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## I. Balance of payments situation and outlook

### 1. Overview of general economic situation.

#### I.

The Korean economy in 1988 recorded a GDP growth of 11.3%, a rate somewhat lower than the previous two years. By sector, manufacturing, which has led the Korean economic growth in the past, exhibited a growth of 13.0%, down from 18.3% in 1987. On the other hand, the agricultural sector, which posted a negative growth in 1987, grew 9.0%, thanks to the unexpected bumper crop. (Table 1).

Meanwhile, the current account surplus reached US\$14.2 billion. The trade balance recorded a surplus of US\$11.4 billion while the invisible trade balance posted a surplus of US\$1.3 billion due mainly to the increase in travel receipts from the Seoul Olympics. (Table 6).

The international situation was favourable to the Korean economy which relies heavily on the global economic environment. The world economy fared well in 1988, in spite of the stock market crisis in October 1987. Furthermore, oil prices continued to be stable.

Domestically, efforts to diversify export-import markets, improve product quality, and counter the won appreciation proved beneficial. Moreover, the domestic demand grew substantially due to rising incomes and has replaced exports as the main engine of growth.

## II.

At first glance, the performance in 1988 seems very remarkable and the Korean economy in general appears sound. However, a closer look reveals a host of worrisome aspects which cast some doubts on the future of the Korean economy.

First, it should be pointed out that the two main sectors, manufacturing and export, which had traditionally led the Korean economy, have started to show unmistakable signs of losing their momentum. The 13.0% growth rate recorded in the manufacturing sector when compared to the higher rates of about 18.0% in the previous years is a proof of this trend.

Second, many destabilizing conditions have appeared on the Korean economic scene since the last BOP consultation. The effects of these new conditions

did not materialize visibly in 1988 because of time lag. But if they are fully realized in the coming years, they will certainly be serious enough to undermine the foundation of the Korean economy. The following are examples of the emerging difficulties faced by the Korean economy.

#### Labour disputes and wage increase

Along with the political democratization process, the social demand for fairness and more balanced distribution of wealth has become widespread among various social sectors.

Serious labour disputes are now a public concern not only because of the resulting contraction in economic activities but also because of the socio-psychological unrest that they create. Already about 350 cases of labour disputes have been reported during the first quarter of 1989, even before the regular wage negotiation season commenced.

It is estimated that more than 1.6 trillion won (about US\$2.4 billion) of production and a moderate amount of exports have been reduced due to labour disputes during the above-mentioned quarter.

These labour disputes resulted in more than 20% wage increase last year, far outpacing labour productivity gains. From January 1987 until June 1988, nominal wages in manufacturing industries increased by a 31.5% cumulative average while the growth rate of labour productivity was only 20.5%. (Table 4).

This trend is expected to continue for some time and will lead to a sharp drop in the competitiveness of Korean industry.

#### Won appreciation

The Korean won has appreciated about 34% against the US dollar since 1985. In 1988 alone, it appreciated 15.8%, more than the gains of any other currency.

In particular, the real effective exchange rate of the won, which is higher than the rate at the time of the Plaza Agreement in September 1985, appreciated by over 19.5% in 1988 and by 1.6% during the first month of this year according to a recent IMF staff report. This paper stated that the growth of export volume declined markedly because of a deterioration in external competitiveness.

Exchange Rate Movement

	'85.9.21	'86	'87	'88	'88.4	Since end of '86
W/US	892.00	861.40 (3 . 3)	792.30 (8 . 7)	648.10 (15.8)	666.30 (2 . 7)	(29.3)
NT\$/US	40.47	35.56 (12.1)	28.55 (24.0)	28.18 (1 . 3)	25.95 (8 . 6)	(37.0)
¥/US	239.05	159.95 (25.0)	123.20 (29.8)	124.90 (-1.4)	133.00 (-6.1)	(20.3)

- End of year figures where appropriate
- ( ) : appreciation rate relative to the end of the previous year (%)

### Difficulties in light industries

The light industries that mainly rely on exports, such as textiles and footwear, are suffering very severely from the won appreciation and rising labour costs.

Statistics in 1988 showed a very sharp decline in the normal profit to net sales ratio in those industries. For example, the ratio for the textiles industry fell to a mere 0.2% in 1988 from 6.6% in 1987.

In 1988, the rate of export increase for light industries fell very sharply from the previous year. For instance, the rate of export increase for the toy industry fell from 48.1% in 1987 to a negative 7.3%. (Table 5).

Since these adversely affected light industries comprise more than 90 thousand small and medium size firms employing about 1.2 million workers, the government cannot help but become apprehensive about the future of these industries.

### Inflationary pressure

Price stability during the past five years had been one of the most favourable factors in the rapid

growth of the Korean economy. The maintenance of price stability was mainly attributable to the sharp drop in international oil prices as well as the efforts of the Korean government toward price stabilization, such as cuts in prices of petroleum products and electricity charges, substantial tariff reductions through five-year schedule and the Tariff Quota, and reduction in special consumption taxes, etc.

But recently, inflationary pressures, which have intensified since the second half of 1987, are becoming one of the most threatening factors to the Korean economy. These pressures are considered to be the result of wage hikes from labour disputes and rising domestic demands reflecting the increase in real income, and to a lesser extent a sharp rise in the prices of imported raw materials and inflationary expectations.

In 1988, these pressures pushed the consumer price up 7.2%, the highest level since 1982. These trends are expected to continue for some time.

It will still be sometime before the effects of the above-mentioned difficulties are reflected in actual economic indicators. However, some unsettling signs have already appeared.

In 1988 alone, numerous small and medium sized enterprises went bankrupt due to the combined effects of rising labour costs and the appreciation of the won.

Investment activities have considerably leveled off. In particular, growth of gross fixed investment in the manufacturing sector slowed to 11.8% in 1988 from 17.4% in 1987, reflecting a sharp drop in machinery and equipment investments.

During the first quarter of 1989, the effects are most evident in the export-import front where, as shown below, export growth became increasingly sluggish while import growth generally maintained its usual pace.

Export-Import Growth Rates

	<u>88.1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>1/89</u>	<u>2/89</u>	<u>3/89</u>
Export	35.7	21.0	31.0	27.4	10.9	5.5	11.2
Import	40.7	20.9	26.5	20.8	18.9	17.6	26.7

(over the same period of previous year, %)

Taking the above various difficulties and recent economic trends into consideration, the Korean economy is likely to show a considerable slowdown over the coming years.

In the meantime, the traditional problems particularly in the agricultural sector which have existed in the Korean economy remain unresolved.

Since the 1960's, Korea has exerted utmost efforts to raise the previously low national standards of living through extensive investments in the industrial sector utilizing all available financial resources. As a result, substantial progress was witnessed in this sector.

By contrast, the agricultural sector, which remains at a developing stage, lags far behind the industrial sector due to low productivity and insufficient government investment. Accordingly, the economic gap between the industrial and agricultural sectors has widened considerably.

Coupled with rapid democratization process in Korea, this has given rise to strong demands by farmers and the National Assembly for rectification, and accordingly, is now one of the primary concerns of the government.

The arable land of Korea stands at only 2.1 million hectares, or 21.6% of the total land mass while 7.3 million people, or 17.2% of the total population, are employed in agriculture, with an average 1.1 ha per farm household, representing 10.9% of total Korean GNP in 1988. In addition, farm households with less than 1 ha constitute 63.7% of the total.

Furthermore, because of the extremely low non-farm income, agriculture is viewed by the farmers not as a mere industry but rather as a means of subsistence.

Due to the structural infancy and laggard development in conventional agriculture, it has become inevitable for farmers to derive the major part of their income from the raising of rice, cattle, fruits, vegetables and other conventional products.

Accordingly, 60.4% of the total income is derived from farming alone, and more than 80% of farmers are presently classified as debtors.

Since agricultural productivity under these conditions could not improve easily, the income gap between urban and rural areas has become wider, bringing about various economic and socio-political problems in Korea.

The Korean government, therefore, is forced to implement a reconstruction plan for the agricultural sector very carefully and a huge amount of finances and sufficient time are required for settling all these problems.

Meanwhile, Korea is still burdened with a debt amounting to US\$31.2 billion (Table 2). Although part of the current account surplus was used to reduce the external debt, Korea's economy remains less developed than that of other Asian NICs. In terms of per capita GNP, Korea finishes last among this group, despite the fact that per capita GNP last year crossed the US\$4,000 mark of which around US\$450 was contributed by the won appreciation. (Table 3)

Despite these situations, the Korean government has exerted considerable efforts to open domestic markets and promote imports.

In the trade sector, import liberalization through the relaxation of laws and the simplification of procedures has been pursued. In particular, the government prepared the further liberalization plan for agricultural products and some non-agricultural products for 1989-1991. This plan will raise the import liberalization ratio to 97.3% by 1991, and 99.9% for non-agricultural products.

Furthermore, tariffs have been lowered substantially through the "Second Five-Year Reduction Schedule" for 1989-1993 and the Flexible Tariff System. The schedule will lower the average tariff rates to 7.9% by 1993, a rate similar to ones existing in OECD countries.

Additionally, the government accepted the obligations of IMF Article VIII in November 1988, as part of the efforts to liberalize the exchange management system.

These efforts, which are explained in greater detail later, were made to pursue the liberalization of the economy, and in response to the call for Korea to assume a greater responsibility in the international community.

## 2. Balance of payments trend and outlook (Table 6-11)

### A. 1987

Both the expansion of the trade surplus and the shift to a surplus of the invisible trade balance led to an increase in the current account surplus of US\$5.2 billion.

During the year, merchandise exports, on a balance

of payments basis, stood at US\$46.2 billion, that is a 36.4% increase over the preceding year.

By commodity group, the exports of heavy industries such as automobiles, electronic products and general machinery as well as the light industrial goods such as textiles, toy and travel goods showed relatively strong gains.

Merchandise imports, on a balance of payments basis, increased 29.9% to US\$38.6 billion.

As a result, the trade surplus reached US\$7.7 billion, an improvement of US\$3.5 billion over the preceding year.

The invisible trade balance changed from a deficit of US\$0.6 billion in 1986 to a surplus of US\$1.0 billion, due to a reduction in net interest payments and an increase in travel receipts.

Consequently, the current account surplus widened to US\$9.9 billion.

The capital account showed an overall net capital outflow of US\$5.8 billion, reflecting the suppression on the further inflow of foreign capital and the early

repayment of foreign debt, in order to guard against an increase in money supply.

Accordingly, it was possible to reduce the external debt by US\$8.9 billion to US\$35.6 billion at the end of 1987.

B. 1988

The current account surplus further increased to US\$14.2 billion from US\$9.9 billion in 1987.

Merchandise exports, on a balance of payments basis, amounted to US\$59.7 billion, an increase of 29.0% over the previous year. This was mainly due to the huge increase in the unit price of exports.

By commodity group, while the exports of light industrial products showed a small increase, the exports of general machinery, electronic products and automobiles in the heavy industrial category posted high growth rates.

Merchandise imports, on a balance of payments basis, stood at US\$48.2 billion, an increase of 24.9% compared with the preceding year. A substantial increase was recorded in the imports of parts and

materials for domestic production, mainly resulting from lower tariff rates and the further opening of domestic markets.

As a result, the trade balance recorded a surplus of US\$11.4 billion, an increase of US\$3.8 billion over the preceding year.

The invisible trade balance closed the year at the level of US\$1.3 billion due to a rise in travel receipts mainly from the Seoul Olympics, and a reduction in the interest payments on foreign debt.

In the capital account, the overall net capital outflow shrank from US\$5.8 billion in the previous year to US\$1.4 billion, reflecting a reduction in the repayment of foreign bank loans and increased short-term trade finance.

Total external debt declined to US\$31.2 billion, a reduction of US\$4.4 billion.

#### C. 1989

For the first three months of this year, the current account surplus was only US\$1.3 billion, less than half the amount posted during the same period

last year. This is a result of a huge reduction in the trade surplus.

The trade balance recorded a surplus of US\$1.0 billion, a decrease of US\$1.2 billion compared with the first quarter of 1988, due mainly to the sluggish growth of exports.

Merchandise exports, on a balance of payments basis, showed a poor growth rate of 8.1% compared with the first quarter of 1988 because of a sluggish increase in both light and heavy industrial exports. In particular, exports of automobiles, footwear, textiles and iron & steel products witnessed either reductions or only slight increases.

In contrast, imports, on a balance of payments basis, grew at a rate of 21.1% reflecting a considerable rise in the imports of parts and raw materials.

The invisible trade balance recorded a surplus but the transfer balance was greatly reduced by a large decrease in net unrequited transfers.

The capital account recorded a net outflow of US\$2.0 billion reflecting the early redemption of bank loans and an increase in the repayments of short-term debts.

Meanwhile, the IMF, OECD and WEFA have all forecasted a modest slowdown in the economies of major trading partners such as the United States, Japan and EC countries.

Furthermore, oil prices and protectionism are both on the rise.

These situations, along with rising wages, appreciating won and higher domestic prices, will lower the competitiveness of Korean industries.

As a result, the remainder of 1989 is expected to witness a continued sluggish exports and expansionary imports which should lead to a sizeable current account surplus reduction.

#### D. Medium-term outlook

The Korean economy achieved high economic growth and maintained current account surplus with relatively stable prices in the years since 1986 when the current account shifted to a surplus.

More recently, however, unfavourable internal and external factors have emerged and will cause great difficulties for the Korean economy.

Domestically, as part of the process of economic democratization, large scale labour disputes are expected to hinder the growth of industrial production and exports through increased wage costs and frequent delays. The tendency of sharp price hikes which began in 1988 is being accelerated this year because of rising consumer demand arising from large wage increases and rapid accumulation of financial wealth. Overall industrial reorganization, which has been pursued with a view to overcoming the limitations on continuous high economic growth imposed by high wages, necessitates a considerable amount of time and cost. The rising demand for greater social welfare is expected to reduce the economic and export growth potential considerably.

As far as external factors are concerned, there is a tendency for the developed countries to put in place stronger protectionist barriers against Korea's exports. Furthermore, oil prices and international interest rates are again on the rise and foreign demand for Korea's exports is declining due to the sluggish growth of the world economy. These factors, together with the continuous appreciation of the won, will reduce the growth of exports.

In addition to these unfavourable factors, cyclical economic movements are one of the reasons for the gloomy prospects of the Korean economy in the near future. According to the overall economic cycle, the Korean economy has been on a downward trend, by and large, from the second quarter of 1988 after two and half years of upward trend beginning in October 1985. As far as the fluctuations of exports and imports are concerned, exports are likely to experience a downturn from 1989 until 1990 because of the potential shortfall in domestic supply caused by the rise in exports and domestic demand over the past three years.

Meanwhile, as mentioned above in an earlier section, the pursuit of export-led economic development has resulted in high economic growth, but at the same time it has also led to growing imbalances in various segments of society such as imbalances between urban and rural areas, incomes classes and big and small-medium sized firms.

These imbalances have now become a major concern of the government.

This structural problem demands that the government focus more on balanced development and enhanced national welfare. Especially, housing

construction for urban low-income people and investment for regional development have become policy priorities.

This, coupled with the import liberalization of agricultural and manufacturing products as well as the reduction of tariffs and income taxes, is expected to boost domestic demand in the future.

As a result, the combination of lower export and rising domestic demand will continue to reduce considerably the balance of payment surplus.

## II. Relaxation and elimination of restrictions

### 1. Trade policy

#### A. Basic principle

In the early 1980s, Korea came to recognize that rapid economic growth could be sustained only in parallel with its degree of market opening and internationalization. As Korea worked to restructure its economy in line with her enhanced international status, free trade became a matter of principle as well as practical necessity. Korea acknowledges that open and free economy is good for the country as well as for its trading partners.

Korea, therefore, began to accelerate internationalization of its economy, restructure its industry, and pursue the basic framework of a free market system. Korea believes internationalization can be best pursued multilaterally. In this respect, Korea has actively supported the General Agreement on Tariffs and Trade and the preeminent multilateral framework for promoting an international free trade regime and has continued to maintain a pragmatic approach in the ongoing "Uruguay Round" of multilateral trade negotiations.

Korea has taken specific steps to turn its free trade principles into action. In 1981, Korea embarked on an ambitious liberalization programme and has carried it out without interruption, despite structural, economic and social constraints that often seemed to threaten its goals.

This programme has been accelerated since 1986, the year in which Korea experienced its first trade surplus.

## B. Promotion of import liberalization

(Table 13-15)

Like other developing countries with persistent trade deficits, Korea had to maintain a system of import licensing to keep its balance of payments problems from escalating beyond control. As trade deficits shrank and its industries strengthened, Korea started to dismantle its import licensing system and accelerated these efforts in 1985 by announcing an import liberalization schedule for 1986 - 1988.

As a result of this concerted effort and by adding 333 items to the liberalization list since the last full BOP consultation, Korea achieved a 94.7% import liberalization ratio (the percentage of products entitled to automatic approval), which is impressively close to that of many developed countries.

This represents a marked improvement over a liberalization ratio of only 68.6% in 1980. The ratio of restricted items dropped to a quarter of previous levels, falling from 20% in 1983 to nearly 5% in 1988. For manufactured goods, Korea has virtually attained total import liberalization, with a ratio of 99.5% in 1988.

The remaining items under import restriction are principally agricultural products, including fruits, vegetables, processed foods, livestock and fishery products, which have proved more sensitive to rapid increases in foreign competition. However, imports of these items under restriction are permitted, on a case-by-case basis.

### C. Simplification of import procedures

#### 1) Import surveillance system eliminated

In 1988, Korea eliminated its import surveillance system, which had been in place since 1977. Korea's system was similar in purpose, though more restrictive, to the GATT "escape clause system," which is used to protect domestic industries from import surges. The items subject to Korea's import surveillance, therefore, were primarily those which caused injury to domestic industries through rapid increases in imports following import liberalization. The items restricted under Korea's system included luxury consumer goods and certain agricultural goods.

The Korean government continuously reduced the number of items under import surveillance and finally abolished the system in 1988.

## 2) Special laws with trade restrictive effects

Korea, like every country, has "special laws" which regulate the import of certain goods for the maintenance of quality, the protection of public health and safety, or national security.

In December 1988, Korea established a Task Force composed of officials from several Ministries to implement the further lifting or mitigating of import restrictive effects under the special laws. On February 17, 1989, the Task Force announced its plan to review potential trade barriers in 39 special laws. The Korean government will introduce a bill this year to implement further amendments to these laws. Those aspects in the programme which could be accomplished without any new legislation were implemented as of March 8, 1989. As a result, the reach of Korea's special laws was dramatically reduced.

## 3) New opportunities for foreign trading firms

Since 1987, Korea has been opening its markets to foreign trading companies. Korea enacted the Foreign Trade Act, which became effective July 1, 1987, and amended the Guidelines on Foreign Investment Approval on January 22, 1988. As a result of this legislation,

foreign trading companies can more easily obtain trading business licenses. Under current regulations, trading companies with a minimum paid-in capital exceeding 50 million won (approximately \$73,000) may receive a license.

In October 1988, Korea dramatically expanded the scope of activities in which foreign trading companies may be involved. Foreign trading companies can now participate in import and export activities in all but twelve sectors (generally in the agricultural and energy area) out of a total of 66 sectors under the Korean Standard Industry Classification and enjoy trading activities not only with parent companies but also with other manufacturers. Previously, foreign trading companies could only deal in nine sectors, and their activities were limited to trade with parent companies.

#### D. Future liberalization plan

(Table 16-17)

As outlined above, Korea has continued its policy of market liberalization through the reduction of tariffs and the elimination of non-tariff barriers, keeping pace with its economic development and improvement in its BOP position.

The removal of import restrictions over 333 items (see page 24) has shortened the list of items still subject to import restriction considerably, leaving only some 500 products on the list.

These remaining import-restricted items are mainly agricultural products, which greatly affect farmers' income.

There is a deep concern that a sudden increase in imports would bring about a sharp drop in prices of agricultural products, jeopardize the viability of Korean farm economy and cause serious economic and social disruptions within the Korean society.

It is difficult for Korean farmers to migrate to other sectors or regions due to the high proportion of elderly and female citizens in the sector and the farmer's traditionally strong attachment to their own land, and this makes rural economic situation even worse.

These potential disruptions should also be viewed against the current volatile social atmosphere accompanying the accelerating demands for greater political and economic democracy within Korea. To reduce such disruption, the Korean government is working strenuously to restructure the agricultural

sector.

Notwithstanding such structural vulnerability and low level of development in the agricultural sector, the Korean government set up a Task Force in December 1988 to establish agricultural import liberalization schedules covering 1989 through 1991. The new plan, announced last April, will liberalize additional 243 agricultural items. This will raise the agricultural import liberalization ratio to 85.2% by 1991. In addition, the Korean government will add 36 items of non-agricultural products to the import liberalization list.

Thus, the final list of items to be liberalized for import into Korea from 1989 to 1991 comprises 301 items, which will increase the total liberalization ratio to 97.3% by 1991.

Further liberalization schedule will be mapped out with due consideration given to the structural improvement in the agricultural sector and the stabilization of the BOP situation.

## 2. Tariff Policy

### A. Overview

Only four years ago, Korea had a trade deficit of US\$0.9 billion and was one of the largest debtor nations in the world. Despite those difficulties, Korea made efforts to promote international trade by initiating the opening of its domestic markets.

As part of these efforts, Korea reduced tariffs according to a five-year schedule adopted in 1983. The schedule lowered the average tariff rate from 23.7% in 1983 to 18.1% in 1988.

In 1988, the Korean government prepared a second five-year tariff reduction schedule. This schedule seeks to lower the average tariff rate from 18.1% in 1988 to 12.7% in 1989, and to 7.9% (the existing level in OECD countries) by 1993.

In addition to the five-year schedule, the Korean government has made further reductions through Tariff Quotas in order to promote imports.

Recently, however, the Korean economy is facing some serious difficulties such as labour disputes, increasing wages, won appreciation and a sharp drop in exports, etc.

Nevertheless, the Korean government will continue tariff reductions as scheduled in the five-year programme and make efforts towards promoting international trade, especially through tariff negotiations in the Uruguay Round.

#### B. Second five-year tariff reduction schedule

##### 1) Tariff reduction (Table 18)

###### - Raw materials

The previous rate of 5 - 10% on non-competitive raw materials has already been sharply cut to 1 -2%

since Jan. 1, 1989. This minimal level of taxation, unlike duty-free entry, is aimed at achieving an optimal balance between revenue-making and reinforcing domestic industrial infrastructure.

In order to maximize domestically available resources, tariffs on competitive raw materials will be reduced gradually from the previous levels of 10% to 3% by 1993.

- Processed inputs and finished products

#### Primary processed inputs

This category covers items that require relatively simple manufacturing processes and ones that will be used in the production of other products. In general, the rates for these items are to be lowered from the previous levels of 10 - 20 % to 10% in 1989 and finally to 5% in 1993. For those items that have already achieved international competitiveness, the rates will be cut directly to 5% in 1989.

#### Other processed inputs and finished products

The previous rate of 20% on almost all manufactured goods, in general was reduced to 15% in 1989 and will be lowered to 8% by 1993. Again, the

rate reduction for those items that are not available domestically or are internationally competitive will be accelerated to 10% by 1989 and to 8% by 1993.

#### Consumer goods

These goods will have their rates reduced in a manner similar to those of other processed inputs and finished products, i.e., 15% in 1989, lowered to 8% in 1993. Rates for high tariff items within the range of 30 - 50% such as luxury goods, will be lowered to 20% in 1989 and then to 8% by 1993.

#### Agro-fishery products

The principle of tariff reduction for agro-fishery products does not differ from that of manufactured goods. For 64% of the items under the whole HS headings, the rate reduction is the same as those for manufactured goods.

Items whose rates are to be cut sharply are raw farm products, not domestically produced items, formerly high tariff goods.

Tariff rates for general farm products which do not directly affect farmers' income, will be reduced by the same percentage as "other processed inputs and finished goods".

Certain cash crops which are essential to farmers' income but whose production structure are fragile will retain the current level of tariffs for the time being.

## 2) Effects of tariff reduction

### Tariff level (Table 19)

The average tariff rate will be reduced from 18.1% to 12.7% in 1989 and gradually to 7.9% by 1993. In particular, the rate of 16.9% on manufactured goods (including raw materials) has already been reduced to 11.2% in 1989, and will fall to 6.2% which is similar to the level existing in the OECD countries.

### Tariff structure (Table 20)

In its effort to focus on tariff cuts for finished goods which have relatively higher rates, the government has lowered the degree of tariff escalation

in accordance with the stage of production, i.e., raw materials, processed inputs and finished products. Furthermore, the balance in the tariff rates between producer and consumer products has improved.

The average tariff rates for raw materials, processed inputs and finished products are to be reduced from 9.8%, 17.1% and 19.1% respectively in 1988, to 3.9%, 11.7% and 13.3% in 1989, and finally to 2.8%, 7.0% and 7.1% in 1993.

#### Tariff distribution (Table 21)

The distribution of tariffs will also change considerably through these tariff reductions. The main tariff level will fall from 11 - 20% in 1988 to 6 - 10% by 1993. In particular, the tariffs on all manufactured products will be below 10% in 1993.

#### C. Flexible tariff system

(Table 22)

There are three usual types of flexible tariff systems designed to deal with short-term changes in the economic environment: Tariff Quotas, Emergency Tariff and Adjustment Tariff. Among these, the Tariff Quota is employed to lower and the others are utilized

to raise the tariffs. These can be temporarily and restrictively applied by Presidential Decree.

Thus far in 1989, there have been no items subject to the Emergency and Adjustment Tariff, but there were three items in 1988; 2 ferro-alloys and acetaminophene. On the other hand, Tariff Quotas have been applied 4 times in 1988 and once in the first half of 1989. Tariff Quotas allow for a temporary cut on tariff rates of up to 40% on certain amounts of imports in order to meet a surge in import demand and to stabilize domestic prices.

Since the balance of payments position has been improving, the government has expanded operation of Tariff Quotas to promote imports.

In 1988, tariffs on 2,235 items, whose coverage is 21.8% of a total of 10,241 items (based on HS 10 digit), have been lowered through Tariff Quotas.

In 1989, tariffs on 1,188 items were further reduced through Tariff Quotas on March 14. The emphasis was on lowering the tariffs on general consumer goods to promote imports and help improve the

living standards of the people, as well as on some raw materials and intermediary goods due to a supply shortage resulting from recent labour disputes, and to contain cost push factors due to the sharp rise in import prices.

As necessity arises, the Korean government will continue to examine the possibility of further tariff reductions.

### 3. Exchange management and capital market policies

#### A. Exchange management system

As the trade volume expanded, the Korean government, responding to the calls to take greater responsibility in the international society, has been pursuing the liberalization of the exchange management system. This led to the acceptance, on November 1, 1988, of Article VIII of IMF Agreement.

Since the last BOP consultation in Nov. 1987, various improvements have been made in regulations on the invisible transactions and overseas investment.

- 1) Relaxation of restrictions on invisible transactions

The government has eased restrictions on the overseas travel allowance; the maximum amount allowed as basic expenses for overseas travel was raised from US\$ 3,000 to US\$ 5,000. The amount permitted for long-term overseas travellers was raised to US\$ 3,000 - US\$ 10,000 per month, and other expenses for overseas travel may be permitted.

Furthermore, overseas travellers are now allowed to use credit cards without obtaining prior permission and without limit.

Korean emigrants are allowed to carry out funds not exceeding US\$ 200,000 for settlement and US\$ 300,000 for investment.

Any resident is allowed to keep foreign means of payment which were bought from a bank or earned through other transactions up to a maximum of US\$ 5,000. This amount may be used in addition to the overseas travel allowance. Residents are also granted the right to remit abroad, without prior approval, an amount not exceeding US\$ 5,000 for individual purposes, and not exceeding US\$ 10,000 in settlement of current transactions.

Procedures for invisible transactions have also been simplified and the range of approval for invisible payments and contracts by a foreign exchange bank has been sharply expanded.

## 2) Foreign Investment

In 1984, the Korean government adopted the Negative List System and Automatic Approval System, and has continuously liberalized its foreign investment system in line with the liberalization and internationalization of the Korean economy.

As a result, the manufacturing sector is almost completely open to foreign investment, with a liberalization ratio of 97.5%.

There has also been steady progress in service sector liberalization such as insurance and advertising.

Total foreign investment into Korea increased rapidly from US\$ 353 million in 1986 to US\$ 1,060 million in 1987 and US\$ 1,283 million 1988.

Overseas investments not exceeding US\$ 2 million are now granted automatic approval as long as certain

minimum requirements are met. Individual investors are permitted to invest overseas under the same conditions. Overseas investments of more than US\$ 2 million are allowed, subject to approval by the Bank of Korea. Debt/equity swap is an available option for overseas investment and the purchase of overseas real estate is permitted in overseas business activities.

The government has also allowed domestic securities companies to make overseas portfolio investments of up to US\$ 30 million for each company. Investment trust companies and insurance companies are able to invest up to US\$ 10 million per company.

### 3) Future direction

In the future, the Korean government will continue to liberalize the exchange management system.

In the short term, the remaining restrictions on invisible trade and overseas investment, etc. will be relaxed. In the long term, exchange management will be changed from a positive system to a negative system, and the price mechanism of the system will be enhanced.

## B. Capital market liberalization

In line with overall market opening policies, the government has pursued the liberalization of the capital markets since 1981. To date, considerable progress has been made in allowing indirect investment opportunities for foreign investors mainly through various foreign investment funds and the issuances of convertible bonds in overseas market.

In December 1988, the government announced a gradual expansion plan for capital market liberalization during 1989 - 1992. According to the plan, foreign investors will be allowed to invest directly in the domestic stock market within certain limits in 1992. Before that time, indirect investment opportunities for foreigners will be continuously expanded through the enlargement of foreign investment funds and additional issuances of overseas equity bonds.

## II. Annexes

- (Table 1) Key Economic Indicators in Korea.
- (Table 2) Debt Outstanding and Repayment.
- (Table 3) Per Capita GNP of Asian NICs (1987)
- (Table 4) Labor Cost
- (Table 5) Export Increase Rate in Light Industry
- (Table 6) Balance of Payments
- (Table 7) Exports by Commodity Group
- (Table 8) Imports by Commodity Group
- (Table 9) Exports by Country
- (Table 10) Imports by Country
- (Table 11) Index of Foreign Trade and Terms of Trade
- (Table 12) Export-Import Growth Rates
- (Table 13) Liberalization of Imports by Number
- (Table 14) Liberalization of Imports by Industry
- (Table 15) Products Liberalized in 1988
- (Table 16) Import Liberalization Schedule (by Number)
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- (Table 18) Tariff Rate Trends
- (Table 19) Average Tariff Rate Trends
- (Table 20) Tariff Structure.
- (Table 21) Tariff Distribution
- (Table 22) Tariff Quotas for 1988-1989.

(Table 1) Key Economic Indicators in Korea

	(%)		
	86	87	88
Gross domestic product	12.4	11.8	11.3
Agriculture, Forestry & Fishing	4.6	△6.8	9.0
Mining & manufacturing (Manufacturing)	18.1 (18.4)	17.7 (18.3)	12.7 (13.0)
Other industries	12.3	13.6	11.7
Gross national product	12.9	12.8	12.2
Total consumption (private consumption)	8.2 (7.8)	8.2 (8.4)	10.0 (9.6)
Total investment (Fixed capital formation)	12.1 (10.9)	15.1 (17.4)	13.0 (11.8)
Exports(FOB)*	14.6	36.2	28.4
Imports(CIF)*	1.4	29.9	26.3
Consumer Prices	2.8	3.0	7.1
Wages in manufacturing Industries	9.2	11.6	-
Unemployment rate** (Non-farm)	4.7	3.8	3.0
Money supply(M2)***	18.4	19.1	21.5
Exchange rate(W/US\$)***	861.4	792.3	684.1

\* Customs clearance basis    \*\* Period average    \*\*\* End of period

(Table 2) Debt Outstanding and Repayments

	Billions of US dollar			
	86	87	88	Mar. 89
External debt	44.5	35.6	31.2	31.2
Medium & long term	35.3	26.3	21.4	20.0
Short term	9.3	9.3	9.8	11.2
Repayments*	5.8	14.1	7.5	1.8

\* Includes principal repayments of medium and long term debt only.

(Table 3) Per Capita GNP of Asian NICs (1987)

Country	Per Capita GNP (US\$)
Taiwan	5,075
Hong kong	8,227
Singapore	7,464
Korea (Rep. of)	4,040(1988)

(Table 4) Labor Cost

(Manufacturing industry, '87.1~'88.6 cumulative; %)

	Korea	Japan	Taiwan
Rate of nominal wage increase (A)	31.5	4.5	20.2
Rate of labor productivity increase (B)	20.5	18.4	15.5
Rate of labor cost increase (A-B)	11.0	-13.9	4.8

(Table 5) Export Increase Rate in Light Industry

	87	88							89	
		during the year	1 Q	2 Q	3 Q	10	11	12	1	2
- overall	36.2	28.4	35.1	20.0	31.0	34.0	29.1	22.0	10.9	5.5
o textile	32.6	22.4	26.7	20.1	16.9	28.7	21.9	24.3	10.1	7.9
o footwear	33.6	24.8	52.6	38.2	20.8	11.5	-5.9	-4.7	-6.7	-15.3
o toys	48.1	-7.3	5.2	-13.3	-16.8	7.0	0.1	2.3	8.2	-0.3

Note: Customs clearance basis, changes over the same period of the previous year (%)

<Table 6>

## Balance of Payments

Millions of US dollar

	'86	'87	'88	1-3	'89.1-3
<b>I. Current Balance</b>	4.617	9.854	14.161	2.903	1.301
Trade Balance	4.206	7.659	11.445	2.258	1.048
Exports	33.913	46.244	59.648	12.960	14.006
(rate of change)	(28.3)	(36.4)	(29.0)	(38.3)	(8.1)
Imports	29.707	38.585	48.203	10.702	12.958
(rate of change)	(12.1)	(29.9)	(24.9)	(37.0)	(21.1)
Invisible (net)	Δ 628	977	1.267	163	115
Transfers (net)	1.039	1.218	1.448	482	138
<b>II. Long-term Capital</b>	Δ 1.982	Δ 5.836	Δ 2.733	78	Δ 1.861
Loans & Investments	2.978	3.307	2.799	774	694
Amortization	Δ 2.532	Δ 5.115	Δ 4.181	Δ 953	Δ 1.121
Borrowings of	Δ 749	Δ 3.729	Δ 1.271	Δ 385	Δ 482
Development Banks					
Others	Δ 1.679	Δ 298	Δ 80	642	Δ 952
<b>III. Basic Balance</b>	2.635	4.018	11.428	2.981	Δ 560
<b>IV. Short-term Capital</b>	Δ 392	Δ 7	1.336	555	Δ 147
<b>V. Errors &amp; Omissions</b>	Δ 544	1.191	Δ 589	189	907
<b>VI. Overall Balance</b>	1.670	5.202	12.175	3.725	200
<b>VII. Financial Account</b>	Δ 1.670	Δ 5.202	Δ 12.175	Δ 3.725	Δ 200
Liabilities	Δ 1.473	Δ 4.009	Δ 1.320	Δ 272	1.315
IMF Credit	Δ 126	Δ 1.223	Δ 492	Δ 48	-
Bank Loans	Δ 569	Δ 2.587	Δ 513	Δ 3	Δ 82
Refinance	Δ 1.837	Δ 1.271	Δ 380	Δ 198	34
Others	1.059	1.072	65	Δ 23	1.363
Assets	226	1.193	10.855	3.453	1.515
Change of Holdings	206	1.238	8.837	3.454	1.743
Others	20	Δ 44	2.018	Δ 1	Δ 229
<b>VIII. Foreign Exchange Holdings</b>	3.351	3.615	12.378	6.996	14.122

- Note :
- 1) Includes exports by deferred payments and long-term trade credits, etc.
  - 2) Includes short-term trade credits, exports on credit, and advance for exports, etc.
  - 3) Includes inter-office a/c of foreign bank branches, on-resident deposits, overdraft, etc.

<Table 7>

Exports by Commodity Group

Millions of US dollar

Commodity Group	'87		'88		1-3		'89.1-3	
	Amount	Increase rate (%)	Amount	Increase rate (%)	Amount	Increase rate (%)	Amount	Increase rate (%)
Foods & direct consumer goods	2.191	30.1	2.621	19.6	641	36.8	584	Δ8.8
Raw materials & fuels	1.522	26.9	1.402	Δ7.9	304	Δ5.4	404	32.9
Light industrial products	19.634	35.9	23.937	21.9	5.177	31.2	5.429	4.9
(Textile goods)	10.908	32.6	13.349	22.4	2.818	29.1	3.051	8.3
(Toys)	1.122	48.1	1.040	Δ7.3	211	0.5	206	Δ2.2
(footwear)	2.731	33.6	3.407	24.8	812	59.0	684	Δ15.8
Heavy & chemical products	23.934	37.7	32.736	36.8	6.750	42.0	7.653	13.4
(Iron & steel)	3.983	18.7	5.377	35.0	1.259	60.9	1.256	Δ0.2
(Machinery)	3.426	77.1	5.169	50.9	1.017	44.3	1.249	22.8
(Electronic products)	6.264	50.3	8.332	33.0	1.700	35.8	2.122	24.8
(Ships)	1.138	Δ37.3	1.760	54.7	130	Δ42.8	180	38.5
(Auto)	2.849	106.6	3.594	20.2	825	67.7	650	Δ21.2
Total	47.281	36.2	60.696	28.4	12.871	35.7	14.069	9.3

\* Customs clearance basis

(Table 8)

Imports by Commodity Group\*

Millions of US dollar

Commodity Group	87		88		89. 1~3	
	Amount	Increase rate(%)	Amount	Increase rate(%)	Amount	Increase rate(%)
Consumer goods	3,928	26.9	4,902	24.8	1,365	30.0
(Grains)	(1,001)	(9.3)	(1,374)	(37.3)	(403)	(42.4)
Raw materials & fuels	22,539	31.3	27,876	23.7	7,814	23.3
(Crude oil)	(3,702)	(10.6)	(3,688)	(Δ0.4)	(1,075)	(2.1)
Capital equipment goods	14,552	28.5	19,033	30.8	4,800	16.2
(Non-electric machinery)	(6,189)	(34.0)	(7,904)	(27.7)	(2,130)	(22.1)
( Electric & electronic)	(5,707)	(31.2)	(7,176)	(25.7)	(1,724)	(12.0)
(Transportation equipment)	(1,040)	(Δ10.1)	(1,845)	(77.4)	(382)	(8.5)
Total	41,020	29.9	51,811	26.3	13,979	21.4

\* Customs clearance basis

(Table 9)

Exports by Country\*

Millions of US dollars

	87		88		89. 1~3	
	Amount	Increase rate(%)	Amount	Increase rate(%)	Amount	Increase rate(%)
U. S. A.	18,311	31.9	21,404	16.9	4,512	1.0
Japan	8,437	55.4	12,004	42.3	3,074	17.8
Saudi Arabia	1,031	20.6	1,130	9.6	232	Δ14.1
W. Germany	2,002	61.2	2,368	18.3	485	Δ16.1
Hong Kong	2,204	30.3	3,561	61.6	857	24.9
U. K.	1,525	47.5	1,951	27.9	457	20.3
Indonesia	241	34.5	402	67.1	128	70.7
Netherlands	770	53.1	825	7.2	156	Δ29.1
Canada	1,451	16.3	1,692	16.6	459	20.2
France	880	61.9	1,070	21.6	236	Δ2.1
Others	10,429	28.5	14,289	37.0	3,473	17.3
Total	47,281	36.2	60,696	28.4	14,069	9.3

\* Customs clearance basis

(Table 10)

<u>Imports by Country *</u>						
Millions of US dollars						
	<u>87</u>		<u>88</u>		<u>89. 1~3</u>	
	Amount	Increase	Amount	Increase	Amount	Increase
	rate(%)		rate(%)		rate(%)	
Japan	13,657	25.6	15,929	16.6	4,126	14.0
U. S. A	8,758	33.8	12,757	45.7	3,310	25.4
Saudi Arabia	1,066	67.9	838	△21.4	291	26.0
Kuwait	160	△26.0	206	28.9	83	43.1
Australia	1,279	18.5	1,797	40.5	514	38.5
W. Germany	1,799	47.9	2,074	15.3	650	36.6
Indonesia	825	92.6	905	9.7	274	41.2
Malaysia	1,086	20.5	1,331	22.6	343	65.2
Canada	947	33.5	1,197	26.4	375	37.9
Taiwan	759	75.7	1,071	41.2	321	32.1
Others	10,684	24.9	13,706	28.3	3,692	19.4
<b>Total</b>	<b>41,020</b>	<b>29.9</b>	<b>51,811</b>	<b>26.3</b>	<b>13,979</b>	<b>21.4</b>

\* Customs clearance basis

(Table 11) Index of Foreign Trade and Terms of Trade\*

1985 = 100

	<u>Quantum Index</u>		<u>Unit Value Index,</u>		<u>Net. Barter</u> <u>Terms of</u> <u>Trade</u>	<u>Income</u> <u>Terms</u> <u>of Trade</u>
	Exports	Imports	Exports	Imports		
1980	55.2	64.6	104.7	110.9	94.4	52.1
1981	64.9	71.9	108.1	116.9	92.5	60.1
1982	69.2	72.0	104.4	108.2	96.5	66.7
1983	80.4	81.7	100.4	103.1	97.4	78.3
1984	93.0	94.3	103.9	104.4	99.5	92.5
1985	100.0	100.0	100.0	100.0	100.0	100.0
1986	112.2	108.1	102.1	93.8	108.8	122.2
1987	138.9	130.7	112.4	100.8	111.5	154.9
1988	156.9	149.4	127.7	111.4	114.6	179.9

\* Customs clearance basis

(Table 12) Export--Import Increase Rate

	88.1 Q	2 Q	3 Q	4 Q	1/89	2/89	3/89 <sup>P</sup>
Export	35.7	21.0	31.0	27.4	10.9	5.5	11.2
Import	40.7	20.9	26.5	20.8	18.9	17.6	26.7

(over the same period of previous year, %)

(Table 13) Liberalization of Imports by Number

	'84	'85	'86	'87	'88	'89.7
Total number of items (A)	7,915	7,915	7,915	7,915	10,241	10,241
Number of liberalized items (B)	6,712	6,945	7,245	7,408	9,694	9,778
Number of restricted items	1,203	970	670	503	547	463
Liberalization ratio (B/A)	84.8	87.7	91.5	93.6	94.7	95.5

\* Figure in CCCN 8 digit by '87, in HS 10 digit since '88

(Table 14) Liberalization of Imports by industry

	'84	'85	'86	'87	'88	'89.7
Total	84.8	87.7	91.5	93.6	94.7	95.5
Primary products, food and beverages	75.8	78.2	79.7	79.9	71.9	76.2
Chemical goods	95.0	95.7	97.9	99.0	100.0	100.0
Steel and metal products	92.8	95.6	99.2	99.5	100.0	100.0
Machinery	78.0	83.0	89.5	93.6	100.0	100.0
Electric & Electronics machinery	62.4	73.8	86.9	96.6	100.0	100.0
Textiles	90.3	93.1	96.1	97.5	99.4	99.4
Miscellaneous	82.1	82.8	85.3	88.3	95.0	96.0

\* Figures show Import Liberalization Ratio

\* Liberalization ratio for primary products dropped in '88 due to the adoption of HS

(Table 15) Products Liberalized in 1988

Commodity	No. of Items	Main Products
• Primary goods & groceries	46	quinces, fruit cocktail, vegetable juice, liver, avocados, meat extracts, apricots, chlorella, anchovies, mackerel, hempseed, etc.
• Chemicals	24	chemical wood pulp, paraxylenes, phenol, toluene, etc.
• Steel & metals	12	flat-rolled products of stainless steel, steel bars and rods, ball bearings, etc.
• Machinery	179	motor cars(1,000-2,000cc), vacuum pumps, engines, compressors, conveyors, grinders, excavators, machine tools, latches, milling machines, shearing machines, tool holders, vessels, cameras, etc.
• Electric & Electronics	20	automatic data processing machinery, printers, floppy disk drives, etc.
• Textiles	5	polyester fibres of special section face, polyester tow, etc.
• Miscellaneous	47	watches and movements, other thermostats, ivory, silversmith's wares, etc.
<b>Total</b>	<b>333</b>	



(Table 16)

Import Liberalization Schedule  
(by Number)

	Total	Restricted ( '89.5)	Import Liberalization Schedule			
			'89	'90	'91	to be determined
Total	10,241	547	84	90	99	274
Agricultural(total)	1,785	501	77	76	84	264
Agricultural	1,159	196	41	30	37	82
Livestock	298	109	10	14	10	81
Fishery	328	196	26	32	37	101
Non - Agricultural	8,456	46	7	14	15	10
Chemical, Steel, Metal, Machinery, Electric, Electronics	6,137	-	-	-	-	-
Textiles	1,346	8	-	1	1	6
Precious stones	113	20	5	7	8	-
Art works & Antiques	12	9	2	2	5	-
Miscellaneous	848	9	-	4	1	4

\* Figures show number of items in HS 10 digit.

(Table 17)

Import Liberalization Schedule  
(by Ratio)

	'89.5	'89.7	'90	'91
Total	94.7	95.5	96.4	97.3
Agricultural (total)	71.9	76.2	80.5	85.2
Agricultural	83.1	86.6	89.2	92.4
Livestock	63.4	66.8	71.5	74.9
Fishery	40.2	48.2	57.9	69.2
Non-Agricultural	99.5	99.5	99.7	99.9

\* Figures show Import Liberalization Ratio.

(Table 18)

Tariff Rate Trends

(Unit : %)

Yearly Trends	'88	'89	'90	91	'92	'93
<b>-Raw materials</b>						
○ Non-Competitive	5-10	1-2	1-2	1-2	1-2	1-2
○ Competitive	10	5	5	4	4	3
<b>-Processed inputs and finished products</b>						
○ Primary processed inputs	10-20	10	10	9	7	5
(Competitive items)		(5)	(5)	(5)	(5)	(5)
○ Other processed inputs and finished products	20	15	13	11	9	8
(Competitive items)		(10)	(10)	(10)	(9)	(8)
<b>-Consumer goods</b>	30-50	20	16	13	10	8
<b>-Agro-Fishery products</b>						
○ Raw farm products & not domestically produced items	10-30	5-10	5-10	4-9	4-7	3-5
○ Processed products	20-50	10-40	10-40	10-35	9-35	8-30
○ Other farm products (cash crops)	20-50	15-40 (20-50)	13-40 (20-50)	11-35 (20-50)	9-35 (20-50)	8-30 (20-50)
○ High tariff item (including liquor)	50-100	20-50	20-50	20-40	20-40	20-30

(Table 19)

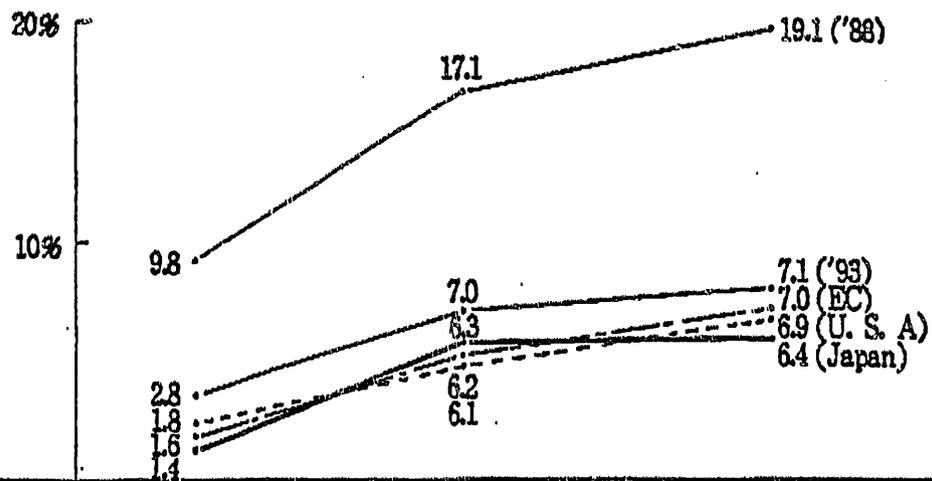
Average Tariff Rate Trends

(Unit : %)

Yearly Trends	'88	'89	'90	'91	'92	'93
○ Total	18.1	12.7	11.4	10.1	8.9	7.9
○ Manufactured products	16.9	11.2	9.7	8.4	7.1	6.2
○ Agro-Fishery products	25.2	20.6	19.9	18.5	17.8	16.6

(Table 20)

Tariff Structure



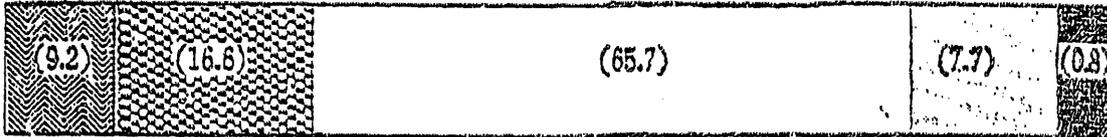
	Raw materials	Processed inputs	Finished products
KOREA ('88)	9.8	17.1	19.1
KOREA ('93)	2.8	7.0	7.1
* U.S.A ('87)	1.8	6.1	6.9
E C ('87)	1.6	6.2	7.0
JAPAN ('87)	1.4	6.3	6.4

\* Source : GATT Tariff Escalation Study

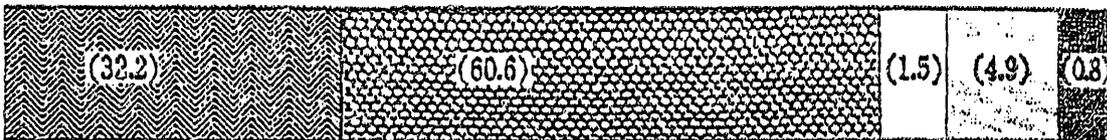
(Table 21)

Tariff Distribution

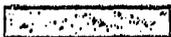
('88)



('93)



Remarks:

	0-5%		10-20%
	5-10%		20-50%
	Other		

(Table 22)

Tariff Quotas for 1988-1989

(by Number : HS 10 digit)

	'88	'89 (1Q)
Total	2,235	1,188
Consumer goods	676	974
Raw materials and intermediary goods	1,559	214