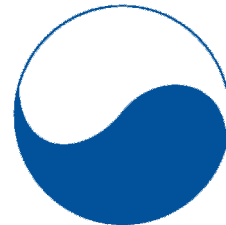


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# KOREA-U.S. ECONOMIC RELATIONS IN 2003: A VIEW FROM SEOUL

by *Lee Hyun-ju*

## Introduction

The year of 2004 was ushered in with palpable optimism after a prolonged world economic impasse. The international economy had been in the doldrums for years—since the bursting of the bubble of a new economy that was once seen as immortal. When 2002 was turning into 2003, gloomy economic forecasts were the standard, punctuated by reports of the legacy of the “lost decade” that haunted Japan and the EU’s “lost opportunity” for a strong euro. The doldrums seemed to worsen as the U.S. military engagement in Iraq loomed. In early 2003, the mood was somber. Fortunately, however, the cycle had hit bottom, and this signaled an upturn. These hopeful signs, combined with a sense of psychological buoyancy garnered by the apparently swift U.S. victory in Iraq, have created a climate of hope for 2004. Those gloomy days are gone, and good riddance.

Since the third quarter of 2003, the world economy, especially the U.S. economy, has continued to show clear signs of recovery. Most economists and economic institutions have agreed that 2004 will see very strong economic growth and a further expansion of trade in most parts of the world. The average forecast for growth is a solid 4 percent.

The Korean economy, now substantially liberalized and deeply integrated into the world economy, has also drifted with the world economic tide. In 2003, the Korean economy experienced its most difficult period since the 1997 crisis. The effect of the world economic recession, coupled with other noneconomic constraints such as domestic political transition, roaring labor disputes, the North Korean nuclear issue, and unprecedented damage from typhoon Maemi, all converged and exacerbated the already depressed economy. Korea’s gross domestic product (GDP) growth plummeted to a level of less than 3.1 percent from a relatively robust 7.0 percent the previous year (based on 2000 price levels). However, it is believed that since the third quarter of 2003 the Korean

economy has bottomed out and moved into a phase of mild recovery. Trade, on the other hand, has remained solid. The external trade volume continued to increase in 2003, with exports registering \$194.3 billion, a 19.6 percent increase from the previous year. Korea also imported \$178.7 billion, 17.5 percent more than the previous year.

While the Korea-U.S. military alliance is one sturdy pillar that secures peace and stability on the Korean peninsula and in the surrounding Northeast Asian region, the strong bilateral economic and commercial relationship is another pillar of the Korea-U.S. partnership that underpins our common prosperity. Although the global economy and domestic conditions fluctuate worldwide, Korea-U.S. economic relations remain the bedrock of the greater bilateral alliance of the two countries. Bilateral trade volume amounted to \$59 billion in 2003, with the United States retaining its position as the largest trading partner for Korea. Korea became the seventh largest buyer of U.S. goods—meaning Korea imports more U.S. goods than France, the Netherlands, and China. In particular, Korea has established itself as the fourth largest importer of U.S. agricultural products.

The United States is also by far the biggest investor in Korea. Although in 2002 China replaced the United States as the largest importer of Korean goods, this will not diminish the Korea-U.S. partnership in the foreseeable future. The fact that the geopolitical map may be reshaped by China’s emergence as a regional economic power in Asia presents both a challenge and an opportunity for Korea as well as for the United States. Developments such as these represent the dynamism of political and economic relationships on bilateral, regional, and global levels, and they underscore the complex and multilayered environment in which Korea and the United States operate. The myriad, multifaceted aspects of the bilateral economic relationship will unfold as we review what we have been doing during the past year.

## Features of 2003 Bilateral Economic Relations

A key event that set the tone for Korea-U.S. economic and trade relations in 2003 and beyond was President Roh Moo-hyun's visit to Washington in May 2003. The visit is widely acclaimed to have set a positive tone between the two countries not only in terms of political and security relations but also in terms of economic and trade cooperation. At the summit, President Roh and President George W. Bush agreed on the importance of working together to promote prosperity in the two countries, in the region, and around the world, and they expressed great confidence in the prospects for continued increases in trade, investment, and growth in the Republic of Korea. President Bush also expressed support for President Roh's goal of making Korea a regional hub for trade, finance, and investment in Northeast Asia.

With regard to bilateral trade relations, the two leaders expressed a desire for enhanced bilateral economic cooperation and reaffirmed their commitment to resolve bilateral trade issues through consultation. Note also that they agreed to explore ways to further strengthen the already close economic and trade partnership. While the quarterly trade talks continue to serve as the primary forum for working out differences on trade issues, both sides have felt the need to strengthen and enhance dialogue and will persevere in exploring further options.

In 2003, both countries continued to manage bilateral trade relations in a sophisticated and amicable way. In the past, Korean newspapers were often dominated by headlines such as "Section 301 Trade Pressure from Washington," but we have not had a major trade conflict since the successful completion of the auto talks in 1998. Contributing to this trend are: (1) Korea's continued economic reforms and market liberalization, which have eliminated most cross-border trade barriers; (2) the use of the World Trade Organization (WTO) dispute settlement mechanism for issues that cannot be resolved through bilateral negotiations; and (3) the continued growth of interaction between our two countries, including an understanding of each other's cultural, social, and political constraints.

Despite our shared belief in the benefits of free trade, however, the sociopolitical realities of each country

have sometimes given rise to bilateral trade concerns. As will be elaborated later, disagreements over whether to standardize wireless Internet platforms are caused by the differences in perception of the role of the government in each country. The screen quota issue, which is blocking the completion of the Korea-U.S. Bilateral Investment Treaty, is also seen in Korea not as a trade issue but as a cultural and political one, making it more difficult to find common ground.

Another characteristic of current trade issues is that, with regard to the Korean market, we are now mostly dealing with doing-business issues, as opposed to cross-border market access issues. Since cross-border trade barriers are virtually gone, the agenda of our bilateral trade talks is now dominated by concerns that U.S. businesses have in doing business in the Korean market. Pharmaceutical issues, protection of intellectual property, and issues related to the telecommunications market are examples of this. With regard to the U.S. market, however, most trade issues are still about traditional import restriction measures such as antidumping, countervailing duties, and safeguard measures.

## Bilateral Trade Issues

### *Standardization in the Telecommunications Market*

In May 2002, Korea's mobile telecom operators developed a wireless Internet platform for interoperability (WIPI) with a view to addressing the lack of service interoperability among operators using different Internet platforms. At the request of the industry, the Korean government has been considering the adoption of WIPI as a mandatory standard to expand consumer choices and create a level playing field among content providers. The U.S. government has been raising concerns that the adoption of WIPI as the mandatory standard would drive the U.S. standard currently in use out of the Korean market. The United States has raised similar concerns about the development of standards for 2.3GHz telecom service and location-based service.

There is a perception gap between our two governments about the role of the government in pursuing standardization policies. The U.S. government insists that the standardization effort in the telecom market

is unnecessary, and, ultimately, the decision of whether or not to adopt a standard should be left to the market. However, the Korean government believes that intervention of the government is sometimes justified and necessary when important public policy interests are at stake and the market system cannot adequately determine such policies. In the case of WIPI, the Korean government believes that interoperability among various telecom service providers—a legitimate policy goal—cannot be achieved by the market system and that government intervention in this case may be justified. However, it is not our belief that the standard must be only WIPI and no other standard can be accommodated. In fact, relevant companies in both countries are continuing a dialogue to find a solution by which interoperability can be achieved through the consolidation of various Korean and U.S. standards. To allow more time for this dialogue, the Korean government recently decided to postpone until after 30 June 2004 the decision on whether to mandate WIPI. Originally, the decision was to be made by the end of 2003. We hope that the dialogue will produce a mutually beneficial solution by that time.

### ***Protection of Intellectual Property Rights***

A strengthened protection of U.S. intellectual property rights (IPRs) in terms of augmenting relevant legal provisions and fortifying enforcement efforts has been a standing U.S. request for the past several years, and 2003 was no different. In its annual Special 301 review in 2000, the U.S. Trade Representative (USTR) placed Korea on a priority watch list, citing increasing concerns; in 2002 USTR downgraded Korea back to the watch list as a result of strenuous bilateral consultation; and in May 2003 the U.S. government kept Korea on the watch list. However, in an out-of-cycle review that took place in the fall of 2003, the USTR put Korea back on the priority watch list, citing growing online music piracy and piracy of U.S. motion pictures as continuing problems.

It was disappointing to learn of the decision and difficult to understand why the U.S. government had to make the decision at that point. The Korean government believes that IPR protection is indispensable in attracting more foreign investment and in achieving sustained long-term economic growth. In this belief, the authorities took numerous steps to strengthen IPR

protection in 2003. Korea granted police authority to a standing inspection team under the Ministry of Information and Communication, which is responsible for investigating software piracy. The National Assembly of Korea passed legislation, partly in consideration of a request from the U.S. government, to strengthen the authority of the Korea Media Rating Board to screen pirated motion pictures. In the press release that announced the outcome of the out-of-cycle review, even the USTR acknowledged that the Korean government had been taking more aggressive steps to crack down on infringement of IPRs. We hope that the U.S. government will fully reflect Korea's efforts to strengthen IPR protection in the 2004 Special 301 review.

### ***Automobiles***

The Korean government is well aware of U.S. concerns about the automobile trade imbalance and has taken various measures to address this continuing issue in accordance with the 1998 memorandum of understanding. In May 2003, the Korean government officially sponsored the 2003 Import Motor Show, which turned out to be a big success, with about a half million attendees. The government also finalized a contract with Ford Motors Inc. to purchase 50 Taurus sedans, in addition to the 50 Tauruses purchased in 2002, to be used by the highway patrol. A working group, established in 2001, successfully managed to work out differences regarding issues in automobile standards and certification in 2003.

These positive efforts led to increased sales of foreign automobiles. As of the end of the 2003, foreign auto sales recorded 19,461 units, an increase of 20.7 percent from the previous year. Foreign sales are expected to continue the trend this year.

### ***Countervailing Duty Imposition on Hynix DRAMs***

On 1 November 2002, Micron Technology, Inc., filed with the U.S. Department of Commerce and the U.S. International Trade Commission (USITC) to seek the imposition of countervailing duties on dynamic random access memory (DRAM) from Korea. The petition, which claimed that the Korean government provided unfair subsidies to the Korean DRAM industry through financial institutions, caused serious concern

for the Korean government and for companies such as Samsung Electronics Co., Ltd., and Hynix Semiconductor, Inc.

The Korean government was responsive to the Department of Commerce and USITC investigations; it explained fully that there were no government subsidies provided to DRAM companies and that, although the government had become a shareholder in financial institutions in the course of overcoming the 1997 financial crisis, it had never intervened in their daily business operations or decision-making processes.

However, the Commerce Department and the USITC issued affirmative determinations in June and July 2003 and imposed countervailing duties on imported Hynix DRAMs. The Korean government rejected the call for duties because the determinations challenged the core element of the actions that the Korean government had taken in order to overcome the 1997 crisis, which were based on the recommendations of the international community and the International Monetary Fund. The government thus referred the matter for WTO dispute settlement in June and August.

It is the intention of the Korean government to prove during the upcoming WTO process the nonexistence of government subsidies.

### *Section 201 Steel Safeguard Measures*

On 5 March 2002, President Bush imposed Section 201 safeguard measures, which became effective on 20 March, on a wide range of steel products imported into the United States market; these measures will be in effect for three years in the form of additional tariffs of up to 30 percent and safeguard duties.

The U.S. safeguard measures caused a great deal of concern for steel-producing countries. In particular, concern about a rising tide of protectionism arose when the European Union (EU), China, and others followed suit and imposed their own safeguard measures on imported steel products to avoid trade diversion.

In response to the U.S. government's measures, eight countries (Korea, the EU, Japan, China, Norway, Switzerland, New Zealand, and Brazil) took their case

to the WTO dispute settlement body in March 2002. After lengthy panel and appellate body investigations, in November 2003 the appellate body confirmed the panel's finding that U.S. safeguard measures were not consistent with the WTO agreement and recommended that the United States bring its safeguard measures into conformity with its obligations under the WTO. Finally, on 4 December 2003, President Bush terminated the safeguard measures.

The Korean government welcomed the U.S. government's decision to rescind the measures. It also follows that, given the fact that U.S. safeguard measures have continued to be found inconsistent with the WTO in the cases of EC–Wheat Gluten, New Zealand–Lamb Meat, and Korea–Line Pipe, the Korean government hopes that the U.S. government will use safeguard measures in a more prudent manner.

### *Visas*

Another issue that needs to be drawn to the attention of U.S. policymakers is the difficulty that South Korean citizens are experiencing in obtaining entry visas to the United States as a result of the new U.S. visa policy. A negative impact on business transactions between both countries will be an inevitable consequence of these constraining new measures.

In May 2003, without providing any additional resources, the State Department instructed its embassies and consular offices to hold mandatory interviews with almost all visa applicants. Pursuant to this instruction, starting 1 August 2003, the U.S. embassy in Seoul eliminated the Travel Agent Referral Program—one of four referral programs that enabled certain people to get visas without personal interviews. Further, the embassy has decided to eliminate the three other referral programs (University Referral, Korean Corporate Referral, and Foreign Corporate Referral) beginning on 1 August 2004. Consequently, the percentage of those who require a visa interview rose from approximately 33 percent to 73 percent, resulting in a sharp increase—from 2–5 days to 30–60 days—in the embassy's visa-processing period.

Many visitors and businesspeople in South Korea have had to change their travel plans by either canceling their trips to the United States or changing their travel

destinations to other countries. The reason for doing so is because they have not been able to get a visa in time to meet their required business schedules in the United States.

Of course, the U.S. government's measures should be understood as an effort to ensure security against terrorism in the aftermath of the "9/11" terrorist attacks. Despite this legitimate concern, the various border control measures by the U.S. government can act as considerable obstacles to exchanges and cooperation between the United States and other countries. In acknowledgment of this adverse effect, U.S. business leaders and academic institutions have urged the government to take appropriate measures to alleviate the situation.

Korea, in particular, has been relatively hard hit by the U.S. border control measures because it is the fifth largest source of foreign visitors to the United States; further, it is the only country among the top five that is not participating in the U.S. Visa Waiver Program (VWP).

When Korea's status as a major economic partner and a longtime ally of the United States is considered, it seems counterintuitive for Koreans to be excluded from the VWP program. Korea raised this issue as part of its trade agenda during the most recent quarterly meeting, held in October of 2003.

### **Cooperation on Multilateral Trade Liberalization**

The Korean government was greatly disappointed at the setback suffered during the Cancun WTO Ministerial in September 2003, especially given the fact that it had set a high priority on the achievement of meaningful results in the Doha Development Agenda (DDA) negotiations. Since then, the Korean government has been actively participating in the Geneva process, which is aimed at finding a way out of the stalemate, and believes that, as a result of most countries' efforts, enough momentum can be maintained to carry on with the negotiations.

The Korean government is concerned about the widespread perception that, owing to the political calendars of some major players, resuming the negotia-

tions in 2004 will be difficult. Bearing in mind that faltering in the negotiations will do serious harm to free trade, we must overcome this negative perception and make every effort to resume the negotiations as soon as possible. Our expectation that the negotiations must move forward is hinged upon the United States' taking an aggressive leading role in resuscitating the stalled talks.

To meet this end, the Korean government is ready to work with other members to successfully conclude the negotiations in a timely manner, specifically considering the Cancun text—in spite of its shortcomings—as the basis for agricultural and nonagricultural negotiations.

Besides market access issues, a wide range of other important issues are on the agenda. Thus, the Korean government is of the view that a balanced approach is needed to move forward the DDA negotiations without creating further difficulty on the points where consensus has yet to be reached.

### **Regional-Level Cooperation**

#### *APEC*

Korea will host the APEC Economic Leaders Meeting and other related meetings in 2005. In 2003, Korea launched the preparatory office for the 2005 APEC meetings, which will be expanded in the years to come. Korea will continue to discuss with other countries the theme for the year 2005 and dates for the APEC meetings.

At the current stage, it is hard to tell what the focus will be in 2005. In my personal view, Korea will consider APEC reform, the strengthening of capacity-building efforts for developing members, and a mid-term stocktaking of the Bogor Goals, while it continues to support APEC's major activities such as free and open trade and investment, and economic and technical cooperation among member economies.

The APEC summit will be a historic occasion where the four major powers that surround the Korean peninsula will meet for the first time in Korea. We will work with the United States and other member economies to make it a great success.

### *Korea's Role as an Economic Hub in East Asia*

The current administration places top priority on evolving into an economic hub in East Asia and believes that Korea is well situated to assume such a role. Furthermore, Korea is equipped with a well-educated population and with the world's highest level of information infrastructure. Building an economic hub will also contribute to the establishment of peace and common prosperity in the region. When President Roh visited the United States in 2003, the United States expressed its support for Korea's efforts to become a regional hub. As a follow-up, both U.S. and Korean business sectors are in the process of preparing to hold a conference that will help translate the idea into a more concrete reality. The Korea-U.S. Business Council and the U.S. Chamber of Commerce will cohost the conference in the first half of 2004, with the support of both countries' governments.

### **Economic Interdependency and Integration**

Evidence of the level of Korea's integration into the international economy is not only explained by its weight of trade volume to GDP—around 70 percent—but also by its financial market transactions. Foreign investors own 40 percent of shares, a value of \$110 billion, that are registered in the Korean stock market. International firms have already become significant players in the Korean market, generating 10 percent of Korea's gross national income. In particular, U.S. investors and companies occupy an ever-growing position in Korea's investment and business activities. U.S. influence as an important and substantial source of foreign direct investment (FDI) flowing into Korea has traditionally remained solid, despite some decrease in investment levels in 2003.

In 2003, total FDI into Korea fell to \$6.47 billion from \$9.1 billion the previous year. This decrease is mainly attributed to the worldwide economic slowdown, domestic labor unrest, the negative influence of the North Korean nuclear issue, and growing competition from China. FDI from the United States fell 72.4 percent during 2003, although the United States retains its position as the largest investor into Korea.

The Korean government has been working aggressively to attract foreign investment, with the aim of increasing the level of foreign capital in Korea to 14 percent of GDP by 2010. To this end, the government continues its efforts to remove impediments to foreign investment and corporate activities and provide incentives with regard to financing and taxation. In addition, the government will pursue its goal of enhancing corporate transparency and accountability. Emphasis will be placed on activities such as strengthening accounting and public disclosure standards, encouraging shareholders to actively exercise their rights, and establishing unified bankruptcy laws.

### **Cooperation in Afghanistan, Iraq, and the War on Terror**

Korea has demonstrated its support of U.S. policy and operations in Iraq through both financial and military contributions. To help Iraq rapidly recover from the damage incurred from war and a long period of dictatorship, Korea has decided to contribute \$260 million to Iraqi reconstruction over the next four years. Korea's assistance is now being provided bilaterally as well as through nongovernmental organizations and international organizations, and it will continue to be supplied in this manner in the future. Korea will continue to cooperate on a wide range of issues with both the U.S. government and private companies to facilitate the reconstruction of the Iraqi economy and society. Korea's commitment to this issue represents a traditional pattern of support for U.S. operations, including the effort in Vietnam, Iraq in 1991, Afghanistan after 9/11, the war on terror, and the current situation in Iraq, for which Korea has agreed to send more than 3,000 forces in the near future. It has already dispatched military units to Afghanistan and Iraq.

### **North Korea Factor**

An interesting feature of early 2003 was the rapidly spreading international concern about the negative impact the North Korean nuclear problem could have on the Korean economy. The North Korean nuclear issue became a source of aggravation in August 2002 when North Korea bluntly acknowledged to a U.S.

delegation that it had a clandestine nuclear weapons development program of enriching uranium. Security experts of the Korean government were immediately dispatched to New York City to mitigate concerns on Wall Street. The North Korean nuclear issue then became the single most important topic at numerous seminars and gatherings on the Korean economy in the United States. Security issues overshadowed economic discussion at almost every turn, and even economists weighed in on the issue, with economic jargon being supplanted by political security language.

Foreign investors' responses turned out to have been affected, quite naturally, more by psychology than by reality. Throughout this confusion, Korean economic fundamentals remained strong and sound; thus, confidence was regained, and the sense of crisis dissipated. In retrospect, it was realized that there was little or no concern on the economic front during the first North Korean nuclear crisis in 1994. What accounted for today's different reactions?

There are two possible explanations. First, the Korean economy has been liberalized and opened up to the outside world a great deal since 1994, when Korea was not yet a member of the OECD and still remained a relatively closed economy. But in the span of 10 years, the Korean economy has transformed itself into an extremely liberalized economy by world standards. Trade and the capital and financial markets are almost completely liberalized, and Korea has a floating exchange rate. Hence, Korea's economy is much more integrated into the international market and is thereby more exposed to the daily fluctuation of the international financial market and far more vulnerable to the psychological perceptions of foreign investors.

Second, foreign investors tend to be more sensitive to this perceived crisis than Koreans. Since the 1960s, the Korean economy has flourished despite the perennial security concerns of a divided nation that faces persistent threats and sporadic provocations from the North. For Koreans, this seemingly tenuous geopolitical reality is in fact the status quo of daily life. Although the North Korean nuclear issue may continue to undermine the confidence of foreign investors in Korea, the open and transparent Korean economy will remain stalwart. The Korean government will not shrink from its policy of market principles and strong

international integration, whatever crises seem to surround it.

The Policy for Peace and Prosperity continues to be a central tenet of the current government. President Roh firmly believes that the North Korean nuclear problem will be resolved in a peaceful manner through talks among the parties involved, and all of the countries involved in the six-party talks are now committed to pursuing a peaceful and diplomatic means by which to settle the situation. The Policy for Peace and Prosperity, backed by the concerted international goal of resolving the North Korean nuclear issue, will eventually transform the Korean peninsula into a land that fosters peace in Northeast Asia; and a peaceful Korea will serve as a bridge linking the Eurasian continent and the Pacific Ocean.

### **Conclusion: Prospects for 2004**

The ongoing trend of recovery in global economic performance is expected to accelerate. Carried by this movement, Korea's GDP growth is expected to regain its momentum by rising to approximately 5 percent in 2004. Korea's external economic performance will also continue in its smooth expansion, with an increase in trade volume. Bilateral trade between Korea and the United States will continue to be brisk, as the U.S. economy is expected to sustain a robust growth rate at an average of 4 percent. This rosy scenario may offer economists and policymakers some sense of relief, but this is no time for complacency, especially given potential hurdles that may lurk beneath the surface—for example, the exchange rate issue. The influence of political events this year in both countries should also not be overlooked. Korea was to have a paradigm-changing general election in April, and the United States is already gearing up for a pivotal Presidential election in November of 2004.

It would thus appear that Korea-U.S. bilateral economic relations in 2004 hinge on the following conditions:

- World economic performance, especially that of major countries like the United States, the EU, and Japan, as well as Korea;
- Progression of the ongoing multilateral trade liberalization negotiations of the DDA;

- China's continuing economic dynamism and the prospect of its eventual emergence as a new economic power;
- Mushrooming network of free trade areas;
- Result of the U.S. engagement in Iraq and the suppression of terrorism;
- Political developments in both countries, as mentioned; and, last but not least,
- Progress on the North Korean nuclear issue, which will continue to be looming large.

These conditions, if properly managed, may evolve into opportunities.

To meet these challenges and help convert them into opportunities, the Korean government is planning to maintain current policies that support economic recovery. To this end, the government will expedite budgetary expenditures in the first half of 2004 to maintain fiscal flexibility and will also make efforts to seek to create a proactive investment environment. The Korean government will also continue to carry out its committed economic reform in various sectors. The reforms focus on enhancing the transparency of the overall market environment. President Roh and his administration are firmly committed to making Korea one of the world's best places to do business. Korea's leadership will endeavor to promote peace and prosperity in Korea through even stronger Korea-U.S. cooperation and friendship and an absolute dedication to a more transparent, more open, and more productive market economy.

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