

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

Spec(84)66*
2 November 1984

Committee on Balance-of-Payments Restrictions

DRAFT

REPORT ON THE 1984 CONSULTATION WITH THE REPUBLIC OF KOREA

1. The Committee consulted with the Republic of Korea on 31 October 1984, in accordance with its terms of reference 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 Mr. J.N. Feij (Netherlands). 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	(BOP/246, Add.1 and Corr.1)
Secretariat Background Paper	(BOP/W/83 and Corr.1)
IMF Report "Korea - Recent Economic Developments", dated 23 May 1984	

* English only/ anglais seulement/ inglés solamente

Opening Statement by the representative of the Republic of Korea

3. In his opening statement, the representative of Korea reviewed recent economic developments, focusing on the external sector, and major adjustment policies pursued by his government since the last consultation in 1979. He elaborated on the present and future direction of liberalization policies covering tariffs, trade, investment, foreign exchange and the banking system, and assessed Korea's medium-term prospects in the light of the uncertain world trade and financial environment and in the context of the rôle of GATT in strengthening international co-operation. In 1980 the Korean economy had suffered a serious setback due to the second oil shock, subsequent worldwide recession and high international interest rates. In response to the decline in output, soaring inflation and deteriorating balance of payments, the government adopted strong adjustment policies including strict fiscal discipline, monetary restraint, flexible management of the exchange rate, greater reliance on the market mechanism, liberalization of trade and investment, and reform of the financial sector. In 1982, growth had been resumed. In response to the debt crisis in mid-1982, the government accelerated its adjustment efforts; by 1983, rapid growth reminiscent of the seventies was achieved, inflation almost eliminated and the current account deficit further reduced. The external debt position had also improved due to slower growth and longer maturity of the debt. In 1984, the government continued to implement its adjustment programme to consolidate the previous gains: real GNP grew at over 8 per cent in the first half and inflation was 3 per cent for the first three quarters. However, the current account deficit was larger than anticipated, partly reflecting higher international interest rates. The prospects for 1984 were for about 8 per cent growth, inflation below 3 per cent, and the current account deficit limited to under 2 per cent of GNP. Over the medium term, growth averaging 7.5 per cent per annum was to be targeted, inflation was expected to be low and the current account gap eliminated. Korea's balance of payments position had steadily improved during 1980-83, as domestic adjustment policies were complemented by favourable external developments. The current account was expected to be in deficit of about US\$1.4-1.5 billion in 1984, in balance by 1986 and to register a moderate surplus averaging 1 per cent of GNP in subsequent years.

4. Since 1980, the government had undertaken a series of liberalization measures designed to preserve the external competitiveness of Korean producers and improve domestic resource allocation. These covered imports, foreign investments, tariffs, foreign exchange, trade procedures and reform of the financial sector.

5. The import liberalization ratio rose from 67.6 per cent in 1979 to 84.8 per cent in 1984, and by 1986 was expected to approach the level prevailing in the advanced industrial countries; by 1988 virtually all restrictive measures on manufactured goods were scheduled to be removed. Since 1981, the Government had attempted to simplify trade procedures by abolishing the systems for end-user recognition, export-import link, and advance import deposits. The 1983 revision of the tariff system had resulted in lowering the simple average tariff rate for manufactured goods from 22.6 per cent in 1983 to 20.6 per cent in 1984; this was scheduled to be reduced further to 16.9 per cent by 1988. The revision of the exchange control system, also in 1983, broadened the foreign currency lending system, extended the maturity on swap transactions and simplified procedures for overseas investments.

6. The adoption early in 1984 of a negative list system for foreign direct investments had considerably simplified administrative procedures. In addition, for certain designated investments, up to 100 per cent foreign ownership was permitted. During 1980-84, the Government had taken several measures to liberalize the financial sector. In 1982, direct credit controls for each bank were replaced by indirect controls through rediscounts, reserve requirements and open market operations; guidelines and interest rates for preferential lending were also abolished and the Central Bank's rediscount rates unified. In 1983, the Government completed its divestiture of all nationwide commercial banks, granted them greater managerial autonomy, and in 1984 authorized them to undertake new activities to improve profitability and competitiveness. Restrictions on local branches of foreign banks were eased in 1984, with equal treatment vis-à-vis Korean banks to be fully implemented by 1986. The government intended to liberalize

interest rates over the medium term; toward this end, long-term deposit rates were raised and a wider band for lending rates was permitted in early 1984. The future, pace and extent of liberalization policies would be determined on a pragmatic basis to meet the development of the external and financial sectors and the challenges posed by the integration of Korea with the world economy.

7. Korea's export-led growth strategy had been dependent on the liberalization policies outlined above. The rapid growth of Korea's trade over the years had significantly benefited Korea and also its trading partners. However, intensified protectionism, high levels of international interest rates, and the fragile and uneven world economic recovery created great uncertainties regarding Korea's prospects for realizing its growth and external objectives. Korea's trade liberalization policies had been designed to promote trade in accordance with GATT free trade principles and to discourage protectionist measures against Korea's exports. He emphasized that access to export markets was crucial to the efforts of developing countries like Korea to achieve sustainable balance-of-payments positions and at the same time attain growth targets; his government supported GATT strongly and would work closely with it to strengthen international cooperation to keep an open world trading environment.

Statement by the representative of the International Monetary Fund

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

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

9. Members praised Korea's recent economic performance and the success it had achieved in improving both its current and trade accounts since 1980.

10. Several members noted the importance of the invisibles account for Korea's overall balance-of-payments position, and were interested in the current prospects in this area. One member asked what steps Korea was taking to arrest the fall in receipts from overseas construction due to the retrenchment of investment in the Middle East. He also noted that a substantial portion of Korea's external debt was short-term, and wondered whether Korea had any plans to try and increase domestic savings as the persistence of the debt might be attributed to a resource gap between investment and savings. Referring to Korea's revised Five-Year Development Plan, he remarked that its objective to narrow the current account deficit was based on two premises: the elimination of protectionism and a reduction in high international interest rates. In this context, he queried some of the assumptions on which the Plan was based, notably the 10 per cent interest rate based on LIBOR. He also asked how the revised figures for external debt, current account deficit and inflation rate had been arrived at.

11. The representative of Korea said that the medium-term prospects for the invisibles account were not very favourable because high international interest rates meant higher debt servicing burdens. He noted that his authorities were attempting to decrease the short-term credit component of Korea's debt profile: the percentage of short-term credits in relation to total foreign debt had declined from 34 per cent in 1980 to 28 per cent in September 1984, and was expected to decline further. He noted that high priority was being given to increasing domestic savings, with stabilization of the economy as a primary means of achieving this. He felt that the present favourable economic situation of the economy was conducive to this end, particularly with the expected rise in household incomes. He acknowledged that reduced inflows from the construction sector had a negative impact on the invisibles account, but that construction companies were endeavouring to overcome the difficulties due to the slowdown in Middle East markets by improving their own financial structures, and by trying to develop more sophisticated projects.

12. The original projection in Korea's Five-Year Development Plan of a total outstanding debt of US\$ 64 billion at the end of the plan period had been based on the oil prices prevailing in 1979-1980. At that time, oil prices were expected to increase annually by ten per cent while commodity prices were expected to increase by eight per cent. When the Plan was revised in 1982-83, the changed situation regarding oil prices had led to a lower estimate of outstanding debt, now projected to reach US\$ 47 billion by 1986. The ten per cent interest rate figure was based on prevailing international interest rates when the Plan was drafted.

13. Some members sought more information on the social impact of adjustment policies. In this connection, noting that real wages in 1983 had offset to a certain degree the reductions made in 1981, they asked how wages had moved in the more recent period. They also noted that the International Monetary Fund report had attributed Korea's decline in unemployment to a change in the labour market participation ratio due to an increase in the number of students continuing education, and wondered to what extent unemployment might again increase in the future once this effect had worked itself out. More generally, they asked what were the basic policy orientations being followed by Korea to reach its stated economic and balance-of-payments objectives.

14. Regarding the social impact of adjustment programmes, the representative of Korea acknowledged that this was not an easy question especially given the need for public consensus. He noted that there had been general acceptance by the Korean people of the need for effective measures to correct the structural problems of the late 1970's and that the 1979 stabilization programme had been generally accepted by the population. Though real wages had been allowed to increase by 9 per cent in 1983, his government emphasised the importance of stabilizing wages consistently with the evolution of relevant economic aggregates. As to declining labour market participation ratios, while he did not have complete figures, his evidence showed that the participation rate had declined due to a higher number of young women staying on at school and higher education institutions. Concerning internal policy measures to achieve external goals, his government was using macroeconomic stabilization policies as a primary means to encourage competition and increase productivity.

15. While welcoming Korea's liberalization actions since its last consultation in 1979, one member hoped that present plans for liberalization could be accelerated. In this context he drew attention to the fact that Korea expected its current account to be in balance by 1986, while the target date for its import liberalization programme was 1988. He also hoped that Korea would reduce the use of "emergency" and "adjustment" tariffs.

16. The representative of Korea noted that 1986 was a projection, while 1988 was a target date. The projected date for achieving current account balance had been set in the Five-Year Development Plan, while the trade liberalization plan was a more recent policy decision. He emphasized the need to proceed with caution in this area, but noted that in any case, by 1986 the import liberalization ratio would exceed 90 per cent.

System, methods and effects of restrictive import measures

17. A number of participants expressed satisfaction at the steps that Korea had taken since the last full consultation to liberalize import licences and to reform the tariff structure. One member also noted that Korea had initiated a significant liberalization of its foreign investment laws and encouraged the Korean authorities to continue this process. However, several questions were posed regarding the application of these liberalization measures and concerning the various safeguard or emergency provisions available under Korean trade legislation.

18. It was noted that the degree of trade liberalization varied considerably according to sector and that a high degree of protection remained in some areas where Korean industry was highly competitive, such as footwear and clothing. A question was asked about the volume of trade in products subject to import liberalization.

19. With reference to tariffs, information was sought on the weighted average of tariff rates applied by Korea. A number of specific questions were also posed regarding the application of differential or higher tariff levels and the limited degree of import liberalization for specific products,

particularly in the agricultural and natural resource sectors, (including bananas, certain oilseeds, processed foodstuffs, wood and wood products including temperate/tropical logs, iron ore, copper and coal), and the prospects of liberalizing restrictions on these products.

20. Questions were asked about the operation and justification in GATT terms of the flexible "emergency" and "adjustment" tariff systems. It was noted that the ability of Korea to increase tariffs on an ad hoc basis under these provisions, which could apply to a significant number of items, led to a degree of uncertainty and lack of clarity in the tariff régime and could undercut the liberalization process underway in the area of import licensing.

21. It was noted that various aspects of Korea's trade licensing, import regulation, certification and approval systems led to excessive complexity and uncertainty and could act as serious product-specific obstacles to trade in certain cases. In particular, the requirements for establishment of trading companies, the need for approval by particular ministries and trade associations of imports of restricted products and the need for regulations to be announced separately by different ministries or bodies in certain cases could create considerable inhibitions for imports. The operation of special laws in such areas as food management and pharmaceuticals could act as a further impediment to trade. The surveillance system under which import surges on liberalized products were closely monitored was an additional source of uncertainty for traders. Some members, referring to the remarks made in the Korean basic document (BOP/246) on simplification of trade procedures, asked if the Korean delegation could provide concrete examples of the work of the Committee on Simplification of Trade Procedures. Another member asked for clarification on the procedures for export-import recommendations on restricted items.

22. A question was also raised regarding the operation of the foreign exchange allocation system as mentioned in paragraph 5 of the secretariat background paper (BOP/W/83). It appeared that even in the case of liberalized goods, importers were sometimes unable to obtain the necessary

foreign exchange. In this context, it was also suggested that controls on important aspects of foreign capital inflows and trade credit procedures enabled Korea to discourage imports.

23. As a general comment, a number of delegations expressed the view that, while the efforts made by Korea to liberalize its trading system were laudable, and recognizing that open markets were particularly important for Korea, Korea's importance as a trading partner and as rapidly developing country should be reflected in its participation in the international trade liberalization process, including, inter alia, adherence to MTN agreements. Strong participation by Korea in trade liberalization could assist in defusing protectionist pressures in major markets.

24. In reply to these questions, the representative of Korea said that the Korean market was being opened steadily to imports of competing products. In respect of clothing and footwear, he noted that all footwear and most clothing, except ladies' silk garments and wool items, were already liberalized. The remaining items would be liberalized in 1985 and 1986. It was estimated that import liberalization now covered slightly less than 80 per cent of the value of imports, as against 84.8 per cent of tariff lines.

25. The question of trade liberalization on agricultural and processed food products touched on problems of agricultural and food policy which were common to most countries. Korea was still at the beginning of its trade liberalization process and further opening could be expected. Korea was a producer of temperate zone timber and had thus given favourable tariff treatment to tropical timber which it did not produce. He noted that the average tariff rate for the wood industry would decrease from 22.8 per cent to 14.7 per cent by 1988. Similarly, tariffs on manufactured goods would be reduced to 20 per cent on average in 1986, and further to 16.9 per cent in 1988. He agreed that this was still high, compared to some developed countries; if further reductions were feasible they would be considered. A tariff on copper, iron ore and coal had been introduced to help to enlarge the tariff base and create a more equitable system: the rate applied in practice was 1 per cent compared with a maximum rate of 5 per cent.

26. The operation of the flexible "emergency" or "adjustment" tariff systems could be compared with safeguard actions under Article XIX of GATT. Such tariffs were aimed at protecting domestic industry from surges of imports. They were essential safeguard provisions without which such liberalization would be narrower in scope. Emergency and adjustment tariffs were not imposed on the 214 items included in Korea's GATT tariff schedule and thus these measures were considered to be legitimate in the context of the GATT. Adjustment tariffs differed from emergency tariffs in that they could be imposed only on products, imports of which had been liberalized, and for an initial period of six months, which could be rolled over up to a maximum of three years from the date of liberalization. The representative of Korea emphasized that adjustment to trade liberalization and tariff reduction was necessarily a process which could only take place over time; the advance notice given by the government was intended to assist in the adjustment process. No data were available on the weighted average of import tariffs. It was generally recognized that unweighted averages would provide a better measure for international comparisons.

27. The representative of Korea stated that the purpose of the criteria for qualification of traders under the Trade Business Licence System was to ensure that those engaging in trading activities had adequate capital and business capability. These criteria were under review with a view to their alleviation. For import of restricted items, criteria for import recommendations were established by business organizations, after consultation with the Ministry of Trade and Industry, taking into consideration the domestic demand and supply situations, the possibilities for domestic production and such factors as quality, price, delivery, etc. Generally, recommendation for import was made when adequate domestic products were not available. Domestic manufacturers could be consulted when the possibilities of domestic production could not be easily judged; he felt that such cases were rare.

28. In relation to special laws regarding food products, pharmaceuticals etc., he noted that such laws, which could be justified under GATT Articles XX or XXI, applied equally to domestic products.

29. The import surveillance system, which had been in effect since 1979, was aimed at analysing the effect on domestic industry of imports of newly liberalized but sensitive items. The number of products subject to such surveillance had declined markedly in recent years from 283 before July 1983 to 127 items since July 1984, out of a total of 6,712 automatic-approval tariff lines.

30. In relation to the annual export - import notice system, he noted that imports of raw materials for export, goods for Government use, research and experimental devices, products for the use of physically handicapped people and security equipment for mines could be imported even where items were on the restricted list.

31. The representative of Korea drew attention to steps taken to simplify import procedures, including abolition of the end-user recognition system, the import-export link and the import deposit. The Committee on Simplification of Trade Procedures had been established in 1983 as a permanent committee to seek further simplification of trade procedures.

32. The Foreign Exchange Demand and Supply Plan related only to capital flows and was not used as a means of controlling imports. No foreign exchange allocation system was in force. Moreover, trade credit periods had recently been shortened from 180 to 90 days, with a view to discouraging imports as well as reducing short-term debt.

External factors

33. In discussing the analysis of factors affecting Korean exports presented by the Korean authorities in BOP/246/Add.1, a number of members complimented the Korean authorities on the quality of the information provided and the analysis undertaken. Some members recalled, however, that the basic rôle of the Committee remained the examination of measures taken for balance-of-payments purposes by a consulting country. Certain members regretted that, because of the short time available for study of this document, they were not in a position to comment on it.

34. Some members felt that some of the statements made in the paper overdramatized the situation in respect to the growth of protectionism and stressed that the maintenance of restrictive trade measures by a consulting country had to be justified in terms of its balance-of-payments situation. They also queried the basis for certain data presented; as an example, in the section on textiles, it was not clear whether data on export growth were given in current value terms: if in value, then changing currency parities would affect the true figures. However, the suggestions made in the concluding section contained many elements with which any GATT contracting party could generally agree. Structural adjustment was certainly necessary; however, many of the protective measures described in the paper were largely due to the problems faced by many developed countries in achieving such adjustment in a socially and politically acceptable manner. Nor could it be said that whole industrial sectors should be abandoned by developed countries; the situation was in reality much more complex. Easier access to markets for developing countries' exports was a shared objective, but contracting parties could not be expected to renounce rights under GATT in the framework of a "standstill" commitment: the need was rather to ensure that GATT rules were fully respected by all parties and that a dynamic process was begun leading toward a more equitable balance of rights and obligations. As regards participation in a new GATT round of multilateral trade negotiations, the position of Korea was noted with interest, but much more preparation and multilateral consultation was needed before a decision to start a new round could be taken. In any case, an agenda for such a round would necessarily have to cover other items in addition to those suggested by Korea. On the whole, those members shared many of the concerns expressed by Korea concerning protectionism, although in a more nuanced manner and with a number of reservations, both regarding the methodology utilized and some of the conclusions drawn.

35. One member gave his view that the study presented by Korea was an example of how other consulting countries might approach the question of external factors affecting the balance of payments, and this example might also be followed by the secretariat in its future background papers for consultations. He called particular attention to the proposal relating to a standstill on new protective measures. He recalled that the Committee had a

duty to fulfil in examining the trading environment facing consulting countries, as noted in paragraph 7 of the Chairman's statement to the GATT Council in March 1984 (C/125). Paragraph 12 of the same statement outlined how the Committee ought to proceed. Trade liberalization had been recognized as an important element in alleviating balance-of-payments problems of consulting countries and the Committee had a clear rôle to play in this regard.

36. Another member agreed that the subject of external factors should be examined in the Committee. He expressed reservations about the use of economic models to assess the general impact of protective measures on the volume of trade: the assumptions underlying any model could affect the results. While the Korean study was very useful as a methodology for analysing the particular problems faced by Korea, care should be taken in extending it to other cases. He also welcomed the Korean suggestions for an agenda for future negotiations. Structural adjustment was a generalized long term problem of interest to all countries. Other points made in the Korean study were also of importance. In relation to some of the particular difficulties identified by Korea he noted that there were several problems of definition which deserved to be carefully examined. He further noted, for example that many so-called administrative barriers reflected perceived differences between legitimate interests and that much work had already been done to eliminate sources of friction in this area.

37. The Korean representative stated that the objective of their paper was not to expose the trade measures taken by any specific country; rather, to illustrate the importance of the effect of protectionism on the balance of payments of one country through the use of a simple, static model. Many other elements affected the balance of payments, but the effect of protective measures in this case was found to be greater than had been first thought. The report was to be regarded as supporting documentation presented to the Committee which might provide a basis for further examination of the question of external factors in the conduct of future consultations. In reply to the question on data relating to textiles and clothing, he stated that these were based on nominal prices unless specifically stated otherwise. In relation to

the idea of a new round, he stated that if a new round was to arrest protectionist trends it could be supported by Korea. Priority should be given to this end in determining the agenda.

38. Certain delegations expressed strong reservations concerning the IMF statement that Korean exports to developing countries had been subjected to protectionist measures, particularly counterpurchase agreements. No evidence had been presented to support this statement. In addition, identification of counterpurchase agreements as such as being protectionist measures, and as being particularly applied by developing countries, was in their view unjustified.

Conclusions

39. The Committee welcomed the recovery in the Korean economy which had taken place in the last few years as a result of the application of sound domestic policies, in particular the marked reduction of inflation, the relatively high rate of growth and a substantial reduction in the balance-of-payments deficit. The Committee appreciated Korea's efforts, as part of its overall economic policy, to introduce a progressive liberalization of import licensing, a reform of the tariff structure, a reduction of other non-tariff restrictions and a revision of import procedures. The Committee urged Korea to pursue its liberalization programme as vigorously and rapidly as possible and expressed the hope that the rapid improvement in the balance of payments would soon obviate the need for trade-restrictive measures.

40. At the same time, the Committee expected that Korea would continue the further simplification of import procedures as well as the reduction in the number of different measures applying simultaneously, thus bringing greater certainty and predictability in Korea's import régime both in the tariff and non-tariff fields and permitting trade liberalization to have its full effect.

41. The Committee noted the concerns expressed by Korea regarding protectionism, and welcomed the special study on the effects of protectionism presented by Korea as a useful contribution to the discussion of external factors affecting a consulting country's trade. Although there had not been sufficient time for a full analysis of the study and several members had expressed reservations on various aspects of it, a number of the suggestions contained in the study deserved careful consideration.