

GENERAL AGREEMENT ON TARIFFS AND TRADE

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1979 CONSULTATION UNDER
ARTICLE XVIII:12(b) WITH KOREA

1. In accordance with its terms of reference, the Committee has conducted a consultation with Korea under Article XVIII:12(b). The Committee noted that a consultation under the simplified procedures (L/3772/Rev.1) had been held in November 1978 (BOP/R/105) when it had been decided that a full consultation would be held under the applicable procedures. The previous full consultation with Korea under the provisions of Article XVIII:12(b) had been held in May 1976 (BOP/R/86). In conducting the present consultation the Committee had before it a basic document supplied by the Government of Korea (BOP/200) and a background paper provided by the International Monetary Fund dated 13 September 1979.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, 18th Supplement, pages 52-53). The consultation took place on 31 October 1979. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Korea. In accordance with the agreed procedures, the representative of the Fund made a statement concerning the position of Korea, as follows:

"There were important changes in the Korean economy during 1978. Unemployment was substantially reduced and has ceased to be a major problem area. The domestic demand for manufactured goods grew more rapidly than the export demand for manufactured goods. This development has continued in the first half of 1979. In addition, during 1977 and 1978 Korea's external position generally strengthened.

"Despite these achievements, domestic inflation remains a matter of concern. On a December-to-December basis, consumer prices rose by 16 per cent during 1978 and it now appears that inflation may rise to over 20 per cent in 1979.

"The major emphasis of the Government's policy for 1979 is on stabilization and on concern with the welfare of Korean consumers. It is realized that one of the major causes of inflation in recent years has been the Government's policy of increasing rural incomes by substantially raising foodgrain prices. The Government is now committed to reducing gradually the foodgrain subsidies provided by the Grain Management Fund.

"For 1979, economic policy plans aim at achieving a moderate current account deficit, limiting the increase in food prices, reducing price controls in the nonfood sector, and at restraining wage increases to rates more in line with increases in labor productivity. The Government has also made some important changes in investment policy. It has decided to slow down investment in the heavy and chemical industries in order to free resources to expand the output of consumer goods for the domestic market. In addition, there is increased awareness of the need for selectivity in future investments to ensure that the country's investment effort is being phased appropriately, and to ensure that it is consistent with monetary and fiscal policy aimed at moderating inflation.

"Although more restrained budget and monetary policies are essential if inflation is to be slowed, the Government obviously faces difficult choices. As the year has progressed, exogenous factors, particularly oil and food price increases, have been disruptive and credit policy may have to be geared to achieve utilization of the substantial increase in capacity in plant and machinery that came on stream during 1978. However, it seems clear that a long and determined effort will be needed to reduce gradually the present high rate of inflation.

"Korea registered a current account deficit of about US\$1.1 billion in 1978. This was more than matched by an inflow of long-term capital of almost US\$2 billion, resulting in a basic balance of payments surplus of over US\$850 million. However, there was a heavy net short-term capital outflow in 1978, due to a substantial repayment of previously contracted short-term trade credits, resulting in an overall balance of payments deficit of some US\$400 million. As there was a substantial increase in foreign exchange deposits and other foreign liabilities of the banking system, gross international reserves in 1978 increased by over US\$600 million and Korea's foreign exchange holdings reached almost US\$5 billion or over four months' imports at their 1978 level.

"The balance of payments outlook for 1979 is subject to considerable uncertainty due to recent developments affecting the trade balance. Korea originally planned for a current account deficit of about US\$1.4 billion but there are indications that it may be much higher. Although export prices are increasing more rapidly than had been anticipated, the original export target of US\$15.5 billion for 1979 will

probably not be met because of a shortfall in volume. The increases in the prices of oil and other imported raw materials will also tend to widen the current account deficit, as will the planned import liberalization measures. During the first quarter of 1979, the current account deficit exceeded US\$900 million and latest forecasts call for an annual deficit in the range of US\$1.9-2.4 billion. Notwithstanding the larger deficit, Korea would appear to be well placed to attract a sizable increase in foreign financing compared to 1978. Thus, on the assumption of an increase in the net long-term capital inflow of the order of US\$500 million and a reversal of last year's massive net short-term capital repayments, an overall balance of payments surplus of US\$200 million appears possible.

"Korea has carried out a substantial import liberalization during the past two years. The percentage of basic items subject to automatic approval has increased from about 50 per cent at the end of 1976 to almost 70 per cent at the beginning of 1979, and it is planned to reach 90 per cent by 1982. Imports (in terms of U.S. dollars), after increasing by 25 per cent per year in 1976-77, grew by 38 per cent in 1978. In the medium term continued import liberalization combined with moderate current account deficits would facilitate the simultaneous achievement of rapid growth, reduced price increases, and an increase in social development expenditure.

"While the current level of gross international reserves would not appear to be a constraint towards continuing on the path of planned import liberalization, it cannot be considered excessive in the light of expected current account developments. In view of the above, the remaining restrictions in effect do not go beyond that necessary to prevent a decline in Korea's monetary reserves."

Opening statement by the representative of Korea

4. In opening the consultation, the representative of Korea presented a review of Korea's balance-of-payments situation and economic development in recent years and an outline of the present trade, tariff and exchange policies. He pointed out, *inter alia*, that the real GNP, with an average annual growth rate of 9.4 per cent, had quadrupled during the successful implementation of three Five-Year Economic Development Plans between 1962 and 1978.

5. As Korea had few natural resources and a small domestic market its development policy centred on the export of manufactured goods. Between 1962 and 1978 exports had risen annually by 41 per cent in value and 33 per cent in volume and, as a result, Korea's share in total world exports had risen from 0.03 to 0.99 per cent. Korea's imports, consisting mainly of machinery, raw materials, chemicals, fuels and food grains, had also increased substantially, namely annually by 28 per cent in value and 22 per cent in volume.

6. Until late 1973 Korea's balance-of-payments position had improved remarkably. Thereafter the current account deficit had grown due to the energy crisis and the concomitant world-wide inflation. Beginning in late 1975 the situation had improved again and in 1977 Korea achieved a positive current account balance of US\$12 million. This had prompted the Korean Government to start an extensive import liberalization programme. Under this programme the overall average import tariff rate had been reduced from 36 to 25 per cent, the percentage of basic items subject to automatic approval had been increased from 54 to 68 per cent, the tariff on ninety-five items had been lowered in the context of a newly introduced elastic tariff system, the advance import deposit scheme had been abolished in relation to the majority of import items and exchange restrictions had been relaxed greatly.

7. In 1978 Korea's current account balance had turned again into a deficit and for 1979 a trade deficit of US\$3.8 billion was forecast. It was the intention of the Korean Government to deal with this situation not through import restrictions but restrictive monetary policy and a moderation of growth targets.

8. The representative of Korea concluded by appealing to the governments of developed countries to refrain from hampering the modernization of developing countries through protectionist measures.

I. Balance-of-payments position and prospects, and alternative measures to restore equilibrium

9. The Committee noted the remarkable economic progress made by Korea and it welcomed the decision of the Korean Government to respond to the balance-of-payments improvement until 1978 by liberalizing imports. It further noted that the balance-of-payments position in 1979 had declined in part because of problems that were a by-product of Korea's success, such as inflation and sectoral bottlenecks. The Committee welcomed the decision of the Korean Government to refrain from restricting imports despite the new problems and expressed the hope that Korea would further liberalize its trade as its external financial position improved. Several members of the Committee noted that the Korean authorities were convinced that government controls in the economic sphere needed to be relaxed as the economy grew more complex and sophisticated; they stated that the further removal of administrative barriers to imports would be consistent with this goal. It was pointed out to the Korean representative that full consultations had been requested mainly to enable the Committee to review the impact of the remarkable changes in the balance-of-payments position that occurred since the last full consultation in May 1976 on the import policies of Korea.

10. One member of the Committee wondered what the outlook for export performance and Korea's future competitiveness was. The representative of Korea replied that exports were projected to increase by 19.8 per cent in

1980 and by 22.5 per cent in 1981 compared to the respective previous year. He added that this target might be difficult to achieve if the protectionist tendencies in various developed countries were to increase.

11. Several members asked which measures the Korean Government were taking to fight inflation and whether import liberalization could not play a more dominant rôle in controlling inflation. In reply the representative of Korea said that a rise in import prices had contributed to domestic inflation; between the end of 1978 and August 1979 import prices had risen by 27 per cent largely due to the rising oil prices. One reaction to this problem had been the introduction of the flexible tariff system under which tariffs had been brought down to zero for such important items as wheat, cotton, iron scrap, oil products and certain petrochemical raw materials. These measures had led to a revenue loss of the equivalent of US\$80 million. Several members of the Committee noted that import restrictions on meat, vegetables, fruits and dairy products had not been lifted despite rising prices and shortages. They wondered why the Government of Korea had not liberalized the import of these goods as one of the first steps in the fight against inflation. The Korean representative replied that substantial amounts of meat had been imported to avoid shortages but a significant import liberalization in the agricultural sector was not possible because of domestic political problems. The situation in Korea was in this respect not different from that in many other countries. One member of the Committee wondered whether the 30 per cent increase in Government expenditures planned for 1980 might not have an effect on inflation. The Korean representative replied that this increase might indeed have an inflationary impact but that it was unavoidable because of rising defence requirements. In response to a question, the representative of Korea confirmed that import liberalization so far had affected 68 per cent of tariff items, which for the first eight months of 1979 accounted for US\$2.2 billion or 16 per cent of total imports.

12. In reply to a question regarding the efforts of the Korean authorities towards greater export diversification the Korean representative said that the combined share of exports to Japan and the United States had declined from 55.7 per cent in 1975 to 52.6 per cent in 1978 while the share of exports to the Middle East had risen from 6 per cent in 1975 to 10 per cent in 1978. The Korean Government made every effort to diversify the sectoral and geographical distribution of both exports and imports. Particular efforts were made to increase exports to South America and Africa as difficulties were being encountered in the European and American markets.

13. One member of the Committee, noting that the net inflow of capital had been growing and was planned to cover the current account deficits projected for the next years, asked what the Korean policies in this area were. The reply was that Korea had promoted in the past, and intended to continue to do so in the future, capital inflows through tax benefits.

14. One member of the Committee said that, in the 1976 consultation, the Korean representative had emphasized that a favourable balance-of-payments effect of the construction contracts concluded by Korean companies in the Middle East could not be expected for some time. In the meantime however the contracts appeared to have had a significant positive effect and Korea now enjoyed a surplus in the services account. He wondered whether the Korean representative had precise figures on the present situation. The Korean representative replied that the orders won by the Korean contractors had increased to over US\$8.2 billion in 1978. During that year the net receipts from such orders amounted to US\$1,050 million which covered about 59 per cent of the trade deficit. As of August 1979 overseas contracts totalled US\$8.5 billion of which US\$2.5 billion had been received mainly in the form of advance payments.

15. In response to various questions about Korea's energy policy, the representative of Korea said that oil imports amounted to US\$2,190 million in 1978 which was equivalent to 14.6 per cent of all merchandise imports. Every effort was made to reduce energy consumption, in particular by promoting energy efficient investment projects and encouraging energy conservation. The Government was planning to stock an amount of oil equivalent to the consumption during one month, but no funds were presently available to realize this plan.

System, methods and effects of the restrictions

16. Several members of the Committee expressed their serious concern about the complexity of Korea's import régime, the frequent changes made in it and the uncertainty generated thereby. They felt that the Korean authorities should, in their trade liberalization efforts, not only lift restrictions on specific products but promote trade generally by improving the transparency of their import régime. They pointed out that the complexity of the import régime had already been discussed at the last consultation and that further progress should be undertaken. Of particular concern to these members were the system of obligatory recommendations by the Government and the various controls administered by industry associations. Import restrictions formally lifted were occasionally reintroduced through such informal or unofficial action. The legal uncertainty created particular difficulties for distant suppliers who needed to know well in advance whether and on what terms their products could enter Korea.

17. The representative of Korea stated that his authorities had made efforts towards a simplification of their import régime in response to the Committee's conclusions at the last consultation. The remaining administrative difficulties were to a large extent normal consequences of the

implementation of the import restrictions and would disappear as the import restrictions disappeared. Efforts had been made to improve the import licensing system and to liberalize the end-user requirement for items on the restricted list. In 1978 import formalities had been greatly simplified. Thus documentary requirements had been eased and regulatory power, which had previously been vested in many different authorities, was now concentrated in the Ministry for Commerce and Industry. The representative of Korea concluded on this point by saying that simplification was by no means a simple matter and that progress could only be achieved gradually.

18. In response to various questions on the import deposit scheme the representative of Korea said that deposits now had to be made only in connexion with deferred payment imports. The main purpose of the scheme was to offset interest rate differentials. The deposits were refunded at the time of final settlement. It was at present not the intention of the Government to abolish the deposit scheme although some adjustments might be made to take into account relative movements in interest rates.

19. In response to the question of how often and on the basis of which criteria the import régime was adjusted the Korean representative replied that adjustments were made through half-yearly notices by the Ministry of Commerce and Industry which were made public one month before becoming effective. In response to a further query, the Korean representative confirmed that under the import licensing system all applications for import licences were automatically approved subject to the general limits set by the Foreign Supply and Demand Plan unless they were on the list of restricted items. One member of the Committee said that certain items which were reported in the basic document for the consultation to be in the "automatic approval" category appeared all the same to be subject to restrictions and he asked for a clarification of this matter. The Korean representative replied that imports of these items were currently being surveyed because a drastic increase in imports was threatening to injure the domestic industry.

Conclusions

20. The Committee agreed with the International Monetary Fund that the overall level of the remaining import restrictions maintained by Korea did not go beyond that necessary to prevent a decline in Korea's monetary reserves but that the current level of these reserves did not constitute a constraint on the continuation of further import liberalization.

21. The Committee welcomed the substantial import liberalization measures undertaken since the last full consultation and noted with satisfaction Korea's intention to continue on the path of planned import liberalization.

22. The Committee recognized that efforts had been made since the last full consultation towards a simplification of the trade control system; it noted however that many problems remained and further efforts were necessary if Korea were to fully benefit from its own trade liberalization. The Committee reaffirmed its view expressed at the last consultation that complexity, lack of transparency and instability in a trade régime acted as a general import barrier with particularly high costs to the economy. The Committee urged the Korean authorities to give high priority to the removal of this trade barrier when implementing their plan to further liberalize trade and to gradually relax government controls in the economic sphere.