

GENERAL AGREEMENT ON TARIFFS AND TRADE

RESTRICTED

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Limited Distribution

Committee on Balance-of-Payments
Restrictions

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

1. In accordance with its terms of reference, the Committee has conducted a consultation with Korea under Article XVIII:12(b). The Committee noted that a consultation under the simplified procedures (L/3772/Rev.1) had been held in November 1975 (BOP/R/83) when it had been decided that a full consultation would be held under the applicable procedure. The previous full consultation with Korea under the provisions of Article XVIII:12(b) had been held in June 1971. In conducting the present consultation the Committee had before it a basic document supplied by the Government of Korea (BOP/152/Rev.1) and a background paper provided by the International Monetary Fund, dated 19 April 1976.
2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, 18th Supplement, pages 52-53). The consultation took place on 3 May 1976. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

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

"The slowdown in economic activity that affected the Korean economy in 1974 was halted by the end of the first quarter of 1975. The expansionary financial policies implemented from the fourth quarter of 1974 through the following quarter helped moderate the decline in the growth rate during the first and second quarters of 1975. Subsequently, the growth rate accelerated reflecting mainly a recovery in export demand associated with a strong upsurge in export volume, and expanded investment by the public sector. These factors and another good harvest of foodgrains, particularly barley and rice, enabled Korea to achieve for 1975 as a whole, a real GNP growth rate of 7.4 per cent, against 8.6 per cent in 1974, and 16 per cent in 1973.

"During 1975, the rate of price increase, although still high, decelerated significantly, with wholesale prices rising at an annual rate of 20.2 per cent, compared with a 42.9 per cent rise in 1974 (on end-of-period basis). The continuing strong pressures on prices in the early months of 1975 were attributable to the expansionary financial policies, the further adjustments in some administered prices to pass on the increased costs of imports, and the depreciation of the Korean won in December 1974. In the second half of the year, the rate of price increase decelerated markedly, mainly as a result of improved financial policies and the end of the bulk of price adjustments.

"The balance of payments position continued to be difficult during 1975. The current account registered a deficit of SDR 1.6 billion, about the same as in 1974, despite an improvement of SDR 0.3 billion in the trade balance. Efforts aimed at trade diversification and selective credit measures succeeded in achieving a moderate increase in exports while on the import side, some temporary increase in restrictions and the financial policies designed to restrain the growth of domestic demand were instrumental in moderating the rise in import volume. Net international reserves of the banking system declined further by some SDR 110 million during 1975; after the sharp decline of over SDR 900 million that took place during 1974. Nonetheless, gross international reserves of the banking system increased by SDR 0.4 billion, to SDR 1.3 billion as of end-1975, equivalent to about two and a half months of 1975 imports. The current deficit and the increase in gross reserves were financed by the net inflow of long-term capital and by increased utilization of short-term monetary and nonmonetary capital.

"The positive trends that brought about the improvement in the trade balance since mid-1975 continued into the first quarter of 1976. Preliminary foreign trade indicators confirm a significant improvement in the trade balance. At the same time, the Korean authorities are confident that they will succeed in securing the planned amounts of long-term capital, so that

these, together with the envisaged reduction of the current deficit, will reduce the country's reliance on short-term financing. The outstanding external debt, although it has increased rapidly in recent years and its maturity structure has deteriorated, still appears to be within manageable limits.

"Korea maintains a system of prior approval of import and export transactions, together with advance import deposit requirements and a variety of control measures related to payments for invisibles and capital transactions. Some tightening in trade restrictions was effected in early 1975 in response to the deteriorating balance of payments position. The increase in restrictiveness consisted mainly in the transfer from the automatic approval list to the restricted import list of goods equivalent in value to about 3 per cent of total imports, and the lengthening of the retention period of advance import deposits from 60 to 90 days. In the latter part of the year and in early 1976, however, the restrictions affecting import licensing imposed in April 1975 were more than offset by successive transfers of several import items to the automatic approval list. In addition, several measures were implemented toward the objective of simplifying and expediting exchange transactions related to invisibles and capital movements.

"As noted earlier, the import licensing system was liberalized in late 1975 and early 1976. In spite of some improvement, Korea's balance of payments situation continues to be under pressure and, in the period ahead, it is expected to register a substantial current account deficit. The gross international reserves of the banking system, although low, are adequate to sustain current trade and payments needs. In view of the above, the remaining restrictions in effect do not go beyond those necessary to prevent a decline in Korea's monetary reserves."

Opening statement by the representative of Korea

4. In opening the consultation the representative of Korea made a statement as follows:

"Under the drastic changes in the world economic situation during the past two years, Korea's balance-of-payments position was seriously aggravated due to unfavourable developments in both exports and imports. The expansion of exports slackened sharply due mainly to the severe reduction in foreign demand reflecting the world-wide recession. On the other hand, imports increased remarkably reflecting drastic price increases for oil and other major raw materials in overseas markets.

"During 1974, the overall balance-of-payments position recorded a setback unparalleled in Korea's recent history. The sizable current account deficit of US\$2,023 million for 1974 was nearly seven times more than in 1973.

"In the wake of this sharp deterioration in the balance-of-payments position in 1974, our Government revised the growth strategy for 1975 and adopted financial and other policies designed to improve the external position in 1975 and beyond.

"Notwithstanding the measures to lessen the current account deficit, the balance of payments witnessed another adverse development last year, recording \$1,845 million deficit in current account.

"In these circumstances, the Korean Government was obliged to maintain some restrictive measures on imports of non-essential commodities together with the implementation of a tight monetary policy although it has kept up a policy of trade liberalization as far as the balance-of-payments situation permits. Needless to say these restrictions were motivated by the desire to safeguard the deteriorated balance-of-payments position, which is very vital to the stability and sustained growth of our national economy.

"In order to improve the balance-of-payments position, my Government has also continued to make every possible effort to expand its exports through quality improvement of export products, geographical diversification and improvement in value-added content.

"In this context, I would like to express our distress over trade policy operations throughout the world which have tended to move in a direction opposite to what the General Agreement is meant to pursue.

"Now, my delegation wishes to express our sincere desire and expectation that trade barriers maintained by developed countries which particularly affect the export interests of the developing countries including, Korea, should be eliminated as soon as possible and, furthermore, the developed countries concerned should refrain from introducing new barriers.

"In concluding my statement, I should like to express again a basic policy of the Korean Government to pursue continuously trade liberalization in response to the spirit of GATT and IMF to the fullest possible extent that our balance-of-payments situation permits. The Government is well aware that excessive import restrictions may result in harmful effects on export performance in world trade. Despite present difficulties in the balance of payments, Korea has not only refrained from introducing import restrictive measures in so far as possible but also has already taken some positive measures to abolish restrictions inevitably introduced during the course of readjustment period after oil price hike. With appropriate export opportunities

resulting from world economic recovery and through domestic structural readjustment we hope, however, that Korea will be able to take some measures towards further liberalization."

1. Balance-of-payments position and prospects

5. The Committee noted that, while Korea's balance-of-payments position had deteriorated during 1973-1974 and the first part of 1975, there had been a significant improvement in the payments situation during the second half of 1975 and the first months of 1976. One member of the Committee pointed out that, according to statistics at his disposal, exports had increased by 47 per cent during the first three months of 1976 while imports had decreased during the same period by 7 per cent as compared with the same period in 1975. He also noted that Korea's Deputy Prime Minister had declared on 22 April 1976 that a decline in the trade deficit to US\$900 million was foreseen for 1976 as a whole.

6. The Committee noted that, according to the basic document submitted by the Korean authorities, the balance-of-payments situation was adversely affected by the structural changes in the Korean economy that resulted from a shift of export growth from light industries to heavy industries in the years 1971-1974. One member of the Committee said that such structural changes in export patterns were a normal feature of economic development and should not be taken as a basis for making pessimistic long-term export forecasts. Another member of the Committee pointed out that, according to the IMF report, exports of light industries expanded in 1975 while the exports of the heavy industries generally declined; thus it appeared to him that the change in the structural pattern of exports had been halted at least temporarily.

7. In response to questions by members of the Committee regarding Korea's payments prospects, the representative of Korea provided the Committee with the following information. In 1974 and 1975, Korea's current account deficit had been over US\$2 billion. In 1976, it was expected to decline to US\$1.4 billion and in 1977 to US\$1.2-1.3 billion. In the early part of the 1980's the authorities expected to attain current account deficits of the levels that prevailed before the oil crisis, namely about US\$300 million per annum. The most recent statistics indicated that these targets might even be exceeded. It is now estimated that Korea will export close to US\$7 billion in 1976 instead of US\$6.5 billion as was expected when the long-term projections were drawn up.

8. One member of the Committee wondered whether Korea foresaw any difficulty in servicing its rising external debt. The representative of Korea replied that at the end of 1975 the total external debt of Korea amounted to US\$7.7 billion, of which US\$2 billion were short-term debts (maturity of less than one year). The debt service ratio had declined from its peak of 21 per cent in 1970 to 12.6 per cent in 1975. It was estimated to rise to 15 per cent in 1977 and 1978 and then to decline again to 12 per cent by 1981. The Korean representative stressed that the expected rise to 15 per cent was well under the 20 per cent limit that was

generally considered as critical. Asked to comment on Korea's policies to attract foreign capital the Korean representative informed the Committee that Korea expected to have an inflow of long-term capital of about US\$1.8 billion this year, of which US\$1.3 billion would result from credits contracted up to the end of 1975.

2. Alternative measures to restore equilibrium

9. Invited to comment on Korea's export promotion policies the Korean representative said that his Government pursued an active policy to promote and diversify exports. A number of governmental measures, among them tax incentives and the liberalization of payments for marketing services, were designed to increase exports to traditional and new markets. One member of the Committee asked whether Korea had policies to reduce the burden of the increase of oil prices on the balance of payments. The Korean representative replied that his Government had been able to reduce oil imports through a nation-wide energy conservation scheme. In recent months oil imports had increased again because of the upturn in economic activity. It was however the Government's firm intention to restrain this trend.

10. Asked to comment on Korea's domestic policies to restore equilibrium, the Korean representative said that his Government had recently begun to attach high priority not only to GNP growth rates but also to the maintenance of price stability and a sound balance-of-payments position. In the light of this policy change, the original growth target of 9 per cent for 1976 had been revised downward to 7-8 per cent. Inflation had declined from 40 per cent in 1974 to 26 per cent in 1975, and was likely to decline further to 10-12 per cent during this year provided there was no further rise in oil prices.

11. The Committee discussed Korea's policies to reduce the deficit in the services account. In this connexion one member of the Committee noted that, according to the IMF report, Korea had succeeded in securing various contracts for construction work abroad, especially in the Middle East, and that receipts from this source were expected to help reduce the deficit in the services account. The Korean representative confirmed that Korean firms had indeed obtained sizable contracts for construction work in the Middle East. The contracts obtained during 1975 amounted to US\$1 billion, and recent figures indicated that they might amount to over US\$2 billion during 1976. The Korean representative added that at present these contracts required investments abroad and that net foreign exchange earnings from this source could therefore only be expected after some time. As to other items in the services account the Korean representative remarked that receipts from tourism might increase as a result of the world economic recovery and that the level of interest payments was largely determined by developments in the international capital markets. Freight payments could be reduced only in the long run through the development of a national fleet.

3. Systems, methods and effects of the restrictions

12. Members of the Committee expressed their concern over the complexity, lack of transparency and instability of the Korean import system. They felt that the system resulted in high costs to the Korean economy because it created distortions in the economic decision-making process, led to high administrative costs for importers and higher sales costs to foreign exporters which in the end had to be borne by the Korean consumers. The adverse effects of the import system were particularly felt by distant foreign suppliers. Members of the Committee felt that both Korea and its trading partners would benefit if Korea placed greater emphasis on import controls working through the price mechanism rather than administrative controls. Members of the Committee were also concerned about the frequent and sudden changes in the import régime that made it difficult for suppliers to plan their investments and shipments. This legal insecurity acted as a significant import barrier that was particularly difficult to overcome by distant suppliers.

13. The representative of Korea responded to these observations by saying that the Korean authorities had made continuous efforts to simplify and streamline the restrictive system. Thus, during 1975 the administration of the licensing system had been transferred from the Government to private commercial banks. To the extent feasible, administrative restrictions, such as import quotas, had been replaced by cost restrictions, such as fixed tariffs, variable tariffs or advance import deposits. It was the Korean Government's policy to move further in the direction of an abolition of administrative restrictions. However, it could do so only within the limits set by the balance-of-payments situation.

14. In response to an enquiry by a member of the Committee, the Korean representative confirmed that Korea had abolished in 1974 a discriminatory licensing system that had served to reduce imports from countries with which Korea had a substantial bilateral deficit. No discriminatory restrictions were presently being applied.

15. The Committee then turned to the various restrictive techniques applied by Korea. As to Korea's tariff system it was noted that a system of flexible tariffs under which import charges could be increased or decreased by up to 50 percentage points had been introduced in 1975. While there had been some tariff reductions under this system, tariffs had been increased on 123 items in 1975. The changes in tariffs had sometimes been introduced rather abruptly which had caused hardships to Korea's suppliers. The Korean representative stated that his Government was making great efforts to improve its tariff system. Thus, to simplify customs procedures, a customs drawback system for raw material re-exports had been introduced in July 1975 to replace the prior customs exemption system. Furthermore,

the Government planned to simplify and harmonize the tariff structure to eliminate to the extent feasible differences in the level of protection of different industries.

16. As to Korea's licensing system it was noted that there were three categories of imports under the licensing scheme: prohibited imports, restricted imports and free imports. Members of the Committee felt that the criteria that determined the categorization of goods and subsequent changes in the categorization were not always clear and that the quota levels were not always published in sufficient detail. Korea was commended for changing from a positive to a negative list system of import licensing. It was noted that import licences were accorded in general only to registered traders. These were engaging in both import and export trade and in some cases the granting of import licences appeared to have been linked to the achievement of certain export targets. The number of goods subject to such linkages appeared to have increased. Thus, electronic components, spare parts for automobiles, typewriters, sewing machines and other items had recently been included in the system.

17. The Korean representative stated that, in his view, the licensing system was not excessively restrictive and complex. Only about 5 per cent of all items were in the category of prohibited imports. The administration of the restrictions was largely in the hands of commercial banks and the administration was such that one could almost speak of automatic licensing. By co-operating closely with the Korean registered importers, foreign suppliers could overcome any difficulties that might arise out of the licensing system. The linkage system was not applied to goods that were free from other types of import limitations.

18. Regarding Korea's import deposit scheme it was observed that the rate of the deposit depended on the nature of the import and the terms of payment and could range up to 200 per cent of 110 per cent of the f.o.b. value, and that the number of goods subject to the maximum deposit rate had recently been increased. The representative of Korea said that the import deposit scheme had been introduced in 1975 to curtail imports, reduce domestic liquidity and promote supplier financed imports. The deposits had to be made at the time the import licence was issued and were retained for ninety days or up to the time of actual settlement, whichever was longer. No interest was paid on the deposits. The maximum rate of 200 per cent was applicable to cash payment imports of certain non-essential and luxury goods designated by the Ministry of Commerce and Industry and of goods subject to a tariff of 50 per cent or higher. Most imports financed by credits with a maturity of over ninety days were subject to a deposit rate of 40 per cent. In the case of crude oil imports and raw materials for re-export the deposit rate was zero. The scheme had been introduced only as a temporary measure to cope with an extremely difficult payments situation and the Government was studying the possibility of

reducing the deposit requirements in the latter part of this year. The removal of the scheme had to be carefully staged so as to avoid a sudden increase in domestic liquidity.

19. As regards other import limiting measures applied by Korea, it was noted that, under recent Korean regulations, Government procurement in foreign markets appeared to be limited to goods not produced domestically, and where foreign procurement was permitted, foreign suppliers were sometimes informed too late to submit bids. It was also noted that the foreign delivery of plants on a turn key basis had been restricted in a number of sectors.

Conclusions

20. The Committee agreed with the International Monetary Fund that Korea's present balance-of-payments position justified import restrictions under Article XVIII: Section B of the General Agreement. It noted that Korea's balance-of-payments prospects were favourable and welcomed the intention of the Korean Government to reduce the level of restrictions as the payments position improves. The Committee commended Korea on the elimination of all discriminatory restrictions.

21. The Committee expressed its concern over the undue complexity, the lack of transparency and the instability of Korea's system of trade controls. The Committee noted that the insecurity to which the system gave rise made it difficult for foreign suppliers, in particular those in distant countries, to plan investments and shipments. This acted as a barrier to imports and created costs that would in the end have to be borne by the Korean economy. For these reasons, the Committee urged the Korean authorities to continue their current efforts to simplify and streamline the trade control system.