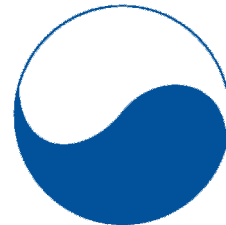

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CONTENTS

Part I: Overview and Macroeconomic Issues

Overview of the Korean Economy <i>Jeon Jong-kyu</i>	1
---	---

Part II: Financial Institutions and Markets

Korea and the IMF–World Bank Financial Sector Assessment Program <i>Meral Karasulu</i>	7
--	---

The Banking Sector <i>Thomas Byrne</i>	15
--	----

The Corporate Bond Market in Korea <i>Kim Sungmin</i>	20
---	----

Part III: Structural Reform

Public Sector Reform <i>Lee Kang-ho</i>	33
---	----

Business Perspective on Corporate Reform <i>Oh Moon-suk</i>	41
---	----

Accounting Reform <i>Lee Suk-jun</i>	48
--	----

Part IV: External Issues

U.S.-Korea Economic Relations View from Washington <i>Nan N. Fife</i>	55
View from Seoul <i>Lee Hyun-ju</i>	61

Korea-China Relations <i>Lee Chang-kyu</i>	69
--	----

Part V: North Korea's Economic Development and External Relations

Economic Reform in North Korea <i>Bernhard Seliger</i>	77
--	----

Japan-North Korea Relations <i>Mimura Mitsuhiro</i>	87
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EXTERNAL ISSUES

U.S.-REPUBLIC OF KOREA ECONOMIC RELATIONS IN 2003: A WASHINGTON PERSPECTIVE

by Nan N. Fife

Introduction—Multifaceted Partnership

The United States benefited during 2003 from its strong and multifaceted partnership with the Republic of Korea (ROK, or South Korea). The year marked the 50th anniversary of the U.S.-ROK military alliance. Soon after new ROK President Roh Moo-hyun's February inauguration, President George W. Bush invited him to visit Washington. The visit, which took place in May, provided an opportunity for the two leaders to establish a personal relationship while exchanging views on the full range of bilateral issues and on important international issues of mutual concern.

North Korea decided early in 2003 to withdraw from the Nuclear Non-Proliferation Treaty and stated its intention to develop nuclear weapons. Bringing about the peaceful, complete, and verifiable end of North Korea's nuclear weapons program is high on the U.S.-ROK agenda. Close U.S.-ROK cooperation throughout the year, including at six-party talks in Beijing in August, advanced this effort. In addition, South Korea made significant contributions during 2003 to efforts in Afghanistan and Iraq. For Afghanistan, the ROK provided engineering and medical units and reconstruction assistance. For Iraq, South Korea pledged \$260 million over five years toward reconstruction and, at year's end, announced its intention to provide 3,000 troops to assist with stabilization efforts. Another major issue on our bilateral agenda was planning for the reconfiguration of U.S. forces in South Korea to enable them to provide more effective deterrence and more flexibility in responding to regional needs.

Robust economic ties between the United States and South Korea have helped anchor our military alliance and have complemented our cooperation on political and security issues. During President Roh's visit to

Washington in May, President Bush stated his support for President Roh's intention to make South Korea a business and logistical hub for the Northeast Asia region. The United States believes that South Korea's emergence as an economic hub will enhance business opportunities for firms in both of our countries. Among the factors that will determine South Korea's success in achieving this goal are its pace of implementation of additional structural reforms, degree of regulatory transparency, efforts to enforce intellectual property rights, and extent of further liberalization of trade and investment.

This article will discuss trade and investment ties between the United States and South Korea during 2003. It will also consider South Korea's record on intellectual property rights protection and regulatory transparency, as well as our bilateral collaboration on science and technology development and our cooperation in multilateral economic forums. The bottom line is that the United States and South Korea have a solid and enduring economic partnership, based on respect for free markets, that benefits both our countries.

High-Tech Trade Partners

The strong and vibrant ROK economy represents an important market for the United States. Despite a challenging global environment, South Korea posted real gross domestic product growth of 3.1 percent in 2003. The International Monetary Fund forecasts even higher economic growth of 5.5 percent in 2004. South Korea thus represents a key export market for the United States and contributes significantly to global growth.

South Korea was the seventh largest merchandise trade partner of the United States during 2003, with two-way trade totaling \$61.1 billion. U.S. goods exports to South Korea increased by \$1.5 billion over

the 2002 level to \$24.1 billion, while goods imports were up by \$1.4 billion to \$37.0 billion. As a result, the U.S. merchandise trade deficit with South Korea decreased from \$13.0 billion in 2002 to \$12.9 billion in 2003.

The largest category of goods exported by the United States to South Korea remained electronic integrated circuits and microassemblies. The goods of greatest total value that the United States imported from South Korea were electrical equipment (particularly cellular phone handsets) and vehicles, while apparel imports from South Korea declined. This continues the trend of recent years of increasingly high-end South Korean exports.

U.S.-ROK trade in services is also active. In 2002 (the most recent year for which data are available), U.S. private sector, nonmilitary services exported to South Korea totaled \$11.7 billion, a large part of which was royalty and license fee payments that South Korean companies paid to U.S. firms. Services the United States imported from South Korea that same year were valued at \$8.4 billion, putting the U.S. service trade balance with South Korea in surplus by \$3.3 billion. This was an increase of \$848 million over the U.S. services trade surplus with South Korea in 2001. We expect that 2003 service trade data, once released, will again show a surplus for the United States and a deficit for South Korea.

While South Korea has officially adopted a flexible exchange rate policy, in practice the *won* is quite closely linked to the Japanese *yen*. Overall, the *won* appreciated 4.7 percent against the U.S. dollar over the year, making U.S. products more competitive in South Korean markets. South Korea's foreign exchange reserves increased 28 percent in 2003 to \$155.4 billion.

Active Dialogue on Sectoral Trade Issues

The number of bilateral trade disagreements between the United States and Republic of Korea has dropped markedly compared with a decade ago, in large part due to structural reforms and liberalization the ROK government undertook in response to the Asian financial crisis in 1997–98. In most instances, U.S. private sector firms are dealing directly with South Korean companies, without any need for government involvement. Nonetheless, some contentious trade

issues remain. Working-level interagency trade talks between the United States and South Korea in June and October 2003 served as the principal mechanism for discussion of the whole range of trade issues. Both sides used these talks as a venue to raise issues of concern.

ROK government plans to mandate various national technology standards have emerged as one of the areas of greatest concern to the United States. Rather than allowing companies to choose the technology that best serves their business needs, the ROK government is moving toward mandating national standards for portable Internet service and other emerging mobile telecommunications technologies. These standards, if mandatory rather than voluntary, will stifle innovation, reduce choices for consumers, discourage foreign investment, and make it much more difficult for U.S. and other foreign firms to compete. The United States and South Korea discussed these issues extensively on a number of occasions during 2003, both on a government-to-government basis and in meetings attended by both government officials and private sector representatives. We hope to reach a mutually satisfactory outcome in 2004.

Bilateral discussion of our trade in automobiles showed some results during 2003, although other significant U.S. concerns remained unresolved. ROK government changes in the special consumption tax in 2003 resulted in lower taxes on imported automobiles. In addition, South Korean consumers' perception of imported automobiles improved, in part due to ROK government purchases of foreign vehicles and ROK tax authorities' cessation of threatening audits of imported car purchasers. However, more needs to be done to reduce tariffs and taxes on imported vehicles and to deal with standards and certification issues. During 2003, the United States imported \$7.9 billion worth of vehicles from South Korea while exporting only \$94 million worth of vehicles to the country.

In the area of agricultural and food products, South Korea continues to impose extremely high tariffs on imports (more than 40 percent on many products) and low quota and price ceilings on rice imports. In addition, it often implements nontariff measures that discriminate against imported agricultural products. One new U.S. concern that arose in 2003 was an ROK government proposal to require annual testing

of all agricultural imports to ensure that they did not exceed maximum residue limits for chemicals, with the cost of the testing paid by importers. In contrast, domestic agricultural products would be tested only on a random basis, with the government absorbing the costs. Although the ROK government subsequently reduced the cost of these tests for imported products, the United States and several of Korea's other trading partners have initiated a dialogue in the World Trade Organization's Sanitary and Phytosanitary Committee regarding concerns that foreign companies are being discriminated against. We are hopeful that the issue will be resolved in the near future. Another issue we are discussing bilaterally is the December 2003 discovery of bovine spongiform encephalopathy (BSE, or "mad cow disease") in the United States. South Korea, like many other U.S. trading partners, responded by suspending all beef imports from the United States pending an international scientific review of the outbreak. We expect reopening those markets to be a difficult and time-consuming process. U.S. exports of beef to South Korea were valued at more than \$837 million in 2003.

Another subject on the agenda for our bilateral trade talks is pharmaceuticals. During 2003, U.S. concerns regarding pharmaceuticals trade related mainly to the pricing of innovative pharmaceuticals under Korea's national health insurance reimbursement system and the lack of transparency in the Korean system. The United States welcomed South Korea's decision during 2003 to terminate the lowest-transaction-pricing system, which reimbursed drug purchasers only up to the lowest recorded price for that drug during the previous quarter, and return to the system of actual transaction pricing. Throughout 2003, a series of government-to-government and government-industry consultations took place that successfully addressed some U.S. concerns. U.S. government officials hope to work cooperatively with ROK officials on pharmaceutical issues in the future.

The United States imposed countervailing duties against South Korean imports in several cases during 2003 to counter government support or dumping in the U.S. market. As of 23 October 2003, the United States had a total of 25 antidumping or countervailing-duty orders in place against South Korea. The most notable such case during 2003 involved support by ROK government-owned financial institutions to the

semiconductor manufacturer, Hynix; the United States decided in June to impose countervailing duties against Hynix DRAMs. In regard to steel, President Bush decided in December to lift safeguard measures on steel that had affected imports from South Korea as well as other countries.

Investment Trends

U.S. foreign direct investment in the Republic of Korea grew rapidly following the Asian financial crisis as more opportunities were opened to foreign investors. Since 2000, foreign direct investment in South Korea by U.S. firms, like overall foreign direct investment in the country, has declined. However, the United States remained South Korea's largest single-country source of foreign direct investment. Investment by U.S. firms in South Korea was an estimated \$1.24 billion in 2003. The total stock of U.S. investment in South Korea at the end of 2003 is estimated at \$27.5 billion.

The government of President Roh Moo-hyun has expressed concern about the decline in foreign direct investment and is giving priority to efforts to attract such investment. During 2003, the Korean government moved forward with plans to open special economic zones to foreign investors, offering tax breaks and numerous other incentives to try to attract firms.

Some U.S. firms have pointed out that lack of flexibility in South Korea's labor laws may be among the factors that discourage potential investors from locating operations in Korea. Recognizing that its labor practices are out of step with those of other major economies, the ROK government appointed a panel of experts to develop a road map for future legislation to amend the Labor Code. (U.S. firms also cite inadequate protection of intellectual property rights and insufficient regulatory transparency as concerns for investors; both issues are discussed below.)

In addition, the government of President Roh is following the example of the previous administration in implementing and enforcing structural changes that encourage foreign investment. For example, it has continued to sell off equity stakes in resolved and restructured banks resulting from the 1997 financial crisis. (When the government has disposed of a financial institution and assets that it took ownership

of during the financial crisis, that bank is considered “resolved.”) The government has also continued steps to enforce fair trade laws against the family-owned business conglomerates, called *chaebol*. Further efforts to open more business sectors to foreign investment and loosen foreign equity restrictions will help keep South Korea’s investment climate competitive.

Intellectual Property Rights Protection

The Republic of Korea’s rapid climb up the high-tech ladder—for example, it now has the highest broadband penetration in the world—has had the effect of rapidly creating new intellectual property protection problems. Speedy action is needed on the ROK government’s part to keep the incentives for technological innovation and intellectual and creative activities high, which is ultimately to everyone’s benefit. Such action would help change the attitudes of those that believe they should be able to enjoy for free the products of other people’s efforts. It would also help the Roh government achieve its goal of attracting more foreign direct investment.

South Korea took some important steps during 2003 to provide better protection for and enforcement of intellectual property rights. First, in an effort to improve enforcement of laws prohibiting software piracy, the National Assembly passed legislation granting the Ministry of Information and Communication’s newly created standing inspection teams the police powers to conduct raids; in addition, a delegation from the software piracy unit of the Ministry of Information and Communication visited the United States in December 2003 to discuss future cooperation with the U.S. private sector and government agencies. Second, the National Assembly passed legislation, drafted by the Ministry of Culture and Tourism, granting the Korea Media Rating Board (KMRB) authority to make determinations of copyright ownership before issuing ratings for film distribution in South Korea. The KMRB will now be drafting procedures describing how it will implement its newly vested authority. Third, ROK authorities made efforts to provide the U.S. government information on their enforcement efforts on a more regular basis. Finally, in the area of sound recordings, the Ministry of Information and Communication initiated legislation to pro-

vide “making available” rights to sound recording producers.

The U.S. government reviewed South Korea’s intellectual property rights record in the spring of 2003 as part of an annual assessment of all U.S. trading partners under the Special 301 process mandated by section 182 of the Trade Act of 1974. The U.S. government decided at that time to keep South Korea on the watch list (concern), while noting that it planned to review progress on a range of outstanding issues during an out-of-cycle review later in the year. The result of the out-of-cycle review, announced in January 2004, was to elevate South Korea to the priority watch list (more serious concern).

The United States is hopeful that South Korea will make further progress in 2004 in a number of intellectual property protection problem areas. In the area of film piracy, the content of the procedures that KMRB drafts under the new law will be important because the law does not address many key issues required for full protection of intellectual property rights. In regard to the ROK government’s sharing information on actions to combat software piracy, the U.S. government would welcome additional information demonstrating the deterrent effect of ROK authorities’ enforcement actions. As for sound recordings, the U.S. government hopes to see passage of the legislation providing “making available” rights and consideration of extending the law to cover the right of communication to the public. Other areas where strengthened ROK government efforts would be helpful are protection for temporary copies and enforcement of book publishers’ rights.

We are encouraged by the fact that private sector South Korean and U.S. rights holders with shared interests are working cooperatively toward the goal of making improved intellectual property rights protection in South Korea a reality.

Regulatory Transparency

The need for greater regulatory transparency in the Republic of Korea is at the core of a number of the bilateral trade disagreements cited above. It is also a factor discouraging potential foreign investment. The South Korean government has made some progress

in this area in recent years. However, redoubled efforts to achieve greater regulatory transparency would do much to help provide a more predictable, stable environment for foreign businesses. Specifically, we would encourage efforts to:

- Draft clear and specific laws and regulations that are not open to varying interpretations;
- Ensure adequate public notice and comment periods on draft legislation and regulations (the ROK government's current comment period is 20 days, which is often not long enough for U.S. firms and the U.S. government to translate and evaluate draft legislation and regulations);
- Seriously consider comments received from foreign stakeholders and take them into account in revising draft legislation and regulations; and
- Avoid reinterpretation of laws and regulations and retroactive application.

Joint Environment, Science, and Technology Programs

Bilateral cooperation on environmental, science, and technology projects is another strong element of the U.S.-ROK relationship. Under the Joint Working Group on Climate Change Research, for example, we are planning or undertaking 13 research programs involving the Environmental Protection Agency (EPA), National Oceanic and Atmospheric Administration (NOAA), and Department of Energy (DOE) on the U.S. side and three Korean government ministries and their technical agencies. One of these, an EPA-Ministry of Environment project on air quality monitoring in the Seoul metropolitan area, provided the necessary scientific base for the landmark Special Act on Air Quality in the Seoul Metropolitan Region, passed by the ROK National Assembly in December 2003.

Most of our joint programs in science and technology come under the umbrella U.S.-ROK Science and Technology Cooperation Agreement, which was last extended in 1999. Government-to-government collaborations under this agreement are under way in the following areas: science (9), energy and climate (8),

aerospace and defense (3), metrology and standards (2), and agriculture, biotechnology, and health (11).

In addition, DOE also has a range of collaborative projects with ROK counterpart agencies and laboratories in nuclear science and engineering fields. The National Institutes of Health are conducting biomedical research with Korean partners in five fields, including stem cell research. NOAA and the Korea Ministry of Maritime Affairs and Fisheries, under a bilateral arrangement they signed in 2000, cooperate on a wide range of marine science and fisheries projects, including coastal management, aquaculture, oil spill response, and others.

Cooperation in Multilateral Forums

Our cooperation with the Republic of Korea on economic matters extends beyond the bilateral to multilateral forums. In fact, constructive cooperation in multilateral forums aimed at further liberalizing trade and investment regimes may prove to contribute more to economic growth in the United States and South Korea than anything we can accomplish on a bilateral basis.

The United States and South Korea cooperate closely within the Asia-Pacific Economic Cooperation forum (APEC), which is the preeminent economic organization in the region. South Korea has been contributing constructively within APEC from its start, particularly in the areas of education, social safety nets, and APEC reform. We believe South Korea's participation in another initiative associated with APEC, the Multilateral Agreement on the Liberalization of International Air Transportation (MALIAT), would be consistent with South Korea's hub aspirations.

South Korea will serve as the chairman and host of APEC meetings in 2005. This coincides with APEC's midterm review of progress toward the goal it set out in 1995 of free and open trade in the Asia-Pacific no later than 2010 in the case of industrialized countries and 2020 in the case of developing countries. This midterm review offers ample opportunity for South Korea to use its chairmanship of APEC to push vigorously for trade and investment liberalization to the benefit of the whole region.

In the World Trade Organization, South Korea was helpful in launching the Doha Development Agenda in November 2001. However, during the September 2003 ministerial meeting in Cancun, Mexico, the Korean delegation showed little flexibility. We hope that Korea, as a major trading nation, will take a leadership role by adopting positions and working to build consensus that will help move the Doha Round forward.

Solid Partners

As evident in the discussion above, the United States and the Republic of Korea, as two different countries with varied interests, do not always see eye to eye on all issues. However, we do share fundamental values of democracy, protection of human rights, and respect for free markets. As a result, when differences emerge, be they economic or political, we are able to discuss them in a constructive fashion and put them into perspective in the context of a long and resilient bilateral partnership.

Changes in the global economic landscape, particularly China's rapid growth, will undoubtedly have repercussions for the U.S.-ROK economic relationship. China (including Hong Kong) already surpassed the United States in 2002 as South Korea's largest export market, and both U.S. and South Korean firms are attracted by investment opportunities there. However, one should not presume this will mean the withering of the U.S.-ROK economic relationship. After all, four of the top six merchandise trade partners of the United States are other developed countries, namely Canada, Japan, Germany, and the United Kingdom. We are confident that the U.S. economic partnership with South Korea will similarly remain healthy and vigorous even as it evolves in response to new commercial opportunities in Asia and around the globe. We look forward to many more decades of strong economic ties that contribute to the prosperity of both Americans and South Koreans.

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