

Korea: Progress in Implementing Regulatory Reform

How much progress has Korea made in regulatory reform?

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Introduction

Regulatory reform is a priority in the effort to promote sustainable economic growth, complementing sound macroeconomic policies. It can help shift economic activity to higher value-added production and services, encourage the use of appropriate and new technology and make national economies more resilient to economic shocks. Regulatory reform is a very important asset as countries move forward in the process of globalisation.

Korea has made impressive progress in a very short time period implementing regulatory reform to streamline regulations, foster growth and competition, but more should be done to strengthen capacity and promote change at local and working level, if Korea is to reap all the benefits of its efforts.

In recent years strong political leadership, with the commitment to a “participatory society” and a shift to “user-oriented regulations” has promoted transparency. The Korea Fair Trade Commission (KFTC) has strengthened its efforts against business misconduct under its “2003 Roadmap”. Customs procedures and public procurement have been streamlined with new information technologies as well as one-stop shops for foreign investors. The communications sector has achieved impressive progress, with Korea leading among OECD countries for broadband internet access. Structural reforms have made the economy more resilient.

But further measures are needed to increase transparency, reduce the scope for bureaucratic discretion, strengthen the powers of the KFTC and improve public perceptions towards imports, foreign firms and foreign investment. Korea needs to do more to promote structural change and increase economic opportunities for its citizens and businesses in a global context, and further close its gap in relation to the most advanced countries. Investment in human capital is key and Korea’s tertiary education system needs reforms to meet the challenges of globalisation.

This *Policy Brief* looks at Korea’s regulatory reform efforts in recent years and at what further measures are needed. ■

How much progress has Korea made in regulatory reform?

Korea was among the first countries to undergo an OECD regulatory reform review in 2000. Since then, the government has been very active in implementing measures to promote regulatory reform, competition policy and market openness, and modernising the regulatory framework for information technologies. This new OECD review of progress identifies some of the lessons learned and indicates what more can be done in light of current challenges.

Progress in regulatory and structural reform has played an important role in the speed and strength of Korea's recovery from the 1997 financial crisis. The crisis occurred despite long-standing strengths, such as sustained high growth, moderate inflation, high national savings, large government financial surpluses and small external deficits. However, the economic model that had served Korea's growth in the preceding 30 years had become less appropriate in a more competitive global economy. The crisis required short-term management, but also made it easier to implement structural reforms.

Regulatory reform became a key element in the shift to a more market-oriented system. Four priority reform areas were targeted: foreign exchange and transaction regulations to encourage foreign investment; industrial and land use regulations to liberalise business activities; monetary and business regulations to improve industrial competition, and procedures and regulations for citizens. The government focused on deregulation. The Regulatory Reform Committee reviewed approximately 11 000 regulations in early 1998, halved their number and improved a further 2 400 regulations. Deregulation efforts proceeded for some major infrastructure sectors, albeit slowly. The government also streamlined the administrative process by establishing a one-stop shop and increasing tax incentives available to foreign firms.

The OECD's initial review on regulatory reform in 2000 discussed how to shift the government's role in the economy from direct intervention towards ensuring the sound functioning of a market economy. The government introduced a regulatory framework aimed at limiting the role in the economy of the business groups known as *chaebol* while supporting SMEs. Further broad-based regulatory reform founded on market principles was essential to create new foundations for long term growth. To further reduce government intervention in private sector decisions, new, pro-competitive regulatory regimes were required to efficiently protect consumer interests, the environment and competition. To remove remaining import barriers, the 2000 OECD Review called for strengthened efforts to harmonise technical regulations and standards with international norms and to recognise the equivalence of other countries' regulatory measures. Action was required in the telecommunications sector to stimulate new entry, to avoid micro-managing the sector and to limit the government's role to establishing the necessary safeguards.

The new OECD report monitors Korea's progress in implementing regulatory reform in the core areas of regulatory quality, competition policy, market openness and telecommunications, within an overall macroeconomic context. It also looks at tertiary education from a regulatory quality perspective, where an appropriate mix of deregulation and re-regulation could foster improved performance. ■

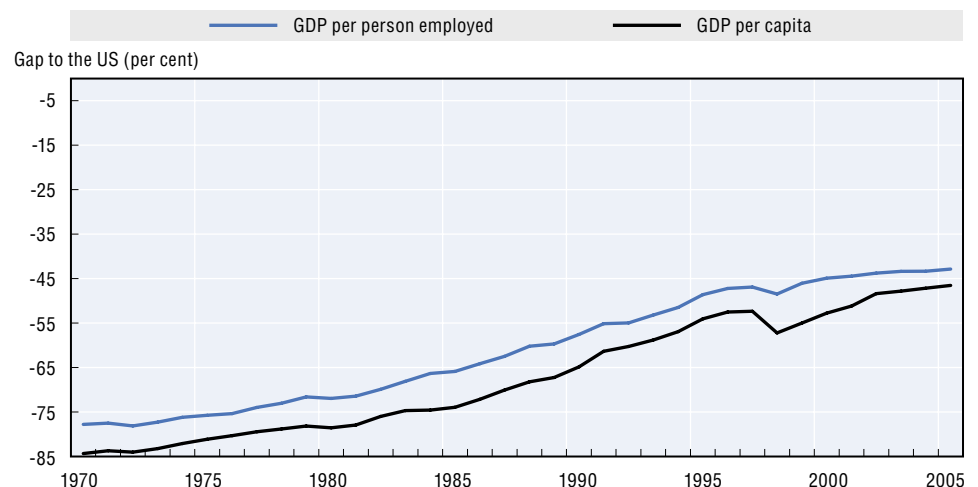
How to close the gap with the US?

Korea is one of the few countries that have managed the transition from a rural, undeveloped society to a modern economy in just one generation. Economic growth averaged 8% a year between 1963 and 1993, taking per capita income from less than 20% of the OECD average to more than 50% by the mid-1990s. GDP per capita relative to US levels went from around 15% in 1970 to almost 50% in the mid-1990s (Figure 1). In the wake of the 1997 crisis, Korea experienced a severe recession in 1998, with output falling by 7%. Labour utilisation was reduced significantly and the reduction in the average hours worked was also more pronounced during this period. Korea achieved a strong recovery, showing an economic rebound since 1999, with GDP per capita increasing at a 4.5% annual growth rate, with slightly lower labour productivity than in the previous period. The employment rate increased again, at a pace comparable to that observed before the crisis. At over 2 500 hours per year, working hours remain 37% higher than in the US, which is itself above the majority of European countries. Korea is one of the few OECD countries where the process of convergence with the US has continued, albeit more slowly, with Korea reaching nearly 55% of the US level in 2005 (Figure 1). ■

How to further improve the quality of regulations?

Korea has made impressive progress to improve its regulatory framework in recent years. The commitment to a “participatory society” has promoted a transparent regulatory regime. Policy has shifted to user-oriented regulations, refocusing the government’s role on strategic issues. The Regulatory Reform Committee and the Regulatory Reform Task Force, both under the direction of the Prime Minister, set regulation policy, review regulations, evaluate progress, and co-ordinate across relevant government ministries. The Internet is used extensively to improve access to regulations, and is linked to efforts to reduce administrative burdens. The emphasis has shifted from reducing the overall number of regulations to further promoting regulatory quality. To consolidate these gains, an explicit statement would support the reform efforts and hold them more accountable against a benchmark for performance.

Figure 1.
CONVERGENCE OF GDP PER CAPITA



Source: OECD (2006), National Accounts of OECD Countries, Paris.

It would also be helpful to review the possibilities for further co-ordination of the many agencies working on regulatory reform. The responsibilities of the Regulatory Reform Committee could be broadened to include more policy areas, such as taxation and subsidies, and industrial and regional development policies. The growing number of bills introduced by assembly which are exempt from the regulatory quality process could be remedied by a permanent mechanism in the National Assembly to assure oversight of the quality of laws. The consultation process should also be made more uniform and effective. While substantial progress has been made in reducing bureaucratic discretion, the possibilities remain, including administrative guidance.

Korea has also taken significant steps to simplify and cut its regulations in recent years. However, further work is needed, together with an analytical methodology for measuring administrative burdens that would help identify priorities for reform. An effective regulatory impact analysis system calls for better training at national and local levels, and clear political support to promote a change in administrative culture, lest RIA become a routine formality rather than an instrument for policy decision-making. ■

How to stimulate competition?

Commitment to market principles at the highest political level has provided strong support for competition policies, reforms of the financial sector and corporate governance, and for opening markets to trade and lowering barriers to foreign investment. Significant progress has been achieved in shifting the focus of the Korea Fair Trade Commission (KFTC) towards core competition problems and increasing its ability to enforce competition policy, even if further challenges remain.

The core of the KFTC's latest reform programme is the "Three Year Market Reform Road Map" launched in 2003. The Road Map concentrated on three general areas. First, it focused on strengthening business transparency and accountability by modifying corporate laws, authorising lawsuits against business misconduct, protecting minority shareholder rights, reinforcing auditor independence, and tightening control of insider misconduct. Second, the Road Map revised the KFTC's regulations for conglomerates to encourage more transparent structures. The third area covered traditional competition policy topics such as doubling the financial penalty against cartel violations, streamlining merger review with pre-notification, retiring anti-competitive regulations and strengthening consumer rights. This plan was embodied in legislation in 2005. The KFTC staff structure was reorganised to reflect these changes. However, the KFTC still lacks "dawn raid" power to enter premises and seize evidence. Increased use of criminal sanctions in hard-core cartel cases, to make the threat of individual liability more realistic, depends on co-operation with prosecutors. Eliminating constraints in professions remains a challenge. The KFTC shares regulatory responsibilities with other agencies. Generally co-operation has been smooth, but there have been occasional tensions in sectors such as insurance and cable television which have exposed businesses to some uncertainty. ■

How to further open markets?

Korea maintains a firm commitment to attract foreign direct investment and to further liberalise the market. Improvements in regulatory procedures, greater engagement of the business community and streamlining customs and public procurement procedures contribute to this end. The Korea On-line E-Procurement System (KONEPS) has enhanced transparency and efficiency. Korea has also worked to change the negative public perception towards imports, foreign firms and foreign investment, and has introduced a framework to reward public servants who promote foreign direct investment. Invest Korea is a one-stop shop for foreign investors, and the Office of the Investment Ombudsman assists foreign investors on problems after establishment.

Strengthening efforts to alleviate the perception of *de facto* discriminatory effects against foreign goods, companies and investment remains a major challenge, however, as changing mindsets necessarily takes time. As in other OECD countries, some negative perceptions persist among the media and the public. Laws and legal instruments may not always be sufficient to improve investors' confidence, as there is also a perception among some foreign investors that officials sometimes interpret and apply regulations more strictly for foreign firms. This calls for further efforts to adapt the administrative culture and to better communicate with the public on the importance of regulatory reform and market openness. There is also a perception among foreign investors that certain standards are specific to Korea and differ from international references, in spite of progress in recent years. Further improvements in transparency and decision making from the perspective of market openness will help ensure that regulations and guidelines are interpreted and implemented in a non-discriminatory manner. Translating public notices and consultation procedures into foreign languages would be beneficial, and would signal the government's commitment towards an open market. There is still scope for further strengthening efforts to avoid unnecessary trade restrictiveness and promote international standard harmonisation and conformity assessments. While FDI is allowed in most sectors, 26 have limitations on foreign participation and 2 – television and radio broadcasting – are fully restricted. Services and agriculture represent specific challenge areas. The current negotiation over Free Trade Agreements could potentially represent a powerful tool to address this challenge although care is necessary so that the results of FTAs do not lead to trade diversion. ■

How to stimulate market dynamics for telecommunications?

Since 2000, the telecommunications sector in Korea showed continued rapid growth. In broadband penetration, Korea now ranks the highest among OECD countries and it is also the 9th largest telecommunication market among OECD countries. Sector liberalisation has produced notable benefits in terms of improved services, lower prices, and innovation. Korea is also among the leaders for wireless broadband as well as digital multimedia broadcasting. Positive reforms have taken place to create a competitive market. Korea Telecom was fully privatised in 2002, a goal that many other OECD countries with state-owned operators have not yet managed to complete. A number of the recommendations made in 2000 have been implemented or partially implemented, even if scope for further improvement remains.

Korea has made impressive progress in developing its telecommunication infrastructure and service markets, with significant emphasis on the information society and IT sector. Korea performs generally well in terms of overall price comparisons, but prices for international calls tend to be among the highest in the OECD. Implementing market-oriented tools and institutions tends to lag behind. Korea is still not emphasising sufficiently the use of market mechanisms to develop a digital economy. There is still not enough clarity of roles between policy making, pushing the development of the sector, and implementing a regulatory framework, despite the devolution of some technical decision-making functions to the Korea Communications Commission. The reliance on *ex ante* regulatory schemes and tools remains insufficient and has at times allegedly included the use of administrative guidance.

Despite significant progress, KCC, the sector regulator, can still not be considered fully independent. This does not mean that deregulation cannot take place, but a more efficient and transparent regulatory framework, with greater independence would support market development, clarifying opportunities for domestic and foreign investors. This would help promote further opportunities for all participants in this dynamic market and would better serve the consumers' interest. Given the perspective of sectoral convergence, it would be advisable to consider a possible joining of the KCC and the Korea Broadcasting Commission. A comprehensive review of legislation to create a single legal framework for the communication sector would represent a useful step and also serve to create a well-balanced market. Foreign ownership restrictions also remain an issue. ■

How to boost the competitiveness of tertiary education?

For innovation and productivity to grow, especially in the service sector which is only about 60% as productive as the OECD average, Korea needs qualified human capital. While Korea's primary and secondary education levels are excellent, as demonstrated by scores at the international level, there is still scope for improving the quality of tertiary education to ensure an adequate supply of high-skilled human capital. There is evidence of skill mismatch, as workers at both low and high skill levels are in short supply. Companies also complain about the quality of domestic tertiary education. Korea represents 5% of foreign student flows to the OECD area, but plays a very modest role as a destination for students.

In this context, severe competition to get into prestigious universities has social consequences and affects secondary education. Higher education is also not prepared for demographic changes, which will imply for the first time in Korean history, a shrinking college age population, with a potential decline of the student population in the future. These issues are further exacerbated by the population concentration in the Seoul Metropolitan Area.

Korea has embarked upon efforts to improve the global competitiveness of its tertiary education system by simplifying and clarifying regulations, eliminating obsolete regulations, and improving co-ordination across ministries. Further efforts call for regulatory reforms affecting institutional autonomy of public universities, including moving to a legal status as school corporations outside the formal government structure. Overall, an effective

system for quality assurance and public accountability would serve the whole system. The regulatory framework for private universities would benefit from stronger transparency and accountability measures as well. The Ministry of Education itself could then focus less on detailed regulation and more on strategic leadership and monitoring performance. ■

What are the lessons for the future?

Korea has made impressive progress in a very short time in adapting and modernising its regulatory framework towards consultation and transparency, improving competition in domestic markets and further consolidating market openness. Such rapid change may give rise to social concerns, with questions about what could be the acceptable rate of change in terms of institutional structures and methods of government. By OECD standards for regulatory quality, Korea is on track, but progress in certain areas seems to be more apparent than in some others. This may certainly test the capacity for reform of entire sectors of the administration and society.

A high-quality regulation approach requires a whole implementation apparatus. In the administrative sphere, there are possible risks of “implementation gaps”, as working level officials need to be more transparent and client-oriented when interacting with society. Capacity building and cultural change, including at the local level, are critical factors to ensure that changes decided at the national level can effectively be implemented. This also requires upgraded skills and new working methods. The ambitious goal of a “participatory society” requires further efforts for public administrations to reach out to the public, to operate transparently and to increase their capacity to listen to the demands of the wider public. Transparency is important, as it represents a social investment, an intangible asset in the form of current and future trust in public institutions, tools and policies.

Beyond the administrative sphere, Korea faces the challenge of reaching out to a wider public, to communicate the benefits of regulatory reform and of building consensus for action. There is a need to publish a government strategy on consultation, but also to show the public that their comments are being heard, or if not, why not.

Further regulatory reform and the application of high quality regulation principles could help Korea better prepare for the future. Regulatory reform can help structural change in the economy, promoting a more integrated policy approach, as well as fostering market openness. This would improve the situation of Koreans as citizens, workers and consumers. Awareness of the need for action is high, and regulatory policy is relatively strong. However, other OECD countries are moving as well, since regulatory reform is a dynamic field. All are further advanced in 2007 compared with the mid-1990s. If Korea is to continue closing its gap in relation to the most advanced countries, it needs to make even faster progress, to ensure smoother market processes, better regulatory tools and more open institutions. ■

For further information

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For further reading

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2005 OECD Guiding Principles for Regulatory Quality and Performance.
Available at: www.oecd.org/regreform.

OECD (2006), **Cutting Red Tape: National Strategies for Administrative Simplification**, ISBN: 978-92-64-02978-1, € 30, 108 pages.

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