SUMMARY

(1) ECONOMIC ENVIRONMENT

1. Korea's export-driven economy has rebounded from the global financial crisis that erupted around the time of its previous Trade Policy Review in 2008. This rebound is the result of the revival of trade world-wide and supportive macroeconomic and financial policies, including the largest fiscal stimulus among OECD countries, as well as accommodative monetary policy and a sharp depreciation of the exchange rate of the won during the latter part of 2008. The rebound was, by and large, achieved without resorting to restrictive trade measures; on the contrary, Korea has instead opened its market further to international trade through major bilateral free-trade agreements. The strong recovery in exports is such that Korea is now the world's seventh largest exporter, up from twelfth in 2008.

2. Policies aimed at enhancing the international competitiveness of exports of manufactures, produced mainly by large business conglomerates, have contributed to a large and widening gap in labour productivity and thus wages, between the manufacturing and services sectors, thereby contributing to income inequality. Although growth in labour productivity recovered quickly from a sharp slowdown in 2008, owing to the recovery of exports and investment, growth in total factor productivity (TFP), a much more accurate measure of economic efficiency and thus international competitiveness, appears to have been virtually zero or even negative in 2008 and 2009, respectively. The unemployment rate rose to a record level of 3.7% in 2010 before dropping to 3.4% in 2011.

3. During the review period, monetary policy, by and large, kept inflation within the target of 3±1%, even in 2011, amid rising food and fuel prices. Korea's prudent fiscal policy, reflected in continuing modest fiscal surpluses during much of the period under review (which have contributed to its current account surpluses), and consequently low central government debt (31.9% of GDP) in 2010, have also served it well.

4. Korea's current account registered a substantial overall surplus, averaging roughly 2.3% of GDP during the review period, reflecting the excess of gross national saving (31.4% of GDP) over gross domestic investment (29.0% of GDP). Foreign exchange reserves increased from some US$200 billion in 2008 to over US$300 billion in 2011 (equivalent to nearly seven months of imports), making Korea's reserve holdings the seventh largest in the world. The economy has continued to be outward oriented, with trade in goods and services rising from 107.2% of GDP in 2008 to 110.3% in 2011. Manufactured goods still account for the bulk of exports (85.3% in 2011). The pattern of trade has continued to shift from the United States, the EU, and Japan to China, especially for merchandise trade.

5. Whereas Korea is a major exporter of capital, inward foreign direct investment is among the lowest in relation to GDP in OECD countries, despite the officially favourable attitude towards inward FDI, generous incentives, and recent improvements in the ease of doing business. Although Korea's share in the global market's total FDI inflows rose between 2008 and 2010, it remains below its 2004 and 2006 levels. This performance seems to be due, *inter alia*, to the cost of doing business in Korea and burdensome regulations, as well as to factors related to the "Korea discount", the amount by which investors undervalue Korean stocks owing to the perceived investment and geopolitical risk in the country. During the review period, Korea has implemented measures to address some of these issues, and, *inter alia,* promote FDI in specialized zones and locations. However, three sectors remain completely closed to foreign investors and 29 are partially restricted.

(2) TRADE POLICY FRAMEWORK

6. Korea is an original Member of the WTO. It grants at least MFN treatment to all its trading partners and, as a developing country, receives the special and differential treatment provided for in the WTO Agreements. The structure of trade policy formulation, implementation, and evaluation in Korea has remained largely unchanged since its previous Trade Policy Review in 2008.

7. Korea has maintained its support for, and commitment to, liberalization and strengthening the multilateral trading system and the successful conclusion of the Doha Round negotiations. Nevertheless, Korea has intensively pursued comprehensive free-trade agreements with major trading partners or regional groups (i.e. ASEAN, India, the EU, Peru, and the United States), and is continuing or planning negotiations to establish FTAs with other large economic blocs and newly emerging economies. These agreements, which have been notified to the WTO and cover, *inter alia*, goods, services, and investment, are seen as a catalyst for reforming the economy and raising competitiveness through further liberalization and deregulation in certain sectors. Nevertheless, agriculture remains only partly covered and sensitive agricultural items (e.g. rice) are excluded from the FTA-driven liberalization. Adjustment measures to compensate domestic producers and companies that seem seriously injured by FTA-induced import competition have been strengthened. Korea, a major donor to the WTO's Trade-Related Technical Assistance and Aid for Trade, has continued to provide duty-free treatment to most imports from least developed countries.

8. Korea attaches high priority to making its laws transparent and readily accessible, including by foreigners; many laws are available in English on Internet sites maintained by relevant ministries and agencies. Regulatory reform has progressed with emphasis on stimulating economic growth, and action taken to, *inter alia*, help overcome the global economic crisis included revising, suspending or mitigating the implementation of some burdensome regulations. Korea has taken steps to fulfil its transparency obligations at the multilateral level by, *inter alia*, meeting its WTO notification requirements, though notifications in certain areas (e.g. state trading, special safeguards, agricultural export subsidies, and government procurement) have been subject to long submission gaps.

(3) TRADE POLICY DEVELOPMENTS

9. The customs tariff is one of Korea's main trade policy instruments as well as a major and increasing source of tax revenue (6% of total tax revenue in 2010). The 2012 customs tariff remains relatively complex, involving a multiplicity of rates (84 *ad valorem*, 46 alternate duties) often with small rate differences and some involving decimal points. No tariff cuts were undertaken during the period under review. As a result of the adoption of the HS 2012 tariff nomenclature, the average applied MFN tariff rate increased from 12.6% in 2011 (virtually the same as in 2008) to 13.3% in 2012. This is high by OECD country standards, thereby requiring tariff concessions or drawbacks (to ensure that tariffs levied on intermediate inputs do not feed through as taxes on exports), adding to the complexity of border taxation. Peak *ad valorem* rates also remained unchanged and concentrated in agricultural items (WTO definition); applied MFN tariff rates range from zero to 887.4% (for manioc); in addition, non-*ad valorem* tariffs tend to conceal tariff "peaks" involving *ad valorem* equivalents (AVEs) of up to 1,506.3% (for cinematographic film) (2010). Some 85% of rates were 10% or below in 2012. Tariff-rate quotas are in place under Korea's multilateral agricultural market-access commitments, with in-quota rates ranging from zero to 50% (2012) compared with out-of-quota rates up to 887.4%, and with a decreasing average fill rate of 66.7% (2011). Other measures (e.g. "autonomous" tariff quotas, usage tariffs, and duty concessions) selectively reduce tariffs on inputs. Korea has bound 89.9% of its tariff lines; that is, 98.4% of agricultural lines (excluding mainly rice) and 88.4% of its non-agricultural lines (WTO definitions). The gap of

4.3 percentage points between the average bound and applied MFN tariff rates imparts a degree of unpredictability to the tariff regime and provides scope for the authorities to raise applied rates within the bindings. Korea has continued to use this gap to apply higher MFN duties (e.g. adjustment duties) termed as "flexible tariffs", which the authorities maintain are within WTO bindings; product coverage under "flexible tariffs" rose from 101 in 2007 to 334 in 2012.

10. During the period under review, Korea pursued wide-ranging trade facilitation by further streamlining and modernizing (and diffusing overseas) its fully computerized, user-friendly customs procedures in line with its World's Best Customs 2012+ plan. Transfer pricing and customs valuation, two areas in which multinational corporations faced difficulties while doing business in Korea, were addressed.

11. Rice remains the only item subject to import quotas (until 2014). Import licensing requirements and prohibitions are maintained mostly for the protection of public morals, human health, hygiene and sanitation, animal and plant life, environmental conservation or essential security interests in compliance with domestic legislation requirements or international commitments. Korea has used anti-dumping provisions against imports involving mainly chemicals, kraft paper, plastics, stainless steel, and particle board; it initiated 8 new cases and has 31 final measures in effect on imports from 13 countries, mostly in Asia.

12. Korea periodically restricts or monitors exports of certain products (e.g. rice and steel) to ensure adequate domestic supplies, and thereby possibly assist downstream processing of these products. Export prohibitions are aimed at protecting animal rights and endangered species, and conserving natural resources. Direct export subsidies are maintained to reduce marketing costs for certain agricultural products (e.g. fruit, vegetables, flowers, kimchi, ginseng, and livestock); they totalled ₩ 32.68 billion in 2008, according to the most recent data available. In addition to the tariff drawback scheme, excises and VAT are rebated at the border, while income tax relief is accorded to enterprises located in free-trade zones. Exporters benefit from export credit insurance, finance, and the promotional activities provided by state-owned institutions.

13. Various measures, involving grants, tax concessions or low-interest loans, continue to support the production and trade of a range of products and to encourage SMEs, R&D, and environmental-protection activities. Although "sunset" clauses were intended to terminate tax incentives automatically, many were extended. SMEs are among the beneficiaries of these measures, which are especially generous for information technology activities; a Fund now supports those who face problems of access to raw materials. Emphasis was placed on financial assistance to new growth engine activities in green technology, high-tech "convergence", and high value-added services.

14. Although attempts have been made during the past five years to ensure that new Korean industrial standards are in harmony with newly adopted international standards, the share of non-harmonized standards has increased considerably. At the same time, the number of mandatory standards increased by about 70%. Efforts have continued to review food labelling standards to better reflect international requirements, including new requirements related to children's favourite food products, nutritional labelling, and irradiated ingredients.

15. Despite the lack of domestic price preferences, government procurement is still seemingly used as an instrument of economic policy to promote SMEs, companies in a "disadvantageous position", regional development, and green purchasing. As a consequence, the government procurement market is more closed than the rest of the domestic market. Korea is a party to the WTO Government Procurement Agreement (GPA); the value of contracts subject to GPA commitments

increased though certain procurement remains uncovered by these undertakings. Most procurement remains decentralized, as more than 63% of the procurement market involves direct purchases by public institutions. The already small share of foreign suppliers has dropped steadily since the previous review, due to the highly sophisticated and increasingly competitive domestic suppliers of manufactures and construction services, as well as the discontinuation of government purchases financed by international public loans, which require international competitive tendering. Consequently, foreign suppliers accounted for 1.6% of the Public Procurement Service's total business operations in 2010.

16. State involvement in the economy persists, as privatization efforts during the period under review yielded little result (only eight firms were privatized), despite the Government's resolve to proceed with divestments. Two government agencies and one producer association are responsible for imports of all rice and some other agricultural items; their operations allow for important price mark-ups, although no mark-ups were imposed on rice during most of the review period.

17. Korea's extensive range of intellectual property rights legislation has been further strengthened with amendments owing partly to the implementation of commitments under FTAs with the EU and the United States. IPR protection was further enhanced with the expansion of international commitments, the reinforcement of border enforcement, and other improvements. Parallel imports of genuine products compliant with certain requirements are allowed, in the interest of competition and thus consumers.

18. During the period under review, Korea removed some anti-competitive provisions in its competition laws and regulations, and monopoly power has decreased steadily. Nonetheless, market concentration remains relatively high. Large business conglomerates are subject to special regulation, and cross-shareholding is banned between subsidiaries under the same holding company; ceilings on the total amount of shareholdings in other domestic companies were removed in 2009. Large corporations and SMEs have been encouraged to voluntarily sign fair-trade and shared-growth agreements; future work is focused on improving competition conditions for SMEs. Liner shipping conferences remain exempt from competition legislation. Consumer protection has also been improved by helping consumers to better protect their rights and interests themselves, as well as ensuring that consumers share adequately in the benefits of FTA-driven liberalization; privacy-related concerns top the e-commerce legislative agenda.

(4) SECTORAL POLICY DEVELOPMENTS

19. During the review period, agriculture was exposed to increased FTA-driven liberalization and was assisted by more market-oriented and environmentally friendly government intervention. Despite domestic support equivalent to 2.2% of GDP (in 2008-10), almost as much as agriculture's declining 2.7% share of GDP (in 2011), labour productivity still remains relatively low, albeit improving, at roughly two fifths of the national average. Although self-sufficiency has been attained for some major products (rice), the average rate has dropped and targets for 2015 and 2020 were increased; at the same time, the volume of agricultural imports has continued to rise. Average applied MFN tariff protection for agricultural goods (WTO definition), at 55%, is more than eight times the average for non-agricultural goods (6.6%). Tariff-rate quotas are utilized, administered or allocated by state-trading entities or industry associations; access was improved temporarily in response to recent domestic supply-side instability. Quantitative import restrictions for rice will remain in force until 2014; quantitative export restrictions have also been in place for rice, but were little utilized. Special safeguard provisions (SSGs) under the WTO Agreement on Agriculture have been used less frequently since 2008. Agriculture receives substantial domestic financial assistance, involving

product-specific support, in line with the relevant WTO provisions. The outcome of such support is that Korean consumers pay much higher prices (on average 1.7 times the world levels). The importance of support in the form of direct payments has increased. Action has been taken to, *inter alia*, foster private investment in agricultural corporations, protect farm household income from natural disasters, support precision farming practices with lower use of fertilizers, expand the traceability information system protecting consumer interests, and assist rural development. The differentiated pricing system to stabilize milk supply and demand has contributed to a further reduction of excess milk supply. Despite retaining fisheries-related subsidies, efforts to reduce over-fishing were continued and action was taken to encourage environment-friendly offshore aquaculture.

20. During the period under review, efforts have continued to reduce oil dependence and cope with rising energy demand, including through increasing the share of renewable sources in total primary energy supply and projects overseas, as well as to reduce energy demand (energy efficiency) and the high energy intensity of production. State involvement in the gas and electricity sectors persists and impedes competition. Some industries have licences to import gas directly for their own use rather than purchasing it from the state monopoly, which regularly adjusts the price of gas to costs. Domestic coal production (mostly anthracite coal), mainly destined for power plants, continues to be assisted by direct production subsidies, a VAT exemption (imported bituminous coal is subject to a 10% VAT), and the compulsory purchase of its expensive output by the loss-making state-run electricity company. The power exchange pool sets power generation prices to manage electricity dispatch; cross-subsidies between consumers distort prices, with agricultural users the main beneficiaries and all tariffs below production cost.

21. Manufacturing's share of GDP increased (to 31.2% in 2011) while its share in employment remained relatively stable (thus, labour productivity improved), as the economy became less services-based. The sector remains heavily outward oriented and a world leader in information and communications technology (ICT), as well as in shipbuilding and cars, activities dominated by large conglomerates. Government policies (including tariffs, tax incentives, and reduced energy prices) have favoured manufacturing over services, which tend to be much less tradeable than manufactures. Border protection, which is almost entirely confined to tariffs and adjustment duties, is virtually unchanged since the previous Review. Several tax and non-tax incentives assist R&D and SME activities. As from 2009, support was focused on activities termed as new growth engines with the objective of increasing exports of "green" goods (e.g. electric cars) by the major industries. Other industry-specific support was made available for improving global competitiveness of the automobile parts, upgrading the steel industry, helping Korea regain the world's leading shipbuilding nation status in 2011, and fostering the pharmaceuticals industry expansion (including in biosimilars).

22. Services, the largest sector of the economy, remain characterized by relatively low labour productivity (now less than half the level in manufacturing) and declining growth in total factor productivity (TFP). This is partly due to the lack of sufficient competition owing to, *inter alia*, state-ownership and excessive regulations, including restrictions on inward FDI. Measures were taken to improve corporate governance, transparency, soundness, and capital adequacy ratios in banking and other financial services; the financial sector restructuring continues to benefit from public funds and its macro-prudential regulations were strengthened. Despite some decline, state-ownership persists in financial and transport services. Maritime and air transport are also subject to cabotage restrictions. In addition, there are foreign-ownership ceilings in several sectors, notably telecommunications, air transport, and coastal maritime services, and a prohibition in radio and television broadcasting. Legislation was passed for the planning and promotion of convergence of broadcasting and communications activities, as well as to create a more competitive broadcasting market. Restrictions on the access of large retailers (super supermarkets) to traditional markets are

about to be implemented. Korea's GATS commitments remain unchanged, but further undertakings beyond its GATS commitments were undertaken in the context of recent FTAs.

(5) OUTLOOK

23. Korea's economic fundamentals remain, by and large, sound. Despite its impressive rebound from the global financial crisis, Korea's economy remains vulnerable to exogenous shocks through international trade, particularly its heavy reliance on exports of manufactures produced mostly by a few large business conglomerates, and financial linkages. Equitable and sustainable growth depends on the Government implementing structural reforms, especially those aimed at improving the investment climate, thereby making Korea more attractive to FDI; addressing labour market rigidities, and the likely decline in the labour force, owing to a rapidly aging population; as well as improving productivity, particularly in energy and services, for example, by further opening them up to domestic and foreign competition through multilateral as well as regional and bilateral liberalization. These and related reforms, including privatization and continued regulatory reforms, would increase the flexibility of the Korean economy and its ability to respond to growing external competition.