OECD Reviews of Regulatory Reform

KOREA

PROGRESS IN IMPLEMENTING REGULATORY REFORM

OECD PUBLISHING

OECD Reviews of Regulatory Reform

Korea

Progress in Implementing Regulatory Reform

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The Commission of the European Communities takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.

Also available in French under the title:

Corée

Progrès dans la mise en œuvre de la réforme de la réglementation

Foreword

Progress in implementing regulatory reform in Korea is the subject of the third in a series of monitoring exercises carried out under the OECD's Regulatory Reform Programme, under which 22 country reviews have been carried out since 1998. Following the initial reviews, monitoring exercises are designed to monitor the implementation of policy recommendations of the initial reviews. Japan and Mexico were the first countries to initiate such an assessment in 2004.

The 23 country reviews completed to date include more than 1 000 specific policy recommendations and approximately 130 chapters each focussing on regulatory reforms in selected areas. Taken as a whole, the reviews demonstrate that a well-structured and implemented programme of regulatory reform contributes to better economic performance and enhanced social welfare. Economic growth, job creation, innovation, investment, and new industries benefit from regulatory reform, which also helps to bring lower prices and more choices for consumers. Linkages among competition, market openness and regulatory policies are mutually reinforcing. Comprehensive regulatory reforms produce results more quickly than piece-meal approaches; and they help countries to adjust more quickly and easily to changing circumstances and external shocks. At the same time, a balanced programme must take social concerns into account. An effort must be made however to pursue medium-term goals in the face of short-term obstacles. Sustained and consistent political leadership is an essential element of successful reform. The OECD 2005 Guiding Principles for Regulatory Quality and Performance reflect the dynamic nature of regulatory reform and have been used throughout the monitoring exercise. This exercise can help renew an action plan, and drawing on useful practices from other countries, can inform public dialogue on the benefits of reform.

The monitoring exercise offers insights on the follow-up of the suggested policy options within a country's economic and institutional context, providing an important opportunity to benchmark status, progress and further challenges on the domestic reform agendas. The pressures for reform often respond to a crisis or shock, which in Korea's case was the Asian financial crisis of 1997. Although the circumstances leading to a decision to give regulatory reform higher priority will vary from country to country, experience shows that governance systems should be more flexible and adaptive. The monitoring exercise also, and importantly, contributes to a better understanding of the problems facing all countries when implementing policies to improve the quality of regulation and the regulatory environment, including when and how to strengthen coordination frameworks, the process of building constituencies and communicating the results of reform, the use of regulatory impact analysis, and other techniques to achieve a "whole-of-government" approach.

Each report consists of an assessment of the progress made to implement the recommendations of past reviews, complemented by ongoing cross-country analytical work of best practices and regulatory performance. The report on Korea includes country-specific assessments of progress in the areas covered by the thematic studies in all past reviews: regulatory performance (macroeconomic context, strengths, successes and main results of regulatory reform); regulatory governance (tools, institutions and management structures to promote regulatory quality); competition policy; and

market openness. The regulatory reform review of Korea published in 2000 included coverage of electricity and telecommunications; an assessment of telecommunications was retained for this monitoring exercise. In addition, Korea requested a new assessment of tertiary education from a regulatory perspective, an innovation in the series of multidisciplinary reviews. The exercise is supported by a self-assessment based on a questionnaire completed by the country, and mission of a Secretariat team to collect further information and to discuss with policy makers. The report, including options and recommendations based on the success achieved to date and on Korea's current context and challenges, was presented to and discussed by the Group on Regulatory Policy at its meeting on 7 December 2006.

Acknowledgements. *The horizontal Programme on Regulatory Reform is headed by Deputy Secretary-General Richard Hecklinger. The country reviews and monitoring exercises are co-ordinated by the Directorate for Public Governance and Territorial Development.*

The monitoring exercise of Korea reflects contributions from the Government of Korea, the Working Party on Regulatory Management and Reform of the Public Governance Committee, the Competition Committee, the Working Party of the Trade Committee, the Working Party on Communication Infrastructures and Services Policy of the Committee for Information, Computer and Communications Policy, the Education Committee, and representatives of member governments and members of the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC).

In the OECD team, Odile Sallard, Rolf Alter, Josef Konvitz, Stéphane Jacobzone, Chang-Won Choi, Glen Hepburn, Michael Wise, Bernard Phillips, Oliver Solano, Osamu Onodera, Anthony Kleitz, Dimitri Ypsilanti, Jaebum Lee, Aims Mc Guinness, Abrar Hasan and Young-Gon Kim contributed substantially to the monitoring exercise of Korea. We are grateful to Randy Jones, Taesik Yoon and Lutecia Daniel for their contributions. The documentation was prepared by Jennifer Stein.

Table of contents

Summary 9

Chapter 1. **Korea Monitoring Exercise: Synthesis** 15

Introduction 16
The initial review of regulatory reform 17
Economic performance 21
Progress made in regulatory reform since the 2000 *OECD Review* 28
Remaining challenges 34
Further challenges: tertiary education 40
Lessons from implementation 43
Conclusion 44
Notes 44
Bibliography 44

Chapter 2. **Government Capacity to Assure High Quality Regulation** 47

Introduction 48
Regulatory policies 48
Regulatory institutions 49
Regulatory tools and procedures 54
Conclusions and policy options 64
Notes 68
Bibliography 68
Annex 2.A1. Implementation of the 2000 Recommendations 69

Chapter 3. **Competition Policy** 71

Introduction 72
Substantive law 74
Institutions and enforcement processes 81
Coverage, sector regulation and policy advocacy 86
Assessment 89

Chapter 4. **Market Openness** 95

Introduction and general considerations 96
Transparency and openness of decision making 97
Market openness and non-discrimination 100
Avoidance of unnecessary trade restrictiveness 107
International harmonisation and equivalence of other countries' regulatory measures 110
Application of competition principles 113
Conclusions and policy options 115
Notes 117
Annex 4.A1. Implementation of the 2000 Recommendations 120
Annex 4.A2. Assessing Results in Selected Sectors 123

Chapter 5. **Telecommunications** 127

Introduction 128
The telecommunications sector in Korea 128
Market participants 133

Regulatory structures and their reform 135
Convergence 154
Conclusions 156
Notes 159

Chapter 6. **The Tertiary Education System** 161
Introduction 162
Context of the tertiary education sector 162
Major issues driving higher education reform 163
Government priorities 164
A perspective on recent historical developments 165
Regulatory framework 167
The policy responses: towards autonomy; competitiveness and accountability 172
Conclusion and policy options 181
Notes 185
Annex 6.A1. Examples of Regulations 187

• • •

List of boxes

2.1. E-government initiatives for businesses and foreigners 63
3.1. The *chaebol* issue 76
3.2. Dominance and mergers 79
3.3. Investigation powers 82
3.4. Private actions and lawyer quotas 85
3.5. Small business protections 88
4.1. Customs reform and trade facilitation 107
5.1. Recommendations on telecommunications 129
5.2. Important events in the liberalisation of the telecommunications sector in Korea since 2000 133
5.3. The roles of KFTC and MIC 139
5.4. The mergers of mobile companies 150
6.1. Goals and priorities of tertiary education in Korea 165
6.2. Examples of regulations linked to major Government reforms 171
6.3. Case of accreditation in the United States 178

List of tables

1.1. Structural indicators 22
2.1. Source of bills debated and passed by the Korean Congress 51
3.1. Implementation of Recommendations from 2000 *OECD Review* 93
4.1. Areas of improvement suggested by the foreign business community 99
4.2. Preferential agreements between Korea and other countries/regions 102
4.3. FDI limitations in Korea 103
4.4. Administration of government procurement contracts 105
4.5. Estimated benefits of the Government e-Procurement System 106
4.6. Government procurement contracts in 2003 by tendering method 106
4.7. Participating agencies in the Single Window 109
4.8. Procedures required to start a business 110
4.9. Relationship between Korean standards and international standards 111
4.10. Current state of harmonisation of Korean standards with international standards 113
4.11. MRAs concluded by Korea 114
4.A1. Changes in special excise taxes: passenger vehicles 124
4.A2. Changes in vehicle taxes: passenger vehicles 124
4.A3. Procurement by KEPCO 126
5.1. Settlement rate for international traffic terminating in the United States 131
5.2. Number of carriers participating in each market 133
5.3. Market share of facility-based operators 134
5.4. Main telecommunications legislation 135

5.5. Market entry requirements 141
5.6. Foreign ownership restrictions 142
5.7. Main system operators in Korea 144
5.8. KT's interconnection charges 145
5.9. Fixed-mobile interconnection charges paid by KT 145
5.10. Telecommunication price changes 1998-2005 147
5.11. Yearly compensation for losses in providing universal service 148
6.1. Percentages of institutions and students by institutional ownership 162
6.2. Regulatory environment in Republic of Korea in comparative context 167
6.3. Governmental entities involved in tertiary education regulations 168
6.4. Non-governmental agencies involved in the evaluation of tertiary education 168

List of figures

1.1. Convergence of GDP per capita 21
1.2. Budget balance and public debt 26
1.3. Trends in public social expenditure 26
4.1. Cases submitted and resolved by the Office of Investment Ombudsman 104
5.1. Broadband penetration 131
5.2. OECD basket of national leased line charges 132
5.3. OECD mobile penetration rates 151

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Summary

Introduction

Korea was among the first countries to undergo a regulatory reform review (2000). In recent years, the government has been very active in implementing measures to promote regulatory reform, competition policy and market openness, and modernising the regulatory framework for information technologies. This Monitoring Exercise identifies some of the lessons learned about implementation and indicates what more can be done in light of current challenges. Progress in regulatory and structural reform has played an important role in the speed and strength of Korea's recovery from the 1997 crisis. A whole-of-government approach supported at a high political level sustains a strategic view of regulatory reform as an investment in the development of the country. Strenuous efforts have allowed the country to cope successfully with the crisis and to ensure long term growth. The move towards technology intensive products highlights Korea's economic achievements.

Commitment to high-quality regulation

Korea has made impressive progress to improve its regulatory framework. Korea's regulatory quality system has been developed and consolidated since the 2000 *OECD Review* and the recommendations in that report have helped guide the Korean government in pursuing further reform efforts. The commitment to a "participatory society" has promoted a transparent regulatory regime. Policy has shifted to user-oriented regulations, refocusing the government's role on strategic issues. The Regulatory Reform Committee, which has functioned since 1998, and the Regulatory Reform Task Force (since 2004), both under the direction of the Prime Minister, set regulation policy, review regulations, evaluate progress, and co-ordinate across relevant government ministries. The Internet is used extensively to improve access to regulations, and is linked to efforts to reduce administrative burdens. The emphasis has shifted from a quantitative reduction of the overall stock of regulations to an effort to further promote regulatory quality. To consolidate these gains, an explicit statement would support the reform efforts and hold them more accountable against a benchmark for performance, for example using the OECD's 2005 Guiding Principles for Regulatory Quality and Performance.

Implementation would benefit from a review of the possibilities for further co-ordination of the many agencies working on regulatory reform. The responsibilities of the Regulatory Reform Committee could be broadened to include more policy areas, such as taxation and subsidies, and industrial and regional development policies. The growing number of bills introduced by congressmen which are exempt from the regulatory quality process is a

concern which could be remedied by a permanent mechanism in the National Congress to assure oversight of the quality of laws. Even if the possibilities of consultation have greatly increased, there remains scope for discretion and the quality of consultation processes varies widely across agencies. The consultation process should be made more uniform and effective. While substantial progress has been made in reducing bureaucratic discretion, for example with the new guidelines published by MOLEG, the possibilities remain, including administrative guidance.

Korea has already made significant steps to simplify and cut its regulations in recent years. However, further work is needed, together with an analytical methodology for measuring administrative burdens that would help identify priorities for reform. An effective regulatory impact analysis system calls for better training at national and local levels, and clear political support to promote a change in administrative culture, lest RIA become a routine formality rather than an instrument for policy decision-making.

Competition policy

Commitment to market principles at the highest political level has provided strong support for competition policies, reforms of the financial sector and corporate governance, and for opening markets to trade and lowering barriers to foreign investment. Significant progress has been achieved in terms of shifting the focus of the Korea Fair Trade Commission (KFTC) towards core competition problems and increasing its ability to enforce competition policy, even if further challenges remain.

The core of the KFTC's latest reform programme has been its launch of the 2003 "Three Year Market Reform Road Map" ("Road Map"). One foundation of this programme was an Index developed by the Korea Development Institute to measure transparency, fairness and competition of firms and markets in Korea. The Road Map concentrated on three general areas. First, it focused on strengthening business transparency and accountability by modifying corporate laws, authorising lawsuits against business misconduct, protecting minority shareholder rights, reinforcing auditor independence, and tightening the control of insider misconduct. Second, the Road Map revised the KFTC's own regulations of conglomerates in ways that were intended to encourage more transparent structures. The third area was traditional competition policy topics such as doubling the financial penalty against cartel violations, streamlining merger review with pre-notification, retiring anti-competitive regulations and strengthening consumer rights. This plan was embodied in legislation in 2005.The KFTC staff structure was reorganised to reflect these changes, notably by reducing the staffing that administers the regulation of cross-holdings among affiliates.

However, the KFTC still lacks a "dawn raid" power to enter premises and take possession of evidence. Increased use of criminal sanctions in hard-core cartel cases, to make the threat

of individual liability more realistic, depends on co-operation with prosecutors. Eliminating constraints in professions remains a challenge. The KFTC shares regulatory responsibilities with other agencies. Generally co-operation has been smooth, but there have been occasional tensions in sectors such as insurance and cable television which have exposed businesses to some uncertainty.

Market openness

Korea maintains a firm commitment to attract more foreign direct investment and further liberalise the market. Improvements in regulatory procedures, greater engagement of the business community and streamlining of procedures in customs and public procurement contribute to this end. The Korea On-line E-Procurement System (KONEPS) has enhanced transparency and efficiency. Korea has also made efforts to change the negative public perception towards imports, foreign firms and foreign investment, and has introduced a framework to reward public servants who promote Foreign Direct Investment. Invest Korea is a one-stop shop for foreign investors, and the Office of the Investment Ombudsman assists foreign investors on problems after establishment.

Strengthening efforts to alleviate the perception of *de facto* discriminatory effects against foreign goods, companies and investment remains a major challenge, as changing mindsets necessarily takes time. As in other OECD countries, some negative perceptions persist among the media and the public. Laws and legal instruments may not always be sufficient to improve investors' confidence, as there is also a perception among some foreign investors that officials sometimes interpret and apply regulations more strictly for foreign firms. This calls for further efforts to adapt the administrative culture and to better communicate with the public on the importance of regulatory reform and market openness. There is also a perception among foreign investors that certain standards are specific to Korea and differ from international references, in spite of progress in recent years. Further improvements in terms of transparency and decision making from the perspective of market openness will support the implementation of regulation interpretation and guidelines in a non-discriminatory manner. Translating public notices and consultation procedures in foreign languages would be beneficial, and would serve as a signal of the government's commitment towards an open market. There is still scope for further strengthening efforts to avoid unnecessary trade restrictiveness and promote international standard harmonisation and conformity assessments. While FDI is allowed in most sectors, 26 have limitations on foreign participation and 2 – television and radio broadcasting – are fully restricted. Sectors of services as well as agriculture represent specific challenge areas. The current negotiation over the Free Trade Agreements could potentially represent a powerful tool to address this challenge although care is necessary so that the results of FTAs do not lead to trade diversion.

Telecommunications

Since 2000 the telecommunications sector in Korea showed continued rapid growth, especially in broadband penetration where Korea now ranks the highest among OECD countries. It is also the 9th largest telecommunication market among OECD countries.

Sector liberalisation has produced notable benefits in terms of improved services, lower prices, and innovation. Korea is also among the leaders for wireless broadband as well as digital multimedia broadcasting. Positive reforms have taken place to create a competitive market. Korea Telecom was fully privatised in 2002, a goal that many other OECD countries with state-owned operators have not yet managed to complete. A number of the recommendations made in 2000 have been implemented or partially implemented, even if scope for further improvement remains.

Korea has made impressive progress in developing its telecommunication infrastructure and service markets, with significant emphasis on the information society and IT sector. Korea performs generally well in terms of overall price comparisons, but prices for international calls tend to be among the highest in the OECD. The implementation of market-oriented tools and institutions tends to lag behind. Korea is still not emphasising sufficiently the use of market mechanisms to develop a digital economy. The clarification of the roles between policy making, pushing the development of the sector, and implementing a regulatory framework, remains insufficient, despite the devolution of some technical decision-making functions to the Korea Communications Commission. The reliance on *ex ante* regulatory schemes and tools remains insufficient, and has at times allegedly included the use of administrative guidance.

Despite significant progress, KCC, the sector regulator, can still not be considered as an independent regulator in its full right. This does not mean that deregulation cannot take place, but market developments could be harmoniously supported by a more efficient and transparent regulatory framework, with greater independence, clarifying opportunities for investors, both domestic and foreign. This would help in promoting further opportunities for all participants in this dynamic market and for better serving the consumers' interest. Given the perspective of sectoral convergence, it would be advisable to consider a possible joining of the KCC and the Korea Broadcasting Commission. A comprehensive review of legislation to create a single legal framework for the communication sector would represent a useful step and also serve to create a well-balanced market. Foreign ownership restrictions also remain an issue.

Tertiary education

For innovation and productivity to grow, especially in the service sector which is only about 60% as productive as the OECD average, there needs to be qualified human capital. While Korea's primary and secondary education levels are excellent, as demonstrated by the PISA scores at the international level, there is still scope for improving the quality of tertiary education to ensure the adequate supply of high-skilled human capital. There is evidence of skill mismatch, as workers at both low and high skill levels are in short supply. Complaints are also being voiced by companies about the quality of domestic tertiary education. Korea also represents 5% of foreign student flows to the OECD area, with however a very modest role as a destination for students.

In this context, severe competition to get into prestigious universities has social consequences and affects secondary education, given the need for private tutoring. Higher education is also not prepared for demographic changes, which will imply for the first time

in Korean history, a shrinking college age population, with a potential decline of the student population in the future. These issues are further exacerbated by the population concentration in the Seoul Metropolitan area.

Korea has embarked upon efforts to improve the global competitiveness of its tertiary education system by simplifying and clarifying regulations, eliminating obsolete regulations, and improving co-ordination across ministries. Further efforts call for regulatory reforms affecting institutional autonomy of public universities, including moving to a legal status as school corporations outside the formal government structure. Overall, an effective system for quality assurance and public accountability would serve the whole system. The regulatory framework for private universities would benefit from stronger transparency and accountability measures as well. The Ministry of Education itself could then focus less on detailed regulation and more on strategic leadership and monitoring the performance of the tertiary education system.

Lessons for the future

The Korean monitoring exercise reveals the impressive progress that has been made by Korea in a very short time period in adapting and modernising its regulatory framework towards consultation and transparency, improving competition in domestic markets and further consolidating market openness. Such rapid change may give rise to social concerns, with questions about what could be the acceptable rate of change in terms of institutional structures and methods of government. By OECD standards for regulatory quality, Korea is on track, but progress in certain areas seems to be more apparent than in some others. This may certainly test the capacity for reform of entire sectors of the administration and society.

A high quality regulation approach requires a whole apparatus for implementation. In the administrative sphere, several parts of the report highlight the possible risks of "gaps in implementation", as working level officials need to adopt new methods of working and of interacting with society. Capacity building, including at the local level, is a critical factor to ensure that changes decided at the national level can effectively be implemented. This also requires upgraded skills and new working methods. The ambitious goal of a "participatory society" requires further efforts for public administrations to reach out to the public, to operate transparently and to increase their capacity to listen to the demands of the wider public. Transparency is important, as it represents a social investment, an intangible asset in the form of current and future trust in public institutions, tools and policies.

Beyond the administrative sphere, this monitoring exercise highlights the challenge of reaching out to a wider public, to communicate the benefits of regulatory reform and building consensus for action. There is a need to publish a government strategy on consultation, but also to show the public that their comments are being heard, or not (and why).

This report has identified a number of areas where further regulatory reform and the application of high quality regulation principles could help Korea better prepare for the future. Regulatory reform can help structural change in the economy, promoting a more integrated policy approach, as well as fostering market openness. This would improve the situation of Koreans as citizens, workers and consumers. Awareness of the need for action

is high, and regulatory policy is relatively strong. However, all other OECD countries are moving as well, since regulatory reform is a dynamic field. All are further advanced in 2007 compared with the mid 1990s. If Korea is to continue closing its gap in relation to the most advanced countries, it needs to make even faster progress, to ensure smoother market processes, better regulatory tools and more open institutions.

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 1

Korea Monitoring Exercise: Synthesis

Introduction

Korea was among the first countries to be reviewed under the OECD horizontal programme on regulatory reform in 2000. The objective of these reviews is to help governments improve their regulatory frameworks as a means of enhancing the environment for competition, innovation and growth, whilst ensuring that regulations efficiently fulfil important social obligations. Korea has made one of the fastest transitions in the world from a very low income to a developed OECD level, with high rates of access to and use of new technologies. Human capital and information technologies are key assets in Korea's economic development.

Since the first *2000 OECD Review*, the Korean Government has been very active in implementing a number of measures to promote regulatory reform, competition policy and market openness and in modernising its regulatory framework for information technologies. (Throughout this report, the *2000 OECD Review* will also be referred to as the *Review*). This Monitoring Exercise will identify some of the lessons that can be learned about the progress of implementation and will indicate what more can be done in light of current challenges.

Regulatory reform can help promote a more efficient economy, through increased transparency, better assessment of impacts, adequate consideration of alternatives, and the reduction of regulatory burdens. A level playing field ensures that all domestic players may face similar rules and enjoy similar opportunities. At the domestic level regulatory reform can foster trust in government, with more efficient markets and more transparent regulatory tools making public authorities accountable to the public.

Regulatory reform is a very important asset as countries move forward in the process of globalisation, as regulatory co-operation can help promote market openness. Korea is not only in the OECD but is also a very active member of Asia-Pacific Economic Co-operation (APEC). APEC and the OECD are engaged in close collaboration on regulatory matters, as indicated through the joint APEC-OECD Co-operative Initiative on Regulatory Reform. Cross country studies can foster a better understanding of the cost of regulatory barriers and the measures needed to overcome them. Each country's regulatory system reflects its values, history, constitution and institutional development. These systems are evolving in an international context shaped by an awareness of innovation and good practice in other countries and by the competitive pressures to increase investment and reap the benefits of international trade and technological innovation. High quality regulation contributes to overall competitiveness as well as to good governance.

Regulatory reform is a priority in the effort to promote sustainable economic growth among OECD countries. As a complement to sound macro-economic policies, regulatory reform can help increase economic output, raise employment, shift economic activity to higher value-added production and services, encourage the use of appropriate and new technology and make national economies more resilient to economic shocks. The 2005 OECD principles for Regulatory Quality and Performance reflect the dynamic feature of

regulatory reform, with the recognition of regulatory policy as a field in its own right. Regulatory reform requires an ongoing process to improve regulatory tools and institutions, to reassess existing regulations in the light of current economic and social developments, and to assess the impact of new regulations when they are drafted. Regulatory policy can encourage new or previously unheard stakeholders into the policy debate, so that policy is better grounded and that social participation can be increased. This serves to create a social and economic environment with better opportunities for citizens. These tasks call for a whole-of-government approach, with a strategic view towards investing in the long term future of the country.

The initial review of regulatory reform

When the initial review was conducted in 2000, Korea was recovering from the severe financial crisis of 1997. The crisis occurred despite long-standing strengths, such as sustained high growth, moderate inflation, high national savings, large government financial surpluses and small external deficits. While the crisis was partly a result of contagion from other Asian countries, it also reflected structural challenges in Korea's economic structures and regulatory frameworks. The economic model that had previously served the growth of Korea in the preceding thirty years had become less appropriate in a more competitive global economy. The crisis required short-term crisis management, but also facilitated the implementation of a number of longer-term structural reforms.

The 1997 crisis led to the implementation of wide ranging reforms, with regulatory reform becoming a key element in the shift to a more market-oriented system. The four areas targeted for priority reform were foreign exchange and transaction regulations to encourage foreign investment, industrial and land use regulations to liberalise business activities, monetary and business regulations to improve industrial competition, and procedures and regulations for citizens. The focus was on deregulation, with the Regulatory Reform Committee receiving the task of reviewing approximately 11 000 regulations in early 1998, halving that number, and improving a further 2 400 regulations. Deregulation efforts proceeded for some major infrastructure sectors, albeit slowly. Entry barriers to electricity generation were lowered. Competition was introduced in international and long distance telecommunications, and mobile cellular services developed very rapidly. State-owned enterprises numbered 108 in 1998 and employed over 210 000 people; 11 were targeted for privatisation. A new regulatory regime was established for the financial sector, with a new system aiming at strict enforcement of prudential rules by an independent regulator. To accomplish this, four existing agencies were merged into the Financial Supervisory Service. Enhancing transparency and market discipline for the *chaebol* became a priority. The exercise of the rights of minority shareholders was facilitated and supported by greater involvement of citizens, such as through the People's Solidarity for Participatory Democracy. The amendment of the Commercial Code in December 1998 clarified the fiduciary duties and legal liabilities of directors, including *de facto* directors. All forms of mergers and acquisitions were allowed. The number of business lines completely or practically closed to foreign direct investment was reduced from 53 in 1997 to 24 at the beginning of 1999. The government also streamlined the administrative process by establishing a one-stop shop and generosity of tax incentives available to foreign firms.

The 2000 *Review* discussed how to shift the government's role in the economy from direct intervention, ("command and control") towards ensuring the sound functioning of a market

economy. In the corporate sector, the government introduced a regulatory framework aimed at the business groups known as *chaebol*, intended to limit their role in the economy. The policies to restrict the *chaebol* were accompanied by measures to support and protect SMEs, for example by restricting certain business lines to SMEs, and offering preferential loans. Nevertheless, the problems in the *chaebol* were a key factor in the 1997 crisis. In the wake of the crisis, the problems have been addressed by some framework improvements, including strengthening corporate governance as well as the regulatory oversight in financial matters. However, restrictive regulations protecting SMEs remain in place.

The 2000 *OECD Review* made the point that "the impact of regulatory reforms will depend on their effective implementation, and continued widening to create an environment conducive to vigorous competition". Early steps in regulatory reform had supported the recovery, including the reforms in the financial sector and the steps towards increased transparency and deregulation by the Regulatory Reform Committee. However, further broad-based regulatory reform founded on market principles was essential to create new foundations for long term growth. This would require a reduction of the government intervention in private sector decisions. The construction of new, pro-competitive regulatory regimes was required to efficiently protect consumer interests, the environment and competition. Opening markets would require removing remaining import barriers. Beyond declines in tariff rates, and the lifting of most quantitative restrictions, the *Review* called for strengthened efforts to harmonise technical regulations and standards with international norms and to recognise the equivalence of other countries' regulatory measures. Telecommunications was identified as a priority for further reform, with action to stimulate new entry, to avoid micro-managing the sector and to limit the government's role to the establishment of the necessary safeguards. The *Review* argued that in the longer-term, Korea's potential growth rate would depend on implementing a market-oriented framework which would drive productivity growth, stimulating supply-side gains in efficiency and technology.

More specifically, Korea was urged to:

- Broaden representation of stakeholders in decision making, to ensure that Korea's civil society would have adequate and meaningful opportunities to participate in regulatory reform.
- Increase the quality of its regulatory impact analysis programme, which was well designed, but with weak implementation by ministries, with low quality as a result of lack of capacity.
- Establish independent sectoral regulators, to foster transparency, accountability and competition, with increased regulatory quality. The establishment of the financial Supervisory Commission was a useful first step. The *Review* also acknowledged that the creation of the Korea Communications Commission (KCC) was a positive step in improving the institutional structure of regulation but that it was not yet an effective independent regulatory body. This was also a need in the electricity sector.
- Refocus the policy attention and resources of the Fair Trade Commission towards measures that are clearly related to "efficiency" goals. *Chaebol*-related competition problems should be dealt with using consistent economy-wide principles, rather than special rules, while reforms of corporate governance and prudential supervision would be better means in the long run to deal with *chaebol* issues that are not directly related to market competition.

- Strengthen the powers of the KFTC to obtain information and the rights of private parties to take legal action against restraints.
- Eliminate protectionist measures that prevent potentially efficient competitors from entry into sectors reserved for "small" business and also protecting them in some aspects of government procurement.
- Strengthen efforts to harmonise technical regulations and standards with international standards and to recognise the equivalence of other countries' regulatory measures.
- Enlarge the scope of consultation with foreign parties not only on trade-related regulations but also on other domestic regulations.
- Speed up regulatory reform in traditionally highly regulated sectors such as services and agriculture.
- Strengthen the government's efforts to eliminate regulations that have *de facto* discriminatory effects against foreign competitors.
- Enhance co-operation between trade policy bodies and other government bodies in charge of domestic regulations.
- Restructure the KCC as an independent communications sector regulator.
- Reduce barriers to entry by introducing a system of general authorisation.
- Implement a price cap system for KT's local charges, leased line services and national long distance services, eliminating all other price approval requirements. Also implement an interconnection pricing framework using long-run average incremental cost.
- Take comprehensive measures to promote infrastructure competition in the local loop; streamline the regulatory framework and introduce competition in the cable TV market.
- Eliminate foreign ownership restrictions in both the fixed and wireless markets.

Since the initial *Review*, developments related to product market frameworks and competition were also covered by a special chapter on product market competition in the 2004 *OECD Economic Survey of Korea*.[1] This 2004 survey noted the legacy in resource allocations in the Korean economy stemming from the early stage of development, with the high concentration in product markets, barriers to entry and exit, government ownership and the issue of the business conglomerates (the *chaebols*). Korea has a dualistic economy, with a highly competitive, export-oriented manufacturing sector and a less dynamic domestic demand-oriented sector, with a very high gap in productivity between the manufacturing and the services sector.

In terms of progress, the 2004 *OECD Economic Survey* found evidence of increased competition since the crisis, except in highly concentrated industries, such as semiconductors and cars, which are part of a larger competitive global market. Import penetration had risen, but with low import penetration for certain segmented industries. This reflects explicit trade barriers, as tariffs remained higher than in OECD countries primarily due to the protection granted to the agricultural sector, which is one of the highest in the OECD, above Japan. Regulatory and administrative procedures for sanitation and safety were still not consistent with international standards. FDI inflows had risen sharply following the reforms to attract FDI and the restructuring of the corporate and financial sectors following the crisis. Despite significant progress, the level of competition indicated by concentration and FDI inflows remained somewhat more limited compared to

other OECD countries. According to a Korean study, the number of strong barriers to entry had been cut by half for manufacturing activities and by 40% for services, but with a greater number of weaker barriers remaining for non-manufacturing activities.[2] The *Economic Survey* also noted the role of land use and zoning regulations, established by 112 different laws administered by 13 different ministries. This was also reflected in the intensity of the concentration in the capital region, which contains 47% of total population with 12% of the national territory, and congestion costs estimated up to 2% of GDP. Regulations and volume-to land ratios have hindered the construction of large-scale outlets in urban districts. The issue of the capital city was analysed in detail in an *OECD Territorial Review of Seoul* in 2005,[3] calling for a bolstering of its international competitiveness and its main engine role in Korea, with better regional co-operation, and making recommendations for developing knowledge-intensive activities and reducing congestion costs.

The 2004 *Economic Survey* noted the efforts to deregulate professional services, with the omnibus cartel Repeal Act to increase competition in professional services (*e.g.* lawyers, accountants, architects). The reforms to lower entry barriers by the Regulatory Reform Committee had already resulted in at least a doubling in annual entry between 1997 and 2002. While sector specific regulators such as the Korea Communications Commission (KCC) and the Korea Electricity Commission had the potential to become independent regulatory bodies, the *Review* noted that they still operated within ministries and lacked autonomy regarding crucial regulations such as licensing and pricing as well as their own staffing and budgeting. Nevertheless, Korea's telecommunication sector had been advancing at a remarkable pace, with competition, one of the highest broadband penetration rates in the world, with low charges.

The *2004 OECD Economic Survey* made further recommendations to reduce barriers and regulations that limit competition, to promote international competition, to strengthen the competition law, increase competition in retail distribution and in professional services. The *2004 Survey* called for specific efforts in the electricity and natural gas sectors as well as for telecommunications.

The 2005 *OECD Economic Survey of Korea* included a focus on reforming the R&D and education systems. This survey noted that the sharp expansion in the number of students going to university had been accompanied by a decline in the quality of tertiary education, which was assessed as relatively poor by international standards. The role of tertiary education is crucial for long term economic growth, as increased human capital not only raises labour productivity but also serves as a driver of technological success. The OECD *Growth Study* has estimated that the long-run effects on GDP per capita of one additional year of education was in the range of 4 to 7%.[4] Already in 2002 the proportion of the population aged 25 to 34 years was the third highest for tertiary education, but there was widespread public discontent regarding the education system. Private companies complain about the low quality of education. The 2005 Survey addressed the quality issue, the public-private balance in funding, and made recommendations for restructuring and consolidating universities. The *Review* also called for greater deregulation to help the universities better respond to signals from stakeholders and to stimulate competition. More diversification was needed, with strengthened industry-university relationships. Tertiary education reflects a core public policy concern in Korea, not least as it is assumed to offer better economic and professional opportunities and the hopes of a better future. However, with rising unemployment, even graduates had found difficulties in securing proper jobs in the recent period.

The current Monitoring Exercise of Korea is therefore well placed to assess progress in all these core areas for future economic progress. After reviewing general economic performance, the Monitoring Exercise will assess progress in implementing reforms in the core areas of government capacity to assure high quality regulation, competition policy, market openness and telecommunication policy. The focus on tertiary education from a regulatory quality perspective will shed light on a core sector, where an appropriate mix of deregulation and re-regulation could foster improved performance.

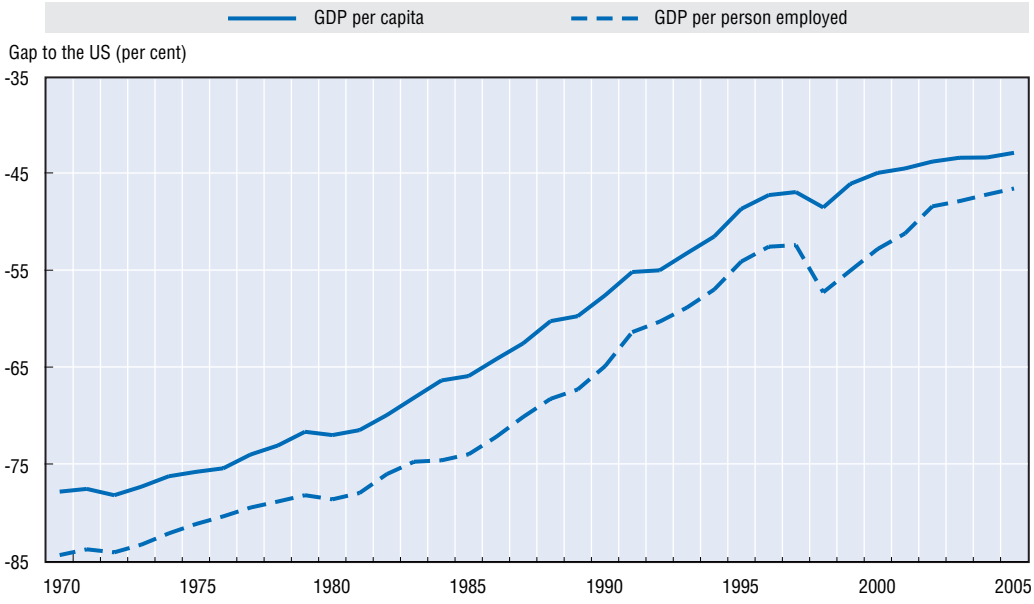
Economic performance

Unprecedented economic growth

Korea is one of the few countries that have managed the transition from a rural, undeveloped society to a modern economy in just one generation. Economic growth averaged 8% a year between 1963 and 1993. Consequently, per capita income converged from less than 20% of the OECD average to more than 50% by the mid-1990s. Relative to the US levels, GDP per capita went from around 15% in 1970 to almost 50% in the mid 1990s (Figure 1.1).

During this early development period, Korea had inherited a legacy of state interventions. The high tide of government intervention was reached with the Heavy and Chemical Industry Drive, from 1973 to 1979. Following the second oil crisis, Korea faced a downturn with inflation reaching 29% in 1980 and a 1.5% drop in output in that year. Economic liberalisation was pursued in the following period, with the government implementing a macroeconomic stabilisation plan and shifting industrial policies. Selective industry promotion laws were repealed, preferential credit and tax concessions were reduced and price control regulations were replaced in 1981 by the Fair Trade Act to promote competition. This led to an outstanding economic performance with annual growth rate of output of 7.7% during the 1980s and almost 7.5% between 1990 and 1997.

Figure 1.1. **Convergence of GDP per capita**



Source: OECD (2006), *National Accounts of OECD Countries*, Paris.

The 1997 crisis

In 1997, Korea was hit by one of the most severe financial crises ever experienced by an OECD country. The crisis revealed weaknesses which were described by the Ministry of Finance and Economy as follows: "The key factors of Korean growth were human resources, high investment and an outward-development strategy. The (Korean) economy was hampered by collusive ties between government and businesses, arbitrary regulations and corruption… Over the past thirty years of accelerated economic growth, former governments were deficient in developing the rules and principles of a market economy, failing to implement structural reform policies consistent with the changes in the international environment".[5] This led to excessive risk-taking overinvestment and insufficient attention to credit and exchange risks.

In the wake of the crisis, Korea experienced a severe recession in 1998, with output falling by 7%. Labour utilisation was reduced significantly with Korea experiencing a significant fall in the employment rate for the first time since 1980. The reduction in the average hours worked was also more pronounced during this period. Korea achieved a strong recovery (Table 1.1), showing an economic rebound since 1999, with GDP per capita increasing at a 4.5% annual growth rate, with slightly lower labour productivity than in the previous period. The employment rate increased again, at a pace comparable to that observed before the crisis. The average working hours also continued to decrease at a rate of 1% a year. However at over 2 500 hours per year, working hours remain 15% higher than in Greece, the next OECD country, and 37% higher than in the US, which is itself above the majority of European countries. Since 1999, the gradual closing of the income gap with the more advanced OECD countries may also explain part of the slow down in productivity. Korea is one of the few OECD countries where the process of convergence with the US has continued, albeit more slowly, with Korea reaching nearly 55% of the US level in 2005 (Figure 1.1).

Led to structural reforms, corporate governance and the financial sector

While favourable international conditions and the growing links with China have made an important contribution, the wide-ranging economic reform programme implemented in the wake of the crisis laid the foundation for the resumption of strong growth in Korea. The 1997 crisis had underlined the dangers of an excessively indebted corporate sector, with weak profitability, and a poorly supervised, shaky financial system. These weaknesses stemmed from the fact that banks and corporations were linked closely with the government in a web of implicit guarantees, which were sometimes known as "Korea Inc.". This close relationship created a moral hazard problem – a "too big to fail" mentality that resulted in excessive risk-taking, over-investment and insufficient attention

Table 1.1. **Structural indicators**

Average growth rates, per cent

	1980-1990	1990-1997	1997-1999	1999-2005
GDP per capita	7.5	6.2	0.3	4.5
Labour utilisation	0.9	0.8	-4.6	0.4
Employment rate	1.7	1.3	-2.9	1.4
Average hours	-0.7	-0.5	-1.7	-1.0
Labour productivity	6.5	5.4	5.1	4.2

Source: OECD (2006), *National Accounts of OECD Countries*; OECD (2006), *Labour Force Statistics*, Paris.

to risks. The heart of the reform programme implemented during the crisis was the change in the economic framework to promote restructuring of the corporate and financial sectors.

The collapse in July 1999 of Daewoo, then the second largest *chaebol* group, was a landmark event that helped to dispel the moral hazard resulting from the "too big to fail" approach. Now that this approach has been abandoned, more than half of the top 30 *chaebol* groups in 1998 have gone bankrupt. Increased market discipline has encouraged a sharp reduction of debt; in the manufacturing sector, the debt to equity ratio has fallen from nearly 400% in 1997 to around 100% in 2005. The remaining groups have significantly improved their balance sheets and their corporate governance structure. The end of "too big to fail" was accompanied by a strengthening of the corporate governance framework, which had been a major reason for the corporate sector's high level of debt and low profitability. The framework was improved by increasing the rights of minority shareholders, strengthening the rights and roles of company directors and giving real responsibilities to outside directors. Another step increasing the power of shareholders was the introduction of class action suits for large firms in 2005 and for all listed firms in 2007. However, the scope for suits, which is limited to securities related cases, still needs to be expanded to other abuses, such as related party transactions and inter-company transfers.

The crisis forced Korea to close nearly a fifth of existing financial institutions and rehabilitate the surviving ones. It created an opportunity to transform the financial system, which had been under heavy state guidance and subordinated to industrial-based objectives, into a more independent market-based system. However, this was a costly process. Between 1997 and 2003, the government spent 161 trillion won (27% of GDP) to re-capitalise viable banks and to purchase non-performing loans. Less than half of these outlays have been recovered. This reform was accompanied by an overhaul of financial supervision based on increasingly rigorous reporting standards to provide accurate estimates of the financial health of institutions. Despite the costs, the prompt action to rehabilitate the financial sector was effective in allowing economic growth to continue. Today, Korea has a banking sector that is profitable and well capitalised, with a relatively low level of non-performing loans.

Increased competition and international openness with the restructuring of the banking sector

Competition has also benefited from regulatory reform, privatisation, reducing trade barriers and liberalising restrictions on inward foreign direct investment. Increased openness accelerated the internationalisation of the Korean economy. The import diversification programme, which had restricted imports from Japan, was abolished. Stronger competition boosted productivity and forced inefficient firms out of business. The restructuring of the corporate and financial sectors strengthened the international integration of Korea's economy. Its international trade rose from 32% to 48% of GDP between 1997 and 2004, driven largely by trade with China – Korea's largest trading partner. The removal or raising of equity ownership limits has resulted in a sharp rise in foreign ownership, with foreign investors holding more than 50% of shares in some companies, such as Samsung Electronics. Foreign direct investment (FDI) has also grown, though comparatively still modest, from 0.3% of GDP in 1997 to 1.2% of GDP in 2005.

The foreign presence in the banking sector increased as a result of the privatisation of the banks that had been re-capitalised using public funds. Foreign investors have become the largest shareholders in eight of the 14 commercial banks, with a substantial presence in two of the others. According to the Bank of Korea, the combined foreign ownership share of the Korean commercial banks rose from 8.5% in 1997 to 27% in 2002 and to 59% in September 2004. The large foreign presence ensures a definitive end to the banks' role in the pre-crisis era as key instruments for implementing government policies. While foreign ownership had been concentrated in investment funds following the crisis, the recent entry of major foreign banks may have an even stronger effect on competition in the Korean banking sector. The comparative advantages of foreign banks can have a positive impact by upgrading practices at domestic banks.

Korean banks have become profitable again after significant restructuring and privatisation. Only one financial holding company remains government-owned. However, despite substantial reforms and improved performance of *chaebol* conglomerates, some concerns still remain about corporate governance and transparency which has prompted interventions by the Korea Fair Trade Commission (KFTC). Unlike the *chaebols*, Korea's small and medium-sized enterprises (SMEs) have not undergone restructuring and thus have low profitability and high debt to equity ratio. The government's loan guarantees and other financial assistance have created moral hazard concerns and have only eroded the competitiveness and autonomy of the SMEs. In turn, the exposure of non-bank lending institutions (*i.e.* credit unions and savings banks) to SMEs has had an adverse effect on them as well.

Despite the entry of foreign investors into the Korean equity market, the capital market remains small relative to the size of the Korean economy. This underdevelopment and lack of long-term instruments are problematic given the rapid ageing of Korea's population. Until recently Korea's household credit bubble was a source of major concern, but the latest indications suggest that consumers have largely recovered from the 2002 credit bubble burst.

Enhancing labour market flexibility and raising labour force participation

Labour market flexibility is also an important factor for economic growth. According to the OECD data on Employment Protection Legislation, Korea's labour market is relatively rigid, comparable to a number of European countries, and less flexible than Japan, Australia, Canada or the United States. The rapid structural changes of the economy may require increased labour flexibility. Over the long term the transformation from one of the youngest populations in the OECD to one of the oldest makes it important to boost labour force participation, particularly for women. By 2050 it is expected that half of the Korean labour force (which will be 15% smaller than today) will be over the age of 50.

As a result of current rigidities, Korea has developed a dual labour market. The employment protection for regular workers has encouraged the hiring of non-regular workers who now account for a third of Korea's labour force. While employers prefer this expendability, non-regular workers create equity and efficiency concerns. These workers are paid 20% to 27% less than regular workers, after adjustment for characteristics such as age or experience. A third of these workers are not covered by any work-related social insurance system. This has probably contributed also to the deteriorating income inequality. In contrast, regular labour flexibility is hamstrung by strong opposition to dismissals.

In terms of labour market participation, Korea's participation rate for men is average for prime age men (aged under 50) from an international perspective. This participation rate is high for men aged 50-65 and particularly high for men aged 65-74, where it is around 50%, which is above the rates of most OECD countries. This may reflect the gaps in the old age support system. The low participation rate of women is also an issue for concern, as Korea's rate is the third lowest in the OECD, above Mexico and Turkey only for women of prime age. These rates are slightly higher for older women, aged 50-64, and even the highest for women aged 65-74 reflecting again the concerns about pensions and old age. The gender gap in wages is estimated at about 20% for regular workers. Increasing participation rates for women will be one of the key issues to address future fiscal concerns and maintain the potential for economic growth.

Increasing labour participation by boosting women's participation, raising the retirement age, expanding the social safety net to non-regular workers, and adjusting the job protection levels for regular workers are key to ensure equity and to further adjust the labour market. However, in spite of a tripartite committee, progress has been hampered by strong opposition, with labour's demand for equal treatment of non regular workers. This is also reflective of the difficult context of industrial relations in Korea, with the sixth-highest number of working days (per 1 000 employees) lost due to strikes over the period 2000-2004, well above other Asian economies. The limited development of the social safety net may explain the strong opposition to dismissals, with less than a quarter of the unemployed receiving unemployment benefits in the recent period, even if the share of employees insured has increased recently.

Sound current fiscal positions

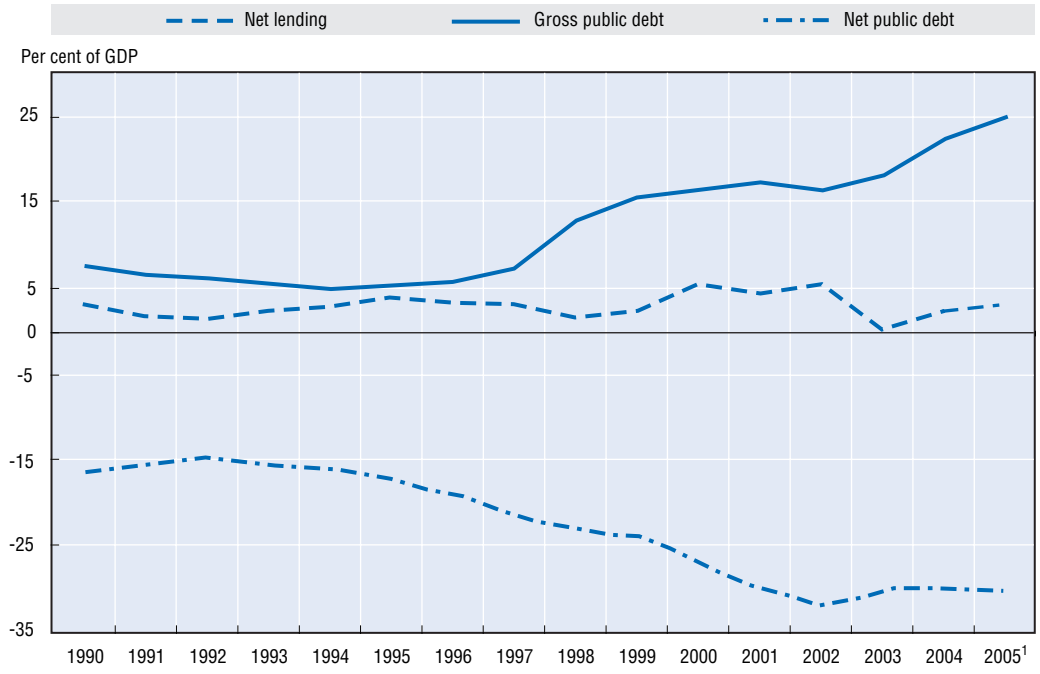
Korea's fiscal position remains sound. Korea is one of the few OECD countries where the public sector, on a general government basis, has run a surplus every year since 1980, thanks in part to the social security surplus, with the early building phase of a publicly funded pension system. Its gross public debt increased from around 5% in the mid 1990s to 25% of GDP in 2005. This partly reflects the cost of the restructuring of the financial sector mentioned above. Even with these additional burdens, Korea's gross public debt remains one of the lowest in the OECD area. Taking public assets into account, the net public debt remains negative, which means that the State is a net creditor. These net assets have even increased since the mid 1990s. The possibility of an eventual economic integration with North Korea would however require a strong fiscal position to absorb the impact.

Since local governments account for half of total government expenditure, local government finances have implications for maintaining a sound general government fiscal position. Plans to decentralise the local government face difficulties given the historical legacy of a strong central government to the point that the duties of the central and local governments were often blurred. Granting greater autonomy to local governments has been complicated by their inability to raise enough revenue, resulting in continued reliance on grants from the central government.

Korea faces the mounting pressures of ageing and future welfare needs

Public social expenditure in Korea has been the lowest in the OECD since 1990, reaching 5.7% in 2003, with 1.4% for pensions and related expenditure, and 3.3% for health and long term care[6] (see Figure 1.3). However, Korea is under greater pressure to increase future spending. Korea has one of the fastest aging populations in the world. Within

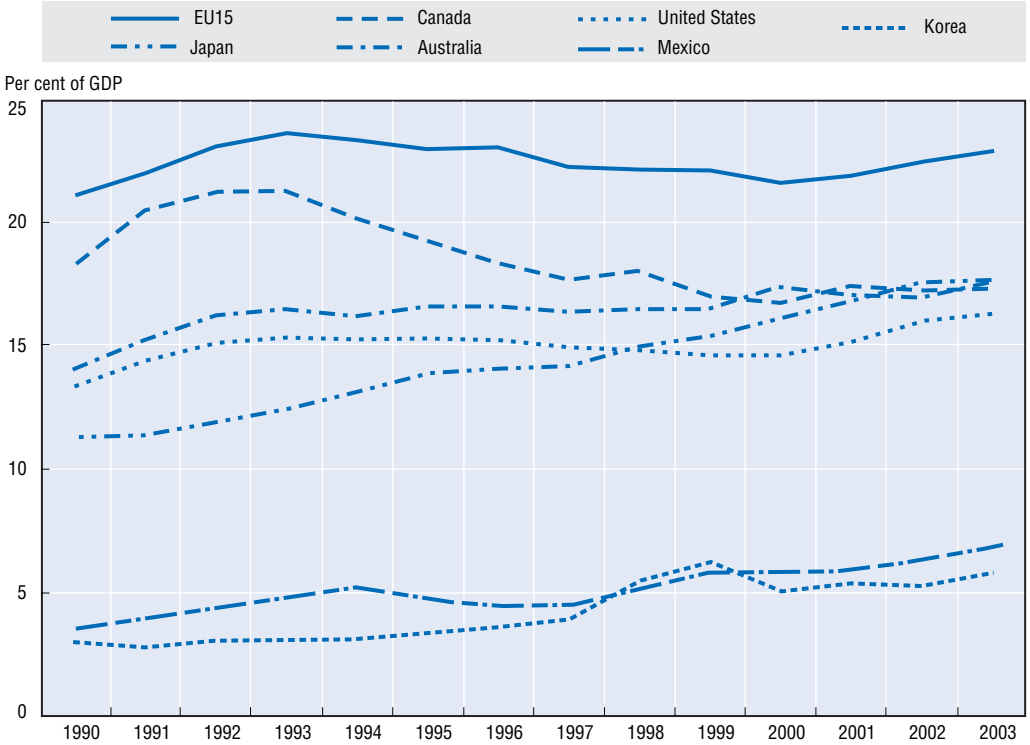
Figure 1.2. **Budget balance and public debt**



1. Estimated by OECD for 2005.

Source: OECD Economic Outlook 80 database.

Figure 1.3. **Trends in public social expenditure**



Source: OECD (2006), Social Expenditure database, SOCX, *www.oecd.org/els/Social/expenditure*.

OECD REVIEWS OF REGULATORY REFORM: KOREA – ISBN 978-92-64-03205-7 – © OECD 2007

50 years, Korea's old-age dependency ratio will increase from the third-lowest to the fourth – highest in the world due to a drop in fertility and increasing life expectancy. The country fertility rate also hit a record low of 1.08 in 2005, far lower than the world 2.6 average and the 1.57 observed in advanced countries. The government has strengthened the safety net by expanding coverage of employment insurance and the public pension system. However, the National Pension Scheme created in 1988 may not be fully equipped to face all future commitments. Total health care expenses, including public and private, are one of the lowest in the OECD at 5.9% of GDP, with half of this expenditure estimated to be financed privately. Additional spending pressures come from the need to eventually expand the social safety net and the need for greater health and long term care, which would involve almost a quadrupling of this expenditure under a scenario of cost pressure, and a tripling under a scenario of cost?containment, at respectively 11.9% and 9.1% of GDP by 2050 against 3.3% in 2005.[7]

The Korean authorities are taking this long term challenge seriously. The Ministry of Budget and Planning just issued a report "Vision 2030", which estimates that, according to Korean definitions, the welfare budget would increase from 8.6% of GDP in 2006 to 21% in 2030, under an assumption of a GDP growth rate of 3.8% over the period 2006-2030. At 21% in 2030, this would be comparable to the current OECD average of 21.2% in 2001. This would also help reduce the poverty rate, which has increased from 9% in 1995, to 13.3% in 2000 and 18% in 2005 to an estimated 10% in 2030. This would also involve an earned income tax credit (EITC) aimed at helping stabilise the incomes of poorly paid salaried workers. The participation rate of women would increase from 55% in 2005 to 65% in 2030. In spite of the shrinking of the defence and education budgets, this would require an increase of the welfare expenditure from 25% to 40% of total expenditure, with significant tax hikes. This does not take into account the possible unification of the two Koreas within the next 25 years.

Recent trends

The collapse of the consumer credit bubble in 2002 contributed to a marked slow down in the first half of 2003. Even as household income grew, private consumption decreased by 1.2% due to liquidity and solvency problems of creditors. The effect of the credit bubble burst was exacerbated by other events as well. A series of accounting scandals, strikes, external shocks such as the SARS and the situation in the Korean peninsula also had an impact. Korea experienced an economic rebound in private consumption in 2005. However, output growth is expected to decelerate from 5% in 2006 to around 4.5% in 2007-08, as a result of sluggish private consumption and construction investment. The policy package introduced in August 2005 and March 2006 to cool down the real estate market is having an impact, slowing down construction investment. The re-development of existing apartments in areas where prices are rising is also limited.

The significant appreciation of the won is bringing the current account from surplus into balance, putting export profits under pressure. This is compounded by deteriorating terms of trade, since Korea is suffering from the relative decline of prices for ICT products. Relative prices of exports to imports have fallen by 36% between 1991 and 2005, while these have remained stable or increased in other developed economies such as the US, Germany or the UK. Even in Finland and Sweden, where Information and Communication Technology (ICT) plays a significant role, these relative prices have only fallen by 15%. Underlying inflation has slowed and remains below the medium term target zone of 2.5 to

3.5%. Wage growth and corporate profits have stagnated due to a combination of rising oil prices in 2006, depreciation of the dollar, and falling semiconductor prices. Concerns over real estate prices prompted the Bank of Korea to raise short term interest rates five times from 3.25 to 4.5% between October 2005 and August 2006.

There are also a number of risks to both consumer demand and exports. Geo-political uncertainty in the Korean peninsula could affect consumer and business confidence, slowing domestic demand and dampening future growth prospects. Household debt, which has risen from 90% of household disposable income to 144% by the end of 2005, makes consumers more vulnerable to such interest hikes. The recent decline in oil prices in the later part of 2006 should ease the squeeze on corporate profitability in 2007. In addition, Korea's increasing concentration on ICT products and close trading links with China may result in a faster-than-expected rise in exports.

Progress in reforming regulatory policies has played an important role in the speed and strength of Korea's recovery. Korea has strengthened its economic and regulatory framework considerably. Even the recent consumer credit bubble in 2002 was followed by a quick recovery, thanks in significant part to the resilience of its reformed institutions. The next section will analyse in more detail the progress made in implementing reforms since the 2000 *OECD Review*.

Progress made in regulatory reform since the 2000 *OECD Review*

Regulatory reform was a new idea in Korea about ten years ago, at the time of its accession to OECD membership. Since then, Korea has come to the forefront of OECD countries in terms of intensifying its efforts. While gaps in implementation remain, much progress has been achieved in a relatively short period of time. Korea now stands on a par with a number of OECD countries in terms of the quality of its overall regulatory framework.

Government capacity to assure high quality regulation

Korea made impressive progress in recent years in terms of introducing policies, institutions and tools to assure high quality regulation. The Korean Government reduced the number of regulations by half within a short time period in 1997-98. The 2000 *OECD Review* commended Korea for this progress but also recommended a broader approach to regulatory quality. Subsequent reforms were therefore oriented towards a more complex and broader goal of improving regulatory quality. President Roh's steadfast support for regulatory reform provided strong political leadership and impetus for reform, fulfilling a key criterion for a successful regulatory regime – high political commitment.

The commitment to a "participatory society" has promoted a transparent regulatory regime consistent with OECD's 2005 *Guiding Principles for Regulatory Quality and Performance*. Korea's regulatory policy shifted from regulator-oriented regulation to user-oriented regulation, with an emphasis on "bundle regulations" that co-ordinate multiple government ministries, and on joint government-private ventures. This helped refocus government's intervention on strategic issues, with a steering function, instead of exercising detailed "command and control".

Effective regulatory institutions are necessary for a strong regulatory framework. The current Korean institutions include the Regulatory Reform Committee (RRC) which is co-chaired by the Prime Minister, and is the oldest and most authoritative agency in

regulatory matters. Since its inception in 1997, the RRC has taken the lead in developing a systematic approach to regulatory quality within the Korean administration and the introduction of regulatory quality tools such as Regulatory Impact Analysis (RIA). Endowed with substantial power, some of RRC's main responsibilities include setting the basic direction of regulation policy, reviewing new or amended regulations, implementing a comprehensive plan on regulatory improvement and evaluating progress made on regulatory reform.

Since 2004 the task of the RRC has been complemented by the Regulatory Reform Task Force (RRTF), which is also under the direction of the Prime Minister. The regulatory reform task force is composed of private sector experts and government officials and, focuses on strategic tasks selected by businesses, reflecting the practical problems of the firms. The RRTF is responsible for co-ordinating regulatory reforms across relevant government ministries, promoting a whole-of-government perspective, as advocated by the 2000 *OECD Review*. That same year, the Business Difficulties Resolution Center (BDRC) was also established as a one-stop shop ombudsman to resolve regulatory issues faced by businesses. It has played an important role by recommending changes that improve regulatory quality based on complaints it receives.

Progress to increase the independence of regulatory authorities has been made, but remains incremental. In 2002, the Telecommunications Business Act was amended to more clearly delineate the responsibilities of the Ministry of Information and Communications and of the Korea Communications Commission (KCC). However, the KCC remains related to the MIC, in terms of budget allocation, staffing.

Korea's regulatory procedures have also become increasingly transparent, as requested by the recommendations of the 2000 *OECD Review*. Consultations with relevant public and private sector representatives have been enhanced to fulfil the goal of a "participatory society". Modifications to the Basic Act of Administrative Regulations (BAAR) have allowed civic groups to become active members of the RRC. In fact, the appointed head of RRC in 2004 was a former member of a civic group.

Like most other OECD countries, Korea has legislated Regulatory Impact Assessment (RIA) as a tool for improving the quality of new regulations, which was already in place at the time of the 2000 *OECD Review*. The 2000 *OECD Review* called for strengthening capacities for implementation. While more time may be needed before the use of RIA is implemented at all levels of the Korean Government, the recent publication of a RIA manual by the RRC and the Korea Institute of Public Administration should facilitate a positive trend towards a more systematic use of RIA. The Korea Institute of Public Administration's Regulatory Research Center and the Korea Development Institute support the government's general efforts to strengthen capacity for regulatory reform. In 2006, the KDI organised an international conference on "Regulatory Reform to Improve Business Environment in Korea". This event provided an opportunity to disseminate technical expertise and assistance and also promotes awareness to the results of regulatory reform. For example, a study[8] found that entry regulations had the effect of restricting firm dynamics including both entry and exit, based on micro data across a number of industries in Korea. The steep reduction in entry regulations allowed by the effort of the RRC has had the effect of stimulating firms' entry in a number of sectors.

The RRC has also worked to constantly review, update, and if necessary, retire regulations. In particular, Article 8 of the BAAR promotes the possibility of "sunsetting"

regulations which do not have a "clear reason to remain in effect". Sunsetting is a powerful tool, but is not necessarily widely used among OECD countries, as the time a regulation is permitted to remain in force is also important. The use of sunsetting has remained moderate, with only 40 regulations currently subject to sunsetting provisions of the BAAR.

Access to regulations has been significantly improved with extensive use of the Internet to provide information on regulatory requirements by the Ministry of Government Legislation (MOLEG). The Korean authorities have also made efforts to simplify the drafting following the advice of language experts. MOLEG also published guidelines to improve the quality of legislation and reduce the scope for discretion, and has been reviewing all laws with discretionary powers in the recent period.

Korean authorities have made significant efforts to alleviate administrative burdens that can discourage business operations, including for foreign firms. Businesses and private citizens alike will benefit from initiatives such as E-government portal services including: Government for Citizens (G4C), Government for Businesses (G4B), and Government for Foreigners (G4F) that are designed to provide a one-stop e-government services for a variety of corporate administrative needs. Government for Business is a single window for business support services, which should offer the services of a one-stop E-government shop in the future. Procedures for foreign investment have also been simplified with Invest Korea providing one-stop shop services to facilitate the fulfilment of administrative requirements.

In order to attract more foreign direct investment, Korea also established three Free Economic Zones (FEZ) in Busan, Incheon, and Gwanyang in 2002. These zones offer exemptions of a number of regulatory requirements for foreign companies, and also provide a one-step process to allow businesses to easily comply with necessary regulations. Foreign companies benefit from additional financial incentives through limited-time corporate, income, and local tax exemptions. In addition, Korea has introduced fifty-eight Special Economic Zones (SEZ) to promote regional development. These involve some deregulation in the areas of education, medical services, immigration control and land use but do not provide any financial incentives and are available both to domestic and foreign firms alike.

Competition policy

Commitment to market principles at the highest political levels in Korea has provided strong support for competition policies, for reforms of the financial sector and corporate governance, and for opening markets to trade and lowering barriers to foreign investment. That conclusion of the 2000 *OECD Review on Regulatory Reform in Korea* is confirmed in the experience since then. In line with OECD recommendations, the KFTC has been shifting its priorities and resources toward core competition problems related to efficiency goals and away from its historic focus on conglomerate financial structure and governance. Since the 2000 *OECD Review*, Korea has met many of the recommendations made by the OECD in regards to its competition policy. The challenge then was to uniformly apply competition policy in a system that was still heavily influenced by government intervention. The independent Korea Fair Trade Commission (KFTC), operating under the mandate of the 1980 Monopoly Regulation and Fair Trade Act (MRFTA), has taken the lead in reforming Korea's competition policy. The KFTC has developed action to prevent market monopolies and oligopolies. In addition, the agency has been further empowered to protect small businesses and consumer rights.

The primary mission of the KFTC has been to focus on resource allocation efficiency through enhancement of business transparency and fair competition. The 2000 *OECD Review*'s principal recommendation was that attention and resources should move toward ensuring efficiency. This Review – echoed by the OECD's *2004 Economic Survey* – recommended that the KFTC shift priorities away from the traditional focus on *chaebol* financial structure and governance and instead concentrate on competition issues related to efficiency goals. The KFTC has since shifted its priorities. In 2002, it ended its policy of targeting the top thirty business groups for scrutiny and instead moved towards regulating general business group conduct. Provisions about the debt-equity ratio were dropped and KFTC's powers to demand financial information were extended. The agency has begun targeting horizontal cartels and has expanded its capacity for economic analysis of monopolies and mergers. The standard for merger control is now whether the transaction would substantially lessen competition. The merger review system, with pre-notification and deadlines for decision, is now in line with those of other OECD member countries.

The core of the KFTC's latest reform programme has been its launch of the 2003 "Three Year Market Reform Road Map" ("Road Map"). One foundation of this programme was an Index developed by the KDI to measure transparency, fairness and competition of firms and markets in Korea. The Road Map concentrated on three general areas. First, it focused on strengthening business transparency and accountability by modifying corporate laws, authorising lawsuits against business misconduct, protecting minority shareholder rights, reinforcing auditor independence, and tightening the control of insider misconduct. Second, the Road Map revised the KFTC's own regulations of conglomerates in ways that were intended to encourage more transparent structures. The third area was traditional competition policy topics such as doubling the financial penalty against cartel violations, streamlining merger review with pre-notification, retiring anti-competitive regulations and strengthening consumer rights. This plan was embodied in legislation in 2005. The KFTC staff structure was reorganised to reflect these changes, notably by reducing the staffing that administers the regulation of cross-holdings among affiliates.

The KFTC has introduced several measures to improve enforcement and compliance. To encourage companies to police themselves, the KFTC will reduce surcharges up to 20% if a firm has a compliance programme in place (and up to 40% if they also correct the violation themselves). A leniency programme was introduced in 1996 and revised in 2001 and 2005. The programme provided incentives for revealing cartels and mechanisms for quick action upon discovery. The programme was applied in the recent telecom industry price fixing case, which led to substantial surcharges against some firms but a 49% reduction in surcharges for the firm that came forward first.

The KFTC also defends consumers' interests in marketplace integrity by applying rules against unfair marketing practices and misrepresentation. That role may soon become more important. The 2002 law about e-commerce followed the OECD 1999 guidelines. The KFTC is encouraging a shift away from the traditional emphasis that treats consumers as in need of government protection, toward a view that the market is determined by informed consumer choice. A plan was underway in 2006 that would give KFTC authority to manage and supervise the Consumer Protection Board, which would become an affiliated organisation with the KFTC, ensuring better policy co-ordination. While businesses have been largely supportive of this evolution, they have also been wary of some of its implications.

The KFTC has gained a reputation for independence, integrity and transparency. As one of the few independent agencies in Korea, the KFTC's independence is reinforced through autonomy in its choice of personnel: five full-time "standing" commissioners who usually are KFTC veterans and four "non-standing" commissioners who often have academic expertise in legal or economic fields. In shifting its focus away from *chaebol* regulation, the agency has merged the Antitrust, Competition and Investigation Bureaus into the Competition Law Enforcement Bureau and the Cartel Bureau. It receives expert analytical support from the reinforced Litigation team and the newly created Economic Analysis team, as well as two other units dedicated to emerging competition issues and advocacy. The agency's decisions are supported by notices and guidelines posted on its website, with decision documents issued within 20 days and also posted on the website.

The number and the scope of exemptions have been reduced, due in large part to the Omnibus Cartel Repeal Act of 1999. Government entities and private enterprises are both subject to the same regulations. Among many changes, the Act ended the previous practice where professional association set fees that were approved by the ministries. Its repeal resulted in a significant decline in the fee rates. Resistance to these changes necessitated additional legislation in 2001 followed by aggressive action by the KFTC specifically targeting professional services for added scrutiny under the Clean Market Project. In addition, a permit system replaced the former state monopoly for tobacco production in 2001.

The 2000 *OECD Review* had also invited Korea to eliminate protectionist measures to prevent potentially efficient competition in sectors reserved for small businesses. The number of business lines where entry of larger firms is restricted was reduced from 88 to 45 by the Regulatory Reform Committee in 2001, and is scheduled to be reduced to 0 in 2007. Of the reserved sectors, 27 out of the remaining were opened as of the end of 2005, and the remainder are set to be opened by the end of 2006.

Market openness

The Government of Korea maintains a firm commitment to create a business-friendly environment, attract more foreign direct investment and further liberalise the market. Since the 2000 *OECD Review*, the Korean Government has taken critical steps towards achieving these goals. Some of the achievements include improvements in regulatory procedures, greater engagement of the business community, and streamlining of burdensome procedures in customs and public procurement.

Transparency and openness of decision making have greatly improved especially in the areas of customs and government procurement. Digitisation and automation of procedures have not only reduced the scope for subjective assessments and corruption, but also generated considerable savings and efficiencies. The 2000 *OECD Review* noted inefficient customs inspection and clearance processes that posed a significant trade obstacle. The Korean Customs Service (KCS) has initiated changes that have realised an about-face change in customs procedures. Through implementation of e-customs, the speed and accuracy of the inspections have increased while dissuading corruption. The KCS has signed mutual assistance agreements with 24 foreign customs agencies. The GePS, which has been renamed as the Korea ON-line E-Procurement System (KONEPS) in July 2006, has enhanced transparency and efficiency in government procurement by enabling all procurement procedures to be processed online and allowing bid results to be

opened online on a real time basis. KONEPS is complemented by the Integrity Pact of 2003 which assisted in combating corruption and unfair practices in government contracting.

Greater efforts are being made to engage the business community in the regulatory reform process including foreign interests (*e.g.* the American Chamber of Commerce (AmCham) and the European Union Chamber of Commerce). The Business Dispute Resolution Centre was established in 2004 to deal with claims and complaints from the private sector. Improvements in the public notice and Regulatory Impact Assessment (RIA) mechanisms, and wider availability of current regulatory information have also improved transparency and regulatory quality.

The Korean manufacturing sector has benefited from deregulation and market liberalisation. Openness of the goods market has improved since 2000 and imported goods are more widely available, although prices remain high especially for some consumer goods. Since the 2000 *OECD Review*, Korea has made efforts to change the negative public perception towards imports, foreign firms and foreign investment. Programmes have been initiated through sponsorship of the Korean Importers Association (KOIMA) and establishment of the Policy Customer Relationship Management (PCRM). The Foreign Investment Promotion Act (FIPA) has been amended making it easier for foreigners to register as investors, instituting a framework to reward public servants who promote FDI, and easing fines on foreigners who violated FIPA. Korea has also tried to improve investor perception by creating Invest Korea (IK) as a one-stop shop for foreign investors at the establishment stage. The Office of the Investment Ombudsman (OIO) continues to assist foreign investors on problems after establishment. In the area of international trade, Korea while remaining committed to the multilateral negotiations in the World Trade Organisation (WTO) has become increasingly active in negotiating bilateral and regional trade agreements. Korea considers that such bilateral and regional trade agreements may contribute to driving reforms in areas that could benefit from further liberalisation (*e.g.* services and agriculture). The current discussions over the intended Korea-US FTA also represent a very significant step, supported at the highest political level.

The 2000 *OECD Review* stated that Korea's cumbersome system of standards and conformity were obstacles to trade. Since then, considerable progress has been made in harmonisation of standards through the implementation of the 1st five year National Standards Plan (2001-2005): as of 2005, 90% of Korean standards were either harmonised with international standards or were established with reference to them. A 2nd National Standards Plan (2006-2010) has been approved with the objective of 1) renovating the national standardisation and conformity assessment procedures and 2) eliminating possible duplication among different standards and certification schemes.

Telecommunications

Since 2000 the telecommunications sector in Korea showed continued rapid growth, especially in broadband penetration where Korea now ranks the highest among OECD countries. It is also the 9th largest telecommunication market among OECD countries accounting for 3.4% of Korean GDP in 2003. Sector liberalisation has produced notable benefits in terms of improved services, lower prices, and innovation. Korea is also among the leaders for wireless broadband as well as digital multimedia broadcasting. Positive reforms have taken place to create a competitive market. Korea Telecom was fully privatised in 2002, a goal that many other OECD countries with state-owned operators have

not yet managed to complete. A number of the recommendations made in 2000 have been implemented or partially implemented, even if scope for further improvement remains.

Korea has given high priority to the development of a digital economy. The Ministry of Information and Communication presented its strategy in a White Paper on Dynamic Digital Korea in 2004. Reforms since 2000 have focused on market entry procedures, price regulation, local loop unbundling, number portability, a policy framework for Voice over Internet, interconnection, and a framework for universal service. Korea has also implemented the use of long-run average incremental cost (LRAIC) as the basis for pricing as recommended by the OECD in 2000. The OECD recommended implementing number portability as quickly as possible for both fixed and wireless carriers. By August 2004, Korea had introduced number portability. One of the major achievements has been the successful privatisation of Korea Telecom (KT) when the government sold the last of its shares in May 2002. The ceiling for foreign shares has also been increased from 33% to 49% in 2001 following the recommendation to eliminate foreign ownership restrictions in both fixed and wireless markets.

The 2000 *OECD Review* recommended more comprehensive measures towards local loop unbundling. Pre-selection was introduced in 2001 for long distance operators. Full unbundling and line sharing were introduced as recommended, in 2002. The Local Loop Unbundling criteria (LLU) were also revised in 2003 to extend the periods of mandatory collocation and to adjust the scope of unbundling to cover a wider range of technologies. The OECD also recommended changes to the system for licence allocation, as well as using auctions to allocate 3rd generation mobile services. The MIC made significant efforts to try to reform the mechanism to allocate spectrum. In 2000, a fee-based system was introduced for the allocation of spectrum. In 2005, further changes introduced a limit on the period for which spectrum was allocated, and established a legal basis to charge for spectrum.

Korea has made partial progress in other areas as well. The 2000 *OECD Review* called for clarifying the conflict in the ministry between industry promotion activities and policies and decisions aimed at fostering the development of an open market. As a result, the Korea Communications Commissions (KCC) has been slightly restructured, receiving responsibility for functions that were previously under the responsibility of the MIC. For example, functions such as approval of agreement related to interconnection, verification of business report, fact-finding investigation of prohibited activities, correction measures and imposition of fines were transferred to the KCC in 2002. There has also been an important shift by the MIC placing greater stress on service competition as opposed to only facility-based competition, which has helped open the market through the implementation of policies such as unbundling.

The 2000 *OECD Review* also called for introducing a system of general authorisation for market entry. Korea has moved towards facilitating entry as facilities-based business can apply for a licence whenever they wish, with a reduced screening period. As a result there is no longer any limitation of entry in the Korean telecommunication market.

Remaining challenges

Progress in reforming regulatory policies has no doubt played an important role in the speed and strength of Korea's economic recovery. Nonetheless, Korea's economic transformation is a continuing process. There are still significant challenges that remain which would require further deepening the reforms initiated since 1997.

Government capacity to assure high quality regulation

In the area of regulatory policy, the approach would benefit from a stronger underpinning with core principles as recommended in the 2000 *OECD Review*. The OECD's *2005 Guiding Principles for Regulatory Quality and Performance* offer a useful point of reference. While the Korean Government's reform strategy embodies many OECD principles, an explicit statement would support the ministerial reform efforts and hold them more accountable against a benchmark for performance. In particular, endorsing an explicit clause in a regulatory policy that justifies regulation on the merits of costs versus benefits should assist in screening new regulatory proposals.

There are challenges for regulatory institutions as well. A multitude of agencies currently work on regulatory reform. While this may be a source of strength by providing independent analysis, it also risks fragmenting reform implementations. A review for the possibilities of further co-ordination of the work of the various institutions could help, including consideration of the need for an overall oversight body, which could bring the RRC and the RRTF closer. A specific issue to be considered is the continued role of the RRTF, which has been important in facilitating private sector involvement in the reforms as well as implementing "bundle regulation". The Korean Government has decided to extend its existence until 2008, continuing to reform bundle regulations.

Another challenge concerns the gaps in implementation. The 2000 *OECD Review* recommended that the responsibilities of the RRC should be broadened to include taxation and subsidies, industrial policies, and regional development policies. These and other areas remain outside the scope of RRC scrutiny under BAAR statutes. In addition, the RRC's area of responsibility is limited to oversight of regulation prepared by government ministries. This implies that bills directly introduced into the Parliament by assemblymen are not subject to the regulatory quality process. In this respect, Korea experiences challenges common with other OECD countries that have implemented successfully a regulatory quality oversight system, where the lack of regulatory control on the legislative side is an issue. The issue lies in the growing number of bills that have been initiated by assemblymen, which represented around 55% of the bills in the 16th Congress (2000-2004) and 69% in the 17th Congress. This may reflect the success of the regulatory oversight system, as special interests may wish to pursue their policy agenda directly through parliament. This lack of legislative oversight may undermine the regulatory reform process. A solution would be to establish a permanent mechanism in the National Assembly to ensure the quality of laws initiated by congressmen.

Because many of the tools and programmes for regulatory quality are new, it will take time before the new regulatory regimes become fully integrated in the policy-making culture. For example, while the possibilities of consultation have greatly increased, there remains significant discretion about how the consultation process is undertaken. As a result, the quality of consultation processes varies widely across the agencies. The minimum period allowed for consultation, currently 20 days, may appear short from an OECD perspective. In the United States, the standard period is often more than 60 days. In addition, publicising the comments received from stakeholders could also improve the effectiveness of the consultation process.

Although access to regulations has improved, scope for further improvement still remains. For example, accessibility of legislation as well as sub-legal requirements in both Korean and English remains a significant issue for foreign stakeholders. While MOLEG has

provided English translation of many Korean laws, many sub-legal regulations remain available only in Korean.

Another issue concerns the use of bureaucratic discretion, including administrative guidance. While substantial progress has been made, for example with new guidelines published by MOLEG, fully changing the administrative culture may take additional time. In addition, administrative guidance may increase uncertainty for foreign firms.

Finally, although the Korean Government has put in place a very effective formal mechanism to undertake high quality RIA, the challenge remains to ensure that there is sufficient capacity to support an effective RIA system. An assessment conduced by the Korean Institute for Public Administration revealed that there was often a lack of time, insufficient capacities in the agencies for undertaking the RIA, a lack of expertise due to job rotation, a lack of financial resources to undertake RIAs, as well as a perception problem among civil servants, who perceived RIA as a routinised formality. This issue may even be more acute at a lower level of government.

This calls for action on several fronts. First is training, which should also target public officials at the local level. This should involve an ongoing process building capacity and skills, and should also involve quantitative techniques and data collection methods. Changing the administrative culture represents an even greater challenge, requiring a broader approach to training, including both technical and political aspects.

While Korea has worked hard to reduce administrative burdens on businesses, it has not yet introduced a measurement programme, such as those implemented in Denmark or the Netherlands. These programmes help focus government efforts and also allow progress to be monitored, thus helping to build a constituency for reform. In the same vein, a monitoring review of the lessons learned from FEZs and SEZs would yield valuable information for updating and creating general regulatory policies, which could transfer economic benefits to the overall Korean economy.

Competition policy

Significant progress has been achieved in terms of shifting the focus of the KFTC and increasing its ability to enforce competition policy, but further challenges remain. Stronger KFTC investigative powers have been implemented only in part, and the KFTC still lacks a "dawn raid" power to enter premises and take possession of evidence. Increased use of criminal sanctions in hard-core cartel cases, to make the threat of individual liability more realistic, depends on co-operation with the prosecutors.

While criminal sanctions are provided so that individual executives may face punishment for antitrust violations, the courts have been reluctant to impose sanctions of imprisonment. The reluctance to support a *per se* rule against horizontal cartels may be related to the increasing sanctions that would apply to them, and the courts' reluctance to impose significant criminal sanctions may be related to uncertainty about how to treat this conduct. The Minister of Justice and the Chief Judge of the Supreme Court have both called attention to the lower courts' reluctance to stiffer white-collar sentencing. There are signs of change, such as a higher ceiling on penalties in the judiciary's non-binding guidelines about sentencing; nonetheless, no one has yet spent any time in jail for violating the competition law. Amendments to the competition law could help to strengthen enforcement against hard-core horizontal cartels, by making clear that these cartels are prohibited without regard to claims about their supposed lack of effects in particular cases.

The amendment in 1999, which was intended to specify the *per se* treatment of horizontal price fixing, did not achieve that result. In law enforcement, the competition authority and the courts need to establish clearly a *per se* rule against hard-core horizontal cartels.

Eliminating constraints in professions remains a challenge. Some reforms in the legal profession are underway, but while the quotas on entry have been raised, they have not been eliminated. Most of the programmes protecting small firms are being dismantled. But repealing all of them, including an anomalous, never-used presumption against acquisitions of small firms by large ones, would send a clear signal that Korea's law supports open competition on the merits of efficiency. Justifications offered for this moribund rule include preventing the spread of "monopoly" by the entry of firms that are more efficient than the incumbent small businesses, and preventing the *chaebol* from expanding their business areas "indiscriminately". These explanations are anti-competitive. Market entry by larger firms could increase market efficiency, and the prospect of acquisition by a larger firm could also increase the value of the smaller firms and improve their access to financing.

The KFTC shares regulatory responsibilities with other agencies as well. Generally the intra-governmental co-operation has been smooth, but there have been occasional tensions, in sectors such as insurance and cable television, which have exposed businesses to some uncertainty. The 2005 price fixing case in the telecommunications sector reveals that there may still be some differences in appreciation about the roles of government direction and competitive initiative. The firms claimed that guidance from the Ministry of Communications had supported their limits on price competition when reforms introduced number portability. But the KFTC rejected that excuse, finding that whatever guidance the Ministry gave was not related to their restraint. The Ministry confirmed during the KFTC's proceeding that it did not issue an instruction such as the one that companies were claiming.

Market openness

Transparency and openness of decision making have improved as the government has made significant efforts to improve public perception towards imports, foreign firms and foreign investment while reaching out to the business community, including foreign interests. However, changing the mindsets necessarily takes time. As in other OECD countries, some negative perceptions persist among the media and the public, as noted more recently in public attitudes towards foreign investment and portfolio investment. There is also a perception among some foreign investors that some officials sometimes interpret and apply regulations more strictly for foreign firms. The Korean Government hopes that such problems may be alleviated through its continued efforts to raise public awareness of the importance of regulatory reform and market openness, the implementation of regulation interpretation guidelines and enhanced training. However, the strengthening of such efforts to alleviate the perception of *de facto* discriminatory effects against foreign goods, companies and investment remains a major challenge.

A number of foreign firms continue to express concern about the lack of transparency in the Korean Government's decision-making process. Translating public notices and consultation procedures in foreign languages would be beneficial not only to international businesses interested in Korea, but will also serve as a strong signal of the Korean Government's commitment towards an open market. Creation of a one-stop shop for all consultation procedures in English similar to the "*www.epeople.go.kr* site" may also

contribute to such ends. There is scope for further improvements in terms of transparency and openness of decision making from the market openness perspective. Another issue related to integrating the market openness perspective in decision making in regulatory matters concerns the role of the Ministry of Foreign Affairs and Trade (MOFAT). Although the MOCIE is a member of the Regulatory Reform Committee (RCC), the Ministry of Foreign Affairs and Trade (MOFAT) is not. MOFAT's role may benefit from a stronger mandate to effectively carry out the responsibilities to ensure that domestic legislation is in line with Korea's international obligations.

Despite the progress achieved on standards and conformity assessment procedures, there is still room for improvement in this area. While there has been considerable progress in harmonisation of KS with international standards, there still is a perception among the international business community that certain "Korea-specific" standards and labelling requirements are unjustified and potentially discriminatory. The existence of country-specific standards in and of itself may not be a problem as country-specific standards exist in other OECD countries. However, care should be taken so that they do not constitute unnecessary barriers to trade and positive consideration should be given to accepting as equivalent the technical regulations of other countries provided the objectives of its own regulations are fulfilled. Progress in the certification system and mutual recognition agreements have been more limited. Therefore, there is scope for further strengthening efforts to avoid unnecessary trade restrictiveness and further promote international standard harmonisation and conformity assessment.

While FDI is allowed in most areas of the Korean economy, some sectors have limitations on foreign participation and two sectors – Television and radio broadcasting – are fully restricted. There is also a possibility that the number of public agencies in charge of FDI related matters may generate co-ordination costs, and may result in confused and frustrated investor/business relations. It would be desirable for all responsibilities related to foreign investment be consolidated. A co-ordinated and streamlined administration could help to improve investor confidence.

These issues highlight the difficulties involved in the implementation of the reforms. While governmental support for greater market openness remains strong, laws and legal instruments may not always be sufficient. A larger, national, phenomenon that hinders market reform measures has been the strong negative perception, fuelled in part by nationalistic sentiment and by media coverage, against foreign goods and services. The reform initiative may have slackened due to resistance by various segments within and across different government branches. This may therefore require further efforts to adapt the administrative culture, including at lower levels, and for better communicating with the public on the benefits of openness and reform.

Finally, the sectors of services as well as agriculture represent specific challenge areas. In contrast to the manufacturing sector, the service sector productivity has been lagging due to the absence of competition as some areas are still closed and highly regulated. Government efforts, which have often been stymied by stiff resistance by stakeholders, should speed up regulatory reform, deregulation and market opening. The current negotiations over the Free Trade Agreements could potentially represent a powerful tool to address this challenge although care is necessary so that the results of FTAs do not lead to trade diversion. To this end, wherever possible preferences should be granted to third parties on a non-discriminatory basis.

Telecommunications

Korea has made impressive progress in developing its telecommunication infrastructure and service markets, with significant emphasis on the information society and IT sector. Korea performs generally well in terms of overall price comparisons, but prices for international calls tend to be among the highest in the OECD. The implementation of market-oriented tools and institutions tends to lag behind. Korea is still not emphasising sufficiently the use of market mechanisms to develop a digital economy. The clarification of the roles, between policy making, pushing the development of the sector, and implementing a regulatory framework, remains insufficient, despite the devolution of some technical decision making functions to the KCC. The reliance to *ex ante* regulatory schemes and tools remains insufficient, while the MIC continues to assume wide authority over the whole IT development in Korea.

Independent sectoral regulators have made a positive contribution to the development of the sector in a number of OECD countries. Despite significant progress, the sector regulator Korea Communications Commission (KCC) can still not be considered as an independent regulator in its full right. The term of the Chairman is 3 years and can be renewed. Its budget and staffing is not independent either. The KFTC is also of the opinion that the KCC should become an independent regulator. The current shortcomings of the KCC as an autonomous regulator do not mean that deregulation cannot take place, but market developments could be harmoniously supported by a more efficient and transparent regulatory framework, clarifying opportunities for investors, both domestic and foreign. Given the perspective of sectoral convergence, it would be advisable to consider a possible joining of the KCC and the Korea Broadcasting Commission (KBC) – which is responsible mainly for administrative details for ground, cable, and satellite programme providers. A comprehensive review of legislation to create a single legal framework for the communication sector, including telecommunications and broadcasting would certainly represent a useful step, and also serve to create a level playing field.

The current situation appears to be also linked with the tendency of the MIC on some occasions to affect conditions of competition rather than use more effective *ex ante* regulations to place limits which would prevent anti-competitive behaviour and allow competition to develop. While the MIC is promoting service-based competition, some of its decisions may point to the opposite direction. Examples would include the imposition of regulations on VoIP, the reclassification of broadband access providers and the lack of introduction of legal requirements to make obligatory access to MVNOs. In the case of facility-based services, the MIC can take action against a company which has at least a 50% market share and if the business size of the company exceeds a certain threshold. The legal framework is insufficiently flexible, as there is no requirement for an independent regulator or a competition authority to undertake market analysis to determine whether there is dominance by a firm in specific markets. (Even if the MIC itself can conduct its own market analysis on an annual basis as a background.)

The MIC has been alleged on a few occasions to have used "administrative guidance" to induce market players to follow certain lines of actions, for example in the pricing of services. Witnesses have commented that some of these administrative recommendations, which may not even be within the scope of the existing policy framework, have caught the market players between action by the KFTC and the MIC. It would be important to reduce the reliance on such administrative guidance.

The initial 2000 *OECD Review* made the recommendation of reducing foreign ownership restrictions in both the fixed and wireless markets. While progress has been made, with the ceiling on foreign ownership increased from 33% to 49%, the restrictions of Korea are relatively severe compared to the other OECD countries which still have some restrictions (except for Canada). While Korea underlines the need to maintain national security or to protect public interest, all governments can, when necessary take action towards these goals using general legal frameworks rather than placing foreign investment restrictions. The 2000 *OECD Review* also recommended streamlining the regulatory framework for Cable Television, introducing competition, a recommendation which remains valid. The system operators still require a licence from the Korea Broadcasting Commission as well as an authorisation of the MIC.

In terms of transparency, the process of public consultation is not sufficiently developed in the telecommunications area. Regulators in other OECD countries will issue draft proposals for wide public comments before elaborating a final proposal which responds to suggestions which were expressed in the comments but were not accepted. There is also scope for improving policy coherence, for example with better co-ordination of efforts between the KCC, the KFTC and the MIC, to reach a closer understanding of the issues in the sector and how to deal with them.

One particular concern from the 2000 *OECD Review* that has not been addressed yet, is that the review of regulations was not conducted systematically and in depth in regards to whether a given regulation is in the public interest and whether it should be modified or discarded. "Forbearance" otherwise known as "sunsetting" clauses (which have been adopted by the KFTC) should aid in this endeavour. Also an issue which has not been addressed since 2000 are the charges imposed on communication facility providers and service operators, especially on charges to financing R&D. There is potential for reducing or possibly eliminating such charges.

Korea, like other OECD countries, is affected by the digital divide. It is possible for the MIC to help establish a universal service system in rural and remote areas without broadband access. Government subsidies, or the more established practice of direct public funding are possible options to bridge the gap. Tax benefits are another option. In all of these practices, however, it is important to ensure competitive neutrality in the development of new services.

Further challenges: tertiary education

Regulatory reform needs to address the whole regulatory framework, including for a wide range of service sector activities. Education, and particularly tertiary education, is a key factor for current and future economic growth, and is essential if societies are to grow and flourish. The supply of highly qualified labour is a key ingredient for the generation and diffusion of innovation. It will be critical if Korea is to transform itself in a service-oriented society, where ICTs are playing a major role. The sectoral chapter of this review will therefore shed new light on tertiary education, from a quality regulation perspective. This perspective can help to support balanced change, promoting both efficiency and equity in the tertiary education system.

Tertiary education represents a major investment for Korean families, and one of the most crucial issues in the public debate. Among OECD countries Korea has the highest spending rate in education and the sixth highest R&D ranking. Unfortunately, it is not

getting the full return of its investment in terms of innovative capacity as indicated by the relatively sparse number of patent applications and publications. Its R&D efforts are also hampered by disjointed interaction between businesses, academia, and the government. Universities are not in a position to fully achieve their potential, as they conduct only 10% of all R&D activities. Instead, R&D is concentrated in a small cluster of firms and industries in manufacturing with half of business-initiated R&D invested in ICT. There is also a lack of connection between higher education and business and industry, with low mobility and low commercialisation of university-based intellectual property.

For innovation and productivity to grow, especially in the service sector which is only about 60% as productive as the OECD average, there needs to be market competition and qualified human capital. In the former, market entry barriers especially in the service sector are directly affecting the productivity of that sector. While Korea's primary and secondary education levels are excellent, as demonstrated by the PISA scores at the international level, there is still scope for improving the quality of tertiary education to ensure the adequate supply of high-skilled human capital. There is evidence of skill mismatch, as workers at both low and high-skilled levels are in short supply. Complaints are also being voiced by companies about the quality of domestic tertiary education. Korea also represents 5% of foreign student flows to the OECD area, with however a very modest role as a destination for students.

In this context, severe competition to get into prestigious universities has social consequences and affects secondary education, given the need for private tutoring. Higher education is also not prepared for demographic changes, which will imply for the first time in Korean history, a shrinking college age population, with a potential decline of the student population in the future, with continued population concentration in the Seoul Metropolitan area.[9]

Government intervention is rooted in the history of tertiary education in Korea, where the demand has been accommodated primarily by private institutions, and where public funding has remained limited. Families are currently supporting the greatest share of the financial burden, which implies strong "market" demands for tertiary education, balanced by some regulatory controls, mainly applied to the public sector. Networks, including those linked to the most prominent universities, such as the Seoul National University, also play a significant role. Public subsidies, such as Brain Korea 21 (BK21) or the New University for Regional Development (NURI) are used to ensure that public priorities, such as social and cultural pressures for equity, can be met at least in part.

Public universities tend to be heavily regulated with a large number of ministries applying regulations related to a wide range of issues, including financing, school operations, budget, staffing, the execution of industry-academia research, immigration policies, the establishment of universities in the capital region or limits on enrolment in health and medical studies. In addition, non governmental agencies are also involved in the evaluation of the system: the Korean Council for University Education (KCUE) and the Korean Council for College Education (KCCE), which operate on a voluntary basis.

Institutional autonomy is strictly limited, as universities are prohibited from requiring written exams for admission. Enrolment quotas apply in the capital region for all universities, and at national and public universities as they affect the national budget. Student selection is a highly sensitive issue. University staff are considered as public officials. Private universities enjoy wide autonomy in this respect. National and public

universities are constrained by budgeting laws, while private institutions have substantial autonomy, under the safeguards of the Private School Act.

Korea has embarked upon impressive efforts to improve the global competitiveness of its tertiary education system. This includes steps to improve regulatory quality. Korea has made significant progress in simplifying and clarifying regulations, eliminating out-dated and redundant regulations, and improving co-ordination across regulatory entities within the MOE&HRD and across ministries. The government is promoting a decentralised and balanced national development, supporting the development of regional universities, and promoting autonomy of university administration. It is also trying to alleviate the excessive hierarchical aspects of the tertiary education system. The goal is to strengthen university competitiveness.

The Government is taking additional actions essential to improve the competitiveness and public accountability of the system. The Government is pursuing an agenda of increasing autonomy and regulatory reform, by giving more autonomy on student affairs, appointment of academic staff or enrolment. It is also implementing financial incentives such as NURI, BK21 or various restructuring projects. The freedom of admission is considered essential for autonomy, with the government charging KCUE and KCCE to propose changes to the College Scholastic Ability Test.

The budget rules also constrain university autonomy. They seem to be linked to the legal status of national and public institutions. What is required is increased autonomy, which implies increased accountability towards stakeholders and the public. The government is pursuing strong policies such as promoting increased specialisation, strengthening the links between institutions and regions, and encouraging the consolidation and merger of institutions. Under the special law on university Administration, National Universities could become school corporations independent from the formal government structure. This action was also taken in Austria and Japan.

In the current context, developing an effective system for quality assurance and public accountability is essential. The accreditation process presents scope for improvement, as there is a lack of independence of the evaluator. KCUE and KCCE are membership organisations and are not independent of the entities being evaluated. There is a limited role for students and external stakeholders and the process relies upon voluntary institutional participation, and on peer review, rather than on persons explicitly trained as evaluators. There are limited consequences, for example in terms of public funding, of not being accredited, as well as limited public information, which is not conducive to accountability. There is currently a government initiative to improve the disclosure of information. However, it is necessary to improve the co-ordination of the various evaluation and accreditation activities, to increase the involvement of stakeholders as well as public access to the results.

Another key element in ensuring a balanced regulatory system is the governance of private universities. There are limits to the current framework for private universities, in terms of transparency and accountability. The government has made attempts to change this situation but with limited success so far. Compared with other countries, there is scope for strengthening this regulatory framework. The public also needs to be better informed, for example on the adequacy between the skills offered and the labour market. Despite a number of efforts, including exchange programmes and financial support under

the Study Korea project, universities have not yet been very successful in attracting foreign students.

The Korean Government has established Free Economic Zones, where some of the regulations are made softer and where foreign private operators could decide to settle. There is also a need to improve the government-wide co-operation on regulatory reform in tertiary education, as approximately ten ministries, in addition to the MOE, are directly or indirectly involved. The MOE itself could to focus less on detailed regulation and more on strategic leadership and monitoring the performance of the tertiary education system

Lessons from implementation

The Korean monitoring exercise reveals the impressive progress that has been made by the country in a very short time period. Such rapid change may give rise to social concerns, with questions about what could be the acceptable rate of change for Korean society, institutional structures and methods of government. By OECD standards, Korea is certainly on track, even if progress in certain areas seems to be more apparent than in some others. This may certainly test the capacity for reform of entire sectors of the administration and society.

In the administrative sphere, several parts of the report highlight the possible risks of "gaps in implementation", as working level officials need to adopt new methods of work and of interacting with society. Capacity building, including at the local level, is a critical factor to ensure that changes decided at the national level, can effectively be implemented. This also requires upgraded skills and new working methods. The ambitious goal of a "participatory society", requires a sort of "Copernician revolution" for public administrations to reach out to the public, to operate transparently and to increase their capacity to listen to the demands of the wider public. Transparency is important, as it represents social investment, an intangible asset in the form of current and future trust in public institutions, tools and policies. A high quality regulation approach requires therefore a whole apparatus for implementation.

The Korean Government is certainly aware of the issues, given the guidance being developed, the training that is organised and the investment in knowledge-based institutions and in tools such as RIA. However, there is always scope for increasing awareness at the local level, including incentives, mobility of staff as well as recognition of the efforts. Another tool which can be employed at the local level is "benchmarking", with the availability of comparative data on service to clients, client satisfaction with regulations and with implementation, which in turn can motivate public administrations for change.

Beyond the administrative sphere, this monitoring exercise highlights the challenge of reaching out to a wider public. It is necessary to communicate on the benefits of Regulatory Reform to foster engagement, trust and confidence. Building consensus for action also represents a challenge, with many discussions, fora and meetings. There is a need to publish a government strategy on consultation, but also to show the public that their comments are being heard, or not (and why). It is also necessary to build constituencies for action, with the right sequencing of reform proposals and options, to ensure that these can be understood, accepted, and also, at a later stage, implemented.

Conclusion

Korea's recent performance is setting an example for many countries, both inside the OECD and beyond. Strenuous efforts have allowed the country to cope successfully with a major crisis, and to ensure long term economic growth. The move towards technology intensive products also highlights the achievements of the major manufacturing firms.

This report has identified a number of areas where further regulatory reform and the application of high quality regulation principles could help Korea better prepare for the future. Regulatory reform can help structural change in the economy, promoting a more integrated policy approach, as well as fostering market openness. This could allow improving the situation of Koreans as citizens, workers and consumers. Awareness to the need for action is high and regulatory policy is relatively strong. However, all other OECD countries are moving as well, since regulatory reform is a dynamic field. All are further advanced in 2007 compared with the mid 1990s. If Korea is to continue closing its gap in relation to the most advanced countries, it needs to make even faster progress, to ensure smoother market processes, better regulatory tools and more open institutions.

Korea is not far from best practice in some areas, while in others, historical considerations and special interests may hinder the pace of change. The challenge, as Korea is moving closer to the group of the most advanced countries, is to sustain the momentum. Even if recent economic trends show that structural economic growth has diminished, the new changes that are currently required are in a sense more difficult to achieve, since they require political action, and may not yield immediate benefits. The experience of Korea together with other OECD countries shows that action does pay off, in the long term, but requires a coherent horizontal policy approach, under strong leadership, to ensure high quality tools, processes and institutions.

Notes

1. The Competition Committee considered developments in Korea since 2000 in its October 2004 examination of 10 member regimes, focusing on the implementation of recommendations about competition law enforcement (see Chapter 3).
2. Jaehong Kim (2002).
3. OECD (2005), Seoul, Korea, Territorial Reviews.
4. OECD (2003), Growth Study.
5. Ministry of Finance and Economy (1999), *DJnomics: A new foundation for the Korean economy*.
6. Recent OECD SOCX data (Social Expenditure Database).
7. See Projecting OECD Health and Long Term Care expenditure: what are the main drivers, Economics Department Working Paper (2006).
8. Sanghoon Ahn (2006), entry regulation and Industries' Performance in Korea, see Korea Development Institute (2006).
9. The issues surrounding human capital and knowledge intensive activities have been addressed in the *OECD Territorial Review of Seoul,* Korea 2005.

Bibliography

Asia and Pacific Leadership Center, Kangwon National University, United Nations Economic and Social Commission for Asia and the Pacific (2005), *Korean Way of Economic Development, Past, Present and Future*.

Conway P., Janod V., Nicoletti G. (2005), *Product market regulation in OECD countries: 1998 to 2003*, OECD Economics Department Working Paper n° 477, OECD, Paris.

EIU (2006), "Country Profile: Korea", available from *www.eiu.com/*.

Kim Jaehong (2002), *Entry Regulation: Theory and Practice*, Korea Economic Research Institute, Seoul (in Korean).

Korea Development Institute (2006), *Regulatory Reform to Improve Business Environment in Korea*, International Conference of Korea Development Institute, edited by MoonJoong Tcha, May, Seoul.

Korean Ministry of Finance and Economy (1999), *DJnomics: A new foundation for the Korean economy*.

Korean Ministry of Budget and Planning (2006), *Vision 2030*, 30 August.

OECD (2000), *OECD Reviews of Regulatory Reform – Regulatory Reform in Korea*, Paris.

OECD (2003), *The Sources of Economic Growth in OECD Countries*, Paris.

OECD (2004), *Economic Survey of Korea*, June.

OECD (2005), *Territorial Review of Seoul, Korea*, Paris.

OECD (2005), *Economic Survey of Korea*, November, Paris.

OECD (2006), *Projecting OECD health and long-term care expenditures: What are the main drivers?*, OECD Economics Department Working Paper No. 477, Paris.

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 2

Government Capacity to Assure High Quality Regulation

Introduction

This chapter is part of the monitoring of developments on regulatory reform since the 2000 *OECD Review of Regulatory Reform in Korea*. It focuses on the developments Korea has made to ensure high quality regulation and analyses the changes that have taken place in the Korean regulatory system since 2000, with particular attention of the implementation of the 2000 *OECD Review*'s recommendations.

Korea has made impressive progress in recent years in terms of introducing policies, institutions and tools to assure high quality regulation. The original impetus for reform was to strengthen the Korean economy through deregulation and to facilitate recovery from the economic crisis of 1997. The crisis provided the opportunity for the administration to undertake significant changes; steps were taken to reduce the number of regulations in place, and many new programmes and tools to promote regulatory quality were established.

However, there remains scope to consolidate the gains that have been made to date and to improve further in a dynamic policy field where the frontiers of the state-of-the-art are still being pushed back. Many of the reforms are new and so have not yet become part of the regulatory culture, particularly at the lower levels of the administration. In addition, policy makers and civil servants need to develop skills and expertise in the use of regulatory policy tools in order to use them to their fullest potential. The chapter, therefore, also highlights some of the challenges ahead and suggests policy options for future reforms.

This chapter is structured around the three key elements of regulatory quality: regulatory policies, regulatory institutions and regulatory tools. The recommendations made in the 2000 *OECD Review* are discussed and analysed under each of these headings. The chapter concludes with a discussion on policy options.

Regulatory policies

The 2000 *OECD Review* commended Korea for its progress in reducing the number of regulations in a very short period of time, but noted that it was not necessarily sufficient for the future. In particular, the OECD recommended that Korea adopt principles of good regulation based on those accepted by Ministers in the 1997 *OECD report on Regulatory Reform*. In addition, the 2000 *OECD Review* recommended that Korea base regulatory reform on comprehensive sectoral plans to ensure that a policy environment supportive of market competition develops.

An explicit regulatory policy can help ensure that the elements necessary to achieve regulatory quality are co-ordinated and consistent. The reform process should be comprehensive and consistently applied across policy areas, thereby promoting a whole-of-government approach. An explicit regulatory policy helps policy makers focus on regulatory quality and not simply on deregulation. Past OECD experience has clearly

demonstrated that such polices are most effective when they are backed up by high-level political support.

The administration of President Roh (inaugurated in 2003) reoriented the reform process away from simply reducing the number of regulations to a greater focus on regulatory quality. In a 2003 presidential report on the regulatory reform process, the President emphasised that: "regulatory reform should not be reckless regulation termination but should be about rationalising regulations with qualitative rather than quantitative approach".[1]

This presidential statement affirms the Korean Government's shift in focus from a quantitative to a new qualitative approach. This is consistent with the direction of regulatory reform in most other OECD countries. The statement also demonstrates the high level of political support and commitment to the reform process.

The administration's stated reform objectives focus on building a best practice regulatory quality system and promoting national competitiveness on a global scale. The regulatory reform strategy embodies the following elements:

- a shift from regulator-orientated regulation to user-orientated regulation;
- a shift in the focus of reform away from individual regulations to "bundle" regulations that involve multiple ministries;
- shift from a government-only effort to a joint government-private effort; and
- shift from a quantitative approach to a qualitative approach to rationalising regulation.

This reform strategy embodies a more open and consultative reform process compared with the initial reforms undertaken in the aftermath of the 1997 economic crisis. This is consistent with the focus on the "participative society" advocated by the President, with greater opportunities for consultation and transparency, as well as citizens' involvement in the reform process.

However, the reform strategy remains rather general and lacks a more explicit formulation such as in the OECD 1997 or 2005 Principles.[2] The Korean Government argues that it has adopted the "principles of good regulation" as the basis for its overall regulatory reform programme and that this is reflected in the various elements of the programme including the Basic Act on Administrative Regulations (BAAR) and the Regulatory Impact Analysis arrangements.[3] But this is not necessarily the same as an explicit all encompassing statement. In particular there is no explicit principle, as recommended in the 2000 *OECD Review*, requiring that regulation will not be made or retained unless the benefits justify the costs. The BAAR does require that the costs and benefits of a proposed regulation should be analysed in a RIA but it does not explicitly state that regulation should not be introduced if the benefits do not justify the costs. Even if such a rule is implicitly followed, an explicit statement would send a clear signal to public officials.

The publication of annual reform plans by the Regulatory Reform Committee and the work on "bundle" regulations by the Regulatory Reform Task Force (both discussed later in the chapter) demonstrate a more coherent and planned approach to regulatory reform across the government.

Regulatory institutions

Appropriate institutions are central to a successful and on-going programme to ensure regulatory quality. Responsibility for the various aspects of regulatory quality should be

clearly allocated to institutions across the government administration, which should in turn be sufficiently resourced to fulfil their responsibilities. The appropriate institutional structure is also important in ensuring that the reform process is transparent and that those making the decisions are accountable for their actions.

Centre of government agencies

Korea has a strong presidential system of government and hence, central government agencies operating with presidential support are in a key position to promote reform across all sectors of government. These agencies can provide leadership and direction to the reform process to ensure that progress is made and momentum is maintained.

Regulatory Reform Committee

The key central government body promoting regulatory co-ordination and management capacities is the Regulatory Reform Committee (RRC) which was created by the 1997 Basic Act on Administrative Regulations (BAAR), under the authority of the President. The secretariat function supporting the RRC is undertaken by the Regulatory Reform Office which is located in the Prime Minister's Office. This unit includes around 40 civil servants and 3 professional experts, under the direction of the Deputy Minister for Regulatory Reform.[4]

The RRC is composed of 25 members, 18 of whom are from the private sector and 7 are government officials from various departments. The RRC is jointly chaired by the Prime Minister and one member from the private sector appointed by the President. There are also 3 sub-committees (economy 1, economy 2 and social administration) which focus in more detail on specific areas. The sub-committees are also composed of both private sector experts and government officials. The RRC meets on a bi-weekly basis and the sub-committees meet weekly.

The RRC has wide ranging responsibilities and powers. These include the preparation of annual reform plans, consultation with stakeholders and the public, and the review of Regulatory Impact Analysis documents prepared by ministries. Article 24 of the BAAR identifies seven functions which are to be undertaken by the RRC. It states that the RRC is responsible for deliberation and co-ordination of:

- the basic direction of regulation policy as well as research and development of regulatory institutions;
- items that pertain to the review of establishing and reinforcing new or existing regulations;
- review of existing regulations, establishment and implementation of a comprehensive plan on regulatory improvement;
- registration and promulgation of regulations;
- gathering and processing opinions on regulatory upgrading;
- inspection and evaluation of progress made by administrative agencies on different levels in terms of regulation improvement; and
- other items deemed by the Head of the Committee as requiring deliberation and co-ordination of the Committee.

The RRC has played a central role in the Korean reform process since its establishment. It has contributed to developing a more systematic approach to regulatory

quality within the Korean administration and championed the introduction of a range of regulatory quality tools – such as Regulatory Impact Analysis. The RRC has also played an important role in increasing awareness of the need for and importance of regulatory reform and quality among ministries and the administration.

While the powers and responsibilities of the RRC are wide, a number of important areas remain outside its oversight. The 2000 *OECD Review* noted the central role of the Regulatory Reform Committee in pushing forward the reform agenda in Korea. However, the *Review* recommended that to facilitate a more comprehensive reform strategy the responsibilities of the RRC should be broadened to include areas such as taxation and subsidies, industrial policies and regional development policies. The *Review* argued that such a broadening of responsibilities would be an effective means of reinforcing policy consistency.

These areas remain largely outside the RRC's scrutiny. The BAAR explicitly excludes the areas of national defence, diplomacy, the tax system, the legislature and the judiciary from oversight by the RRC. This implies that major reforms with significant implications, such as regulations for regional development, tax-related regulation and industrial policy remain outside the scope of RRC scrutiny. However, the exclusion from the RRC review relates to the broad policy objectives and strategies of the government. New individual or strengthened laws relating to these areas would still be subject to RRC oversight.

The RRC's area of responsibility is limited to oversight of regulation prepared by government ministries. This is an important issue because under the Korean system of government, bills can be introduced directly into the Parliament (Congress) by congressmen themselves. Table 2.1 provides data on the number of bills introduced into Congress by the executive and congressmen as well as the number of bills passed. There is a clear trend towards an increasing number of congressmen initiated bills being submitted to Congress and being passed into law.

A significant (and increasing) proportion of Korean legislation therefore escapes from the detailed scrutiny of the RRC and is introduced into Congress without going through the normal regulatory quality checks established by the Korean Government.

The Korean authorities have recognised that this circumvention of the regulatory quality assurance processes must be addressed. An *ad hoc* committee, the Special Committee on Regulatory Reform, was established in the National Assembly in July 2004. However, this was a temporary committee which only lasted one year. Other existing committees such as the legal committee may also review draft laws submitted by congressmen but it is not a specialist regulatory reform type of committee with an emphasis on ensuring regulatory quality. These committees are unlikely to subject the draft laws to the level of scrutiny that would be exercised by a standing specialist committee.

Table 2.1. **Source of bills debated and passed by the Korean Congress**

	Bills initiated by the executive	Bills initiated by congressmen	Passed bills initiated by the executive	Passed bills initiated by congressmen
The 16th Congress (2000-2004)	595 (23.7%)	1 912 (76.3%)	423 (45.1%)	514 (54.9%)
The 17th Congress (2004-31 Dec. 2005)	443 (13.5%)	2 841 (86.5%)	196 (31%)	437 (69%)

Source: Government of Korea.

The lack of a permanent body with responsibility for reviewing draft laws proposed by congressmen from a regulatory quality perspective represents a significant gap in Korea's regulatory quality infrastructure, which has been amplified by the recent trend toward increasing numbers of draft laws initiated by congressmen. Temporary committees may provide useful input during their existence but the lack of an ongoing body means that not all draft laws are subject to oversight. In addition, the lack of a permanent body means that the opportunity to build the skills and expertise necessary to ensure effective oversight is lost.

Regulatory Reform Task Force

The Regulatory Reform Task Force (RRTF) was established under the Prime Minister's Office in August 2004 to facilitate reform of "bundle regulations" that involve multiple ministries, rather than single regulations. The RRTF is under the responsibly of the Deputy Minister for Regulatory Reform and comprises 26 public officials and 24 experts from research institutes and business. The work of the RRTF and the RRC are directly co-ordinated by the participation of the Prime Minister in both the RRC and the Regulatory Reform Ministerial Meeting which oversees the work of the RRTF. In addition, the Deputy Minister in charge of regulatory reform under the Prime Minister is the administrative co-ordinator of the work of the RRC, RRTF and the Business Difficulties Resolution Center.

An important characteristic of the RRTF is that its membership is almost equally split between private and public sector representatives. This mixed composition shows the government's strategy of fully involving the private sector in the reform process. The RRTF attempts to improve the regulatory environment for business through public-private co-operation from setting the reform agenda through consideration of how reform should be undertaken.

The RRTF has focused on bundle regulations in 45 strategic areas which by the end of July 2006 included marine transportation, internal administrative regulation, job training regulation and golf course construction. These sectors where chosen as priority areas by the RRTF drawing on the advice of the private sector members of the taskforce as well as government representatives. By July 2006, the RRTF had drafted 1 421 detailed improvement plans relating to the 45 strategic areas.

The approach adopted by the RRTF enables a comprehensive assessment of the regulatory reforms needed in particular sectors or industries. It therefore allows the reform body to consider the overall impact of regulations, how they interact with each other and how reform in one area may impact on the operation of other regulations. The high proportion of private sector members on the task force has also ensured that the RRTF focuses on priority areas for reform from a business perspective.

The RRTF was established with a short mandate which originally was due to expire at the end of 2006. However, the Korean Government decided to extend it to 2008 and it will continue to focus on reforming bundle regulations, including additional strategic areas. Thus, its expertise and approach will continue to contribute to further regulatory reform in Korea.

Business Difficulties Resolution Center

The Business Difficulties Resolution Center (BDRC) was established in 2004 under the Prime Minister's Office. It acts as a form of one-stop shop ombudsman to resolve regulatory issues faced by businesses. In the period between its establishment and July 2006, the BDRC had received 1 337 complaints from businesses, of which 774 were resolved satisfactorily.[5]

The centre is primarily focused on resolving difficulties faced by businesses. However, the BDRC activities involve a significant contribution to regulatory quality. In resolving issues raised by business it can recommend changes to the laws or regulations to improve their operation and minimise adverse impacts on businesses. It also provides another process through which business can have a direct input into the regulatory reform process in Korea.

Other central institutions

Korea has a number of research centres and institutes which can provide a general research capacity to support central government agencies. These agencies work in close collaboration with the central government reform agencies.

Established in 1991, the Korea Institute of Public Administration (KIPA) is primarily a government-funded research institute (70% of its funding is provided by the government), and is part of the Korea Research Council for Humanities and Social Sciences under the Office of the Prime Minister. Its work covers a wide range of areas relating to public administration.

In May 2003, the Regulatory Research Center was established within the KIPA. Its general mission is to conduct research and develop policies on regulatory matters. It is available to conduct Regulatory Impact Analysis on new regulations on behalf of the initiating ministry. It also serves as a "clearinghouse" for regulatory resources by collecting, accumulating, and disseminating various materials and information on government regulations.[6] The Center and the Prime Minister's Office have jointly, for example, published a Manual on Regulatory Impact Analysis and a Manual on Regulatory Alternatives.

Another important "think tank" is the Korea Development Institute (KDI) which is a policy-oriented research institute founded in 1971. KDI was established by the Korean Government to undertake research, analysis and provide advice on a wide range of economic policy issues.[7] KDI's coverage is much wider than that of the KIPA, and it does not focus specifically on regulatory reform issues. The work of the KDI incorporates both long and short term economic policy and development issues both those related to the domestic Korean economy, as well as international trade and development issues. This wide focus allows KDI to consider regulatory reform and the role of regulatory quality in a very broad economic development context. For example, in May 2006, KDI hosted a major international conference entitled "Regulatory Reform to Improve Business Environment in Korea" (KDI, 2006).

The Korean Institute for Industrial Economics and Trade (KIET) is another important research institute which, although not a specialist regulatory reform institute, has undertaken research on regulatory issues affecting industry. KIET was established by the Korean Government in 1976 and one of its main objectives is identifying and exploring ways to strengthen economic efficiency and industry competitiveness of Korean industry. This includes undertaking research on regulatory issues which impact on business performance and competitiveness.

Independent regulatory authorities

Independent regulatory authorities with responsibility for regulating and overseeing particular economic sectors, such as electricity or communications, play an important role

in fostering a competitive environment within those sectors. The 2000 *OECD Review* noted that the idea of independent regulators was relatively new in Korea and that the evolution of the institutional framework for such regulators was not consistent – the *ad hoc* creation of the new regulatory structures seemed to lack a coherent approach. The *Review* recommended that to improve the policy foundation for the efficiency, independence and accountability of new independent regulatory agencies, the Korean Government should consider developing guidelines for their systems of governance, policy coherence, working methods and relations with the competition authority. It was suggested that a high level and independent review of these issues would be a useful step.

The Korea Communications Commission (KCC) has been in existence since 1992 and was established under the Telecommunications Basic Act. The 2000 *OECD Review* noted that the KCC was not a fully independent body as it was under the jurisdiction of the Ministry of Information and Communications. In December 2002, the Telecommunications Business Act was amended to strengthen the division between the policy-making functions of the Ministry and the implementation functions of the KCC. This was done by delegating some rights – including the right to order a fact-finding investigation into prohibited acts by service providers and the right to issue a corrective order – from the Minister of Information and Communications to the KCC.

This move in the right direction helps reinforce the independence of the KCC and has allowed the KCC to play a more active role in the market. However, the KCC remains closely related to the Ministry of Information and Communications. Its budget is allocated from that of the ministry, many of its staff previously worked in the ministry and it shares office space in the same building.

The Korea Electricity Commission (KEC) was established in 2001 as foreshadowed in the 1999 Electricity Industry Restructuring Basic Plan. The KEC remains under the umbrella of the Ministry of Commerce, Industry and Energy. Although some measures have been put in place to enhance the independence of the KEC, such as including a majority of private sector members, its basic subordination to the Ministry remains a concern.

The Korean Government has made progress in terms of increasing the independence of its regulatory agencies. This is consistent with the continuing move towards a more competition and market friendly environment. Independent regulatory agencies can act to improve regulatory efficiency by providing a check on the power of ministries to favour government-owned firms and interest groups. Their operation can also be more transparent and accountable than internal political decisions – this can give market participants confidence that the sector is being regulated in an open and consistent manner.

However, there is scope to further improve the independence of these agencies through, for example, ensuring greater budgetary autonomy, which would further enhance confidence in the operation of the respective markets.

Regulatory tools and procedures

Effective tools and procedures are essential to ensure well functioning and transparent regulatory processes. The 2000 *OECD Review* made a number of recommendations aimed at improving consultation and representation of stakeholders in the regulatory process. The *Review* also made a number of recommendations aimed at improving the Regulatory Impact Analysis (RIA) process.

Transparency and predictability

Transparency is a key element of an efficient and effective regulatory process. A transparent process provides a form of quality check on new regulations. In addition, transparency ensures that those affected by the regulation understand why it is being introduced – it therefore reinforces the legitimacy and fairness of the regulatory process. Korea has taken concrete steps to improve transparency and consultation with affected groups. In addition, Korea has also moved to reduce the degree of discretionary power given to regulators.

Consultation

Public consultation can be a powerful tool to improve regulatory quality by acting as a quality check on the draft proposals and by providing input and data to the policy-making process. The Administrative Procedures Act and the BAAR establish the legislative basis for public consultation mechanisms. The major elements of the consultation process are:

- ministries are expected to consult with affected parties prior to drafting new regulatory proposals; and
- draft regulations are available on a "notice and comment" procedure for a minimum of 20 days. In the case of new or revised regulation, Article 9 of the BAAR requires heads of agencies to "… gather sufficient evidence of public opinion through public hearings and public notices on legislation by administrative agencies, civic groups, interested parties, research institutes, and experts."

Public and stakeholder perspectives can also be voiced through their representatives on the various regulatory reform bodies and committees. The key central government body, the RRC (and its sub-committees) provides an important channel through which a range of views can be expressed. The RRC comprises both government and non-government members. However, the 2000 *OECD Review* noted the growth in the number of NGOs which were active across a range of policy fronts but which were not explicitly represented on the RRC. The *Review* recommended that the membership of the RRC should be broadened to include representation from major Korean civil society groups.

The Korean Government has directly addressed this recommendation with an amendment to the BAAR in December 2005 which has increased its maximum membership from 20 to 25. Some of the additional members are representatives of civil society groups, including women's groups and the media. The Korean Government appointed a representative from a civil society group as the chairman of the RRC in 2004.

In addition to the formal committee structures for stakeholders to express their views the government has made use of a range of consultation mechanisms including greater use of the Internet to facilitate an exchange between government and society. There have also been initiatives aimed at foreign firms and investors in Korea. In 2005 the Korean authorities established a formal mechanism for quarterly consultation with foreign chambers of commerce based in Korea in order to gather the views and suggestions of foreign business organisations.

Individual ministries acknowledge, in writing, the comments received from stakeholders. This acknowledgement will usually include the ministries' assessment of the comments and what action they propose to take, if any, as required. Although compliance with this requirement is high, discussions with stakeholders indicated that the speed with which a response to comments was obtained and the degree of detail in the

response varied widely between ministries. The comments received from stakeholders are not, however, generally made public. In April 2006 the Korean Government created an electronic discussion system to encourage an exchange of views on proposed legislation – this will significantly enhance the transparency of the consultation process. In some cases stakeholders may not wish their comments to be made public for commercial reasons or other concerns relating to confidentiality. But in general publication of the comments received by ministries on draft laws or proposals can help inform the policy and law-making process.

Overall, the degree of consultation and the ability of stakeholders and the public to express opinions and provide input into the policy-making process have increased significantly since the 2000 *OECD Review*. This is consistent with the Korean Government's concept of a "participative society" highlighted above.

However, there remains a great deal of discretion about how the consultation process is undertaken. The BAAR sets out general requirements to consult but there is little detail on how this consultation is to be undertaken – this can be viewed as both an advantage and disadvantage of the current arrangements. The Administrative Procedures Act further specifies the nature of consultation regarding the pre-announcement of new legislation. Agencies are to notify widely the purpose and contents of proposed legislation and the agency may hold public hearings about it.

The degree of discretion available to agencies can be both an advantage and disadvantage. It is an advantage to the extent that the ministry is free to find the best way to contact and hear the views of relevant stakeholders. The lack of precision can also be a disadvantage by allowing ministries to conduct a less than detailed consultation programme if that is in their interest.

The time limits allowed for consultation may also be a problem in some cases. Currently, a 20 day minimum period is allowed for consultation – although ministries are free to allow a longer period, at their discretion. The specification of a minimum consultation period is consistent with OECD best practice, but 20 days may be too short. In the United States, for example, the standard period is more often 60 days. The 20 day period is especially likely to be insufficient where the draft law under consideration is complex or community and civil society groups need to consult their members to gather their views on the possible impacts and implications of the legislation. Strict enforcement of the 20 day limit may in some circumstances be a barrier to consultation and transparency.

Additional direction on the form of consultation to be undertaken in particular cases could be a useful next step. This could be incorporated into a broader consultation strategy which outlines the objectives of consultation, the mechanisms available to consult with stakeholder and how the information collected is to be used.

Accessibility of regulations and compliance

Accessibility to the list of regulations currently in force is a key requirement of an effective and transparent regulatory system. Citizens and businesses must be aware of and understand their obligations under the regulations in force. This involves ensuring that businesses and citizens have access to the text of the regulation in force, but also that the regulations themselves are written in "plain" language so that they can be understood by the non-specialist.

Korea, like most OECD countries, has made extensive use of the Internet as a way of providing information on regulatory requirements. The Ministry of Government Legislation (MOLEG) makes all laws and regulations available on its Internet homepage. In addition, MOLEG publishes a monthly periodical entitled "Legislation" which contains information on all laws and regulations enacted or amended during the month as well as any other important news relating to legislation.[8]

A requirement for "plain" language drafting is also a feature of the Korean law-making process. In part, the "plain" language requirement is embodied in Article 5(3) of the BAAR covering principles of regulation which states that "The scope and the methods of regulation shall be kept to a minimum required to achieve the objective of the regulation through the most effective methods and in a way that guarantees objectivity, transparency and impartiality".

The Korean authorities have supported this "plain" language requirement with guidance material on plain language drafting to assist ministries' draft legislation. In addition, there have been other innovative initiatives to simplify the language used in regulations. For example the Prime Minister's Office has used Korean language experts to assist in the review of regulations to simplify the language used. In 2005, the language used in 37 regulations was simplified following the advice of language experts. The Ministry of Government Legislation (MOLEG) also includes clarity of the regulation as one of the factors it considers when reviewing draft regulations prepared by ministries.

Accessibility to legislation is important not only to Korean nationals, but to others as well. The Korean Government is actively promoting foreign investment in Korea. However, foreign organisations have noted that the lack of availability of relevant legislation in a language other the Korean increases business costs and uncertainty. While MOLEG has provided translations of many Korean laws (primarily those relating to economic and immigration issues) in other languages, primarily English, in order to meet the demands of foreign investors, many regulations, including sub-legal regulations, relevant to international businesses remain available only in Korean.

Bureaucratic discretion and administrative guidance

Widespread use of bureaucratic discretion, including administrative guidance, is unlikely to be consistent with a transparent and predictable policy process. Administrative guidance refers to the use of advice, recommendations or other actions by regulatory bodies, which do not have legal binding force, but which are intended to affect the actions or behaviour of other entities.

The 2000 *OECD Review* noted the substantial progress that Korea had made in reducing the degree of administrative discretion open to regulators, but noted that further initiatives could be taken to further improve the situation. The Korean authorities have continued efforts to minimise the use of discretion and administrative guidance.

The RRC plays an important role when it reviews draft regulations. One factor it considers is that if there are instructions or announcements that have the effect of limiting the rights and freedoms of citizens then these should be stipulated in a binding law. This gives greater clarity and transparency to the provisions and opens up the opportunity for the validity of the provisions to be challenged in the courts.

In 2005, MOLEG published a guideline, the "Discretionary Action Transparent Guideline," which is aimed at improving legislation which is vague and opens the

opportunity for guidance. In addition, MOLEG has an ongoing programme to review all laws with discretionary powers between 2005 and 2007. The aim of this review is to identify and minimise the degree of discretion available in the interpretation of regulation. Concurrently with the review, MOLEG has prepared a more detailed manual on regulation interpretation for regulators and civil servants.

Administrative guidance and scope for discretionary action and interpretation are not only issues for domestic Korean firms. Foreign firms also expressed concern at the interpretation placed by the authorities on some regulations changed over time and for reasons that were not clear to the businesses. This can increase regulatory uncertainty faced by foreign firms trying to do business in Korea. The problem may be exacerbated if the regulations are only available in Korean and the foreign firms must rely on translations of the original laws.

The difficulty is compounded by the relative scarcity of business lawyers in Korea, especially ones with sufficient proficiency in English. The lack of English (or foreign translations generally) is likely to be particularly problematic in respect to financial regulation where foreign firms are particularly active in Korea and the regulations can be complex. It should be noted, however, that the number of English speaking lawyers is increasing over time and both MOFE and MOLEG provide English versions of many major laws (but many lower subordinate regulations remain available only in Korean). In any case the Korean version of the regulation will always be the final point of reference.

Understanding regulatory effects: the use of Regulatory Impact Analysis

Regulatory Impact Analysis (RIA) is an important tool for ensuring that efficient and effective regulatory options are chosen. The value of the tool is reflected in the fact that most OECD countries have introduced a RIA system and Korea is no exception.

The Korean RIA system was established under the Basic Act on Administrative Regulations and came into effect from 1 June 1998. A RIA is required to be conducted for all types of legislation, including presidential decrees and ordinances. Article 7 of the BAAR requires that eight elements be addressed in a RIA:

- necessity of establishing a new regulation or reinforcing an existing one;
- feasibility of the objectives of the regulation;
- existence of alternative means to regulation or possible overlapping with existing regulations;
- comparative analysis of the costs and benefits for those impacted by the regulation;
- inclusion of elements that might limit competition;
- objectivity and clarity of regulation;
- concerns regarding establishment or reinforcement of regulation, such as the relevant administrative agency, work force and budget; and
- propriety of documents submitted by people and procedures in civic tasks.

The 2000 *OECD Review* noted that the BAAR had, in theory, established a good RIA framework, but given its recent introduction it was too early to assess its effectiveness and practical implementation. The report recommended that quality control procedures for RIA be improved by ensuring that all draft RIAs are reviewed by an expert regulatory reform body at the centre of the government administration. It was also recommended that RIA be publicly released as part of the public consultation process.

The Korean Government has continued to develop and embed RIA in the policy development process. An important step was the publication in 2005 of a RIA manual prepared by the KIPA and the Regulatory Reform Office under the Prime Minister's Office.

A critical self examination of the operation of the current system can provide important insights into weaknesses in the existing system and help identify areas where it can be improved. The KIPA conducted a survey of RIAs in 2005 and found that agencies experienced the following problems in conducting effective high quality RIAs:

- a lack of time – in some cases there was insufficient time to conduct fruitful consultation and to fully analyse all elements required in the RIA;
- in some agencies there were insufficient staff responsible for undertaking the RIA;
- a lack of expertise – in part due to job rotation. KIPA found that 41% of respondents to their survey had been responsible for regulatory practices for less than one year, 46% for between one and two years, and 13% for over two years;
- a lack of financial resources to undertake a RIA; and
- perception problems among civil servants. RIA was perceived as a "routinised formality" in the legislative process.

A lack of resources, whether time, staff or appropriate skills, will result in lower quality RIA analysis. These constraints are likely to have resulted in RIAs being produced which are not as comprehensive or analytical than would have been the case if additional resources had been available. Further developing the skills of those responsible for undertaking RIA will be central if it is to lead to high quality regulation. Less than fully comprehensive RIAs are unlikely to result in a full analysis of impacts and consideration of alternate instruments. Policy makers and civil servants must consider RIA as being an integral part of the policy-making process and not an additional burden at the end.

In order to maximise the value of a RIA process officials must be sufficiently skilled to use the tool to its potential. Several groups expressed concern at the lack of expertise within the government administration necessary to prepare high quality RIA studies and also relating to the evaluation of these studies by the RRC.

Effective training and skills acquisition are necessary to ensure that the full advantages of a RIA system are realised. The publication of guidance such as the RIA manual is an important element of this, but it must be supported by the ongoing training of civil servants. The Korean Government has initiated a range of training programmes for civil servants. The training involves civil servants participating in formal training programmes, lectures and workshops. The Prime Minister's Office has been instrumental in establishing many of these training programmes.

Training is not only important for proving the skills necessary to undertake a high quality RIA but also for changing the policy-making culture of the civil servants. Training can help reinforce the need for regulatory quality and RIA and make it an inherent part of the policy-making process rather than a compulsory "add-on" at the end of the process. However, such cultural change is not always easy to achieve. There needs to be ongoing training to continue to reinforce skills and ensure that the conduct of quality RIA becomes a key element in the policy-making process.

The training undertaken to date has focused on civil servants and policy makers at the central government level. Policy makers at local government level are only just beginning to benefit from this training and yet regulations made at local government level can have

significant impacts on citizens and businesses. This training has been supported by the publication in June 2006 of a regulatory reform manual for local government organisations.

A key element of an effective RIA is to ensure that all possible alternative policy instruments have been considered to achieve the government's objective. Experience in other OECD countries has shown that there is not always a full and comprehensive consideration of alternatives and one of the reasons is that there is a lack of knowledge regarding the types of alternative instruments available. Korea has taken a major step by publishing a manual on alternatives to provide information to policy makers concerning the types of alternative instruments that are available and may warrant consideration.

The existence of a RIA system – and even a requirement that it be compulsory – does not necessarily ensure that the RIAs undertaken are of high quality. Effective RIAs require good quality data on the possible impacts of proposed regulations and there appears to be scope to improve data collection and analysis in Korea. In addition, there may be resistance to conducting a comprehensive RIA by civil servants who may wish to promote a particular action, or they may regard RIA as a time consuming process which adds to their workload.

A centre of government body with the power to examine draft RIAs can be a powerful quality control mechanism. In Korea the RRC has responsibility for reviewing draft RIA documents. The review function of the RRC was supported by the establishment of a Regulatory Research Centre within the KIPA to facilitate the analysis and review of RIA documents.

RIA can be costly and time consuming to undertake. Many countries, including Korea, have therefore introduced mechanisms to target RIA. The RRC decided in April 2004 to target its review of RIA to those dealing with "core regulations", RIA conducted on other regulations will be subject to review by the Internal Regulatory Reform Committee (IRRC) under the relevant ministry. Core regulations are those which:

- have over 10 billion won (approximately 8.5 million euros) of annual cost of regulatory impact;
- affect over one million regulated people;
- explicitly restrain competition;
- are excessive or unreasonable in the light of international standards; or
- are recognised by the RRC as in need of review because a regulation is controversial among related ministries or stakeholders, or has significant social and economic ramifications. (Although, as noted earlier some important areas remain outside the scope of RRC review).

This is a useful mechanism for the RRC to focus its oversight and resources on those regulations which are likely to have significant economic or social impacts, while still ensuring that the RIA conducted on non-core regulations are still subject to oversight and quality control by the IRRC in each ministry.

There is other evidence of issues which reduce the effectiveness of the Korean RIA system. The Korean Government has put in place the formal mechanisms for a very effective RIA system which, in principle follow OECD best practice. It can take time for the process to become an established part of the policy-making process and for those undertaking the RIA to be experienced and trained so that the RIA can maximise its contribution to good policy making.

While the RIA system which has been established to improve the quality of government-initiated laws has been in place for some time, important areas of regulation continue to escape such scrutiny. These omissions weaken the overall regulatory quality programme in Korea.

One important area, as discussed above, is the growing proportion of bills and legislation initiated by congressmen rather than the executive. These do not go through the rigorous RIA process described above. While there have been some attempts to improve the quality of regulation initiated by congressmen, this area remains an important gap in the Korean regulatory quality system. Korea is not alone in this regard. Mexico, for example, has also observed the legislature becoming more active in initiating new laws.

Local government regulations also escape the detailed scrutiny and assessment of an effective RIA process. Although local governments are required to conduct RIA when enacting or amending regulation, less emphasis is placed on the RIA conducted by local government compared with those conducted by the central government. This is also a concern because local government regulation can have a significant impact not only on local economic development but, in the case of major cities, also on the national economy. The RRC is playing an important role in raising awareness of the need for RIA and quality regulation at the local government level.

These issues are not unique to Korea and have been experienced by most OECD countries. This review shows that the Korean authorities are clearly focusing on improving the system to ensure that it works to its full potential. The review also highlights the areas which could be the focus of the Korean Government in the future.

Review and simplification measures: keeping regulations up-to-date

Regulations are introduced to deal with particular problems, but over time as a result of economic, social or technological change, the problems may change, or new instruments may become available which may better address them. However, the old regulation or administrative formalities may remain in force (though perhaps not always enforced) and so most OECD countries have accumulated significant stocks of regulations and procedures which may no longer be relevant. There is therefore a need to continuously review and look for ways of simplifying the stock of regulation.

Korea made an impressive start to reviewing and reducing its stock of regulations immediately after the 1997 financial crisis. Under the auspices of the RRC and with the President's support Korea reduced its stock of regulations by 50% during 1998-99. This, as was noted in the 2000 *OECD Review*, is an impressive achievement. It is likely to have facilitated a shift in thinking among Korean Government officials away from command and control regulation and contributed to the momentum for regulatory reform. However the *Review* also noted that given the timeframe and the lack of a full and detailed analysis, such a drastic procedure should not be repeated.

The Korean Government has moved away from a focus simply on the number of regulations to focus on quality issues. Annual regulatory reform guidelines for regulatory improvement are prepared by the RRC and sent to ministries each year. Each individual ministry is then responsible for reviewing existing legislation in accordance with the direction given in the guidelines and is required to report progress to the RRC the following year.

This approach has the advantage of ensuring central guidance from the RRC, while the review is undertaken by the relevant ministry which will have a detailed knowledge of the regulation. This review is undertaken following consultation with the RRC. One concern is that the relevant ministry may have a vested interest in maintaining existing regulation or may have a strong sectional interest which may hinder the reform process. The effectiveness of the system will depend upon the degree of oversight maintained by the RRC and its ability to "sanction" underperforming ministries.

The Korean Government also makes some use of sunsetting as a mechanism to keep regulations up-to-date. The legal basis for sunsetting is provided in Article 8 of the BAAR which deals with the continuation of regulation. This article states that regulations which do not have "a clear reason to remain in effect" should not remain in force for longer than what is necessary to achieve their objective and in principle this period should not exceed five years. Article 8 also provides for the head of a central administrative agency to request a review by the RRC of a regulation prior to expiration to assess whether an extension is necessary. If the RRC deems an extension is necessary it can recommend the additional time the regulation is to remain in force. A revision of the BAAR in 2005 also requires that the head of the central administrative agency responsible for a regulation that is to be extended must submit the revised bill to the National Assembly three months in advance of its expiration.

Sunsetting is not a tool widely used among OECD countries. Its value in terms of keeping the stock of regulations up-to-date must be weighed against the resources required to regulatory review regulation subject to sunsetting. The time a regulation is permitted to remain in force is an important consideration. The 2000 *OECD Review* noted that five years may be too short and leads to excessive resources being devoted to reviewing and revising regulation.

The Korean Government has used sunsetting sparingly. There are only 40 regulations currently subject to the sunsetting provisions of the BAAR. Effective use of sunsetting requires that it be evaluated to ensure that it is achieving its objectives. Such an evaluation is undertaken by the RRC prior to extending the sunsetting period.

Reducing administrative burdens

The Korean Government, along with the majority of OECD countries, is committed to reducing administrative burdens imposed on businesses and citizens. The 2000 *OECD Review* noted that Korea had introduced a number of one-stop shops for regulatory approvals and the relatively new use of new technology to process approvals.

Korea has continued with significant development of electronic means of reducing administrative burdens. The Ministry of Government Administration and Home Affairs (MOGAHA) has developed the G4C (Government for Citizens) portal which is an electronic system for civil applications. The objective of the G4C is to reduce administrative costs for citizens who require government attested documentation and to enable civil applications to be made via the Internet. Other electronic means of reducing administrative burdens have focused on businesses and foreign firms (see Box 2.1)

Another major innovation is the introduction of an Electronic Data Interchange (EDI) system in relation to import and export clearance processes. This system is discussed further in the market openness chapter of the report.

The Korean Government has also continued the development of one-stop shops to simplify the collection of relevant regulatory information and application procedures.

Box 2.1. **E-government initiatives for businesses and foreigners**

The Korean Government is currently developing a single window for business support services (G4B) which will provide a one-stop e-government services to businesses including corporate administrative affairs, industrial information and other services related to activities throughout the corporate life-cycle of an enterprise from establishment to closure.

The Korean Government is also developing a comprehensive foreigner support service (G4F) which will simplify formalities relating to foreign entry and investment. The service will cover:

- life cycle immigration requirements relating to entry, employment and departure; and
- foreign investment by improving foreign investment-related laws and regulations.

Source: MOGAHA, 2006.

Foreign investors have been a particular focus for the development of one-stop shops. For example, in 2003, the Korea Trade-Investment Promotion Agency established a unit entitled "Invest Korea" with the objective of providing a one-stop shop to facilitate foreign investment. Invest Korea can help foreign companies with customs procedures, immigration and a number of tax-related applications and requirements. One-stop shops are also an important element in the special economic zones (SEZ) aimed at encouraging foreign investment in specific regions.

The Korean Government has introduced many programmes to reduce the administrative burdens faced, particularly by businesses, in recent years. However, Korea has not yet undertaken a major effort to measure administrative burdens. Evidence from other OECD countries suggests that measurement of burdens is useful both to identify areas where burden reduction is possible but also to maintain the momentum once a burden reduction programme has been initiated.

Measurement programmes can help focus burden reduction efforts on those areas where burdens are particularly large – thereby maximising the return in terms of reducing burdens. In countries such as the Netherlands and Denmark, the use of the Standard Cost Model to measure administrative burdens has permitted detailed burden reduction programmes to be implemented. In addition, ongoing measurement allows progress to be monitored and helps build a constituency for continued reform.

Business permits and licences

The number of permits and licences required by businesses or citizens can also impose significant administrative burdens on those required to obtain them. The Korean authorities achieved a significant reduction in the number of licences and permits between 1998 and 2000, and since then the total number of business licences and permits has remained relatively steady.

The administrative burdens imposed by these licences and permits are likely to have been reduced to the extent that application procedures have been simplified, possibly through the use of technology and the Internet – a programme to measure administrative burdens would provide data on this.

Free economic zones and special economic zones

A recent innovation in Korea has been the establishment of special zones where regulatory requirements on businesses differ from those applying in the remainder of the country. There are two types of special zones, both under the responsibility of the Ministry of Finance and Economy: free economic zones and special economic zones.

Free economic zones (FEZ) have been designated in three areas (Incheon, Busan and Gwangyang) since the introduction of legislation allowing their creation in 2002. The FEZs are intended to develop the designated areas into the business hubs of Northeast Asia by attracting foreign direct investment through creating a business and living environment favourable to foreign businessmen and investors.[9]

FEZs offer exemption from a number of regulatory requirements relating to employment, medical and education services. These exemptions are available to foreign companies. Businesses establishing themselves within a FEZ can also take advantage of an integrated one-stop administrative process which streamlines compliance with 36 regulations. In addition, foreign companies setting up within these zones can also benefit from a package of financial incentives including an exemption from all corporate tax, income taxes and local taxes for the first three years (and a 50% reduction for the following two years). These financial incentives are not available to domestic companies.

Special economic zones for regional development (SEZ) were introduced in 2004 to promote development and economic growth in regional areas through region specific regulatory reform initiatives. These initiatives can include deregulation in the areas of education and medical services, immigration control and land utilisation regulation. At the end of June 2006, fifty-eight areas had designated SEZs. There are no financial incentives offered to businesses establishing themselves within one of the SEZ and the regulatory benefits are available to both foreign and domestic firms.

Korea is not the only country that has introduced special zones to promote development and investment. In 2002, Japan launched special zones for structural reform, which are geographic zones where regulations are eased or lifted, with the intention of stimulating local economies and acting as a testing ground for reforms before they are implemented more broadly.[10]

The creation of such zones clearly demonstrates the Korean Government's belief that regulatory reform is an important facilitator of investment and economic activity. The creation of these zones represents an opportunity to assess the impact of reforms and to gather information on successful approaches. These zones could act as the first stage for some reforms before they are applied more generally.

Conclusions and policy options

Korea has made significant progress in terms of establishing the machinery required to produce quality regulation. The focus of regulatory reform in Korea has shifted from simple deregulation and quantitative reductions in regulations to quality regulation. This transformation is even more impressive because it has occurred very quickly. The Korean regulatory quality system has largely been put in place since the 2000 *OECD Review* and the recommendations made in that report have helped guide the Korean Government.

While the speed with which the system has been put in place is remarkable, it has also resulted in some gaps in terms of implementation and the skill set amongst those

responsible for regulatory issues. The policy options outlined in the following section are designed to offer some suggestions to further build capacity to ensure high quality regulation. The policy options should be viewed in the context of consolidating and improving upon the effective policy apparatus established in recent years.

Policy options

The policy options are discussed under each of the three key elements of regulatory quality: regulatory policies, regulatory institutions and regulatory tools. Regulatory impact analysis and whole-of-government co-ordination are two themes which cut across these elements.

Regulatory policies

An explicit regulatory policy ensures consistency and provides guidance and direction to the reform process. The Korean Government's current stated reform objectives have led to a more open and consultative reform process. Regulatory policy could be further enhanced by considering the following options.

1. Adopt an explicit policy that regulation only be adopted if the benefits justify the costs.

- The current reform strategy embodies many of the OECD principles for a good regulatory policy, but they are not explicitly stated. An explicit statement helps support the reform efforts of ministries and hold them more accountable for their performance. Importantly there is not an explicit statement that regulation only be adopted if the benefits justify the costs. The explicit adoption of this threshold test would enhance the screening of new regulation to ensure that it was justified but would also add pressure on the administration to improve its quantitative evaluation of new regulations.

Regulatory institutions

An efficient institutional structure is critical to ensure regulatory quality and to provide leadership and maintain the momentum for reform. The RRC has been the driving force in Korean regulatory reform for some time but new institutions have also been created.

2. Consider ways to further improve co-ordination among Korea's reform agencies and independent institutions.

- There are currently many institutions working on regulatory quality and regulatory reform in Korea. These include both formal government institutions such as the RRC and RRTF, and also a number of research institutes, such as KIPA and KDI which contribute to the process. This can be a strength of the system to the extent that there are independent views and independent analysis of the process. It may also ensure that the government can draw on a range of views and research capacities to support the reform process. However, there is also the risk that the work of the agencies is not well co-ordinated and that efforts may not be well focused. A formal review of the effectiveness of the various institutions could be undertaken to explore how their work could be enhanced. The review could consider, among other things:
  - the need for an overall oversight body to set the research agenda and facilitate co-ordinating of the various bodies;
  - whether there is scope to integrate the work of some bodies (such as the RRC and RRTF);

- the scope to encourage staff exchanges between institutions; and
- the adequacy of funding and resources available to the institutions, including whether there are sufficient staff with relevant skills in economic and quantitative analysis.

3. Create a permanent mechanism in the National Congress to ensure the quality of laws initiated by members of Congress.

- The lack of a body to scrutinise draft laws initiated by congressmen from a regulatory quality perspective is a serious (and growing) weakness in the current Korean capacity to ensure regulatory quality. *Ad hoc* bodies are not sufficient. There should be a permanent committee established within the Congress as a matter of priority to undertake these reviews. The committee should interact closely with the RRC to ensure that draft laws, whether initiated by the government or by congressmen, are subject to the same degree of scrutiny from a regulatory quality perspective.

Regulatory tools and procedures

The Korean Government has put in place many of the tools required to ensure regulatory quality. In many respects this infrastructure can be considered at the forefront of many OECD countries. However, many tools are new and policy makers and civil servants lack experience in their use. The following policy suggestions are aimed at improving the tools and ensuring that they are used to their maximum potential to ensure high quality regulation.

4. Enhance the integration of RIA into the policy-making process through training, with a view towards changing the policy-making culture of civil servants.

- RIA is a key tool to ensure the quality of new or revised laws. The Korean Government has put in place very effective formal mechanisms to undertake high quality RIA. The challenge is to ensure that civil servants have both the skills required to use RIA and the commitment to ensure that it is used to its maximum potential. To this end, the Korean Government should provide ongoing RIA training to officials as a matter of priority. This should be an ongoing process building capacity and skills amongst civil servants – otherwise civil servants lack the incentive to master and improve their skills.
- In addition to general training in the use of RIA, there should be a specific training on the use of quantitative techniques and data collection methods. This training should aim to build expertise within the administration in the use of these techniques and build the base for more quantitative RIA studies.
- The initial focus of training and skills development should be on civil servants at the central government level as well as on increasing the capacity of the RRC to examine the quality of RIAs submitted to it. The next step should ensure that officials at the local government level also receive training in the use and value of RIA.
- Overall, it is important that the training and instruction received by officials focuses not just on the technical aspects of conducting a RIA – this could lead to a formulaic approach – which does little to change the policy-making culture of civil servants. To ensure that RIA is not just an "add-on", there needs to be a focus on developing a data collection strategy to ensure that RIA studies are undertaken with quality data on the possible impacts of regulatory proposals.

5. *Publish a general government-wide strategy and statement on consultation and consider increasing the minimum time allowed for consultation.*

- The degree of consultation with stakeholders has increased significantly since the 2000 *OECD Review*. However, there is still a great deal of discretion open to agencies as to how the consultation process is undertaken. The degree of discretion open to agencies can be an advantage as they can tailor the consultation process as required given the specific matter under consideration. Nevertheless, the Korean Government could consider producing an overarching consultation strategy which would outline the objectives of consultation, the process, and mechanisms available. This document could provide more direction and guidance to agencies than is currently available, thereby ensuring that all stakeholders, including small and medium sized firms, non-government organisations, labour organisations and foreign firms have the opportunity to provide input to the law-making process. As a key input to this process the Korean Government could undertake an assessment of the impact of the consultation process on draft laws. The review could consider who has made comments, what consultation mechanisms have worked best and what impact has the consultation process had on the development and improvement of draft laws. The insights and conclusion of such a review could be incorporated into a government-wide consultation strategy.

6. *Make all comments received from stakeholders public (for example, available on the web) unless the stakeholders request that their comments not to be made public for commercial confidentiality reasons.*

- Agencies are currently required to respond directly to comments made by interested parties, but the comments themselves, and the responses, are not made available to the general public. The Korean Government could consider making all comments and responses (or at least summaries of the comments and responses) available more generally (unless the stakeholders specifically requests their comments be kept confidential). This would help promote debate and increase information on the range of views and concerns that stakeholders have on proposed laws. It would also enhance the transparency of the process as stakeholders would be able to see the views of others and offer responses. Increased transparency will also lead to increased accountability on the part of government agencies responding to the comments.

7. *Initiate a programme to measure administrative burdens.*

- The Korean authorities have no comprehensive programme to measure administrative burdens imposed on businesses or other groups in society. Evidence from other OECD countries suggests that programmes to measure burdens can play an important role in targeting further burden reduction programmes and can help maintain the momentum for further reform. As a first step, the Korean Government could investigate the methodologies available to measure burdens, including burdens inside government, and undertake pilot projects to assess the effectiveness of the chosen methodology and the value of the results.

8. *Monitor the success of special economic zones and ensure that successful measures are evaluated and applied nationally.*

- The Free Economic Zones and Special Economic Zones are recent innovations which demonstrate the importance of regulatory reform to promoting economic growth and

regional prosperity. To the extent that these zones are successful they can be regarded as testing grounds for various reforms. The Korean Government should take full advantage of the information and experience gained in these zones to evaluate the reforms and assess the possibility of applying them nationally. This role could be given to the RRTF if its tenure is to be extended.

Notes

1. Korean response to the OECD Secretariat questionnaire.
2. Establish principles of "good regulation" to guide reform, drawing on the 1995 *OECD Recommendation on Improving the Quality of Government Regulation*. Good regulation should: *i)* be needed to serve clearly identified policy goals, and effective in achieving those goals; *ii)* have a sound legal basis; *iii)* produce benefits that justify costs, considering the distribution of effects across society; *iv)* minimise costs and market distortions; *v)* promote innovation through market incentives and goal-based approaches; *vi)* be clear, simple, and practical for users; *vii)* be consistent with other regulations and policies; and *viii)* be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.
3. Korean response to the OECD Secretariat questionnaire.
4. Staffing numbers as at January 2006.
5. Korean response to the OECD Secretariat questionnaire.
6. KIPA (2005), The Korea Institute of Public Administration, information booklet published by the institute, p. 18.
7. For more information on KDI, see *www.kdi.re.kr/kdi_eng/main.jsp*.
8. MOLEG undated, Guide to the Ministry of Government Legislation, Republic of Korea, p. 19.
9. For more information on Free Economic Zones, including more details on the regulatory exemptions and incentives offered see *www.fez.go.kr/*.
10. For a more substantive discussion of special zones for structural reform, see the Monitoring report on Japan OECD (2004), *OECD Reviews of Regulatory Reform — Japan: Progress in Implementing Regulatory Reform*, OECD, Paris.

Bibliography

Jacobzone S., Chang-Won Choi, C. Miguet (2007), "Quality Indicators of Regulatory Management Systems", OECD Working Papers on Public Governance No. 2, forthcoming.

Korea Development Institute (2006), *Regulatory Reform to Improve Business Environment in Korea*, edited by MoonJoong Tcha, May, Seoul.

OECD (2004), *OECD Reviews of Regulatory Reform – Japan: Progress in Implementing Regulatory Reform*, OECD, Paris.

OECD (2006), *Cutting Red Tape, National Strategies for Administrative Simplification*, Paris.

The Korea Institute of Public Administration, KIPA (2003), A Study on "Institutional Arrangements and Cooperative Rules of the Regulatory Reform Committee", Daeyong Choi, *www.kipa.re.kr*.

The Korea Institute of Public Administration, KIPA (2005), "Information booklet", *www.kipa.re.kr*.

ANNEX 2.A1

Implementation of the 2000 Recommendations

Recommendations of the 2000 *OECD Review*	Actions taken since the 2000 *OECD Review*	Assessments/recommendations
I. Regulatory policies		
Adopt principles of good regulation based on those accepted by Ministers in the *1997 OECD Report on Regulatory Reform*. Adopt as an explicit principle the requirement that regulation will not be made or retained unless the benefits exceed the costs.	Many of the principles have been incorporated into relevant regulation. A Presidential statement has affirmed a shift in perspective away from quantitative reform to regulatory quality.	However, many of the principles are not explicitly stated and there is no statement that regulation only be adopted if the benefits justify the costs.
To ensure that a policy supportive of market competition develops, regulatory reform should be based on the development of comprehensive sectoral reform plans containing the full set of steps needed to introduce effective competition, followed by rapid implementation and periodic public evaluation.	The RRC prepares annual regulatory reform plans and evaluates the progress of ministries in achieving reform.	
II. Regulatory institutions		
To carry out a comprehensive reform strategy, broaden the responsibilities of the Regulatory Reform Committee to include issues of direct relevance to the success of regulatory reform in establishing and protecting market-oriented economic policies. Such issues include taxation and subsidies, industrial policies, and regional development policies.	The RRC has wide ranging responsibilities and these have been gradually expanding.	Important regulatory areas with economic and social implications remain outside the RRC scrutiny.
Review the linkages between regulatory reform policy and administrative reform to ensure adequate co-ordination and a mutually supportive policy environment.	The work on regulatory reform and administrative reform is co-ordinated between the Office of the Prime Minister and Ministry of Government and Home Affairs (MOGAHA). The Minister responsible for MOGAHA is also a member of the RRC.	
Improve the policy foundation for the efficiency, independence and accountability of new independent regulatory agencies by developing guidelines for their systems of governance, policy coherence, working methods, and relations with the competition authority. A high-level and independent review of these issues would be a useful step.	The degree of independence given to regulatory authorities varies. Some enjoy a high level of independence while others remain subordinated to the relevant ministry.	

Recommendations of the 2000 *OECD Review*	Actions taken since the 2000 *OECD Review*	Assessments/recommendations
III. Regulatory tools and procedures		
Ensure that RIA disciplines are systematically applied to the review of existing regulations planned in the annual programmes of regulatory reform.	RIA is required when reviewing all new or amended regulation. General RIA principles are used by the RRC when reviewing existing regulation.	Training is required to improve skills in using RIA. Data collection and quantitative analysis should also be improved.
Improve quality control mechanisms for RIA by ensuring that all draft RIA are reviewed by an expert regulatory reform body at the centre of the government administration.	Major RIAs are reviewed by the RRC. For those that do not meet the criteria for being reviewed by the RRC they are subject to assessment by the Internal Regulatory Reform Committee in each Ministry.	Technical skills of those assessing RIAs should be improved.
Broaden the current membership of the Regulatory Reform Committee to include representation from major Korean civil society groups.	Amendments to the BAAR in 2005 have increased the membership of the RRC from 20 to 25. Private sector and civil society groups will have increased representation.	
Consider the development of an explicit public consultation strategy aimed at improving the participation of civil society groups in the development and reform of regulation.	The BAAR and Administrative Procedure Act provide institutional mechanisms and requirements for consultation.	The degree of consultation has increased significantly since 2000. However, agencies have some discretion open to them. The Korean authorities could publish a general government-wide strategy and statement on consultation. They should also consider increasing the minimum time available for consultation.
Reform the Basic Act on Administrative Regulations to require that RIA be released to the public as part of the public consultation process.	The BAAR has been amended to require public release of RIAs.	As of 1 July 2006 RIAs have been made public.
Focus reform on user-oriented programmes which meet the specific needs of identified constituent groups. Prepare and implement a programme aimed at assuring high levels of compliance with regulatory requirements, including development of means of incorporating compliance-friendly design principles as part of regulatory development.	A number of mechanisms have been introduced to increase user input to the reform process. These include the RRTF and Business Difficulties Resolution Center.	User-oriented reform has been a particular focus of the Korean authorities.
Review the success of reform initiatives taken to date to limit and reform the use of bureaucratic discretion, including administrative guidance.	A number of initiatives have been taken to limit the use of bureaucratic discretion and administrative guidance.	

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 3

Competition Policy

Introduction

This report is part of the monitoring review of developments since the 2000 *OECD Review*, particularly of the implementation of its recommendations. It follows the same outline as the chapter on competition law and policy of the 2000 *OECD Review*, dealing with substantive law and application, institutions, coverage and policy issues. The recommendations of the 2000 *OECD Review* are highlighted in boxes. It deals mainly with recent developments; further detail and analysis about other aspects of the law and policy can be found in the 2000 *OECD Review*. Developments related to competition policy were also covered in a special chapter on product market competition in the OECD's annual *Economic Survey of Korea*, published in June 2004 ("Annual Survey"). The Competition Committee considered developments in Korea since 2000 in its October 2004 retrospective examination of 10 member regimes, focusing at that time on implementation of recommendations about competition law enforcement.

Application of the Monopoly Regulation and Fair Trade Act (MRFTA), originally adopted in 1980, by the independent Korea Fair Trade Commission (KFTC) concentrates on horizontal constraints and unfair practices. The KFTC also applies laws to protect small businesses and consumer rights. Historically, it has been deeply involved in direct regulation of the structure, governance and operations of the *chaebol* conglomerate business groups. A series of priority-setting projects has increasingly targeted competition problems in services, choosing sectors for attention that have a direct and visible impact on consumers or that have been significantly deregulated. The KFTC emphasises a law-enforcement approach along with its important advocacy and reform roles. It is perceived as an aggressive prosecutor, and recent amendments to the law have strengthened some enforcement tools.

The KFTC's conception of its role is broad. Its goal, set out in a January 2004 policy announcement, is "to nurture growth potential by enhancing efficiency in resource allocation through transparent business management and fair competition, thereby distributing the value-added in an effective and reasonable way." The KFTC holds that improving market confidence by supporting these core values of transparency and fairness will encourage human and physical capital to flow into more productive and healthy sectors. To implement this general competition policy of stimulating dynamic efficiency to facilitate adaptation and improve efficiency and consumer welfare, the KFTC's specific targets are preventing monopoly and oligopoly market structures through merger enforcement, removing regulations that hinder competition, deterring cartels and vertical restraints, improving conglomerate ownership structure and transparency, promoting fairness in transactions with consumers, and strengthening private enforcement against unfair practices. The goal of promoting "balanced development" of the economy responded to a longstanding concern the economy has been "overwhelmingly" dominated by conglomerate investment groups, whose influence has distorted competition and concentrated economic power. This priority was reinforced by a belief that in this respect

Korea's situation was unique. Thus, although enforcing law about cartels and mergers and eliminating regulations that constrain market competition are important, the KFTC has placed equal importance on improving the machinery of capitalism, that is, on reforming the ownership and investment structures of the *chaebol* so that resources respond better to market signals. The KFTC has considered these functions to be as important as competition law enforcement, and it has been just as strict in enforcing these rules, through enforcement campaigns to check for undue transactions and other violations.

The policy options proposed in the 2000 *OECD Review* dealt with the KFTC's *chaebol* responsibilities and with competition law enforcement. The principal recommendation was that attention and resources should move toward more emphasis on measures related to efficiency goals. This theme was echoed in the Annual Survey, which made what amounted to the same recommendation, from another perspective: that regulatory functions related to financial structure and corporate governance should be concentrated in regulators that are responsible for financial and securities matters, while transactions that have an exclusionary or distorting effect on product market competition in particular cases should remain subject to competition-law control. Both reviews also called for strengthening the KFTC's investigative powers and tools. Other subjects of recommendations included individual sanctions, private remedies, substantive standards applied to abuse of dominance and mergers, and protectionist measures favouring "small" businesses. Regulatory reforms recommended in the Annual Survey included improving competition in retailing and professional services and strengthening competition and regulatory structure in network industries. These recommendations follow measures that had been set out in other chapters of the 2000 *OECD Review*.

Steps taken since the 2000 *OECD Review* have moved toward implementation of many of these recommendations. In 2001, easing the strictures on holding companies invited the *chaebol* to shift toward this more transparent structure. In 2002, the KFTC ended the system of designating the top 30 business groups for special attention, moving instead toward a system of general regulation of business group conduct. Most significantly, in 2003 the KFTC set up a comprehensive "Three year market reform roadmap" that included measures to resolve remaining problems with the corporate groups' structure and governance. The plan was embodied in legislation that took effect in April 2005.

Enforcement improvements include expanding the leniency programme in 2001, adding an informant-reward feature in 2002 and strengthening both in 2005. The financial penalty against cartel violations was doubled under the legislation to implement the "Three year market reform road map". These amendments also revised the merger review system, to require pre-notification of major mergers and set deadlines for KFTC action on them, while exempting acquisitions of small firms from the notification requirement. The law now explicitly reaches anticompetitive conduct outside Korea that affect the domestic market, and it tries to make it easier for private plaintiffs to claim and prove their damages due to violations. The KFTC staff structure was reorganised at the end of 2005 in order to underscore its reorientation toward better economic analysis and stronger enforcement against horizontal violations. The principal special-protection programmes for small business are set to expire by 2007.

The KFTC's current priorities and ambitions are set out in its January 2006 statement of "policy goals and implementation tasks". The first general goal, to improve institutions, is to be implemented through a new approach to issues of corporate structure, encouraging

voluntary resolutions of disputes, adopting more formal, transparent case decision procedures at the KFTC and strengthening international co-operation. The second general goal is to promote market competition, through anti-cartel enforcement focused on markets with direct consumer impact, more efficient merger reviews, focused attention to potential abuses of dominance and unfair marketing practices and continued oversight of regulatory constraints on competition. The third general goal recognises the KFTC's historic concern about the situation of small businesses, encouraging both greater fairness and greater transparency in subcontracting and franchisee relationships. The last general goal highlights the new importance of consumer issues, by proposing to enhance consumer sovereignty by empowering consumers through better information and linking the dispute settlement process of the Consumer Protection Board with the KFTC's enforcement tools.

Substantive law

The core competition rules about restrictive agreements, dominant firms and mergers remain basically unchanged since the 2000 *OECD Review*. There are some new procedures for applying them, and the KFTC's priorities are shifting. The most important changes have been in the most unusual aspect of Korea's competition jurisprudence, the oversight of conglomerates. That topic was also the subject of the most important recommendation of the 2000 *OECD Review*, and the changes are generally consistent with that recommendation.

Historically, the *chaebol* regulations have taken many forms. The KFTC has designated the groups that are subject to special regulation because of their size, enforced rules governing the structure of holding companies, limited total shareholdings of other domestic companies, limited loan guarantees within a group, restricted how financial affiliates in a group could vote shares, and policed "undue" transactions within a group. The KFTC refined its approach in 2002, in part because reforms since 1997 changed *chaebol* structure and conduct. Provisions about the debt-equity ratio were dropped, while the KFTC's powers were extended to demand financial information from financial institutions concerning their customers' "undue transactions".

The ambitious "Three Year Market Reform Road Map" ("Road Map") that the KFTC issued at the end of 2003 demonstrates the continued high priority of the *chaebol* regulation function, while underscoring the progress made and the likelihood of major changes soon. A foundation of the plan is an index developed for the KFTC by the Korea Development Institute to measure transparency, fairness and competition of firms and markets in Korea. Transparency and fairness are assessed based on systems for monitoring management and corporate performance and on the gap between the "cash flow" rights and the voting rights of controlling shareholders. Competition is assessed based on industry concentration. Of the three principal sets of policy measures set out in the Road Map, the first two are devoted to issues of corporate structure and governance.

The first part of the Road Map is about changes to general corporate laws, to strengthen transparent and accountable business management by authorising class action suits about corporate and securities misconduct, strengthening auditor independence and accountability and minority shareholder rights, disclosing insiders' efforts to preserve their powers and preventing insiders from using financial affiliates to extend control. The second set of measures in the Road Map addresses the KFTC's own regulations of corporate structure, announcing changes intended to encourage the *chaebol* to adopt more transparent structures. In addition to requiring more disclosures about insider holdings

and transactions, the Road Map announced revisions to the system of policing circular intra-group shareholdings while making it easier for the groups to reorganise into conventional holding companies. The KFTC's regulation of total shareholding by the *chaebol* had been introduced first in 1987, to prevent insiders from extending control and inflating capital via complicated holdings among affiliates. The regulation prohibits affiliates of large business conglomerates (those with assets over KRW 6 trillion) from acquiring shares of other domestic companies in excess of 25% of the affiliate's net assets. The Road Map promises that firms could avoid this limit by improving their corporate ownership and governance structures. One measure of improvement is adopting sound systems for shareholder voting and director oversight. Alternative criteria for earning an exemption from the shareholding limit are transforming the group structure into a holding company, simplifying its ownership (to fewer than five affiliates) or reducing the gap between voting rights and cash flow rights. The last set of proposals in the Road Map is about more familiar competition policy topics, of eliminating anti-competitive regulations, doubling sanctions against cartels, streamlining merger review, facilitating private suits in competition cases and improving consumer protection oversight.

The KFTC's plan envisioned that simpler and more transparent structures would evolve from the *chaebols*' tangled webs of intra-affiliate shareholdings. The Road Map anticipates that the ownership structures would be holding companies, although the particular form would depend on each group's characteristics. For some, loose relationships might be maintained among more independent affiliated businesses sharing the same brand name, while others might be divided into smaller business groups or even dissolved completely into independent businesses. A justification offered for the plan was that improving transparency and fairness in corporate governance and ownership would make Korea a more attractive destination for investment. In announcing it, the KFTC indicated that part of the plan was to evaluate its implementation at the end of the three year period, with a view to revising or even ending this programme of direct regulation.

The promised review of the regulation of total shareholdings is underway. The KFTC and the Ministry of Finance and Economy are expected to report their findings and recommendations by the end of 2006, 3 years after the Road Map plan was proposed. The need for further KFTC oversight would depend, in part, on the capacity of corporate law and financial and securities regulators to deal with the problems that these regulations have addressed. Those capacities have expanded greatly since the crisis of the late 1990s. The KFTC notes that stronger securities market regulation and stricter observance of accounting standards might still miss some issues arising in non-listed companies, a category that includes a substantial proportion of the holdings in the principal business groups. Nonetheless, the KFTC is moving to withdraw from these responsibilities as Korea's corporate governance structure improves. The change is evident in the allocation of KFTC staff resources, where the staff that administers the regulation of cross-holdings among affiliates has been reduced to one 9-member team.

Another aspect of the KFTC's historic agenda of *chaebol* oversight, the investigation of "undue" intra-group transactions, is more closely related to conventional conceptions of competition law. It is also handled by different KFTC staff than the team that applies the regulation of cross-holdings. Subsidies in the form of transactions within a group on more favourable terms are conceived to present competition problems analogous to state aid subsidies. For example, the KFTC contends that if a firm should be liquidated according to market standards but an affiliated firm props it up, the result is anti-competitive because

entrenching inefficient large firms bars entry of potentially more competitive small ones. The Supreme Court has recently underlined this connection, by requiring that KFTC enforcement decisions demonstrate how the undue transactions had an anticompetitive or unfair effect.

Box 3.1. **The *chaebol* issue**

"*Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to 'efficiency' goals.*"

The 2000 *OECD Review* recognised the KFTC's longstanding position, that reducing the power of the chaebol and correcting the distortions of competition that have been caused by their group structures must be a high priority and that this task cannot be understood solely in terms of conventional competition policy categories. To link the chaebol policies with the usual conceptions of competition policy, the KFTC has contended that greater transparency will lead to broader, more stable capital and factor markets, supporting innovations in those markets that will encourage entry and adaptability in other markets. That is, correcting the problems of corporate and financial structure will lead to market behaviour that increases competition, even if the problems themselves are not usually conceived as results of particular constraints on competitive conduct.

The 2000 *OECD Review* noted that it would be appropriate to continue to focus attention on intra-group transactions that may have effects on competition in markets. The KFTC observed then that close supervision of "undue" transactions was a temporary, transition tactic, to help ensure that capital markets develop and function. The 2000 *OECD Review* argued that reforms of corporate governance and prudential supervision, as well as market openness, are the better means in the long run to deal with major *chaebol* issues. The analogy between "undue" intra-group transactions and anti-competitive state aid was more apt when it appeared that the *chaebol*, or some of them, would be treated as too big to fail. In the absence of implied government support for the supposed subsidies, there should be a stronger presumption that transactions will be subject to the discipline of market forces, even within a group – although controlling shareholders may nonetheless try to escape that discipline. KFTC monitoring in the absence of any such implicit guarantee is reminiscent of older styles of regulatory intervention, such as control over firms' investment decisions and adherence to consensus price levels. Suspicious intra-group transactions may involve unfairness or something like predation, but more often the real problem is misappropriation, breach of fiduciary duty or embezzlement. KFTC enforcement actions against clearly identifiable threats to market competition are of course necessary, but actions may fail where they aim at corporate misconduct that is not actually anticompetitive.

The KFTC contends that the other aspects of its unusual enforcement agenda are consistent with reliance on markets for growth and efficiency, because transparent structures and fair competition support confidence in market transactions, thus encouraging the flow of resources into productive uses. That general "dynamic efficiency" motivation is undermined by some of the rules' constraining effects. For example, concerns have been expressed that the ceiling on *chaebol* shareholdings (a rule that is aimed principally at curbing "circular" shareholding structures) may make it more difficult to set up large-scale projects that require teaming substantial Korean firms as strategic investors with substantial foreign investors; however, the KFTC has not found any instances of projects that could not be done for this reason. The KFTC has also defended its attention to corporate governance and shareholding matters on the grounds that corporate, financial and securities laws and regulatory institutions were not established well enough to do the job adequately.

Box 3.1. **The *chaebol* issue** *(cont.)*

Opaque corporate structures needed to be cleared up, because they allowed financial leverage at a scale that undermined stability. To do that task, the KFTC was more independent and effective than the existing financial regulators. But there have been numerous reforms to improve corporate governance, financial soundness, and transparency since 1997. Other enforcement agencies, notably the Financial Supervisory Commission and the Financial Supervisory Service, which were created in 1998, are in place to deal with problems related to corporate financing. Supervisory functions related to shareholdings and guarantees and intra-group transactions that amount to misuse of corporate assets should be concentrated in regulators responsible for financial and securities matters, while transactions that have an exclusionary or distorting effect on product market competition in particular cases should still be subject to competition-law control.

Changes in the KFTC's policies and in the financial situations of the *chaebol* themselves suggest that the long run will arrive soon. Measures of financial balance have improved significantly. The KFTC is evidently stepping back from its strategy of broad dragnet investigations. The "Three-Year Market Reform Roadmap" has offered the *chaebol* incentives to improve their corporate governance practices and ownership structure. Specific criteria allow companies to graduate from the regulations on total shareholdings, and firms that improve their governance and structure will no longer be subject to special regulations.

Horizontal cartels are now the top enforcement priority, despite the lack of a clear *per se* rule against horizontal price fixing. Changing the relevant language in Article 19 of the MRFTA in 1999, from whether a restriction is "substantial" to whether it restricts competition "unfairly", was intended to achieve a *per se* approach. The FTC's *Guidelines* about cartels contend that no market analysis of effects is needed in particular cartel cases, since cartels reduce competition inherently. Agreement is all that is needed to establish a cartel. But the Supreme Court, in a January 2005 ruling, rejected a strict *per se* rule and suggested that courts consider factors that could mitigate anticompetitive effects. The KFTC is pursuing amendments to the MRFTA to clear up this uncertainty about the scope of proof that is needed. Despite those uncertainties, the KFTC has scored several successes in price fixing and boycott cases. In two investigations in 2003, 7 major cement firms and their trade association were assessed surcharges of KRW 26 billion for conspiracy, group boycott and price fixing, and manufacturers of iron bar were assessed surcharges of KRW 79 billion for agreeing to boycott tenders in 2001 and 2002 and for price increases in early 2003. In both cases, several of the parties were also referred for criminal prosecution. In 2002, the first international cartel was caught under the MRFTA, as the KFTC imposed surcharges of KRW 9 billion on six manufacturers of graphite electrodes. These sanctions were affirmed on appeal in August 2003. Important cases in 2004 targeted prices for car batteries and apartments. In 2005, the KFTC imposed the highest surcharge to date on a single firm, KRW 115 billion, against an agreement to limit price competition between telephone companies.

The telecoms case shows the KFTC's stern view of claims about "administrative guidance." The KFTC's *Guidelines* about collective action warn that conduct which is not legitimately taken pursuant to the authority of statutes or secondary legislation risks violating the MRFTA. The KFTC had previously taken corrective measures against

agreements in beer, pesticides and property insurance that the parties had claimed were authorised by administrative guidance. A KFTC case in the 1990s, involving bathroom tissues, challenged several sequences of parallel price changes that followed administrative guidance admonishing the industry to cut prices. In the recent telecoms case, the firms claimed that guidance from the Ministry of Communications had supported their limits on price competition when reforms introduced number portability. But the KFTC rejected that excuse, finding that whatever guidance the Ministry gave was not related to their restraint. The Ministry confirmed during the KFTC's proceeding that it did not issue an instruction such as the companies were claiming. The MRFTA provides for the possibility of exemption, for agreements about industry rationalisation, research and development, restructuring, rationalisation of trading terms, responding to economic depression or enhancing competitiveness of small enterprises. But since 1999, the KFTC has not approved (that is, exempted) any cartels under this authority; some arrangements that favour small businesses are based on other legislation, discussed below. A 20% market-share threshold in the KFTC *Guidelines* provides a "rule of reason" safe-harbour for non-hard core agreements.

Resale price maintenance is generally prohibited, although limits on maximum resale prices are allowed for "justifiable reasons". The law still includes a provision for setting resale prices for publications and some other products, but this provision depends upon prior designations by the KFTC. The KFTC has designated literary works that are eligible for resale price maintenance, but it has not made the required prior designations for any other products. Most other competition issues arising in distribution are covered by the KFTC's application of MRFA Article 23 on "unfair business practices", as elaborated by enforcement guidelines issued in 2005. Those guidelines treat some kinds of conduct covered by Article 23 as restrictions on competition, and provide that such conduct will not be considered to violate the law if the party setting the restraint has a market share below 10%. This rule of thumb shows the connection between these rules and principles about abuse of market dominance. In addition, Article 23 also addresses unfair competition and taking advantage of bargaining power, that is, economic dependence.

In dealing with dominant firms and mergers, the traditional structural approach is shifting toward greater emphasis on economic analysis of particular market situations. The definition of a market dominant enterprise is general, that is, one that has the power to determine prices or terms, individually or jointly with others. Whether a firm is dominant is determined by examining market features such as entry barriers and market share. A *de minimis* threshold prevents finding dominance for a firm with turnover in a market below KRW 1 billion. The law also includes a structural test, presuming dominance from a market share of 50% or a combined share of 75% or more for the top three firms (not including any firm whose share is below 10%). The KFTC's criteria for assessing dominance also include entry barriers, the relative sizes of firms and the possibility of collusion among them, differentiation from other products and markets, foreclosure, financial capacity and technological prospects. In cases about abuse of dominance, the KFTC has always found dominance where the market share presumptions were met. Some mergers, however, have been permitted to proceed even though the firms' market shares exceeded the threshold for dominance. In several cases, the KFTC has found joint dominance where the industry concentration fell below the level of the statutory presumption. In a step away from an overtly structural enforcement approach, though, the KFTC no longer maintains a listing of dominant firms subject to particular scrutiny. Claims about predatory low pricing are

Box 3.2. **Dominance and mergers**

"The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered."

The *2000 OECD Review* observed that essentially the same structural standards were used for cases of abuse of dominance and for merger analysis. But correcting an existing situation may present different issues than preventing new problems. In addition, over-reliance on market-share criteria in both settings may inhibit sensitive application of policies motivated by efficiency.

The same basic structural test is still used for cases of dominance and for mergers. The structural test for presuming a market dominant position, in Article 2(7), also supports a presumption that a merger will restrain competition (Article 7(4)(1)(a)). The merger control part of the law has an alternative structural criterion, presuming an adverse effect if the merging parties would have the highest share in the market and that share would be 25% greater than the next largest firm. The differences between cases about abuse and review of mergers are evidently not considered significant enough to warrant more discriminating treatment, and the KFTC finds that examining other economic characteristics of the markets at issue can support appropriate differences in dealing with these situations.

subjected to the sceptical "recoupment" test, that the predator be able to recover its losses by raising prices free from the challenge of competitive re-entry. Since 2001, denial of network access has been defined in the law as an abuse of dominance.

The KFTC has taken enforcement action against abuse of dominance on only a few occasions. Activity may increase in the future, as priorities shift toward greater emphasis on standard antitrust matters. A notable recent example is the 2005 decision against Microsoft for tying its media player, media service and messaging to its operating systems. The KFTC decision noted the "tipping" effect that followed from the positive network externality due to Microsoft's very high market shares in PC and server operating systems. In addition to paying an administrative fine of KRW 32.5 billion, Microsoft must offer versions of its operating system from which the tied products are unbundled. A special team to keep abreast of emerging issues involving competition and intellectual property rights was set up in late 2005 in the wake of this complex proceeding.

Merger control is moving beyond structural presumptions. The substantive standard for merger control is whether the transaction would substantially lessen competition. The statute backs up this standard with presumptions based on market share. In practice, the structural standards are not conclusive, for the KFTC also considers the likelihood of entry and particular aspects of the market situation that affect the likelihood of a reduction of competition, either through unilateral conduct or co-ordination. The KFTC has declined to take action despite market shares above the threshold level in a market for intermediate technology components because overcapacity and the threat of foreign entry reduced the risk to competition; conversely, the KFTC has required corrective measures where shares were below the thresholds but where the circumstances and the enforcement record of the industry, steel, showed a propensity to collusion or single-firm market power. There is no provision for overriding KFTC decisions on mergers, or on anything else, based on other policies, and policies other than competition are not considered at the KFTC. Remedies may be both behavioural and structural. Responding to a combination in late 2005 that

eliminated potential competition between the top brand names in beer and *soju* (rice wine), the KFTC imposed a hold-separate order and price controls.

The merger review system has been updated to bring Korea's system more closely into line with merger review systems in most other member countries. Pre-notification is now required for mergers or acquisitions by a firm with assets or annual turnover in excess of KRW 2 trillion. Notification must be made within 30 days after the firms reach agreement, and the deal may not close before the KFTC finishes its review. The normal review period of 30 days can be extended up to 90 days. Post-transaction notification is required for mergers or acquisitions by a firm with total assets or annual turnover in excess of KRW 100 billion. But no notification is needed in either case if the acquired firm's assets and or turnover are below KRW 3 billion. As of June 2003, rules about the notification of foreign acquisitions were modified, by setting a test based on sales in Korea (of KRW 3 billion for each party) in order to distinguish those that are less likely to have effects in Korea.

Rules that protect small businesses from unfair practices, particularly in relationships with suppliers and between contractors and subcontractors, still represent a significant component of the KFTC's workload. Some of these rules are in the MRFTA itself, and some are in separate legislation, such as the Fair Franchise Transactions Act and the Fair Subcontract Transactions Act. The Subcontract Act prohibits unreasonable delays or reductions in payments and other unreasonable practices. There is a *de minimis* standard, which confirms that the principal motivation of these rules is protection of equality of bargaining positions: the rules do not apply if the contractor is no more than twice the size of the subcontractor (in terms of turnover or employees). It also does not apply to small businesses, which are defined for these purposes in terms of turnover: below KRW 1 billion for services, KRW 2 billion for manufacturing and repairs, and KRW 3 billion for construction.

The KFTC also defends consumers' interests in marketplace integrity by applying rules against unfair marketing practices and misrepresentation. That role may soon become more important. Here too, some rules are found in separate legislation, such as the Fair Labelling and Advertising Act and other statutes about door-to-door sales, instalment transactions, contracts of adhesion and electronic commerce. The 2002 law about e-commerce followed the OECD's 1999 guidelines on the subject. The KFTC is encouraging a shift away from the traditional emphasis that treats consumers as in need of government protection, toward a view that the direction of the market is determined by informed consumer choice. In addition to its own enforcement functions, the KFTC has other opportunities to advance this integration of competition and consumer policies. The KFTC is a member of the Consumer Policy Deliberative Committee, set up under the Consumer Protection Act to co-ordinate policies about consumer interests that are implemented in sectoral laws and regulations. Historically, the KFTC has collaborated with the Consumer Protection Board and NGO consumer organisations. The relationships will become even closer with the implementation of a restructuring plan that was under consideration in mid-2006. Under this plan, the KFTC would have the authority to manage and supervise the Consumer Protection Board, and it would share the "executive secretary" function for the Consumer Policy Deliberative Committee with the Ministry of Finance and Economy. The Consumer Protection Board would thus become an affiliated organisation with the KFTC. This could lead to co-ordination of both policies and enforcement tools. Claims about consumer injury, now often resolved by non-binding settlement agreements, could be backed up by KFTC sanctioning powers against violations of labelling laws or the MRFTA's provisions about unfair competition, while the Consumer Protection Board's work about product safety could

follow the KFTC's emphasis on consumer information. The Consumer Protection Board will remain a separate, independent agency, and the basic enforcement tools and responsibilities would remain in place. Smaller cases will still be handled by mediation, while the KFTC might take an initiative on larger matters with market-wide effect.

Institutions and enforcement processes

The KFTC is one of only a few independent agencies in the Korean Government. Independent regulatory bodies deal with broadcasting and the financial sector, while the bodies responsible for energy and telecoms regulation have less autonomy from their ministries. The KFTC tends to reinforce its independence through long-term autonomy in the choice of personnel. The five full-time "standing" commissioners have usually been KFTC veterans, while the four "non-standing" commissioners have often been law or economics professors. In a variation from the traditional pattern, the current chair and his predecessor have been professors from outside the government. The overall staff level has increased substantially, from 413 in 2000 to 484 in 2005. About 25% of the staff and budget are devoted to enforcement of laws about subcontract rights, unfair contract terms and consumer protection.

The KFTC staff was reorganised in 2005 to address new priorities. As the KFTC de-emphasises *chaebol* regulation and wide-ranging investigations of their internal transactions, its bureaus have been restructured into the Competition Law Enforcement Bureau and the Cartel Investigation Bureau. The needs for consistency and specialised legal and economic expertise in enforcement are addressed by the newly reinforced Litigation Team and Economic Analysis Team. Two other teams were set up for emerging competition issues and advocacy. The OECD Regional Centre for Competition in Seoul, operated in conjunction with the KFTC, could be a resource for improving staff analytic skills.

Most competition complaints to the KFTC are about abuse of dominance and refusal to deal (although the largest share of total complaints is about unfair practices), but most of the enforcement attention has gone to collusion and, until recently, to *chaebol* issues. The targets of the KFTC's priority-setting "clean markets" project have been mostly in services. In 2001, the industries chosen were telecoms and broadband Internet service, medical services and pharmaceuticals, wedding and funeral services, construction materials and apartment and office rents, media, and school uniforms and private institutions. In 2002, they were LNG-LPG, credit cards and insurance (other than life insurance), Internet shopping, real estate agents and home maintenance services, job referral, and private instruction institutions. And in 2003, similarly, the targets were electric power, instalment finance and banking, Internet shopping, real estate services, advertising, and professional certification. The "clean markets" campaigns produced a surge in complaints, which tripled between 2000 and 2001, from 1 576 to 4 791. The number of matters resulting in financial sanctions also increased, although not as dramatically. The total sanctions imposed has varied greatly, from KRW 225 billion in 2000 to KRW 36 billion in 2004 and then back up to KRW 249 billion in 2005. One reason for the lower total in 2004 was that the KFTC shifted enforcement attention toward firms that deal directly with consumers, which are often smaller, while the telecoms price fixing case explains much of the higher total in 2005. Over the period 2000-2004, about 10% of the KFTC's enforcement actions stronger than a warning were against concerted practices, that is, on average about 40 out of an annual total of about 420. A much larger proportion, over 180 annually, dealt with "unfair business practices", which can include refusal to deal,

elimination of competitors, coercion and resale price maintenance, as well as "undue" support. But in the aggregate, the financial penalties have usually been concentrated on cartels. Surcharges against concerted practices in this period averaged about KRW 83 billion annually, about twice the total against "unfair business practices" at about KRW 42 billion. In 2001, though, the total against unfair practices and undue support, of KRW 121 billion, was substantially more than the total against cartels, of KRW 24 billion. The number of cases about labelling, advertising, contracts and subcontracting is nearly 6 times greater, averaging about 2 350 per year, but the sanctions imposed are usually insignificant. In 2002, though, sanctions against advertising and labelling violations totalled KRW 5 billion.

Notices and guidelines explain the KFTC's policies and analytic methods. Subjects addressed include abuse of dominance, cartels, approval of concerted actions, unfair practices generally, undue supportive behaviour, unfair practices concerning gifts and large retail stores and newspaper business. They are published and posted on the KFTC website. Most are available only in Korean. Decision documents are to be issued within 20 days, and they are posted on the KFTC website. The KFTC is moving toward a more transparent process for preparing decisions. A "deliberation preparation process" has been instituted, to give staff and the respondents the opportunity to contest each others' arguments and evidence (in writing) in advance of any formal hearing at the Commission.

The KFTC's investigative powers still need to be strengthened, to target conduct that parties would prefer to conceal. Difficulties have been encountered in investigations of cartels and of compliance with *chaebol* regulations. The sanction for non-compliance with investigation is an administrative fine. Although stronger sanctions can now be applied to discipline non-compliance with orders and investigations, the basic information gathering powers remain ones that were originally designed for voluntary processes. The KFTC cannot perform a "dawn raid" to search premises and take possession of evidence. Administrative law enforcement bodies that deal with labour, tariff, environment, and tax compliance have such powers, as does the prosecutor. To make the KFTC's administrative enforcement more effective and obviate the need to resort to criminal processes for inappropriate reasons, the KFTC needs such compulsory investigative powers.

A leniency programme has been in place since 1997. The leniency programme was refined in 2005, to make clear the promise of complete leniency for the first party to come

Box 3.3. **Investigation powers**

"*The KFTC's powers to obtain information in investigations may need to be strengthened, so there is less need to refer small matters for criminal prosecution.*"

The *2000 OECD Review* noted that measures that might be considered could include the power to seek a court order for access to documents or information.

So far, the only concrete step was to authorise higher fines to punish non-compliance with administrative orders and processes. The amendments to the MRFTA in 2001 raised the maximum fine for this from KRW 10 million to KRW 50 million for an individual, and from KRW 100 million to KRW 200 million for a corporation. It is not clear that this step has made very much difference yet in practice, though. On 3 occasions in 2003, after this increase, firms decided to pay the fine rather than comply with the process.

in (and 30% off the surcharge for the second). A regulation assures applicants of confidential treatment. The programme now includes "amnesty plus", an additional benefit for revealing another cartel, and a "marker" system to encourage rapid action. The improvements produced immediate results. The KFTC had received 7 applications between 1999 and 2004 under the previous programmes, but 11 cases were treated with leniency in 2005 after the changes became effective. The recent telecoms case followed a leniency application, which led to a 49% reduction in the surcharge that would have applied. So far, the leniency programme has promised reductions in administrative fines and corrective measures. Proposed amendments to the MRFTA would offer a reduction of criminal penalty as an additional incentive. In addition to the prospect of a lower surcharge for the corporation, the KFTC programme has a "whistleblower" component, offering a positive inducement to encourage individuals to come forward. Similar rewards to informants are found in other areas of law enforcement in Korea. An informant can be paid a proportion of the surcharges that are eventually assessed. This programme too was not very successful when it was first launched in 2002. With a low reward and little protection of the informant's identity, it produced only about one lead per year. In November 2003, the ceiling on the bounty was increased to KRW 100 million, and up to KRW 1 billion for information about cartels. Measures were also introduced to protect informants' identities. These changes led to a record reward in case about welding rods, another case about Internet cafes and several matters that are still under investigation. These "whistleblower" rewards are available not just for cartel cases, but also for other parts of the KFTC enforcement agenda, including unfair competition issues involving department stores and newspaper discounts.

Another innovative detection tool is the Bid Rigging Indicator Analysis System, which the KFTC set up at the end of 2005 to uncover cases of collusion in procurement. The KFTC obtains information about public bidding processes from the national procurement office's electronic bidding systems. The KFTC focuses on tenders for construction contracts worth over KRW 5 billion and tenders for products or services worth over KRW 2.5 billion. It analyses six criteria, including the ratio of the winning bid to the estimate, the number of bids, any pattern of unsuccessful bids and the number of failed bids transferred to private contracts. Some cases are already under investigation. To introduce the BRIAS system, the KFTC presented a briefing about the programme to about 100 procurement office officials.

A programme to encourage firms to adopt formal compliance programmes was introduced in 2001. The KFTC enlisted a Committee on Compliance for Fair Trade, led by the chairman of the Korea Chamber of Commerce and composed of business and academic representatives, to help plan and publicise this programme. As an inducement and incentive for firms to establish compliance programmes, the KFTC promises that their surcharges will be reduced by up to 20% (and up to 40% if they also correct the violation themselves) and that complaints against them will not be filed with the prosecutor; however, having a compliance programme is not considered a mitigating factor in hard-core cases. Over 250 firms set up programmes by the end of 2005.

Corrective measures can include orders to take specified actions, such as to initiate a transaction or terminate an agreement, as well as orders to cease violations. Orders can also require notification to the public or customers and reporting to the KFTC. The KFTC issued a guideline in November 2005 setting out its policies for employing these corrective measures. An obvious application of an order for specific performance would be in a dispute about denial of access to a network or essential facility.

The basis for computing administrative fines, or "surcharges", was expanded in 1999. That change, combined with stepped up enforcement, greatly increased the sanctions actually imposed against competition violations. Yet provisions for financial sanctions were still less stringent than in most other member countries. The ceiling on the administrative fine was 5% of turnover (the annual average total turnover over the previous 3 years) or a minimum of KRW 1 billion, and the level actually imposed was typically about 2.5% to 3.5% of turnover. The amendments that took effect in 2005 doubled the ceiling for cartel fines, while changing the basis to the turnover affected by the violation. The basic surcharge level against cartels in Korea, 10% of turnover affected by the violation, is now similar to the newly revised basic surcharge level in Japan; however, in Korea the KFTC has some discretion in setting the actual surcharge imposed. That discretion is subject to guidelines that make the computation transparent. The 10% multiplier is comparable now to that used in most of Europe, but the resulting sanction may not be as stringent because the base could be smaller. Thus even the new level in Korea could still result in fines that are effectively lower than those in countries where sanctions are a percentage of total firm turnover, not just the turnover related to the violation. The surcharge can be increased up to 50% for repeat offences. Repeat offences are an increasing problem, as half of the complaints to the KFTC in 2004 were about non-compliance with KFTC corrective measures. The KFTC is finding it necessary to follow up, evidently because sanctions have not been fully effective.

Criminal sanctions are available but are still rarely applied. Individual executives may face criminal punishment in Korea for antitrust violations. In case of a violation by a trade association, surcharges can be imposed on the members who participated in them. Individuals who are managing directors or executives can be held criminally responsible for violations by their firms. A recommendation from the KFTC is generally required to initiate a prosecution. The Ministry of Justice has proposed that its prosecutors have the power to initiate competition cases on their own. The KFTC has been concerned that prosecutions applying a purely criminal law perspective, without its economic input, could impair competition. The Ministry of Justice, on the other hand, has resisted giving the KFTC stronger investigative powers as long as the KFTC has a monopoly on initiating prosecutions.

The courts' reluctance to support stiff sanctions against business violations and white-collar crimes may be changing. Since 2000, sentences of imprisonment have been imposed in 6 competition cases, but in 5 of these cases the sentence was suspended, and in the other, the court suspended service of the imprisonment. No one has yet spent any time in jail for violating the competition law. The prosecutors, conceiving of cartels as economic crimes, did not demand high fines. That history has become an issue of public debate. The Minister of Justice and the Chief Justice of the Supreme Court both called attention to the lower courts' unwillingness to impose heavy white-collar sentences. In the judiciary's non-binding guidelines about sentencing, the ceiling on penalties for white-collar crimes has been raised.

Judicial familiarity with economic issues is improving, but a proposed procedural reform may interrupt that progress. Appeal from decisions of the KFTC can be taken to the Seoul Regional High Court, with a further appeal possible to the Supreme Court. (There is also a provision for an internal appeal at the KFTC, which results in re-examination by the General Counsel and a consideration by the full Commission, but that step is not a prerequisite to an appeal to the courts). Two special 3-judge panels of the Seoul High Court specialise in KFTC cases. Judicial capacity to deal with economic issues is improving as the

subject is becoming more familiar, in practice and in legal education. The Seoul High Court can retain its own economic expert, and it has done so on occasion. The Supreme Court has added an antitrust expert as a research counsel. Pending legislation would change the process for appeal from KFTC decisions to make it conform more closely to the usual steps for judicial review of government agency decisions. Under the usual system, the first judicial step is the administrative division of the district court, as a court of first instance. Under the proposed legislation, the first step for appeals from KFTC decisions would be to the separate Seoul Administrative Court as a court of first instance, with further appeal to the Seoul High Court. The proposed change, although consistent with the usual administrative appeal process, would give up the concentration of expertise that has developed at the Seoul High Court. The usual review process is reasonably efficient. The administrative division of the district court finishes half of its cases in 6 months. The High Court handles most appeals in 6 months to a year. At the Supreme Court, most administrative cases are completed within 6 months, but competition cases often take up to 2 years. That period is expected to decline as the Supreme Court strengthens its capacity for these cases. The rules provide for a "fast track" for some important matters. The

Box 3.4. **Private actions and lawyer quotas**

"*Strengthening rights of private action should be considered.*"

To apply more resources and expand the base of support for competition policy, the 2000 *OECD Review* concluded that strengthening rights of private action should be considered, taking into account the characteristics of Korea's legal system. Measures could include easing the proof of damages in competition cases or facilitating consumer and customer recoveries in price-fixing cases. The quota on new lawyers should be eliminated.

Private suits for damages, following KFTC enforcement, were already possible under the MRFTA. Plaintiffs can also claim damages under the general provisions of the Civil Code, but in Civil Code suits the plaintiffs have the burden of showing intent or negligence. In private cases following KFTC action under the MRFTA, the defendants have the burden of showing the absence of intent or negligence. In 2004, the MRFTA was amended to permit private actions for damages without waiting for the KFTC's final decision. Another aspect of the amendment's effort to make private actions more attractive was to overcome the courts' insistence on detailed proof of the amount of damage. As of 2004, there had been about 30 private cases claiming damages, and the plaintiffs had apparently gotten some relief in about half of them. A recent and prominent example followed the KFTC's case imposing surcharges of KRW 11.5 billion for fixing prices of school uniforms, and recommending prosecution as well. About 3 500 customers filed lawsuits, and damages were awarded in June 2005. Outside of the area of competition violations, some big private suits have been filed to recover consumer damages in e-commerce.

Private actions for injunctive relief are not yet provided, but the KFTC is considering amendments to the MRFTA that would do so. Another, indirect avenue for relief is available, at least in theory: if the KFTC has declined to initiate a case or has decided there was no violation, this can be the subject of a complaint in the Constitutional Court. The *2000 OECD Review* observed that creating a general right to challenge KFTC inaction in the ordinary courts, though, could require a more significant change in Korean law.

The legal profession is being allowed to expand. The ceiling on the number of new lawyers admitted each year was raised from 300 to 1 000, and a plan is under consideration to open a law school in 2008 to provide an alternative means of entering the profession.

number of administrative cases increased 30%, to 12 000, between 1998 and 2004, but the greater workload did not slow down the process significantly.

Coverage, sector regulation and policy advocacy

The scope of exemptions from competition law is now limited. Government entities are subject to the same rules as private enterprises. This equal treatment applies to *chaebol* regulation too, as large government-related entities have been designated as groups whose transactions are regulated, and the KFTC fined several of them for undue transactions and abuse in relationships with contractors. Claims that anti-competitive conduct is authorised by official action are treated sceptically. Conduct following discretionary administrative guidance that is not backed explicitly by statute is not exempted from the MRFTA.

Some sectors are still protected or controlled to some extent. Liner shipping conferences are exempted by special legislation on the grounds that they are "internationally recognised" cartels. Minimum resale price maintenance, which is normally prohibited *per se*, is permitted for literary works. Collaboration is permitted through producer co-operatives in agriculture and forestry, and through contracts between ginseng farmers and processors, in order to strengthen the negotiating position of atomised producers. Other protections have been eased. Tobacco production is subject to a permit system, which replaced the state monopoly in 2001, and prices are no longer subject to government approval, although they must be reported to the government in advance. Some agreements that are exempted from the MRFTA, because they have little competitive impact or even a net economic benefit, include joint establishment of telecoms facilities by key providers and joint purchase and allocation of equipment in maritime transport.

Most remaining exemptions were eliminated by the Omnibus Cartel Repeal Act of 1999. For example, this law revised a provision allowing premium-fixing by insurance companies, limited co-ordination directives to cases of compliance with inter-governmental agreements or export of military equipment, and abolished government co-ordination of bidding competition for overseas construction projects and territorial allocation of unsterilised rice wine. The law ended fee-setting arrangements for a number of professional services: lawyers, certified public accountants, architects, certified tax accountants, patent attorneys, customs brokers, certified labour services, administrative recorders and veterinarians. Previously, professional associations would set fees, which would then be approved by the relevant ministries. After this practice became illegal, the KFTC reported that fees declined significantly in the affected sectors. But some professions resisted the changes and even succeeded in having them reversed. The restriction on fee-setting for architects was reintroduced in 2001, although it takes the form of direct notification by the government rather than delegation of the power to the professional association. For notaries and engineers, too, fees are set by regulation rather than by market competition. In 2003, five professional services (lawyers, certified public accountants, architects, certified tax accountants, and judicial recorders) were included in the KFTC's Clean Market Project for close scrutiny, following enforcement action against some associations, including the certified public accountants, and a KFTC inquiry into professional fees which revealed that liberalisation had not reduced overall fee levels, though it had led to more differentiation based on the type of service.

Eliminating competition constraints in professions and services remains a challenge. The number of new lawyers permitted to enter each year has risen from 300 to 1 000. New forms of practice are now authorised, for domestic lawyers. Restraints on lawyers' advertising were relaxed. A law school is planned, but it will not open until 2008 or 2009. Decisions yet to be made by the Ministry of Justice about the size of the eventual graduating class from that school will have an effect on any decisions to lift further the ceiling on the number of new lawyers. Proposals to make it easier for foreign lawyers to provide services to clients in Korea, by setting up branch offices, forming joint ventures with Korean firms or employing Korean or foreign lawyers, remain under study. The law restricting operation of pharmacies to pharmacists operating as natural persons was struck down by the Constitutional Court, so the legislature is considering permitting pharmacies in corporate form; however, permitting a pharmacist to operate more than one pharmacy and permitting corporations not composed of pharmacists to operate pharmacies are not being considered.

Other regulators are involved in the network industries, where the KFTC also can apply the competition law. About some subjects, including mergers, business transfers, and access to essential facilities, the relevant ministry and the KFTC are required to consult in order to avoid potential conflicts. The KFTC has not invoked the "essential facilities" doctrine to decide access disputes. In practice, the KFTC and ministries have shared responsibility, with the KFTC accountable for competition issues and the ministries accountable for technology issues. The Financial Supervisory Commission shares responsibility for handling mergers in the industries it covers. It would normally heed any KFTC objections on competition grounds, but it not required to accept the KFTC's views. Although relations among the regulators have generally been smooth, there have been some tensions, which can expose companies to uncertainty. For example, in insurance, where the Financial Supervisory Commission was concerned that excess competition would undermine financial soundness, the KFTC warned that co-ordinating marketing of offers of free services would amount to an illegal cartel. In cable television, the Korean Broadcasting Commission encourages mergers to monopoly within service territories to achieve economies of scale, but the KFTC, concerned about regional market power, has imposed conditions such as information disclosures and limits on price increases.

In telecoms, the most prominent competition matter was the 2005 price fixing cases. Much of the KFTC's other enforcement action in the telecom sector has been *chaebol* regulation. Among the 36 enforcement actions that the KFTC took here between 2003 to 2005 were surcharges of KRW 640 million against LG Telecom for coercing or inducing customers of competitors, KRW 5.1 billion against SK Telecom for undue support for its affiliates, and KRW 740 million against KT for violating the limit on shareholding in other domestic companies. The KFTC and the Ministry of Communications entered a Memorandum of Understanding in March 2001, to ensure that overlapping jurisdiction would not lead to dual penalties. That is, if the Ministry imposes a fine in applying telecoms regulation, the KFTC cannot act in the same matter. For example, in 2005 the KFTC investigated whether mobile carriers had prevented their subscribers from accessing competing portal sites over wireless Internet, but ultimately it took no action because the Korea Communications Commission had already determined this to be a violation of the anti-discrimination rules in the telecoms law. The memorandum of understanding focuses on access to essential facilities, recognising that for this issue the telecommunications legislation takes precedence over the competition law and providing that the authorities

will consult to prevent overlapping regulation. For other issues, the memorandum of understanding calls for discussion. In the price fixing cases, the KFTC rejected the firms' claims that the Ministry's guidance excused their conduct.

In electric power and gas, regulation has had less to do with competition law, though, because there is still little competition in these sectors. A 9-member regulatory commission for electric power was established in 2001, but because the extent of liberalisation remains limited, it is occupied principally with standard issues of public utility regulation of prices in a market that is still dominated by the historic monopoly, KEPCO. The generation function has been separated, but further reform in distribution and sales has stalled, partly because of concerns raised by events such as the California crisis. KEPCO divided itself into independent business units. These six KEPCO parts compete in the wholesale market, accounting for 90% of it. In addition, there are 59 other power

Box 3.5. **Small business protections**

"Eliminate protectionist measures that prevent potentially efficient competition in sectors reserved for 'small' business."

Such measures include rules that prevent entry, that reserve some aspects of government procurement to cartels of small businesses and that apply stricter structural tests to discourage large firms from acquisitions in the protected "small business" sectors.

The most significant of these prevents entry by larger firms in as many as 88 business lines. The Regulatory Reform Council decided in 2000 to reduce the number of protected small business sectors to 45 in 2001 and to 0 by 2004. The government's target now, under legislation adopted at the end of 2004, is to complete that process by 2007. Of the reserved sectors, 27 out of the remaining 45 were opened as of the end of 2005, and the remaining 18 are to be opened by the end of 2006.

The procurement cartel system may have a more limited effect on competition, since it does not prevent buyers from seeking sources other than the cartel, and permitting a degree of co-ordination among very small firms could help them achieve some efficiencies. The 1999 Omnibus Cartel Repeal Act as drafted planned to reduce the "collective free contract" system by 40% in 2000 and another 20% thereafter. But the legislature intervened and by an overwhelming vote eliminated the second stage. Nonetheless, the government still intends to eliminate this programme by 2007, and the necessary legislation to do so was adopted in 2004.

The rule discouraging large-firm acquisitions in sectors dominated by small businesses is still in the MRFTA, and there is evidently no plan to eliminate it. An acquisition by a large company of a firm with more than a 5% share of a market that is otherwise dominated by small businesses (that is, one in which small businesses account for more than two-thirds of the market) is presumed to restrict competition. This provision has never actually been invoked, but the KFTC believes that it retains some symbolic value as a protection of small firms against economic power.

Some special subcontracting requirements were not identified in the 2000 OECD Review. For about 22 sectors and about 800 items, in the shipbuilding, automotive and electric equipment industries, large firms are required to outsource. This regulation dates from the heavy industry era, when it represented a deliberate effort to build up a parts business. It may not be significant any more. The government wants to repeal these rules, while the small business association wants the repeal period to be stretched out.

generation companies, most of them co-generators or relying on new or renewable energy sources. Their production is mostly sold to KEPCO for transmission and retail sale, although there are some sales into the wholesale pool, and local sales have been possible in some districts since 2004. In theory, customers could purchase directly from generators, but only in excess of a high threshold, and there have been no such purchases yet. Thus the regulator has had no occasion to set a transmission tariff or handle disputes about access to the network. There is no retail price competition. A reduction in the outage rate over the last 3 years is some indication that these modest structural reforms have improved productivity and efficiency. The Ministry of Commerce, Industry and Energy is studying the post-separation performance to identify improvements in competitiveness and financial health. But a consultant's study of further structural reform in distribution, carried out pursuant to a joint labour-management-government consultation, concluded that the risks outweighed the likely benefits, so further reforms are likely to be limited. A privatisation proposal 3 years ago did not proceed because of adverse market conditions. Continued delay in privatisation is probably due chiefly to commercial factors. The government would like to privatise at least some parts of KEPCO to create a yardstick and encourage private participation in the market.

Natural gas monopolies are being phased out gradually. Most gas supply is imported LNG, and most demand (60%) is for households. There are 4 terminals, 3 of them owned by the historic monopolist, KOGAS, and one by POSCO. Legislation is in preparation to provide for third party access. In the meantime, POSCO has negotiated pipeline access to transport gas it has imported for its own account. Competition issues in this industry would be covered by the MRFTA.

The KFTC continues to be vigilant against anti-competitive regulation, reviewing about 400 items per year and submitting opinions concerning about 40 of them. The framework legislation about regulatory quality mandates competition review as part of regulatory impact analysis. The KFTC chairman is a member of the Regulatory Reform Committee, and senior staff are on its subcommittees. This process has been reasonably successful, but the KFTC continues to identify items for improvement. The 2003 round of review identified 174 regulations requiring attention, of which about half ended up being eliminated or significantly improved, through consultations with the agencies involved. In 2005, the KFTC reports agreements to eliminate or improve another 48 regulations.

Assessment

The 2000 *OECD Review* concluded that commitment to market principles at the highest political levels in Korea provided strong support for competition policies, for reforms of the financial sector and corporate governance and for opening markets to trade and lowering barriers to foreign investment. Korea had shown it was willing to rely on the market rather than the government to correct business failures. But the commitment was not equally strong everywhere. Policy implementation sometimes appeared still to resort to central controls, while industry reportedly received instructions through administrative guidance, which was typically unwritten.

The 2000 *OECD Review* noted the prominence of Korea's determined and pro-active competition policy institutions to underpin the consistency and sustainability of market-oriented policies. It described how the KFTC had become stronger and more active, imposing higher sanctions and turning to more sophisticated and difficult competition

enforcement problems. Further experience has confirmed these basic strengths and directions. The KFTC has exemplified strong independence in vigorously pursuing its reform plan despite opposition from the *chaebols*. Expert observers in Korea give the KFTC high marks for intensity and commitment. The recent reorganisation, with performance and results oriented management, encourages vigorous enforcement action.

The principal recommendation of the 2000 *OECD Review* was for the KFTC to shift its priorities and resources toward core competition problems related to efficiency goals and away from its historic focus on conglomerate financial structure and governance. The Annual Survey repeated this recommendation, emphasising more explicitly that financial and corporate affairs which do not have clear competition impacts should be handled by other laws and regulators. The KFTC's 2006 Policy Goals show that this shift is well underway. The KFTC's first goal for 2006 is to examine the results of its 3-Year Market Reform Roadmap and decide what, if any, new structure might be needed when those reforms are completed. This wrap-up is likely to conclude with a substantial retrenchment in this area of KFTC activity. The KFTC's other announced goals confirm that it is concentrating on more effective application of competition laws to improve efficiency and promote consumer interests.

The KFTC is examining its case handling and "hearing" procedures, to make its enforcement process more effective and also more transparent. Doubling the level of the basic administrative fine against cartels shows support for stronger sanctions. The broader sanction powers are now being tested, and it remains to be seen whether they will be strong enough to deter. The Annual Survey also called for better deterrence through such measures as credible sanctions against individuals.

To encourage the courts to support stronger enforcement against hard-core horizontal cartels, the statute should be amended to make it clear that they are prohibited without regard to claims about their supposed lack of significant effect in particular cases. The courts' reluctance to support a *per se* rule against horizontal cartels may be related to the increasing sanctions that would apply to them, and their reluctance to impose significant criminal sanctions may be related to uncertainty about how to characterise and treat this conduct. The amendment in 1999, which was intended to specify the *per se* treatment of horizontal price fixing, did not achieve that result. In law enforcement, the competition authority and the courts need to establish clearly a *per se* rule against hard-core horizontal cartels.

As economic analysis of markets has become a more important element of KFTC decisions, the recommendation in the 2000 *OECD Review* about uncritically using the same structural tests for mergers and abuse of dominance cases may no longer be very relevant. KFTC decisions often refer to analytical factors other than market share, and some merger decisions have declined to follow the usual market share presumptions. Some remedies in merger cases appear analytically awkward, though. Where sectoral regulation uses market share to identify something akin to "dominance", it is too tempting to use the same market share level as a benchmark for a merger order, without analysing whether capping shares might actually inhibit desirable competition rather than promote it. Requiring merged parties to maintain or limit their post-merger prices sends a confusing signal, too. Regulators may see nothing wrong with telling competitors to constrain their pricing if the KFTC's orders themselves constrain pricing freedom. It is important that the KFTC explain clearly how such rulings are expected actually to improve post-merger competitive

conditions in the markets affected. The KFTC's encouragement of company "compliance" programmes also sends a confusing signal about incentives. A firm should expect lower penalties, not because the KFTC will hold off when it is nonetheless caught violating the law, but through the reduced likelihood that there will be any violation to catch. The KFTC does not extend this promise to hard-core matters, and perhaps the inducement is intended to soften the edge of the remaining regulation about *chaebol* issues and to provide a margin of flexibility about complex monopolisation problems.

Stronger KFTC investigative powers, as recommended in the 2000 *OECD Review*, have been implemented only in part. Raising the administrative fine turned out not to be enough to get firms to provide sensitive information. Even after the increase, firms on several occasions decided that it was cost-effective from their perspective to pay the fine instead of comply. The KFTC needs the power to examine and copy evidence about possible MRFTA violations, that is, to conduct a so-called "dawn raid". More use of criminal sanctions in hard-core cartel cases, to make the threat of individual liability more realistic, depends on co-operation with the prosecutors. The terms of the MRFTA do not limit the application of criminal sanctions to hard-core cartel behaviour. Thus, to avoid excessive and inappropriate extension of criminal sanctions to other anti-competitive practices, the KFTC decides which cases to refer for prosecution. Refinement of the MRFTA provisions about criminal violations could facilitate co-operation with the prosecutors and thus strengthen enforcement against hard-core cartels.

The recommendation from the 2000 *OECD Review* to consider means of strengthening private suits has borne fruit, in measures to permit suits before KFTC action is completed and to facilitate proof of damages. Permitting private litigants to sue to obtain orders, as well as damages, is under study. Whether this will be a sound idea could depend on the capacities of the courts that will hear these suits. Proposals to change the system of judicial oversight of competition cases, to make it consistent with the administrative court review of ministry actions, could be a setback for sound policy, though. The independent KFTC is more like an adjudicatory body or first-instance court than a Ministry administrator. More importantly, the change would require recreating the Seoul High Court's accumulated experience and perspective about competition matters in the administrative courts.

The Annual Survey examined competition policy and sector regulation, while other chapters of the 2000 *OECD Review* dealt with telecommunications, which is also being reviewed in this monitoring process, and electric power, which is not. The Annual Survey noted that the conflict between industrial development and competition, which still exists in the ministries responsible for network industries, should be resolved by the establishment of sectoral regulators that are independent of ministries. This process should continue by removing remaining entry barriers and further increasing openness to international trade and investment. Setting up a sector regulator in telecoms has not ended all controversy, although the Memorandum of Understanding with the Ministry has cleared up many issues. In the most recent high-profile case, what was at stake was not the conceptually complex issue of network access and pricing, but agreements to stabilise prices among competitors vying for market position in new competitive circumstances. The claims, which the KFTC rejected, that ministry guidance should excuse this conduct reveals a continuing gap in appreciation about the roles of government direction, including administrative guidance, and competitive initiative.

Programmes to protect small businesses from competition were the principal subject of the recommendations in the 2000 *OECD Review* about the coverage of competition law. Decisions have been taken, and necessary legislation adopted, to eliminate the most important of these programmes by 2007. It is important to follow through. The legislature's intervention to derail the government's repeal plans in the last round demonstrates that it is not over until it is over. One special rule will remain in place, and it too should be repealed. The protectionist presumption against large firm acquisitions in markets dominated by small business has never been used. Justifications offered for this moribund rule include preventing the spread of "monopoly" by the entry of firms that are more efficient than the incumbent small businesses, and preventing the *chaebol* from expanding their business areas "indiscriminately". These explanations are patronising and even anti-competitive. The KFTC may have felt that retaining the presumption had some symbolic value, in preserving the image of protecting the weak against the powerful. It would be better, though, to permit open competition on the merits of efficiency. If large firms would indeed be less efficient in these markets, they would not enter or they would tend to fail if they tried. Meanwhile the prospect of entry could encourage smaller scale firms to adopt more efficient methods and organisation, while the prospect of acquisition by a larger firm could increase their value and improve their access to financing. The KFTC may review this rule in the course of its next project for improving the MRFTA.

Some anti-competitive constraints still apply in some professions. The 2000 *OECD Review* called for eliminating quantitative limits on entry into the legal profession, in part in order to supply the expertise to make the right of private action more useful. The cap has been raised but not lifted entirely. In addition, alternative means for entering the profession through law school are being pursued too. These are steps in the right direction, but they have not yet eliminated the reason for concern. It may be years before their effect will be felt in the professional services marketplace.

In assessing the impact of proposed regulations, the Regulatory Reform Commission pays particular attention to those that would explicitly restrain competition. But regulations that do not on their face restrain competition can nonetheless have a net anticompetitive effect. The OECD is preparing a draft manual for the analysis of the competitive impact of regulations, to be used in RIA programmes. The KFTC, which has long been active in advocating reform of anti-competitive regulations, could help establish a stronger foundation for the process of regulatory impact analysis generally in Korea by assisting in the final development of this manual. A "field test" by the KFTC could demonstrate how its methods apply to actual regulatory problems. In the process, other officials responsible for RIA could also learn more about the importance of identifying and correcting competition problems in regulatory proposals.

Joining the KFTC to the system for applying consumer law is a logical and valuable evolution of its role. Business representatives support stronger consumer protection; however, they have expressed some anxiety that the KFTC could use this role as a new outlet for attacking big business, now that its *chaebol*-regulation function may be winding down. Integration can make consumer policy more consistent with market competition and make competition policy more sensitive to effects on consumers. Competition and consumer policies are each concerned with making markets work well, not only to support competitiveness and efficiency but also to promote economic justice by securing opportunities for both producers and consumers.

Table 3.1. **Implementation of Recommendations from 2000 *OECD Review***

Recommendation of the 2000 *OECD Review*	Actions taken	Assessment and recommendations
Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to "efficiency" goals.	Reorganisation of the KFTC staff targets horizontal cartels and expands economic analysis capacity; the "three-year market reform road map" promises to reduce the priority of the non-competition aspects of *chaebol* regulation.	The KFTC is shifting priorities as recommended.
The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered.	The law is unchanged; decisions about mergers show flexibility in use of structural presumptions.	The evolution of more sophisticated analysis and decision practice makes it less important to revise the statutory language.
The KFTC's powers to obtain information in investigations may need to be strengthened, so there is less need to refer small matters for criminal prosecution.	Administrative fines were increased.	"Dawn raid" power is still needed.
[Annual Survey] Make the threat of individual sanctions more credible to ensure that it is an effective deterrent.	Criminal penalties are applied, lightly.	More use of criminal sanctions depends on co-operation with the prosecutors.
Strengthening rights of private action should be considered.	Amendments have permitted suits without waiting for the KFTC action and made proof of damages easier.	Adding private rights to seek injunctions could be considered, provided the courts hearing the cases have the capacity to reject abusive or frivolous suits.
Eliminate protectionist measures that prevent potentially efficient competition in sectors reserved for "small" business.	Most programmes are to be repealed by the end of 2006.	The unused presumption that discourages large-firm acquisitions in "small business" sectors should be repealed too.

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 4

Market Openness

Introduction and general considerations

The 2000 *OECD Review* evaluated the impact of domestic regulations, regulatory procedures and practices on the openness of the Korean market and made broad recommendations on how the potential benefits of market openness may be induced by further regulatory reform. The overall objective of the 2007 monitoring report is to discuss Korea's progress and the most relevant developments since the previous review.

Since the 2000 *OECD Review*, Korea has undertaken several institutional and policy reforms and achieved considerable progress in a number of areas. The Korean Government at a high level (policy makers) is firmly committed to regulatory reform with the objectives of creating a more friendly business environment, attracting more FDI and increasing market liberalisation. Notable achievements include improvements in its Regulatory Impact Assessment (RIA) mechanism, further engagement with the business community, and digitisation and automation of procedures in customs and public procurement, among others. The private sector openly acknowledges these and other regulatory reform achievements. However, some major issues still need to be addressed, and as discussed in the 2000 *OECD Review*, there remain problems related to the implementation of reforms.

In the government, there continues to be a general commitment towards regulatory reform and market openness. As suggested in the 2000 *OECD Review*, the Korean Government has made an effort to change the bad image among the public of imports, foreign firms and foreign investment. The economy in general seems to have become more receptive to foreign goods as can be seen in the considerable expansion of its import market. However, ordinary people do not necessarily see or feel the benefits from regulatory reform and, in terms of market openness, unfavourable attitudes and perception towards foreign investment, goods and companies continue to exist. It is certainly true that regulatory reform and market openness may not have immediate or tangible benefits for all stakeholders, and negative voices tend to come from those that benefited (or continue to benefit) from protective regulations and see regulatory reform as a threat to their interests.

The attitude towards reform and level of its acceptance within government is also not uniform and may vary from central to local government, and between the policy-making level and the enforcement or working level where contacts with the private sector generally occur. Attitudes of government officials may affect application and enforcement of regulations. While recognising that the Korean Government has made significant improvements in this area, some members of the private sector perceive that some officials sometimes tend to interpret and apply regulations more strictly or conservatively for foreign firms that they do for their Korean counterparts. Such perceptions, despite the Korean Government's efforts in this area, may be undermining its considerable efforts to promote inward FDI. The Ministry of Legislation has established a law interpretation and deliberation committee to solve difficulties caused by ambiguous interpretation of government agencies and in June 2006, it issued a law interpretation manual that contain

the process of dealing with law inquiries, interpretation method and actual Q&A cases. As a result, civil servants will no longer be able to give one's own interpretation on the law, if inquired by the public or companies, reducing the scope for subjective interpretation and application. The Korean Government will also continue with training programmes, while making more of an effort to change the mindset of the local governments and the lower level officials (see also section on transparency and non-discrimination).

An additional and very important issue that has drawn considerable attention from both public and private sectors recently is the need for comprehensive reform of the services sector, of which some areas are still closed and highly regulated (*e.g.* legal services). The government is committed to services sector reform and has endeavoured to open and deregulate its domestic services sector through FTAs and various deregulation initiatives. While some progress has been made (*e.g.* film sector), there is a general concern that implementing regulatory reform will be difficult because of the entrenched interests of the current services sector stakeholders.[1] The politically strong service providers, worker unions and business interests may hinder the deregulation and regulatory reform process.

Transparency and openness of decision making

Electronic procedures and enhanced transparency in customs and government procurement

Automation and electronic procedures have an enormous potential to enhance access to information and transparency in government procedures. With the e-government initiative, Korea has taken important steps towards this goal and has made notable achievements, especially in the areas of customs procedures and some areas of government procurement.

In the area of customs, the electronic clearance procedure has enhanced transparency, allowing business to track down every step of the customs process and reducing the scope for subjective assessments and corruption (see section on customs reform).

Likewise, in the area of public procurement, an integrated Government e-Procurement System (GePS renamed as KONEPS in July 2006) that enables all procurement procedures to be processed online has been introduced. This new system benefits from a higher level of efficiency and transparency. Bid results are opened online on a real-time basis, thus reducing the possibility of arbitrary decisions by public officials. The English version of the GePS was launched in November 2004 as part of the government initiative to ensure that foreign suppliers have convenient access to procurement information further enhancing transparency (see section on government procurement).

A new law, the Integrity Pact (enacted in 2003) aims to remove unfair practices in government contracting such as the offer and receipt of bribes and entertainment, and collusion among bidders. Contract officials and suppliers submit pledges in relation to the Integrity Pact to ensure they will not engage in any type of unethical behaviour. Specific reference to the Integrity Pact is also included in the contract terms in order to regulate the cancellation of a contract in the case of any violation. Violators may be banned from participating in bids, and such violators may also have to pay a "bid bond" for a period of two years even after the ban has been lifted. While the increase in penalties for bidding violations is a sign of notable progress, care should be taken so that banning companies from bids do not lead to a subsequent decrease in competition in the market.

Engaging the business community

The Government has engaged the private sector to shift from government-led reform to private sector led reform. The Regulatory Reform Committee (RRC), the Regulatory Reform Taskforce (RRTF) and the Regulatory Reform Office (RRO) are composed of government officials and representatives of the private sector, including academics and members of the business community. The inclusion of members of the private sector allows them to voice their opinion and engages them in the process. Also, to ensure that the opinion of foreigners is taken into account, representatives of business organisations like the American Chamber of Commerce (AMCHAM) and the Ombudsman for Foreign Investments were appointed as members of the RRC.

In April 2004, the Office of the Prime Minister (OPM) established the Business Difficulties Resolution Center (BDRC) to deal with claims and complaints from the private sector and, if applicable, to try to address the problems with the relevant ministries. On the basis of the information it receives from businesses (regardless of their nationality) the BDRC can re-examine regulations and make recommendations.

In 2005, the Office for Policy Co-ordination (OPC) within the Prime Minister's Office established consultation mechanisms with foreign business organisations in Korea including the AMCHAM, the European Union Chamber of Commerce in Korea (EUCCK) and the Seoul Japan Club (SJC). The aim of these consultations is to discuss regulatory and policy issues raised by foreign companies on a regular basis. Several ministries also engage in consultation efforts with the business community. For example, the Ministry of Finance and Economy (MOFE) holds regular meetings with AMCHAM and EUCCK to discuss economic policy and other important issues. MOFE and EUCCK also have regular working group meetings to address specific issues in various areas. Likewise, the Ministry of Commerce, Industry and Energy (MOCIE) consults directly with foreign businesses on specific issues and, when there is merit, it tries to address them with the relevant ministry or government agency.

In addition, foreign investors and business organisations like AMCHAM and EUCCK issue yearly reports detailing their policy concerns, comments and recommendations. The Korean Government is in continuous dialogue with these organisations so reforms in these areas are an ongoing process. Since the views and perceptions of the Korean Government may differ from those of business, it is not always possible or practical to address all the issues that the international business community perceives as a problem. Nevertheless, the government has made progress in addressing many of these concerns.[2] However some members of the international business community opine that improvements can still be made, especially in key areas and sectors such as *i)* agriculture, *ii)* local regulations, *iii)* standards, *iv)* labelling, testing and certification requirements, *v)* some taxes and tariffs, and *vi)* services.

The following table outlines some of the concerns of the EUCCK, AmCham Korea and the US-Korea Business Council in these areas.[3] They only present a qualitative indication of some concerns held by the international business community and, as noted above, these views are not always shared by the Korean Government, so no conclusions or implications should be drawn as to their validity.

Table 4.1. **Areas of improvement suggested by the foreign business community**

Area/Sector	Concerns
Agriculture	This sector remains relatively closed and highly regulated.
Local governments	There are restrictions and barriers imposed by local authorities which create uncertainty and unnecessary obstacles to doing business.
Standards	Certain standards are specific to Korea and differ from international standards (*e.g.* foods (including health/ functional foods) automobile and telecommunications) and are considered unjustified and discriminatory against foreign products.
Labelling, testing and certification requirements	Certain other standards, labelling, testing and certification requirements are considered unfair and discriminatory against foreign products (*e.g.* cosmetics and pharmaceuticals).
Taxes and tariffs	Certain taxes, tariffs and regulations, especially regarding the beverage sector, are deemed unfair and discriminatory.
Services	The services sector remains closed and highly regulated.

Source: EUCCK, AmCham Korea and US-Korea Business Council.

Regulatory Impact Assessments and public notices

Korea had already introduced the Regulatory Impact Assessment (RIA) in the 1977 Basic Act on Administrative Regulations (BARR), but positive changes were introduced through the revision of the BARR in 2005. From July 2006, relevant ministries are required to disclose on their websites a RIA together with proposed regulations during the public notice period. Although the legally mandated consultation period is 20 days, since 2005 the Ministry of Government Administration and Home Affairs has distributed "Administrative Procedures Guidelines" advising ministries and government agencies to extend the administrative pre-announcement consultation period to 60 days concerning major policies affecting foreigners. RIAs are required to contain an analysis on "aspects that hinder fair market competition and business activities" but there is no specific or explicit requirement to evaluate the impact on trade and investment. It remains to be seen whether the effect of regulations on trade and investment will be sufficiently considered in the RIAs.

The Korean Government also gives public notices on 49 trade-related domestic laws and internationally recognised procedures and requirements for exporting and importing items classified under HS codes. Under the Foreign Trade Act, public notice is given when enacting or revising guidelines of exports or imports before their entry into force.

The Korean Government is increasingly making information including major laws, regulations and policy data available in English. The Korean Government has also increased its efforts to involve the general public in the regulatory process, making it easier for them to monitor possible future changes in legislation by for example putting in place a single window electronic consultation website (*www.epeople.go.kr*) where announcements are made on new-legislation. However, the website is only in Korean and foreign businesses do not fully benefit from such mechanisms. While it would be certainly be burdensome to have all of the above information formally translated, the international business community would benefit greatly from such a one-stop website in English even if such a website referred only to the subject matter with the actual attached documents in Korean. This would not only benefit the international business community but would send a clear signal of the Korean Government's commitment to attract more trade and investment. More importantly it may improve the quality of regulations by reflecting a wider range of views.

Interpretation and application of regulations

In the 2000 *OECD Review* it was noted that foreign firms perceived lack of transparency in the decisions taken by government officials as a major obstacle to doing business in Korea. It was also noted that many regulations lacked clarity so that officials were given large discretionary powers in their application.

Since the 2000 *OECD Review*, the Korean Government has made significant efforts in this regard through training programmes for officials and holding regular meetings with major foreign organisations. However, the perception by the private sector, especially the international business community, has been that progress remains limited. Of the respondents to the "2006 Management Environment Difficulties Survey" conducted on foreign firms by Invest KOREA, 22.1% saw improvement in the transparency of administrative procedures, 58.2% saw no change and 19.3% saw deterioration. Concerns mainly seem to lie with the application of regulations rather than substance; and with the working level civil servants, who are in charge of day-to-day procedures rather than with the high level government officials (policy makers). As previously noted in the Introduction and general section, there is a perception that some officials tend to interpret and apply regulations more strictly or conservatively for foreign firms that they do for their Korean counterparts.

The Korean Government is aware of these unresolved issues and is taking further steps to address them. Continuing training programmes for officials and publication of regulation interpretation manuals are some general measures being taken to mitigate discretionary powers and the scope of subjective interpretations. According to Korean officials these manuals have been issued and are being implemented this year. Other measures being taken include automation and introduction of electronic procedures, and the creation of specific committees and appeals procedures.[4]

Market openness and non-discrimination

Overview, public perception and awareness

It is a generalised view in Korea that the productivity and profitability of the manufacturing sector has improved greatly thanks to deregulation and liberalisation. With a few exceptions, the goods market is quite open. Foreign products are widely available although prices are very high, especially for consumer goods. There remains a considerable price gap between foreign and domestic agricultural products, although this gap has narrowed somewhat in recent years.[5] Although Korea has been making an effort to liberalise its agriculture sector, it remains among the countries with the highest indexes of government support to agriculture.[6]

The productivity in the services sectors has been lagging. Korea has a very low ratio of contribution of the services sector to productivity growth vis-à-vis manufacturing and other industries; in fact it is manufacturing and not services that accounts for the bulk of the aggregate productivity growth in Korea.[7] This is largely attributed to lack of competition, since some service industries and professions are still closed and highly regulated.[8] The Korean Government and the private sector both recognise that in the future the economy will be driven by the services sector and consider that the service sector needs to be liberalised in order to make it more competitive. However, there has been strong resistance from some stakeholders whose interests would be affected.

Market openness is an important area for raising public awareness. It has been previously noted that a major obstacle to market openness in Korea comes from the unfavourable perception of "all things foreign". The fact that Korea has considerably expanded its import market[9] shows that the economy in general has become more receptive to foreign goods.[10] However, these disapproving attitudes and perceptions continue to be seen among the media and the public in general especially, and more recently, towards foreign investment and particularly portfolio investment.

There are still nationalistic sentiments and negative perceptions of foreign products, foreign companies and foreign investment. For example, the share of imported cars in Korea is still around three to four percent despite a considerable increase from the 0.26% in 1999 (see Annex 4.A2). Foreign capital and private equity funds have largely been criticised as vultures or predators whose only interest is to maximise short-term profits without giving any long-term benefits (*e.g.* employee training, technology transfer, etc.).

At a high level, the Korean Government has a strong commitment towards open markets, but this policy objective is not necessarily shared by other levels of government or by the public in general. As noted in the transparency section, there continues to be a perception in the foreign business community that on a practical level and on a day-to-day basis, enforcement of regulations may be applied more stringently on foreign firms than on national firms. The Korean Government is addressing these issues by introducing regulation interpretation manuals to reduce the scope for subjective interpretation and providing further training for officials. In addition, some ministries like MOCIE have taken specific measures such as:

- Sponsoring the Korean Importers Association (KOIMA) which contributes to influence the public opinion with positive perceptions of imports through seminars, forums, publications and events.[11]
- Establishing the Policy Customer Relationship Management (PCRM) system to promote the importance of foreign direct investment to businesses, the press, and the academia via email on a regular basis.

International trade framework

The Ministry of Foreign Affairs and Trade (MOFAT) is responsible for trade negotiations on behalf of the Korean Government on the basis of policy agendas drafted by the relevant ministries. In the process of drafting trade-related regulations, MOFAT can be consulted by the relevant ministries to ensure that the domestic policy is consistent with Korea's international agreements. Consultation also takes place if it is deemed that existing regulations do not conform to the respective international obligations.

As noted in the 2000 *OECD Review*, the MOCIE is consulted concerning regulation that may restrict trade and investment and is also a member of the Regulatory Reform Committee. MOFAT is also consulted concerning regulation that may affect trade and investment. However, MOFAT which is responsible for trade negotiations is not a regular member of the Regulatory Reform Committee. MOFAT's role may benefit from a stronger mandate to effectively carry out the responsibilities to ensure that domestic legislation is in line with Korea's international obligations.

Compared to its past limited participation in preferential agreements, Korea has become increasingly active in negotiating bilateral and regional trade agreements since 2004, while remaining committed to the multilateral negotiations in the World Trade Organisation (WTO). This corresponds with an international trend.

Table 4.2. **Preferential agreements between Korea and other countries/regions**

Existing trade agreements	Agreements under negotiation	Possible future negotiations
Chile (2004)	ASEAN	China
EFTA (2006)	Canada	European Union
Singapore (2006)	India	Mercosur
	Japan (suspended)	
	Mexico	
	United States	

Source: MOFAT.

Preferential agreements give more favourable treatment to specified countries and are thus inherent departures from the most favoured nation (MFN) and national treatment (NT) principles. As the preferential agreements which have already been concluded are with relatively smaller countries, it is not clear whether there has been significant trade diversion. Care should be taken in concluding future agreements so that they do not lead to trade diversion. Wherever possible, such as in the area of investment and services, preferences should be granted to third parties on a non-discriminatory basis.

These trade agreements and negotiations are expected to contribute to driving reforms and deregulation in some sectors that are still lagging and could benefit from further liberalisation. In particular, it is perceived that the Korea-US FTA will not only enhance the liberalisation process but it will also add momentum (and pressure) to regulatory reform efforts in the service sector. The FTA is likely to cement Korea's commitment to regulatory reform and open markets. Also, with the potential increase in competition, the FTA may change the competitive mindset of the various sectors and facilitate structural adjustment.

However, some in the private sector are of the view that negotiations should proceed without considering the time limit of the US President's fast-track authority which ends in mid 2007. Otherwise, a hurried agreement could lead to an incomplete FTA if some of the more sensitive issues are left out. Others from the public have voiced the need for sufficient or adequate safety nets to absorb the potential losses and displacements.

Foreign investment framework

Presently, most of the economic activities in Korea allow participation of Foreign Direct Investment (FDI). However there are still 26 sectors in Korea where foreign participation is limited and two sectors (Television broadcasting and radio broadcasting) where foreign participation is fully restricted.

In order to create a more investment-friendly environment and attract more FDI, Korea has developed a comprehensive strategy that aims not only to enhance the regulatory framework, but also to improve investor perception and the overall working and living conditions in Korea.

From a regulatory perspective, several changes were introduced to improve the investment framework. The Foreign Investment Promotion Act (FIPA) has been amended three times (in 2000, 2003 and 2004). Some of the more significant changes have been the following:

1. The Minister of Commerce, Industry and Energy was made responsible to annually collect and announce information concerning restrictions on foreign investment from

relevant government agencies. The agencies have to consult with MOCIE in advance if they intend to make any amendments.

2. As of 2000, a foreign investor was allowed to register as a foreign-invested company prior to full payment if certain criteria are met. Previously, full payment of the investment was required.
3. A new provision was put in place allowing the head of a local government to provide monetary awards to public servants who greatly contribute to attracting foreign investment.
4. All support measures concerning industrial sites for foreign investors were incorporated and integrated into FIPA.
5. Punitive measures on foreign nationals who violate the provisions of the Act were eased to the imposition of fines.

Table 4.3. **FDI limitations in Korea**

Sector	Limitations
Growing of cereal crops and other crops for food	Allowed except for the growing of rice and/or barley
Farming of beef cattle	Less than 50% foreign equity ownership
Inshore fishing	Less than 50% foreign equity ownership
Coastal fishing	Less than 50% foreign equity ownership
Publishing of newspapers	Less than 30% foreign equity ownership
Publishing magazines and periodicals	Less than 50% foreign equity ownership
Processing of nuclear fuel	Allowed except or the manufacturing and supplying of nuclear fuel for nuclear power plants
Electric power generation	Nuclear power generation businesses are excluded
Electric power transmission	Allowed only under the following terms: 1. Total share of foreign investment should be less than 50%. 2. Number of voting shares owned by foreign investors is less than that owned by No. 1 domestic shareholder
Distribution and sales	See permission standards for electric power transmission
Wholesale of Meat	Less than 50% foreign equity ownership
Coastal water passenger transport Coastal water freight transport	Passenger or container transportation between South and North Korea is allowed. Permitted if foreign investor enters into Joint Venture with Korean shipping companies and the share of foreign investment is less than 50%.
Scheduled air transport	Less than 50% foreign equity ownership
Non-scheduled air transport	Less than 50% foreign equity ownership
Leased line service	49% or less foreign equity ownership
Wired telephone and other telecommunications	49% or less foreign equity ownership
Wireless telephone	49% or less foreign equity ownership
Wireless paging and other telecommunications	49% or less foreign equity ownership
Other electric communications	49% or less foreign equity ownership
Domestic commercial banking	Permitted only for commercial and local banking
Radioactive waste disposal	Permitted except for radioactive waste management
Broadcasting channels	49% or less foreign equity ownership
Cable broadcasting	49% or less foreign equity ownership
Satellite broadcasting	33% or less foreign equity ownership
News agency activities	Less than 25% foreign equity ownership
Radio broadcasting	Wholly closed
Television broadcasting	Wholly closed

Source: MOCIE.

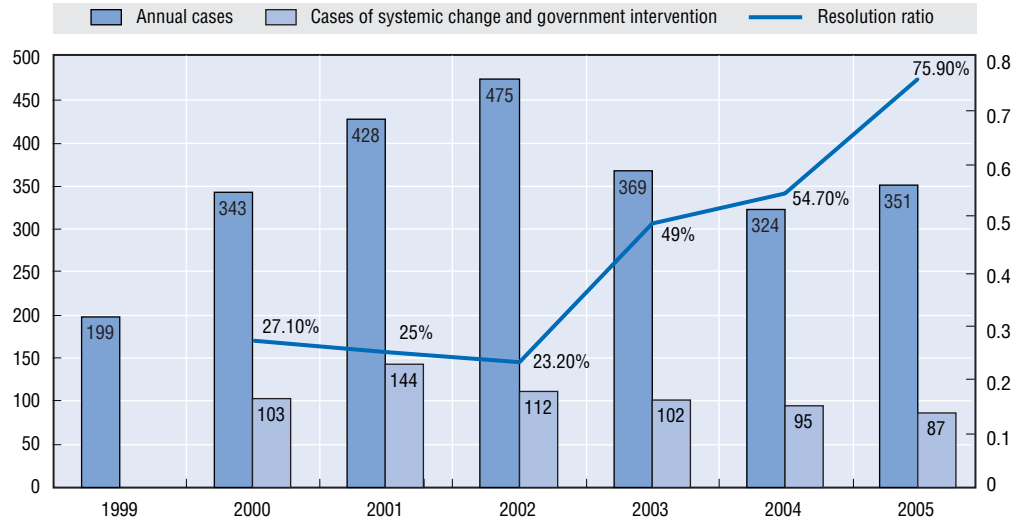
Beyond the specific legislative and regulatory changes, a number of government bodies, agencies and committees have been established to deal with investment-related issues. On the policy level, a Foreign Investment Committee (FIC) and a Foreign Investment Subcommittee made up of officials in relevant economic ministries have been in place since 1998 to discuss revisions and changes to trade and investment-related regulations.

To improve investor perception and the overall working and living conditions in Korea, in 2003 the Korea Investment Service Center (KISC) was transformed into Invest Korea (IK), a new agency with a view to providing a one-stop or single window service for foreign investors at the establishment stage. The new agency has increased the number of experts and delegated officials. The staffs are specially trained in the FDI Graduate School. To efficiently attract potential investors and increase the feasibility of actual investments, public relations activities that were previously developed for unspecified persons are now more targeted or specifically project-oriented.

In 2004 a new Project Manager (PM) system was introduced within Invest Korea. Under the PM system, a potential investor may receive the support of a PM even before the investment decision has been made and throughout the entire process. The PM collects and supplies foreign investors with all the information they request and also arranges meetings, handles civil affairs on the foreign investors' behalf and assists executives and their families to settle down in Korea. In addition, a Five-Year Plan for Improving Foreigners' Living Environment was established, a guidebook for Foreigners' Life and Investment Service Newsletter is regularly published and various cultural experience programmes have been introduced.

The Office of the Investment Ombudsman (OIO) created in 1999 continues to assist foreign investors on problems after establishment. The OIO itself has limited decision-making power and can only make recommendations to the responsible government agencies themselves who will take a decision on cases raised by the OIO. However, it plays an active role in raising issues with the responsible government agencies. Figure 4.1

Figure 4.1. **Cases submitted and resolved by the Office of Investment Ombudsman**



Source: OIO.

OECD REVIEWS OF REGULATORY REFORM: KOREA – ISBN 978-92-64-03205-7 – © OECD 2007

provides some information in terms of the numbers of cases submitted and resolved by the OIO. Between 1999 and 2005, a total of 2 489 cases had been submitted to the OIO, out of which 643 were cases concerning systemic change and government intervention. In 2005, 87 cases out of 351 were considered to be cases concerning systemic change and government intervention. There has been considerable improvement in the resolution ratio, defined as the number of cases resolved by systemic change through government intervention divided by the number of requests for systemic change through government intervention, which was 75.90% in 2005. While the Korean Government has stated that all other cases (264) in 2005 have been resolved without systemic changes or government intervention, there is no data available to verify if this was indeed the case.

It appears that there are multiple business and investment-related bodies that deal with private sector grievances, consultations, concerns, claims, etc. Indeed, although investors can bring their claims to the IK or OIO, they can also bring their claims to the BDRC, the OPC, the RRO, RRC, RRTF or through direct consultation with the relevant ministries, among others.

Although this positive attitude towards business and investor dispute resolution is desirable, having multiple bodies and agencies dealing with the same issues may be inefficient and may lead to investor/business confusion and frustration especially if there is lack of co-ordination. Ideally, all the business and investment-related claims and concerns should be dealt with by a single agency to consolidate a single window dealing with all business and investor claims and disputes which will be held accountable by transparency. Giving more authority to the OIO or some single organisation and its recommendations; and holding Ministries more accountable to change or enforce regulations in line with recommendations wherever possible and/or providing good reasons for not being able to do so, are steps that will likely lead to improved investor confidence and possible increase in Foreign Direct Investment.

Government procurement

In Korea, government procurement of goods & services above USD 100 000 and construction projects above USD 3 000 000 is handled by the Public Procurement Service (PPS),[12] a government body specifically established for that purpose. Procurement of state-owned enterprises and government procurement below the threshold is handled in-house in the relevant central or sub-central government. In 2003, the PPS handled 9.1% of all procurement contracts which represented 25.5% of the value of all procurement activities for that year. In 2004, the share of PPS in all procurement activities increased slightly to 30% in terms of contract value.

The Korean Government has taken a number of steps to improve transparency in government procurement, and to provide relevant information and non-discriminatory

Table 4.4. **Administration of government procurement contracts in 2003**

	Total contract	Contract by PPS	Contract awarded directly by individual procuring entity
Number of contracts	212 437 (100.0%)	19 341 (9.1%)	193 096 (90.9%)
Value of contracts (million KRW)	55 758 909 (100.0%)	14 211 271 (25.5%)	41 547 638 (74.5%)

Source: MOFE.

treatment to all interested parties. In accordance with the principle of non-discrimination, domestic and foreign bidders receive equal treatment and the same bid and contracting processes are applied to both.

The traditional procurement system was changed in 2002 and converted into the integrated Government e-Procurement System (GePS renamed as KONEPS in July 2006) that enables all procurement procedures to be processed online. This new system benefits from a higher level of efficiency and transparency. Bid results are opened online on a real-time basis, thus reducing the possibility of arbitrary decisions by public officials. An English version of the GePS was launched in November 2004 as part of the government initiative to ensure that foreign suppliers have convenient access to procurement information. The relevant legislation is made publicly available through the websites of the relevant ministries and agencies.[13]

In terms of efficiency, it is estimated that USD 4.5 billion in cost savings per year have been achieved by the use of GePS in both the private and public sector through the digitisation of the process and sharing of integrated data.

Table 4.5. **Estimated benefits of the Government e-Procurement System in 2005**

Components	Work improvements	Benefits (million USD)
Simplified process	Cutting down red tapes, etc.	63
Standardised process	Using the standardised way of contracting, etc.	918
Digitised process	E-bidding, bid notice on the Internet, etc.	169
Integrated data sharing	Obtaining information in a single window, etc.	3 388
Total		4 538

Source: PPS.

Despite these tangible benefits and although all government agencies (including central and local government organisations) are able to use the GePS (renamed as KONEPS in July 2006), there is room for improvement in utilising KONEPS as the transaction volume in 2004 (approximately USD 42.9 billion)[14] accounted for about 56% of total procurement market volume in Korea (approximately USD 76 billion).[15] It would also be desirable from a transparency and efficiency perspective to see further progress in the use of the KONEPS.

The government has also strengthened the evaluation criteria to provide quantitative factors and limit the cases for private contracts, which can only be concluded after evaluating each item to determine whether the specific requirements for private contracts have been met.[16] Despite this, less than one third of all procurement activities are carried out through open tendering, while more than 66% is still awarded through selective and limited tendering. However, open tenders represented almost 66% of the value of the contracts in 2003.

Table 4.6. **Government procurement contracts in 2003 by tendering method**

	Total contract	Open tendering	Selective tendering	Limited tendering
Number of contracts	212 437 (100.0%)	68 638 (32.3%)	2 585 (1.2%)	141 214 (66.5%)
Value of contracts (million KRW)	55 758 909 (100.0%)	36 694 052 (65.8%)	1 557 607 (2.8%)	17 507 250 (31.4%)

Source: MOFE.

Avoidance of unnecessary trade restrictiveness

Customs procedures

The 2000 *OECD Review* mentioned that slow and cumbersome customs inspection and clearance procedures were often pointed out as a significant impediment to trade in Korea.

Since the last review, the Korean Customs Service (KCS) has made great improvements (see Box below). The burdensome customs and borders procedures have been practically turned around. The number and complexity of procedures have been reduced and time required for clearance has decreased significantly.[17] Enhanced efficiency has led to reduced human resources requirements. An e-customs system with a 100% electronic clearance procedure has been achieved through continuous digitisation of the customs administration and use of electronic data interchange (EDI) over the Internet. The electronic clearance system can track down every step of the process, so importers can check the status of their imports on the Internet on a real-time basis reducing the possibility for corruption.[18]

Box 4.1. **Customs reform and trade facilitation**

The Korean Customs Service (KCS) has drastically improved customs procedures and introduced automation to the level of the most advanced customs agencies. As a result, time required for customs clearance has been reduced substantially.

Time required for customs clearance[1]

	Arrival → Entry	Entry → Declaration	Declaration → Acceptance	Arrival → Acceptance
1999	n.a.	n.a.	3 hours 10 mins	n.a.
2000	n.a.	n.a.	2 hours 44 mins	n.a.
2001	n.a.	n.a.	2 hours 30 mins	n.a.
2002	n.a.	n.a.	2 hours 03 mins	n.a.
2003	2.3 days	7.2 days	1 hour 32 mins	9.6 days
2004	1.6 days	3.9 days	1 hour 48 mins	5.5 days
2005	1.4 days	2.9 days	1 hour 40 mins	4.4 days

Source: KCS.

KCS has pursued a multi-pronged comprehensive regulatory reform strategy, simplifying and improving clearance procedures and introducing new technology as follows:

1. Reducing the number of items subject to import/export verification requirements from 4 810 items in 30 laws to 4 114 items in 26 laws. The pre-clearance requirement verification has been limited to drugs, firearms, and items in direct relation to public health/safety and environment.
2. Broadening thresholds for clearance of express goods and cargo. For simplified clearance the threshold was raised from USD 600 to USD 2 000 and for list-clearance[2] it was raised from USD 60 to USD 100.
3. Simplifying unloading procedures by increasing automatic acceptance of unloading declaration from 60% to 98%.
4. Addressing the problem of prolonged cargo storage at air/seaports by reducing the unloading period[3] and the storage periods at bonded areas.[4]
5. Establishing a one-stop transportation system for sea/air transshipment cargoes that need to be immediately transported to the airport after port arrival. Procedures for unloading, transportation, warehouse entry, and aircraft loading are all handled in the one-stop service, with bonded transportation declaration waived.[5] In case bonded transportation is required, bundle transportation per vessel is allowed without having to submit a deposit, helping businesses cut logistical costs.

Box 4.1. **Customs reform and trade facilitation** *(cont.)*

6. Improving taxpaying procedures. Monthly payments, self-audits and other incentives were made available for companies with good compliance records. Self-correction within 3 months after payment can be done without an additional tax on the supplementary payment.
7. Improving drawback procedures which encourage efficient and lawful declaration practices. Drawback request is made with export declaration and refund is made upon loading. Speedy drawbacks increase convenience of small companies and exporters and a "Finding unclaimed drawback" campaign is available for small businesses.[6]
8. Introducing X-ray screening equipment instead of manual/physical inspections. Inspection time per container has been cut from 4-5 hours to 10 minutes. Manual inspection is only used when X-ray results indicate suspicious contents or X-ray screening is not practicable.
9. Establishing an electronic customs administration system as a part of the e-government initiative. A single window for all verification and clearance procedures has been established linking 8 verification agencies (see table) through an online system. This includes the establishment of an Internet-based Clearance Portal site that processes import/export clearance. Export declarations are processed within 2 minutes and import declarations within 100 minutes. Paperless clearance applies as follows: exports (95%), import/drawback (75%), cargo (100%).

Participating agencies in the single window[7]

Name of agency	Related law	Subject work
National Plant Quarantine Service	Plant quarantine law	Plant quarantine request
National Fisheries Products Quality Inspection Service	Food hygiene law	Import declaration of food
Korea Medical Devices Industry Association	Medical devices law	Requirement verification of medical devices
Korean Dental Trade Association	Medical devices law	Requirement verification of medical devices
Korea Food and Drug Administration	Food hygiene law	Import declaration of food
Korea Pharmaceutical Traders Association	Pharmaceutical affairs law	Requirement verification of medical supplies
National Veterinary Research and Quarantine Service	Livestock disease prevention law and Animal product processing law	Animal/animal product quarantine request and Import declaration of animal product
Korea Animal Health Products Association	Pharmaceutical affairs law	Requirement verification of medical supplies

Source: KCS.

1. From 1999 to 2002 KCS only dealt with the process of import declaration to declaration acceptance (Declaration → Acceptance) and no data was collected for each individual step.
2. Based on consignment lists forwarded by express courier operators.
3. From 5 to 3 days.
4. At bonded warehouses from 1 year to 3 months (2 months at major sea/airports); and at designated storage areas from 6 months to 2 months.
5. The procedure was downscaled from 5 stages (Submit manifest and unloading declaration → declaration of entry to bonded area → declaration of bonded transportation → declaration of release → loading on aircraft) to 2 stages (Submit manifest and unloading declaration → loading on aircraft).
6. 15.7 billion KRW of unclaimed drawbacks were refunded in 2005.
7. According to the Korean Government, the following foreign companies participate in the single window through their respective trade associations. 1) GC Korea (Japan), Philips and Oral B through the Korean Dental Trade Association; 2) Merial Korea Ltd., Boehringer Ingelheim Vetmedica Korea Ltd. and Pfizer Animal Health Korea Ltd through the Korea Animal Health Products Association; 3) Pfizer, Roche, DHC Korea and Aventis Korea through the Korea Pharmaceutical Traders Association; and 4) Essilor Korea, Johnson & Johnson Medical Korea and Nippon Intek Holding Korea through the Korea Medical Devices Industry Association.

A single window system is being implemented, where importers would only need to electronically submit one declaration which would then be transferred to the relevant ministries. KCS has simplified and standardised forms and items with other agencies to streamline the procedures. Currently 8 Korean agencies participate in the single window system[19] and other agencies and organisations are expected to be included in the future.[20]

In terms of international co-operation in border procedures, the KCS currently maintains customs co-operation conferences with 31 foreign customs and mutual assistance agreements with 24 foreign customs including developing economies.[21] In addition, Korea's recent interest in FTA negotiations is likely to increase bilateral and regional co-operation among customs agencies. However, the expected increase in trade volumes and international passengers will undoubtedly stretch the resources of the KCS.

In order to raise efficiency in the customs regulation system amid the increasing trade volume and passengers, KCS shows a strong commitment to continue improving the passenger clearance system, expanding the Single Window and the Internet Clearance Portal services, and achieve a paperless office in the long term.

Streamlining business and administrative procedures

The 2000 *OECD Review* stated that Korea's trading partners pointed to a large number of cumbersome and trade-restricting procedures. The Korean Government has made a number of efforts to create a more favourable and less restrictive business environment by reducing unnecessary administrative burdens on businesses.

As previously mentioned, Regulatory Impact Assessments (RIAs) have been introduced to evaluate potential changes to the regulatory environment. The Basic Law on Administrative Regulations stipulates that RIAs must be conducted in order to establish new regulations or reinforce existing ones. The relevant RIA must be disclosed together with the proposed regulation during the process of public notice and must also include specific analyses on whether the regulations contain factors restricting fair market competition or factors undermining corporate activities.

The regulatory reform process up to now has focused more on deregulation and has been successful in reducing unnecessary or burdensome procedures. However, although regulation has decreased from a quantitative perspective, it is difficult to make a detailed qualitative assessment on the progress of regulatory reform. Therefore the government is now aiming to shift from a generic quantitative approach to a more qualitative approach to regulatory reform. The introduction of RIAs is expected to contribute to this shift in government policy. However, there are strong concerns about the potential lack of quality and quantity control of parliamentary initiatives which can entirely bypass the RIA process.

As also mentioned above, the Government has developed a close partnership with the private sector and is continually engaging the business community through consultation mechanisms. Since 2000, the OPC has regularly received suggestions from representatives of business organisations (*e.g.* AmCham, EUCCK and Seoul Japan Club) and consultations with such organisations have been handled as regulatory reform tasks since 2005. When possible or applicable, steps have been taken to address issues taken up.

The Regulatory Reform Taskforce (part of OPC) was established in August 2004 to spearhead regulatory reform especially in areas which relate to several Ministries. As of July 2006, the Taskforce has addressed reform packages in 45 regulatory areas, including

Table 4.7. **Procedures required to start a business**

Procedure	Days required
1. Certification of the articles of incorporation/minutes 2. Certificates of the amount of paid-in-capital issued from bank	1 day
3. *a)* Certificates of registration and education tax payments issued *b)* Purchasing of public bonds 4. Registration of incorporation	1 day
5. *a)* Report on incorporation *b)* Business registration	1 day

Source: Korean Government.

e-commerce, software industry, construction and trade-related regulations such as air transportation and agricultural and maritime product distribution. In collaboration with MOCIE and IK, the Taskforce is also planning to review investment-related regulations to provide a more favourable business environment for foreigners.

As part of the efforts to streamline the procedures to set up a business, a study was conducted on the status of the start-up procedures in 2005. Based on the study, several regulations were modified, including the minimum paid-in-capital requirement for venture establishment,[22] the required certification of the article of incorporation/minutes, introduction of an on-line registration system, and unification of related application forms. As of 2006, there are only 5 start-up procedures that require a total of 3 days to complete.

As noted previously, the private sector has acknowledged and commended the important transformation of Korea to create a more business-friendly environment. However the foreign business community has pointed out several concerns in areas where they suggest further reforms and improvements are needed.[23]

International harmonisation and equivalence of other countries' regulatory measures

Harmonisation of standards and conformity assessment

The 2000 *OECD Review* stated that the cumbersome Korean system of standards and conformity certification was deemed by trading partners as a source of obstacles to trade. However, as also noted in the previous *Review*, the Korean Government implemented an active policy in favour of enhanced transparency of the standardisation and certification system, and increased use of internationally harmonised standards.

Korea is to review Korean Standards every five years based on the Industrial Standardisation Act, and may revise or withdraw them if required. In 2000, the National Standards Council announced the 1st five-year National Standards Plan (2001~2005) to begin implementing this provision. The plan's aim was to improve national standards and conformity assessment in Korea by harmonising Korean Standards (KS) with corresponding international standards and adopting international accreditation programmes, among others. MOCIE has undertaken specific efforts to harmonise KS standards with relevant international standards such as ISO (International Organisation for Standardisation) and IEC (International Electrotechnical Commission) standards since 2000. By the end of 2005, approximately 60% of KS were subject to international ISO/IEC harmonisation. About 30% of KS standards have been established by reference of other international standards excluding ISO or IEC, and roughly 10% of KS standards have been established without any reference to international standards.

Table 4.8. **Relationship between Korean standards and international standards**

Category	Relevant International Standards (IEC/ISO)	Number of Korean Standards (KS)	Number of KS subject to International Harmonisation	% of KS subject to International Harmonisation
Basic standards and miscellaneous	870	982	459	47
Mechanical engineering	3 520	3 763	2 360	63
Electrical and electronic engineering	3 630	3 032	2 564	85
Metals	987	1 572	831	53
Mining	263	421	217	52
Civil engineering and architecture	447	802	190	24
Household goods and office supplies	112	376	88	23
Food products	628	435	279	64
Textiles	481	793	420	53
Ceramics	612	423	323	76
Chemical engineering	3 131	3 906	2 219	57
Medical equipment	640	679	460	68
Transportation machinery	561	1 044	371	36
Shipbuilding	256	784	227	29
Aircraft and aviation	465	471	248	53
Information technology	2 231	1 768	1 637	93
Total	18 675	21 251	12 691	60

Source: Korean Government.

The National Standards Council, chaired by the Prime Minister, approved the 2nd National Standards Plan (2006~2010) on 18 May 2006. The key objective of this plan is 1) to renovate the national standardisation and conformity assessment procedures to promote co-ordination among relevant ministries and agencies and 2) to eliminate possible duplication among different standards and certification schemes.

In the context of the 2nd National Standards Plan, the National Standards and Certification Innovation Committee which has been established by the National Standards Council will review more than 37 000 national standards, technical regulations and 140 certification systems to find any duplication or contradiction among them. They will also examine if there are any inappropriate standards or certification systems that can constitute unnecessary technical barriers to trade.

As of December 2005, out of the total of 12 691 KS subject to IEC/ISO harmonisation, 99.8% (12 669) had been harmonised with relevant international standards. Out of which, 88.7% (11 262) were Identical (IDT) and 11.1% (1 407) were Modified (MOD).

Since December 2001 Korea added the services sectors by revising the Industrial Standardisation Act to the scope of standardisation which is being enlarged as for trade and commerce. The following areas of services are now subject to specific standards:

1. Public information symbols.
2. Tourism services.
3. Food services.
4. Outbound travel services.
5. Condominium services.
6. Domestic travel services.
7. Furniture removal for households.

8. Carriage of parcels.
9. Commercial motorcycle carriage service.
10. Warehousing services.
11. Car rental services.
12. Automobile insurance services.
13. Personal accident insurance services.

Progress has been made in the percentage of internationally harmonised standards as outlined in the previous paragraphs. However, there is a perception among the international business community that certain "Korean-specific" standards and requirements are unjustified and potentially discriminatory and there are various references to these so-called "Korean-specific" standards by several chambers of commerce and trade associations.[24] The existence of country-specific standards in and of itself may not be a problem as country-specific standards exist in other OECD countries and their use may be justified in some cases.[25] However, country-specific standards should only be maintained when there are no equivalent international standards and where there is sufficient justification to maintain them. Care should be taken so that they do not constitute unnecessary barriers to trade.[26] Positive consideration should be given to accepting as equivalent the technical regulations of other countries, even if these regulations differ from their own, provided they are satisfied that the regulations adequately fulfil the objective of their own regulations.

An additional concern is that several ministries still have and manage their own individual standards and technical regulations independently from Korean Agency for Technology and Standards (KATS) and KOLAS. While it is not uncommon to have several agencies involved in standards, having several agencies and ministries working

Table 4.9. **Current state of harmonisation of Korean standards with international standards**

Category	KS subject to International Harmonisation	KS is identical (IDT)	KS is modified (MOD)	KS is not equivalent (NEQ)	% IDT	% MOD
Basic standards and miscellaneous	459	419	39	1	91.3	8.5
Mechanical engineering	2 360	2 071	289		87.8	12.2
Electrical and electronic engineering	2 564	2 293	265	6	89.4	10.3
Metals	831	640	188	3	77.0	22.6
Mining	217	198	19		91.2	8.8
Civil engineering and architecture	190	112	76	2	58.9	40.0
Household goods and office supplies	88	81	7		92.0	8.0
Food products	279	279			100.0	0.0
Textiles	420	333	87		79.3	20.7
Ceramics	323	270	48	5	83.6	14.9
Chemical engineering	2 219	2 130	84	5	96.0	3.8
Medical equipment	460	428	32		93.0	7.0
Transportation machinery	371	342	29		92.2	7.8
Shipbuilding	227	220	7		96.9	3.1
Aircraft and aviation	248	236	12		95.2	4.8
Information technology	1 637	1 408	229		86.0	14.0
Total	12 691	11 262	1 407	22	88.7	11.1

Source: Korean Government.

Table 4.10. **MRAs concluded by Korea**

Partner country	Sectors covered	Establishment date	Effective date	Type of MRA	Remark
Canada	Telecommunication equipment	1997-01	1998-07	ACC	
United States	Telecommunication equipment	2005-05	2005-05	ACC	
Singapore	Electrical and electronic equipment	2005-08	n.a.	CERT	Under the umbrella of FTA between Korea and Singapore
Singapore	Telecommunication equipment	2005-08	n.a.	ACC	Under the umbrella of FTA between Korea and Singapore

Note: ACC: conformity assessment dealing with acceptance of data; CERT: conformity assessment dealing with certification.

Source: Korean Government.

independently without much co-ordination may lead to potential overlapping of functions and ineffective use of resources. In addition if different ministries or agencies work on similar issues without proper co-ordination, it may create confusion and unnecessary burdens for trading partners and the private sector users. It would be desirable for KATS to have a more prominent role in co-ordinating international standardisation efforts among the relevant ministries and agencies. In addition, the creation of a central WTO Enquiry Point would facilitate trade and increase transparency.

Other countries' regulatory measures concerning conformity assessments, accreditations, certifications and test results must comply with specific requirements or criteria in order to be granted recognition of equivalence of conformity assessment results in Korea. Most commonly, Mutual Recognition Agreements (MRAs) are established between the trading partners and/or Memorandums of Understanding (MOUs) between certification bodies. Some specific requirements include:

- For electric appliances, it is required that MOUs be established between certification bodies for recognition of test results, or that MRAs be established between governments for recognition of test results and/or full certification.
- For consumer products, it is required that MOUs be established between certification bodies for recognition of test results (which will be implemented from 24 December 2006), or that MRAs be established between governments for recognition of test results and/or full certification.
- For gas cylinders, it is required that MRAs be established between governments.
- For aircraft parts, Korea is currently negotiating a Bilateral Aviation Safety Agreement (BASA) on Technical Standard Order with the US Federal Aviation Administration.
- For fire protection equipment, MRAs need to be established between respective governments.
- For machines, instruments and equipment, if their safety has been certified by a foreign safety certification institution recognised by the Minister of Labour, they may be partly or fully exempted from the inspection.

The 2000 *OECD Review* noted that in order to improve the Korean certification system, it was important for all ministries and agencies to designate laboratories and certification bodies based on internationally harmonised accreditation systems, such as the Korea Laboratory Accreditation System (KOLAS). Although efforts have been made to improve the

certification system in Korea, the degree of co-ordination between government agencies has been disappointing. As of 2006, 7 ministries use KOLAS as an internationally harmonised accreditation system.[27]

Application of competition principles

Competition policy and enforcement can make valuable contributions to trade policy, both playing an important role in the overall market openness by jointly shaping the market structure. The Korean Fair Trade Commission (KFTC), while not directly participating in trade policy, has been involved in regulatory reform. Through the prior consultation mechanism stipulated by the Monopoly Regulation and Fair Trade Act (MRFTA) the KFTC has worked with relevant government agencies to prevent enactment of new competition-restricting regulations and to try to identify remnants of such restrictions in existing regulations and discuss ways of abolishing or improving such regulations. A number of regulatory changes concerning competition-restricting regulations on imports and exports have taken place since the previous *Review*:

1. Easing of facility requirements for agrichemical import industry.
2. Quality test of imported oil products prior to customs clearance was replaced by test after clearance.
3. Gradual reduction in the number of import-banned herbal medicine and simplification of import process.
4. Abolition of Korea Animal Health Products Association's import requirement confirmation system.
5. Quality test for imported and domestic salt products was replaced by quality labelling by producers in January 2002, and items that need to be documented in reporting import were reduced and simplified.
6. Elimination of the obligation to provide a cosmetics production and sales certificate, which restricted parallel imports of cosmetics.

In the area of public procurement, the 2000 *OECD Review* stated the need to strengthen the KFTC's investigations and penalties against bid rigging and to make recommendations to government agencies in their procurement procedures. In this regard, the KFTC has developed and operated the "BRIAS" bid rigging information analysis system that automatically receives electronic bid information from government agencies and looks for the telltale signs of collusion. Tenders for construction projects above 5 billion KRW and for purchases of products or services above 2.5 billion KRW are subject to this analysis. If information of the bid situation board indicates signs of bid rigging, the information is used as data for investigation.

Since 1999, the KFTC has strengthened law enforcement and imposed the highest fines in its history on collusive bidding.

1. collusive bidding in highway construction in 1999 (10.1 billion KRW);
2. collusive bidding in supply of oil products to the Korean Armed Forces in 2000 (121.1 billion KRW);
3. fine of 7.1 billion KRW on bid rigging for Seoul Metro's project in 2002;
4. fine of 14.9 billion KRW on bid rigging for supply of steel products to the PPS.

Overall, the KFTC has aided in deterring collusive bidding by notifying the PPS of companies that received sanctions from the commission to limit their participation in bids for public projects for a certain period of time. In applying this useful sanction, care may be necessary so that banning companies from bidding does not lead to a decrease in competition.

Another area of concern stated in the 2000 *OECD Review* was that a major source of potential discriminatory and anticompetitive practices lay in the delegation of some regulatory powers to industrial associations and the difficulties and problems encountered by foreign firms trying to become members of these associations.

The industry associations' limit on foreign companies' participation could violate the MRFTA and Prohibited Activities of Enterprisers Organisation. However, the delegation of regulatory powers to industrial associations is stipulated by law, so the KFTC has tried to address these issues as part of its efforts to improve anti-competitive regulations. The KFTC acknowledges that these are ongoing problems that still need to be corrected.[28]

Conclusions and policy options

Korea has made notable progress since the previous review of regulatory reform in such areas as harmonisation of technical regulations and international standards, increased foreign participation in the regulatory process, and introduction of electronic procedures in customs and government procurement. As discussed in the previous sections and outlined in Annex 4.A1, some of the concerns and recommendations raised in the 2000 *OECD Review* have been addressed, albeit some with more positive results than others. The following policy recommendations suggest some areas where further improvement can be made in order to allow Korea to continue reaping the benefits of regulatory reform with increased liberalisation and market openness.

1. Strengthen efforts to alleviate the perception of de facto discriminatory effects against foreign goods, companies and investment.

- Continue to raise public awareness of the importance of regulatory reform and market openness. Strengthen efforts to improve the negative perception toward foreign investment, products and companies by explaining their benefits.
- Reduce the room for discretionary interpretation, application and enforcement of regulations through further training and by carefully monitoring the implementation and adherence to the recently issued regulation interpretation manuals.
- Continue and enhance training of certain public officials (especially at the working-level and local-level) to enhance their understanding of the benefits of regulatory reform and market openness.

2. Further improve transparency and openness of decision making from the market openness perspective.

- When practicable, encourage all governmental bodies to provide more information about changes to regulations, consultation procedures and public notices in foreign languages, especially concerning international trade and investment issues. This would allow foreign businesses to better understand not only current regulations but future direction of regulations. Creation of a one-stop shop for all consultation procedures in

English similar to the *www.epeople.go.kr* site may further enable foreign businesses to follow Korean regulatory changes more easily.

- Since there are multiple business and investment-related bodies that deal with private sector grievances and concerns, the user friendliness of this framework could be improved, ideally through the consolidation of a single window to deal with all business and investor claims and disputes which may be held accountable by transparency.
- Require explicit assessments of the effects of proposed regulations on trade and investment as part of the regulatory impact analysis.
- Continue to increase and foster the exchange and co-operation between Ministries to review laws with market openness implications and ensure consistency with international agreements. Strength MOFAT's role in the domestic legislation process (*e.g.* by making it a member of the Regulatory Reform Committee).

3. Strengthen efforts to avoid unnecessary trade restrictiveness and further promote international harmonisation of standards and conformity assessment.

- Encourage all relevant government agencies to join the single window system being implemented by the Korean Customs Service to further improve efficacy of the customs clearance system.
- Promote further use of the KONEPS (Formerly GePS) by for example mandating the use of KONEPS to the extent possible.
- Strengthen efforts to harmonise technical regulations and standards with international standards in its review under the 2nd National Standards Plan (2006-2010) soliciting more active involvement from foreign businesses earlier in the process as necessary with a view to eliminating any remaining unnecessary technical barriers to trade. Although the use of country-specific standards may sometimes be justified, care should be taken to ensure that they don't constitute unnecessary obstacles to trade. Special effort should be made to accepting as equivalent the technical regulations of other countries, even if these regulations differ from their own, provided they adequately fulfil the objective of their own regulations.
- Strengthen efforts to recognise the equivalence of other countries' regulatory measures through use of internationally accreditation systems (the Korea Laboratory Accreditation System (KOLAS) and through more active negotiation of mutual recognition agreements.
- Encourage greater co-ordination between ministries in the area of standards and conformity assessment, providing KATS/MOFAT with greater authority for such co-ordination in its review under the 2nd National Standards Plan (2006-2010). In addition, the creation of a central WTO Enquiry Point would facilitate trade and increase transparency.

4. Continue to speed up regulatory reform, deregulation and market opening in the traditionally protected sectors such as services and agriculture.

- Strengthen dialogue with various stakeholders such as business interests and unions to explain the benefits of further regulatory reform and to better understand their concerns in areas such as transition costs and safety nets with a view to building constructive solutions.

5. *Strengthen competition policy enforcement to increase market openness regarding anti-competitive practices that impair market openness.*

- Continue to strengthen competition policy enforcement in areas such as bid-rigging and the use of regulatory powers delegated to industrial associations who may use these powers for uncompetitive purposes.

Notes

1. Some of the most controversial service sectors include financial, telecoms, professional services, education, legal, accounting, medical/healthcare and logistics.
2. In 2005, among 224 cases submitted, 63 cases have been addressed and 44 cases are being addressed as long term tasks of the government.
3. US-Korea Business Council and American Chamber of Commerce in Korea's Joint Policy Paper and the US-Korea FTA position paper available at *www.uskoreacouncil.org/* and *www.amchamkorea.org/*; and European Union Chamber of Commerce in Korea's Trade Issues and Recommendations available at *www.eucck.org/*.
4. The National Tax Service introduced the Transfer Pricing Review Committee to make the transfer pricing process more rational and transparent. Before closure, the taxpayer is entitled to appeal to the Committee for a re-evaluation and validation of the assessment.
5. For example, consumers still pay on average 2.5 times the world price for agricultural commodities and farmers receive prices which are 153% higher than the world prices (see "Agricultural Policies in OECD countries at a glance", OECD, 2006).
6. Market price support and output/input-based payments continue to account for more than 92% of the agriculture support in Korea. Although support to producers has decreased, it is still double the OECD Average (see "Agricultural Policies in OECD countries at a glance", OECD 2006).
7. See "Enhancing the Performance of the Services Sector" (OECD 2005).
8. These include financial services, professional services (including legal and accounting) medical/healthcare and logistics.
9. Imports grew from USD 160 billion in 2000 to more than USD 220 billion in 2004.
10. The rise in imports is also related to increased demand for raw materials and intermediate input goods and components, and not necessarily or exclusively consumer goods.
11. Some examples of these are the Foreign Company Day and the yearly Imported Goods Fair.
12. The Supply Administration of the Republic of Korea (SAROK) was transformed into the Public Procurement Service (PPS).
13. The relevant legislation is made publicly available through the websites of Ministry of Finance and Economy (MOFE), Ministry of Legislation (MOL), Public Procurement Service (PPS) and GePS renamed as KONEPS in July 2006. Additional information on enactment and revision of government procurement legislation is accessible through the electronic official gazette.
14. KW 42.9 trillion.
15. KW 76 trillion.
16. General issues (30 points) and technical issues (70 points) are evaluated. When a contract receives more than 90 points, it may be concluded in the form of a private contract.
17. 24 hours at major air/sea ports.
18. For a detailed description of the progress in customs reforms please see the respective Box: Customs Reform and Trade Facilitation.
19. The participating agencies are: the National Plant Quarantine Service, the National Fisheries Products Quality Inspection Service, the Korea Medical Devices Industry Association, the Korean Dental Trade Association, the Korea Food and Drug Administration, the Korea Pharmaceutical Traders Association, the National Veterinary Research and Quarantine Service and the Korea Animal Health Products Association.

20. Four additional organisations engaged in assessing import requirements of industrial goods are expected to join the single window program: the Korea Environment and Merchandise Testing Institute, the Korea Testing and Research Institute for Chemical Industry, the Korea Toy Industry Co-operative, and the Korea Testing Laboratory.

21. These include China, Hong Kong-China, Indonesia, Iran, Israel, Kazakhstan, Malaysia, Mongolia, Philippines, Poland, Russia, Thailand, Ukraine, Uzbekistan and Vietnam.

22. As of October 2005 the minimum paid-in-capital requirement for venture company establishment was lowered from 20 to 5 million won.

23. For a detailed discussion of the concerns of the foreign business community see, *e.g.*, US-Korea Business Council and American Chamber of Commerce in Korea's Joint Policy Paper and the US-Korea FTA position paper available at *www.uskoreacouncil.org/* and *www.amchamkorea.org* and European Union Chamber of Commerce in Korea's Trade Issues and Recommendations available at *www.eucck.org/*.

24. US-Korea Business Council and American Chamber of Commerce in Korea's Joint Policy Paper and the US-Korea FTA position paper available at *www.uskoreacouncil.org/* and *www.amchamkorea.org*; European Union Chamber of Commerce in Korea's Trade Issues and Recommendations available at *www.eucck.org/* and The Consumer Electronics Association's comments on a U.S.-Korea FTA available at *www.ce.org/* Concrete examples include the following:
1) Concerning the regulation on dryness/moisture content of tea/herb tea products, the Korean standard establishes a maximum of 10% moisture content, which is more stringent than the internationally accepted standard (EU/CODEX Alimentarius) which establishes a maximum of 12-13% moisture content. (See EUCCK's Trade Issues and Recommendations 2006, p. 92.)
2) Regarding labelling of liquor products, Korean regulations require at least 18 pieces of information on the label, which exceeds those established by the CODEX Alimentarius. (See EUCCK's Trade Issues and Recommendations 2006, p. 232.)
3) Concerning maximum caffeine content in foodstuffs, KFDA provisions establish a maximum added amount of 150 mg/l. Although there is no relevant international standard in this respect, this standard *de facto* precludes the import sale and distribution of numerous internationally accepted high-caffeine content beverages (*e.g.* Energy Drinks). (See EUCCK's Trade Issues and Recommendations 2006, p. 92.)
4) Regarding the breadth of vehicles, the Korean standard establishes a breadth of 2.5m which is smaller than American and European standards which establish breadths of 2.55m (Europe) and 2.60m (US). (See EUCCK's Trade Issues and Recommendations 2006, p. 44.)

25. See *e.g.* Article 2.4 of the WTO TBT Agreement: "Where technical regulations are required and relevant international standards exist or their completion is imminent, member s shall use them, or the relevant parts of them, as a basis for their technical regulations except when such international standards or relevant parts would be an ineffective or inappropriate means for the fulfilment of the legitimate objectives pursued, for instance because of fundamental climatic or geographical factors or fundamental technological problems."

26. See *e.g.* Article 2.2 of the WTO TBT Agreement: "Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products."

27. Ministry of Commerce, Industry and Energy (MOCIE), Ministry of Maritime Affairs and Fisheries (MOMAF), Ministry of Environment (ME), Ministry of Construction and Transportation (MOCT), Ministry of Government Administration and Home Affairs (MOGAHA), Ministry of Health and Welfare (MOHW), Ministry of Finance And Economy (MOFE).

28. As noted in Section 2.6 of the 2000 *OECD Review*, some industrial associations (*e.g.* in the automotive, pharmaceutical, cosmetics and agricultural sectors) use their regulatory powers to prevent foreign firms from entering the market. Restrictions on entry to such industrial associations may violate the MRFTA and Prohibited Activities of Enterprisers Organisation.

Bibliography

CEA (The Consumer Electronics Association) (2006), "Comments on a US-Korea FTA", available from *www.ce.org/*.

EIU (Economist Intelligence Unit) (2005), "Country Profile: Korea", available from *www.eiu.com/*.

EIU (2006), "Country Profile: Korea", available from *www.eiu.com/*.

EIU (2005), "Country Report: Korea", available from *www.eiu.com/*.

EIU (2006), "Country Report: Korea", available from *www.eiu.com/*.

EUCCK (European Union Chamber of Commerce in Korea) (2005), "Trade Issues and Recommendations", EUCCK, Korea, available from *http://trade.eucck.org/site/2005/en/*.

EUCCK (2006), "Trade Issues and Recommendations", EUCCK, Korea, available from *http://trade.eucck.org/site/2006/en/*.

Invest Korea (2006), *Invest Korea Journal,* Vol. 24, No. 2, March-April, Korea.

Korea Customs Service (2006), *Realising an Advanced Trading Nation through World Best Customs,* Korea.

Lee, Y.K. and H. Kim (2003), "Korean Agriculture after the Uruguay Round and World Agricultural Policy Reform", paper contributed for the International Conference "Agricultural policy reform and the WTO: where are we heading?" Capri (Italy), 23-26 June 2003, available from *www.ecostat.unical.it*.

Ministry of Government Administration and Home Affairs (MOGAHA)/National Computerisation Agency (NCA) (2005), *e-Government in Korea,* Korea.

MOGAHA (2005), *Annual Report for e-Government*, Korea.

OECD (2006), *Agricultural Policies in OECD – Countries at a Glance*, OECD, Paris.

OECD (2005), *Enhancing the Performance of the Services Sector*, OECD, Paris.

OECD (2005), *Economic Surveys: Korea*, OECD, Paris.

OECD (2000), *Regulatory Reform in Korea*, OECD, Paris.

US-Korea Business Council/AMCHAM (American Chamber of Commerce in Korea) (2005), *2005 Policy Paper,* available from *www.amchamkorea.org/*.

US-Korea Business Council /AMCHAM (2006), *US-Korea FTA Position Paper,* available from *www.amchamkorea.org/*.

WTO (2000), *Trade Policy Review*, Republic of Korea, WTO, Geneva, available from *www.wto.org/*.

WTO (2004), *Trade Policy Review*, Republic of Korea, WTO, Geneva, available from *www.wto.org/*.

ANNEX 4.A1

Implementation of the 2000 Recommendations

Recommendations of the 2000 *Review*	Assessment of actions taken since the 2000 *Review*	Further recommendations
1) Strengthen efforts to harmonise technical regulations and standards with international standards and to recognise the equivalence of other countries' regulatory measures: *a)* Reinforce the technical capacities of standards-related bodies, such as standards institutions, laboratories and certification bodies, so that they can effectively engage in aligning technical regulations and standards to internationally harmonised ones and accepting other countries' standards or certification procedures. *b)* Co-ordinate efforts of international co-operation conducted by different ministries. *c)* Engage more actively in the negotiation of MRAs.	Korea has made considerable progress in harmonisation of technical regulations and international standards. A high percentage of Korean standards have been harmonised with relevant international standards and the technical capacities of relevant bodies has been strengthened. Use of internationally harmonised accreditation system [*i.e.* Korea Laboratory Accreditation System (KOLAS)] has remained low.	Co-operation and co-ordination between relevant ministries and agencies need to be strengthened. Use of KOLAS and negotiation of MRAs needs to be promoted. When applicable, country-specific standards should be reviewed to ensure that they do not constitute unnecessary obstacles to trade. Special efforts should be made to accept as equivalent technical regulations of other countries, even if these regulations differ from their own, provided they adequately fulfil the objective of their own regulations. Creation of a central WTO Enquiry Point would facilitate trade and increase transparency
2) Enlarge the scope of consultation with foreign parties, so that they are consulted not only on directly trade-related regulations, but also on other domestic regulations. *a)* Apply the transparency-enhancing approach developed by trade policy bodies, according to which foreign participants are invited at consultative meetings on trade policies, to other domestic policy areas. *b)* Induce all government bodies to put more information about their policy agenda and major current issues on their Internet sites, if possible in foreign languages as well. *c)* Open advisory councils to all interested parties, including consumers, environmental or other NGOs and foreign firms.	Transparency and the scope for foreign participation in the regulatory process have been improved (*e.g.* inclusion of representatives of the American Chamber of Commerce in the Regulatory Reform Committee). Draft regulations are available for consultation of all interested parties during the respective notice periods, and disclosure of Regulatory Impact Assessments (RIAs) has become a requirement. The Korean Government has actively engaged the foreign business community allowing additional opportunities for consultation to address specific policy and regulatory concerns.	Whenever possible and practical, more information about changes to regulations, consultation procedures and public notices should be provided in foreign languages, especially concerning international trade and investment issues. Creation of a one-stop shop for all consultation procedures in English similar to the *www.epeople.go.kr* site may further enable foreign businesses to follow Korean regulatory changes more easily. Since there are multiple business and investment-related bodies that deal with private sector grievances and concerns, the user friendliness of this framework could be improved, ideally through the consolidation of a single window to deal with all business and investor claims and disputes which may be held accountable by transparency.

Recommendations of the 2000 *Review*	Assessment of actions taken since the 2000 *Review*	Further recommendations
3) Speed up regulatory reform, deregulation and market opening in the traditionally highly regulated sectors such as services and agriculture.	Efforts have been made toward reform and deregulation in the agriculture and services sectors but progress has been slow. The Korean Government, at the policy level, recognises these shortcomings and the need to push for these reforms.	Regulatory reform, deregulation and market opening in the traditionally highly regulated sectors such as services and agriculture should be speeded up. Dialogue with stakeholders such as business interests and unions needs to be strengthened to explain the benefits of further regulatory reform and to better understand their concerns in areas such as transition costs and safety nets with a view to building constructive solutions.
4) Engage public efforts to change the bad image of imports and foreign firms among the Korean public. *a)* Enlarge chances for consumers to have contact with imported goods by organising imported fairs, exhibitions, etc. *b)* Give more opportunities to foreign producers to participate in fairs such as the Seoul Motor Show, machine fairs, electronic goods fairs, computer fairs, etc. *c)* Publicise the objectives of the government's market opening policies by using mass media, open seminars, etc.	The Korean Government remains committed to the benefits of open markets and substantial efforts have been made to improve the bad image of imports and foreign firms. The increased imports show the economy has become more receptive to foreign goods. However, nationalistic sentiments, disapproving attitudes and negative perceptions of foreign products, foreign companies and foreign investment continue to be seen among some working-level government officials, the media and the public in general.	Awareness of the importance of market openness should be promoted and efforts to improve the bad image of imports and foreign firms, especially foreign direct investment, should be strengthened with particular attention to working-level government officials.
5) Strengthen the government's efforts to eliminate regulations that have *de facto* discriminatory effects against foreign competitors.	Introduction of electronic procedures in customs and government procurement have enhanced transparency and made discrimination more difficult. In addition to existing mechanisms for business claims such as the Office of the Investment Ombudsman, the Business Difficulties Resolution Center was established in 2003 to deal with claims and complaints from the private sector. The international business community continues to perceive that there is *de facto* discrimination from working-level officials at the implementation level. The Korean Government is addressing this problem through further training and implementation of regulation interpretation manuals.	Co-ordination efforts between government ministries and agencies need to be strengthened Efforts to alleviate the perception of *de facto* discriminatory effects against foreign goods, companies and investment should be strengthened by reducing the room for discretionary interpretation, application and enforcement of regulations through further training and by carefully monitoring the implementation and adherence to the recently issued regulation interpretation manuals.
6) Enhance co-operation between trade policy bodies and other government bodies in charge of domestic regulations in order to reduce trade restrictiveness of their regulatory measures. *a)* Strengthen the supervisory role of trade policy bodies over the regulatory decision making processes of other ministries and agencies: use actively the articles of the Foreign Trade Act that give trade policy bodies the right to intervene in the regulatory making process. *b)* Enhance officials' understanding of trade and investment issues, for example through exchange of views with trade policy officials. Make special efforts for officials of local governments. *c)* Strengthen the role of cabinet level meetings for co-ordination of international economic affairs. *d)* Require explicit assessments of the effects of proposed rules on trade and investment as part of the regulatory impact analysis.	There is some co-operation between government agencies but the degree of progress has been mixed. There has been remarkable progress in areas like customs and government procurement but other areas remain a concern. MOCIE and MOFE are regular members of the Regulatory Reform Committee and are consulted on all issues related to regulatory reform. MOFAT is consulted concerning regulation that may affect trade and investment but is not a regular member of the Regulatory Reform Committee. Although Korea has made good efforts to enhance understanding of trade and investment issues, attitudes of government officials toward reform and market openness in particular varies especially at the working and local levels. The RIAs have to analyse "aspects that hinder fair market competition and business activities", but there is no explicit assessment of the impact on trade and investment.	Exchange of information and co-operation between ministries should be fostered to ensure consistency with international agreements. MOFAT's role in the domestic legislation process may benefit from a stronger mandate (*e.g.* by making it a member of the Regulatory Reform Committee) to effectively carry out the responsibilities to ensure that domestic legislation is in line with Korea's international obligations. Training at the working-level and local-level government officials should be strengthened to enhance their understanding of the benefits of market openness, trade and investment. Explicit evaluation of the impact of proposed regulations on trade and investment should be required as part of the regulatory impact analysis to prevent potential problems in the area of market openness.

Recommendations of the 2000 *Review*	Assessment of actions taken since the 2000 *Review*	Further recommendations
7) Strengthen competition policy enforcement regarding anti-competitive practices that impair market openness. *a)* Keep vigilant that the *chaebol* reform does not give rise to anti-competitive or discriminatory effects against foreign firms. *b)* Integrate the international market openness perspective into the action of the KFTC against the anti-competitive practices of *chaebols* or industrial associations. For example, as part of the *chaebol* reform programme, enlarge chances for foreign companies to participate in mergers and acquisitions.	Consultation mechanisms have been established between the KFTC and relevant government agencies leading to identification and abolition/ improvement of some competition-restricting regulations. The introduction of the Integrity Pact in 2003 has improved regulations on bid rigging and strengthened enforcement has led to imposition of significant fines. There continues to be legal delegation of regulatory powers to industrial organisations. While limitation of foreign companies' participation in these organisations is illegal, there is a continued need to improve enforcement in this area.	Competition policy enforcement should continue to be strengthened for example in the areas of bid-rigging and the improper use of regulatory powers delegated to industrial associations.

ANNEX 4.A2

Assessing Results in Selected Sectors

Automobile and components

As noted in the 2000 *OECD Review*, despite a reduction of general tariffs and the lifting of the prohibition on imports of cars from Japan in 1999, the foreign penetration rate of the Korean motor vehicle market was low at 1% compared to 6% in Japan, 25% in the European Union and 30% in the United States. Trading partners have complained that the bad image of imports in Korea, automobile standards and certification procedures and taxation system were considered to be some of the reasons for this low penetration rate.

Since 1999, the Korean Government has made a substantial effort in each of the above areas. As a result, automobile imports have continued to grow since 1999. The share of imported vehicles in the Korean market increased from 0.26% in 1999 to 2.65% in 2004 and 3.27% in 2005. In particular, imports accounted for 35.2% of passenger vehicles with 3 000 cc and over in 2004.

Consumer sentiment towards imported vehicles has considerably improved as a result of efforts by the Korean Government. The 2005 Seoul Motor Show, which was co-hosted by local auto manufacturers and foreign auto importers, is one example of the government's approaches to create greater market access opportunities for imported vehicles.

Substantial improvement has been seen in Korea's automobile standards and certification procedures. In the area of certification, the Type Approval System was abolished in January 2003 and a Self Certification System was introduced to make auto manufactures ensure the safety of their products. Under the Self Certification System, vehicles are required to be labelled as such and manufactures or importers are held liable for product defects.

In the area of standards, virtually all new standards in the area of safety have been based on international standards (*i.e.*, ISO/IEC standards, UN/ECE regulations and FMVSS) after a thorough review and comparison with them.

In the area of emission and noise, manufacturers and importers of motor vehicles are required to receive noise and emissions certification to ensure that vehicles meet regulations during the warranty period. In the case of off-road vehicles, however, construction equipment such as excavators, loaders, fork-lift trucks, bulldozers, cranes, and rollers is subject to only emissions certification. The allowed levels of emissions vary depending on the type of vehicle and fuel. Gasoline- and gas-powered vehicles are subject to low emission vehicle (LEV) and ultra low emission vehicle (ULEV) certification standards, which is the same as that of California. Euro 4 standards were introduced for light duty

diesel vehicles in January 2006 and are being phased in for other types of vehicles. Noise level standards are equal to those effective in Europe. Auto makers are also required to install on-board diagnostic (OBD) systems on all vehicles. The system has been gradually introduced from 2005 for gasoline-powered vehicles. In the case of diesel vehicles, the system primarily applies to newly-manufactured vehicles in 2006, and then medium-duty vehicles by 2007, and heavy-duty vehicles by 2010. Some trading partners continue to express concerns about policies which can effectively become barriers to trade. The United States for example raises concerns on the lack of acceptance of self test reports from manufacturers.

Automobile taxation system: lower tax rates and streamlined classification

There were three areas where problems were pointed out in the 2000 *OECD Review*; *i*) the special excise tax, *ii*) vehicle tax and *iii*) the Education tax and the Rural Development Tax. All three have been improved as follows:

i) The special excise tax rates on automobiles have been gradually lowered and tax classifications were simplified.

Table 4.A2.1. **Changes in special excise taxes: passenger vehicles**

Engine displacement	1999	Dec. 2001	July 2003
In excess of 2 000 cc	20%	14%	10%
1 500 cc—2 000 cc	15%	10%	5%
1 500 cc or less	10%	7%	

Source: Korean Government.

In an effort to boost consumption of automobiles, special excise tax rates were lowered by up to 30% of the standard tax rates (described in the table above) during a certain period of time.*

The heavy taxation system on households with more than two vehicles was abolished starting January 1999.

ii) Vehicle tax

The tax classification was streamlined from seven to five and have resulted in lowering of taxes as follows.

Table 4.A2.2. **Changes in vehicle taxes: passenger vehicles**

	800 cc and below	1 000 cc and below	1 500 cc and below	2 000 cc and below	2 500 cc and below	3 000 cc and below	Above 3 000 cc
1 998.1	100	120	160	220	250	310	370
1 999.1	80	100	140	200	220	220	220

Unit: KRW/cc.

Source: Korean Government.

* From December 2001 to August 2002 (9 months) and from April 2004 to December 2005 (21 months).

From January 2001, used vehicles are subject to lower automobile taxes and entitled to 5% annual tax cuts three years after registration for up to 50%.

iii) Education taxes and Rural Development Tax

Starting in January 1999, Education Taxes (20% of the registration tax) and Rural Development Tax (10% of the acquisition tax) to promote agriculture and fisheries were abolished, which was followed by the abolishment of automobile license taxes in January 2001.

Environmental standards and promotion of "Green Cars"

The Average Fuel Economy Programme was adopted in 26 March 2004 and became effective as of 1 January 2006. The system applies to vehicles with a capacity of up to 10 passengers, excluding light-duty and LPG vehicles. The standard annual fuel economy is 12.4 km/l for vehicles with 1 500 cc or less and 9.6 km/l for 1 500 cc vehicles and above. If the average fuel economy of a manufacturer's annual passenger vehicle or truck production falls below the defined standard, the manufacturer is subject to improvement and public notification orders. Exceptions, however, are made for manufacturers whose fuel efficiency remained at the same level or showed improvements compared with the previous year.

The "Act on the Development and Promotion of Environmentally-friendly Cars" was enacted in October 2004 and various plans are underway to promote development and wider use of "green" vehicles on a five-year and one-year basis. Moreover, new provisions were added to "Special Act on Air Quality Improvement in the Metropolitan Area" to promote the supply of low-emission vehicles by manufactures.

From an environmental perspective it is desirable to increase fuel efficiency and reduce emissions of vehicles through effective environmental standards. However, such environmental standards should be based on or be in line with international standards where applicable.

Electricity

As noted in the 2000 *OECD Review*, electricity has historically been a sector dominated by Korea Electric Power Corporation (KEPCO), a state owned enterprise. It controlled 100% of transmission and distribution services and owned 94.3% of the total generating capacities in 1999. In January 1999, the MOCIE presented a "Basic Plan for Restructuring the Electricity Supply Industry" and has been promoting Regulatory Reform in this area.

KEPCO's monopoly on non-nuclear power generation was abolished in 1999, and in April 2001, the generation capacity of KEPCO was split into six separate subsidiaries, introducing full competition in the power generation sector (Act on Promoting Restructuring of the Electricity Industry, 2000). These power generation subsidiaries with the exception of one, the Korea Hydro and Nuclear Power Corporation, was to be privatised according to the Basic Plan but has been considerably delayed. KEPCO accounts for 89.9% of total generating capacities in 2005 (compared to 94.3% in 1999).

In order to facilitate the creation of an electricity market, the Korean Electricity Commission was formed within MOCIE as a regulator responsible for licensing electricity businesses and settling disputes between operators, and the Korea Power Exchange was established in April 2001 as an electricity trading pool. KEPCO distribution subsidiaries

were to be formed and competition in the wholesale market was to be introduced by the end of 2002. However, this has been halted and being reconsidered by suggestion from Tripartite Committee of Business, Labour, and Government (June 2004). According to Korean authorities, the setting up of an independent distribution division and privatisation of the one of the generation business is underway.

In terms of procurement in this sector, it was noted in the 2000 *OECD Review* that the proportion of contracts awarded to foreign suppliers was low. As shown in the table below, in 1998 the share of tenders open to foreign suppliers was over 70% and those awarded to foreign suppliers was less than 3%. After 1999 the total value of the procurement contracts decreased dramatically along with the share of tenders open to foreign suppliers. From 2003 to 2005 the share of international tenders rose above 30% and the share of contracts awarded to foreign suppliers also increased considerably. The decrease of the total value of procurements after 1999 is attributed to the fact that the generation capacity of KEPCO was divided after the restructuring of the electricity industry and the available information only includes data for material purchase contracts. The increase of contracts awarded to foreign suppliers is due to procurements of foreign materials from foreign suppliers by the power generation subsidiaries to maintain their power generating facilities. Since the opening of the procurement market, KEPCO has been selling by international tender 450 000 SDR (750 million won) worth of materials and 15 000 000 SDR (25.2 billion won) worth of work. Because of the changes and restructuring in the sector it is difficult to accurately assess the trend of foreign participation, but the steady rise since 2003 is encouraging.

Table 4.A2.3. **Procurement by KEPCO**

	Total contracts	Tenders open to foreign suppliers		Contracts awarded to foreign suppliers	
	Value	Value	Share %	Value	Share %
1998	6 554	4 665	71.18	196	2.99
1999	1 152	148	12.85	39	3.39
2000	1 289	154	11.95	16	1.24
2001	1 506	141	9.36	24	1.59
2002	1 518	174	11.46	16	1.05
2003	2 626	815	31.04	355	13.52
2004	3 736	1 146	30.67	556	14.88
2005	4 145	1 419	34.23	333	8.03

Unit: Billion won.
Data for 2003-2005 includes KEPCO's subsidiaries.
Source: KEPCO.

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 5

Telecommunications

Introduction

In the context of its work on regulatory reform the OECD undertook a review of regulatory reform in the telecommunication sector in Korea during 1999-2000. The *Review* put forward a number of recommendations to the Korean Government. The purpose of the present report is to assess and review the extent to which the OECD recommendations were implemented, to draw policy implications from their implementation, and to highlight issues which have changed and where further regulatory reform may be necessary.

The main recommendations which were put forward by the OECD to the Korean Government in-2000 are shown in Box 5.1. This report, in examining changes in the market, policy and regulatory framework in Korea, will elaborate on whether these recommendations were taken into account, their relevance today and what necessary changes may be required.

The chapter on telecommunications in the *Review of Regulatory Reform in Korea* provided an overview of the development of the telecommunications sector in Korea and regulatory changes which had taken place over the 1990s. This report essentially examines changes which have taken place since 2000.

The telecommunications sector in Korea

The national context for telecommunications policies

Korea, as emphasised in the initial 2000 *OECD Review* on regulatory reform in the telecommunications sector, has made impressive progress in developing its telecommunication infrastructure and service markets. This progress continued during the period 2000-2005 covered by the present report. This period showed continued rapid growth in telecommunication markets and, in particular, the rapid diffusion of broadband penetration in Korea resulting in it becoming pre-eminent in the OECD area in broadband market penetration. In other technological areas Korea has also been among the leaders such as for wireless broadband and digital multimedia broadcasting.

Liberalisation of telecommunication markets in Korea has also had significant benefits in terms of better quality services, lower prices and innovation. The process of market liberalisation was gradual but, by the end of the 1990s, the essential framework for telecommunication liberalisation and market competition was largely in place. Since then further reforms have taken place in order to create conditions for effective competition to develop. Despite these reforms there is still scope, however, for further changes which would help stimulate competition and meet Korea's ambitions to become a leader in the information society.

Korea has placed significant emphasis on the information society and the development of the IT sector. As an example the Ministry of Information and Communication put forward a White Paper on Dynamic Digital Korea in 2004 outlining its

Box 5.1. **Recommendations on telecommunications (*OECD Review on Regulatory Reform in Korea* published in 2000)**

1. Restructure the Korea Communications Commission as an independent communications sector regulator (not fully implemented) and thus clearly differentiate between MIC's policy responsibilities from regulatory responsibilities (some changes).

2. Reduce barriers to entry by introducing a system of general authorisation, thus minimising the requirements to obtain a licence (some changes), reduce the number of conditions attached to licence (some changes), and eliminate the pre-set dates for licence applications (implemented).

3. Implement a price cap system for KT's local charges, leased line services and national long distance services, and eliminate all other price approval requirements (not implemented).

4. Implement an interconnection pricing framework using long-run average incremental cost (LRAIC) as the appropriate cost basis for pricing (implemented).

5. Implement number portability as rapidly as possible and ensure that numbering allocation policies for both wireline and mobile carriers are competitively neutral (implemented). Develop an adequate methodology to cost universal service.

6. Use auctions to allocate licences for 3rd generation mobile services and also for licence allocation in the mobile sector as a general rule (not implemented).

7. More comprehensive measures should be taken to promote infrastructure competition in the local loop, including unbundling of the local loop (implemented).

8. Streamline regulatory framework and introduce competition in the CATV market (partially implemented).

9. Eliminate foreign ownership restrictions in both the fixed and wireless markets (restrictions have been eased but not eliminated).

10. Review regulations in all areas of telecommunications regularly and systematically with a view to streamlining and where appropriate abandoning them (changes have occurred).

strategy for the introduction of new telecommunication and broadcasting services.[1] The White Paper puts forward a number of ambitious plans for the development of the digital economy in Korea. Although it may be important for the government to have a vision of the future development in the communications sector, it is also important to clear the hurdles to competition and ensure that the market environment is conducive for the private sector to choose appropriate technologies and services. Korea now has an ICT manufacturing sector, which is among the leaders in the OECD, and service companies which are well experienced in new communication technologies and services, so that they should be capable of mapping their own technological and service future. The Korean Government must take care that the policy tension that can arise from pushing for technological leadership and priority in the development of ICT manufacturing, and regulating the users of this technology – the communications service sector – does not lead to market distortions, as noted in the 2000 *OECD Review*. As this *Review* argues, the reform process has also been characterised by decisions which have not always been helpful in creating more effective competition or have been concerned with dealing with less important issues rather than tackling some major problems.

Reforms since 2000 have been in the area of market entry procedures, price regulation, local loop unbundling, number portability, interconnection and the accounting system. Despite the important reforms that have taken place since 2000 some fundamental problems which had been highlighted in OECD's earlier *Review* have still not been tackled. These include the fact that a sector regulator that is completely separated and independent of the policy-making institution has not yet been created, and the use of "guidance" on certain occasions by the Ministry of Information and Communications as a means of indirect control on the sector in addition to direct regulation. This procedure is linked with the tendency of the MIC on some occasions to affect conditions of competition rather than use more effective *ex ante* regulations to place limits which would prevent anti-competitive behaviour and allow competition to develop. In addition, one conflict which arises within the Ministry in carrying out its goals in industry promotion and its role in ensuring that the policy framework in place is conducive to the development of effective competition in telecommunication is in the *de facto* "taxing" of telecommunication service companies to raise funds for research and development for the essential benefit of the hardware sector.

The MIC has since 2000 shifted emphasis by promoting service-based competition *e.g.* though unbundling, number portability, etc. At the same time, however, as noted below, it has taken actions which have not helped in the development of service-based competition, for example, by imposing regulations on VoIP, by reclassifying broadband access providers and by not introducing legal requirements to make obligatory access to MVNOs.

A number of OECD countries have started to lighten some of the regulations imposed on market players and in particular on the incumbent. Often such forbearance is because competition conditions are such that further regulation (*e.g.* for prices) is viewed as unnecessary, but also because regulators have had their powers increased and are able to take action if necessary rapidly to forestall any unfair or abusive practices. Korea has yet to reach this more mature stage of regulation because it does not have a independent regulator with sufficient powers, nor does the Ministry of Information and Communication always have sufficient powers or flexibility to act to forestall action which may threaten the competitive environment.

Market performance

In 1999 the telecommunication sector in Korea had total revenues of USD 13.5 billion and by 2003[2] had reached USD 20.4 billion. This meant that Korea became the 9th largest telecommunication market in the OECD area accounting for 2.2% of total OECD telecommunication revenue in 2003 (up from 1.8% in 1999). The sector accounted for 3.4% of Korean GDP in 2003, slightly above the OECD average.

The historic fixed-line incumbent, KT (Korea Telecom) is the 24th largest public telecommunication operator in the OECD area. The fixed network in Korea had expanded during the 1990s at a relative higher rate than the OECD average so that telecommunication channels per 100 inhabitants reached 58.4 by 2003 (compared to the OECD average of 52.9). Since 2000 the rate of network digitalisation, which was lagging in Korea compared to other OECD countries, was rapidly improved attaining 100% digitalisation by 2003. Less rapid growth occurred in mobile markets where the cellular mobile penetration rate in Korea increased from 50.3 subscribers per 100 inhabitants in 1999 to 70.1 in 2003 resulting in Korea's relative ranking in the OECD falling from 7th to

23rd. By 2006 the 2G penetration rate was 79.5 per 100 inhabitants. Korea is experiencing rapid penetration of 3G mobile services.

Like in many OECD countries, the number of subscriber lines per inhabitant is declining as a result of substitution either through broadband and IP telephony or through mobile services. From a peak of 46.8 lines per inhabitant Korea is now at 43.1 lines per inhabitant in 2004. Competition is also leading to a decline in call volume as measured by the number of domestic long distance minutes and local calls over fixed networks.

As shown in Figure 5.1 Korea has excelled in the development and diffusion of broadband in the OECD area. With the broadband market reaching maturity in Korea growth has slowed and by early 2006 Korea's lead in broadband was challenged by a number of other OECD countries.

In terms of the OECD price comparison baskets Korea performs well and has prices below the OECD average. Korea has among the highest international telephone charges in the OECD for business and residential customers.[3] Korea still has relatively high settlement rates as shown in Table 5.1. The table compares settlement for traffic terminating in the US between Korea and the United States and other countries which are at a similar distance from the United States. The reductions in average settlement rates for these countries have been much more significant than in the case of Korea, although since 2002 Korea has shown significant

Figure 5.1. **Broadband penetration**

Historic, top five OECD countries for June 2006

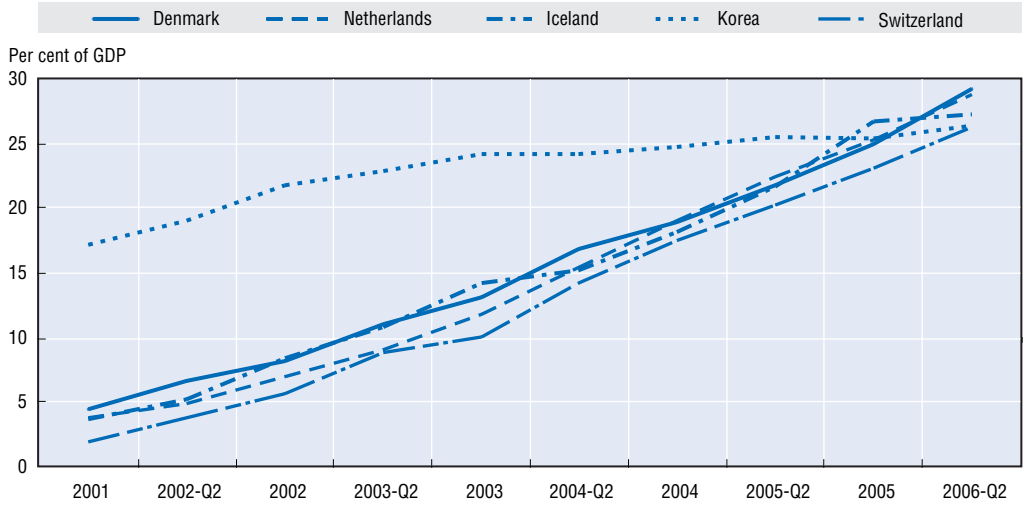


Table 5.1. **Settlement rate for international traffic terminating in the United States**

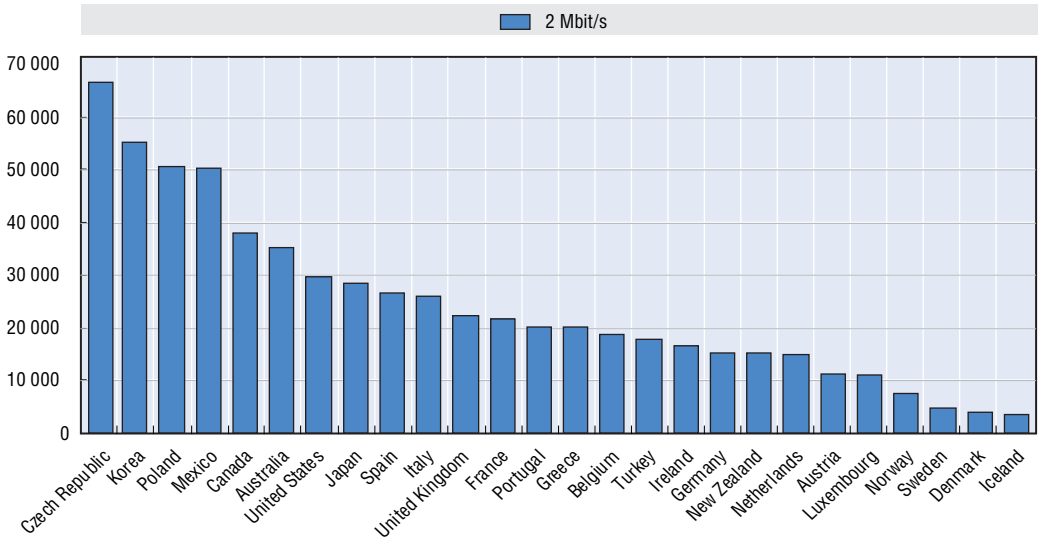
In USD; Settlement rate = Outgoing payment/Outgoing minutes

	2000	2001	2002	2003	2004
China	0.254	0.138	0.071	0.039	0.029
Hong Kong	0.092	0.063	0.069	0.043	0.049
Japan	0.092	0.077	0.068	0.054	0.056
Korea	**0.255**	**0.162**	**0.155**	**0.089**	**0.081**
Singapore	0.135	0.093	0.045	0.048	0.043

Source: Federal Communications Commission, United States, Section 43.61, International Traffic Data.

Figure 5.2. **OECD basket of national leased line charges**

August 2006, USD PPP, 2 Mbits, excluding VAT



Source: OECD and Teligen.

improvements. In addition, Korea has high leased line prices relative to other OECD countries and relative to other countries in the region (Figure 5.2).

General features of the regulatory regime, telecommunications market and market participants

Since 2000, Korea has introduced a number of new regulatory measures as shown in Box 5.2. These include number portability, local loop unbundling, a policy framework for Voice over Internet Protocol (VoIP), the use of long run incremental costs to determine interconnection charges and a framework for universal service. A major achievement during this period was the successful full privatisation of KT which was finalised in May 2002 – a goal that many other OECD countries with state-owned operators have committed to undertake, but have not yet managed to complete.

Reform since 2000 has concentrated in improving conditions of competition as well as in facilitating the introduction of new technologies. The emphasis on broadband in Korean policies has also stimulated a number of changes in particular in the context of unbundling. As noted in Section 2 a number of initiatives have been taken to change legal frameworks, but there have been few changes over the last five years which have led to institutional changes, which was one of the key recommendations in the 2000 *OECD Review*. This has meant that the emphasis within the Ministry of Information and Communications between its goals to promote the development of information technology and the equipment manufacturing sector and the goal toward market liberalisation have, at times, come into conflict. Korea is still not emphasising sufficiently the use of market mechanisms to develop a digital economy. Policy is very much geared to using government financial incentives and development of new services as a growth pole to stimulate research and development and promotion of the manufacturing industry. This has also led to industry complaints that they do not have sufficient time to amortise existing investments before they are pressured by government to invest in new substitute technologies and services.

Box 5.2. **Important events in the liberalisation of the telecommunications sector in Korea since 2000**

2000: Introduction and implementation of universal service system.

2000: Selection of 3G (IMT-2000) facility-based operator.

2001: Ceiling increase of foreign share of KT to 49% from 33%.

2002: Introduction and Implementation of Local Loop Unbundling (LLU).

2002: Sale of government-owned KT shares (complete privatisation).

2002: Functions such as approval of agreement related to interconnection and report acceptance, verification of business report, fact-finding investigation of prohibited activities, correction measures and imposition of fine in case of committing prohibited activities transferred to Korea Communications Commission from the Ministry of Information and Communication.

2003: Introduction and implementation of handset subsidy policy.

2003: Introduction and implementation of wire-line telephone number portability system.

2004: Introduction and implementation of mobile phone number portability system.

2004: Increased ceiling of foreign indirect investment to facility-based operators. The provision regarding the 80% ceiling on a foreign share of domestic corporations, which is regarded as a foreign corporation, is deleted.

2004: Designation of high-speed Internet as a facilities-based telecom service. Designation of VoIP services as a facilities-based telecom service.

2005: Revision of merger and acquisition approval criteria of facilities-based telecom operators. Inclusion of the "impact affecting competition" category into the evaluation criteria and reduction of the examination period.

2005: Revision of approval criteria of facilities-based telecom operators. Introduction of all-time approval system and reduction of approval examination period.

Market participants

The number of carriers participating in major communications markets is shown in Table 5.2. Compared to many OECD countries the number of market participants in the fixed telecommunication market is quite low as is the number of mobile operators. This has implications for competition. These numbers have also been declining over time as a result of the weakened financial state of some operators resulting in mergers and

Table 5.2. **Number of carriers participating in each market**

Category	Local	Long-distance	Int'l	Cellular	PCS	CATV (1)	
						SO	NO
1991	1	1	2	1	–	–	–
1991-95	1	2	2	2	–	53	3
1995-98	2	3	3	2	3	77	104
2005	3	5	5	1	2	2	119

Note: SO refers to Service Operator that runs the channel, and NO refers to Network Operator that provides the physical network.

acquisitions in the telecommunications service sector. For the fixed network, the facilities-based operators are KT, Hanaro Telecom, Onse Telecom and Dacom. Onse provides long distance and international call services, while KT, Hanaro and Dacom provide local, long distance calls and international calls.

The market share of operators is shown in Table 5.3. In Korea there are 3 categories of telecommunication resellers (Category I to III depending on whether they used lease facilities and the service items offered). KT is dominant in all the fixed telephony markets, except the international market.

Table 5.3. **Market share of facility-based operators, 2005**

Market		Market share %
Subscriber lines	KT	93.0
	Hanaro Telecom	6.8
	Dacom	0.2
Local services (2004)	KT	93.8
	Hanaro Telecom	6.2
Long-distance services	KT	79.4
	Dacom	10.7
	Onse Telecom	4.4
	Hanaro Telecom	4.2
	SK Telink	1.3
International services	KT	26.5
	Dacom	24.7
	Onse Telecom	13.8
	SK Telink	9.9
	HanaroTelecom	4.2
	Other resale companies	21.1

Source: MIC.

The mobile cellular market in Korea uses CDMA and PCS technology. Korea, in 2000, had 5 mobile service providers. This number has now decreased to 3 following two mergers and acquisitions (see Box 5.3). The existing service providers are SK Telecom, KTF (the fixed line incumbent has a share of 48.7% of KTF), and LGT with market shares respectively of 50.7%, 32.2% and 17% (April 2006). In 2002 SKT merged with ShinSegi, which had been providing service since 1996. The mobile sector has grown rapidly, but less than in many OECD countries. Mobile penetration rates were at 70.1 subscribers per 100 inhabitants in 2003. By April 2006 the penetration rate was 79.5 per 100 inhabitants. The number of 3G subscribers was 19.2 million (SKT), 12.2 million (KTF) and 6.1 million (LGT) as at the end of June 2006.

In December 2001, 2 IMT-2000 licences (W-CDMA technology) were issued to SK-IMT consortium and KT-ICOM and five months later a further licence (CDMA2000) was provided to LG Telecom (LG lost this licence in July 2006 because it had not complied with the deadline to start 3G services by 30 June 2006).

KT corporation

KT, formerly Korea Telecom, is the incumbent fixed line telecommunication operator. It became a commercial entity under the commercial code in 1997. As noted above it has the dominant market share in the subscriber line market, local and long distance call market and in the broadband access market. The privatisation of KT has been undertaken gradually starting from 1991. The complete privatisation was completed in May 2002 when the government's final share of 28.36% was sold. SK

Telecom, the largest mobile operator, became the largest shareholder of KT with an 11.34% stake. Due to swapping of KT-SKT shares, SKT no longer holds any shares of KT (Brandes Investment Partners has become the largest shareholder of KT). KT is also the only integrated fixed-mobile operator.

Regulatory structures and their reform

Regulatory frameworks and institutions

> 2000 *OECD Review* Recommendations: Restructure the Korea Communications Commission as an independent communications sector regulator and thus clearly differentiate between MIC's policy responsibilities from regulatory responsibilities.

Table 5.4 lists the main legislative instruments providing the telecommunications policy framework in Korea. A number of changes have taken place in these acts to incorporate regulatory changes. As noted in the 2000 *OECD Review* a significant part of the Telecommunications Basic Act is taken up by articles on the "promotion of telecommunication technology", providing the Ministry of Information and Communication (MIC) with authority to "adopt new telecommunication modes", etc. These articles provide MIC with the justification to support new technologies and industry promotion. However, this Act does not sufficiently stress the importance of market forces and the creation of conditions of competition which would help significantly the process of regulatory reform in the sector.

As can be seen from Table 5.4 there are three main Acts applying to the fixed sector. The first two could easily be consolidated. The third is the Telecommunications Business Construction Act which aims to ensure that the construction of facilities by specialised construction companies independent of the telecommunication operators meets a certain

Table 5.4. **Main telecommunications legislation**

Legislation major provisions concern

Telecommunications Basic Act	Basic guiding principles on telecommunications. Ministerial authority regarding promotion of telecommunications technology and technical standards for telecommunication facilities. Management of telecommunication networks. Organisation and operation of the KCC.
Telecommunications Business Act	Licensing criteria and reporting procedures for telecommunication service providers. Telecommunication service providers competition safeguards. Rights of telecommunication service users. Construction and maintenance of telecommunication facilities.
Telecommunications Construction Business Contractors Act	Basic guiding principles for telecommunications construction principles. Construction business classification, licensing criteria and scope. Establishment of the Association of telecommunications contractors.
Basic Act on Informatisation Promotion	Basic guiding principles on building KII and creating an information society.
Basic and Action Plan for Informatisation Promotion	Operation of the Informatisation Promotion Fund.
Radio Waves Act	Efficient utilisation and control of radio waves. Establish Basic Plan for Promotion of Radio Waves. Licensing.
Broadcasting Act	Basic guiding principles on broadcasting Licensing of Terrestrial, Satellite and CATV and programme providers. Technology standards of CATV facilities.

level of quality. The 2000 *OECD Review* recommended that the provisions of the Telecommunication Basic Act which provides the MIC with powers to recommend joint-construction of facilities should be eliminated since construction (as opposed to sharing of facilities) is a business decision. MIC recommends joint-construction of telecommunication facilities only in cases where there is a request from the concerned carrier.

There is a clear need for a comprehensive review of legislation to create a single legal framework for the communications sector which would include telecommunication and broadcasting. This would provide an opportunity to treat facilities in a neutral way, allow facilities to carry a range of different services and take into account convergence issues. Such a review could also highlight the importance in the telecommunication sector of enhancing consumer benefits and creating effective competition as the key elements of new legislation. Such changes would also have profound institutional changes in terms of regulatory structures as discussed below under the heading "Convergence".

The Telecommunication Basic Act needs to be reformulated to provide more discretionary power to the sector regulator (the KCC) to take discretionary action. Because of this lack of discretionary power to act when market developments are not conducive to competition the MIC is constrained to take action which are seemingly unusual. For example, the Act basically allows the application of *ex ante* regulation for facility-based services. In 2004, broadband access services market was reclassified as facility-based services. This subsequently allowed *ex ante* regulations to be imposed in this market. The Act further restricts the ability of the regulator to take action because in the case of facility-based services, action can only be taken against a company if it has a 50% market share and if the business size of the company – measured by revenue is above a threshold business size in that market set by MIC. For price regulation the firm with the highest market share and the revenue from the service in question exceeds the threshold business size for that service set by MIC. This lack of discretionary power has also led MIC to impose in the licences for WiBRO a stipulation that after the market has reached a level of 5 million subscribers then it would be possible to licence MVNOs to enter the market (a premature stipulation in particular when obligatory requirements have not been implemented to permit MVNOs for the 2G mobile market). The law should not equate market share with market power, which is not necessarily the same, and contrary to other countries does not require the regulator to undertake market analysis to determine whether there is dominance and on this basis impose *ex ante* regulations.

It seems that the Ministry of Government Legislation (MOLEG) is opposed to allowing a Ministry to have a free hand to take discretionary action in the market if such action is not based on specific legal enactments. The issue seems to be that government institutions are not given power to interpret "abstract" concepts such as "dominance". A solution to this dilemma is the devolution of these powers to an independent regulatory body which could be given such discretionary power (the KFTC is allowed through a Ministerial decree to have such power) thus allowing the regulatory body to impose *ex ante* regulation when, after adequate market analysis, a problem becomes apparent relative to competition in that market.

Ministry of Information and Communication

The MIC is responsible for establishing and co-ordinating informatisation policies, high-speed information and communication networks, and information protection, foster

ICT industries, foster the telecommunication business and establish and administer policies regarding spectrum and broadcasting. In addition, it has responsibility for postal services although these are expected to be shifted to a separate postal entity in the near future.

The 2000 *OECD Review* highlighted the conflict in the ministry between industry promotion activities and policies and decisions aimed at fostering the development of an open and competitive telecommunication service market. Changes have taken place in the responsibilities of MIC, namely by transferring certain market oversight functions to the Korea Communications Commission (KCC) (see below). There is still, however, further scope in increasing the independence of the KCC from the MIC and separate more clearly industry promotion from policy and regulatory functions. In this context these changes are far from being sufficient although they have set the groundwork for the future creation of an independent regulatory body for the communication sector.

Since 2000, however, there has been an important shift in emphasis by the MIC by placing greater stress on service competition as opposed to facility-based competition. This shift has helped open the market through the implementation of policies such as unbundling. Despite this, there is concern in the industry that the focus of MIC is more on managing the process of competition rather than creating the right conditions to stimulate the process of competition.

To highlight the role of MIC in industry promotion,[4] it is sufficient to mention a number of projects which came within the context of the "IT 839" strategy published in 2004. Projects include WiBro (Wireless Broadband) service with commercial selection of operators in March 2005 and commercial operation in 2006; Terrestrial-Digital Multimedia Broadband (T-DMB) service launched in the December 2005 in the Seoul area and extending throughout the country in 2006; BcN (broadband convergence network). Given the limited number of companies in the market, such new projects invariably include dominant companies and thus tend to provide an added advantage to these companies. In this context there is a conflict between policies aimed to promote new technologies and services and those aimed at reducing the advantage of operators with dominant market power.

Promoting new services may also have financial implications for existing service providers who wish to recuperate their investment from existing investments. Certainly it is important to ensure that market conditions facilitate the entry of new technologies and services, but the choice of when to begin using these new technologies and services should be left to the market. At the same time it is important for the government to provide the necessary resources for these new commercial activities in the form of spectrum or numbering resources.

The MIC has been alleged on a few occasions to have used "administrative guidance" to induce market players to follow certain line of actions, for example in the pricing of services. Some market participants have commented that some of these administrative recommendations may in fact not be within the scope of existing policy frameworks. Such decisions have also resulted in market players being caught between actions taken by the competition authority and the MIC (see below). It is important in order to foster more transparency and predictability in the market that "administrative guidance" is not used. Some of these administrative decisions relate also to planning market development.

Korea Communications Commission (KCC)

The KCC is set up within the MIC under the Telecommunications Basic Act. The Commission (maximum of 9 Commissioners including the Chairman) is appointed by the President. The term of the Chairman is 3 years, which is shorter than is the case in many countries, and can be renewed. Employees of the KCC are officials of the MIC but also include other private experts. Therefore, the KCC does not have the same degree of independence in comparison to the majority of its peers in other OECD countries.

The responsibilities of the KCC were enhanced at the end of 2002 and include responsibility in areas such as discrimination in the provision of facilities and interconnection, unfair pricing including for interconnection charges, and violation of service contracts. The KCC has no legal obligation to notify the MIC when it finds unfair practices as a result of its investigation and it can take action against these unfair practices on its own. KCC is also responsible to arbitrate in disputes between carriers and between carriers and users. As a result of these changes the KCC has begun to play a much more active role in the market. Even though the KCC still lacks independence the transfer of responsibilities has some positive implications in that it has begun the process of differentiating policy formulation from functions related to enforcement of laws and regulations. It has also, as noted above, provided an important stepping stone to the eventual creation of a regulatory body.

Earlier work at the OECD, as well as the Peer Reviews of telecommunication policy taken in the context of regulatory reform, have stressed the importance of having a regulator independent of government ministries on the basis that an independent regulator maintains a distance from the ministry or other government bodies that remain as the major shareholder of the incumbent and, an independent regulator can avoid conflict of interest that can occur if the regulator is also responsible for industry promotion.[5] For this reason this paper has taken the position that MIC should step back from regulating whereas KCC can be used as a basis to create an independent regulatory body. An important power for an independent regulator to be effective is to have sufficient powers to initiate action on its own and put in place at an early stage *ex ante* regulation to facilitate competitive conditions in the market to prevent dominant positions becoming embedded.

Despite obtaining new functions in 2002 the staff of KCC was not increased significantly so that at present it has 45 staff (compared to 20 in 2000). KCC's staffing level is clearly inadequate in order to effectively undertake the functions that have been assigned to them and it should have the resources that correspond to its mission.

Korea Fair Trade Commission (KFTC)

The KFTC enforces the general law about cartels, company mergers, abuse of market dominance and unfair business practices in the context of the Monopoly Regulation and Fair Trade Act (MRFTA). KFTC and MIC have joint-responsibility regarding unfair trade practices within the ICT sector. According to agreements reached by the two organisations, the MIC regulates unfair activities as stipulated in the Telecommunications Business Act. The KFTC regulates all unfair business practices, such as cartels, abuse of dominant position, and violation of consumer protection laws. Questions on mergers and acquisitions are co-ordinated by both organisations. In addition, when changes are being proposed to legal frameworks and when these have implications for competition, then the

Box 5.3. **The roles of KFTC and MIC**

On 14 September 2005, the Korea Fair Trade Commission (KFTC) reached a decision to order telecommunications operators in the long-distance, international calls and broadband Internet access services markets to correct violations:

1. KFTC imposed a fine of a total of 25.7 billion won for a violation involving long-distance call prices (KT, Dacom, Onse, HanaroTelecom) against collusion regarding their individual unlimited flat-rate long-distance call service offerings, to have the same service offerings to consumers in order to minimise tariff-based competition.
2. KFTC imposed a fine of 20.6 billion won because the telecommunication operators agreed to co-operate so that HanaroTelecom would obtain 400 000 subscribers for long-distance calls while Dacom and Onse would maintain the level of subscribers they had by end of 2004. In addition they agreed not to introduce any kind of tied services offerings with tariff discounts.
3. KFTC imposed a fine of 5.4 billion won because KT, Dacom and Onse colluded on the level of decrease of international call tariffs, to cope with the low level of tariff offered by resellers.
4. KFTC ordered 6 broadband access companies including KT, HanaroTelecom to publicise their violations in the newspaper. The violations were that the companies agreed to (or not to) prohibit from inserting a monthly usage charge or installation fee into their broadband service contracts and the companies agreed to establish and operate a monitoring group to check the enforcement of the agreements.

The companies claimed that the collusion in question was justified because it resulted from the binding administrative guidance (rather than informal guidance) by Ministry of Information and Communication (MIC). The KFTC in reviewing the claims stated that there was no direct administrative guidance by MIC about the level of tariff and content of service offerings which should be decided by service providers. Under the general competition law (the Monopoly Regulation and Fair Trade Act), collusion resulting from administrative guidance without a clear lawful ground is unlawful.

A cited response in the press was: "We think the FTC ruling was made without considering a tradition in the communication industry that forerunner group members have been encouraged by the Ministry of Information and Communication (MIC) to co-ordinate phone service fees within a level to protect latecomers," a KT official said." Korea Times 15.09.2005.

KFTC needs to be consulted. The KCC has no legal mandate to consult with the KFTC when it takes corrective actions against unfair practices (Telecom Business Act Article 36-3 through 37-2). However, if a telecommunication operator is subject to corrective actions including fines against unfair practices under the Telecommunications Business Act, the same operator shall not be subject to corrective actions including fines under the "Monopoly Regulation and Fair Trade Act" with respect to the same unfair practices (Telecom Business Act 37-3). The KFTC is of the opinion that the KCC should become an independent regulator.

Since 2000 the KFTC has taken corrective action in 35 cases in the telecommunication sector. These include the mergers in the mobile sector (see below) where the order of the KFTC, although consistent with the conception of market power that appears in the telecommunication legislation, did not succeed in creating long term conditions for

effective competition in the sector essentially because of flaws in the legal framework (*i.e.* there was no scope for requiring the licence to be returned, defining market power in a mechanical way).

A recent case points to some confusion in the market regarding the role of the KFTC and the MIC. In 2004 an investigation into alleged unfair collaborative practices in the local and domestic long distance telephone service markets, in the broadband Internet access market, and in leased lines was undertaken against KT, Hanaro Telecom, Dacom and Onse Telecom. The KFTC fined these operators (KT 116 billion won, Dacom 1 billion won, Hanaro 2 billion won). However, the companies claimed that they were following administrative guidance from the MIC. For example, KT in its United States Securities Exchange Commission (20F filing) stated that they were following administrative guidelines from the Ministry of Information and Communication.[6] This claim is subject to legal proceedings in Korea. Although there are guidelines as to whether the KFTC or the KCC should take action on specific competition cases it is not evident that they are always followed and seem to be decided on a case by case basis. This also leads to confusion in the market on the respective roles of the different bodies. In the broadcasting area the Korea Broadcasting Commission has the power to take action in ensure fair competition according to Article 20 of the Broadcasting Act and can levy fines. Fines which have been levied by the KBC have been, however, been in the context of licence violations rather than unfair market practices.

Korea Broadcasting Commission

The major functions of the KBC are the licensing, authorisation and registration of terrestrial, cable, satellite programme providers. The MIC is responsible for frequency distribution, establishment of technological standards, policy formation with respect to broadcasting technology and licensing a broadcasting station. The KBC is responsible for licensing and regulation of broadcast media. In this context the KBC claims responsibility for providing permission to ISPs and other broadband operators to provide IPTV since it considers that IPTV falls within the definition of broadcasting. However, there is no common agreement as to whether they have authority in this area or not (see section on convergence).

Competition environment evaluations

MIC uses an external research organisation (KISDI) to evaluate the level of competition in the telecommunication market and uses the valuation results as a reference to telecommunication market policies. The markets for local, long distance, and international calls, mobile and leased lines have been subject to annual evaluation since 1999. Such evaluations are important and undertaken by many regulators and are now being used by MIC to determine whether *ex ante* regulation, including price controls, should be imposed in different markets.

Regulations and related policy instruments in the telecommunications sector

Since 2000 a number of improvements have been undertaken in the policy and regulatory framework aimed largely at facilitating the ability of new entrants to compete in the market. To some extent these changes have also signalled a shift from emphasising only facility-based competition to placing more importance on service-based competition. *Ex ante* regulation is applied only to facility-based service providers. All facility-based service providers are subject to accounting separation requirements.

Market entry

2000 *OECD Review* Recommendations: Reduce barriers to entry by introducing a system of general authorisation, thus minimising the requirements to obtain a licence, reduce the number of conditions attached to licence, and eliminate the pre-set dates for licence applications.

An important improvement since the 2000 *OECD Review* has been in market entry requirements. These are shown in Table 5.5. Since December 2005 facilities-based business can apply for a licence whenever they wish (before there were only two periods in the year when applications could be filed). The screening period for applications has been shortened from 3 to 2 months. Obligations on facility-based providers include preparing a business plan, preparing a sales plan, a technology plan and a R&D plan.

Licensed facilities-based providers are subject to charges (0.5% of the previous year's sales value). Under the Telecommunications Basic Act facility-based service providers and specific service providers are obliged to contribute a share (dominant operator 0.75%, other facilities-based/special service operator 0.5%) of total annual revenues for R&D expenditure.[7] These charges are not necessary. Licensing should be assessed on a cost-oriented basis (*i.e.* the costs incurred in processing a licence) and the fixed-line facilities-based service providers should have no financial obligations other than those normally required for the private sector in form of taxation and participation in a universal service fund.

There is no longer any limitation of entry in the Korean telecommunications market. It is thus appropriate to implement further loosening of market entry requirements in the fixed line market by using a simple registration framework. This would be an important step in view of the small number of participants in the market and the lack of effective competition in this market and would reflect OECD best practice in the context of market entry.

Landing cables in Korea requires a facilities-based licence. It should be possible to land cables through a general authorisation procedure. A company also needs to contract with a local operator or establish a joint venture in Korea to land cables.

Table 5.5. **Market entry requirements**

Category	Facilities-based	Special	Value-added
Facilities	Owned	Leased	Leased
Service type	Telephony Leased line mobile Internet access Phone Paging Terrestrial radio system	Voice resale Internet telephony Call back	Data Transmission Online service
Entry requirement	Authorisation (licence)	Registration	Notification

Source: MIC.

Voice over IP

Korea recognises VoIP service as a distinct service category. Facilties-based and special operators can both provide VoIP services. A special service provider can carry out business through registration.

As an alternative to the PSTN, local operators started using VoIP technology to provide voice services to their existing customers, and they requested clarification from MIC to

confirm that the provision of voice services using VoIP technology would come within their existing local license. The MIC confirmed that VoIP-based voice provision still came under the existing facilities-based local telephone service license, and that the providers of VoIP services were allowed to use geographic numbers subject to certain requirements. The requirements state that the VoIP providers must not unduly discriminate against subscribers in terms of quality and usage conditions compared with those served by circuit-based technology and the VoIP providers must meet the legal obligations imposed on the traditional PSTN local telephone service license holders, including the provision of emergency calls, universal service obligation, provision of carrier pre-selection for long-distance calls, and compliance with local call areas. This confirmation enabled the alternative PSTN operators to continue to use local geographic numbers in attracting customers with the low cost technology. MIC issued a separate license to facilities-based VoIP providers in the first half of 2005 and also allowed business by special service operators through registration.[8]

VoIP is classified as a basic service in order to guarantee to the VoIP provider the right to interconnect with the PSTN and to obtain a call number. Korea is also one of the few OECD countries where the use of a nomadic VoIP service provider, not geographically located in the country (*e.g.* such as Skype), requires local presence. To provide services without local presence in Korea nomadic companies need to conclude a contract with a local operator or it can register as a special service provider (PC-to-PC type VoIP service can be provided through notification).

Foreign ownership restrictions

2000 *OECD Review* Recommendation: Eliminate foreign ownership restrictions in both the fixed and wireless markets.

Progress has been made since 2000 with respect to foreign ownership restrictions in Korea. The ceiling on foreign ownership increased from 33% to 49% (see Table 5.6). This is higher than the commitment by Korea in the context of the WTO agreement on basic telecommunications. Nevertheless, Korea has relatively severe restrictions on foreign direct investment in the telecommunications sector, while some countries also impose different levels of restrictions.[9] For cable networks foreign-investment must not be more than 49% of the total investment amount (similarly for cable and other programme distribution).[10]

Table 5.6. **Foreign ownership restrictions**

Classification		Restriction	Remarks
Foreign Ownership	Facilities-based telecommunications operator Reseller Value-added telecommunication operator	49% No limit No limit	Regarded as a foreign corporation: a domestic corporation which has a foreign government or foreign shareholders possessing more than 15% of shares is considered as a foreign corporation when the foreigner is the largest shareholder.
Large foreign shareholder		KT prohibited	As a principle, a foreigner who has the largest shareholding of KT is prohibited from holding 5% or more of shares, but there is an exception and the current largest shareholder of KT is a foreign company.

Source: MIC.

From a Korean perspective, the reasons for maintaining the foreign ownership ceiling are linked to the need to maintain national security or to protect public interest. However, all governments can, when necessary, take action to protect national security and public interest through general legal frameworks rather than indirectly through foreign investment restrictions.

In the case of the incumbent, Korea Telecom, the MIC may under the Telecommunications Business Law prohibit a foreign shareholder from being KT's largest shareholder, although through exceptions KT's largest shareholder is a foreign company. In accordance with the Foreign Investment Promotion Act, in the case where 50% or more of issued shares of a company is owned by a foreigner, and when the company is investing in Korea through acquisition, the company is required to report to the Minister of Industry and Energy. As of 1 January 2005 49% of KT's shares were owned by foreign investors.

In addition to the direct restriction on foreign ownership there is an indirect restriction, which by setting a foreign ownership ratio provision designates Korean companies as a foreign entity (a company is deemed to be foreign if the largest shareholder is a foreign entity and owns collective shares of equal to or greater than 15%). The 80% threshold of collective shares owned by foreigners, which was used as the threshold to consider a domestic company as a foreign company for the purposes of foreign ownership restrictions, was abolished. In addition the ceiling on ownership by a single entity was removed in August 2002: this ceiling was 10% for fixed networks, 33% for wireless networks, and 3% for KT.

The easing of foreign investment restrictions should be commended. However, the level of foreign investment restrictions remains too high at this stage and policy should be aimed at eliminating these restrictions. As has become fairly clear, new entrants are often short of capital. Hanaro Telecom, which has played a significant role in stimulating the development in Korea's broadband market and competition in this market, is one example. Experiences in other countries show that other approaches can be taken to ensure that any notion of the "public interest" can be protected other than using existing direct limitations on foreign direct investment. In addition, Korean companies, such as SKT, are beginning to invest internationally so that a more open domestic market may facilitate this process as well. There are no foreign ownership restrictions for resellers or value-added telecommunication operators.

Cable television sector

2000 *OECD Review* Recommendation: Streamline regulatory framework and introduce competition in the CATV market.

The cable television (CATV) sector is Korea has developed rapidly with the number of subscribers increasing from 3.1 million in 2000 to 13 million by 2004.

The OECD's 2000 recommendation is still valid for the CATV sector. The cable television sector in Korea is relatively fragmented compared to many OECD countries. This is because of the differentiation between system operators *i.e.* the companies that put together a package of programmes to offer to subscribers (SO), programme providers who develop or market content (PP) and network operators who provide the network linking SOs to subscribers (NO).

A SO requires a licence from the Korea Broadcasting Commission and the authorisation of the MIC. The KBC is responsible for examining the broadcasting programme and determining whether it is in the public interest, and the MIC examines the technology standards to be used and plans for the establishment of facilities. A PP requires registration to enter the market as do network operators (NOs).

The Broadcasting Act stipulates that a CATV operator cannot own the shares of an other CATV operator when the revenue of the CATV operator accounts for more than 33% of total revenues of all CATV operators, and a CATV operator cannot run its operation in more than 1/5 (20%) of all CATV broadcast areas.

However, despite these restrictions there has been some consolidation in the cable market as a result of allowing mergers since 1999 between system operators and between programme providers. As a result 8 system operators (so-called Multiple System Operators) own 88 SOs and 7 multiple programme providers (MPPs) operate 44 channels.

Table 5.7. **Main system operators in Korea**

System operators	Market share based on number of subscribers (June 2005) %
Taekwang Industrial Co.	28.4
C&M	13.6
CJ CableNet	13.4
Central Network	13.8
Hyundai Department Store	7.8
Qrix	4.4
Other (8 SOs)	18.6

Source: MIC.

Interconnection

2000 *OECD Review* Recommendation: Implement an interconnection pricing framework using long-run average incremental cost (LRAIC) as the appropriate cost basis for pricing.

All facilities-based telecommunications operators are required to conclude interconnection agreements on request within 90 days from the date of the request from any other telecommunication service operator. The MIC is responsible for determining the scope of interconnection agreements, the conditions and procedures and the methodology to calculate interconnection prices. For the incumbent, KT, a specialised agency designated by MIC calculates KT's costs and KT is required to submit required data. An operator with essential facilities (KT) or that has market dominance (SKT) is required to provide access to all facilities including exchanges to allow for collocation and to common channel signalling networks. An operator requesting interconnection can choose the point of interconnection.

Important changes took place in the interconnection framework from January 2004 when the MIC decided to change the system of interconnection by implementing interconnection charges based on a long run incremental cost methodology (LRIC). This came into effect in 2004/2005. The LRIC methodology is applied to interconnection of local, long distance and mobile services. Thus Korea has moved towards applying best practice in this area.

However, it is not clear why this led to a significant increase in the interconnection charges of KT. The trend has been for interconnection charges to fall as they have become

Table 5.8. **KT's interconnection charges**
Won/minute

	Local		Long distance
	Subscriber line	Local exchange	
2000	8.19	4.60	3.01
2002	7.53	5.16	3.46
2003	6.12	5.19	3.38
2004	10.49	5.73	1.62
2005	10.66	5.83	1.64

Source: MIC.

based on forward looking LRIC rather than on historical costs. In the case of KT there was a marked increase in these charges (see Table 5.8 below).

Fixed-mobile interconnection, starting in 2004, was determined by the MIC on the basis of the long-run incremental cost of mobile service providers and taking into account future expected costs and technological change. Charges differ for each operator taking into account network investment costs and call volumes (Table 5.9).

The KCC is responsible for arbitration in the context of interconnection disputes. If contracts on interconnection are not signed within 90 days the KCC can be requested to intervene.

For the Internet the MIC has set general guidelines but allows operaotrs to determine interconnection.

Table 5.9. **Fixed-mobile interconnection charges paid by KT (won)**

	May 2002	January 2005
SK Telecom	45.7	31.2
KTF	53.5	46.7
LG Telecom	59.0	55.0

Source: KT.

Local loop access

OECD *2000 Review* Recommendation: More comprehensive measures should be taken to promote infrastructure competition in the local loop, including unbundling of the local loop.

Joint use

Korea allows joint use of the local loop so that a local telephony or a broadband Internet service operator may use the local loop of other local telecommunication service providers by concluding an agreement. The MIC lays down the criteria and standards for calculating prices for such agreements. Joint use also includes use of poles. An operator designated as a major supplier is required to allow joint use of telecommunication facilities and equipment.

Rights of way

Rights of way regulation applies only to essential facilities, which effectively means that it is restricted to KT's facilities in the fixed market. However, fibre cable networks deployed

since 2004 are exempt from rights of way requirements (this exclusion applies only to new cable and not fibre which replaces copper cable). According to MIC this is a measure to promote investment in wired networks for BcN (broadband convergence network). Such exemptions should be made on the basis of the market conditions *i.e.* whether there is significant market power or not rather than on the basis of different technologies being used.

Carrier selection and preselection

Preselection was introduced in 2001 for long distance operators. Hanaro Telecom was also required to provide long distance preselection as of August 2004. In general preselection has not been successful with a trend toward the reduction in the number of customers choosing preselection for long distance. There may be two reasons for this: the advent of VoIP as well as the increasing use of mobile phones for long distance given that these charges are not distance sensitive.

Local Loop Unbundling

In April 2002, after a revision of the Telecommunications Business Act, full unbundling and line sharing was introduced with the enactment of a MIC Notification (Criteria for Local Loop Unbundling). A local telecommunication service operator is also required to provide line sharing. Unbundling applies to an essential facility, although what constitutes an essential facility has not been well defined in Korea by MIC. KT is subject to unbundling because it has been designated as a dominant operator. There are no published data on the speed in which unbundling was implemented but complaints by new entrants have implied that during this initial period of unbundling only 20-30% of requests for LLU were activated. The fact that KT was penalised for slow activation of unbundling also indicates that there were initial problems.

The LLU criteria were revised in November 2003 to allow for longer periods of mandatory collocation (from 1 to 3 years) and adjust the scope of unbundling from ADSL to cover other DSL technologies. In addition to unbundling dominant carriers are now also required to provide essential facilities to new carriers so that they could use poles, etc. LLU applies to copper and fibre loops. Prices are fixed for totally unbundled loops but appear to be too high. As a result, little use is made of unbundling. For example, by the end of 2005 there were only 435 subscribers using unbundled local loops. This is also partly due to the fact that the main competitors to the incumbent, Hanaro Telecom and PowerCom, have their own facilities. As well, when unbundling was introduced, Korea already had a relatively mature broadband market. This could also explain the relative lack of popularity of unbundling.

The MIC has decided that fibre cables deployed after 2004 should not be subject to unbundling requirements in order to promote further investment in fibre (this applies to new fibre and not fibre replacing existing copper loops). However, such decisions should not be on the basis of the type of technology being used, but on whether or not there is significant market power in the market. By not requiring unbundling there is a danger that this significant power will be transferred to a new area which will also make it difficult in the future to reduce that company's dominant position. Such policy also appears to contradict other statements by MIC where they have explicitly indicated that their policy is to avoid transferring dominance in new technology areas.

There is a so-called reservation rate for unbundled loops which could be up to 25% of loops in a local exchange area. At the end of 2003 this rate has been reduced to 8%. According to Korea operators need the reservation rate for unanticipated needs that arise due to changes in installation location and poor quality cable.

Price regulation

2000 *OECD Review* Recommendation: Implement a price cap system for KT's local charges, leased line services and for national long distance services, and eliminate all other price approval requirements.

Unlike many other OECD countries there has been a relatively less active policy in Korea to rebalance the incumbent's prices so that they are cost-oriented. At the same time the incumbent's prices have been subject to approval by the MIC. By adopting a benchmark of cost-orientation and a rebalancing strategy the approval process becomes more useful as a policy tool while, at the same time, meeting some general social concerns regarding the level of prices or concerns regarding price increases during a period of inflation.

In the PSTN market the incumbent's local telephony prices (monthly subscriber charge and local calls) are subject to approval by the MIC (MIC consults with the Ministry of Finance and Economy). The time required for price changes to be approved is 30 days with the possibility for a one-time extension although market players have complained that in reality price approval takes longer. The incumbent, KT, also is required to have its retail broadband access prices approved since July 2005 when the MIC reclassified the broadband market. For price control the law seems to imply that only the company with the highest market share is subject to regulation. Having a market share over 50% is an important consideration for price approval but other competition indices are taken into account. In addition to regulating price in that market the MIC regulates the general terms of providing services. Telecommunication tariffs which are not subject to approval have to be reported to become effective. In addition, prices of long distance services and leased lines must be filed with MIC.

Price regulation of the local telephony market may result in the slowdown of converged services, as for example in the emerging of fixed and mobile services. For this reason it may be appropriate to review price regulation and use competition powers to stop any perceived abuse from dominance in the market. There are also arguments that local call prices are considered too low for the use of preselection by new entrants.

In principle bundling of services is allowed as long as the incumbent provides a wholesale service to allow competitive operators to provide similar bundling on an equal footing.[11] Thus, when KT introduced its One-Phone service in 2004, which bundled its fixed service with mobile services (using KFT's network), MIC required that the price of fixed calls and mobile calls should be the same as those of each of the separate services. In other words, customers would not have any price discounts. The company was also required to disclose service

Table 5.10. **Telecommunication price changes 1998-2005**

		1998	2005
Local (KT)	Subscriber charge Call charge	4 000 won/month 45 won/3 min.	5 200 won/month 39 won/3 min.
Long distance (KT)	10-30 km 30-100 km 100 km >	45 won/3 min. 172 won/3min. 245 won/3 min.	39 won/3 min. 14.5 won/10 sec. 14.5 won/10 sec.
International (KT)	Standard price to US	14 won/1 sec.	4.7 won/ 1 sec.
Mobile (SKT)	Subscriber charge Call charge	18 000 won/month 26 won/10 sec.	13 000 won/month 20 won/10 sec.

Source: Ministry of Information and Communication.

specifications and terminal information to those firms which wanted to provide a similar service. Restricting price discounts *a priori* will clearly reduce innovation and new services. The impact can be seen in the lack of commercial success of the One-Phone service which after several years is still considered as a "pilot service". The incumbent should be allowed to merge with its mobile service if that could provide new and innovative services, consistent with preserving competition in affected markets. At the same time, however, MVNOs should be allowed so that other fixed operators can also have access to a mobile network.

Universal service obligations

2000 *OECD Review* Recommendation: Implement number portability as rapidly as possible and ensure that numbering allocation policies for both wireline and mobile carriers are competitively neutral. Develop an adequate methodology to cost universal service.

Designated universal service providers are required to provide local telephone service, discount services for disabled and low income persons, telecommunication service for remote islands and wireless communications for ships. KT is the designated universal service provider.

The 2000 *OECD Review* recommended that MIC develop a transparent universal service funding mechanism and move away from the system in place at the time of allowing the incumbent that had responsibility for universal service to fund this through access deficit charges imposed on interconnection charges. This system has now changed. From 2000 a methodology to cost universal service has been applied (see Table 5.11). Exemptions were introduced so that resellers, value-added service providers and regional paging operators and operators with revenue equal to or less than 30 billion won have been exempt from contributions.

Table 5.11. **Yearly compensation for losses in providing universal service (100 million won)**

	2000	2001	2002	2003	2004
Losses	793	764	2 194	1 209	666

Source: Ministry of Information and Communication.

From 2004 to 2007 contributions to the universal service fund have been differentiated to take into account the financial strength of operators: an operator with a net loss for three consecutive years can obtain a 50% reduction in its contribution. An operator which needs government approval for a user agreement (including pricing) can be subject to levies of up to 10% more contribution than the original amount of contribution the operator pays in proportion to its revenue. By differentiating between the proportion that different operators pay there is a danger that the MIC is discriminating against more efficient operators relative to inefficient operators. The flexibility in adjusting operators' contributions to cover the losses in providing universal service is being applied for a period of 3 years according to the Telecommunication Business Act.

The MIC is moving to a LRIC system to determine the costs of universal service and allocate the costs of KT across the different services. The costing of universal service has been transferred to the KCC beginning 8 May 2006.[12]

Number portability

> Implement number portability as rapidly as possible and ensure that numbering allocation policies for both wireline and mobile carriers are competitively neutral.

Number portability was introduced in Korea in 2003 gradually across the country and was completed in August 2004 for the fixed network. KT claim that they have lost 215 000 subscribers as a result of portability (and gained 18 000).[13]

For the mobile network, portability was introduced in several steps. Beginning in January 2004 SKT, the dominant mobile carrier, was obliged to implement portability first, followed by KTF in July 2004 and finally LGT in January 2005. The purpose of this asymmetric approach was to limit the possibility that the dominant carrier benefited immediately from the introduction of portability. For mobile portability subscribers have the ability to switch their number to a new operator immediately unlike in many other OECD countries where this process can be relatively lengthy.

Numbering policy for mobile operators has also changed. All new subscribers are given a uniform number code "010" and existing subscribers can opt to have this code. Once 80-90% of subscribers have the uniform mobile code, the MIC has stated that it will be implemented for all subscribers.

Allocation of spectrum

> Use auctions to allocate licences for 3rd generation mobile services and also for licence allocation in the mobile sector as a general rule.

The MIC should be commended for trying to reform the mechanism to allocate spectrum. During the process of revising the Radio Waves Act in 2000 efforts were made to introduce a spectrum auction system but these were rejected by the Congress. The changes in the Radio Waves Act in 2000 introduced a fee based system for the allocation of spectrum. This was first applied to the 3G mobile licences. The spectrum fee which is set by the government is determined by research institutions based on their evaluation of the market prospects for the relevant service. The government sets a higher and lower limit for fees when allocating spectrum and the firm that applies for spectrum and is ready to pay the highest price gets more points in the beauty contest procedure (*i.e.* the highest bid does not necessarily obtain the spectrum).

A further revision of the Radio Waves Act took place in 2005. This placed a limit on the period for which spectrum was allocated (an initial period of five years) and established a legal basis to charge for spectrum. After the initial spectrum allocation period is terminated the government may renew the period up to a maximum of 20 years. In addition, operators that have paid fees for spectrum are allowed to rent the allocated spectrum. WiBro licences, which were acquired by KT, SKT and Hanaro Telecom, were through a beauty contest (Hanaro subsequently gave up its application for spectrum). The licence fee was 125.8 billion won for KT and 117 billion for SKT.

There is need for further spectrum reform. The MIC should again try to implement an auction system as well as introduce more flexibility in the allocation of spectrum. In particular this could come about by allowing secondary markets to develop in spectrum. The MIC is

investigating whether to introduce an auction system in the mid-to-long term. It is also considering whether to allow leasing or transfer of frequency which was allocated through administered prices. It should also consider policy for allocating the "digital dividend", that is the spectrum that would be made available after the switch-off of analogue TV signals and the adoption of digital TV. Given the increasing importance of spectrum in the communications sector it is also important the MIC determine a switch-off date for analogue TV.

Mobile sector

A major reason for the relatively lower penetration rates in Korea for 2G services is that prepaid mobile subscriptions have not flourished in Korea. There could be a number of reasons for this. The fact that MIC eliminated handset subsidies meant that the cost of handsets is relatively high for those with lower incomes who want to enter the mobile market – these would tend to be the main clients for prepaid subscriptions. In addition, the low ARPU associated with prepaid cards often means that service providers are not very willing to push these subscriptions. This is evident in Korea from the websites of the

Box 5.4. **The mergers of mobile companies**

The KFTC imposed corrective measures on the SKT-ShinSegi merger requiring that the market share of the two operators be lowered to under 50% by the end of June 2001. In itself this request was consistent with the structuralist presumption of the telecommunication legislation about the definition of "market power" (*i.e.* 50% market share), but inconsistent with the requirement to create competition in the market since SKT had to restrict marketing and advertising efforts in order to limit the number of new subscribers. It also resorted to cancelling subscriptions of customers who had bad debt records. However, the KFTC has argued that the measure was taken to prevent the creation of a monopolistic/ oligopolistic market from forming while enhancing the increased efficiency form the merger. In June 2000 Hansol PCS merged with KTF.

For both the Hansol PCS merger with KTF and the SKT-Shinsegi merger it would have been preferable if a condition of the merger was to return the original licence to MIC and to limit the merger to the acquisition of subscribers and the network. However, the laws did not confer the power on either the KFTC or MIC to require this. The fact that the licences (and spectrum) did not return to MIC meant that any possibility in the future to increase competition was limited – after the merger SKT had 45% of the total spectrum allocated for mobile phone services. The problem in this context is that according to Article 14 of the Radio Waves Act an operator who has been allocated frequencies may transfer the right to exclusive use after a lapse of a period as determined in the Presidential decree (3 years). This gap in the law allowed mergers without providing MIC any powers to conditions on wireless infrastructure operators in the event that a merger may have negative implications for the creation of effective competition. In Dec. 2005, the Radio Wave Act was revised and seemed to accommodate this point in the revised Article 14 item 4. The Article 14-4 says that "the MIC minister can put conditions for efficient and fair spectrum use when permitting transfer or lease of spectrum 3 years after initial assignment of spectrum."

An attempt could have been made to further mobile competition when 3G licences were allocated. However, only 3 licences were issued, *i.e.* to existing 2G licensees, instead of following a practice which many other OECD countries followed which was to issue one more new licence (*i.e.* a total of 4 licences) to encourage new entry into the market.

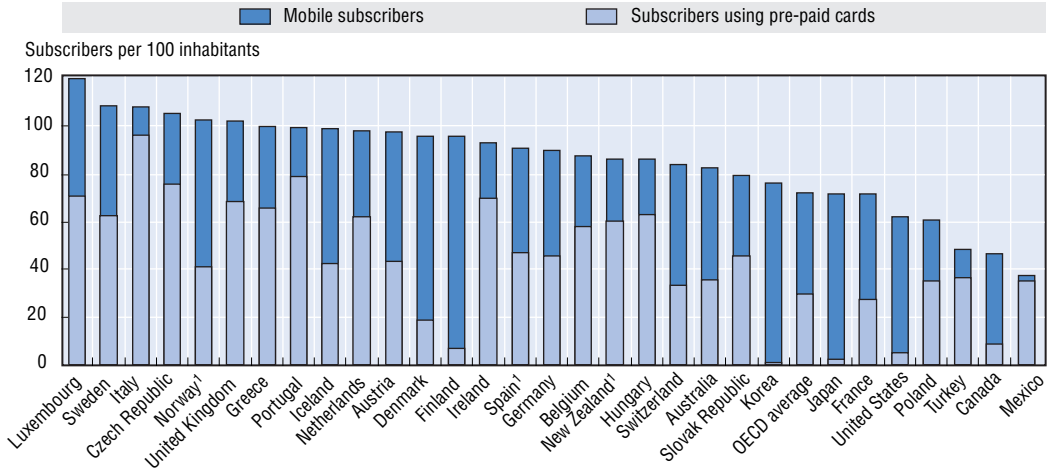
mobile service providers where no information is provided on prepaid options. Data access is also not available on prepaid subscriptions which would also tend to discourage users. The fact that competition has diminished with the reduction in the number of market players could also be a factor in the relatively lower penetration rates.

The dominant player in the mobile sector has been subject to some asymmetric regulations. This is the case for number portability (see below) where the dominant carrier had to provide port numbers to other carriers during 6 months before being allowed to obtain customers through number porting from other market participants. In addition, there is a differentiation in frequency fees between cellular and PCS given that network constructions costs are usually higher for PCS services. At the same time SKT is subject to price controls. This is because SKT has over 50% of the mobile market. The policy, which is set out in the Telecommunication Business Law, of imposing *ex ante* controls automatically on market participant on the basis of their market share alone but does not consider whether a market player has significant market power, should be reviewed in order to replace it with a more rigorous set of criteria which determines the extent to which a market player has significant market power.

The decision to have asymmetric number portability requirements for a 6 month period prior to introducing portability for the other operators only contributed to a limited extent to the reduction of SKT's market share.[14] At the end of 2003 its market share was 54.4%. By July 2004 its market share had declined to 52% and it declined further to 50.9% by January 2006.[15] However, during this period the total number of new subscribers in the mobile market increased by 4.5 million and SKT only obtained 1.3 million of these new customers.

Although the MIC has recognised that insufficient competition exists in the mobile sector its solution have been modest, *e.g.* trying to change policy on mobile handset subsidies or deferring for a short period the application of number portability to the 2nd and 3rd market players, rather than tackling the problem head-on. This should be done by providing spectrum to and licensing more market players and by requiring the existing mobile operators to support MVNOs.

Figure 5.3. **OECD mobile penetration rates, 2004**



1. Estimations.

Source: OECD ICT Key Indicators [*www.oecd.org/sti/ICTindicators*], February 2006.

Korea granted licences for Wireless Broadband Service (WiBro) in March 2005 with commercial service beginning in June 2006. The MIC has played an important role in pushing this new technology on the market. WiBRO license were provided through an open beauty contest. KT, SKT and Hanaro obtained licences, however, Hanaro's licence was revoked. For some market players the introduction of WiBRO was viewed as being too early in that it may jeopardise their investment in third generation mobile services.

MIC has stated that it may introduce MVNOs in this market once the WiBro market has reached 5 million subscribers within 3 years of starting service (just under 14% of the total number of mobile subscribers). The decision or not to increase MVNOs will depend on whether it is considered that there is insufficient competition by mobile carriers and Internet access operators without WiBro.

Handset subsidies

In most OECD countries handset subsidies are used by mobile service providers. These subsidies are usually linked with an obligatory subscription period which tends to reduce competition by locking a customer into a subscription plan. Korea uses the CDMA standard which do not have SIM cards so that unlike GSM handsets which can be unlocked and used for service with other providers, Korean mobile subscribers have to change their handset when they want to change mobile carriers. The policy to forbid the use of subsidies for handsets was based on the argument that there was too much predatory pricing in the mobile sector based on handset competition and insufficient emphasis by operators on competition based on price and quality. The banning of subsidies imposed a cost on consumers in the short term[16] because handsets cannot be unlocked but needed to be replaced. Handset subsidies are clearly viewed as an important marketing tool by the mobile operators who have ignored the ban on several occasions (mobile companies have been fined by the competition authority several times for ignoring this ban).[17] The debate on handset subsidies has been an issue which has been ongoing for close to a decade. The issue of handset subsidies has been difficult to resolve because of several competing regulatory objectives, including consumer protection, effective and fair competition and the balanced development of service markets. It had been difficult to reconcile the different views of the MIC, KCC, and KFTC on handset subsidies policy in the past, and consequently different solutions, particularly at the beginning of the debate prior to 2001 had been put forward. Since then the two sides have reached a consensus on this issue.

An alternative, which could have been preferable, would have been to allow subsidies but limit the legal contract period that mobile operators could require from their customers (*e.g.* to 1 or 2 years) – this in itself would have served to limit the subsidy that mobile operators would have been willing to cover to obtain a new customer. The Korean Government has reviewed setting an obligatory subscription period and allowing subsidies but concluded that this would impede consumer interest and limit their choice of operators and create a lock-in effect limiting the choice of operators for the duration of the contract.

The subsidy on handsets was revived in March 2006 so that subscribers who have been with the same provider for at least 18 months can purchase subsidised handsets. This policy change would be in effect for 2 years. Subscribers to new services (*e.g.*, WiBRO, HSDPA) can obtain subsidies irrespective of the aforementioned conditions. In order to stimulate the take-up of mobile services it would have been more effective if new subscribers could take advantage of handset subsidies instead of existing subscribers. The time a subscriber spends as a customer of a specific mobile operator must be taken into

account when that subscriber uses number portability to move to a new mobile operator, in other terms the 18 month period does not act as a disincentive to change operator.

The development and diffusion of broadband

Korea, until 2006, has been the leader in the development and diffusion of broadband Internet services. Its significant lead in this area has been notable. At the end of 2005 Korea lost its leading position as other countries have caught up (Netherlands, Denmark). The Korean Government played a role in highlighting the importance of broadband. It did this essentially by constructing a broadband network made available for government services and stimulating government agencies to use the broadband network to provide services. A key player in the development of broadband competition was Hanaro Telecom that, instead of concentration on the voice market, decided to market broadband access and managed to obtain an early lead in the market. Broadband coverage was facilitated by the fact that approximately 98% of fixed line customers live within a 2-3 kilometre radius of DSLAMs, by the high population density, and the fact that about 50% of households live in apartment complexes.[18]

There are several issues which need to be reviewed in the context of broadband policy. In July 2004 the broadband access market was designated as a *facilities-based service*. The change in market designation, which was undertaken with the intention to promote competition, came about because in the Telecommunication Business Law *ex ante* regulation can only be imposed on facilities-based services not value-added services (which was the designation used for the broadband access market). This action was taken because KT was viewed as having a dominant position in the broadband market, in particular because its market share in broadband access increased above 50%.

Two issues arise in this context. First, was there any evidence of abuse of dominant position which required controls or action taken against the dominant firm? If so the KFTC should have played a role. Second, why designate broadband services as a facility-based service? If the purpose of designation is to enhance competition then there is a problem with the law which does not provide the flexibility to impose *ex ante* regulations if deemed necessary on a single market player rather than redefine the entire market in order to apply the law. If anti-competitive practices of dominant players in the market can be addressed separately then it was not necessary to designate the broadband market as a whole as facilities-based. As such, it may be useful to reconsider the law so that it provides more regulatory flexibility and rigour so that there is not an automatic response to a company's market share passing the 50% threshold, but more weight given to a larger number of criteria including whether there are close substitutes to the service and whether the firm has its own distribution network, etc. The presumption of the existing clause in the law is that holding a dominant position (defined as 50% of the market) is wrong in itself.

Although the concern by MIC with players having a dominant position should be applauded the remedies tend to be mechanical and without consideration of whether a dominant position is being abused. The policy framework should also become more nuanced and flexible so that it is the company that has a dominant position that is singled out rather than the total market.

As a result of the existing policy framework and by designating the broadband access services market as a *facilities-based service*, operators in that market were subject to the same obligations as PSTN carriers including providing business plans, subject to licensing,

etc., rather than the more simple market entry procedures that they had been subject to as value-added service providers.

Wireless Broadband Service (WiBro) began trial service in Seoul in March 2006. The commercial service started in June 2006 and will be spread from metropolitan cities to nationwide areas.[19]

Regulatory reviews and consultation

> 2000 *OECD Review* Recommendation: Review regulations in all areas of telecommunications regularly and systematically with a view to streamlining and where appropriate abandoning them.

An important part of regulatory reform is the undertaking of regular reviews of the regulatory framework and regulations with the object to streamline, and if necessary remove, regulations which are too cumbersome or no longer necessary. In Korea, as a requirement under the Administrative Regulation Basic Act, an annual review is required of regulations for telecommunication services.

The process of public consultation is not well developed in the telecommunications area. Many regulators in OECD countries will often issue draft proposals for wide public comments (including outside of the immediate sector). Best practice consultations are often followed up with a final proposal which also responds to those suggestions which were made in comments but were not accepted. Adoption of a wider consultation procedure in Korea would be useful not only to end users but to the regulators and would help improve transparency in the market.

Convergence

Although the process of convergence between telecommunications and broadcasting has already begun in Korea, this process could accelerate significantly. However, for this to occur there is a requirement for an appropriate legal and institutional framework to be implemented. Both industry as well as different government bodies in Korea are well aware of the need for policy and institutional change. But, there needs to be much more consensus on the way forward than exists at present, especially between the broadcasting policy and regulatory community and the telecommunication policy and regulatory community. Under the supervision of the Prime Minister's Office a Telecommunication Broadcasting and Telecommunication Convergence Task Force is determining a convergence agenda. This is expected to lead to a Telecommunication Broadband Broadcasting and Telecommunication Convergence Promotion Committee. It is important that such a Committee reaches consensus rapidly.

The Korean Broadcasting Commission administers regulations of the broadcasting industry (but not for infrastructure) and the MIC for the telecommunications industry and broadcasting infrastructure. Nevertheless, in order to operate a terrestrial broadcasting or satellite broadcasting business a licence is required from the MIC (essentially to get access to spectrum) after having received a recommendation from the KBC. Similarly, for cable television the MIC needs to provide a licence (to allow for the construction of facilities) to a cable operator.

The different roles of institutions and the lack of consensus on how to move forward on some issues has stopped telecommunication operators from offering new services. The

offer of IPTV is being delayed until there is agreement between KBC and MIC. This stalemate is occurring in spite of the fact there is a joint Telecom Broadcasting Convergence Promotion Committee set up in July 2006.

Although the MIC is in favour to allow telecommunication operators to offer new content services, such as IPTV, KBC argues that there is a need to change the legal and institutional framework before allowing new linear services to be offered. Under existing laws and regulations CATV operators have a limited regional market. The concern of CATV operators and the KBC, is that telecommunication operators (KT and Hanaro) have nationwide coverage in providing IPTV so they would have a commercial advantage over the CATV operators especially in obtaining programming and in advertising. Providing CATV operators with a nationwide franchise area would be an option. This could be done while still requiring them to maintain a level of regional programming.

In a number of OECD countries IP TV is already on offer without resulting in any significant economic harm to broadcasters. In addition, IPTV is being offered while the number of terrestrial broadcasting channels is increasing as a result of the introduction of digital television (which is not yet occurring in Korea). The decision taken by the CRTC in Canada with respect to mobile TV is worth consideration and can be equally applied to IPTV: the CRTC has put forward a New Media Exemption Order which applies to services delivered and accessed over the Internet and considers "that exempting mobile television services promotes innovation ... without adversely impacting the ability of licensed broadcasters to fulfil their obligations under the *Broadcasting Act*".[20]

This impasse is restricting the ability of telecommunication operators to multiple play and is reducing the ability of mobile operators to manage their own service offerings since they have to use dedicated mobile broadcast channels. Cable industry participants argue that telecommunication operators should be subject to the same rules that they are in offering broadcast content, which would require telecommunication operators to obtain regional licences.

There is thus an urgent need to review existing legislation to allow for a level playing field. Both MIC and KBC seem to agree that there is a need in a converged environment to differentiate between network regulation and service regulation. The KBC and MIC argue in favour of revising the Broadcasting and Telecommunications Act to set up a system of unified regulation and are discussing how to set up a system of unified regulation. The 2000 *OECD Review* has already argued for the need for a more independent telecommunication regulator *i.e.* the KCC should become independent of MIC. In the context of convergence a number of OECD countries have created converged regulatory institutions which are proving to be successful in dealing with issues arising from convergence. If Korea were to follow such a model, which given delays in implementing appropriate policy and regulatory changes, should have beneficial effects, it should do so by merging the KCC with the KBC covering telecommunication regulation, the allocation of spectrum, market entry and broadcasting regulations, as well as content. Ofcom, the UK regulator provides a good example of a converged body, structured horizontally, independent of the policy formulation functions. The converged regulator in Korea would need to be accountable to a policy formulating body which would most appropriately be the MIC.

This new policy framework should abolish cable regional franchise licences requiring a single national license for cable operators and allowing for competition by cable

operators in the same areas. Cable operators should be allowed to offer telephony services with geographic or non-geographic numbers. Telecommunication service providers and Internet Service Providers should also be allowed to offer IPTV on their networks. In order to ensure that telecommunication operators and ISPs can offer IPTV on their networks it will be important to examine the content market to ensure that new entrants to this market have adequate access to content.

In a converged environment many of the existing regulatory provisions would remain. For example, interconnection frameworks would remain in place for telecommunication providers offering voice services. For Internet traffic peer-to-peer arrangements could exist for backbone providers and industry interconnect arrangements would need to be agreed to between market players (with the regulator acting only where no agreements can be reached and where dispute settlement is required).

Conclusions

Korea has made important progress in adopting best practice regulatory practice and in creating the conditions for effective competition in the communications market. Much more, however, remains to be done and, to their credit, the authorities are aware of the need for further changes. Both MIC, the KCC and KBC have developed internal expertise which could allow for rapid changes to be made in existing frameworks which would allow for the development and diffusion of new innovate services to be provided to consumers and which will bring lower prices and higher service quality. They have a good understanding of the issues and possible solutions but need the incentives to work toward a new communications market regulatory framework which would allow for the rapid development of a digital economy.

As noted at the beginning of this report a number of the recommendations made in the 2000 *OECD Review* were implemented or partially implemented. The recommendations which were not implemented still apply and for some of the areas where recommendations were implemented improvements can be made.

Policy recommendations

The following recommendations are based on the above analysis, taking into account the "Policy Recommendations for Regulatory Reform" set out in the OECD *Report on Regulatory Reform* (OECD, June 1997), supplemented by the OECD 2005 *Guiding Principles for Regulatory Quality and Performance*.

1. Ensure that regulations and regulatory processes are transparent, non-discriminatory, and applied effectively.

The recommendation was made in the 2000 *OECD Review* was to restructure the sector regulator, KCC, as a communications sector regulator fully independent of the MIC. Since then the KCC has been given some more powers and responsibilities but not sufficient resources, relative to its mandate, to effectively carry out its responsibilities. The KCC has not changed from being closely linked to the MIC, nor has there been any attempt to provide it with some greater independence. Since 2000, however, the responsibilities of the KCC have increased, most recently by being provided with the responsibility to assess interconnection costs and the compensation of losses related to the provision of universal service. Increasing KCC's responsibilities but not providing it with resources sufficient to carry out its mandate may, arguably, make the KCC even more dependent on the MIC than

in the past. As has been stressed in the previous *OECD Review* on Korea the creation of a fully independent regulatory authority is of prime importance in Korea to ensure transparent and non-discriminatory regulations aimed at maximisation of consumer welfare through a market-oriented regime. In particular, this will help eliminate the conflict that still exists in the MIC between industry promotion functions and telecommunication regulatory functions. Steps should be taken to allow for new converged services to be made available without waiting for new legal frameworks. For example, this could be taken though the MIC/KBC working group on convergence which could allow for telecommunication operators to provide IPTV and for CATV service providers to provide telephony services on an interim basis until agreement is reached on a final framework.

- Undertake a thorough review of the existing communications legal framework in order to make appropriate changes to support a converged communications market structure;
- Restructure the KCC and the KBC to create a single regulatory body to act as an independent communications sector regulator and with MIC responsible for policy.

Although progress has been made in reducing market barriers to entry further changes could be made by emulating OECD best practice, in particular by introducing a system of authorisation (class licensing system) rather than requiring individual licenses for facility-based service providers. Other market participants should be able to enter the market through simple registration procedures. Value-added service providers should not need any specific market entry requirements.

- Introduce a simplified market entry framework through general authorisation for facility-based service providers (class licensing) and registration for other market participants.

The existing practice to impose controls is neither sufficiently flexible nor rigorous. The relevant clauses in the Telecommunications Business Law should allow for a much more flexible assessment of conditions in a market, and the availability of close substitutes to networks or services, and to impose *ex ante* conditions only when necessary rather than as at present on the basis of a criterion, namely market share. A review of specific markets to determine whether market power exists which warrants *ex ante* controls is one way to allow for a much more flexible assessment of conditions in the market.

- Implement an effective framework to address and correct market power problems.

The need to regulate prices of SKT and broadband access prices should be reassessed. If there is a continued need to regulate KT's PSTN prices this should be limited to subscriber line prices at the wholesale level and a target to attain cost-oriented prices should be set. Administrative guidance on prices should be avoided. *Ex post* action can be taken by the relevant authorities if a dominant carrier is suspected of abusing this position through its pricing policy.

- Review price regulation with the objective of reducing and or eliminating *ex ante* retail price approval of KT and SKT.

The importance of wireless technologies is growing so that efficient allocation of spectrum is becoming of key importance. This applies both to the allocation of the initial licence as well as to subsequent use of spectrum. A thorough review of spectrum policies is opportune.

- Use auctions to allocate spectrum licences as a general rule.
- Introduce secondary markets for spectrum.

Future local competition will depend importantly on the ability of alternative infrastructure to offer both voice telephony services and newly developing information services. In this context the introduction of unbundling could help generate competition in the Korean communications market. The fact that unbundling has not been used as much as in other OECD countries where it is available is of concern. A review of prices for unbundled local loops would help clarify whether this is due to pricing or whether the existence of alternate infrastructure reduces the need for unbundling. The limitation of unbundling so that it does not apply to new fibre networks put in place since 2004 may not be sufficient in generating competition and reducing the incumbent's dominant position.

- Local loop unbundling should be extended to apply to all local loops of dominant carriers irrespective of the technology being used or the date of implementation.
- Existing second generation mobile operators should be obliged to allow MVNOs to use their resources.

CATV infrastructure provides one of the most rapid and efficient means to stimulate entry into the local loop. Although improvements have been made over the last few years in industry structure there is still scope to simplify industry structure by not differentiating between service operators, programme providers and network operators. This would allow for the integration of these functions in one company. In addition, entry should be by registration, allowing multiple entry by integrated cable companies in any one geographic area. The decision to allow able television providers to provide voice service on their infrastructure in the first half of 2007 is a step in the right direction.

- The restrictions with regard to the market structure of CATV operators (franchises) should be lifted and they should be allowed to compete in all regional areas and all communication markets.

2. Reform regulations to stimulate competition and eliminate them except where clear evidence demonstrates that they are the best way to serve the broad public interest.

New investment could further competition in the local as well as leased line market and national long distance markets. Much progress has been made in reducing foreign investment restrictions. Further progress can be made by working towards eliminating these restrictions within a given time frame. As noted in the *2000 OECD Review of Korea*, restrictions on foreign ownership may restrain the development of a state of the art communications infrastructure and stimulate the rapid diffusion of new advanced services and technologies, even if these still exist in some countries. Effective means already exist to provide guarantees for network security.

- Take steps to eliminate foreign ownership restrictions in both the fixed and wireless markets.

3. Review, and strengthen where necessary, the scope, effectiveness and enforcement of competition policy.

The KFTC needs to be more effective in ensuring fair conditions of competition in the Korean communications market. The KCC, the KFTC, and the MIC need to co-ordinate in a much more effective way and have a closer understanding of the issues in the sector and how to deal with them.

- Set up a working group of the KFTC, MIC, KCC and KBC in order to explore ways to improve understanding and ensure more co-ordinated action with respect to competition issues in the communications sector.

In the 2000 *OECD Review*, it was emphasised that reviews of regulations need to be conducted more systematically and in depth to ascertain whether the regulations are still in the public interest, benefit users, and whether such regulation should be abandoned or modified. "Forbearance" procedures (or "sunset clauses") should be incorporated to ensure that regulations no longer necessary are eliminated. The 2000 *OECD Review* in particular stressed the need that unnecessary charges imposed on communication facility providers and service operators should be eliminated. An example is the charges to finance R&D. In addition, charges such as those for licences should be cost-based (contributory obligations have been adjusted as part of the revision of the law at the end of 2005).

- Review regulations in all areas of telecommunications regularly and systematically with a view to streamlining and where appropriate abandoning them.

As in most OECD countries the digital divide is of concern in Korea. In Korea the MIC has the ability to introduce a universal service system to ensure the deployment in rural and remote areas of broadband, or use budgetary support to provide satellite access to Internet services. The use of government funding to stimulate developments in the Information Society has become common practice in Korea. For example, in the BcN project the government is investing in a high-tech R&D network aimed at stimulating private investment and elsewhere it is participating in pilot projects. Korea should ensure that the disbursement of funds is competitively neutral and does not advantage existing market players to the detriment of new entrants. This applies equally to the introduction of new technologies which may have the inadvertent effect of strengthening existing market players.

- Ensure competitive neutrality in the development of new services and in policies aimed at reducing the digital divide.

Notes

1. MIC, White Paper 2005, Dynamic Digital Korea, IT 839 leading to U-Korea.
2. In this report the year 2003 is used for comparative data across OECD countries. This is because during the time of drafting in the first half of 2006 the OECD Communication Outlook 2007 was not yet available and the latest end of year comparative data were for 2003 (broadband data are the exception).
3. For example, using the data from the 2005 *OECD Outlook*.
4. MIC has put forward recently: *Broadband IT Korea Vision 2007* (December 2003) which has the aim to overcome economic slowdown with adoption of IT as growth engine.
   Basic Plan for Building of Broadband Convergence Network (BcN) (February 2004) with the aim to create an environment for high quality broadband multimedia through convergence.
   Basic Plan for the Building of u-Sensor Network (USN) which is aimed at attaching electronic chips to objects (promotion of RFID).
5. See for example, *Telecommunications Regulations: Institutional Structures and Responsibilities* (DSTI/ICCP/TISP(99)15/FINAL).
6. See KT, SEC Form 20-F for the fiscal year 2004, *www.kt.co.kr/kthome/eng/ir/data/filling/Form_20F_A.pdf*, page 12.
7. These funds go to the Institute of Information Technology Promotion Fund operated by the government. KT contributed won 64 billion in 2004 (USD 67 million).

8. See OECD, *The Policy Implications of Voice over Internet Protocol*, DSTI/ICCP/TISP(2005)3/Final, *www.oecd.org/sti/telecom*.
9. See, OECD *Communications Outlook*, 2005, Table 2.8.
10. Broadcasting Act, Article 14, Paragraph 3 (revised 22 March 2004).
11. In the Ministerial Decree of the Telecommunication Business Act the "prohibited behaviour" as regards bundled services is when such services harm users or may potentially harm users. In deciding on the harmful effect of bundled services several factors need to be considered including cost reductions, the increase in user benefits and the harmful effects on fair competition which may result in the transfer of market power.
12. KISDI will still maintain responsibility for work on developing the accounting framework for universal service and interconnection.
13. KT, Form 20-F/A, as filed with Securities Exchange Commission (US) on July 18, 2005.
14. Market churn for SKT remained fairly stable during the six month period following January 2004 and the total number of subscriber activations during this period was 2.5 million compared to deactivations of 2.2 million. See *www.sktelecom.com/english/down/06-02-03_SKT_Factsheet_Eng.xls*.
15. *Ibid*.
16. But not necessarily in the long run, as Korean tariffs are generally competitive from an OECD perspective.
17. For example the 3 wireless operators were fined a total of 19 billion won on 6 March 2006 for offering handset subsidies in the beginning of 2006.
18. Korea's population density is 483 inhabitants per square kilometre compared to the OECD average of 33 (or EU-15 average of 118).
19. *http://wibro.kt.co.kr/wibro.comn.Index.laf*
20. See CRTC, 12 April 2006, *www.crtc.gc.ca/eng/NEWS/RELEASES/2006/r060412.htm*.

ISBN 978-92-64-03205-7
OECD Reviews of Regulatory Reform: Korea
Progress in Implementing Regulatory Reform

Chapter 6

The Tertiary Education System

Introduction

This chapter focuses on tertiary education as part of the Monitoring exercise. Tertiary education was not part of the initial 2000 *OECD Review*, but represents a key sector of the Korean economy, if it is to develop into a RD intensive and service-oriented society. This report follows the development of a conceptual and analytical framework for review of national regulatory policies and practices in Higher Education.[1] The preparation of this chapter is based on a Country Response (Republic of Korea, 2006), hereafter referenced as CR. In addition, a Thematic Review of Tertiary Education had been prepared under the education committee in 2005, which led also to the preparation of a country background report, hereafter referenced as TRCBR (Tertiary Review Country Background Report).

Context of the tertiary education sector

As of 2005, Korean tertiary education included 419 institutions enrolling 3.3 million students, lifelong learning institutions enrolling 300 000 students, and more than 2 000 education and training institutions. The two largest institutional categories are universities (41%) and junior colleges (offering 2- and 3-year programmes) (38%). A key dimension of Korean tertiary education is the high reliance on the private sector and financing from students and parents through tuition fees to accommodate enrolment growth. The Government budget for support of tertiary education is only 0.49% of GDP (2003 budget) which is only one-half the OECD average of 1.06% (CR, p. 69). Although private institutions have private founders, they must operate within the framework of the Higher Education Act, the Private School Act, and regulations of the MOE&HRD and other ministries. National universities and public universities within the jurisdiction of local governments constitute only 15% of universities and enrol only 22% of university students. Public junior colleges constitute only 9.5% of institutions at this level and enrol only 4.3% of the students.

Korea has experienced an extraordinary increase in tertiary education institutions and enrolments over the past quarter century fuelled by "education fever" and a "strong desire for academic credentials" (CR, p. 9). From 1990 to 2004, the number of institutions increased by 58% and student enrolments by 110%. Significant increases in secondary

Table 6.1. **Percentages of institutions and students by institutional ownership**

Institutional categories	Percentages by institutional ownership			
	National/Public		Private	
	Per cent institutions	Per cent students	Per cent institutions	Per cent students
Universities	15.2	21.6	84.8	78.4
Junior colleges	9.5	4.3	90.5	95.7

Source: Tertiary Review Country Background Report (TRCBR), pp. 12-14.

education completion as well as tertiary education participation drove tertiary-level increases (TRCBR, p. 7). Liberalisation of laws related to the establishment of universities in 1995, led to a surge in the establishment of new institutions.

Major issues driving higher education reform

Regulatory reform in Korea is a central element of the Government's strategy to increase the country's competitiveness in the global knowledge-based economy. The concern is that Korea must have a higher quality, more diversified, flexible and responsive higher education system to meet the future needs of the nation. The Thematic Review of Tertiary Education Country Background Report (TRCBR), the Country Response to the OECD questionnaire for the regulatory review (CR), and interviews with Ministry officials and others during the review emphasised these points:

- Severe competition to get into prestigious universities has a negative impact on the quality of secondary education and is a threat to social cohesion. The most contentious debates about regulation over the years have been – and continue to be – about how to address this issue (*e.g.*, "exam hell" and private tutoring which represents 2% of GDP). (Kim, G. J., 2005).
- Higher education is not prepared for demographic changes: an ageing population, a projected population shortage in the working age population by 2020, and a shrinking college-age population, and continued population concentration in the Seoul Metropolitan area.
  - The birth rate declined from 1.59 to 1.47 from 1990-2000, with the result that the potential pool of university applicants declined from 4.3 million to 3.8 million in the same period (TRCBR, p. 137). Difficulties in sustaining enrolment are threatening the financial position of private universities that depend heavily on tuition from student enrolment.
  - The population continues to concentrate in the Seoul Metropolitan area and students prefer to attend institutions in this region. Regional universities (outside of Seoul and Gyonggi province) are having increasing problems filling their student populations).
  - Korea is facing a potential crisis in 2020 resulting from the shrinking working age population. The proportion of the population age 15-29 is projected to decrease from 32% in 2000 to 18% in 2020. The proportion age 30-54 will shrink from 48% to 37% in the same period, while the population over 55 will increase from 19% to 30% (Kim, G. J., 2005).
- Korean students are increasingly going to foreign universities for their undergraduate education but Korean universities are not attracting foreign students or professors. These trends further exacerbate the loss of potential university enrolment and the projected shortage of highly educated people. The number of students studying abroad increased by 33% from 120 000 in 1999 to 160 000 in 2003 (TRCBR, p. 137). Despite efforts to increase internationalisation, the percentage of foreign students in Korea totalled 0.6% and the percentage of foreign professors totalled 2.1% (TRCBR, p. 139).
- Hierarchical market competition has not led to differentiation but to a "monotonous system", with many universities offering the same profile of academic programmes. Seventy percent of the universities offer doctoral programmes. The unemployment rate among engineering graduates increased from 9.8% in 1997 to 16.6% in 2003.

- There is a general concern with the quality of education. Industry CEO's are dissatisfied with the knowledge and skills of graduates. The Federation of Korean Industries reports serious concerns about graduates' level of practical and field experience and creativity. The Korean National Statistical Office reports that 49% of junior college majors and 40% of university majors were mismatched or badly mismatched with available jobs (Kim, G. J., 2005).
- Higher education is not well connected to business and industry.
  - Low mobility between academia and business.
  - Universities get a small share of industry's R&D investment (only 1.7% in 2003).
  - Low commercialisation of university-based intellectual property (universities had 1% of patents in 2001, 1.3% in 2002, 1.9% in 2003, and 1.9% in 2004, compared with a 69.1% share of patents by companies in 2001, 70.5% in 2002, 71.9% in 2003, and 74.4% in 2004) (Korea Intellectual Property Office, 2005).

Government priorities

The key education policy of the current government is to establish a tertiary education system that is competitive in the global knowledge-based economy. The main issue is how the regulatory institutions and regulatory tools could be tuned towards achieving those goals. The agenda for tertiary education reforms pursued by the current Government (The Presidential Transition Committee, 2003) (CR, p. 20) include:

- "Decentralisation and Balanced National Development" with specific tasks:
  - "University Specialisation Programmes by Region";
  - "Development of the Foundation for Regional Universities".
- "Education Reform and Realisation of a Knowledge and Cultural Powerhouse" with specific task:
  - "Strengthening of Democracy and Autonomy of University Administration";
  - "Abolition of Academic Cliques and Alleviation of university Ranking";
  - "Sophistication of the Quality of Science and Technology Education".

According to the plan announced by the Ministry of Education and Human Resources Development (MOE&HRD), the aim is to strengthen university competitiveness to reach the national goal of increasing per capita income to USD 20 000 (CR, p. 13). The MOE&HRDs' strategies to address the major challenges emphasise (Kim, G. J., 2005) the following elements, which are supporting the goals and priorities for tertiary education:

- Minimum regulation to maintain social solidarity, reflected in proposals for changes in the university admissions policies by 2008 (see discussion below).
- Promotion of restructuring and competition through use of various incentives and disincentives.
- Targeting funding for specialisation and regional parity.
- Financing learners rather than providers though new student loans.
- Improved labour market information on skill requirements.

Enhancing networking and partnerships between higher education and local governments and the business community.

Box 6.1. **Goals and priorities of tertiary education in Korea**

National goals and public priorities

- Raising tertiary education competitiveness through specialisation of universities.
- Structural reform of universities to respond to decreased enrolment due to low rates of births.
- Strengthening the role of university as an engine to achieve balanced national development.
- Manpower supply meeting the demand of industry.
- Fostering regional universities.
- Establishment of quality assurance system reflecting the changes in the global environment.
- Increasing equal access to tertiary education opportunities as a means of alleviating social and economic polarisation.

Public priorities related to students

- Increasing access to tertiary education services regardless of financial situation.
- Increasing employment by offering curriculum reflecting the rapidly changing needs of the labour market.
- Increasing opportunities for students in the selection of institutions, programmes, and major fields of study.
- Raising the international acceptability of Korean credentials and degrees.

Public priorities related to institutions

- Achieving specialisation to secure competitiveness which can respond to the decrease of students.
- Attraction of foreign overseas students.
- Strengthening co-operation of international networks with foreign institutions and universities for globalisation.
- Management innovation meeting socio-economic changes.
- Strengthening of institutional capacities as well as accountability of universities.
- Enhancing of internal and external evaluations and international accreditation of programmes and degrees.
- Strengthening of industry-academia co-operation.

Source: Country Response, (CR) p. 14.

A perspective on recent historical developments

Recent periods of regulatory intervention

The Country Background report for the Tertiary Education Thematic Review identifies several regulatory periods in the Republic of Korea (TRCBR, pp. 6-7):

- Non-intervention from 1945 to 1960 following Japanese Colonialism.
- Government control from 1960 to 1979. In this period, the Government implemented regulations to limit uncontrolled growth of universities and to maintain quality. Regulations included a limitation on student recruitment, degree registration, university entrance requirements, a degree confirmation examination, a college entrance

examination, and the Private School Law (1963). In 1974, a university specialisation programme attempted to allocate roles among the different universities and to foster development of regional universities.

- Unsuccessful liberalisation in the 1980s. Efforts to reform the university entrance processes including deregulation of the number of students admitted and admission policies were attempted but implementation was problematic and ineffective.
- Beginning of significant regulatory reform in the early 1990s. With the election of the first civilian President in 1992, regulatory reforms emphasised increased autonomy, decentralisation, deregulation, and an education system focused on users. In 1996, the Government introduced the "Simplified University Establishment Rules", intended to encourage competition and thereby cause some universities to excel while others would cease to draw students as a result of market forces. In contrast to the intent, Korea experienced an explosion in new private universities, many of questionable quality, and weaker institutions continued to exist. The current Government is proposing changes that would again strengthen the regulations for the establishment of institutions. In this early period, the MOE pursued a "Sunset" process whereby existing administrative rules were terminated and, where appropriate, new policies were established. The Country Response indicates that this led to a reduction in the overall number of regulations affecting tertiary education.
- A renewal of reform following the economic crisis of 1997 and the election of a new President in 1998, including both deregulation and aggressive new initiatives such as Brain Korea 21 (BK 21) to increase Korea's competitiveness in the global knowledge economy.
- Continuing emphasis on regulatory reform from 2003 to the present. Government Capacity to Assure High Quality Regulation, the administration of President Roh (inaugurated in 2003) reoriented the reform process away from simply reducing the number of regulations to a greater focus on regulatory quality. In this context, the Government, led by the Ministry of Education, has been pursuing a broader range of initiatives related to the quality of regulation, emphasising increased institutional autonomy and structural reform balanced by a new generation of regulatory policies related to quality assurance, evaluation, transparency and improved information for student choice.

Cultural and historical context

The motivating forces behind regulation of tertiary education in Korea are in many respects fundamentally different from those found in other developed countries, especially those in Europe, where the state has been – and continues to be – the principal provider (either direct or through state authorised corporations) and source of funding for tertiary education. As summarised in the Country Response, "The justification of government intervention in tertiary education in Korean history can be found in the "socio-cultural background' more than in economic factors such as failure of the market" (CR, p. 11). Table 6.2 illustrates this contrast.

Divergent views of tertiary education create serious barriers to reaching consensus on regulatory reform. These perspectives differ in particular on key issues of the relationships between faculty and institutions, the internal governance of institutions, and the

Table 6.2. **Regulatory environment in Republic of Korea in comparative context**

Countries where the state is the principal provider and source of funding	Republic of Korea
Demand for tertiary education accommodated by deliberate decisions by government and largely through expansion in government controlled and subsidised institutions	Demand accommodated primarily by private institutions and with low levels of public subsidy
Financing provided primarily through public subsidy with limited (and in some cases intentionally no) funding from students and parents	Funding for expansion of tertiary education provided primarily by students and parents with comparatively low levels of public subsidy
Historically, a high emphasis on centralised bureaucratic control of state institutions and low reliance on the market	A consistent reliance on a mixture of strong "market" demands from students and parents for tertiary education balanced by regulatory controls the whole tertiary education sector (public and private)
In recent years, a shift toward "steering" through market mechanisms and emphasis on decentralisation, *ex ante* regulation greater institutional autonomy, and diversification of non-governmental funding	Shift toward more limited regulation and use of targeted subsidy (*e.g.*, Brain Korea 21 – BK21 and New University for Regional Innovation – NURI) to enforce the public interest, ensure responsiveness to social and cultural pressures for equity and other public priorities, and stimulate institutional change

Source: OECD Secretariat.

relationships between institutions and the state. The current tertiary education system reflects a mix of conflicting culture and traditions (KIM Ki-Seok, 2006):

- Centuries-old indigenous traditions of academic circles ("Gates") with prominent scholars of Buddhism and Confucianism as the central figure that operated outside the European concept of university.
- The impact of American missionaries who introduced the concept of American colleges in the late 19th century.
- The impact of the Colonial Era (1910-1945) in which Japan imposed a version of the German Humboldtian university on Korea, resulting in a tradition of strong professorial autonomy within the university structure, elected presidents, and a separation between academic structures controlled by the professoriate and administrative matters performed directly by Ministry officials.
- The higher education system established during the US Military Administration (1945-1948), which strongly influences the current Korean tertiary education system. These traditions emphasise, in contrast to the Humboltian tradition, strong presidential leaders responsible for academic and administrative policy, academic administrators (deans), academic departments, collegial faculty governance at the university and departmental levels, and open democratic governance engaging students and other stakeholders in addition to the professoriate.
- The reality that many of the current faculty of Korean tertiary education institutions received their graduate education in the US or Western Europe with the result that they tend to refer to these experiences in shaping their expectations about Korean institutions.

Each of these points has had a profound impact on the Korean regulatory framework for tertiary education. They present significant challenges for the Government as it pursues reform.

Regulatory framework

Regulatory oversight entities

The regulating entities include not only the Ministry of Education and Human Resource Development but several other ministries. Entities involved in tertiary education

including both government and non-governmental organisations: The MOE&HRD is the lead ministry on tertiary education policy. The Minister of Education and Human Resources Development has dual responsibilities as the leader of education policy as well as Deputy Prime Minister for Human Resources Development. Table 6.3 displays the full range of governmental entities and the main regulations for which they are responsible.

Korea relies on non-governmental agencies such as the Korean Council for University Education (KCUE) and the Korean Council for College Education (KCCE) to carry out regulatory functions through indirect rather than direct governmental intervention. For example, as discussed below, reforms intended to increase university autonomy have delegated to KCUE the responsibility for establishing the basic plan for university entrance and the management of personnel files of academic staff and certain record-keeping activities related to national universities (CR, p. 25). Table 6.4 lists the non-governmental entities and their principal regulatory roles.

Table 6.3. **Governmental entities involved in tertiary education regulations**

Institution	Main regulations
Ministry of Education and Human Resources Development	Regulations related to school operations such as establishment, student affairs, personnel and financing
Ministry of Planning and Budget	Regulations related to the budget allocation and execution of national universities
Ministry of Government Administration and Home Affairs	Regulations regarding the limit on administrative staff for national and public universities
Ministry of Science and Technology	Regulations regarding the method and results of research related to science and technology
Ministry of Commerce, Industry and Energy	Regulations regarding the execution of industry-academia research and projects
The Korean Intellectual Property Office	Regulations related to the patent application of academic research results
Ministry of Labour	Regulations related to the working conditions and labour practices of private university workers
Ministry of Environment	Regulations related to the disposal of pollutants such as waste at universities and regulations related to the environmental impact analysis
Ministry of Justice	Regulations related to the immigration policies and visa issuance of foreign students
Ministry of Health and Welfare	Regulations regarding the limits on enrolment in health and medical studies
Ministry of Construction and Transportation	Regulations related to the establishment of universities in the capital region

Source: Country response, Table 6, p. 32.

Table 6.4. **Non-governmental agencies involved in the evaluation of tertiary education**

Agency	Main regulatory role	Remarks
Korean Council for University Education	Comprehensive evaluations of four year universities	Voluntary participation
Korean Council for College Education	Evaluations of programmes at junior colleges	Voluntary participation
Accreditation Board for Engineering Education of Korea	Evaluation of the engineering faculty department	Voluntary participation
Korea Medical Studies Education Evaluation Centre	Evaluation of the medical studies department	Voluntary participation
Korea Nursing Studies Education Evaluation Centre	Evaluation of the nursing studies department	Voluntary participation

Source: Country response, Table 7, p. 33.

Scope of regulation

The Constitution of the Republic of Korea, Article 31, Paragraph 6, requires that the basic rules regarding operation, financing, and the status of teaching staff for education systems, including school and lifelong learning, must be stipulated by law. Therefore, the Higher Education Act and related enforcement decrees regulate activities such as the establishment of universities, organisation, curriculum, student selection, and staffing (CR, pp. 28).

Regulations differ according to type and characteristics of the institution (*e.g.*, universities, junior colleges, industrial universities, open universities, etc.), founders (the national government, local autonomous governments, or private corporations/education foundations) (CR, pp. 39-40).

- Regulations related to institutions concern:
  - Governing establishment and operation of private institutions under the Private School Act.
  - Defining the parameters for institutional decision-making on academic policy.
  - Governing student enrolment and selection methods.
  - University decisions on research related to governmental support.
  - Human resources, including decisions by national and public institutions on types and qualifications of professors.
  - Institutional financing and structure.
- Regulations related to students concern:
  - Eligibility for entrance and student selection.
  - Limits on enrolment (quotas).
  - Student financing.
- Regulations related to research, science and technology, including research funding support, protection of intellectual property rights, and other matters.

The Annex includes a more extensive listing of regulations related to institutions, students, and government-support research, science and technology.

Limits on institutional autonomy

From a legal perspective, Korean tertiary education institutions (national, public and private) have significant autonomy on academic and substantive issues. Nevertheless, this autonomy is limited in several specific ways that, from the perspective of higher education, restrict essential elements of autonomy (Kim, Ki-Sook, 2005) (CR, pp. 64-65).[2]

Student selection

Student selection is regulated by:

- prohibiting universities from requiring written exams for admissions, in order to "normalise" secondary education, discourage private tutoring;
- targeting certain high schools (high school ranking) for admission; and
- enrolling students based on contributions from parents.

The selection process is further restricted in terms of "regular" selection and "occasional" selection. These three regulations are commonly referred to as the "Three Nots".

Enrolment quotas

Regulations establish enrolment quotas at:

- All institutions in the Metropolitan Seoul area in order to curb congestion in the capital region.

- National and public universities to the extent that enrolments directly affect the national budget.
- Teachers' universities and health professions departments (*e.g.* medicine and nursing) to ensure a match with labour market demand in these fields.

Research

Universities have autonomy to decide on what research to pursue, but if the Government provides support for research, Government guidelines must be followed (*e.g.*, funding provided under the Industry-Academic Co-operation initiative).

Student affairs administration

Government regulations define the minimum requirements and basic parameters for institutional decisions on student affairs administration issues such as the schooling period, years required for graduation, hours required to earn credits, and other academic matters (see illustrations in Table 6.3).

Appointment of staff

The Government through the MOE&HRD administers and supervises the appointment of secretary generals, directors and deputy directors at national universities and controls the appointment of staff while autonomous local governments have the same responsibilities with respect to public universities. The reason for such control is that university staff have the status of "public officials" with certain benefits and privileges associated with that status. The Government is pursuing increased autonomy for appointment of academic staff at national and public universities (CR, p. 66), while private institutions have substantial autonomy in the appointment of academic and non-academic staff.

Budget and financial management

National and public universities have limited autonomy on procedural matters such as budgeting, financial management, purchasing and entering into contracts, according to the Budget and Accounting Act and other laws.

Private institutions have substantial autonomy in these matters, subject to safeguards in the Private Schools Act.

Government initiatives to increase autonomy

Since 2003, the MOE&HRD has been pursuing a consistent agenda to increase academic autonomy. Initially through the work of the Academic Autonomy Promotion Committee and then after April 2004, the Academic Autonomy-Structural Reform Committee, the MOE&HRD has been following a two-phase strategy (CR, pp. 1-4). The first phase is to increase autonomy in all or part of the functions of the major task areas of:

- Student affairs and entrance standards.
- Limits on enrolment.
- Appointment of academic staff.
- Private institutions
- Operation of national universities.

The second phase will focus on clarifying the work and functions of the MOE&HRD and revising laws as necessary to reflect the increased institutional autonomy. The Country Background Report includes a summary of the implementation plan for autonomy from 2004 to 2007, including the results by task area as of 2005. Of 63 tasks, 28 have been completed, 9 are still in process and work on the remaining 26 remains to be scheduled.

Regulations connected to "pushing" reform

As the Government pursues increased institutional autonomy, it is also pursuing a policy of "pushing" change to increase competitiveness and other policy objectives through targeted funding linked to specific requirements for eligibility and institutional change. Underlying the new initiatives is a fundamental shift in financing policy leading to a decrease in the percentage of formula funding for the operation of national and public

Box 6.2. **Examples of regulations linked to major Government reforms**

- NURI project (conditions for a university-wide participation project).
  - Number of actual students enrolled in the university must be more than 80% of the university's student quota during the entire project duration.
  - Number of professors must be more than 60% of the numbers of faculty required by the regulation for the university when the university applies for the NURI project (the percentage should increase by 80% by the end of the project).
- BK 21 project (general conditions for application).
  - University should have a central research fund management system as well as a faculty performance evaluation system.
  - University should also meet the conditions required by the plan for reducing student quota from 2004 to 2009 (part of the Restructuring Project).
- Restructuring Project (conditions for reducing the size of the university).
  - Minimum percentage of professors actually hired against the ones required legally (the latter is based on the number of students): 57.5% at research-oriented university, 56.0% at education-oriented university, and 42.0% at industrial university and two-year university.
  - Plan for reducing student quota from 2004 to 2009. National university, more than 15% and private university, more than 10%.
  - Specialisation at the university and college levels programme is included in the restructuring and consolidation programme. For instance, if the university wants to obtain restructuring or consolidation funds from the MOE, it must submit a plan for its specialisation to the MOE.
- Professional Graduate School System (conditions for MBA courses).
  - A University that wants to establish a professional graduate school for MBA must abolish the existing specialised graduate school.
  - The ratio of professors to students should be at least 1: 12.5.
- Industry-Academic Co-operation/Collaboration.
  - Special regulations relate to the implementation of this programme, but no additional regulations are imposed such as changes in student quotas or teacher recruitment limitations.

Source: Country response to additional technical questions, July 2006.

universities and an increase in the percentage of targeted funding for specialised projects awarded through a competitive application and evaluation process. Specialised funding increased from 11% of Government funding in 1994 to 35% in 2003 (TRCBR, Sec. 9.4). In addition, the percentage of funding from ministries other than the MOE&HRD is increasing. In 2005, of the 2 trillion won in the Government budget for tertiary education 30% or 600 billion won came from ministries other than the MOE&HRD (TRCBR, Sec. 9.3).

The new initiatives such as Brain Korea 21, the New University for Regional Innovation (NURI) project, and the Industry-Academic Co-operation/Collaboration project, are innovative, important policy initiatives for the Government. Nevertheless, the regulations to implement these projects add to the complexity of the existing regulatory policy. The Government further extends the projects' impact by linking institutional eligibility to compliance with other requirements (*e.g.*, eligibility for BK 21 linked to restructuring).

One of the Government's major initiatives is to use targeted funding and related mandates and regulations to prompt the restructuring of national universities and provide incentives for merger and consolidation of private institutions. The potential impact of this initiative is to increase significantly the regulatory impact of the MOE&HRD, especially with respect to private institutions. In 2005, the Government provided USD 50 000 000 to support the consolidation of national universities and USD 30 000 000 to support the consolidation of private universities. The Government has no authority to mandate merger or consolidation of private institutions but can induce these changes through significant financial incentives. Institutions must submit plans to the MOE&HRD to be approved for this initiative. The restructuring funds will help strengthen university leadership, governance or management. As of June 2006, eight national universities had been consolidated to create four universities and eight private universities had been consolidated to create four institutions. As a result of these changes, the universities' academic and administrative departments were downsized and their student quotas were significantly reduced (8% or 50 946 students from 2004 to 2009).[3]

The policy responses: towards autonomy, competitiveness and accountability

The systematic process toward increased institutional autonomy is a critical step in improving the regulatory environment for tertiary education in Korea. It certainly represents a challenge to accomplish change in light of the long-standing nature of many of the issues and the culture and political context for reform.

The MOE&HRD clearly recognises that further progress on regulatory reform will depend on fundamental changes in the relationships between government and institutions, and changes to increase the capacity of institutions – national, public and private – to assume greater responsibility for their own strategic leadership, mission focus, internal quality assurance, and resource management. At the same time, the Government recognises the need for significant improvements in the co-ordination, transparency and effectiveness of the nation's quality assurance and accountability mechanisms.

The Government is already taking actions to address these problems and proposals pending at the time of this review represented additional important steps in this direction. These actions and proposed actions focus on:

- Strengthening capacity for institutional strategic planning, budgeting and evaluation.
- Improving national university administration.

- Establishing a higher education evaluation institute.
- Implementing a university information disclosure system.

Regulation related to student selection and enrolment quotas

Over the years, the most highly controversial regulatory issues have been on student selection (the "Three Nots)" and enrolment quotas (see description above).

These regulations clearly restrict institutional independence in areas considered essential for autonomy such as the freedom to determine which students should be admitted to study and to establish enrolment levels. There appears to be a number of political and emotional challenges facing the Government as it pursues reforms. The headline in the *JoongAng Daily* during the mission (Wednesday, 3 May 2006), "Universities drop a Bombshell on Criteria for 2008 Admissions," dramatised the intensity of the on-going debate.

As the headline in the *JongAng Daily* points out, the admissions policies are to change in 2008. The MOE&HRD has assigned high priority to reforming the policies and has given the responsibility for working out the details to the Korean Council for University Education (KCUE) and the Korean Council for College Education (KCCE) as part of the efforts to increase institutional autonomy (see below). The changes proposed for 2008 would alter the methodology for using the CSAT (College Scholastic Ability Test) scores and high school grade point averages, and increase the importance of other admission criteria and diversity of social composition (Kim, G. J.). The use of the KCUE and KCCE to develop the details of the policy change is an important step in improving autonomy and engaging the higher education community in coming up with a solution to difficult issues.

Enrolment quotas in two areas, the limits on enrolments in Metropolitan Seoul and the limits on enrolments related to health professions, are the responsibility of ministries other than the MOE&HRD. The Ministry of Construction and Transportation is responsible for regulations regarding limits on establishment of universities in the capital region. The Ministry of Health and Welfare is responsible for limits on enrolments in health and medical studies.[4]

In both these areas, it would be preferable theoretically to use incentives rather than regulation to influence student and institutional behaviour. In the case of regional balance, the Government's priorities to strengthen regional universities and to link universities to regional economic development (NURI initiative) are good examples of efforts to use non-regulatory means to encourage students to remain within the regions rather than attend an institution in the Seoul Metropolitan area. It is too early to tell whether these initiatives will have a strong enough effect to allow changes in the restrictions.

The Ministry of Health and Welfare emphasised that the quotas were important to avoid a mismatch between supply and demand. Other countries use enrolment quotas (*numerus clausus*) to limit enrolments in fields deemed important to the national interest. Nevertheless, use of incentives is preferable to regulation whenever possible, but in certain fields such as health, countries still find it necessary to regulate enrolments.

Another issue relates to the impact of enrolment quotas on institutions. It seems that, because of staff limitations, the Ministry of Health and Welfare had not actually visited institutions to understand the impact of the regulations on institutional operations. It is also not clear how the Ministry of Health and Welfare co-ordinates the implementation of

the enrolment quotas with the MOE&HRD. However, an integrated regulatory management system (see below), with proper RIA, would require to assess the combined impact of regulations from several different ministries.

Strengthening capacity for institutional strategic planning, budgeting and evaluation

Significant improvements are needed in the management capacity of Korean tertiary education institutions in order for them to assume more responsibility for their own management in a de-regulated policy environment (Country Response pp. 75-76). Institutions vary markedly in their capacity for strategic planning engaging both internal (students and faculty) and external stakeholders, managing their assets and allocating resources, and internal evaluation and quality assurance. Information in the Country Background Report for the Thematic Review of Tertiary Education (TRCBR Section 11.3) indicates that progressive management practices are employed more frequently among private than national and public institutions, yet there are wide differences among institutions in both sectors in implementation. The culture and history (see above) of tertiary education in Korea serve no doubt as barriers to broad acceptance of the need for strengthened university-wide leadership. Most countries with strong traditions of elected presidents or rectors face strong internal resistance from the professoriate and other constituencies to these reforms. Nevertheless, most countries are finding ways to strengthen leadership while respecting traditional values and continuing, if not increasing, engagement of the faculty in shaping the university's directions and internal quality assurance processes.

How the MOE&HRD organises its work and carries out its regulatory responsibilities can have a significant impact on whether institutions assume responsibility for their own management. The experience of other OECD countries is that poorly designed or implemented regulatory policies can either undermine institutional management capabilities or indirectly have the effect of relieving the institutions of the responsibility for self-management. Centralised ministerial control can weaken the capacity of institutions to develop their own internal capacity to assume responsibility for leadership and management. The result can be a self-defeating cycle in which the failure of institutions to assume responsibility can foster an even greater government role to oversee institutional affairs.

Improving national university administration

The Government is pursuing several important reforms to strengthen the leadership, planning, management and governance of national and public universities.

- The budgets for these institutions follow the Law on Budget and Accounting that is generally applied to all state organisations with the result that the institutions have limited capacity to establish independent strategic plans and related budgets. The Government is trying to address this issue by pursuing the adoption of the "University Accounting System", which would provide the necessary accountability for autonomous university management.
- All universities, including national, public and private institutions, are restricted in the scope of profit-making activities to create revenue for self-financing. Through the "School Corporation System" initiated in 2003, universities can now accelerate industry-academia co-operation and allow universities opportunities for self-financing.

- The leadership and management of national and public universities are linked directly to the MOE&HRD, in contrast to private institutions, which have a degree of independence (subject to the provisions of the Private School Act) in leadership and management under the authority of incorporated boards of directors.[5] Following the traditional pattern in several Continental European Countries (*e.g.*, Germany), in Korea the MOE&HRD places a secretary general within each national and public university to oversee matters such as budget accounting, staff salaries, and management of government property and school facilities. The secretary general also supports academic development by functioning as a bridge between the MOE&HRD and the university. In an attempt to recruit experts in national university administration, eight out of 42 national universities are recruiting the secretary general through open competition, and have expanded application eligibility to civilians and civil officials from other ministerial departments. An increasing number of national universities plan to adopt this open recruitment system.

In the long-term, it is essential for Korea to change the basic legal status of national and public institutions to ensure that they have the capacity for strategic leadership and self-management. In many ways, the word "autonomy" is inappropriate in this context because it can convey a sense of "independence without accountability". Korea must change laws to 1) increase the capacity of institutions for effective decentralised governance and management, and 2) hold these institutions accountable to key stakeholders and the public for performance, quality and efficient use of resources.

In a Special Law on National University Administration, the Government is seeking changes that would permit National Universities to become school corporations independent of the formal governmental structure. At the time of the *OECD Review*, this bill had not passed the National Assembly. Nevertheless, in response to clarifying questions, the Korean authorities indicated that planning was already underway to make Seoul National University and Inchon City University independently incorporated institutions. In addition, MOE&HRD is planning to establish one of the recently consolidated national universities, Ulsan National University set to be opened in 2009, as a separate corporation.[6]

Establishing national and public universities as school corporations independent of the governmental structure is an important step to improve the quality and global competitiveness of Korean tertiary education. Several countries (*e.g.*, Austria and Japan) have taken sweeping action to change the legal status of universities in a single large-scale reform. A more pragmatic approach in Korea, however, may be to move in this direction on a systematic basis over several years. The experience of countries that have made such changes emphasises the need for careful planning to ensure effective implementation of these changes. Plans are needed to protect essential rights of staff, students and other stakeholders. Institutions must have the leadership, governance, management capacity and internal quality assurance mechanisms to function effectively under a new legal status.

Several countries are now using agreements between the Government and universities (called contracts, compacts or agreements, depending on the country) to establish mutually agreed upon conditions for moving specific universities to a more autonomous status (OECD, 2003). These agreements are useful means to:

- Differentiate among institutions according to mission and readiness to assume increased self-management responsibility.
- Link the Government's reform initiatives to internal institutional change.

- Provide for systematic change over several years.
- Provide for public accountability according to performance expectations that 1) relate to the institution's specific mission, and 2) reflect the Government's priorities.

In some cases, governments are establishing clear criteria for institutions to move at different speeds over time to a legal status that is more independent. For example, the Restructuring Act of 2005 in the US Commonwealth of Virginia represents a significant renegotiation of the relationship between the state and its public colleges and universities. It gives more autonomy to the public colleges for conducting certain operations, but checks that autonomy with new accountability targeted directly at the needs of the state. Each institution enters into an agreement with the state defining the conditions for the change. The Act also sets forth criteria for institutions to obtain greater independence, which may occur over several years depending on the institution's readiness for change. Three institutions, the University of Virginia, Virginia Polytechnic Institute and State University (Virginia Tech), and the College of William and Mary, will be the first to make significant changes (Couturier, L. 2006).

Quality assurance and public accountability

As the Government pursues regulatory reform and seeks to increase institutional autonomy, development of an effective system of quality assurance and public accountability is essential. Korea currently relies on four approaches to quality assurance in tertiary education. First, the MOE&HRD utilises an indirect means of quality assurance by supporting the work of non-governmental accrediting organisations. These include the Korean Council for University Education (KCUE), the Korean Council for College Education (KCCE), and specialised accrediting boards for medical education, engineering education, and nursing education. Second, the MOE&HRD undertakes direct evaluations linked to institutional participation in targeted funding and initiatives. The Government includes an evaluation component in all funding initiatives related to tertiary education. Third, the Korean Education Development Institute (KEDI), a policy centre linked to the MOE&HRD, evaluates teacher education programmes and undertakes special studies of the education system. Fourth, the daily newspaper, *JoongAng Ilbo*, publishes evaluations and rankings of institutions and programmes to guide students and parents.

The MOE&HRD provides funding to the KCUE and KCCE to carry out their evaluation and accreditation functions, but in an effort to support institutional autonomy, the Ministry maintains an arms-length relationship with these organisations. With efforts to increase institutional autonomy, the MOE&HRD has entrusted certain functions to the KCUE and KCCE such as the establishment of the basic plan for university entrance procedures and management of personal files of academic staff (CR, Table 4, p. 25). The MOE&HRD also funds the KCUE to undertake departmental reviews to examine clusters of departments across universities. For example, in recent years the KCUE has reviewed departments of economics, physics, and library and information science.

The accreditation functions of the KCUE and KCCE focus primarily on fostering internal self-diagnosis and as a tool to encourage institutions voluntarily to enhance competitiveness in education and research. Accreditation in Korea exhibits the fundamental tension between the evaluation for improvement and evaluation to make a definitive, public judgement about quality. Accreditation in Korea is designed to encourage internal improvement and it therefore emphasises a degree of confidentiality in order to

gain the trust and engagement of the faculty. It is not designed well enough to meet the needs of students, parents, employers, and the Government for information about quality and performance. The current accreditation process has some weaknesses from the perspective of public accountability:

- Lack of independence from institutions being evaluated. KCUE and KCCE are membership organisations and, as such, are not independent of the entities being evaluated.
- Limited roles for students and external stakeholders (*e.g.*, parents and employers).
- Voluntary institutional participation.
- Reliance on peer-review rather than persons explicitly trained as evaluators.
- One-size-fits-all approach.
- Limited consequences of not being accredited. There is no link between an institution's accreditation and its eligibility for Governmental funding.
- Lack of co-ordination with other Government sponsored evaluation activities. The process is disconnected from the MOE&HRD evaluations related to projects and targeted initiatives (see below).
- Limited public information. The accreditation process has traditionally provided limited public information that could be useful to parents, students, employers or the general public to assess institutional quality and performance – only whether an institution or programme is accredited (Yes or No). No details are made public on weaknesses and areas for improvement. Through the Government's initiative to establish a "university information disclosure system", this situation may improve (see below).

In addition to the indirect evaluation and accreditation functions of KCUE and other organisations, the MOE&HRD undertakes its own direct evaluations related to projects and targeted funding. The Country Background Report for the Tertiary Review indicates that institutions do not see these evaluations as crucial processes for internal evaluation but as a "nuisance and superficial formality or process… used to induce universities to adopt policies" (TRCBR, Section 11.5). It is a common practice in most OECD countries for ministries to include evaluation requirements in regulations for special or targeted funding programmes. The important point in the Korean case is that these project evaluations are not effectively co-ordinated with other evaluation and accreditation requirements.

The current regulatory framework for quality assurance is heavily focused on traditional institutions and modes of provision and is not well equipped to address the quality assurance demand of cross-border and new modes of provision (Open/distance learning, e-learning, etc.). This is a common challenge faced by countries whose quality assurance standards continue to emphasise traditional quality assurance standards. These standards focus on inputs such as faculty-student ratios, faculty qualifications, and adequacy of libraries and other facilities and do not emphasise outputs (evidence of student learning, research productivity, employment of graduates, etc.). Also, traditional quality assurance processes, especially those controlled by existing institutions, can be significant barriers to the development of new, more cost-effective modes of delivery.

The MOE&HRD is well aware of the need to strengthen the nation's overall quality assurance and evaluation system. The Government is proposing legislation to establish a higher education evaluation institute. At the time of the *OECD Review*, the legislation was

Box 6.3. **Case of accreditation in the United States**

The reliance upon non-governmental accrediting agencies in Korea is similar to the approach used in the United States. The US system is being criticised for reasons that are remarkably similar to the debate in Korea. The US has a strong tradition of "voluntary" accreditation by non-governmental organisations formed by and funded by member institutions. In contrast to Korea, not being accredited in the US has significant consequences for an institution. An institution must be accredited to receive funding under the major federal student financial assistance and other programmes. The federal government relies upon these non-governmental organisations to carry out the accreditation function rather than undertake the accreditation process directly. This indirect approach is widely recognised as essential to maintain institutional autonomy. The federal government "recognises" accrediting organisations provided they meet certain federal requirements in terms of substantive and procedural aspects of the accreditation process.

The US is likely to continue to rely on non-government accrediting organisations as a core element of its quality assurance system. Nevertheless, accreditation is being widely criticised because its perceived weaknesses as a means for public accountability. A Commission on the Future of Higher Education appointed by the US Secretary of Education in its recent draft report calls for accreditation to be transformed. Problems cited by the Commission include lack of public accountability and transparency, comparable data about institutional performance, and means to benchmark an institution's performance against other institutions (US Department of Education 2006).

still under development. It seems that key elements of the proposal could represent important improvements:

- Improved co-ordination of the different evaluation and accreditation activities.
- Increased involvement of external stakeholders.
- Greater public access to accreditation and evaluation results.
- Linkage between quality assurance and institutional eligibility for governmental administrative and financial support.
- Actions to address the challenges of cross-border provision and new modes of provision such as e-learning.

A key challenge for Korea is to balance the need for greater institutional autonomy with the need for greater public accountability. In contrast to countries such as the UK with largely public institutions, Korea must devise a system that encompasses the large private sector. The practical alternative for Korea is most likely a balance between quality assurance agency meeting the criteria established by the European Association for Quality Assurance in Higher Education (EAQAHE, 2005) and the US system, which continues to rely strongly upon non-governmental "voluntary" accrediting associations approved by the government. In this alternative, Korea would establish a quality assurance entity but continue to rely upon indirect non-governmental entities such as KCUE and KCCE to carry out specific functions. At the same time, the MOE&HRD should have a regulatory framework for quality assurance to ensure that accreditation and evaluation functions serve not only the internal purposes of tertiary education, but also the need for public accountability: transparency, fiscal responsibility and integrity, and responsiveness to public priorities.

The governance of private universities

Ensuring a stable regulatory framework and a level playing field among all providers is a condition for regulatory quality. Private universities and colleges have played a key role in the development of tertiary education in Korea and in facilitating access to tertiary education to a large part of the population, given the existing constraints in the public sector. The contribution of the private universities is essential to the development of the whole tertiary education system in Korea, which is now, in quantitative terms, one of the most advanced among OECD countries. While public and private universities are governed by different sets of laws, both public and private universities are grappling with the need to establish and consolidate a more efficient regulatory and governance framework to fulfill their important mission. Several analysts have pointed the limits of the current regulatory framework for private universities, particularly in terms of ensuring transparency and accountability in a context where corporate governance requirements are playing a much stronger role in all private entities across all OECD countries. In Korea, the government has already made some steps in this direction in a field that has led to significant discussions.

Private universities are subject to specific laws, including the private school act. Private universities must be founded by educational corporations. Educational corporations may freely decide on issues regarding the organisation and operation of the board of directors and the appointment of executives as long as the issue is not mentioned in the private school act. Private universities are heavily relying on tuition. The transfer of educational finances to other areas is restricted by separating school finances from corporate financing. In order to secure transparency in school finances, the budget and settlement of accounts of private institutions are opened on the website for the university. In addition, in order to protect the assets of educational corporations, basic requirements as seen in related laws on the disposal of university assets such as receiving the approval of the respective authority in selling, donating, and warranting assets of the educational corporation must be followed (CR, para. 107). Such approval procedures are not new; they have been carried out prior to the enactment of the Private School Act. While a number of conditions apply on the board, and while regulations also apply on the disposal of school assets, the provisions governing the management of the board remained limited until recently.

However, it would appear that, compared with other countries, there is still scope to increase the quality of the governance framework for private providers and private universities in Korea. The government has already taken some steps. In order to raise the integrity and transparency in educational corporation operations, the minutes of the board meetings must be opened to the public, and the "Open Director System" which allows the participation of directors recommended by the representatives of school or university members was introduced in July of 2006.

Information for the public

To improve public information, beginning in 2005, a database is to be available on the Internet so that students and employers can access information on the results of evaluations. According to the Country Background Report for the Tertiary Review, a "university information disclosure system" will provide information about each institution's student population, faculty-student ratio, employment rates of graduates, proportion of part-time lecturers, and the budget. A database on evaluation results is also to be available.

Korean authorities should also consider providing additional public information on the extent to which institutions are preparing students for the changing needs of employers. As summarised at the beginning of this paper, Korean employers are dissatisfied with the knowledge and skills of graduates, especially in the graduates' practical experience and understanding of expectations of employers. The MOE&HRD should consider two alternatives to respond to these concerns. First, the MOE&HRD could require institutions to publish information on how they provide students with practical work experience with employers in conjunction with the academic curriculum (internships, apprenticeships, etc.).

Second, the MOE&HRD, in collaboration with the Federation of Korean Industry and the KCCE and KUE, could develop an assessment of the general competencies necessary for graduates to be successful in the workplace. These competencies would include both general academic skills such as mathematics and written and oral communications as well as "soft skills" including problem-solving, teamwork, and ability to following directions.[7] The "work-ready" assessment could be made available at a national level to be used *voluntarily* by colleges and universities to assess the work-readiness of their students. It would be used for diagnostic purposes only for the institution as well as participating students. However, the MOE&HRD development could provide strong incentives for institutions to make the results of these assessments available to the public. For example, in the new public information system, the MOE&HRD could require institutions to publish on their websites information available based on objective measures of the "work-readiness" of their graduates.

Internationalisation of Korean higher education

Despite the government's initiatives related to internationalisation, the number of foreign students studying in Korea and the number of foreign institutions operating in the country remain small.[8] The Government's initiatives to strengthen the competitiveness of Korean institutions, including increasing institutional autonomy, are important steps. However, major regulatory barriers cutting across several ministries seem to remain for there to be a marked increase in foreign students and institutions in Korea. In the brief time available in this review, it was not possible to explore the full range of regulatory barriers.

The development of branches of foreign universities in the Jeju International Free City was quoted by MOE&HRD officials as a promising development to open the Korean tertiary education system. This change is made possible by the Special Law on Foundation and Management of Foreign Educational Institutes in Free Economic Zones and Jeju International Free City. This is a promising development, but it also indicates that the Free Zone initiative is an exception in the relatively closed Korean system (TRCBR, p. 141). If the Government's goals regarding internationalisation are to be met, there is a clear need for a broad review of the regulatory obstacles to greater openness. At the same time, it is also important that this framework have the capacity to ensure quality in cross-border provision (see OECD, 2005). As a short-term alternative, the Government should continue support to further facilitate the operation of tertiary education institutes in the "Free Zones".

Government-wide co-ordination

As illustrated in Table 6.3, approximately ten ministries in addition to the MOE&HRD provide funding for and/or regulate some dimension of tertiary education in Korea. The functions of these ministries create multiple, unco-ordinated vertical "silo" relationships with institutions and the regions in which they are located. Regulatory reform in Korea

must address not only regulation within individual ministries but also between and among ministries. As suggested above, the regulatory impact analysis could be strengthened by a "bottom-up" analysis of the combined impact of multiple and potentially conflicting Government regulations on institutional leadership, governance and management.

The Government is already acting to improve co-ordination across all ministries on significant crosscutting issues. The National Human Resources Development Committee chaired by the Deputy Prime Minister and Minister of Education and Human Resources Development has established the University Specialisation Support Committee to create synergy effects of Ministries' investment in higher education. This committee functions as a mechanism for co-ordinating financial support policies for universities by Ministries. The MOE&HRD and the Ministry of Science and Technology will collaborate when they analyse the impact of financial supports for universities. These two ministries will also work together to connect human resources development projects with R&D projects.

Regulatory review and impact analysis

The Basic Law on Administrative Regulations enacted in 1997 requires all government departments, including the MOE&HRD, to perform a regulatory impact analysis to assess the costs and benefits of establishing or reinforcing administrative regulations. At the national level, all central administrative bodies including the MOE&HRD registered all regulatory affairs under their jurisdiction with the Regulatory Reform Committee (RRC) and these are open to the public on the RRC website (*www.rrc.go.kr*). Within the MOE&HRD, the results of the regulatory impact analysis are submitted to a regulatory review committee which then makes recommendations on the scope, subject, and period of the proposed new or amended regulations. All the major MOE&HRD initiatives since 2001 have been reviewed in this process. The Country Response indicates that the process has led to positive feedback from institutions regarding the improved clarity and simplicity of the regulations (Country Response, pp. 5, 60).

The assessment criteria for the regulatory impact analysis are consistent with the points in the OECD 2005 Guiding Principles for Regulatory Quality and Performance. The process provides extensive opportunities for public comment and feedback from stakeholders. However, the process could be strengthened by a deliberate step to assess the existing or potential impact of the regulation on the capacity of institutions to assume greater responsibility for management and internal quality assurance. Fragmentation could also lead to the risk of "stovepipe" government, which is familiar in a number of OECD countries. Multiple and potentially conflicting Government regulations are implemented "vertically" to institutions in a manner that can fragment or splinter institutional-level implementation. As noted earlier in the discussion of enrolment quotas administered by the Ministry of Health and Welfare, there is a need to assess the combined impact of regulations from several different ministries. Such a "bottom-up" analysis of regulations might reveal ways that new or revised regulations could be better synchronised to support institutional efforts to strengthen management capacity which would foster policy coherence. Such improved institutional capacity is an important Government objective and a pre-requisite for increased institutional autonomy.

Conclusion and policy options

The Republic of Korea has embarked upon an impressive, ambitious agenda to improve the global competitiveness of the country's tertiary education system. This

agenda includes important steps to improve regulatory quality. Korea has made significant progress in simplifying and clarifying regulations, eliminating out-dated and redundant regulations, and improving co-ordination across regulatory entities within the MOE&HRD and across ministries. The Government is taking additional actions that will be essential to improve the competitiveness and public accountability of the system. As the Government is pursuing an agenda of increasing autonomy and regulatory reform, it is adding a new level of complexity to its relationships with institutions as it pursues aggressive policies such as promoting increased specialisation, strengthening the links between institutions and regions, and encouraging the consolidation and merger of institutions. In broad terms, the highest priorities should be given to:

- Ensuring clarity and consistency in long-term policy goals and strategies.
- Increasing the co-ordination and synergy across the Government in pursuit of these goals and strategies.
- Increasing the capacity of institutions, especially the national and public universities, for leadership, governance, and internal quality assurance.
- Establishing a new framework for quality assurance, including policies and related regulations related to cross-border and new modes of provision of tertiary education.
- Redefining the role and mission of the MOE&HRD to focus less on detailed regulation and more on strategic leadership and monitoring the performance of the tertiary education system.

The Korean history and culture add critical dimensions to the context for regulatory reform. Consistent attention to the reform agenda, sustained over changes in Governments, will be necessary in the regulatory environment.

Policy options

The following are specific policy options, which are presented in priority order, although all require action.

1. Establish an entity responsible for overall leadership and co-ordination of quality assurance for tertiary education.

- Model the new entity on a balance between a quality assurance agency meeting the criteria established by the European Association for Quality Assurance in Higher Education (EAQAHE, 2005) and the US system, which continues to rely strongly upon non-governmental "voluntary" accrediting associations approved by the government.
- Establish a quality assurance entity but continue to rely upon indirect non-governmental entities such as KCUE and KCCE to carry out specific functions.
- Structure the new entity to ensure independence from both the MOE&HRD and KCUE or KCCE and the capacity to represent the perspectives of civil society and employers, and staff it adequately.
- Establish a MOE&HRD regulatory framework for quality assurance to ensure that accreditation and evaluation functions serve not only the internal purposes of tertiary education, but also the need for public accountability: transparency, fiscal responsibility and integrity, and responsiveness to public priorities.

- Establish an integrated, co-ordinated quality assurance framework for all tertiary education and evaluation functions:
  - Use indirect modes of quality review and evaluation such as KCUE and KCCE and the specialised accrediting bodies within standards and policies established by the MOE&HRD and the new quality assistance entity.
  - Require involvement of key internal and external stakeholders (government, business, parents and students as well as academic community) in the governance of the new entity and in quality assurance and accreditation processes.
- Increase the quality and consistency of data used in the accreditation and evaluation processes.
- Require independent audit by professionally trained personnel of the accuracy of data and other information used in the accreditation process.
- Implement the new University Information Disclosure System:
  - Require public disclosure of accreditation results.
  - Emphasise the MOE&HRD role in ensuring accurate, comparable information to inform the market.
- Link evaluation for eligibility for targeted funding (*e.g.*, BK 21, NURI and Academic-Industry Co-operation/Collaboration) to institutional and programme accreditation.

2. Move the national and public universities to a legal status as school corporations outside the formal Governmental structure.

- Instead of undertaking a single, large-scale reform affecting all universities, take a phased approach by moving institutions to this new status based on differences in institutional mission and Government-established criteria regarding readiness for self-management.
- Establish a multi-year agreement (compact) between the Government and each national and public university. These agreements should:
  - Differentiate among institutions according to mission and readiness to assume increased self-management responsibility.
  - Link the Government's reform initiatives to internal institutional change.
  - Provide for systematic change over several years.
  - Provide for public accountability according to performance expectations that 1) relate to the institution's specific mission, and 2) reflect the Government's priorities.

3. Increase the capacity of institutions for strategic leadership, management and internal quality assurance.

- Link eligibility of all institutions for major initiatives (*e.g.* NURI) to evidence of institutional commitment to improved institution-wide strategic planning and management and to accreditation as redefined by the reformed quality assurance process (see below).
- Refine the regulatory review process to include a "bottom-up" assessment of the impact of regulations on the capacity of institutions to strengthen management and internal quality assurance to accompany the top-down assessment of impact.
- Strengthen the quality assurance process in relation to private providers. Even in the absence of direct public subsidies, there is a need to ensure the quality of the curricula offered by all private providers.

4. Strengthen the governance framework for private universities and colleges, building on existing government efforts.

- Continue efforts to improve accountability with increased transparency in the finance, as well as the production of an annual report for all stakeholders by all private institutions.
- Further improve the openness of the board, appointing directors recommended by representatives from stakeholders, such as school governing committees and university councils. Careful attention should be paid to the implementation of the recent revision of the private school act.

5. Assess and make public information related to employability of graduates.

- Develop an assessment of the general competencies necessary for graduates to be successful in the workplace as an effort lead by the MOE&HRD, in collaboration with the Federation of Korean Industry and the KCCE and KCUE.
- Include competencies of both general academic skills such as mathematics and written and oral communications as well as "soft skills" including problem-solving, teamwork, and ability to following directions.
- Make the "work-ready" assessment available at a national level to be used *voluntarily* by colleges and universities to assess the work-readiness of their students to be used for diagnostic purposes only.
- Provide incentives for institutions to make the results of these assessments public. For example, in the new public information system, the MOE&HRD could require institutions to publish information available based on objective measures of the "work-readiness" of their graduates.

6. Undertake a review of the regulatory obstacles to greater openness of Korea to foreign students and institutions as a step toward developing a comprehensive change in regulations.

- Continue support to further facilitate the operation of tertiary education institutes in the "Free Zones".
- Use the Jeju City and new "Free Zones" as case studies for how regulations related to the whole tertiary education system need to change for greater openness.
- Ensure that Korea has in place the capacity to ensure quality in cross-border provision (see OECD/UNESCO Guidelines 2005).

7. Strengthen Government-wide co-ordination of policies among different ministries.

- Examine in particular the impact of multiple, unco-ordinated regulations on the capacity of institutions to undertake integrated comprehensive planning and collaborate with other institutions, regions, and business and industry.

8. Shift the role of the MOE&HRD from detailed management and regulation of higher education to strategic leadership and monitoring system performance.

Focus on:

- Developing a long-term strategic agenda providing coherence across all Ministries linking higher education to the future global competitiveness of the nation through the role of the Minister as Deputy Prime Minister.

- Co-ordinating the multiple initiatives of other ministries as they impact tertiary education.
- Developing the information systems necessary for monitoring and informing the market (see above).
- Using strategic investments and incentives to leverage change.
- Improving co-ordination of regulations related to major initiatives (NURI, consolidation, industry-academic collaboration, etc.).

Notes

1. Which was prepared by Dr. McGuiness and discussed by the OECD Education Committee in 2006.
2. Granting of a high level of institutional autonomy has a long tradition in higher education dating back to universities in Europe. The founders of the University of Berlin adopted two basic principles upon its establishment in 1810: Lehrfreiheit ("freedom to teach") and Lernfreiheit ("freedom to learn"). Professors had the right to research and teach according to their interests, and students had the right, free from administrative coercion, to choose their own course of study. Justice Felix Frankfurter gave one of the most quoted and respected definitions of institutional autonomy in a concurring opinion on a case before the US Supreme Court in 1957. Justice Frankfurter enunciated the "four essential freedoms" of a university – to determine for itself on academic grounds who may teach, what may be taught, how it shall be taught, and who may be admitted to study (Sweezy v. New Hampshire, 354 US 234 (1957), Bollinger, 2005.
3. Information received from Korean authorities in June 2006.
4. The OECD experts met with officials of all these ministries during their mission to Korea.
5. Changes related to private institutions implemented in 2005 abolished the Dismissal Approval system which controlled the appointment of the board chairpersons, executives and auditors of private institutions. Meanwhile, the Government is pursuing changes that would raise the integrity and transparency of school corporation operations, including requirements that minutes of board of directors' meetings be open to the public, and the "Open Director System", which allows the participation of outside directors. Changes are also proposed to protect the assets of education corporations, especially in cases of institutional closure. Several of these changes were being debated at the time of the OECD mission.
6. Information received from Korean authorities in June 2006.
7. See ACT Workkeys, an assessment developed by the American College Testing Service, which is widely used in the US and increasingly used for public accountability (*www.act.org*).
8. According to the Background Report for the Thematic Review on Tertiary Education (TRCBR, pp. 136-146) and the Country Response (pp. 47-55).

Bibliography

Couturier, L.K. (2006), *Checks and Balances at Work: The Restructuring of Virginia's Public Higher Education System,* A case study of Virginia's 2005 Restructured Higher Education Financial and Administrative Operations Act, San Jose: National Centre for Public Policy and Higher Education.

European Association for Quality Assurance in Higher Education (EAQAHE) (2005), Standards *and Criteria for Quality Assurance in the European Higher Education Area*, Helsinki, Finland.

Kim, Ki Seok (2005), "The Making of a World-Class University of the Periphery: A Diagnosis of the Self-Strengthening of the Graduate Programme at Seoul National University, 1995-2005."

Kim Ki-Seok (2006), Supplementary Document, Power Point presentation to OECD project team, 1 May.

Kim Gwang-Jo. (2005), "Higher Education Reform in South Korea: Policy Responses in a Changing World", Power Point presentation to Higher Education Seminar, Moscow, 5 July.

OECD (2003), "Changing Patterns of Governance in Higher Education", *Education Policy Analysis*, Chapter 3.

OECD (2004), *Quality and Recognition in Higher Education: The Cross Border Challenge*, Paris.

OECD (2005), *Guidelines for Quality Provision in Cross-border Higher Education*, Paris.

Republic of Korea (2006), Document for the *OECD Review of Regulation in Korea*, 1 May (CR).

Republic of Korea (2005), *OECD Thematic Review of Tertiary Education*, Country Background Report, November (TRCBR).

Rhee Byung-Shik (2005), "Quality Assurance System of Higher Education in Korea", PowerPoint presentation, Korean Education Development Institute.

US Department of Education (2006), Secretary of Education's Commission on the Future of Higher Education, Draft Commission Report, 14 July, Washington, D.C. *www.ed.gov/about/bdscomm/list/hiedfuture/index.html*.

ANNEX 6.A1

Examples of Regulations

Institutions

- Governing establishment and operation of private institutions under the Private School Act, including: regulations related to:
  - Education foundations, the entities which establish private institutions.
  - Conditions necessary for establishment of an institution (facilities, financing and staff).
  - Organisation and operation of the board of directors of education foundations.
  - Disorganisation and merger of institutions.
- Regulations define the parameters for institutional decision-making on academic policy:
  - Regulations define the limits within which institutions can make decisions on areas such as school year, accreditation, types of graduate schools, the years required for graduation, conditions for graduation and types of degrees
  - Regulations governing student enrolments and selection.
  - Limits on enrolment and student selection methods.
  - Criteria for special admissions.
  - Selection methods for part-time students.
- Regulations on University decisions on research related to governmental support are limited by regulations on:
  - Management and use of research funds.
  - Agreements with industry for establishment and operation of vocational training courses.
  - Operation of industry-academic co-operation teams.
- Human resources
  - Regulations define the parameters for institutional decision-making on qualifications for professors and assistants, and appointment of professors.
  - Private institutions make decisions on appointment and dismissal, and salary.
  - National universities are regulated by the State Public Officials Act and public universities by the Local Public Officials Act in terms of appointment and dismissal, promotion, and salary of employees.

- Institutional financing and structure:
  - Private institutions are regulated in terms of:
    - The method of collecting tuition fees and other payables.
    - The extent of contributions by the educational foundation to university operating costs.
    - Asset management.
    - Accounting practices.
  - Because national universities are part of the central government organisation and the national budget is allocated to cover expenses such as labour costs, they are regulated in terms of:
    - Any reorganisation with implications for increased labour costs.
    - Establishment of new departments.
    - Establishment of branch campuses.

Students

- Regulations governing eligibility for entrance and student selection.
- Limits on enrolment (Quotas).
- Special admission for enrolled students.
- Student financing, including regulations on:
  - Tuition and entrance fees.
  - Eligibility for student loans.
  - Eligibility for other student benefits (*e.g.*, discounts for public transportation).

Regulations for government include those related to support for research, science and technology

- Research funding support.
- Protection of intellectual property rights.
- Overhead costs.

Source: Country response, pp. 28-31.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(42 2007 11 1 P 1) ISBN 978-92-64-03205-7 – No. 54483 2007

OECD Reviews of Regulatory Reform

KOREA

PROGRESS IN IMPLEMENTING REGULATORY REFORM

Korea was among the first countries to feature in the OECD in-depth series *Reviews of Regulatory Reform*. The Korean review was released in 2000 after the financial crisis of 1997. Since then, Korea has made bold efforts to enhance conditions for long term growth: promoting regulatory reform, cutting red tape, strengthening competition policy and market openness. The Korean government has also modernised its regulatory framework for information technologies, an area where Korea plays a leading role among OECD countries.

This publication assesses progress since 2000 and analyses many of the lessons of implementation of regulatory reform. It highlights possible responses to current challenges. These include the pressures of an ageing society, future welfare needs and human capital development. The study includes a new special chapter on tertiary education, where improvements in the regulatory framework can yield significant benefits for future innovation and productivity. Political support at the highest level has been instrumental in the shift to user-oriented regulations, improving consultation to create a "participatory society" and changing the government role from direct intervention towards ensuring the sound functioning of a market economy. The report takes account of the specific Korean context, but can be of wider value in other countries as well, within and beyond the OECD.

The goal now is to sustain the momentum for reform. Regulatory reform is a dynamic process, reassessing existing regulations in light of recent economic and social developments, and assessing the broad impact of new regulations while they are in preparation. It requires a coherent whole-of-government approach, under continued strong leadership, to ensure high quality tools, processes and institutions for citizens and businesses.

In the same series:

Canada
Czech Republic
Denmark
Finland
France
Germany
Greece
Hungary
Ireland
Italy
Japan
Korea
Mexico
Netherlands
Norway
Poland
Russia
Spain
Sweden
Switzerland
Turkey
United Kingdom
United States

www.oecd.org

OECD

OECDPUBLISHING

ISBN 978-92-64-03205-7
42 2007 11 1 P

9 789264 032057