SUMMARY

1. Since the Republic of Korea's previous Trade Policy Review in 2016, relatively strong economic fundamentals and solid buffers to external shocks have helped the country maintain macroeconomic stability and ensure the resilience of its export-led economy. Korea was able to weather the COVID-19 pandemic comparatively well, supported by a comprehensive set of fiscal, monetary, financial, and other measures. During the review period, Korea's annual GDP growth peaked at 3.2% (2017) and progressively declined to -0.9% (2020) due to the COVID-19 outbreak, a considerably milder contraction than in most other advanced economies. Annual average GDP growth rate for 2016-20 stood at 2.1%, a further decline compared to previous performances (averaging 2.8% in 2012-15 and 4.4% over 2001-11). Developments in Korea's position among the most competitive economies in the world involved variable labour and total factor productivity (TFP) growth, but also weaknesses in areas where some reforms have been under way. Whereas headline inflation remained below target and dropped progressively to 0.5% (about a fourth of its 2017 peak level) in 2020, the unemployment rate rose slightly (4%) in 2020, reflecting weak private job creation and the impact of the pandemic.

2. During the review period, trade and trade-related structural reforms (e.g. in taxation, competition policy, corporate governance, and the labour market) were undertaken. Reforms were, *inter alia,* focused on supporting income, creating jobs, assisting small and medium-sized enterprises (SMEs) and start-ups, and promoting productivity-boosting innovation, as well as strengthening social safety nets and substantially raising the minimum wage. Since June 2016, the Bank of Korea has progressively cut its policy rate five times from 1.25% to a record-low 0.5% (May 2020). The responsiveness of the floating exchange rate system to economic developments continued reducing external imbalances to levels consistent with Korea's fundamentals. The nominal exchange rate depreciated (2019 and 2020) after a slight appreciation (2016-18) whereas, overall, the effective exchange rate appreciated (except for 2018 and 2019), thus affecting Korea's international competitiveness. Imbalances in the economy – particularly weak domestic demand – led to irregular large current account surpluses below their 2016 level, averaging 4.8% of GDP during 2016-20 compared to 6% over 2012-15. Foreign exchange reserves increased steadily due to continuously increasing returns from the management of reserve assets. Gross external debt increased considerably, by 42.6%, during the period 2016-20 amid, *inter alia,* financial market volatility due to the COVID-19 pandemic and a rise in foreign investment in Korean treasury bonds, compared to a 3.6% rise in 2012-14, followed by a 6.4% drop in 2015.

3. Korea's openness to international trade and its integration into the world economy continued to be reflected by the high ratio of its trade (exports plus imports) in goods and services to GDP, which stood at 69.2% in 2020, though lower than in 2016. International trade and foreign direct investment (FDI) trends reflect the continued importance of Asia-Pacific as Korea's main regional market and FDI supplier. China, the United States, the European Union, and Japan remain its major individual trading partners; furthermore, trade under free trade agreements (FTAs) and regional trade agreements (RTAs) continued to steadily rise during the review period. The FDI regime went through significant changes during the review period with: (i) tax incentives in the form of local tax and import tariff reductions/exemptions and discontinuation of the granting of new corporation tax relief to foreign invested enterprises as from 2019; (ii) the elimination of foreign investment restrictions on fishing and support air transport activities; and (iii) the main legislation, the Foreign Investment Promotion Act, amended in 2020, now allowing for incentives to be granted for the reinvestment of unused retained earnings. Nonetheless, FDI stock levels remain low compared with those in other OECD countries.

4. Since its previous TPR, Korea has continued to promote a free and open economy based on market principles. As an important step in supporting the development of SMEs, in 2017 the Small and Medium Business Administration was reorganized and expanded into the Ministry of SMEs and Startups. Korea continued its efforts to improve transparency in public administration by following e-government strategies and by implementing participatory budgeting at the national level. Under the Five-year Plan for the Administration of State Affairs, launched in 2017, job creation is considered as the top economic policy priority. In 2019, a vision for an innovative and inclusive nation was announced. Regulatory reforms were conducted to reduce trade and investment barriers by applying regulatory sandboxes, designating regulatory-free special zones, and following the "cost-in, cost-out" approach when introducing new regulations.

5. Korea continued to participate actively in the WTO. In October 2019, Korea committed to not seek special and differential treatment for developing countries in ongoing and future negotiations. During the review period, Korea was involved in seven WTO disputes – four as a complainant and three as a respondent. Korea continued to pursue market opening opportunities through RTAs. Also during the review period, it signed the Regional Comprehensive Economic Partnership (RCEP) Agreement, as well as RTAs with five Central American countries (in force as from 1 March 2021), the United Kingdom (in force as from 1 January 2021), Israel, and Indonesia. These added to the extensive list of its existing RTAs with both large economic blocs and newly emerging markets (ASEAN, Asia-Pacific Trade Agreement (APTA), Australia, Canada, Chile, China, Colombia, the European Free Trade Association (EFTA), the European Union, India, New Zealand, Peru, Singapore, Turkey, the United States, and Viet Nam). Agriculture remains partially covered, and rice excluded, from all RTAs.

6. Since its previous TPR, Korea has maintained its general trade policy thrust, which has remained relatively unchanged though particular emphasis was placed on SMEs and innovation. While no unilateral liberalization has been undertaken, there have been regulatory or institutional developments in certain areas, including trade facilitation, anti-dumping, export control of strategic goods, enterprises in repatriation/re-shoring, standards, sanitary and phytosanitary (SPS) requirements, government procurement, competition policy, and intellectual property rights. COVID-19 circumstances led to the implementation of temporary trade-related measures in certain areas. Some measures continue to protect domestic producers, especially farmers, from foreign competition.

7. The tariff remains one of Korea's main trade policy instruments, and a relatively significant, albeit declining, source of tax revenue. The 2021 customs tariff remains transparent but is relatively complex, involving a multiplicity of rates (88 *ad valorem* duties, and 41 alternate duties) often with small rate differences and some involving decimal points. As a result of changes relating to the implementation of the expansion of the Information Technology Agreement and changes in the tariff nomenclature (from HS12 to HS17), the average applied MFN tariff rate dropped slightly from 14.1% in 2016 to 13.9% in 2021. This remains high by OECD country standards, thereby requiring tariff concessions or drawbacks to ensure that tariffs on intermediate inputs do not become taxes on exports, adding to the complexity of border taxation. Peak *ad valorem* rates also remained unchanged and concentrated in agricultural items (WTO definition); applied MFN tariff rates ranged from zero to 887.4% (for manioc). As in 2016, 84.9% of rates remain at 10% or below in 2021 (85.2% in 2016). Tariff rate quotas (TRQs) remain in place under Korea's multilateral agricultural market access commitments, with in-quota rates ranging from zero to 50% (2021), compared with out-of-quota rates of up to 887.4%, and with a decreasing average fill rate of 58% (2020). Other measures (e.g. "autonomous" tariff quotas, usage tariffs, and duty concessions) selectively reduce tariffs on inputs. Bound rates cover 90.7% of Korea's tariff lines, a slight increase due to the nomenclature change; 99.7% of agricultural lines (excluding seaweeds and bait for fishing) and 89.2% of non-agricultural lines (WTO definitions) are covered by tariff bindings. The gap of 4.2 percentage points between the average bound and applied MFN tariff rates imparts a degree of unpredictability to the tariff regime and provides scope for the authorities to raise applied rates within the bindings. Korea has continued to use this gap to apply higher MFN duties (e.g. adjustment duties) termed "flexible tariffs", which the authorities maintain are within WTO bindings; product coverage under flexible tariffs (including seasonal and adjustment duties) increased from 145 (at the 6-digit HS level) in 2016 to 184 in 2021.

8. Korea's customs clearance performance remains appreciated at the international level and is considered as the cutting edge of best practice. During the review period, its trade facilitation developments included the full implementation of WTO Trade Facilitation Agreement (TFA) commitments and transparency notifications, the extension of e-clearance examination to all goods imported by authorized economic operators, and the exploration of blockchain technologies. Wide-ranging trade-facilitating initiatives were undertaken to stop the spread of the COVID-19 pandemic and mitigate its damage, including the speeding up of customs clearance, tax relief measures, and the operation of Customs Clearance Support Centers. Regarding customs valuation, Customs introduced services to protect taxpayers' rights to assist them on matters not resolved by tax appeals, and reinforced cooperative schemes on action against tax evasion, encouraging enterprises to be voluntarily tax compliant. RTA/FTA action to help companies, including SMEs, utilize trade preferences subject to diverse and complicated rules of origin was continued.

9. During the review period, rice imports remained tariffied, and the process of modification and rectification of its Schedule of Concessions, now incorporating the relevant TRQ rates (5% in-quota, 513% out of quota), was completed. Import licensing requirements cover numerous tariff items, and prohibitions are maintained mostly for the protection of public morals, human health, hygiene and sanitation, animal and plant life, environmental conservation, or essential security interests in compliance with domestic legislation requirements or international commitments. During the review period, recourse to anti-dumping initiation action remained relatively stable, but there has been an increase in the number of definitive measures in place. Korea continued to use anti-dumping provisions, mainly against imports of chemicals, plastics, paper, plywood, and stainless steel originating mostly in Asia. Price-based special safeguard provisions (SSGs) under the WTO Agreement on Agriculture were used on ginseng root and powder, as well as products of red ginseng and wild cultivated ginseng.

10. Korea continued to maintain the option to restrict or monitor certain exports to ensure adequate domestic supplies, thereby possibly assisting downstream processing of these products. In response to domestic needs related to the COVID-19 pandemic, Korea introduced a temporary export ban (entirely lifted on 23 October 2020) on surgical and sanitary masks, filtering respirators, and melt blown filters involving domestic supply-linked quantitative restrictions depending on the item. During the review period, no quantitative export restrictions for rice or any other agricultural products were in place. Direct export subsidies were kept in order to reduce marketing costs for certain agricultural products and are to be eliminated by 2023. A drawback scheme continues to provide refunds of border taxes on raw materials used in exports. Internal indirect taxes are reimbursed on exports; no new corporation tax relief to foreign enterprises located in free trade zones has been granted since 2019. Exports continue to benefit from government finance, insurance, and guarantees, as well as the promotional activities provided by state-owned institutions.

11. Measures involving grants, tax concessions, and low-interest loans continued to support production and trade of various agricultural, forestry, fishing, coal mining, renewable energy, the Fourth Industrial Revolution, and manufacturing industries, and to encourage SMEs, innovation, research and development, and environmental protection activities. Although tax incentives were to terminate automatically in accordance with sunset clauses, many were extended. SMEs remain among the major beneficiaries of these measures; there has been persisting emphasis on them, including through more favourable incentives in virtually all policy areas (e.g. customs clearance, rules of origin, export promotion, export finance/insurance, taxation, financing, SPS, and public procurement), as well as the COVID-19 response involving direct and indirect tax reductions for certain taxpayer categories. Furthermore, the 2020 Korean New Deal initiative is to pursue job creation and enhancement of competitiveness of the manufacturing sector by increasing public investment in digital and green energy infrastructure. Agriculture continued to receive substantial financial support. Government support of FDI through the operation of foreign investment zones, export-oriented free trade zones, and free economic zones remains. Tax and non-tax benefits for repatriating Korean companies expanded to cover information technology services and information and communications firms; compensation or adjustment support for farmers and manufacturers adversely affected by a bilateral free trade agreement remains in place.

12. During the review period, regulatory and other initiatives were undertaken to, *inter alia*, improve food and drug safety and align domestic standards to international standards. The number of Korean industrial standards slightly increased over the review period, but the actual share of those adopted in mandatory technical regulations is unknown; the share of those harmonized with international standards remains virtually unchanged. Control over imported safety food hazards was reinforced by making Hazard Analysis of Critical Control Point (HACCP) certification mandatory, as well as expanding its coverage and unifying the certification process. As at 2019, Korea fully implemented its "positive list" system (PLS) to all pesticides in agricultural products except for those with domestically set maximum residue limits. A Rapid Clearance System for Planned Import for reliable business operators with a long-time record of safe food imports was introduced in 2019.

13. State involvement in, *inter alia*, agriculture, mining, energy, finance, and transport persists. No major privatization efforts were pursued during the review period, and at the same time, the level of government shareholding at several entities rose for different reasons. The Ministry of Agriculture, Food and Rural Affairs (MAFRA) remains the sole entity responsible for imports of all rice within the tariff quota, and the state-owned Korea Agro-Fisheries and Food Trade Corporation is responsible for some other agricultural items; their operations allowed for important price mark-ups or mark-downs depending on the product. Changes were made to the main government

procurement legislation in areas including contracting, qualification, and conciliation; the small share of foreign supplies remained relatively stable during the review period. Despite the non-utilization of price preference schemes, government procurement is still seemingly used as a policy tool for promoting SMEs, companies in a disadvantageous position (firms owned by women or people with disabilities), regional development, and green purchasing. Most procurement remains decentralized.

14. During the review period, several legislative amendments were undertaken in competition policy necessary for the realization of a fair economy and the promotion of innovation and competition in the age of the Fourth Industrial Revolution, including the complete revision of the Monopoly Regulation and Fair Trade Act. A prohibition on new cross-shareholdings (i.e. circular-shareholding after 2014) between subsidiaries under large business groups, many of which are family controlled (chaebols), led to their reduction, but its impact on preventing market concentration remains unknown. Large corporations and SMEs continued to be encouraged to voluntarily sign agreements on fair trade and shared growth. Price controls remain in place in specific areas. Consumer protection was reinforced by strengthening transparency and law enforcement with respect to products and areas that closely affect consumers, such as daily necessities and e-commerce.

15. Korea's intellectual property rights regime continued to evolve rapidly in response to technology developments and to pursue public policy objectives. Legislation was strengthened, including in the area of penalties, to better protect right holders in several areas; in response to COVID-19 challenges, the deadlines applicable under certain industrial property legislation were extended, and measures were announced to combat a rapidly increasing online distribution of counterfeit products.

16. Agriculture accounts for a small share in GDP (2% in 2020), and 5.4% of total employment. Korea is a land-scarce country with a high population density, and it is a net food importer. The Government uses a wide range of policy tools, both at the border and domestically, to facilitate the country's development and to improve the welfare of rural residents. Policy objectives also include self-sufficiency in food and staples, and targets for rice, barley, grains, livestock products, and forage were maintained. At the border, peak tariffs and the much higher average applied MFN tariff protection for agricultural goods than for non-agricultural goods persist. SSGs affected certain imports of ginseng products. Export approval is required for ginseng seeds and animals. Export subsidies continued to be provided. Domestic support to agricultural production and trade measures continued to make Korean consumers pay much higher prices than the world levels. Tax and non-policy tools including in the form of low or no irrigation water fees, as well as cross-subsidized electricity tariffs, remain in place. Foreign investment in rice growing is prohibited. Eco-friendly agriculture and aquaculture production is encouraged by providing direct payments to certified farms, and by increasing the share of smart fish farm supplies.

17. Korea's fisheries output is increasingly led by aquaculture production in shallow sea areas, whereas fisheries resources in distant and adjacent waters continue to deplete. FDI restrictions on fisheries were removed in 2016, while border protection mainly takes the form of tariffs and adjustment tariffs. The Government continues to fight against illegal, unreported, and unregulated (IUU) fishing, and provides domestic support for vessel decommissioning and fisheries resources management. It also continues to promote the development of sustainable fisheries and aquaculture production.

18. Mining accounts for a tiny share of GDP, and Korea, an energy-intensive country, relies heavily on imported energy, particularly fossil fuels. This high reliance has focused Korea's energy policy on the security of supply. Recently, the Government committed to advance energy transition by increasing the share of renewable electricity to 20% by 2030, and to 30%-35% by 2040, and to gradually phase out coal and nuclear from the energy mix. To reach these targets, the Government lowered the consumption tax and import surcharge on liquified natural gas while raising the tax on coal, and enhanced decarbonization across all energy sectors in line with its Green New Deal. Various measures including financial and technical support and tax credits continue to be applied in support of the sector. Foreign investment in electricity transmission and distribution faces an equity limit of 50%, and the largest shareholder must be Korean. State-owned companies continue to play a major role in the energy sector, and prices are often regulated (coal and electricity).

19. Manufacturing is an important and export-oriented activity (27.2% of GDP in 2020, 91.4% of total merchandise exports in 2020). Korea is one of the main hubs in international manufacturing

production network. The sector remains dominated by large conglomerates, while the labour productivity gap between large firms and SMEs is large. Border measures are confined to tariffs, adjustment duties, and autonomous TRQs, whereas several tax and non-tax incentives continue to be used to pursue policy objectives. Foreign investment in manufacturing in general is allowed. Sector-specific measures include those to promote the purchase of eco-friendly vehicles and the use of information and communication technology (ICT), and to meet environmental requirements set by international organizations in the shipbuilding industry. In line with the Korean New Deal, ICT's role as an important policy tool to facilitate the development of various sectors, and to meet environmental protection targets has been emphasized. Consequently, public investment in, *inter alia*, smart agriculture, smart fish farms, digital and green energy infrastructure, and intelligent transport systems increased.

20. The contribution of services to GDP rose slightly during the review period, from 60.5% in 2016 to 62.3% in 2020. Labour productivity, particularly of traditional services (such as wholesale and retail, and transport and accommodation), is lower than that of manufacturing. Korea has made commitments beyond GATS in the context of some of its RTAs. The Government plans to increase subsidies to some services activities (such as transport and tourism). Subsidies have also been allocated to various services sectors to mitigate the impact of the COVID-19 pandemic.

21. The financial services sector maintained its robust growth during the review period, and with government support it managed to weather the challenges posed by the COVID-19 pandemic. Several pieces of legislation were revised to deregulate certain financial services, including those on online investment-linked financing, supervision of electronic financial transactions, data privacy for financial institutions and financial technology (fintech) operators, financial consumer protection, and cybersecurity. Foreign banks operate through locally incorporated subsidiaries, branches, and representative offices, while no foreign equity restrictions exist for insurance companies.

22. Korea ranks high internationally in information and communications services. In 2020, fixed broadband was designated as a universal service. The telecommunications sector remains relatively concentrated with three companies dominating the fixed-line sector, and three dominating the mobile phone services sector; none of them is state owned. Foreign investment remains subject to a ceiling of 49% in facilities-based services, while value-added services are fully open to foreign investment. Several postal services (including letters weighing less than 350 grams and parcels weighing less than 2 kg) are reserved for the state-owned Korea Post. While postal services stagnated, courier services grew quickly.

23. International transport for freight is mainly by sea, whereas for passengers is mainly by air. In 2017, a five-year plan was launched to restructure the maritime transport sector by, *inter alia*, building more ultra large container and eco-friendly ships, and supporting vessels going green. Measures to reduce marine pollution and enhance marine safety and cybersecurity were also adopted. Tax incentives remain available to the maritime sector, and a rescue fund to help shippers manage the difficulties caused by the pandemic was introduced. Foreign ownership of Korean airline operators is limited to less than 50%, and foreign owners must register their aircraft in Korea. Cabotage for air and land transport is not permitted, although for maritime transport some exceptions exist.

24. The distribution and the tourism sectors contracted significantly in 2020 due to the COVID-19 pandemic. The regulatory framework and FDI restrictions for distribution services remain unchanged. As a result of the country's very high Internet penetration rate, e-commerce develops quickly, and, due to COVID-19, it recorded its strongest growth in 2020, reflecting changes in consumption styles. In 2017, the Government relaxed visa rules and included more cultural content into tour programmes, to help the tourism sector cope with its trade deficit challenges. A Tourism 2020 Strategy identified policy tools to address challenges facing the sector. The level of financial support to the tourism sector was raised, and the use of online platforms to improve digital marketing of tourism services was promoted.

25. Korea's economic growth is expected to gradually gain momentum in 2021, although uncertainty surrounding the outlook reflecting external and domestic COVID-19-related risks remains elevated. Notwithstanding the considerable success of its existing buffers and weathering of the pandemic, the economy remains vulnerable to exogenous shocks, such as a persistent slump in world trade, rising protectionism, retreat from multilateralism, geopolitical tensions, and/or weaker-than-expected global growth, particularly due to Korea's heavy reliance on exports of

manufactures produced mostly by a few large business conglomerates. Future prosperity and sustainable growth would depend on the Government implementing TFP-enhancing structural reforms; promoting balanced, private sector-led growth; promoting fair competition between large corporations and smaller firms; fostering innovation, especially in SMEs; and reducing the regulatory burden on firms, especially in the services sector. These and related reforms, including tax, privatization, and continued regulatory reforms, would increase the flexibility of the Korean economy and its ability to respond to growing external competition, thus enabling Korea to continue meeting its broad-based economic and welfare objectives, including inclusive growth and a narrower wealth divide.