

GENERAL AGREEMENT ON

RESTRICTED

BOP/R/171

10 December 1987

TARIFFS AND TRADE

Limited Distribution

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1987 CONSULTATION WITH THE REPUBLIC OF KOREA

1. The Committee consulted with the Republic of Korea on 24 November 1987, in accordance with its terms of reference, pursuant to Article XVIII:12(b) of the General Agreement and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held under the Chairmanship of Ambassador P.-L. Girard (Switzerland). The International Monetary Fund was invited to participate in the consultation in accordance with Article XV of the General Agreement.

2. The Committee had the following documents before it:

Basic document by Korea	BOP/278
Secretariat background paper	BOP/W/113
Notification by Korea on Quantitative Restrictions	NTM/W/6/Rev.3/Add.1
International Monetary Fund, "Recent Economic Developments"	dated 2 September 1986
"Supplementary Background Material"	dated 27 October 1987

In addition, Korea notified its list of restricted import items as of 1 July 1987. This will subsequently be issued as an L/- document.

Opening statement by the representative of the Republic of Korea

3. The opening statement by the Korean representative is contained in Annex I.

Statement by the representative of the International Monetary Fund

4. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in Annex II.

Balance-of-Payments position and prospects: alternative measures to restore equilibrium

5. Several members of the Committee noted the considerable improvement in the balance-of-payments situation of Korea since the last full

consultation. Surpluses on trade and current accounts had been achieved in 1986 and the current account surplus was expected to increase in 1987 to some \$9-10 billion, the fourth largest among the GATT contracting parties. The debt burden, while still large, had been substantially reduced, and was not high in per capita terms. Moreover, it could be expected that the goals for reduction of the debt burden mentioned in the IMF statement would be achieved ahead of time. The high domestic savings rate should, in addition, reduce the future need for external borrowing. It was also recognized that these achievements had been the result of the domestic adjustment policies pursued by Korea which had enabled it to take advantage of favourable external circumstances. Members welcomed the programme of trade liberalization and tariff reductions which Korea had pursued determinedly since 1984. It was noted that the number of products now subject to import restrictions were relatively limited.

6. In the light of these factors, members questioned whether there was now any justification for the maintenance of restrictions for balance-of-payments purposes. Some members gave the view that the conditions for invocation of Article XVIII:B no longer existed. Others noted that, while until 1985 there had been deficits in the basic and current balances of payments, the remarkable improvements in the results for 1986 and 1987 implied that balance-of-payments restrictions should be further reduced. Some members noted that GATT provisions relating to balance-of-payments difficulties were not intended to be used for protective or economic development purposes, and in this context reference was made to the provisions of the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes. Members of the Committee therefore stated that existing restrictions should be phased out according to a clearly established timetable.

7. It was recognized that there were uncertainties in the present economic and political situation, in particular in relation to the levels of wage costs and their effects on the economy. While the economic results for 1988 were not likely to be so favourable as those for 1986 and 1987, growth was expected to remain high. One member, while recognizing these uncertainties, questioned how serious an effect factors such as the increase in wages expected to occur in 1988 were likely to have on the Korean economy. Input-output studies suggested that the results of a 20 per cent wage increase would be to add only some 2.2 per cent to overall industrial costs, even assuming no reductions in profits or increases in productivity. He suggested that Korean manufacturers could be expected to adjust well to such a development. He noted that Korea's current success was heavily reliant on export growth and suggested that a reorientation of the development process towards more rapid growth of the domestic market would lead to a better balance of resource use both internally and externally. Further reductions in trade restrictions, together with a more active and realistic exchange rate policy, would help in this process.

8. The representative of Korea noted that the wage increases conceded in recent months, and those which were expected to be concluded in early 1988,

would principally affect industrial costs from 1988 onwards; they did not show up in figures for the third quarter of 1987. He estimated that, considering the ripple effect, wage costs had much more impact than the level mentioned by one delegation. In relation to external debt, he noted that the expected level of \$35 billion at the end of 1987 still represented more than 40 per cent of Korea's GNP. While the current account surplus for 1987 was expected to be some \$9 billion, this should not be expected to be maintained in 1988, given its close relationship to the international economic environment, in particular to the course of oil prices and international interest rates. If the 1987 level of surplus was maintained in 1988, trade liberalization would be accelerated and exchange rate policy would be used more actively. He stressed the need for Korea to maintain an economic growth rate of 7-8 per cent in order to avoid increasing unemployment. In relation to the disinvocation of Article XVIII:B, he recalled that only some 370 items would remain under restriction by the end of 1988; of these, some 270 would be agricultural products. He noted the importance of agriculture in the Korean population and its structural weaknesses. He also noted that the liberalization programme which had been announced to the Committee in 1984 had been maintained. This programme was due to be concluded in 1988; during the next year, a new programme of trade liberalization and tariff reduction would be formulated and would come into effect in 1989. He also expected that more emphasis would be placed from next year on promoting domestic demand; development was expected to emphasise such factors as decreasing imbalances in income distribution and regional development, and promoting road construction and housing. He recalled that the level of per capita income in Korea was still relatively low.

9. In response, members recalled that the Committee's rôle was to discuss whether Korea's balance-of-payments situation justified the import restrictive measures maintained. They emphasized that, in their view, the present situation and outlook did not justify the maintenance of balance-of-payments restrictions. However, they did not necessarily expect Korea to disinvoke Article XVIII:B immediately, but to establish a clear timetable for the phasing out of remaining restrictions maintained for balance-of-payments purposes. The representative of Korea reiterated that further plans would be formulated by the new Government next year. He proposed that another full consultation with the Committee could be held in the first part of 1989, in order to review these at that time.

System, methods and effects of the restrictions

10. One member of the Committee asked whether there were any restrictive measures maintained for balance-of-payments purposes other than those mentioned in section II of the Secretariat background paper. Reference was made to the operation of import licensing together with the system of "recommendation" by industrial associations; it was noted that some 500 items were covered by this system, and that its operation was less than completely transparent. It was noted that recommendations by protected industries led to the risk of arbitrary decisions. The question was asked

whether liberalization of individual items from non-automatic import licensing also implied their liberalization from the recommendation systems. Some members of the Committee noted that some changes which had been made in the lists of items liberalized appeared to reflect more closely bilateral trading considerations than overall economic developments. They noted that such developments had discriminatory implications which went counter to the spirit of the General Agreement. One member referred to discriminatory trade restrictions maintained against its exports for the reason of bilateral trade imbalance, which could not be justified by any GATT Article, and recalled that such discriminatory treatment should be eliminated because it would violate Articles I and XIII.

11. Questions were asked concerning the planned abolition of the import surveillance mechanism and its replacement by a new safeguard system, in relation to the latter's compatibility with Article XIX of GATT. In this connection, reference was made to the newly established Korean Trade Commission and members asked how this body would be able to assist in easing import procedures. It was also noted that the Korean system of trading licences and registration of "offer agents" could lead to imported goods being given less favourable treatment than domestic products. Questions were also asked relating to restrictions on foreign investment, local sales by joint venture enterprises, the operation of the distribution system, packaging and labelling regulations and other technical barriers to trade (such as the testing of motor vehicles by companies with close links to domestic industries, and the operation of import procedures by monopolies such as the Korean liquor monopoly). The impact on imports of the "individual laws" mentioned on page 21 of BOP/278 was also queried.

12. With respect to tariffs, it was noted that substantial reductions had already been made, and members expressed the hope that these would be bound in Korea's GATT schedule. Korea's intention to limit the use of the system of "elastic" tariff rates was also noted. However, it was asked how soon the system of emergency or adjustment tariff rates would be phased out, and how the present system was administered.

13. In reply, the representative of Korea stated that the only restrictions which Korea sought to justify for balance-of-payments reasons were those noted in section 11(a) of the Secretariat paper. The import recommendation system gave the right to private business associations to recommend approval of imports. However, detailed guidelines for the recommendations were laid down by the Government and every effort was made to apply these neutrally. If products were liberalized from non-automatic import licensing, the recommendation mechanism was also abolished. In this connection, he stated that 133 items were expected to be liberalized in 1988, leaving only 370 items subject to non-automatic import licensing, and that only 48 items were subject to import surveillance. Regarding specific products, he referred to the up-to-date information contained in the list which his delegation had distributed to the meeting. He also noted that the import surveillance system, which was not maintained for

balance-of-payments reasons, was to be abolished within the next year; the new import relief system, which had been explained in Korea's basic document, was closely related to Article XIX of GATT. Criteria for its invocation included import surges, injury, and review procedures.

14. In relation to the trading licence system, he noted that two types existed. Under Class A licences, any type of import or export activity could be undertaken; Class B licences were issued to certain specific categories of traders, for example to manufacturers in order to export their own products and import necessary raw materials and equipment for their production. Both categories of licences could be issued to foreign or local companies. The requirements for Class A licences had recently been lowered to 50 million won of capital value and L/C of US\$20,000 for export. "Offer agents", whether foreigners or nationals, could register with the relevant authorities.

15. The representative of Korea noted that 39 special and individual laws applied for health, safety and other reasons. In September 1987, more liberal provisions for inspection, testing and documentation on food, cosmetics and pharmaceuticals had been introduced. In relation to the import system for alcohol, he noted that import of beer had already been liberalized and that a plan for liberalization of imports of wine had been adopted in October 1987. In order to import beer and wine, a company must have over 500 million won capital and sales contracts covering the whole of Korea. Concerning joint venture companies in the distribution sector, he noted that since July 1984, the scope for foreign investment in Korea had been considerably opened up. At present, 98 per cent of the manufacturing sector was open to foreign investment; while some restrictions still existed in the services and distribution sectors, the scope for joint ventures in these areas was being gradually enlarged.

16. In relation to tariffs, Korea's policy had been to provide for temporary tariff increases (adjustment tariffs) on liberalized products for a maximum of three years. This could be regarded as part of a movement from non-tariff to tariff-based protection. He underlined that, while Korea did not intend to phase out the system of "elastic" tariff rates, the intention was to limit its use. He noted that at present no items were subject to adjustment tariffs. Emergency tariffs could be compared with Article XIX safeguards; these were only applied to unbound items and at present only five products were affected. He expected that an expansion of the scope of Korea's bound tariff schedule would result from mutually beneficial tariff negotiations under the Uruguay Round. Further study was being given by the Korean authorities to tariff reductions in the light of the present current account surplus.

Factors relevant to paragraph 12 of the 1979 Declaration

17. A number of members noted that reference to paragraph 12 of the 1979 Declaration was contingent on balance-of-payments justification for a

consulting country's import restrictions and recalled their views that such justification did not exist in the case of Korea. They took issue with a number of statements in the IMF and Secretariat documentation concerning the intensification of restrictions on Korea's exports, and noted that some of the measures cited - for example Article XIX restrictions or antidumping or countervailing duties - were introduced under GATT or Tokyo Round Code provisions. It was pointed out that Korea's exports had continued to grow rapidly in recent years. Two members clarified the status of restrictions mentioned in Annex II to the Secretariat background paper; one made reference to country-specific surveillance mechanisms notified in L/4935/Add.3; the other noted that the items mentioned fell under a global quota which had been regularly reviewed in GATT and which was non-discriminatory in nature. The representative of the Fund and the Chairman noted that measures cited in the documentation were mentioned without prejudice to their GATT status, as restrictions which affected products of export interest to Korea.

18. The representative of Korea noted that import restrictions in major foreign markets affected 206 items covering 31 per cent of Korea's exports; for individual markets the share of trade affected varied between 20 and 36 per cent of exports. He noted that Korea was being pressed to liberalize its imports more rapidly while other countries were erecting new barriers; this made it difficult to promote the idea of trade liberalization at home.

Conclusions

19. The Committee took note with great satisfaction of the improvement in the Korean trade and payments situation since the last full consultation, which had been fully reflected in the documentation presented to the meeting.

20. It commended the Korean authorities for the policies of internal adjustment and external liberalization which had been pursued consistently in the past few years, including phasing out of import restrictions, a programme of tariff reductions and a reduction in the number of goods subject to import surveillance. The Committee took note of Korea's commitment to maintaining the pace of the adjustment and liberalization process.

21. In assessing Korea's current economic situation, the Committee noted that the principal economic variables such as GDP growth, investment, savings, and the trade and payments accounts were very favourable. It also noted that, although the foreign debt was still substantial, the positive evolution of the external accounts had permitted considerable advance repayment of debt and that reserves had improved despite the outflows that this had implied. While noting the uncertainties persisting with respect to developments in the fields of wage costs, interest rates, oil prices and the possible effects of these on Korea, the Committee was nevertheless of

the view that the present basically favourable situation of the Korean economy was likely to continue.

22. The prevailing view expressed in the Committee was that the current situation and outlook for the balance of payments was such that import restrictions could no longer be justified under Article XVIII:B. The conditions laid down in paragraph 9 of Article XVIII for the imposition of trade restrictions for balance-of-payments purposes and the statement contained in the 1979 Declaration on Trade Measures Taken for Balance-of-Payments Purposes that "restrictive trade measures are in general an inefficient means to maintain or restore balance-of-payments equilibrium" were also recalled. It also noted that many of the remaining measures were related to imports of agricultural products or to particular industrial sectors, and recalled the provision of the 1979 Declaration that "restrictive import measures taken for balance-of-payments purposes should not be taken for the purpose of protecting a particular industry or sector".

23. The Committee therefore stressed the need to establish a clear timetable for the early, progressive removal of Korea's restrictive trade measures maintained for balance-of-payments purposes. It welcomed Korea's willingness to undertake another full consultation with the Committee in the first part of 1989. However, the expectation was expressed that Korea would be able in the meantime to establish a timetable for the phasing out of balance-of-payments restrictions, and that Korea would consider alternative GATT justifications for any remaining measures, thus obviating the need for such consultations. The representative of Korea stated that he could not prejudge the policy of the next Government in this regard.

ANNEX I

Statement by the representative of the Republic of Korea

Recent economic performance

1. The Korean economy has performed outstandingly since the beginning of 1986, after a period of relatively slow growth in 1985. Last year, GNP grew 12.5 per cent in real terms. Consumer prices rose 2.3 per cent while wholesale prices actually declined. In the external sector, Korea recorded its first current account surplus at US\$4.6 billion. This surplus was put to good use to reduce the nation's foreign debt by 5 per cent last year to US\$44 billion.

2. Korea's strong economic performance continued through the first half of this year. Growth was robust with a record high GNP growth rate of 15.3 per cent. Inflation remained well under control as both wholesale and consumer prices increased by less than 3 per cent. In addition, the nation's balance-of-payments position continued to improve, resulting in a US\$4.2 billion current account surplus. Once again taking advantage of this favourable development in the nation's balance-of-payments position, the Korean government reduced the external debt by 9 per cent to US\$40 billion.

3. This strong economic performance was due in no small measure to favourable changes in the external environment, in particular, the drop in oil prices, low international interest rates and the realignment of exchange rates of major currencies. In this respect, the fall in oil prices contributed to price stabilisation and significantly reduced import values. Lower international interest rates in 1986 eased Korea's external debt service burden. In addition, the recent revaluation of major currencies improved the competitiveness of Korean products in world markets and led to a recovery of export growth.

4. However, it is important to note that Korea's strong economic performance was also due largely to the implementation of painful but effective adjustment reforms initiated in the preceding period. Were it not for these reforms, Korea would not have been able to take full advantage of the recent favourable changes in the external environment. What is more, implementing these reforms took great political courage because they were launched during a period when Korea still sustained heavy external debts and current account deficits.

Positive reform measures

5. These reforms, which have been under way since the early 1980s, focused on two main objectives: price stability and greater efficiency through competition. To promote price stability, we drastically curtailed government spending and monetary growth.

6. In 1984, the year before our Congressional Election, for example, we froze the government budget, including the salaries of civil servants, and we also froze the grain-purchase-price level, the biggest source of fiscal deficit. These were difficult and unpopular moves, but we held firmly to our plan to curb excessive government spending, while making a strong effort to broaden public support and understanding for fiscal restraints. Thanks to this belt-tightening, the fiscal deficit was greatly reduced, from 4.7 per cent of GNP in 1981 to less than 0.1 per cent last year.

7. Tight fiscal and monetary policies resulted in a drastic reduction of inflation. Measured in wholesale prices, the inflation rate fell from a high of 39 per cent in 1980 to 4.7 per cent in 1982 to -2.2 per cent in 1986. Stable prices helped to eliminate real-estate speculation, a major headache which is common in countries as small as Korea, ensure more efficient allocation of resources, and improve income distribution. In addition, by guaranteeing stable, positive real interest rates, low inflation helped raise domestic savings.

8. The other side of Korea's reform policies involved greater emphasis on competition and private initiative while reducing government intervention. For instance, five major commercial banks, which were de facto public enterprises, were privatized in the early 1980s. Administrative price controls were reduced or removed completely, and a new fair trade and anti-monopoly law was enacted to prevent unfair business practices and collusion among firms.

9. By far the most important part of our reforms has been in the area of trade liberalization. Korea lacks almost all natural resources and is therefore dependent on trade to create employment opportunities and to improve people's living standards. In order to finance imports, Korea must generate foreign exchange through exports. But products can be sold abroad only if they are competitive, and the best way to strengthen competitiveness, we believed, was to invite foreign competition through import liberalization. Accordingly, we raised the nation's import liberalization ratio, or the percentage of automatically approved imports, from 68.6 per cent in 1980 to 93.6 per cent this year.

10. In December last year, the Korean government enacted the Foreign Trade Act. The goal of this act is to promote free and fair trade by emphasizing private sector initiatives. To accomplish this goal the act contains measures designed to aid domestic industries in adjusting to a new and rapidly changing international trade environment while reducing the role of government in day to day trade procedures. Among other things, the act contains a system of safeguards against import surges that is more transparent and less restrictive than the old import surveillance list.

11. Korea's progress in liberalizing trade has been accompanied by reductions in the average tariff rate and tariff differentials between products. The average tariff rate on industrial products has fallen from

31.8 per cent in 1980 to its present level of 18 per cent. In fact actual tariff reductions are running ahead of original schedules.

12. Korea has also been liberalizing foreign exchange controls. As the nation's balance-of-payments position continued to improve, the government took steps to eliminate substantially restrictions on invisible transactions this year. In addition, direct and indirect foreign investment into Korea as well as Korean investment overseas have been accelerated.

13. The structural reforms I have outlined so far have been very successful. During these last few years, prices have stabilized, industrial productivity has increased, the overall efficiency of the economy has improved significantly, and as a result so has Korea's external competitiveness. Thanks to these reforms, we were able to fully exploit favourable developments in the external economic environment and the country has made great progress since the beginning of last year.

Challenges facing the Korean economy

14. During the second half of this year, a number of domestic and international developments began to slow Korea's economic growth momentum. Moreover, these developments pose considerable difficulties for the prospects of continued economic expansion and price stability in the future.

15. On the domestic side, Korea is currently going through an important and difficult stage in its development. Politically, Korea faces its direct presidential election before Christmas this year. While the election is sure to be an historic landmark on the nation's road to political development, the uncertainty surrounding this historic event will act as an impediment to economic activity. In addition, a few months ago Korea faced large scale labour unrest, reflecting the rising expectations of workers for improved income distribution. Besides causing production and export losses, this labour unrest led to average annual wage hikes of 18 per cent this year. As a result, increased labour costs are stimulating inflationary pressures domestically as well as reducing the competitiveness of Korean goods internationally.

16. On the international side, the beneficial effects of the "three lows" are beginning to subside. Oil prices are rising and this development is expected to reduce the nation's current account surplus. The appreciation of the Korean won vis-a-vis the United States dollar is undermining the competitiveness of Korean goods and reversing gains made through previous currency realignments. In 1987 between April and October the Korean won appreciated 7.3 per cent against the US dollar. In addition, the rising trend of protectionism abroad is presenting fresh problems for Korea's trade-oriented economy. Korean exports have been increasingly subject to restrictive measures including import quotas, voluntary export restraints,

administrative/procedural measures and the aggressive use of countervailing and anti-dumping duties.

Meeting the challenges

17. Far from standing by idly, Korea is moving ahead to meet the challenges it currently faces. Domestically, the government is taking steps to encourage Korean firms to implement the structural adjustments necessary to cope with higher costs. The government is supporting the private sector in its efforts to enhance efficiency, improve competitiveness and modernize facilities. Moreover, government spending on social welfare programs is being expanded. Minimum wage and pension systems will be implemented from next year and the scope of medical insurance will be widened to cover a greater portion of the population.

18. Internationally, Korea is taking steps to improve competitiveness and deepen the nation's industrial structure by moving ahead with policies to liberalize trade, tariffs, foreign exchange controls and foreign investment. For example, Korea will open its doors even wider to foreign goods by liberalizing 133 new items for import in 1988 and 370 items thereafter. By the time the 1988 Summer Olympics open in Seoul, Korea's import liberalization ratio will reach 95 per cent, a level that matches those of advanced countries. In addition, Korea halved the number of items under import surveillance to 48 in 1987 and by 1988, the list will be eliminated altogether.

19. Hand in hand with liberalizing trade, Korea will be lowering the average tariff rate on manufactured goods by 10 per cent next year. The Korean government is also stepping up its actions to liberalize foreign exchange. The government recently announced a three-year plan designed to liberalize foreign exchange transactions and steps will also be taken to liberalize foreign exchange controls to the same level as advanced nations in the future. Finally, as the economy continues to mature, Korea will continue to open new avenues for foreign investment into the country while increasing its own investments overseas.

20. Given this positive response to the challenges currently facing the nation, I am reasonably optimistic that the overall outlook for the Korean economy is bright. In the short term, owing to the adjustments Korea is making to meet these challenges, growth is likely to slacken and unemployment is expected to rise. In addition, we will have to carefully monitor the effects of inevitable price increases on the competitiveness of Korean goods in international markets. Nevertheless, the long-term outlook for the economy will be brightened as domestic developments work to strengthen Korea's industrial structure and accelerate the transition of Korean firms toward more technology-oriented production. Moreover, continued liberalization will in the long-run strengthen the competitiveness of the Korean economy while increasing mutually beneficial relationships with trading partners overseas.

21. This positive view, however, depends upon a stable international economic environment. As I have already noted, the Korean economy is currently undergoing an adjustment process that is both difficult and sensitive. Given the opportunity to complete this process successfully, we expect that the Korean economy will be on course for a good performance. However, if the Korean economy is burdened by increased protectionist barriers or currency market pressures, this bright outlook could be endangered and the economy could well run into difficulties.

22. For one thing, Korea might not be able to maintain the minimum surplus necessary to pay back its external debt. Given the nation's strong economic performance, many forget that Korea has the fourth largest debt in the world at around \$16 billion. Since last year, Korea began to generate a surplus in its current account for the first time in its modern history. However, instead of stockpiling this surplus, as other nations are doing, Korea has been using it to repay loans outstanding.

23. The important point to make here is that Korea has been improving the standard of living of its people through the successful implementation of a development strategy recognized and endorsed by international economic institutions including the IMF and World Bank. Simply put, under this strategy, Korea has borrowed, it has put those borrowings to good use and it has started to pay back those loans but it has stopped generating surpluses in its current account for the time being. If this is not done, otherwise, the nation's plans to reduce its external debt to a reasonable level will be halted and could even be reversed.

Conclusions

24. In conclusion, the Korean economy showed an outstanding performance in 1987 and the first nine months of 1988. This performance was due to favourable external developments and the successful implementation of liberal reforms which enabled Korea to take advantage of these developments.

25. Since the situation is good, domestic and international economic developments have been favourable. Domestically, Korea has been making adjustments to overcome political and economic constraints. Internationally, Korea has generated its market opening measures and economic policy reforms. Korea has committed to maintaining and widening the scope of its open trade policy. However, in order to maintain this progress it is important that the current rise in worldwide protectionist measures be halted. To accomplish this all countries will have to act together in a coordinated and open manner. Moreover, the leadership and advice exerted by international economic institutions, such as the GATT, will become increasingly important. In this respect, Mr. Chairman, I would like to express on behalf of the Korean Government our sincere appreciation for the GATT's efforts to defend and promote free and fair trade worldwide, and I please to call for closest cooperation to achieving this goal in the future.