Case Number: 2009-0528-F

FOIA MARKER

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. cable	re: Report on June 24 Consultations. (1 page)	07/01/1993	P1/b(1)
002. cable	re: Korean Trade Union. (2 pages)	07/13/1993	P1/b(1)
003a. memo	For Laura Tyson, Joe Stiglitz, and Marc Noland from Peter Orszag. Subject: Visit of Dr. Pak Chae-yun. (1 page)	11/19/1993	P1/b(1)
003b. report	Republic of Korea Economic Issues. (1 page)	11/18/1993	P1/b(1)
003c. talking points	Korea. (1 page)	11/18/1993	P1/b(1)
003d. report	Korea's Uruguay Positions. (1 page)	11/18/1993	P1/b(1)
003e. report	U.S. Government Report. (2 pages)	11/12/1993	P1/b(1)
004. report	U.S.-Korea Financial Policy Talks. (2 pages)	06/21/1993	P1/b(1)

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Menzie Chinn
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FOLDER TITLE:

Korea [3]

2009-0528-F
vz1395

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RR. Document will be reviewed upon request.

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EXIM-06 E-01 FRB-03 H-01 TEDE-00 INR-00 ITC-01
JUSE-00 L-00 ADS-00 NSAE-00 NSCE-00 OES-09 OMB-01
OPIC-08 SNP-00 SP-00 SS-00 STR-16 TRSE-00 USIE-00
CORE-00 /055R

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DRAFTED BY: EAP/K: JPRICHARDSON
APPROVED BY: EAP/K: CFKARTMAN
EB/TDC/BTA/ODC: YHANDERSON/EBB
OES/SCT: LSTAHELI (SUBS)
EB/ERF/OGE/ECC: FWMAERKLE/EBA
EB/IFD/OIA: CJBEEDE (INFO)
EB/TRA/MA: DADENNY
DOC: JDONIUS
USDA: THOWES
CUSTOMS: AKENT
USTR: PCOLLINS
DOE/EP: JHARDY
DOT: ALEVINE
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LIMITED OFFICIAL USE STATE 171398

E.O. 12356: N/A
TAGS: ECON ETRD EINV KS
SUBJECT: JUNE 24 ECONOMIC SUBCABINET AGENDA REVISION
REF: (A) 93 STATE 149370

1. SUMMARY AND ACTION REQUEST: ON JUNE 2 ROK EMBASSY ECONOMIC COUNSELOR KI HO CHANG CALLED ON EAP TO SUGGEST MODIFICATIONS TO THE DRAFT AGENDA FOR THE JUNE 24 ECONOMIC SUBCABINET PREVIOUSLY SUGGESTED BY THE U.S. THE ROKG PROPOSED CHANGES ARE DISCUSSED BELOW. EMBASSY IS REQUESTED TO DRAW ON THIS DISCUSSION AND SEEK ROKG AGREEMENT TO THE DRAFT AGENDA CONTAINED PARAGRAPH 7 BELOW. END SUMMARY AND ACTION REQUEST.

2. OVERVIEW OF ECONOMIC AND TRADE RELATIONS: THE ROKG PROPOSES TO DELETE THIS AGENDA ITEM AS DUPLICATIVE OF THE OPENING STATEMENTS. THE U.S. HAD INTENDED THIS ITEM ALSO TO ALLOW A DISCUSSION OF TRADE AND ECONOMIC ISSUES NOT COVERED BY GROUPS PROVIDING STATUS REPORTS, FOR EXAMPLE TRANSPORTATION. COUNSELOR CHANG AGREED THAT SUCH ISSUES COULD BE COVERED UNDER THE ITEM "OTHER ISSUES." THE U.S. CONCURS WITH THIS DELETION.

3. ENERGY SUBGROUP: THE ROKG PROPOSES TO DROP THIS ITEM SINCE THE ENERGY SUBGROUP HAS NOT MET SINCE THE LAST ECONOMIC SUBCABINET. THE U.S. CONCURS IN THIS DELETION.

4. STRENGTHENING OF THE KOREA-US ECONOMIC PARTNERSHIP: THE ROKG PROPOSED THIS NEW SECTION TO INCLUDE THREE SUB-ITEMS: PREPARATIONS FOR PRESIDENTIAL ACTION;

SCIENTIFIC AND TECHNOLOGICAL COOPERATION; AND INDUSTRIAL COOPERATION.

-- S&T COOPERATION: THE ROKG INTENDS THIS ITEM TO BE A REPORT OF THE STATUS OF THE S&T AND PSA AGREEMENTS AND HOPES THAT DATES FOR THE FIRST MEETING UNDER THE S&T AGREEMENT CAN BE ADDRESSED.

WE THEREFORE SUGGEST THIS ITEM BE ADDED UNDER THE SECTION ON STATUS REPORTS.

-- INDUSTRIAL COOPERATION: THE ROKG PROPOSES TO DISCUSS THE PROPOSAL FOR INDUSTRIAL COOPERATION PRESENTED BY MOTIE TO DOC DURING MINISTER KIM'S RECENT VISIT. THE U.S. AGREES WITH THIS ADDITION.

5. OTHER ISSUES: THE ROKG'S PROPOSED REVISION HAD DELETED THIS ITEM. AS NOTED ABOVE, THIS ITEM SHOULD BE RETAINED.

6. CONCLUSIONS: THE U.S. CAN AGREE TO THE ADDITION OF THIS ITEM BUT DOES REQUEST ROKG VIEWS ON THE NATURE OF CONCLUSIONS THEY WOULD HOPE TO SEE.

7. (DRAFT AGENDA FOR JUNE 24 ECONOMIC SUBCABINET:)

DRAFT AGENDA

U.S.-KOREA ECONOMIC CONSULTATIONS
SEOUL, KOREA
JUNE 24, 1993

I. INTRODUCTIONS AND ADOPTION OF AGENDA

II. OPENING STATEMENTS

III. STATUS REPORTS

A. FINANCIAL POLICY TALKS

B. PRESIDENTS' ECONOMIC INITIATIVE - FINAL REPORT

C. TRADE SUBGROUP

D. TECHNOLOGY SUBGROUP

E. SCIENTIFIC AND TECHNOLOGICAL COOPERATION

IV. STRENGTHENING OF THE KOREA-U.S. ECONOMIC PARTNERSHIP

A. PREPARATIONS FOR PRESIDENTIAL ACTION

B. INDUSTRIAL COOPERATION

V. MULTILATERAL AND REGIONAL ECONOMIC ISSUES

A. GATT - URUGUAY ROUND

B. APEC

VI. OTHER ISSUES

VII. CONCLUSIONS

CHRISTOPHER

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
003a. memo	For Laura Tyson, Joe Stiglitz, and Marc Noland from Peter Orszag. Subject: Visit of Dr. Pak Chae-yun. (1 page)	11/19/1993	P1/b(1)

COLLECTION:
Clinton Presidential Records
Council of Economic Advisors
Menzie Chinn
OA/Box Number: CF 1941

FOLDER TITLE:
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2009-0528-F
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003b. report	Republic of Korea Economic Issues. (1 page)	11/18/1993	P1/b(1)

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003c. talking points	Korea. (1 page)	11/18/1993	P1/b(1)

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MN

OFFICE OF THE UNITED STATES
TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON
20506

UNCLASSIFIED with
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March 28, 1993

TO : Members of the Trade Policy Staff Committee

FROM : Frederick L. Montgomery FM
Chairman

SUBJECT: Annual 1377 Review: Korea

Attached is TPSC Draft Document 1994-31, Annual 1377 Review of Telecommunications Trade Agreements: Korea. The paper has been reviewed and approved by the TPSC Subcommitee on Telecommunications.

Please phone your clearance to Carolyn Frank (395-7210) by Noon, Wednesday, March 30. Substantive questions or comments should be phoned to David Long (395-6160).

Attachment

Cleared
M. Nobel 3/29

UNCLASSIFIED with
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TRADE POLICY STAFF COMMITTEE

DRAFT DOCUMENT 1994-31

SUBJECT

Annual 1377 Review of Telecommunications
Trade Agreements: Korea

SUBMITTED BY:

Office of the United States
Trade Representative

DATE: March 28, 1994

LIMITED OFFICIAL USE

March 28, 1994

KOREA: ANNUAL 1377 REVIEW

I. ISSUE

This review examines the operation and efficiency of the United States' telecommunications trade agreement with Korea.

In the annual review of the remaining agreements, the interagency group had identified evidence of non-compliance with the telecommunications trade agreement on the part of the Korean Government, but the problems involved have been resolved.

II. RECOMMENDATION

That the USTR find that there has been no violation of the trade agreement between the United States and Korea, i.e., make no determination of non-compliance with the terms of a trade agreement between Korea and the United States.

In addition, however, concerns remain about an equipment approval issue as described more fully below in Section II.B of this report. In the event that USTR receives complaints from industry on this question, the interagency group recommends that USTR address the issue in an out-of-cycle Section 1377 review.

BACKGROUND

I. The 1992 Agreement

A. Summary of the Agreement

The February 1992 Record of Understanding (the "ROU" or "Agreement") was negotiated following the identification of Korea in 1989 as a priority telecommunications market closed to U.S. suppliers under section 1374 of the 1988 Trade Act. In satisfying the statutory negotiating objectives, the Agreement closed out the section 1374 negotiation, and USTR reported the result to Congress.

The Agreement contains a number of action items for the ROKG with respect to the liberalization of enhanced or value-added telecommunications services, the uses of leased communications channels, procurement procedures, standards-making and equipment approval processes, and other topics.

B. Implementation of the Agreement

With respect to the Agreement's deadlines for action, the ROKG appears to be in compliance.

March 28, 1994

The following highlights the recent scheduled actions of the ROKG to carry out its obligations under the Agreement:

- In July 1993 the MOC revised its Telecommunications Business Law (TBL) to eliminate all registration requirements applicable to international database and remote computer services. The MOC also acted to simplify registration requirements in the remaining enhanced or value-added services, permitting registrations to be made in regional MOC offices throughout the country. In the past, registrations could only be filed in Seoul. MOC is also examining whether registration requirements may be eliminated for all the other enhanced services.

- The ROKG has eliminated all foreign investment restrictions for enhanced telecommunications services in Korea, effective January 1, 1994.

- With respect to interconnection of private lines to the public switched telecommunications network (PSTN), the MOC permits interconnection of data lines for both international and domestic service. MOC plans to permit interconnection to the PSTN of domestic local leased lines (i.e., lines within one exchange area) for voice service in 1994 and is still reviewing possible interconnection of long-distance leased lines for voice services in 1994. With respect to interconnection to the PSTN of international leased lines for voice, MOC stated that it had no current plans to allow interconnection now.

- With respect to competitive safeguards for value-added service providers, in July 1993 MOC issued its Directive 1993/73, which had been circulated for public comment at the beginning of 1993 and had still been in draft during the February 1993 consultations. Article 37 of the TBL has also been revised to require cost separation among competitive and monopoly services.

- In the matter of the Open Network Service Provision (ONSP) directive, the MOC is reviewing the interconnection plans developed by the network service providers, for approval by MOC later this year.

In the area of further liberalization of the restrictions on the shared use of leased lines, MOC had previously reported that financial entities were added last year to the list of entities qualified for shared-use of circuits. Since then, no entities from other industrial sectors have requested similar treatment, according to MOC and substantiated by informal U.S. industry reports. MOC still appears to be taking a case-by-case approach to this issue.

No difficulties were reported under the sections of the agreement that concern standards-making activities *per se* in Korea. Previous concerns about the ROKG's administration of standards concerning electromagnetic emissions by telecommunications equipment appear to be receiving active attention by the ROKG since the promulgation of the new regulations in

June 1993 and have sharply declined in number this year, according to the U.S. Department of Commerce. (No formal complaints were received this year on this subject.)

Two problems, however, emerged during 1993 concerning the ROKG's treatment of equipment quality approvals and procurements by Korea Telecom, as described more fully below.

II. Results of 1994 Review

A. Raychem Issue

During 1993, the U.S. company Raychem, a manufacturer of communications cable sheathing and joining materials, identified difficulties in the processes by which the Korean Government conducts quality inspections related to approvals to supply products in the Korean market. The problem was that the government quality control inspections of manufacturing facilities involved in this process could only be conducted in Korea, rather than by inspectors sent abroad as most other countries with similar requirements do. As a result, in practice, only products manufactured in Korea could pass the approval processes.

This difficulty was first identified during the summer of 1993 and addressed in a series of contacts through the US Embassy in Seoul and in consultations conducted with the Korean Government in October 1993 in Seoul, February 1994 in Washington, and March 1994 in Seoul. Following these talks, the Korean Government has revised its administrative procedures to address this problem, and Raychem has been able to introduce its products into the Korean market through Korean distributors without further difficulties. Raychem reports as of March 18 that this problem has been resolved to its satisfaction.

B. AT&T 5ESS-2000 Software Upgrade

AT&T reports that Korea Telecom officials have indicated that the software upgrades associated with the 5ESS-2000 central office switches qualified by KT last year may need to be considered "new" products, requiring qualification periods of more than 126 weeks before the software can be used in the KT network. Other categories of qualification that KT has suggested as alternatives are approximately the same length (e.g., certain "upgrades" may require 113 weeks of certification), which would effectively prevent the upgraded central office switches from competing in the market.

AT&T notes that it was late in submitting the software for qualification and has stated that its discussions with KT over the qualification process are proceeding. Expecting that these talks will end some time during April or May 1994, AT&T asks that we not find a violation of the agreement now but instead maintain pressure on the Korean Government to have KT apply more reasonable, shorter qualification periods for this product.

The interagency group accordingly concludes that there is no basis for identifying the ROKG as violating the agreement now, but recommends that the Section 1377 review be reopened or started for next year on an accelerated basis in the event that the discussions between AT&T and KT fail to yield a satisfactory outcome. In its evaluation, that review would have to focus on two pieces of information: the period of time reasonably needed for KT to decide what category of product the upgraded AT&T software falls into, and the normal period of time for such qualifications.

The question of qualifying software upgrades was specifically mentioned in the March 31, 1993, letter from Korean Ambassador Hong-Choo Hyun to Ambassador Kantor in satisfaction of Korean obligations to qualify AT&T switching equipment under the new procurement regulations published at that time. In that letter, the ROKG committed that "AT&T will be qualified as a supplier and be allowed to bid its switching equipment and appropriate upgrades, now in use in the KT systems, regardless of the place of manufacture, in the upcoming KT procurements originally scheduled for May 1993."

This issue has been raised at the last two staff-level consultations with the Korean Government in February and March 1994 and will be on the agenda for further discussions in talks with the Korean Foreign Affairs Ministry for April 1994. The issue was also raised in ministerial consultations by Ambassador Kantor with Minister Han in February 1994 and at the subministerial level by Ambassador Barshefsky in March 1994. The US Embassy in Seoul has also worked actively to resolve this issue since it was brought to our attention at the end of January 1994.

C. Mutually Advantageous Market Opportunities

In conducting the section 1377 review USTR is required to consider whether foreign countries deny U.S. firms, within the context of their telecommunications agreements with the U.S., mutually advantageous market opportunities (MAMO) in that foreign country. In such reviews, USTR must consider "any evidence of actual patterns of trade (including United States exports to a foreign country of telecommunications products and services, including sales and services related to those products) that do not reflect patterns of trade which would reasonably be anticipated to flow from the concessions or commitments of such country based on the international competitive position and export potential of such products and services."

Summaries of the actual patterns of trade in telecommunications goods and services with Korea, supplied by the Department of Commerce and by the U.S. International Trade Commission, have been circulated to the TPSC subcommittee.

D. Industry Views

To prepare for this year's review of Korean compliance under section 1377, the USG solicited comments from the following private sector representatives:

ISAC 5 (Electronics and Instrumentation),
ISAC 13 (Services),
the Services Policy Advisory Committee (SPAC),
IFAC 2 (Standards),
the Labor Advisory Committee,
the United States Chamber of Commerce Telecommunications Trade Task Force,
the Telecommunications Industry Association (TIA),
the North American Telecommunications Association (NATA), and
the International Communications Association (ICA).

We received written responses from AT&T, ISAC 5, TIA, Motorola, and Sprint. Written materials from Raychem were received prior to the start of the section 1377 review. The following summarizes the comments about the markets in Korea:

Sprint commented that the United States Government should encourage the Korean Government to institute a "well-defined and non-burdensome licensing process consistent with the bilateral IVANs agreement. Although the Koreans have committed to allow international value-added services to be provided by foreign service providers, the absence of a simple and transparent licensing regime makes the provision of such services impossible." Sprint is currently working with its local representatives in Korea and with the US Embassy in Seoul to resolve its concerns about IVANS licensing.

TIA noted several concerns about Korean telecommunications outside the agreement and stated that it was aware of no new negative experiences under the agreement itself.

TIA states that one of the persistent problems in working in Korea is that there are considerable pressures to transfer technology in lieu of, or in conjunction with, sales of products. The association also noted pressures of varying degrees of subtlety to manufacture in Korea. A related problem reported by some TIA members is that intellectual property rights violations occur and Korea Telecom becomes the purchaser of the pirated products.

In another area, TIA noted that cable television franchises in Korea leave little room for foreign participation, thus reducing the likelihood that US suppliers will be able to provide those companies with equipment. The same pattern -- using services regulation to affect equipment markets -- also appears, according to TIA in other advanced mobile services markets.

TIA also urges the USG to press the Koreans to avoid further delays and to complete the award process for the second cellular telephone license.

ISAC 5 stated that it was not aware of possible violations by Korea of its telecommunications agreement. ISAC 5 urged the United States Government to monitor the situation and ensure full compliance with the agreement.

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March 28, 1994

AT&T stated that it "is generally pleased with improvements in market access since last year's annual review under Section 1377 of the Omnibus Trade Act." In noting that it nevertheless had some concerns about Korean practices, AT&T continued: "while none appears to constitute a clear and present violation of bilateral trade agreements, each of these issues provides an important measure of Korea's commitment to open and non-discriminatory market access in telecommunications." The issues are:

(a) Qualification of software upgrades to the 5ESS switch (see sections above for full discussions of this issue);

(b) Concerns about excessive requests for information about products prior to receiving type approvals in the Korean system; and

(c) Concerns about limited access to tenders for products resulting from local co-development projects. In this example, local vendors, in AT&T's view, enjoy a favored position over the foreign firms once there is a decision to build new products rather than buy them in the market.

Motorola noted that it had been working for some time to encourage the Government of Korea to develop an appropriate regulatory framework for mobile communications technologies and services. "Recently, the Ministry of Communications reportedly agreed to, among other things, take certain steps to open the public and private trunking markets. These developments should be monitored carefully to ensure that they result in a fair and open market for competitive American products and services."

E. Congressional Views

Consultations in February 1994 with the staffs of the Senate Finance and Commerce committees and the House Energy and Commerce Committee identified no additional problems with the operation of the telecommunications trade agreements.

F. International Trade Commission Consultations

As required by the statute, USTR has consulted with the U.S.I.T.C. staff to determine whether the actual patterns of trade correspond to the expected results measured against the MAMO standard. The U.S.I.T.C. has provided a statistical analysis of telecommunications trade patterns for the Section 1377 review, circulated to the TPSC subcommittee. During these consultations, the U.S.I.T.C. indicated that the statistical sources were inadequate for an assessment of MAMO with respect to services.

Drafted by: D. Long
395-6160 3/28/94

International Telephone Traffic
United States and Japan

Year	U.S. Carrier Receipts from PTT	Payouts to PTT	Net Settlements[1]
		(thousand dollars)	
1987	120,477	198,864	(78,387)
1988	133,978	225,379	(91,401)
1989	147,311	225,805	(78,494)
1990	207,927	280,477	(72,550)
1991	276,556	322,063	(45,507)

International Telephone Traffic
United States and Korea

Year	U.S. Carrier Receipts from PTT	Payouts to PTT	Net Settlements[1]
		(thousand dollars)	
1987	31,394	116,586	(85,192)
1988	38,759	145,003	(106,244)
1989	50,725	162,367	(111,642)
1990	56,313	166,885	(110,572)
1991	83,086	182,996	(99,910)

Estimated International Telephone Traffic
United States and Canada[2]

Year	U.S. Carrier Receipts from PTT	Payouts to PTT	Net Settlements[1]
		(thousand dollars)	
1987	234,375	215,057	19,318
1988	216,320	216,044	276
1989	233,197	237,882	(4,685)
1990	200,839	201,257	(418)
1991	303,742	190,664	(113,078)

Source: Federal Communications Commission (FCC), *Statistics of Communications Common Carriers* and *Trends in the International Communications Industry*, various years.

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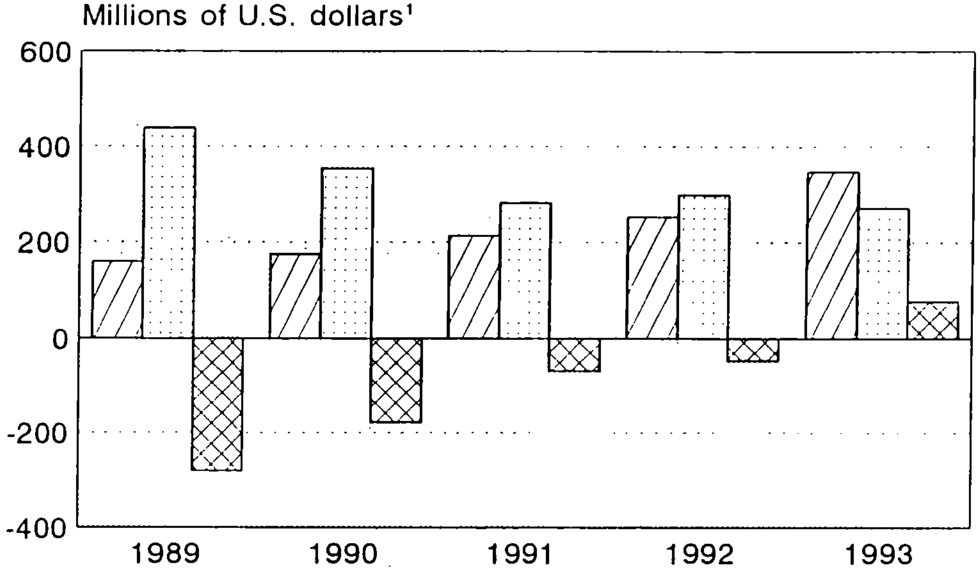
[1] Figures in parentheses reflect deficits in the telecommunication service accounts with the subject country.

[2] Until 1991, the FCC did not collect or publish traffic data for telephone service between the United States and Canada. The net settlement figures for 1987-89 reflect data provided to the FCC by AT&T alone. Figures for 1990-91 reflect receipts and payouts of AT&T, MCI, and Sprint.

United States - Korea Telecommunications Equipment Trade Balance



	1989	1990	1991	1992	1993
U.S. Exports	158	174	212	251	347
U.S. Imports	439	353	280	298	270
Balance[2]	-281	-179	-69	-47	78

[1] Export values are f.a.s. values (free alongside ship) and import values are customs values. Both figures were tabulated using the Census database.
[2] Trade figures may not balance to figure shown due to rounding.

U.S. TELECOMMUNICATIONS IMPORTS FROM KOREA
(Customs value, thousands of U.S. dollars)

HS commodity / Time period	1989	1990	1991	1992	1993
Total selected commodities	438,782	353,011	280,425	297,622	269,653
8517100020--Telephone sets, one line, no features, tone signal	2,435	435	491	482	2,008
8517100040--Telephone sets, one line, no features, o/t tone...	6,169	5,791	1,677	1,316	677
8517100050--Telephone sets, 1 line, w/spcl features, w/answ dv	23,203	6,980	3,172	296	291
8517100070--Telephone sets, one line, w/special features, neso	15,868	18,514	8,712	3,335	6,128
8517100080--Multiline telephones incl key, call director......	57,641	43,798	20,982	22,355	23,190
8517200000--Teleprinters and teletypewriters..................	3	0	0	0	0
8517301500--Central office telephone switching systems........	4,384	184	65	0	10
8517302000--Private branch exchange telephone switching aprts.	549	3,696	2,469	30	8
8517302500--Electronic key telephone systems..................	7,246	5,568	6,034	4,846	2,317
8517303000--Telegraphic switching apparatus...................	325	203	347	98	59
8517305000--Telegraphic switching apparatus...................	1,844	1,641	540	2	33
8517401000--Modems,of a kind used with adp eqp.in heading 8471	6,537	6,229	6,165	6,079	5,590
8517405000--Telephonic apparatus, carrier-current line system.	7,329	6,295	3,651	3,637	2,480
8517407000--Telegraphic app for carr-current line systems.....	5,068	4,051	4,228	4,628	3,584
8517810010--Telephonic intercom systems.......................	625	1,122	1,342	688	1,369
8517810020--Telephonic apparatus, nesoi.......................	2,773	443	1,405	2,236	46
8517820040-- facsimile machines...............................	18,817	26,714	64,740	59,961	46,846
8517820080--Telegraphic apparatus, nesoi......................	4,838	1,891	382	367	218
8517900500--Parts for central office telephone switching aprts	611	228	203	61	41
8517901000--Parts for private branch switching apparatus......	475	735	380	433	118
8517901500--Parts for telephonic switching apparatus, nesoi...	5,893	12,121	4,680	1,935	1,042
8517903000--Parts of telephone sets...........................	3,438	5,599	3,563	2,417	2,763
8517903500--Parts of telephonic terminal apparatus,nesoi......	20	200	225	209	80
8517904000--Parts of telephonic apparatus,nesoi...............	5,106	1,566	1,894	1,634	1,850
8517905500--Parts modems of a kind used in heading 8471.......	773	32	199	393	160
8517906000--Parts of telegraphic switching apparatus..........	274	61	464	1	149
8517907000--Parts of telegraphic terminal apparatus...........	2,465	128	388	23	44
8517908000--Parts of telegraphic apparatus,nesoi..............	2,806	2,361	774	1,095	639
8518301000--Telephone handsets................................	734	1,341	1,136	1,349	1,290
8518401000--Line telephony audio frequency amplifier repeaters	162	152	8	0	14
8518901000--Parts of telephone handsets and repeaters.........	521	1,185	662	739	852
8520200040--Announce and record telephone answering machines..	39,563	23,117	8,971	6,011	3,990
8520200080--Telephone answering machines, nesoi...............	1,829	122	1,787	453	153
8525106020--Radio transmitters =< 30 mhz......................	125	31	40	11	3
8525106040--Radio transmitters f freq > 30 mhz but < 400 mhz..	118	148	108	70	9
8525106060--Radio transmitters > 400 mhz but =< 1000 mhz......	15	99	245	100	100
8525106080--Radio transmitters for freq > 1000 mhz............	0	259	448	68	0
8525108000-- radio transmission apparatus,nesoi...............	27	88	208	409	284
8525203010--Radio transcievers, hand-held, freq<30mhz.........	214	2	52	88	34
8525203015--Radio transcievers, hand-held, freq>30mhz =<400mhz	2,681	4,693	3,879	4,904	6,802
8525203025--Radio transcievers, hand-held, freq >400 mhz......	1,416	2,060	2,245	3,446	5,485
8525203040--Radio transcievers, marine vhf-fm.................	1,209	798	1,430	1,828	950
8525203050--Radio transcievers, =< 30 mhz, nesoi..............	67	25	13	1,337	0
8525203060--Amateur radio transcievers, freq. not exc 30 mhz..	0	0	0	0	282
8525203065--Radio transcievers, =< 30 mhz, nesoi..............	0	0	0	0	860
8525203070--Radio transcievers, > 30 mhz but =< 400 mhz, nesoi	2,301	1,956	3,061	901	2,874
8525203080--Radio transcievers, exc handheld, > 400 mhz.......	1,410	1,058	614	930	4,819
8525205000--Cordless handset telephones.......................	112,474	73,987	49,727	23,627	7,628
8525206020--Cellular radiotelephones..........................	60,017	57,515	22,248	45,372	26,107
8525206060--Cellular radiotelephones for pcrs weighing ov 1 kg	12,499	18,241	27,142	28,499	19,813
8525206070--Cellular radiotelephones for pcrs, 1 kg and under.	37	13	2	2,036	47,085
8525206080--Radio and television transmission apparatus, nesoi	1,823	840	5,706	40,452	20,176
8527310500--Radio receivers to connect with telephonic apprts.	0	0	125	67	0
8527904000--Other articles designed for connection to tlph....	183	107	0	113	35
8527908010--Radio paging receivers............................	156	2,424	5,893	8,697	12,645
8527908020--Radio receivers =< 30 mhz, citizens band, (cb)....	153	0	146	84	0
8527908030--Radio receivers =< 30 mhz, nesoi..................	131	0	0	0	0
8527908040--Radio receivers > 30 mhz but =< 400 mhz...........	1,079	237	208	1,220	18
8527908050--Radio receivers f freq > 400 mhz but =< 1000 mhz..	10	57	15	920	3
8527908060--Radio receivers for freq exceeding 1000 mhz.......	0	0	121	56	0
8527908070--Reception apparatus for radio,nesoi...............	1,312	542	368	328	972
8529106000--Antennas & parts,nesoi,for hog 8525 to 8528.......	3,471	3,556	2,768	2,501	2,156
8543806000--Articles to be connected to telephonic appts, ntwk	3,285	15	8	0	0
8544200000--Insulated coaxial cable and coaxial electrical cdt	1,467	888	896	1,722	2,475
8544700000--Insulated optical fiber cables with indvuly sh fbr	77	0	956	711	2
8803903000--Parts of communications satellites................	136	16	17	2	2
9001100030--Optical fibers/transmission of voice not of 8544..	570	850	0	0	0
9001100050--Optical fibers, plastic, nesoi....................	0	2	0	0	0
9001100085--Opt fiber bundle & cable exc of 8544 not plastic..	0	0	0	16	0

Source: Compiled from official statistics of the U.S. Department of Commerce.

U.S. TELECOMMUNICATIONS EXPORTS TO KOREA
(F.A.S. value, thousands of U.S. dollars)

HS commodity / Time period:	1989	1990	1991	1992	1993
Total selected commodities	157,938	174,069	211,718	251,055	347,271
8517100000--Telephone sets	2,377	1,210	892	1,959	2,688
8517200000--Teleprinters and teletypewriters	37	725	0	284	96
8517301040--Telephonic key system switching apparatus	19,275	0	0	0	0
8517301080--Telegraphic switching apparatus	67,438	0	0	0	0
8517301500--Central office telephone switching systems	0	519	5,789	4	3,357
8517302000--Private branch exchange telephone switching aprts.	0	1,033	73	1,780	807
8517302500--Electronic key telephone systems	0	25,270	1,973	960	159
8517303000--Telegraphic switching apparatus	0	12,746	1,192	600	1,135
8517305000--Telegraphic switching apparatus	3,463	12,570	2,095	3,519	14,714
8517401000--Modems,of a kind used with adp eqp.in heading 8471	0	3,551	2,253	2,541	1,585
8517404000--Telephonic apparatus, carrier-current line system.	16	0	0	0	0
8517405000--Telephonic apparatus, carrier-current line system.	0	2,166	1,012	2,597	3,010
8517407000--Telegraphic app for carr-current line systems	0	1,934	1,990	839	808
8517408010--Modems (modulator-demodulator apparatus)	2,488	0	0	0	0
8517408090--Telegraphic app for carr-current line system,nesoi	5,453	0	0	0	0
8517810010--Telephonic intercom systems	119	35	314	211	210
8517810020--Telephonic apparatus, nesoi	1,086	1,696	2,563	889	3,058
8517820000--Telegraphic apparatus	1,086	1,555	3,424	6,232	1,842
8517902000--Parts for telephonic switching apparatus	12,479	46,513	63,563	34,820	74,735
8517905000--Parts,nesoi,for telephonic apparatus	10,868	10,230	10,759	14,156	10,656
8517909000--Parts for telegraphic apparatus	580	1,810	3,842	4,938	5,822
8518301000--Telephone handsets	116	22	81	127	56
8518401000--Line telephony audio frequency amplifier repeaters	1,033	27	134	0	33
8518901000--Parts of telephone handsets and repeaters	2	230	2,061	26	5
8520200000--Telephone answering machines	2,132	1,412	3,533	3,322	4,099
8525106010--Radio transmitters for civil aircraft	0	140	3	61	24
8525106030--Radio transmitters =< 30 mhz	249	309	622	1,198	1,225
8525106050--Radio transmitters > 30 mhz but =< 400 mhz	695	1,985	5,498	1,831	264
8525106070--Radio transmitters > 400 mhz but =< 1000 mhz	0	216	872	577	378
8525106090--Radio transmitters for freq exceeding 1000 mhz	399	595	266	1,240	205
8525108020--Transmission apparatus,nesoi,for civil aircraft	308	0	0	5	497
8525108040--Communications transmission apparatus,nesoi	1,255	2,767	6,548	2,940	3,149
8525203005--Radio transceivers for civil aircraft	0	56	68	19	652
8525203010--Radio transcievers, hand-held, freq<30mhz	591	0	0	0	0
8525203030--Radio transceivers, hand-held, nesoi	622	600	1,968	3,363	9,060
8525203040--Radio transcievers, marine vhf-fm	1,368	7	67	252	411
8525203042--Radio transceivers, nesoi,=< 30 mhz	987	1,422	2,287	1,861	1,752
8525203045--Radio transceivers, nesoi,> 30 mhz but =< 400 mhz.	4,643	3,754	3,554	4,524	6,424
8525203055--Radio transceivers, nesoi,> 400 mhz	1,323	3,561	8,773	23,637	24,920
8525205000--Cordless handset telephones	2,316	4,548	323	493	4,059
8525206000--Transmission appar incorporating receivers,nesoi	2,645	13,146	54,956	112,097	147,671
8527904000--Other articles designed for connection to tlph	392	2,458	241	969	708
8527908005--Radio receivers for use in civil aircraft	0	4	0	0	4
8527908015--Radio receivers, radio paging type	28	0	498	2,356	97
8527908025--Radio receivers =< 30 mhz	0	1,262	127	501	160
8527908035--Radio receivers > 30 mhz but =< 400 mhz	41	109	137	287	162
8527908045--Radio receivers > 400 mhz but =< 1000 mhz	132	417	24	15	0
8527908055--Radio receivers > 1000 mhz	20	950	1,527	1,433	1,389
8527908075--Reception apparatus radio communications,nesoi	1,074	5,809	5,949	3,947	4,012
8529106000--Antennas & parts,nesoi,for hdg 8525 to 8528	3,006	2,058	5,605	2,770	3,942
8544200000--Insulated coaxial cable and coaxial electrical cdt	2,200	2,279	3,623	4,494	3,985
8544700000--Insulated optical fiber cables with indvuly sh fbr	3,182	67	410	63	2,513
8803903000--Parts of communications satellites	252	71	177	111	455
9001100000--Optical fibers, optical fiber bundles and cables e	162	225	52	205	279

Source: Compiled from official statistics of the U.S. Department of Commerce.

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Department of the Treasury
Office of Asian and Near East Nations
Room 5221, Fax: (202) 622-0349

Date: June 21, 1993 (4:50 pm)

From: Martha Brettschneider, (202) 622-1710

To: Marcus Nolan
CEA (Tel: 395-3310)

Fax: White House Situation Room (wash fax)

Pages to
Follow: 17

Message:

Marcus --

As we discussed, attached are some background materials on Treasury's Financial Policy Talks with the Korean Ministry of Finance and on the Korean financial sector in general.

I will be out of the office until next Monday, but my boss, Meg Lundsager, is very up to speed on these issues if you have further questions. She would be interested in seeing your paper when it's drafted as well. Meg can be reached at 622-0359.

Martha

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P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

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b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

Korea-MISC

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THE INSTITUTE OF INTERNATIONAL FINANCE, INC.

South Korea

Special Report on Financial Liberalization

November 2, 1992

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THE INSTITUTE OF INTERNATIONAL FINANCE, INC.
2000 PENNSYLVANIA AVENUE, N.W. SUITE 8500
WASHINGTON, D.C. 20006-1812

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SOUTH KOREA(92)1(SR)

November 2, 1992

SOUTH KOREA: SPECIAL REPORT ON FINANCIAL LIBERALIZATION*

Summary

The Korean financial system has been remarkably effective in mobilizing domestic as well as external finance for the rapid industrialization of the economy. The government's industrialization policies, however, have had adverse affects on the financial system itself. Relatively high real interest rates, weakness in the banking sector and disintermediation from banks are symptoms of inefficiencies and lack of competitiveness of the financial system. The government's use of financial institutions to implement policy has lowered banks' profitability. Its shielding of the banking sector from other more competitive financial institutions has reduced banks' incentive to improve performance and contributed to moral hazard risks. This also explains the prevalence of market access barriers to foreign financial firms in Korea. Opening of the financial sector to foreign competition has been given a lower priority than trade liberalization.

Reform during the 1980s was piecemeal, but the authorities initiated in early 1992 a comprehensive program as part of the long-term "Blueprint for the Opening and Liberalization of the Financial Sector." The proposed program is reasonable in terms of scope and overall timing providing that it is consistently implemented. Measures taken under the first stage of the program, which is on track, have already improved market access in some areas for foreign financial institutions. This is in addition to fundamental changes made in the beginning of 1992 that allow for direct stock market investment by foreign securities firms. The opening of the equity market, however, has come after previous delays and at a time when the government has sought through various measures to stem the deterioration in the performance of the stock market. Persistent pressures from the international community have also played a role.

Deregulation and liberalization of financial services would benefit domestic companies and households. It would also help the authorities' ability to manage the economy. The use of direct measures to influence economic activity has become more problematic as the economy has grown in size and complexity. Financial liberalization would allow the authorities to employ orthodox policy instruments to control more effectively excess demand and inflationary pressures. An enlarged role for foreign financial institutions could lead to an improved competitive environment and stimulate a more efficient use of savings.

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The Banking System and the Role of Foreign Institutions

Despite progress in liberalizing the financial sector since the early 1980s, the government maintains pervasive controls. Credit allocation, interest rates, inflows of external finance, foreign currency transactions and the introduction of new financial products by commercial banks remain subject to varying degrees of direct controls, restrictions and administrative "window guidance." The regulatory environment lacks transparency, which results in ambiguities in regulations and seemingly inconsistent and selective enforcement not only for domestic banks but foreign bank branches as well.

The authorities' wide-ranging influence in the economy contributed to the success of its policy of rapid industrialization. The development of some sectors, however, has lagged behind that of the economy as a whole. The government's preference for not relinquishing direct control over resource allocation has weakened the financial sector in general and banking sector in particular. Administratively determined interest rates have contributed to disintermediation. In earlier years the government directed credit through "policy loans" largely at below market rates to heavy and chemical industries. Specialized deposit-taking banks (in large part relying on government deposits) were also established to complement the role of commercial banks in ensuring funding to specially designated sectors of the economy such as small and medium-size enterprises, housing and agriculture.[1] These policies, however, contributed to a rise in nonperforming loans. The government restructured some insolvent firms, but it generally tolerated "moral hazard" by failing to impose market discipline on corporate borrowers. Insolvent firms had loans assumed by the government or by healthy firms with whom they were merged. Government-directed lending and borrowing continued as banks largely carried out official industrial policy.[2]

The government has also allowed other financial institutions to compete with commercial banks. Nonbank financial institutions (NBFIs) were established in the 1970s primarily to absorb household and business savings from the informal curb market and to develop a formal money market.[3] These institutions have greater leeway than banks in setting interest rates and in managing their assets, deposits and other liabilities. The rise of the NBFIs, however, undermined the competitive position of commercial banks, leading to disintermediation of the banking system. The relatively stronger performance of the NBFIs as well as foreign banks is in sharp contrast to that of domestic commercial banks whose return on assets has been substantially lower (Table 1).

Table 1

Performance of Selected Financial Institutions in Korea
(return on asset ratios)

	1986	1988	1989	1990	1991
Mutual savings and finance companies	1.00	3.14	3.26	3.21	4.50
Foreign banks	1.42	1.80	1.83	1.39	1.72
Nationwide commercial banks	0.11	0.36	0.68	0.54	0.52

Source: Korea Times, May 19, 1992.

In an effort to reverse the declining importance of commercial banks and increase competition in the financial sector, the government privatized its remaining holdings of stocks in four nationwide commercial banks between 1981 and 1983. It also amended the General Banking Act to promote autonomy in the management of banks. Entry barriers were lowered as two nationwide foreign joint-venture commercial banks were established in 1982, three new nationwide commercial banks were established in the late 1980s, and the Korea Exchange Bank, which was a specialized bank for international trade and financing transactions, was converted into a nationwide commercial bank. In addition, the expansion of regional commercial banks has been encouraged and branching restrictions were eased in 1990. Between December 1978 and April 1992, regional banks increased their share of assets in the commercial banking system from 13 percent to 24 percent.

Despite these changes, the role of the commercial banks in the economy diminished considerably relative to other financial institutions. Commercial banks' share of loans and discounts in the financial sector shrank from 47 percent in December 1975 to 28 percent in June 1991. Specialized banks' market share fell from 26 percent to 20 percent over the same period. By June 1991, NBFIs attracted 60 percent of deposits in the financial sector compared with only 21 percent in 1975 and provided 52 percent of financial sector loans and discounts compared with only 27 percent in 1975.[4]

The major role of foreign banks in the initial period of industrialization was to help channel resources from international financial markets to Korea. As an incentive, the authorities gave foreign bank branches certain privileges, e.g., exchange risk free won-dollar swap facilities at the Bank of Korea. Although the first foreign bank branch began operations in 1967, regulations governing the establishment of bank branches were not relaxed until the mid-1970s. This was prompted by severe pressure on the balance of payments from the first oil price shock which resulted in increased demand for external financing. The number of foreign bank branches subsequently more than tripled between 1976 and 1978. Foreign banks provided most of Korea's external financing during the late 1970s and early 1980s. More than 60 percent of Korea's external debt at its peak in 1985 was owed to foreign banks. At the same time, branches of foreign banks in Korea provided over two-thirds of the domestic banking system foreign currency loans.

The strong growth in exports after 1985 lessened Korea's dependence on financing channeled by foreign banks. This, coupled with developments in the domestic banking sector, led to changes in the banking environment and in Korea's relationship with foreign banks. Repayment of external debt owed to banks was accelerated. Between 1985 and 1989, debt owed to foreign banks was more than halved to $13 billion from $30 billion. By 1989, domestic banks also became the largest source of foreign currency loans in the domestic banking system in part as foreign banks reduced such lending because of its relatively low profitability. The authorities also steadily rescinded privileges extended to foreign banks. Limits on foreign currency swap lines were cut by 10 percent a year between 1987 and 1989. This reduced the won currency funding base of foreign bank branches and limited their lending capabilities in the domestic market. As a result, foreign banks' share of loans and other assets shrank from almost 9 percent of the total in December 1985 to slightly above 5 percent in December 1989 where it has remained (Table 2).

In response to changes in the external situation and the domestic banking environment, foreign banks have increasingly developed other lines of business. They have taken advantage of the strong demand for liquidity in the domestic corporate sector by devising new products such as fee-based Treasury management products. Administrative credit controls on large corporations imposed by Korean banks have contributed to the demand for these services, as have expansionary macroeconomic policies over the past two years. Increased reliance on these types of transactions, which are replacing traditional interest-based loan business, has helped maintain foreign bank profitability around historical levels.

Table 2

Trends in Accounts of Deposit Money Banks: Loans and Other Assets in Domestic Currency to Domestic Borrowers
(trillions of won)

	December 1985	December 1989	February 1992
Total	63.4	119.3	167.0
% of total	(100.0)	(100.0)	(100.0)
Nationwide banks(1)	26.6	51.7	81.3
(% of total)	(41.9)	(43.3)	(48.7)
Foreign banks	5.5	6.5	9.6
(% of total)	(8.7)	(5.4)	(5.7)
Other banks(2)	31.3	61.2	76.2
(% of total)	(49.4)	(51.3)	(45.6)

(1) Includes the Korea Exchange Bank after 1989.
(2) Includes regional commercial banks and specialized banks.
Source: The Bank of Korea.

The Bank of Korea stated in its 1990 report on the financial system that the new role of the foreign banks would be to "motivate domestic banks to improve their banking practices and managerial skills."[5] The authorities, however, had not yet committed themselves to ease restrictions over foreign banks' domestic activities. The United States Treasury initiated financial policy talks with the Korean Ministry of Finance in February 1990 "with the express purpose of pressing for financial sector liberalization, regulatory transparency, and national treatment of U.S. financial institutions."[6]

Issues on the Treatment of Foreign Banks

The diversity of foreign banks operating branches in Korea and their varying corporate market strategies have led to differences in emphasis on how reform of the Korean financial system would best suit each bank's interests. U. S. banks have the largest market share, holding 35 percent of the W15.4 trillion ($21 billion) in total assets of foreign banks in Korea as of March 1992 (Table 3).

Table 3

Balance Sheet Comparison of Branches of Foreign Banks in Korea
(April 1990 - March 1991)

	Total Assets	Total Liabilities	Total Head Office Equity	Net Income
Total all banks (billions of won)	15,375	14,330	1,045	128
Total percent shares	100.0	100.0	100.0	100.0
U.S. banks	35.4	34.4	49.0	46.2
Japanese banks	22.8	23.0	19.4	23.5
French banks	19.4	20.2	8.8	11.9
Other banks	22.4	22.4	22.8	16.4

Foreign financial institutions in Korea have primarily sought to improve market access which, compared with domestic institutions, is impeded by more stringent criteria governing branch office operations and investments by foreign financial firms. Foreign banks primarily conduct wholesale banking, providing finance to local Korean companies and serving their home country corporate clients. They also have a comparative advantage in cross-border financing and in the international foreign currency market. Consequently, there is a widely shared convergence of views on the need for regulatory changes in these areas.

National treatment is sought by foreign banks, but only to the extent that it improves market access and does not subject them to the administrative controls faced by domestic banks. Foreign banks have largely avoided government attempts to implement industrial policy through them. In particular, banks from countries in the European Community are reported to have taken the position that they do not seek national treatment for these reasons.[7] Foreign banks are concerned that efforts to extend national treatment to them should be accompanied by steps to liberalize the financial industry as a whole.

As foreign banks moved away from their traditional focus of foreign currency lending, access to won currency funding has become the most crucial issue faced by all banks. Problems in obtaining sufficient won to meet the demand for loans illustrate discriminatory treatment faced by foreign banks. The sources of won funding are paid in local branch capital, retained earnings and swap facilities with the central bank. To improve access to won currency funding, the central bank in 1986 allowed foreign banks to issue short-term negotiable certificates of deposit (CDs), which domestic banks were earlier allowed to issue. These instruments became more attractive to depositors when formal interest rate controls were relaxed in 1988. To prevent a shift of funds out of controlled interest rate instruments into CDs, however, the authorities imposed ceilings on CD issuances by domestic as well as foreign banks, thereby limiting the ability of banks to augment their funding base through this source.

Foreign banks, however, are at a disadvantage in building up the CD funding base. Effective ceilings are more restrictive for foreign banks because of a more narrowly prescribed capital base on which CD issuance levels are set. This is despite successive increases in the ceilings for foreign banks, from 120 percent of the capital base in 1986 to 225 percent in 1992. Although nationwide domestic banks are subject to an issuance limit of 40 percent of capital base, their capital base is global and much larger than that for foreign banks which is restricted to local branch capital. Foreign banks, in general, would prefer the elimination of CD issuance limits so that they can better meet their local currency funding needs.

Foreign banks, however, have partially offset this disadvantage by offering higher interest rates to depositors. As a result, their share of total CD issuances increased from less than 1 percent in December 1987 to between 8 and 10 percent in early 1992. Although interest rates on CDs were formally decontrolled in 1988, the authorities exercise "window guidance" on domestic banks which comply by maintaining relatively lower rates but, as a result, lose some deposits. Foreign banks, in contrast, have resisted efforts by the authorities to influence interest rates on these instruments.

The authorities have also actively constrained foreign banks' ability to conduct foreign exchange transactions and treasury operations, circumscribing the use of their expertise in such areas. The Ministry of Finance is to clarify prohibited foreign exchange practices, which currently includes 84 items, and the number of prohibited items may be shortened. Foreign banks also often encounter unpublished rules and regulations. Restrictions on cross-border fund transfers pose one of the principal obstacles to new investment by foreign and domestic firms alike.[8] Foreign financial institutions, however, are more seriously affected because they have greater need for cross-border financial transactions.

Bank branching is of more limited concern to many foreign banks, but those seeking expansion face impediments despite recent regulatory improvements. Foreign banks are allowed to open additional branches, but restrictive criteria, including branch capitalization requirements and a lengthy approval process, have crimped expansion. In contrast, Korean banks, even those newly established, do not face these restrictions. One nationwide bank that opened in 1989 was immediately authorized to open 12 branches and an additional 48 branches by the end of 1990.[9] Moreover, any physical presence outside the main branch, such as automated teller machines (ATMs), is treated as a separate branch.

Recommendations for eliminating market access barriers were made in a recent report issued by the American Chamber of Commerce. These were similar to conclusions made by the U.S. Treasury in its 1990 National Treatment Study and include the following major proposals:[10] The Korean authorities started to address these issues in their November 1991 plan to liberalize interest rates and more recent "Blueprint" for financial sector opening and liberalization.

1. Increase transparency of government policies and regulations.
2. Eliminate restrictions on the foreign currency market.
3. Eliminate discrimination in the interbank market.
4. Globalize capital requirements from branch to a home office basis.
5. Allow greater access to offshore financing.
6. Liberalize interest rates.

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The Securities Market and the Role of Foreign Institutions

Opening of the securities market is a more recent development than the banking sector. The first representative office of a foreign security firm was established in Seoul in 1980. In the early 1980s the government announced its intention to internationalize the securities market in four stages (Table 4). This anticipated the opening of the Korean market to direct investment, and in 1985 the government allowed Korean companies to issue international securities. Measures initially scheduled for the second and third stages in 1985-87, however, were delayed. The government announced a revised medium-term plan in 1989 and by early 1992 the main features of the plan were implemented.

Table 4

Highlights of Capital Market Liberalization

Year	Item
1981	Announcement of the long-term blueprint for capital market opening. Stage 1 (1981-84) Opening of international investment trusts. Stage 2 (1985-87) Direct investment by foreigners. Stage 3 (1988-90) Gradually lift limits on foreign investment. Stage 4 (early 1990s) Allow investment in foreign securities by domestic investors.
1984	Establishment of first closed-end international investment vehicle, the Korea Fund. (A second fund, the Korea-Europe Fund, was set up in 1987.)
1985	Permission given to domestic firms to issue convertible bonds to foreigners.
1989	Announcement of revised, medium-term capital market opening plan. Capital increase of existing funds for foreign investors. Expansion of overseas securities issues by domestic firms. Expansion of international business of Korean securities companies.
1991	Establishment of branches of foreign securities companies and joint-venture companies.
1992	Foreigners allowed to invest directly in Korean securities market and to reinvest converted stocks into other Korean stocks.

Source: Financial System in Korea, The Bank of Korea (December 1990) and A Guide to Asian Stockmarkets, Second Edition, and The Korea Stock Exchange Overview, October 1990.

The role of the stock market in Korea's financial system expanded rapidly between 1980 and 1989 when total market capitalization rose from less than 7 percent of GDP to almost 70 percent and the market index climbed to a peak of 1008 in April 1989. Diversion of funds to the real estate market and declining corporate profitability, however, have contributed to a downward trend in share prices over the past three years. By June 1992, the stock index had fallen to the mid-500s, its lowest level since President Roh took office six years ago, and market capitalization fell to about 30 percent of GDP from almost 70 percent in 1989.

The government reacted to the downturn in the stock prices by attempting indirectly and directly to support the market. New issues were discouraged and the establishment of a W4 trillion stabilization fund was set up through mandatory subscriptions by financial institutions and listed companies. The failure of the latter plan recently led to a W3 trillion subsidized support loan from the Bank of Korea to three investment trust companies that could not meet interest payments on funds borrowed for stock market investments. The prolonged downturn in market performance may also have contributed to the decision to move ahead on the capital market liberalization program so as to increase the demand for stocks.

Foreign securities firms started to convert their representative offices into branch operations in 1992 with about 10 of the 24 firms represented in Seoul having expressed interest in expanding their presence in the Korean market. Stringent criteria for entry, however, have discouraged most interested foreign firms from undertaking the full range of operations (brokerage, underwriting and dealing). Investment ceilings limit aggregate foreign investment to 10 percent of total market capitalization. To date, foreign firms have not formed a joint venture with a domestic firm. Foreign ownership of certain strategic industries is even more restrictive, although the government has recently started to allow holdings in the largest public sector corporations.

These limits restrict liquidity demanded by foreign investors in both available stocks and in the overall market. In addition to continuing problems with administrative barriers, including the lack of regulatory transparency and the inefficient system for placing and monitoring stock orders, foreign firms face high financial barriers to entry. Brokerage capital requirements are set at about $13 million (W10 billion) and the full range of allowable activities, dealing and underwriting, would bring the capital requirements close to $30 million, a very large sum in view of the size of the Korean market and limits imposed on foreign participation.

The modest progress in opening the capital market will need to be reinforced by further lowering administrative and financial barriers if foreign investors are to play a more active role and the competitive environment of the securities market is to be improved. In spite of the relatively large size of the Korean market and its favorable long-term potential, the response so far by foreign securities firms has been cautious. The following measures to improve access were recently recommended by the European Chamber of Commerce in Korea:[11]

1. Increase foreign ownership limits, both aggregate and individual.
2. Allow additional branch applications and approvals.
3. Reduce operating/capital funds requirements.

Liberalization Policies in the 1990s

After the largely piecemeal reforms in the 1980s, the government is now preparing a comprehensive approach to liberalization of the financial system. The government's ability to adhere consistently to fundamental reform, however, remains to be demonstrated. The first attempt to liberalize interest rates was initiated in December 1988 but was quickly postponed following a cabinet reshuffle. Controls were reinstated on deposit rates and the competitive tender of monetary stabilization bonds was discontinued in the second quarter

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of 1989, just months after the deregulation of this key instrument of monetary policy was introduced. It was not until November 1991 that the government reintroduced an interest rate liberalization plan to be implemented in four phases (Table 5). As with reform programs in other areas, this is to be a gradual process with deregulation of most short-term deposits and government instruments deferred until the latter two phases. Complete liberalization is not envisaged until 1997 at the earliest.

Table 5

Interest Rate Liberalization Plan (November 1991)
(percent of deposits and loans affected)

	Banks(1)		NBFIs(1)	
	Loans	Deposits	Loans	Deposits
Phase 1 (11/91-6/92)	10	10	25	45
Phase 2 (7/92-12/93)	75	30	100	65
Phase 3 (1/94-12/96)	100	70	100	90
Phase 4 (1997 onwards)	100	100	100	100

Source: The Ministry of Finance.

In early 1992, the Ministry of Finance announced a more comprehensive reform program in its three-stage "Blueprint for Liberalizing and Opening of the Financial Sector" (Table 6). The overall intention is to deepen and broaden the financial sector, expand the scope of indirect policy instruments by the monetary authorities, and allow greater competition in the financial sector by widening market access for foreign financial institutions. Measures under the first stage, scheduled for 1992 and 1993, are to improve market access in a number of specific areas for foreign financial initiations and have already been largely implemented. The second stage, 1994-1996, provides for a wider expansion of market access for foreign financial institutions and also reduces controls over outward capital movements by Korean individuals. The third stage (starting in 1997), while further opening Korean financial markets, envisages a fundamental change in the structure of the markets and conduct in official policy in the financial sector. Interest rates are to be market determined, the capital and money markets are to be deepened and direct government intervention in credit allocation is to be phased down. Further details on the long-term aspects of the plan will be identified later this year. Implementation of the second and third stages, however, will depend on consistent improvement in Korea's macroeconomic performance. The major conditions require a narrowing of interest rate differentials between domestic and international rates, restoration of balance in the current account of the balance of payments and achievement of lower inflation.

Foreign financial institutions have welcomed the release of a schedule, but have also, in general, expressed concerns over the phasing of particular measures and the ability of the government to adhere to the schedule. For example, some of the most crucial issues, such as improved transparency of regulations, interest rate liberalization and a review of continued need for government directed loans, are postponed until the latter stages. Despite the long-term commitment to liberalize interest rates, the authorities have continued to seek to influence administratively the level of interest rates. This was seen early this year when

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window guidance was exerted on the inter-financial institution call market interest rate. Foreign financial institutions would, in general, prefer a shorter timeframe for enlarged access to the domestic market so that they can meet more fully the demand for their services. The implementation in the course of 1992 of many of the first stage measures, however, is a positive development.

Table 6

Blueprint for the Liberalization and Opening of the Financial Sector

Implementation Schedule	Items
First stage (1992-93)	1. Expand CD issuance quotas, extend maturities and lower minimum denominations. 2. Allow regular membership in the Korea Federation of Banks and the KFTCI. 3. Improve the transparency of regulations. 4. Extend maturities on short-term call market. 5. Widen the daily won-dollar trading margin. 6. Ease requirements for underlying documentation prior to FX transactions. 7. Extend national treatment for stock market investments. 8. Allow securities companies to hedge funds against exchange rate risk. 9. Allow over-the-counter trading of domestic bonds. 10. Liberalize over-the-counter option transactions.
Second stage (1994-96)	1. Allow automatic teller machines. 2. Allow more branches of foreign securities companies. 3. Open securities investment trust business. 4. Improve transparency of regulations. 5. Allow Korean individual access in foreign securities markets. Macroeconomic conditions: Current account in balance, Korean international interest rates differential narrowed to half that of 1992, below 7 percent.
Third stage (1997-onwards)	1. Complete proposed liberalization of interest rates. 2. Open domestic bond market. 3. Develop short-term financial markets. 4. Eliminate mandatory purchase of monetary stabilization bonds by foreign banks. 5. Permit foreign banks to establish subsidiaries. 6. Expand limits on foreign investment in the stock market. 7. Review credit controls and policy loans for small- and medium-size companies. Macroeconomic conditions: Current account in surplus, interest rate differential narrowed to 2-3 percent, inflation of 5 percent.

Source: Various English translations by law firms retained by foreign banks in Korea.

Consequences of Delayed Liberalization

Progress towards greater financial sector liberalization is likely to remain tempered by the unresolved institutional constraints of the domestic financial system and Korea's development strategy which still uses the banking system to implement policy directly. Market access by foreign banks has improved recently under the first stage of the "Blueprint" (Table 6); substantial gains, however, will likely be elusive without system-wide deregulation and a strengthening of domestic banks' position. It will be difficult for domestic banks to improve their financial position, while they are shielded from competition and burdened by policy loans. The authorities admit that entry barriers are stiff for both domestic and foreign banks, but consider that different criteria are inevitable for prudential reasons.[12] In particular, in view of the relative weakness of domestic commercial banks and their relative competitive disadvantage to NBFIs and foreign banks, the authorities are concerned that rapid deregulation and liberalization could lead to instability.[13]

Although the government is well on track in carrying out the first stage of its blueprint for liberalization of the financial sector, there are few indications that the government is ready, in the near term, to change fundamentally its traditional view on the need for control over the financial system to further official development policy. The leading advocates for liberalization have been foreign governments and financial service firms, but the authorities have repeatedly resisted advice to let interest rates and competition determine the allocation of credit. Accordingly, the 1992 "Blueprint" envisages that over the next five years interest rates will largely be kept below market-determined levels and policy loans will continue. The government still believes that directed credit can mobilize business support for export promotion programs or industrial development and help to maintain the cooperation of the business community.[14] While state intervention to encourage greater investment may have been a unique strength of Korea's policy for rapid industrialization, it remains to be seen whether this will be as effective in a more developed and open economic system.[15]

Foreign governments and legislators have also noted that the growing role of Korea in the global economy has not been accompanied by a commensurate opening of the domestic economy to foreign financial institutions. In the late 1980s Korean banks' presence in the United States expanded rapidly, with 7 banks operating 13 branches having total assets of $3.3 billion.[16] Pressure for liberalization benefiting foreign branches of U.S. banks has come from the U. S. Congress in an unsuccessful attempt in its most recent session to enact new legislation (Fair Trade in Financial Services). This would have required "reciprocal national treatment" by foreign regulators of U.S. banks and brokerages overseas. The intent was to encourage foreign countries to provide equality of competitive opportunity and to end discrimination against U. S. financial institutions in foreign markets. Foreign bank participation in the United States is governed by the International Banking Act (IBA) of 1978 which provides a strict standard of national treatment. It does not, however, require inquiry into how foreign countries treat U. S. banks' access to foreign markets. Application of a reciprocal national treatment standard under a new Fair Trade in Financial Services Act would jeopardize the position of Korean banks in the U. S. unless American banks were given improved access in Korea.

Present multilateral efforts by the international community to liberalize financial services apparently may not impose any binding pressure for more rapid reform on Korea. The inclusion of financial services in the GATT Uruguay Round may not help foreign financial institutions gain greater access over the near to medium term. This is the first time trade in services is to be governed by GATT principles and many industrializing countries have more restrictive financial systems than Korea. In addition, Korean offers in the GATT negotiations as of early 1992 largely commit the government to measures already implemented. The GATT, therefore, will probably agree to less deep reform.

Deregulation and improved competition in the financial system would not only benefit foreign banks and investors in Korea but also more importantly, would give Korean households and companies improved access to financial services. Pressure from Korean companies may, therefore, eventually compel the government to allow further liberalization and competition in the domestic financial markets. The Korean Chamber of Commerce concluded in a report released in early 1992 that pervasive restrictions in financial markets raise companies' funding costs and are therefore detrimental to their ability to compete in international markets. The inefficiency of the domestic financial market has raised companies' financing costs, reduced profitability and increased risks from highly leveraged balance sheets. These factors have, in general, adversely affected the perception of companies' creditworthiness in international markets so that even some of the best known Korean companies have had difficulties in arranging long-term debt or equity-linked loans.[17]

The prevailing external current account deficit with investment exceeding domestic savings provides a stimulus to opening the economy to foreign investment and financial institutions. This has benefited securities firms as companies seek greater equity finance in the face of government controls on external borrowing. These conditions are similar to those in the past when the authorities sought to relieve internal strains by increasing access to external finance and enlarging the role played by foreign financial institutions. The pace of liberalization of the financial system over the medium- to long-term stages of the "Blueprint" -- when fundamental changes are to be made in official interest and credit policy -- remains an open question. Citing persisting micro- and macroeconomic imbalances, the Finance Ministry recently reported that implementation of the second phase of the interest rate liberalization schedule will not start in the second half of 1992 as originally scheduled (Table 5).[18]

The Korean authorities believe that macroeconomic stability should precede financial market liberalization. They suggest that low inflation, low interest rates and ample savings accompanied by balance of payments surplus would prove conducive to reform. Academic economists also point out that with low interest rates administrative attempts to limit them become meaningless or nonbinding.[19]

This, however, raises another question of how to bring about and maintain macroeconomic stability. In the mid-1980s dynamic export performance, in part facilitated by previous exchange rate depreciation, and sound fiscal policy were instrumental in setting the stage for the desired macroeconomic conditions. In the mid-1990s these conditions are unlikely to be easily repeated. Korea has suffered from a substantial erosion in export competitiveness as wage increases have exceeded productivity gains since 1988. Fiscal restraint is also likely to prove much more difficult in a democratized political environment of competing interests. Moreover, Korea's huge investment requirements to improve its overstretched infrastructure will impose added pressures on the budget. In view of these problems, other policy instruments become more vital for ensuring stability. The authorities' efforts to maintain macroeconomic stability will be hampered without financial sector reform that leads to greater intermediation of savings and loan financing and improves the effectiveness of monetary policy instruments.

NOTES

1. The specialized banks consist of The Industrial Bank of Korea, Citizens National Bank, Korea Housing Bank, National Agricultural Cooperative Federation, National Federation of Fisheries Cooperatives and National Livestock Cooperatives Federation.

2. Nam, Sang-Woo, "Korea's Financial Reform Since the Early 1980s," Korea Development Institute, March 1992. This theme is developed as an example of failure in government industrialization policy.

3. The nonbank financial institutions can be grouped into five broad categories: three development institutions, including the Korea Development Bank, the Export-Import Bank, and Korea Long-Term Credit Bank; six types of savings and trust institutions; about 40 investment companies; insurance companies, and other institutions such as securities companies and leasing companies.

4. Financial System in Korea, October 1991, Research Department, the Bank of Korea.

5. Financial System of Korea, the Bank of Korea, December 1990, p. 30.

6. National Treatment Study, U.S. Department of the Treasury, p. 243. In addition to Korea, the U.S. Treasury has conducted such discussions with the governments of Japan, Taiwan, Mexico, Venezuela, Canada and the European Community.

7. The Korea Times, May 19, 1992, p. 10.

8. United States-Korean Trade Issues, March 1992, The American Chamber of Commerce in Korea, p. 14.

9. National Treatment Study, p. 250.

10. United States-Korean Trade Issues.

11. European Chamber of Commerce, Outline of Principal Issues, Korean Securities Industry and Market Liberalization, May 15, 1992.

12. National Treatment Study, p. 250.

13. Nam, op. cit. A major factor attributed to the slow pace of financial sector liberalization.

14. The Economic and Social Modernization of the Republic of Korea, Edward S. Mason, et al., Harvard University Press, 1980, p. 336.

15. Alice H. Amsden makes this proposition in Asia's Next Giant, South Korea and Late Industrialization, Oxford University Press, 1989, but does not express uncertainty as to the future success of state intervention and considers that it is preferable given the concentrated structure of Korean industry.

16. National Treatment Study, p. 246 and 247.

17. Korean Economic Journal, "Reform Benefits Korean Firms," Paul Muther, May 5, 1992, p. 3.

18. Korea Economic Weekly, October 12, 1992, p. 9.

19. Korean Financial Liberalization, one of the themes discussed by Thomas Cargill in his paper, November 1989.