

GENERAL AGREEMENT ON

TARIFFS AND TRADE

RESTRICTED

BOP/289/Add.2/Rev.1*
16 October 1989

Limited Distribution

Committee on Balance-of-Payments Consultation

1989 CONSULTATION WITH THE REPUBLIC OF KOREA
UNDER ARTICLE XVIII:12(b)

Basic Document for the Consultation

Revision

The following additional information has been supplied by the delegation of the Republic of Korea for the information of the Committee.

1. Overview of general economic situation

The Korean economy has been experiencing a severe decline this year, in contrast to high growth of the past years.

During the first half of this year, GDP grew by only 5.8 per cent, sharply lowered from 11.1 per cent last year. This sudden and dramatic decline in economic growth is largely attributable to sluggish export growth and lower production levels in the manufacturing sector (Table 1).

The current account surplus also dropped to US\$2.7 billion during the first eight months of this year, marking a 65 per cent drop from US\$7.9 billion from a year ago.

Although fixed investment expanded by 11.2 per cent down from 11.7 per cent last year, facility investment slowed down substantially to record only a 7.6 per cent growth.

These negative developments may be a reflection of the adjustment process following the economic boom over the last three years. However, a more realistic view is that the present economic downturn stems from deep-rooted structural problems, including won appreciation, wage hikes and labour disputes among many others.

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Exports and investment, which have driven the growth of the Korean economy in the past, are expected to continue to decline over the next several years. Accordingly, GNP will grow by less than 7 per cent this year, lower than the initial target of 8 per cent.

2. Trend in balance of payments

During the first eight months of this year, exports recorded a sharp decline, causing more than a 65 per cent drop in the current account surplus to US\$2.7 billion (Table 2).

The trade balance recorded a surplus of US\$2.3 billion, a US\$3.8 billion reduction compared with the same period of 1988. This decline was mainly attributable to the sluggish exports performance.

Particularly in August, the downward trend accelerated with both the trade balance and the current account showing deficits for the first time since February 1986. The trade balance recorded a deficit of US\$127 million, while the current account deficit amounted to US\$136 million.

Merchandise exports on a balance-of-payments basis showed a poor growth rate of 5.2 per cent compared with 30.5 per cent recorded in the first eight months of 1988 due to marginal increase in Korea's major export items both in light and heavy industries. In particular, exports of automobiles, footwear, textiles, and iron and steel products recorded either negligible or minus growth rates.

In contrast, imports on a balance-of-payments basis grew at a rate of 18.5 per cent during the same period, reflecting a considerable rise in imports for domestic use.

The surplus on the invisible trade balance declined by half, while the transfer balance showed a considerable reduction, due to a large drop in net unrequited transfers.

Meanwhile, reflecting the above-mentioned trends in the balance-of-payments situation, reduction of external debt has been virtually stopped, the volume of outstanding debt remaining at US\$30 billion as of July 1989, almost the same as that of the end of 1988.

The substantial decline in GNP and export growth this year stems from the serious structural problems in the economy. Drastic won appreciation, prolonged labour disputes and large wage hikes in recent years have tended to dampen business confidence, causing lower levels of investment, thereby weakening the long-term growth potential of the economy.

To make the situation worse, rapid GNP growth and higher incomes achieved over the past years have fuelled domestic demand, exerting an upward pressure on prices.

Taking these factors into account, the decline in trade surplus is expected to continue, which will also lead to a sizeable decline in the current account surplus for the years to come.

3. Further relaxation of import restrictions

A. Recent development

In spite of severe balance-of-payments difficulties this year, Korea has stood firm on its commitment to import liberalization, particularly since the BOP consultation in June. As in the past, the Government has continued to forge ahead with the policy for balanced expansion of the economy through simultaneous increases in imports and exports.

On 1 July 1989, eighty-four import items were liberalized, most of which are agricultural products, in accordance with the Three-Year Import Liberalization Schedule for the 1989-1991 period announced on 8 April 1989.

In addition to the ongoing effort to liberalize agricultural imports, the tariff rates have been reduced even further. To encourage imports from major trading partners, on 1 July of this year, a flexible tariff system was implemented to lower the tariff rates on fifty-five import items, including wine, cognac, and almonds.

B. Future policy direction

Korea has steadfastly undertaken liberalization of agricultural imports in the face of increasing social and political pressures. As in all other countries in the world, Korea's agricultural sector is more than a figure in gross national product.

With the agricultural sector employing one out of every five Korean workers and accounting for 11.4 per cent of GNP, agricultural import liberalization is more than a commonplace economic issue. It is a highly volatile political issue with strong passions on the part of those who oppose the Government's import liberalization policy.

The domestic environment surrounding this issue is quite understandable given the fact that the remaining restricted agricultural items are the ones that directly affect farm household income, which still trails far behind urban household income.

Therefore, it is extremely difficult to liberalize the remaining restricted agricultural items in the short-run. To enable the farmers to absorb the shock arising from virtual elimination of production of these items, a sufficient adjustment period is necessary. In other words, the farmers need sufficient time to switch to other farm products or another industry altogether. Without adequate adjustment, the negative consequences of import liberalization will be catastrophic not only for farm households but also for the nation's political and economic stability.

Recognizing these problems, the Korean Government is currently in the process of formulating a comprehensive agricultural adjustment policy to prepare for the eventual and gradual liberalization of agricultural imports. The actual implementation of this adjustment policy must be undertaken carefully and deliberately to guarantee support from the farmers, without which a failure is inevitable.

Thus, in the years to come, the Korean Government, in spite of these difficulties, will continue to make every effort to encourage imports, as long as domestic conditions allow it, through import liberalization and tariff reduction.

Table 1
Key Economic Indicators in Korea

(Z)

	1988	1988.1-4	2-4	1989.1-4	2-4
Gross domestic product	11.3	14.6	8.1	4.8	6.7
Agriculture, forestry and fishing	9.0	5.8	-1.0	6.4	5.7
Mining and manufacturing (manufacturing)	12.7 (13.0)	19.1 (19.1)	6.5 (7.0)	0.9 (1.0)	4.9 (5.2)
Other industries	11.7	12.7	11.5	7.6	8.2
Gross national product	12.2	15.2	8.9	5.6	7.4
Total consumption (private consumption)	10.0 (9.6)	10.4 (10.5)	7.8 (9.1)	9.7 (10.3)	10.2 (10.2)
Total fixed investment	11.8	13.5	10.3	8.5	13.3
Exports (f.o.b.)*	28.4	35.7	21.0	9.2	4.5
Imports (c.i.f.)*	26.3	40.7	20.9	21.4	19.0
Consumer prices	7.1	7.5	7.2	5.6	5.7
Wages in manufacturing industries	19.6	19.3	20.5	19.5	24.6 ¹
Unemployment rate** (non-farm)	3.0	3.7	2.8	3.7	2.9
Money supply (M2)***	21.5	19.2	16.9	19.9	17.1
Exchange rate (W/US\$)***	684.1	746.2	728.3	671.9	667.2

*Customs clearance basis
**Period average
***End of period
¹April 1989

Table 2
Balance of Payments

(Millions of US dollars)

	1988	1988.1-8	1989.1-8
Current balance	14,161	7,905	2,714
Trade balance	11,445	6,128	2,290
Exports	59,648	37,336	39,261
(Rate of change)	(29.0)	(30.5)	(5.2)
Imports	48,203	31,208	36,971
(Rate of change)	(24.9)	(28.7)	(18.5)
Invisible (net)	1,267	700	229
Transfers (net)	1,448	1,077	196
Long-term capital	-2,733	-838	-2,207
Loans and investments	2,799	1,872	1,411
Basic balance	11,428	7,068	508
Short-term capital	1,336	2,075	1,154
Errors and omissions	-589	16	1,535
Overall balance	12,175	9,159	3,197
Financial account	-12,175	-9,159	-3,197
Liabilities	-1,320	-741	1,156
Assets	10,855	8,418	4,353
Foreign exchange holdings	12,378	10,716	16,657

Table 3
Debts Outstanding and Repayments

(Billions of US dollars)

	1986	1987	1988	July 1989
External debt	44.5	35.6	31.2	31.0
Medium and long term	35.3	26.3	21.4	18.8
Short term	9.3	9.3	9.8	12.2
Repayments*	5.8	14.1	7.5	3.4

*Includes principal repayments of medium- and long-term debt only