PART 6

TRADE POLICIES AND TRADE SYSTEM

21. Trade Policies in Korea

Handbook of Comparative Economic Policies: National Trade Policies,
ed. by D. Salvatore,
Greenwood Press, 1991

ed. by D. Salvatore, Greenwood, 1992 AN EXCERPT

TRADE POLICIES IN KOREA

IMPORT LIBERALIZATION AS A LONG-TERM POLICY GOAL

The balance of current accounts improved substantially in 1983, and the movement toward import liberalization appeared again but this time as a long-term policy goal with a definite annual liberalization timetable.

The simple arithmetic average basic tariff rate was reduced from about 36 percent in 1977-78 to about 25 percent in 1979-81. The weighted average tariff rate also fell steadily from about 19 percent in 1978 to about 16 percent in 1979, about 13 percent in 1980, and about 12 percent in 1981. In early 1983 the Ministry of Finance (MOF) took the decisive initiative in the import liberalization movement by presenting a Five-Year Tariff Reduction Program (1984-88): the simple arithmetic average (basic) tariff rate for manufactured products was scheduled to fall from 22.6 percent in 1982-83 to 16.9 percent in 1988, that for agricultural products from 31.4 percent to 25.2 percent, and that for all commodities from 23.7 percent to 18.1 percent. In principle, the basic tariff rates on noncompetitive raw materials (including those that were previously subject to the zero tariff rate) were to converge to 5 percent and those on competitive raw materials to 10 percent. The basic tariff rates on luxury consumption goods, were to converge to 30 percent and those on the rest of intermediate, investment, and consumption goods to 20 percent, minimizing the deviations around the respective mean values. The maximum basic tariff rates on the exceptional items were not to exceed 100 percent, and 91.1 percent of all dutiable import items would be subject to less than 20 percent tariff rates by 1988.

Following the initiative taken by the MOF, the MTI presented its own schedule of import liberalization: the share of AA items was to increase from 76.6 percent in 1982 to 80.4 percent in 1983, 91.6 percent in 1986, and 95.2 percent in 1988. Then in February 1984 MTI also presented the concrete list of RI items that would be liberalized during the period 1984-86.

According to the import liberalization schedule for 1987-88 that was announced on October 30, 1985, a 100 percent import liberalization for metal and iron and steel products would be achieved by 1987, and that for electronics, electrical, and nonelectrical machineries by 1988. Imports of pulp and paper, ceramics, and chemicals would be liberalized up to 99.6

percent by 1988. Textiles imports would be liberalized up to 97.8 percent by 1988. Among textile products, only those related to sericulture such as raw silk, silk yarn, and silk fabrics would continue to be subject to import control, and among the chemicals only ethyl achohol and some toxic insecticides (eight items altogether) would continue to be subject to import controls after 1988.

As of 1986, 56 monopolistically produced manufactured commodities out of 254 such items were subject to import restrictions. However, by 1988 only 3 monopolistically produced commodities (milk powder, fruit juice, and fermented lactic bacterium) would continue to be subject to import control. Out of 10,205 importable items, only 534 items indeed remained as RI by August 1988, and 450 of these consisted of agricultural, livestock, fishery, and mining products. Among the remaining 84 RI items, 18 were silk products, 33 alcoholic beverages, 20 precious stones, and 13 sundry products including paintings, antiques, and softwares.

U. S. INTERVENTION ON IMPORT LIBERALIZATION

In 1982, for the first time since World War II, Korea registered a trade surplus with respect to the United States that amounted to about $0.3 billion. It caused the United States to request a more substantial import liberalization from the Korean government that was conducive for MOF and MTI undertaking the Five-Year Tariff Reduction Program (1984-88) and Long-Term Import Liberalization Schedule (1984-88), respectively. Because of the mounting resistance offered by the vested-interest group of capital-intensive intermediate and investment good sectors, however, the Korean government appeared to be wavering in 1985, as if to halt the import liberalization movement once again. At this crucial juncture, however, the rapidly rising trade surplus caused the direct and fierce intervention of the U.S. government. Korea's trade surplus with respect to the United States rose rapidly from about $2.0 billion in 1983 to $4.3 billion in 1985 and to $9.6 billion in 1987. The United States immediately started to exert irresistible pressure on the Korean government to completely liberalize trade not only in commodities but also in services.

By the mid-1980s the Korean people appeared to suffer from a somewhat exaggerated feeling of U.S. persecution. The Reagan government seemed to have decided to invoke the Section 301 unfair trade clause against the Asian NICs who were extremely weak in international power politics. To the Korean people, the United States appeared to have singled out the most vulnerable country, Korea, as the outlet for the frustrations of the American mass. Indeed, the U.S. government claimed that Korea's average tariff rate of 20 percent was too high for foreign products to get into the Korean market, completely ignoring the fact that Korea had one of the lowest average tariff rates among the 124 developing countries in the world and the fact that Korea's import/GNP ratio amounted to about 45 percent. The U.S. government said that the planned reduction of the average tariff rate from 23.7 percent in 1982 to 16.9 percent by 1988 was too slow, completely ignoring the fact that no other developing countries had ever tried to cut the tariff rates so significantly in such a short period of time. The United States also accused Korea of unfairly restricting imports of agricultural, forestry and fishery products as well as such specific items like cigarettes and wine, completely ignoring the fact that almost all the resource-poor advanced Organization for European Cooperation and Development (OECD) countries were restricting the imports of these primary products in one way or another.

COMPLETING IMPORT LIBERALIZATION: 1988-89

Owing very much to the successful control of inflation since 1982, it was possible to observe a dramatic increase of domestic savings in Korea in the mid-1980s. For the first time since its independence, Korea could achieve a complete self-financing of domestic investments in 1986. Furthermore, the magnitude of excess domestic savings (over domestic investment) began to increase rapidly in 1986. Fortunately, the rapid increases in domestic savings propensity did not cause a Keynesian recession for the Korean economy. External conditions were very favorable in allowing rapid expansion of Korea's exports. Oil prices and interest rates declined sharply in international financial markets. The OECD countries maintained relatively high growth rates. There were drastic appreciation in the Japanese yen and Taiwanese dollars, enhancing Korea's competitive power against its two arch rivals in international markets. However, the current account surplus began to generate serious inflationary pressures.

The Korean government wanted to reduce the outstanding external debt at a reasonable rate each year, say, by around $5 billion a year. The current-account surplus in 1987, however, amounted to nearly $10 billion, aggravating trade frictions with the United States and increasing U.S. pressure to appreciate drastically the Korean currency. The Korean government decided to solve the current-account surplus problem by completely liberalizing the imports of manufactures, for example, by increasing the number of AA items and lowering the rates of tariff as scheduled, making special concessional tariff cuts, eliminating the Surveillance List, and revising Special Laws that used to restrict imports even for items on the list of automatic approval.[1]

The surplus in Korea's commodity trade balance with the United States rose from $4.3 billion in 1985 to $9.5 billion in 1987. It led to a chorus of complaints from U.S. business people, members of Congress, and government officials about Korea's "unfair" trading practices, to demands for more severe protectionist measures against Korea's exports, and to pressure on the Korean government to drastically appreciate its currency and completely liberalize imports of not only manufactures but also services and agricultural products.

On the other hand, the deficits in Korea's commodity trade balance with Japan rose from $3 billion in 1985 to $5.2 billion in 1987. The Korean economy has been heavily dependent on intermediate and capital goods imported from Japan, while its exports of finished consumption goods have been heavily dependent on the U.S. market. In order to redress this undesirable situation, the Korean government has enforced the Import Source Diversification and Localization Program whose sole objective was to reduce imports from Japan and has provided product-specific incentives (such as low-interest foreign exchange loans) to switch import sourcing from Japanese to U.S. products.

Having been subject to extreme pressures from the United States since 1986 to drastically appreciate its currency and expand imports from the United States, the Korean government adopted the import-increasing liberalization method as much as possible instead of the export-reducing exchange rate realignment solution.

In early 1988 the Ministry of Finance again took the decisive initiative to complete import liberalization by presenting a long-term scheme that would reduce the level of tariff protection in Korea to a rate comparable to the current rates of many countries in the OECD by the early 1990s. According to the new tariff schedule that passed the National Assembly in December 1988, to be implemented over a five-year period covering 1989-93, the simple arithmetic average (basic) tariff rate for manufactured products was scheduled to fall from 16.9 percent in 1988 to 11.2 percent in 1989 and to 6.2 percent in 1993; that for agricultural products from 25.2 percent in 1988 to 20.6 percent in 1989 and to 17.9 percent in 1993; and that for all commodities

[1]Since the liberalization program began, Korea has maintained a 'surveillance list' of import with a threatened import surge. This list has included between 100 and 200 items in recent years; the present list contains 90 items and covered imports valued at $720 million in 1986. . . the appearance of an item on the list apparently affects the likelihood that an import agent provides the clearance necessary to effect imports from the relevant industry association" (IBRD, 1987, p. 96).

from 18.1 percent in 1988 to 12.7 percent in 1989 and to 7.9 percent in 1993. In principle, the basic tariff rates on noncompetitive raw materials were to be reduced from 5 percent in 1988 to 1 percent after 1989, and those for competitive raw materials from 10 percent in 1988 to 5 percent in 1989 and then to 3 percent by 1993. The basic tariff rates on luxury consumption goods were to be reduced from 30 to 50 percent in 1988, to 20 percent in 1989, and to 8 percent in 1993. The rates on other consumption goods would also be reduced from 20 percent in 1988 to 8 percent in 1993. The basic tariff rates on semiprocessed intermediate products would be reduced from 10 to 20 percent in 1988 to 5 percent in 1993, and the other intermediate products would be reduced from 20 percent in 1988 to 8 percent in 1993. The major import-competing agricultural products were subject to 30 to 50 percent rates of tariff in 1988 but were scheduled to converge to 30 percent tariff rate by 1993. The representative tariff rate was 20 percent in 1988, but it was scheduled to be reduced to 8 percent by 1993. Prior to 1990, a 2.5 percent defense surtax was collected from all import items. Following the abolition of the defense surtax in 1991, however, the government decided to postpone the tariff reduction schedule by one year. As a result, the terminal year for New Tariff Schedule was changed from 1993 to 1994.[2]

Import liberalization of agricultural products constitutes the real challenge to Korean people. As of 1988, 11 agricultural products (including tobacco, alcoholic beverages, and bananas) were subject to a 100 percent tariff, and fruits, dairy products, vegetables, and meats were subject to 30 to 50 percent tariffs. The major import-competing food grains such as rice and wheat were subject to only 5 percent tariff, but their imports were severely restricted by special laws. Out of 299 items of import-restricted products (based on eight-digit CCCN classification), 202 items (67.6 percent) were subject to less than 20 percent tariffs, but almost every one of these agricultural imports was subject to strict quantitative import control on the basis of various special laws enforced by the Ministry of Agriculture.

Under the ever-escalating threats from the U.S. government and Congress, the Korean government earnestly started dismantling various tariff and nontariff barriers in 1987. The Korean government reduced tariffs on 1,873 items identified as priorities by the United States, including passenger cars, tobacco products, cosmetics, electrical goods, and paper and paperboard.

[2]Before October 1988 the government required an import deposit amounting to 10 to 15 percent of the value of imported goods. By June 1989 the deposit requirement was reduced to 5 percent for large companies and was waived for small and medium-sized companies.

Furthermore, in February 1989 tariffs on 203 items of particular U.S. concern were reduced, including such items as chocolate, refrigerators, and computers (see MTI, 1989).

The Korean government began applying the Import Surveillance System in 1977 in order to monitor the import trends of newly liberalized products and to resume protection if sharp rises in imports inflicted damage on specific sectors. The number of items subject to this system was reduced from 48 to 25 (in eight-digit CCCN classification) in 1988; the system itself was abolished in January 1989.

Import-related restrictions on over 814 items covered by seventeen special laws were abolished during an eleven-month period in 1987-88 (see MTI, 1989, pp. 22-23). The government eliminated various licensing requirements, simplified inspection and approval procedures, and reduced various import-related fees. According to the Agricultural Chemicals Act, the number of agricultural chemicals that can be imported freely amounted to only 20 items as of 1989, but the government decided to raise the number to 416 by 1993 (see MTI, 1989, p. 24). The number of items whose imports were controlled by thirty-nine special laws (such as the Quality Control Act, the Law of Weights and Measures, the Food Sanitation Act, the Drug Control Act, and the Atomic Power Act), still amounted to 1,980 items (in ten-digit HS classification) as of 1988, but in 1989 the Korean government promised the U.S. government that it would keep reducing the number of such items and that these special laws would never be abused as nontariff import barriers. In July 1988 Korea abolished local content restrictions in government procurement and decided to apply membership in the General Agreement on Tariffs and Trade (GATT) to government procurement. The number of items subject to the Import Source Diversification System (which was designed to prevent certain imports from Japan) was reduced from 147 to 98 in 1988 (according to four-digit CCCN classification). The system itself was scheduled to be abolished in the early 1990s.

The overall import liberalization ratio was scheduled to expand from 94.7 percent in May 1989 to 97.3 percent in 1991. Among the nonagricultural products, only 6 silk products and 4 mineral products (anthracite and salts) were scheduled to remain import-restricted after 1991.[3] Even the import liberalization ratio for agricultural and fishery products was scheduled to increase from 71.9 percent in 1989 to 85.2 percent in 1991, leaving only 274

[3]Products like pesticides are nominally import-liberalized, but their import is strictly controlled by Special Laws. In the case of pesticides, the government plans to completely liberalize their imports by 1993.

out of 10,205 items subject to import restriction (based on a ten-digit Harmonized Tariff System classification). By late 1989, Korea's status in GATT changed from a developing country subject to Article XVIII (Clause B) to advanced status subject to Article XII. Korea has pledged to liberalize, in principle, its entire agricultural imports by July 1997.

The Korean government decided to solve the current-account surplus problem by enforcing a thorough import liberalization, particularly of manufactures. It seems to have more than succeeded in achieving its objective: Korea's current account turned from surplus to deficit in 1990. Of course, other factors, such as serious labor problems and rapidly rising wage rates, must also have contributed to get this result, but import liberalization must have been one of the most important factors.

FUTURE TRENDS AND POSSIBLE PROBLEMS

As far as manufacturing sectors are concerned, domestic markets were almost completely opened to international competition as of 1990. A few items are still protected against Japanese products, but they, too, will soon be opened up. A more serious problem is the extreme pressure Korea is under, particularly from the United States, to open up its domestic markets for services and agricultural products. Since 1987, Korea has introduced a new copyright law that parallels U.S. protection, extended the intellectual property protection to computer software, substantially opened the insurance market, provided national treatment for foreign banks, allowed greater participation to foreign firms in trading company and distribution businesses, opened the motion picture market, and promised the total opening up of the advertising market by 1991 and a step-by-step opening up of capital and security markets during 1991-92. Future liberalization actions will include allowing the establishment of additional branch offices of foreign banks for retail banking. (See MTI, 1989.) Korea also became an Article 8 country of the International Monetary Fund (IMF) in 1988 and hence cannot impose restrictions on payments or transfers in international transactions.

While Korea's manufacturing sectors have been able to sharpen their international competitiveness through a quarter century of export drive, most service sectors have been allowed to enjoy protected life in the captive monopolized domestic markets. The service sectors have yet to be trained for the operation under competitive market principles, free from direct government intervention and control. Since the Korean government has maintained an extremely repressed financial regime based on credit rationing, banking and capital markets, in particular, constitute the most backward area in the Korean economy.

On the other hand, most of the major agricultural sectors have been shielded from foreign competition under the dual price system. The Uruguay Round aims at eliminating agricultural subsidies and price support systems as well as all kinds of quantitative import restrictions. Almost all of Korea's agricultural sectors, however, can be wiped out with free trade. As of 1989, the agricultural sectors still accounted for nearly 10 percent of Korea's GNP and about 19 percent of total employment. Land per farmer amounted to only 0.67 hectare in Korea, which might be comparable to that in Japan (1.1 hectare) but not comparable to that in, say, West Germany (9 hectares) or in the United States (117 hectares). The domestic price for rice is almost five times that of import price.

In 1970 the agricultural sector absorbed about 50 percent of total employed persons. But its share declined to 32 percent in 1980 and to about 21 percent by 1987. The absolute number of persons employed in agriculture decreased from about 4.4 million persons in 1980 to about 3.4 million persons in 1987. If an identical trend continues in the future, there will be only about 0.4 million persons in the agricultural sector by the year 2008 and less than 0.3 million by 2010. Furthermore, as of 1988, more than 60 percent of farm household heads were over fifty years of age, and hence there is a good possibility that the Korean agricultural sector will experience a fundamental structural change in the 1990s and thereafter, provided that the Korean government seriously implements a structural adjustment in accordance with the exogenously determined progress in agricultural import liberalization.

Through an expanded scale of production managed by full-time professional farmers and assisted by modern biotechnology and mechanized agro-engineering, the need to protect and subsidize farm sectors can be drastically reduced. By transformation into capital- and technology-intensive farming, quite a few agricultural sectors can become export sectors, while some of them may completely disappear through international competition. If the Korean government simply copies the agricultural policy of Japan in the 1960s and 1970s, however, Korea may well end up with the hopelessly inefficient Japanese style mini-scale weekend farming conducted by part-time farmers which cannot survive without heavy protection.

The external pressures on Korea to open up its domestic market completely provide a new growth potential if the government gives positive responses to these pressures. In the absence of systematic responses, there is the danger of chaotic destruction of Korea's service and agricultural sectors. The government-controlled financial sectors have yet to learn open competition based on market principle, and the Korean government has yet to implement truly market-determined interest and exchange rates. Unlike the manufacturing sector, the liberalization of service and agricultural sectors would require good preparation and systematic implementation over a long period of time. But it is not certain whether Korea will be allowed to have sufficient time for an orderly adjustment and whether the Korean government will be capable of enforcing a systematic implementation of structural adjustment even if it is given a reasonable grace period.

REFERENCES

Hong, Wontack. 1991. "Import Restriction and Import Liberalization." *In Liberalization in the Process of Economic Development*, edited by L. B. Krause and K. Kim. Berkeley: University of California Press.

Ministry of Finance (MOF). 1989. *'88 White Paper on Tariff Rates Reform.* (In Korean.) Bureau of Tariff. February.

Ministry of Trade and Industry (MTI). 1989. *Free and Fair Trade; Korea's Record and Commitment.* March.