



## COUNTRY STUDIES

# Korea – Updated Report 2004

### Introduction

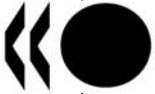
This Report examines the state of competition policy in Korea in 2004. It focuses particular attention on developments since the OECD's 2000 "Report on the Role of Competition Policy in Regulatory Reform" ("2000 Report"), which was prepared as part of a larger OECD study of regulatory reform in Korea.

### Overview

### Related Topics

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**KOREA - REPORT ON COMPETITION LAW AND INSTITUTIONS (2004)**

*The attached report updates information on the current state of competition policy in Italy. It was edited after the Competition Committee discussion (Item VII) in October 2004, which compared experiences in ten countries. It is circulated FOR INFORMATION.*

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**UPDATED REPORT ON COMPETITION LAW  
AND INSTITUTIONS (2004)**

**KOREA**

1. Competition policy and enforcement in Korea were the subject of a peer review in the Competition Committee in 1999 and a report published in 2000 in the regulatory reform program. This report reviews developments since that time, including the status of the implementation of recommendations about competition law enforcement. Product market competition was also the subject of a special chapter in the EDR Committee annual economic survey of Korea, published in June 2004.

2. Application of the 1990 Monopoly Regulation and Fair Trade Act (MRFTA) by the independent Korea Fair Trade Commission (KFTC) concentrates on horizontal constraints and unfair practices. The KFTC also applies laws to protect small businesses and consumer rights, and it is heavily involved in direct regulation of the structure, governance and operations of the *chaebol*. The KFTC systematically monitors industry structure in manufacturing, but most of the targets of its priority-setting “clean market” projects have been in services. In the last three years, these targets have included telecoms and broadband internet service, medical services and pharmaceuticals, wedding and funeral services, construction materials, apartment and office rents, media, school uniforms, private instructional institutions, liquid natural gas, credit cards and insurance, internet shopping, real estate agents and services, home maintenance services, job referral, electric power, instalment finance and banking, advertising, and professional certification. The sectors were chosen by the KFTC for monitoring because they have a direct and visible impact on consumers and because many have been significantly deregulated in recent years. The KFTC emphasises a law-enforcement approach along with its important advocacy and reform roles. It is perceived as an aggressive prosecutor, and amendments to the law that are in progress will strengthen its enforcement tools.

3. The KFTC’s conception of its role is broad. According to its January 2004 policy announcement, its goal is “to nurture growth potential by enhancing efficiency in resource allocation through transparent business management and fair competition, thereby distributing the value-added in an effective and reasonable way.” The KFTC holds that improving market confidence by supporting these core values of transparency and fairness will encourage human and physical capital to flow into more productive and healthy sectors. To implement this general competition policy of stimulating dynamic efficiency to facilitate adaptation and improve efficiency and consumer welfare, the KFTC’s specific targets are preventing monopoly and oligopoly market structures through merger enforcement, removing regulations that hinder competition, deterring cartels and vertical restraints, improving conglomerate ownership structure and transparency, promoting fairness in transactions with consumers, and strengthening private enforcement against unfair practices. Enforcing law about cartels and mergers and eliminating regulations that constrain market competition are important, but the KFTC places equal importance on improving the machinery of capitalism, that is, on reforming the ownership and investment structures of the *chaebol* so that resources respond better to market signals.

## Substantive law

4. In competition law enforcement, the KFTC pays most attention to horizontal collusion. The KFTC has tried to establish a *per se* rule against price fixing. The legal foundation for that approach, which treats such agreements as illegal without the need to show their effects in the particular case, is still uncertain in Korea. Changing the relevant language of the MRFTA in 1999, from “substantial” restriction to “unjustified” restriction, was intended to achieve a *per se* effect. An internal guideline about surcharge levels lists seven kinds of cartels, from hard-core cartels (1-4) to less serious ones (5-7). Since 1999, the KFTC has not approved (that is, exempted) any cartels. The KFTC’s guidelines about collective action warn that conduct which is not grounded on legislative authority risks violating the MRFTA, and the KFTC has taken corrective measures against agreements in beer, pesticides and property insurance that the parties had claimed were authorized by administrative guidance.

5. The KFTC has scored several successes in price fixing and boycott cases. In two investigations in 2003, 7 major cement firms and their trade association were fined KRW 26 billion for conspiracy, group boycott and price fixing, and manufacturers of iron bar were fined KRW 79 billion for agreeing to boycott tenders in 2001 and 2002 and for price increases in early 2003. In both cases, several of the parties were also referred for criminal prosecution. In 2002, the first international cartel was caught under the MRFTA, as the KFTC imposed fines of KRW 9 billion on six manufacturers of graphite electrodes. These sanctions were affirmed on appeal in August 2003.

6. In dealing with dominant firms and mergers, the KFTC focuses principally on structure, while showing increasing sensitivity to economic analysis of particular market situations. In characterising dominance, it uses three-firm concentration as its basic market structure test, presuming dominance if the share of the top three firms is 75% or more (or if the share of the top firm is over 50%). The KFTC acknowledges that such high concentration can be consistent with strong competition if the three large firms are all healthy. But the structural presumption appears to be conclusive. Although a number of criteria may be invoked to identify dominance, the KFTC has always found dominance where the market share criteria were met. Comparisons of structural tests show that Korea is more tolerant of concentration than Germany (which presumes dominance at CR1 of 33%, CR3 50%, and CR5 67%) and less tolerant than Japan (CR1 50%, CR2 75%). Still, by defining dominance at a higher level of concentration than in many other Member countries, the KFTC in effect permits more latitude to large-firm market conduct. The KFTC no longer maintains a listing of dominant firms subject to particular scrutiny. Ending that practice had no effect on the number of cases about abuse of dominance. Claims about predatory low pricing are subjected to the sceptical “recoupment” test, that the predator be able to recover its losses by raising prices free from the challenge of competitive re-entry. Since 2001, denial of network access has been defined as an abuse of dominance.

7. The MRFTA’s structural test for mergers is the same as the test for a dominant position. In addition, a merger is presumed to be anti-competitive if the merging parties would have the highest share in the market and that share would be 25% greater than the next largest firm. Structural tests in the KFTC’s guidelines outline some safe harbours based upon factors such as rank and relative market shares. The relatively permissive conception of dominance also means that merger control is more likely to permit large combinations. Often large mergers may be efficient, especially if markets are international in scope. When the tests have been relaxed, such as when the KFTC approved restructuring transactions following the financial crisis (the so-called Big Deals), the KFTC has imposed behavioural restraints to deal with risks of market power. Recent merger decisions show reliance on structural as well as behavioural remedies. There is no provision for overriding KFTC decisions based on other policies, and policies other than competition are not considered at the KFTC; the only recourse is to court.

**Box 1. Dominance and mergers**

**The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered.**

The 2000 Report observed that essentially the same structural standards were used for cases of abuse of dominance and for merger analysis. But correcting an existing situation may present different issues than preventing new problems. Not only do the standards permit formation through merger of substantial firms in concentrated industry structures, but the reliance on market-share criteria, being essentially formalistic, may inhibit sensitive application of policies motivated by efficiency.

There has been no change. The same basic structural test is still used for cases of dominance and for mergers. The differences in the situations are evidently not considered significant enough to warrant more discriminating treatment.

8. Modifications in the merger review system are planned, to expand the scope of required pre-notification and provide more time for investigation, while eliminating the notification requirement for small acquisitions. Mandatory pre-notification will be required for stock acquisitions by firms with over KRW 2 trillion in assets. Notification is already required for mergers and asset acquisitions. Notification would no longer be required, though, for smaller acquisitions (of firms with assets or turnover under KRW 3 billion) or for interlocking. The review period would be extended from 60 days to 90 days. As of June 2003, rules about the notification of foreign acquisitions were modified, by setting a test based on sales in Korea (of KRW 3 billion for each party) in order to distinguish those that are less likely to have effects in Korea. These changes would bring Korea's system more closely into line with merger review systems in most other Member countries.

9. The KFTC applies rules about unfair practices, particularly in dealing with suppliers and subcontractors, that protect small business interests. This function is adapting to changes in the economy: the Fair Subcontract Transactions Act is being extended from manufacturing and construction to also cover transportation and other service sectors. The KFTC applies rules to protect consumers too, against unfair marketing practices and misrepresentation. These functions, which are a significant component of the KFTC's workload, can complement competition enforcement, although some "fair trade" rules that limit promotional offers could risk dampening market competition. In other cases, the KFTC is concerned that rules imposed by others to protect consumers may limit competition. For example, in dealing with the credit card problems, which some saw as the result of excessive competition for customers, the financial regulator wanted companies to control premium offers because they threatened financial stability. At the same time, the KFTC was concerned about the anti-competitive effects of self-regulation. On the grounds that changing rules and eligibility without notice was unfair to consumers, the KFTC ordered the card issuers to make clearer disclosures of the terms of their offers.

**Institutions and enforcement processes**

10. The KFTC is one of only a few independent agencies in the Korean government. Independent regulatory bodies deal with broadcasting and the financial sector, but the regulators for energy and telecoms regulation are still attached to ministries. The KFTC tends to reinforce its independence through long-term autonomy in the choice of personnel. The five full-time "standing" commissioners (including the chair and vice-chair) have usually been KFTC veterans. In a variation from that pattern, the new chair is a professor, also from outside the government. The four "non-standing" commissioners include two economics professors, a law professor and a lawyer. The overall staff level, of about 416, is essentially unchanged since 2000. About 25% of the staff and budget are devoted to enforcement of laws about subcontract rights, unfair contract terms and consumer protection.

11. Most competition complaints are about abuse of dominance and refusal to deal, but most of the enforcement attention goes to collusion and to *chaebol* issues. The latter are also the most difficult and resource-intensive areas of enforcement. Although the KFTC still keeps track of industry structures, particularly in manufacturing, the targets of its priority-setting “clean market” project have been mostly in services. In 2001, the industries chosen were telecoms and broadband internet service, medical services and pharmaceuticals, wedding and funeral services, construction materials and apartment and office rents, media, and school uniforms and private institutions. In 2002, they were LNG-LPG, credit cards and insurance (other than life insurance), internet shopping, real estate agents and home maintenance services, job referral, and private instruction institutions. And in 2003, similarly, the targets were electric power, instalment finance and banking, internet shopping, real estate services, advertising, and professional certification.

12. The KFTC’s investigative powers still need to be strengthened, to target conduct that parties would prefer to conceal. Difficulties have been encountered in investigations of cartels and of compliance with *chaebol* regulations. Although stronger sanctions can now be applied to discipline non-compliance with orders and investigations, the basic information gathering powers remain ones that were originally designed for voluntary processes. For example, the KFTC cannot search premises and take possession of evidence. Administrative law enforcement bodies that deal with labour, tariff, environment, and tax compliance have such powers, as does the prosecutor. To make the KFTC’s administrative enforcement more effective and obviate the need to resort to criminal processes for inappropriate reasons, the KFTC needs such compulsory investigative powers.

#### Box 2. Investigation powers

**The KFTC’s powers to obtain information in investigations may need to be strengthened, so there is less need to refer small matters for criminal prosecution.**

The 2000 Report noted that measures that might be considered could include the power to seek a court order for access to documents or information.

So far, the only concrete step was to authorise higher fines to punish non-compliance with administrative orders and processes. The amendments to the MRFTA in 2001 raised the maximum fine for this from KRW 10 million to KRW 50 million for an individual, and from KRW 100 million to KRW 200 million for a corporation. It is not clear that this step has made very much difference yet in practice, though. For cartel investigations, at least, the carrot appears to be more effective than the stick: key evidence in several cases was supplied by informants who were rewarded for coming forward.

13. The KFTC has a leniency program, authorised by the 2001 MRFTA amendments, which has produced enforcement results in about a half dozen cartel cases. In addition to the prospect of a lower surcharge for the corporation, the KFTC program has a “whistleblower” component, with a positive inducement to encourage individuals to come forward. An informant can be paid a proportion of the surcharges that are eventually assessed. In November 2003, the ceiling on these bounties was increased to KRW 100 million. So far, the leniency program has promised reductions in administrative fines and corrective measures. Proposed amendments to the MRFTA would offer a reduction of criminal penalty as an additional incentive.

14. The basis for computing administrative fines, or “surcharges,” was expanded in 1999. That change, combined with stepped up enforcement, greatly increased the sanctions actually imposed against competition violations. Fines against cartels in 2003 totalled KRW 108 billion, and the total against competition violations over the period 1998 to 2003, about KRW 455 billion, greatly exceeds the total of KRW 234 billion over the previous decade. Yet provisions for financial sanctions are still less stringent

than in most other Member countries. The ceiling on the administrative fine is 5% of turnover related to the violation (or a minimum of KRW 1 billion), and the level actually imposed is typically about 2.5% to 3.5%. The single case incurring the largest surcharge, of KRW 85.4 billion, was the cartel to rig bids for oil sales to the military. The KFTC has asked the National Assembly to double the ceiling for fines, which would make the multiplier comparable to that used in most of Europe (10%). Even that level could still be effectively lower than it is in countries where sanctions may be based on total firm turnover, not just the turnover related to the violation.

15. Individual executives may also face criminal punishment in Korea. In case of a violation by a trade association, surcharges can be imposed on the members who participated in them. And individuals who are managing directors or executives can be held criminally responsible for violations by their firms. There have been a few prosecutions, but no one has actually gone to jail because sentences have typically been suspended. That may change, though. A trial court recently sentenced several defendants to up to a year in prison and the case is on appeal to the Supreme Court. Making the threat of individual sanctions credible will make it a more effective deterrent.

### Box 3. Private actions

#### Strengthening rights of private action should be considered.

To apply more resources and expand the base of support for competition policy, the 2000 Report concluded that strengthening rights of private action should be considered, taking into account the characteristics of Korea's legal system. Measures could include easing the proof of damages in competition cases or facilitating consumer and customer recoveries in price-fixing cases. To give parties standing to seek court review of KFTC decisions not to pursue complaints may be more difficult, because it would require a more significant change in Korean law. The quota on new lawyers should be eliminated.

No particular measures have been taken yet to implement this. Private suits for damages, following KFTC enforcement, are already possible. There have been about 30 private cases, and the plaintiffs have apparently gotten some relief in about half of them. The KFTC has proposed an amendment to the MRFTA that would permit third party actions for damages without waiting for the KFTC's final decision. The KFTC has also considered providing for "public interest" suits to deal with damages to groups of individuals, and to make it easier to bring private suits for damages from commercial bribes or demands for favours under the subcontract fairness laws.

### *Chaebol* oversight

16. Regulating the *chaebol* is a significant KFTC function. The KFTC designates the firms that are subject to special regulation because of their size, enforces rules governing the structure of holding companies, limits total shareholdings outside a designated group and cross-holdings within it, limits loan guarantees within a group, restricts how financial affiliates in a group can vote shares, and polices "undue" transactions within a group. The KFTC considers these functions to be as important as competition law enforcement, and the KFTC is just as stern in enforcing these rules, periodically announcing enforcement campaigns to check for undue transactions and other violations. Since 1998, nearly half of the financial sanctions imposed (KRW 341 billion out of a total of KRW 752 billion) were against violations of the *chaebol* rules. The KFTC refined its approach in 2002, in part because reforms since 1997 have changed *chaebol* structure and conduct. Rather than list the top 30 groups in total assets and apply uniform controls to all of them, the KFTC now differentiates them according to their total assets. The KFTC plans to ask the National Assembly to delete provisions about the debt-equity ratio and to extend the KFTC's powers to demand financial information from financial institutions concerning their customers' "undue transactions."

17. The investigation of "undue" intra-group transactions is the *chaebol* regulation that is most closely related to conventional conceptions of competition law. Subsidies in the form of transactions within

a group on more favourable terms are conceived to present competition problems analogous to state aid subsidies. For example, the KFTC contends that if a firm should be liquidated according to market standards but an affiliated firm props it up, the result is anti-competitive because entrenching inefficient large firms bars entry of potentially more competitive small ones. The analogy to anti-competitive state aid was more apt when it appeared that the *chaebol*, or some of them, would be treated as too big to fail. In the absence of implied government support for the supposed subsidies, there should be a stronger presumption that transactions will be subject to the discipline of market forces, even within a group although controlling shareholders may nonetheless try to escape that discipline. KFTC monitoring in the absence of any such implicit guarantee is reminiscent of older styles of regulatory intervention, such as control over firms' investment decisions and adherence to consensus price levels. Suspicious intra-group transactions may involve unfairness or something like predation, but more often the real problem is misappropriation, breach of fiduciary duty, or embezzlement. KFTC enforcement actions against clearly identifiable threats to market competition are of course necessary, but actions may fail where they aim at corporate misconduct that is not actually anticompetitive. Meanwhile, the new laws and institutions for dealing with corporate misconduct could remain underdeveloped as long as the KFTC is occupying the field.

18. The KFTC contends that the other aspects of its unusual enforcement agenda are consistent with reliance on markets for growth and efficiency, because transparent structures and fair competition support confidence in market transactions, thus encouraging the flow of resources into productive uses. That general "dynamic efficiency" motivation is undermined by some of the rules' constraining effects. For example, concerns have been expressed that the ceiling on *chaebol* shareholdings (a rule that is aimed principally at curbing "circular" investment structures) may make it more difficult to set up large-scale projects that require teaming substantial Korean firms as strategic investors with substantial foreign investors; however, the KFTC has not found any instances of projects that could not be done for this reason. The KFTC also defends its continued attention to corporate governance and investment matters on the grounds that corporate, financial, and securities laws and regulatory institutions are not yet established well enough to do the job adequately. Meanwhile, it is relaxing the requirements for forming holding companies, a structure that would increase transparency and reduce the risks of chain bankruptcies. Holding companies were first allowed in 1998, but because of the conditions attached to them only a few have been created so far. In addition, the KFTC has proposed a "Three-Year Market Reform Roadmap" that would offer *chaebol* incentives to improve their corporate governance practices and ownership structure. This proposal, which is under consideration by the National Assembly, would set specific criteria that would allow companies to graduate from the regulations on equity investment. At the same time, the KFTC intends to provide more information on corporate governance and ownership structure to investors and stakeholders.

#### Box 4. The *chaebol* issue

**Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to "efficiency" goals.**

The 2000 Report recognised the KFTC's longstanding position, that reducing the power of the *chaebol* and correcting the distortions of competition that have been caused by their group structures must be a high priority and that this task cannot be understood solely in terms of conventional competition policy categories. It would be appropriate to continue to focus attention on intra-group transactions that may have effects on competition in markets. The KFTC observed then that close supervision of "undue" transactions was a temporary, transition tactic, to help ensure that capital markets develop and function. The Report argued that reforms of corporate governance and prudential supervision, as well as market openness, are the better means in the long run to deal with major *chaebol* issues.

The long run has not yet arrived, but changes in the KFTC's policies and in the financial situations of the *chaebol* themselves suggest that it is coming closer. As of 2003, there were 17 corporate groups of "type A," which are subject to a ceiling on total equity investment outside the group. But one group, Korea Water Resources, which was previously included, was dropped because its debt-equity ratio fell below 100%. The "type A" groups now include government-related enterprises too, such as

KEPCO, Korea Highway Corporation and KOGAS. There are 49 groups of “type B,” which are subject to controls on cross-shareholdings and cross-debt guarantees; all of the “type A” groups are also “type B.” Measures of financial balance have improved significantly. The debt-equity ratios of the “type A” groups declined, on average, by 2.3% from 2002 to 2003 (to 122.8%), for the type B groups, by 5.9% (to 116.4%). In 1998, the ratio for the top 30 groups had been well over 500%. The KFTC is evidently stepping back from its strategy of broad dragnet investigations; instead, it will target investigations upon allegations of undue transactions in particular cases.

The KFTC’s plans would encourage further improvement. Under its proposal, firms that improve their governance and structure will no longer be subject to these special regulations. The KFTC’s proposal outlines potential criteria and measures of improvement. This include having good corporate governance and effective monitoring, achieved through cumulative, written voting and an “internal transaction” committee of outside directors); adopting a holding company structure; simplifying their cross shareholdings (reducing the structure to fewer than 5 affiliates); and reducing the gap between voting rights and cash flow rights. If in 3 years the ownership structure and governance of conglomerates has improved and the market monitoring mechanism works effectively, direct regulations will be completely reviewed.

To link the *chaebol* policies with the usual conceptions of competition policy, the KFTC contends that greater transparency will lead to broader, more stable capital and factor markets, supporting innovations in those markets that will encourage entry and adaptability in other markets. That is, correcting the problems of corporate and financial structure will lead to market behaviour that increases competition, even if the problems themselves are not usually conceived as results of particular constraints on competitive conduct.

19. Opaque corporate structures needed to be cleared up, because they allowed financial leverage at a scale that undermined stability. To do that task, the KFTC was more independent and effective than the existing financial regulators, although they failed to prevent the problems that led to the 1997 crisis. But there have been numerous reforms to improve corporate governance, financial soundness, and transparency since 1997. Other enforcement agencies, notably the Financial Supervisory Commission and the Financial Supervisory Service, which were created in 1998, are in place to deal with problems related to corporate financing. Supervisory functions related to internal cross-holdings and guarantees and intra-group transactions that amount to misuse of corporate assets should be concentrated in regulators responsible for financial and securities matters. Transactions that have an exclusionary or distorting effect on product market competition in particular cases should still be subject to competition-law control.

### **Coverage of competition law and policy**

20. The scope of exemptions from competition law is now limited. Government entities are subject to the same rules as private enterprises. This equal treatment applies to *chaebol* regulation too, as large government-related entities are now designated as groups whose transactions are regulated, and the KFTC has fined several of them for undue transactions and abuse in relationships with contractors. Claims that anti-competitive conduct is authorised by official action are treated sceptically. The KFTC has intervened against several cartels whose members claimed they had acted pursuant to administrative guidance.

21. Some sectors are protected or controlled to some extent. Liner shipping conferences are exempted by special legislation on the grounds that they are “internationally recognised” cartels. Minimum resale price maintenance, which is normally prohibited *per se*, is permitted for literary works (and may be permitted for some consumer products, upon designation by the KFTC). Collaboration is permitted through producer co-operatives in agriculture and forestry, and through contracts between ginseng farmers and processors, in order to strengthen the negotiating position of atomised producers. Other protections have been eased. Tobacco production is now subject to a permit system, which replaced the state monopoly in 2001.

22. Many exemptions were eliminated by the Omnibus Cartel Repeal Act of 1999. For example, this law revised a provision allowing premium-fixing by insurance companies, limited co-ordination directives to cases of compliance with inter-governmental agreements or export of military equipment, and abolished

government co-ordination of bidding competition for overseas construction projects and territorial allocation of unsterilised rice wine. The law ended fee-setting arrangements for a number of professional services: lawyers, CPAs, architects, certified tax accountants, patent attorneys, customs brokers, certified labour services, administrative recorders and veterinarians. Previously, professional associations would set fees, which would then be approved by the relevant ministries. After this practice became illegal, the KFTC reported that fees declined significantly in the affected sectors. But some professions resisted the changes and even succeeded in having them reversed. The restriction on fee-setting for architects was reintroduced in 2001, although it takes the form of direct notification by the government rather than delegation of the power to the professional association. For notaries and engineers, too, fees are set by regulation rather than by market competition. In 2003, five professional services (lawyers, CPAs, architects, certified tax accountants, and judicial recorders) were included in the KFTC's Clean Market Project for close scrutiny.

23. Of the remaining exemptions and regulatory constraints on competition, those involving the legal profession may be the most important. Limits on the admission of new lawyers and unnecessary restraints on forms of practice undermine the development of stronger legal oversight of corporate governance and hamper foreign investment. Foreign lawyers have requested permission to set up branch offices, form joint ventures with Korean law firms, and employ Korean and foreign lawyers (see Office of Ministry for Trade, 2003). Now, foreign licenses are not recognised in Korea, and foreign lawyers can only be employed as "legal assistants" in local firms. Limitations regarding commercial presence and the recognition of qualifications of other countries restrict the availability of international professional services, such as legal and accounting services. Access to such services encourages foreign investors, so these constraints may produce an indirect barrier to FDI.

24. Several programmes to favour small and medium-sized enterprises (SMEs) appear to distort competition. The most significant of these, which prevents entry by larger firms in as many as 88 business lines, is to end in 2004. The most pervasive programme, which permits wide-ranging cooperatives, is subject to a competition test. These groups should be watched carefully, as their self-regulatory codes of unfair practices could impair competition. The Omnibus Cartel Repeal Act cut back a system of small-business "cartels" in government procurement, reducing them to 154 items in 2000. The program anticipated a further cut to 103, but the National Assembly rejected this second stage. The actual effect of this system on competition may not be very significant, though, since it does not prevent buyers from seeking sources other than the cartel, and permitting a degree of co-ordination among very small firms could help them achieve some efficiencies.

#### **Box 5. Small business protections**

##### **Eliminate protectionist measures that prevent potentially efficient competition in sectors reserved for "small" business.**

Such measures include rules preventing entry, that apply stricter structural tests to discourage large firms from acquisitions in the protected "small business" sectors, and that reserve some aspects of government procurement to cartels of "small" businesses.

The Regulatory Reform Council decided in 2000 to reduce the number of protected SME sectors to 45 in 2001 and to 0 by 2004. This process appears to be on track. But the legislature intervened to stop further reform concerning the procurement cartel system. The 1999 Omnibus Cartel Repeal Act as drafted planned to reduce the government procurement cartel system by 40% in 2000 and another 20% thereafter, but an initiative from the legislature, adopted by an overwhelming vote, eliminated the second stage. The government recognises there is still a problem. The KFTC and audit office surveyed the items covered and are planning to try again to trim the list.

Some special subcontracting requirements were not identified in the 2000 Report. For about 22 sectors and about 800 items, in the shipbuilding, automotive and electric equipment industries, large firms are required to outsource. This regulation dates from the heavy industry era, when it represented a deliberate effort to build up a parts business. It may not be significant any more. The government wants to repeal these rules; the small business association wants the repeal period to be stretched out.

25. Other regulators are involved in the network industries, where the KFTC also can apply the competition law. In some areas, including mergers, business transfers, and access to essential facilities, the relevant ministry and the KFTC are required to consult in order to avoid potential conflicts. The KFTC has not invoked the “essential facilities” doctrine to decide access disputes. The MRFTA does not apply to practices that are allowed by other laws, but it requires a ministry to consult with the KFTC when enacting a law that could have anti-competitive implications. In practice, the KFTC and ministries have shared responsibility, with the KFTC accountable for competition issues and the ministries for technology and economic issues.

26. The KFTC remains active in the process of eliminating anti-competitive regulation. The KFTC chairman is a member of the Regulatory Reform Committee, and senior staff are on its subcommittees. This process has been reasonably successful, but the KFTC continues to identify items for improvement. The latest round of review identified 174 regulations that need attention, some of which are being addressed in a draft second Omnibus Cartel Repeal Act in 2004. In connection with corporate restructuring, bankruptcy reforms are also on the agenda. The KFTC has announced that it will examine rigorously claims about efficiencies and failing companies in merger cases, and it has called for the government to curb private restructuring efforts that may harm minority interests by streamlining the bankruptcy law, rather than extending the Corporate Restructuring Promotion Act. Bankruptcy reforms under discussion include repealing composition procedures, extending the potential liability for fraudulent conveyances from 6 months to a year, and providing for debtor in possession operation and financing.

### **Further recommendations**

27. The recent EDRC *Annual Survey* of Korea examined competition policy and sector regulation. It noted that the conflict between industrial development and competition, which still exists in the ministries responsible for network industries, should be resolved by the establishment of sectoral regulators that are independent of ministries. This process should continue by removing remaining entry barriers and further increasing openness to international trade and investment. The EDRC called for strengthening the KFTC, through compulsory investigative powers and better deterrence through such measures as credible sanctions against individuals. In addition to eliminating the remaining regulatory constraints on competition in areas such as professional services, the EDRC recommended focusing the KFTC’s efforts on competition policy. *Chaebol*-regulating functions such as controlling internal cross-holdings and guarantees and probing misuse of corporate assets that are related to finance and corporate governance should be concentrated in regulators responsible for financial and securities matters. Transactions that have an exclusionary or distorting effect on product market competition in particular cases should remain subject to competition-law control.