UNICE
Union of Industrial and Employers' Confederations of Europe
Union des Confédérations de l'Industrie et des Employeurs d'Europe

OPPORTUNITIES FOR SUCCESS

UNICE Status Report on EU-Korea Economic and Trade Relations

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Contents

Executive Summary

- In response to the Asian financial crisis, Korea has enacted unprecedented economic and financial reforms. Provided these reforms are resolutely pursued and implemented, Korea will return to enhanced competitiveness and sustainable economic growth.

- The dramatic steps made by Korea to open virtually the entire economy to foreign participation according to market principles, are scheduled to be implemented in several stages between 1998 and 2001.

- UNICE is very much concerned over the Korean renewed export drive towards the European Union. Korea's reliance on exports alone to boost growth is not sustainable, either economically or politically.

- For the foreseeable future and in spite of recent liberalisation, the Korean market will remain one of the most difficult in the world. This is mainly due to still excessively onerous and non-transparent regulations, which will only slowly disappear. This resistance to change continues to have a negative impact in terms of concrete market access and may delay speedy renewal.

- Korea has adopted the first of a new series of measures to open the Korean capital market and to lower the barriers to portfolio and direct investment. First measures enacted on 1 July 1998 include:
  - raising the aggregate foreign equity ownership ceiling
  - easing the restrictions on land purchases by foreigners.

- Further actions for full liberalisation will be implemented in two consecutive stages (1 April 1999 and 1 January 2001). Only then are the ongoing restructuring reforms in the banking and manufacturing sectors expected to be complete.

- UNICE strongly supports Korea in the pursuit of the historic changes being made. However, for business, the real test of reform is effective implementation. Investor confidence may be severely tested by the social consequences of the massive economic restructuring.

- UNICE proposals for concrete actions for improved market access include:
  - recognition of the "EU certificate of origin"
  - coherence in the interpretation of customs regulations
  - reduction of high tariffs and tax burdens,
  - simplification of standards and certification
  - pro-active confirmation of abolition of "frugality campaigns"
  - effective enforcement of the protection of intellectual property rights
  - elimination of deficiencies in competition legislation
  - establishment of an open and competitive public procurement system.

- UNICE welcomes further deepening of EU-Korea relations and co-operation (e.g. through the 1996 "Framework Agreement for Trade and Co-operation"). This broadened EU-Korea relationship forms an integral part of the "Asia-Europe Meeting" (ASEM) process and enhanced EU-Asia relations as a whole.

- UNICE reaffirms its commitment to pursuing ways and means to strengthen dialogue with the European institutions and Korean business. This paper is a contribution to ongoing work in the European Commission to improve the EU-Korea relationship.

A. Introduction: Crisis and Renewal

Korea has seen more deregulation and liberalisation in the past few months than in the previous ten years. In response to the Asian financial crisis and its dramatic fallout on the Korean economy, the Korean Government has launched an unprecedented economic reform policy, including major financial measures to stimulate the depressed economy.

The programme has essentially two objectives: *first*, to prevent the collapse of the economy and control unemployment; and *second*, to rebuild Korean industrial and financial structures by opening virtually the entire economy to foreign participation according to market principles.

The market-opening phase of the reform is already well advanced. The limits on foreign ownership of Korean companies have basically been removed, and most restrictions on foreign ownership of land will be ended as well. Foreigners can undertake mergers and acquisitions without restrictions. If these dramatic changes are pursued, it will offer new and unprecedented opportunities also for European companies.

But, while capital markets can be opened up fairly quickly through legislation and administrative action, industrial restructuring is necessarily a longer, more complex process. It requires building new behaviour and traditions, rather than just abolishing old rules and regulations. Moreover, it must be carried out mainly by business and civil society, rather than by government decree alone.

European business welcomes these tremendous changes which go in the direction of market economics and increased integration in the world economy. However, the new favourable conditions for trade and investment still have to be fully tested in the marketplace.

The test of investor confidence could also be under strain with the social consequences of the massive economic restructuring and, in particular, high unemployment likely to continue for the next few years with future political prospects of an unstable balance between crisis and renewal.

The following:

- gives an overview of the Korean market access regulations, taking into account the reforms,
- enumerates concrete proposals to assist implementation of the restructuring process.

This report supplements the comprehensive information given by the "Market Access Database" of the European Commission[1] as well as by the "Data Bases" of the European Union Chamber of Commerce in Korea[2], both internet databases.

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[1] http://mkaccdb.eu.int/mkdb/sec1.pl
[2] http://www.eucck.org

B. Opening to Foreign Direct Investment

1. Foreign Exchange Transactions

All foreign exchange transactions related to foreign direct investment, equity investment and mergers and acquisitions have been loosened by first liberalisation measures as of 1 July 1998 ("Immediate Liberalisation Measures"). Further actions for full liberalisation will be implemented in two consecutive stages. The first starting on 1 April 1999 ("First Stage Liberalisation Measures"), and the second starting on 1 January 2001 ("Second Stage Liberalisation Measures"). As a result, by the year 2001 Korea's foreign exchange system is expected to improve to the mid-group level of OECD members. This should round off structural reforms in the banking and manufacturing sector.

This means that:

- restrictions are abolished on foreign investment in short-term financial instruments such as currency derivatives (CDs),
- foreign investment is allowed in over-the-counter stocks (OTC) and local real estate,
- the foreign exchange bank system is abolished so that foreign investors are no longer required to handle all of their currency transactions through a single domestic foreign exchange bank.

Furthermore, the new Korean foreign exchange regime means that

- local companies can borrow abroad for short-term trade financing,
- restrictions are abolished on maximum maturities and types of import goods eligible for deferred import payment,
- restrictions are removed on the receipt of down-payments for exports and on the maximum period for advance payments for exports,
- medium-term foreign borrowings and issuance of foreign bonds with maturities of one to three years by domestic firms will be liberalised,
- separate regulations on spot positions at foreign exchange banks will be abolished.

2. Foreign Direct Investment

The Korean government enacted epoch-making changes with the "Foreign Investment Promotion Law" from "control and regulation" to "promotion and support". Among the new regulations the following may be noted:

- increase in permissible purchase of a Korean company in a first stage up to 55% and in due course up to 100% of equity by a foreign owner
- authorisation for "unfriendly" mergers and acquisitions
- authorisation to establish 100% foreign-owned manufacturing and service subsidiaries in nearly all sectors of the economy.

A foreign representative office or a subsidiary may now be established within 60 to 90 days with minimum capital of US$ 100,000. Administrative procedures to obtain permission to start a manufacturing facility are lengthy and cumbersome, even for local investors.

Until recently, acquisition of land required special permits, which were usually given only for manufacturing activities, preferably on certain designated industrial sites. However, land acquisition by foreigners is also being liberalised. Now it is possible to report the transfer to the authorities after the transaction has taken place.

Controls on mergers and acquisitions of domestic companies by foreign investors are also being relaxed. Previous requirements for mandatory tender offers, which had made M&A activities more difficult, have been abolished. The limit on stock acquisitions by foreigners requiring the consent of board directors was also raised from 10% to one third, and will be completely eliminated later this year which means that hostile take-overs will be legally possible.

To further facilitate foreign direct investment, a "single package service" is to be set up offering guidance on investment, help with finding industrial sites and obtaining permits and approvals for factory construction. There are special tax incentives for approved high-tech investments with a 5-year tax holiday from the first profitable year for corporation tax, income tax, acquisition, property and aggregate land taxes, and exemption from tariff duties, special excise tax and value-added tax on imported capital goods. Among new incentives to be mentioned are easier conditions to obtain rent reductions at the two industrial parks especially built for foreign investors.

The Korean government has committed itself to continue the liberalisation of investments within a set time-schedule.

- UNICE welcomes these measures and commitments for the liberalisation of capital markets and foreign investment with the objective of 100% foreign equity ownership allowed before too long.

- In view of the next EU-Korea Ministerial meeting, in October 1998, UNICE suggests the deepening of the EU-Korea dialogue on capital and investment liberalisation, in particular through the speedy implementation of the "Investment Promotion and Action Plan" (IPAP) as agreed during the ASEM2 Summit in London, April 1998.

- UNICE looks for active involvement of Korea in

  - the multilateral OECD investment negotiations with a view to concluding the negotiations on the "Multilateral Agreement on Investment" (MAI) in 1999, and in
  - the WTO work on investments in view of getting the support of Korea for launching WTO negotiations on investments in the year 2000.

C. Market Access Status

1. Tariffs and taxes

Korean tariff levels have been continuously lowered in recent years and the average applied tariff rate is now 7.9%. But the combination of persistently high tariffs and taxes for some consumer goods, especially in the case of motor vehicles, continue to make foreign imports prohibitively expensive.

Around 90% of tariffs are now bound, but for the rest (mostly industrial products) there is the possibility to raise tariffs for products such as motor vehicles, television sets, computer equipment, gas turbines etc., if the local industry felt of needed protection.

If a domestic industry is threatened by injury because of foreign competition, the government may introduce so-called ”adjustment duties” within the limits of bound tariff levels, which may lead to substantial extra costs for importers. Changes in tariff levels are especially important for companies which import raw materials and components and where the local value added is low.

UNICE therefore proposes as concrete measures:

- Reduce the tax burden on imported goods and services to a reasonable level and comparable to other OECD standards, to place importers of foreign products and domestic manufacturers on a more equal footing.

- Make substantial commitments in the forthcoming WTO negotiations in the year 2000 by the Korean government to lower tariff peaks and to bind them at levels which stimulate trade and make it easier for both parties to make greater use of comparative advantages.

  Such commitments would reduce

  - the lack of transparency and predictability in tariff schedules encountered today, and
  - the possibility of short-notice adjustment duties.

2. Import quotas and licences

Tariff quotas concern around l5% of total imports, especially foodstuffs, chemicals, textiles and steel. Quotas are determined on the basis of recommendations from associations of local manufacturers. This means that local producers are given preferential access to cheap inputs.

For some 130 products, restrictions apply for imports from Japan under the “Import source diversification programme”. This also affects most European companies invested in Korea which are unable to import to Korea Japanese components or accessories used elsewhere in their products world-wide. Special waivers can be obtained in some circumstances. The programme is scheduled to be abolished as part of the IMF rescue package for Korea (as already agreed for the automobile sector).

UNICE proposes that the Korean government be encouraged to:

- Commit to eliminate import quotas, to reduce licence requirements and to extend the agreement with the automobile industry for the abolition of the import source diversification programme for other sectors as well.

3. Competition policy

Deficiencies in the rather rudimentary Korean competition legislation and its implementation regularly affect EU companies operating in Korea or exporting to Korea. The distribution system, for example, is dominated by wholesalers which tend to abuse their dominant position. Some collusion between public institutions and big domestic conglomerates ("chaebol") is apparent.

It appears that Korean industry, as an example carriers and shipbuilding, are paying less than market based interest rates on loans. This can only be seen as an indirect subsidy which has a distortive effect on world market competition.

UNICE proposal for action:

- Eliminate deficiencies in competition legislation and in the implementation of competition policies which are in many cases an additional impediment to market access due to the predominant role of the chaebols.

- Assure proper implementation of IMF aid by taking necessary steps to stop indirect subsidies to Korean companies by financing on a non-market basis.

4. Customs procedures

Customs clearance (still involving "de facto customs brokers") has recently been speeded up considerably by the adoption of a self-declaration system, instead of a permission system, which was used before. This has reduced lead-times from an average of 15 days to around 3 days. According to government figures, 76% of all imports are cleared within four hours. Handling and storage charges in connection with customs clearance may add an extra 5% on top of the customs duty, depending on the goods in question.

Another issue is the fact that companies which have no manufacturing activities in Korea are not allowed to set up their own warehouses.

UNICE proposals for action:

- Improve coherence in the interpretation of customs regulations of the "Customs Office" and the "Office of National Tax Administration".

- Implement announced liberalisation of restrictions on bonded warehouses for foreign companies and importers.

- Reduce bonded warehousing charges, bringing them closer to comparable regional rates.

5. Marketing and distribution of foreign products

Most consumer goods are required to carry an engraved country-of-origin mark, irrespective of the size or material of the products. This is clearly impractical for small or delicate objects (e.g. glass products). Furthermore stickers or marks on the packaging are only allowed in special cases. Enforcement of this regulation at local level is subject to varying interpretations, adding an element of uncertainty to the already higher costs for special country-of-origin marking. An additional complication for complex products is that country-of-origin marks must agree with Korean rules of origin. The European Union is not recognised in Korea as a country of origin.

So-called dual-price labelling was until recently required for consumer goods, indicating both the final price and the import price (cost, insurance, freight/cif) plus duty for imported products. Local products were required to state ex-works prices. Production costs in this case could easily be manipulated by the producer and the distributor. This labelling was sometimes used to claim excessive distribution margins for imported products.

UNICE proposals:

- Implement and maintain the abolition of burdensome and discriminatory "dual price labelling" requirement (final price and import plus duty price for imported goods).

- Recognise the "EU certificate of origin" as a valid certificate of origin, giving European companies in Korea similar conditions as exist for Korean companies distributing in Europe. Abolish discriminatory country of origin requirements on front of packaging and on the product itself to avoid anti-foreign campaigns.

6. Frugality campaign and customs audits

Since 1996 and earlier largely government-financed consumer organisations have launched "frugality campaigns" ostensibly directed against luxury consumption, but frequently targeting foreign consumer products, which - for instance - are not supposed to be sold within 200 m of schools, where teenagers might be induced into a wasteful "consumerism" patter of behaviour. Owners of foreign automobiles have, in recent years, frequently faced tax-audits, which have had a dissuasive effect on the demand for foreign automobiles.

There are also customs audits at retail level, ostensibly to check against fraud or negligent labelling for items which are not considered desirable on the Korean market by the authorities and by local manufacturers. Such audits had become so disruptive and frequent that they had in the past to be regarded as administrative harassment of importers.

Tax authorities also often applied standard minimum mark-ups and commissions for assessing taxes, irrespective of real sums. For the purpose of calculating taxable profits, tax authorities did not allow discounts below listed prices. Sometimes tax authorities insisted on lower transfer prices (for calculating taxes) and customs authorities on higher ones (for calculating customs duties) with no co-ordination between the agencies.

UNICE proposes as political action:

- *for the EU*

  - Despite recent improvements, maintain European vigilance regarding frugality campaigns along the lines of the Commission's action of 1997, which required Korea to respect its WTO commitments.

- *for Korea*

    - Ensure that measures proposed by the Korean government to reduce practices of discriminatory tax-audits and "anti-luxury-product campaigns", targeting more particularly imported products, are fully implemented and not reactivated in the aftermath of today's crisis.
    - Continue to support pro-actively the abolition of these discriminatory practices by public announcements and goodwill measures (e. g. public procurement of imported goods).

7. Standards and certification

Korean standards in many areas are a mixture of US and in some cases European standards. Certification procedures are complicated by non-recognition of foreign test results, even for tests against Korean standards. In some cases the certification procedure includes documentation not only of the product but also of the production process.

In March 1998 new rules came into effect which will allow homologation of passenger cars through inspection by Korean officials in the country of production. Exactly the same standards will apply to US and EU imports. However, "by-pass noise tests" and brake tests must still take place in Korea. If a motor vehicle manufacturer changes distributor a new homologation must take place. Despite stringent local testing requirements grey parallel imports of models made for the US market exist.

In the area of mobile telephones, the "Code Division Multiple Access" (CDMA) standard not widely used elsewhere makes entry by non-Korean producers difficult. If the widely used "Global System for Mobile Communication" (GSM) standard were to be allowed, this would facilitate market entry by major foreign producers.

Clinical tests are required for pharmaceuticals in Korea, generally taking about one year. For food and cosmetics, all ingredients must appear on a Korean positive list of approved ingredients.

Korea is seeking a "Mutual Recognition Agreement" (MRA) with the EU on testing and certification. Partly for administrative reasons, the EU has not so far entered into any such negotiations with Korea, but preparatory seminars were held in May and July 1998 in Seoul and Brussels. An agreement may be reached only in five years' time. Of special interest to European producers are automobiles, telecommunications equipment, health-care equipment, pharmaceuticals and cosmetics. Some companies doubt whether an MRA would be implemented in the same way in Korea, and have the same market-opening effect as it would have in Europe.

UNICE suggests that Korea be urged to:

- Simplify the system of technical standards and conformity certification which constitutes a significant impediment to market access by its complexity and lack of transparency for importers.

- Do not delay reforms concerning standards and certification in view of future "Mutual Recognition Agreements" (MRAs).

- Abolish unnecessary and repetitive testing and accept "Good Manufacturing Practices"/GMP, 'Self-certification" or certificates made in the country of origin by internationally recognised testing bodies.

- Implement the WTO code on technical barriers to trade (TBT) in full.

8. Intellectual property rights

Korea has up-to-date legislation for protection of intellectual property rights, but implementation and enforcement still present some problems, especially for audio-visual products and computer software. Royalties paid by local patent users are subject to government scrutiny and sometimes there is pressure to lower royalty payments.

For pharmaceutical products, protection has only existed since July 1987. Patents approved before that date only give process protection and they cannot be transformed into product patents. This means that other producers can produce generic copies of older patented products. Processes against patent infringements are possible but lengthy and costly. A case through all three instances may last from five to seven years.

Trademark protection is in practice deficient, since local trademarks and models very similar to well-known foreign brand names are allowed registration by the "Korea Industrial Property Office" (KIPO). Sometimes counterfeit products are even ordered and marketed by foreign distributors.

Concerning industrial designs, protection is still very weak and recourse difficult. Even almost identical designs are often considered to be different. Pirate copies of auto spare parts are widely sold, and there is a substantial risk of visual copies of inferior quality.

UNICE proposals:

- Improve the protection of intellectual property rights to stimulate increased production and marketing investment by high-tech companies for a faster rise in the overall technological level.

- Prevent registration of trademarks or models similar to previously registered ones and reinforce measures against counterfeiting. Strengthen control on export of counterfeit goods.

9. Government procurement

Government procurement in Korea is regulated by the "Act Relating to Contracts to which the State is a Party" (ARCSP) and its enforcement decree (EDARCSP).

Korea is committed to implement the WTO "Government Procurement Agreement" (GPA) since 1 January 1997. Overall, the system discriminates against foreign suppliers in cases where products or services are available domestically. However, foreign-invested companies manufacturing in Korea can qualify as "domestic sources".

For engineering contracts a local presence in the Korean market is necessary. Transfer of technology is an important factor in the award of government contracts. The EU and Korea agreed on 29 October 1997 on a bilateral public procurement agreement in telecommunications. The agreement concentrates on non-discrimination, enabling European companies to compete on the same footing with US companies.

The "Supply Administration of the Republic of Korea" (SAROK) is responsible for procurement by government agencies, and sometimes also by government-owned enterprises. Tendering procedures are still described as bureaucratic and cumbersome with huge amounts of information collected by the procuring agencies.

In telecommunications, the emergence of private operators has to some extent facilitated market access for foreign equipment producers.

In the area of pharmaceuticals, imported and local products are treated differently concerning government reimbursement of costs for medicines. No margin is allowed on imported products, whereas locally produced products are allowed a margin of 25%. There is a conscious effort by public hospitals to reduce the cost of medicines by using cheaper copies manufactured in Korea under the old patent rules. Private hospitals, which are more quality-conscious, often prefer original medicines.

UNICE suggests that Korea:

- Establishes an open and competitive public procurement system to enhance efficiency and to reduce government budgets.

- Implements the Korean obligations under the WTO GPA and reduces the excessive number of exceptions to the GPA coverage.

10. Trade in services

As a part of its membership of the OECD and WTO Korea is now opening up its financial services sector, including banking (subsidiaries of foreign banks will be allowed by December 1998) and insurance. The Asian financial crisis and the agreement with the IMF have speeded up this process. By the year 2000 97% of all service sectors are due to be open to foreign investment.

Because of government controls over the foreign exchange market, capital inflows remain restricted. Banks have been subject to detailed and opaque regulations, which prevent foreign-owned banks from taking advantage of their competitive advantage in many areas. Insurance services are gradually being opened up, but foreign companies are still barred from selling personal accident insurance. Foreign insurers currently hold around 7% of the market.

Korea has committed itself in the "General Agreement on Trade in Services" (GATS) of the Uruguay Round to open up its distribution sector to foreign direct investment. There are however still restrictions against take-overs of domestically-owned distribution companies.

Problems may also occur for foreign distributors in securing necessary permits at the municipal level.

For shipping, problems exist in securing equal treatment with domestic shipping lines in Korean ports. Restrictions still exist for a number of other sectors such as telecommunications, advertising, radio and TV, etc.

Despite remaining regulations and administrative problems substantial opportunities for foreign companies do now exist in banking, insurance, engineering, logistics and transport.

UNICE looks for:

- Improved commitments by Korea in the GATS 2000 negotiations to liberalise financial, telecommunications, legal and other professional services sectors on the basis of transparency and non-discrimination.

- Elimination of market access restrictions for services.

D. Conclusion

Korea has the reputation of promising reforms that are then never carried out. The much-heralded government measures against frugality campaigns and discriminatory tax-audits are notorious examples of this. In spite of recent deregulation statements and liberalisation measures, at the working level, elimination of restrictions against foreign business interests have not yet improved much.

Legislative changes already undertaken and other reforms announced need time to reach the market place and to have a material impact on the ground. Long-standing discriminatory treatment of imported products and over-burdensome and non-transparent administrative procedures will not disappear within months. This requires building new behaviour and traditions.

However, UNICE expects that this situation is of a transitional nature only and that the above concrete proposals will be fully and swiftly implemented to further economic and social reforms. To this end, it underlines the importance of a stable, predictable and non-discriminatory legal and administrative framework for sustainable economic development.

UNICE is looking for the EU and Korea to strive together to promote a favourable trade and investment climate through continuous dialogue, co-operation, and effective bilateral and multilateral agreements.

The forthcoming WTO negotiations are a good opportunity for Korea to confirm its new market access liberalisation policy by making substantial new commitments.

At bilateral level, UNICE welcomes further deepening of EU-Korea relations, e.g. through the 1996 "Framework Agreement for Trade and Co-operation" or other respective co-operation agreements.

With this perspective, UNICE reaffirms its commitment to pursuing ways and means to strengthen the dialogue on Korea issues with the European institutions and Korean business. It is ready to contribute to and to develop recommendations for improving the EU-Korea relationship.

Last but not least, UNICE is looking forward to the next "Asia-Europe Business Forum" (AEBF4) to take place in Seoul in November 1999. This Business Forum will be a new opportunity to assess the progress of Korea's economic and financial reforms and to further the direct dialogue between European and Korean companies.

AEBF4 will be relevant to strengthen the interaction between the European Commission, the Korean and European governments, European and Korean business and civil society. The Forum will contribute to the broadened EU-Korea relationship which forms an integral part of the "Asia-Europe Meeting" (ASEM) process and enhanced EU-Asia relations as a whole.

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Attachment

Statistics/Background information[3]

1. Overview

The Republic of Korea occupies the southern half of the Korean peninsula covering 98,480 square km of which 21% is cultivated land, and with approximately 46 million inhabitants. This makes Korea one of the most densely populated countries in the world with 470 inhabitants per square km. 23% of the population is under 15 years, while 6% is 65 years or older. 20 million are active in the workforce, of which 21% are occupied in agriculture, fishing and forestry, 27% in manufacturing and mining, and 52% in services and other activities.

Major Korean industries (with some important investments in major growth markets – USA, EU, Eastern Europe and Latin America) include:

- heavy engineering: steel, shipbuilding, heavy machinery and earth-moving equipment.
- petrochemical: now the second largest in Asia in many sectors after Japan (and in some sectors Taiwan).
- automotive: five manufacturers with a domestic production capacity of 2.5 million vehicles a year (global capacity up to 5 million, with 30% for sale/export to the EU), soon expected to be restructured to three manufacturers.
- electronic: microchips with both memory and non-memory chips.
- electrical: domestic appliances.

Textiles, clothing, footwear and food processing also remain important industries but with little new growth.

Korea was a rapidly industrialising economy with a sustained growth rate of 8-9% until 1997 and a per capita GDP of US$ 10,500 in 1996, placing it number five in Asia after Japan, Singapore, Hong Kong and Taiwan. While GDP growth in constant domestic prices was calculated to rise by 6% in 1997, US$ GDP per capita went down in 1997 because of the sharp devaluation of the Won. Today the Won is around 40% lower than in 1996 in relation to the US$. In 1998 real GDP was expected by the IMF in April to decline by 0.8%. Later estimates by other forecasters point to an even sharper reduction in GDP this year.

Inflation has been at between 4 and 5% for the last few years, fuelled by high wage increases and a gradually weakening Won. The recent devaluation may lead to higher inflation over the coming years, with an IMF forecast of 10.5% for 1998. The Korean economy is largely export driven with exports in 1995 reaching US$ 125.4 billion, but imports have also risen rapidly to US$ 135.1 billion in 1995. Major exports are electronic and electrical equipment, machinery, steel, automobiles, ships, textiles, clothing, footwear and fish. Major imports are machinery, electronic equipment, oil, steel, transport equipment, textiles, organic chemicals and cereals.

[3] statistical sources: Eurostat, Wall Street Journal, Financial Times

Major export markets are the US (19%), Japan (14%) and the EU (13%), while imports mainly come from Japan (24%), the US (22%) and the EU (13%).

The Asian financial crisis has led to a de-facto devaluation of the Won by around 35%. An IMF package of loans and structural reform measures has accelerated the restructuring of the Korean economy especially in the financial sector, and among the large conglomerates (chaebols). The credit squeeze combined with more stringent profitability requirements have reduced investment, and economic growth is expected to slow down to around 3% for a number of years until the economy regains its balance, instead of around 6 to 8% as previously predicted.

The Korean government has taken drastic measures to bring about a restructuring of Korean industry in order to remove the weaknesses which led to the present crisis. The large business groups, with outstanding debt of Won 250 billion, have also signed capital structure improvement agreements with their banks to improve their capital structure, to dispose of unprofitable subsidiaries and to repay debts.

Banks have been encouraged to review their credit analysis capacity and to apply more stringent criteria to their lending. So far the credit crunch seems to have hit small and medium-sized companies worse than the large chaebols.

To improve corporate governance, the “Commercial Code” will be revised so that the controlling majority shareholders will be considered de facto directors and therefore accountable for the management of the company.

2. Foreign Direct Investment

Foreign direct investment in Korea reached a record high of US$ 2.8 billion in 1996, of which around 33% came from the US, 24% from the EU and 10% from Japan. The recent fall of the Won against the US$ has created increased opportunities for profitable foreign investments, especially the acquisition of existing assets, where regulatory restrictions have also been eased. Many observers believe that the Won will strengthen later in 1998 to an equilibrium level of around 1,400-1,500 to the US$.

Officially 97.6% of manufacturing activities are open to direct foreign investment.

Under the IMF programme, the ceiling on the acquisition of shares in domestic companies by individual foreign national investors was raised from 7 to 50%, and on a foreign-owned company from 26 to 55%. The limitation on the acquisition of shares by foreigners will be completely removed by the end of 1998.

3. Trade

According to Korean statistics, European Union exports to Korea amounted to US$ 18,934 million in 1997, down by 10.7% from US$ 21,204 in the previous year. Over the same period Korean exports to the European Union amounted to US$ 16,864, up by 10% from US$ 15,325 million in 1996. With the recent devaluation of the Won and the financial difficulties in Korea, total Korean imports have decreased sharply by 35% over the first four months of 1998 and are likely to remain sluggish, especially for consumer products such as automobiles.

European exports mainly consist of investment goods and industrial inputs. In 1995 43% of EU exports to Korea were engineering products, 15 % industrial components, 13% mineral and chemical products, 7% automobiles, 11% consumer goods and 4 % agricultural products. European imports from Korea also were dominated by engineering products (53%) with an additional 16% motor vehicles and 11% consumer goods and industrial supplies respectively.

According to a recent study by the Washington based "Institute of International Finance", part of the impact of the Asian crisis will be a US$ 168 billion improvement in the collective trade balances of the seven Asian developing economies. Among them, Korea stands to gain the most from the shifts in export price-competitiveness. These changes could improve Korea's trade balance by as much as US$ 55 billion, owing mostly to the large volume of its 1996 trade and the extent of the Won's fall against the dollar.

According to recent figures by the Korean Ministry of Commerce, Industry, and Energy, the accumulated trade surplus in the first half of 1998 was US$ 19.99 billion, with exports totalling US$ 67.58 billion and imports totalling US$ 47.58 billion.

However, this huge Korean surplus does not indicate economic recovery, since the surplus was due mainly to lower imports rather than higher exports. Korean imports fell by 36.1% compared to the first half of 1997, while exports rose by only 3.6% over the same period. If exports of gold collected through the national gold-gathering campaign are excluded, the actual export growth rate was a mere 0.8%.

The outlook for Korea's exports in the second half of the year is bleak, particularly since exports fell in June for the second month in row. The percent change in exports was –3.0% in May 1998 compared to May 1997 and –5.6% in June 1997 compared to June 1998. Considering that export activities in the second half of last year were brisk, negative export growth in the second half of this year is likely.

Looking by region, prospects for Korea's exports to major markets – with the exception of US and EU – are dim. In particular, exports to South East Asia are expected to be hurt severely since the region will probably not escape from economic depression and regain its previous vitality until the end of 1998. Because prospects for the Japanese and Chinese economies are not very good either, Korea's exports to those countries are likely to be hurt as well. The implications for Korea could be serious, since exports to South East Asia and China comprise a large part of Korea's total exports. In 1997, those markets received roughly 50% of Korea's total exports.

EU trade with Korea (January – June 1998):

EU15 exports to Korea			EU15 imports from Korea			trade balance	
1998	1997	growth	1998	1997	growth	1998	1997
4.5	7.1	-36.6%	7.6	6.0	26.6%	-3.1	1.1

source: eurostat billion ECU

4. Tariffs and taxes

The average applied tariff rate is now 7.9% ((6.2% for industrial products and 1.3% for raw materials). Korea now has a uniform tariff system with standard rates of 5% for intermediary products and 8% for most manufactured products. For some products tariffs are higher, such as pharmaceuticals (10 - 15%) and for a few items 30%. For some consumer goods and for most agricultural products tariffs are 20%. In 1996 tariffs corresponded to around 8% of total government revenue. Tariffs are calculated on a cost-insurance-freight/CIF basis rather than a free-on-board basis/fob, which leads to a higher duty being assessed.

Excise tariffs on automobiles (Korean and foreign) are 8%. But on top of this there are several layers of taxes which especially hit larger (usually imported) passenger cars, with a special consumption tax of 15% (under 2 litres) or 20% (over 2 litres) on top of the tariff, plus an "education tax" of 30% on top of previous charges, plus 10% VAT on top of all this. In addition there are also a municipal acquisition tax and a municipal registration tax of 6%. All this makes it very difficult to sell large passenger cars in Korea. Imports of foreign cars actually went down by around 50% in the first half of 1997, compared with a 3% overall shrinkage of the car market during the same period.