Social Commission for Asia and the Pacific (ESCAP), which is referred to as the Bangkok Agreement. It has granted concessions for 220 items under this agreement. Finally, along with 47 other countries, Korea is a signatory of the Global System of Trade Preferences among developing countries (GSTP), a trade arrangement initiated by the GATT under the auspices of UNCTAD. Korea submitted the instrument of ratification in May 1989 and has made concessions for 26 items.

14. The Consolidated Public Notice on Guidelines of Exports and Imports covers a wide range of laws. This includes:

MOCIE: Petroleum Business Act, High Pressure Gas Safety Control Act, Liquefied Petroleum Gas Safety and Business Management Act, Act of Control on the Production of Specified Substances for the Protection of the Ozone Layer, Electronic Appliances Safety Control Act, Law for Manufacturing Management of Elevator, Quality Management Promotion Act, Weights and Measures Act.

Ministry of Agriculture: Food Grain Management Act, Fertiliser Management Act, Agrochemicals Management Act, Livestock Epidemics Prevention and Control Act, Plant Protection Act, Major Agricultural Crop Seeds Act, Seeds Management Act, Livestock Act, Pharmaceutical Act, Sericulture Act, Ginseng Industry Law.

National Forestry Administration: The Law concerning Protection of Wildlife and Game.

Ministry of Marine Affairs and Fisheries: Fisheries Act.

Ministry of Finance and Economy: Foreign Exchange Transaction Act, Tobacco Business Act.

Ministry of Science and Technology: Atomic Energy Act.

Ministry of Health and Welfare: Pharmaceutical Act, Narcotics Act, Cannabis Control Act, Psycotropic Substances Control Act, Food Sanitation Act, Quarantine Act, Public Health Act.

Ministry of Labour: Industrial Safety and Health Act.

Ministry of Information and Communication: Radio Waves Act, Telecommunications Basic Act.

Ministry of Culture and Sports: Act relating to Import and Distribution of Foreign Publications, Motion Picture Promotion Act, Act relating to Records and video Works, Tourist Promotion Act, Cultural Properties Protection Act.

Ministry of National Defence: Special Measure Act relating to Defence Industry.

National Police Agency: Firearms, Swords, Explosives, etc. Control Act.

Ministry of Environment: Toxic Chemicals Control Act, Natural Environment Preservation Act, Drinking Water Management Act, Wastes Control Act, Noise and Vibration Regulation Act, Atmospheric Environment Preservation Act.

Ministry of Construction and Transportation: Motor Vehicles Control Act, Construction Machines Control Act.

National Tax Administration: Liquor Tax Act.

15. For details on the EDI system, see OECD (2000).

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16. Communication from AMCHAM to the OECD, July 1999.

17. Based on the definition of identical and equivalent standards given in the ISO/IEC Guide 21:1891.

18. Communication from the Government of Korea, MOCIE, to the OECD, July 1999.

19. Under the EU New Approach, the responsibility for defining technical specifications to meet "essential requirements" set in "New Approach" directives has been entrusted to three European standardisation bodies mandated by the European Commission: CEN (European Committee for Standardisation), CENELEC (European Committee for Electrotechnical Standardisation) and ETSI (European Telecommunication Standards Institute). Conformity with the harmonised standards produced by these standardisation bodies confers a presumption of conformity with the essential requirements.

20. The legal term for *chaebol* is "enterprise group". According to the Monopoly Regulation and Fair Trade Act, the "enterprise group" is "a group of companies the contents of whose business are substantially controlled by the same person or the same company".

21. For an example of the concern of foreign trading partners about the potential negative effects of the reform of *chaebols* on market openness, see *Nikkei Weekly*, 21 June 1999, "South Korean Conglomerates Showing Strength, Newly Restructured Groups Seen as Threat to Japanese Rivals".

22. The European Union has pointed out several such cases: the Korea Cosmetics Industry Association does not allow a foreign firm to be a full member, the Trust and Investment Association and Korea Stock Exchange ask new members to pay 300 million won and 16.5 billion won respectively, which is considered excessive; the Toxic Chemical Products Management Association asks foreign members to submit confidential business information (EUCCK, 1999).

23. The statistical robustness of the result is however limited as only 52 firms responded, compared to 1026 surveyed firms.

24. Taxes levied at the time of purchase are : the special consumption tax, the education tax levied on the special consumption tax, the value added tax, the acquisition tax, the registration tax, and the buying subway bond. The taxes levied during ownership of the car are: the automobile tax, the education tax levied on the annual vehicle registration tax and the licence tax.

25. Article 62-2 of the Electricity Business Act.

26. Article 2(1) of the Framework Act of the Management of Government-Invested Institutions.

27. http://www.kepco.co.kr.

28. Communication from KEPCO to the OECD, July 1999.

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