

# KOREA'S ECONOMY, TRADE POLICY AND IMPLICATIONS FOR UZBEKISTAN

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# Contents

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I . KOREAN ECONOMY: Past and Present

II . TRADE POLICY of KOREA

III. Lessons from Korean Experience

IV. Challenges of Korean Economy Today

# I . KOREAN ECONOMY: Past and Present

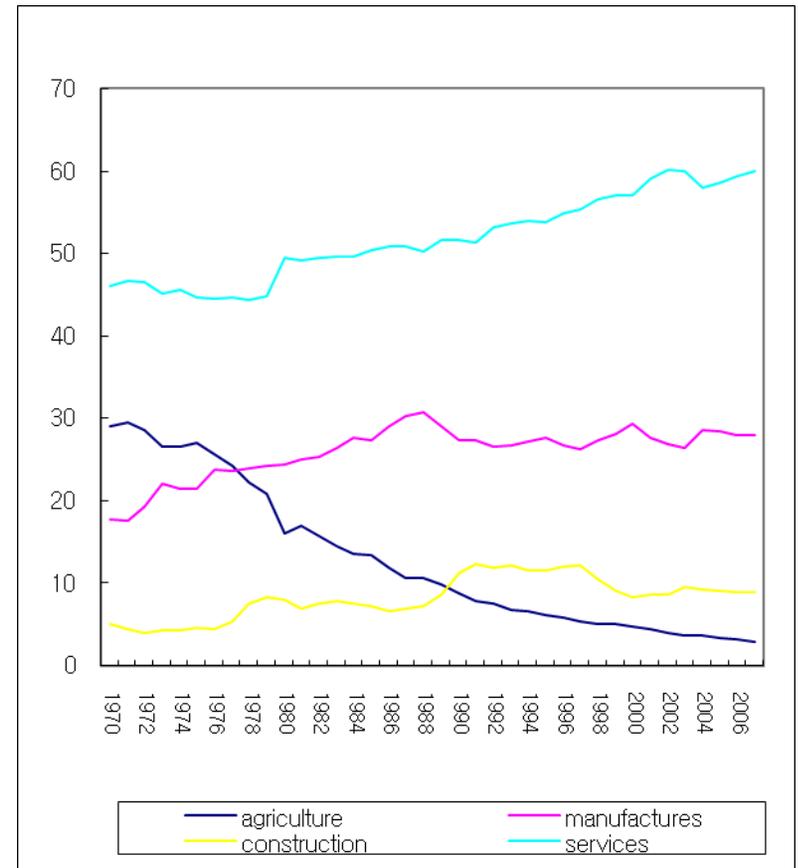
## ● GDP, Trade

	1970	1980	1990	1995	1998	2000	2003	2005	2007
<b>GDP (Bil. US\$)</b>	8.0	64	263	517	346	512	608	788	970
<b>GNI Per Capita (US\$)</b>	254	1,645	6,147	11,432	7,355	10,841	12,720	16,291	20,045
<b>Exports (Bil.US\$)</b>	0.8	17.5	65.0	125.1	132.3	172.3	193.8	284.4	371.4
<b>Imports (Bil. US\$)</b>	2.0	22.3	69.8	135.1	93.3	160.5	178.8	261.2	356.8

Source: The Bank of Korea, Economic Statistics Yearbook

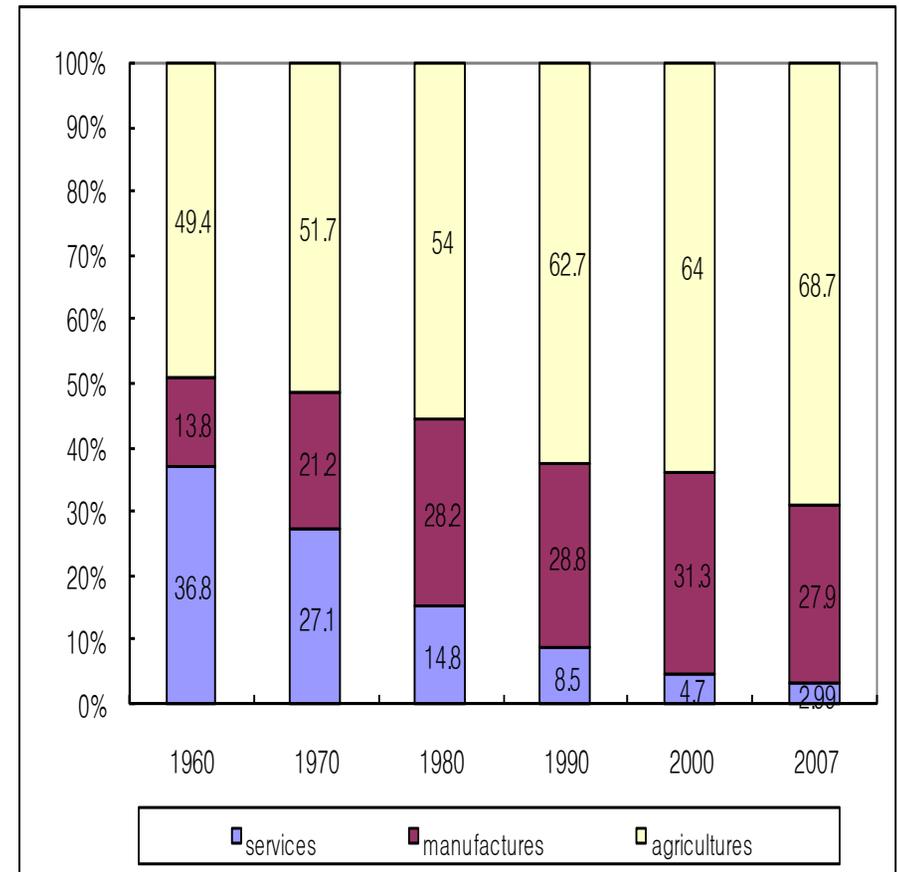
## ● Key Aspects of Industry Structure

- n Industry Structure by Employment
  - u Services : from 44% to 57%
  - u Manufactures: from 18% to 28%, peaked in 1988 at 31.7%
  - u Agricultures: from 29.2% to 7%
- n Financial Crisis in 1997 rebounded manufacturing sector

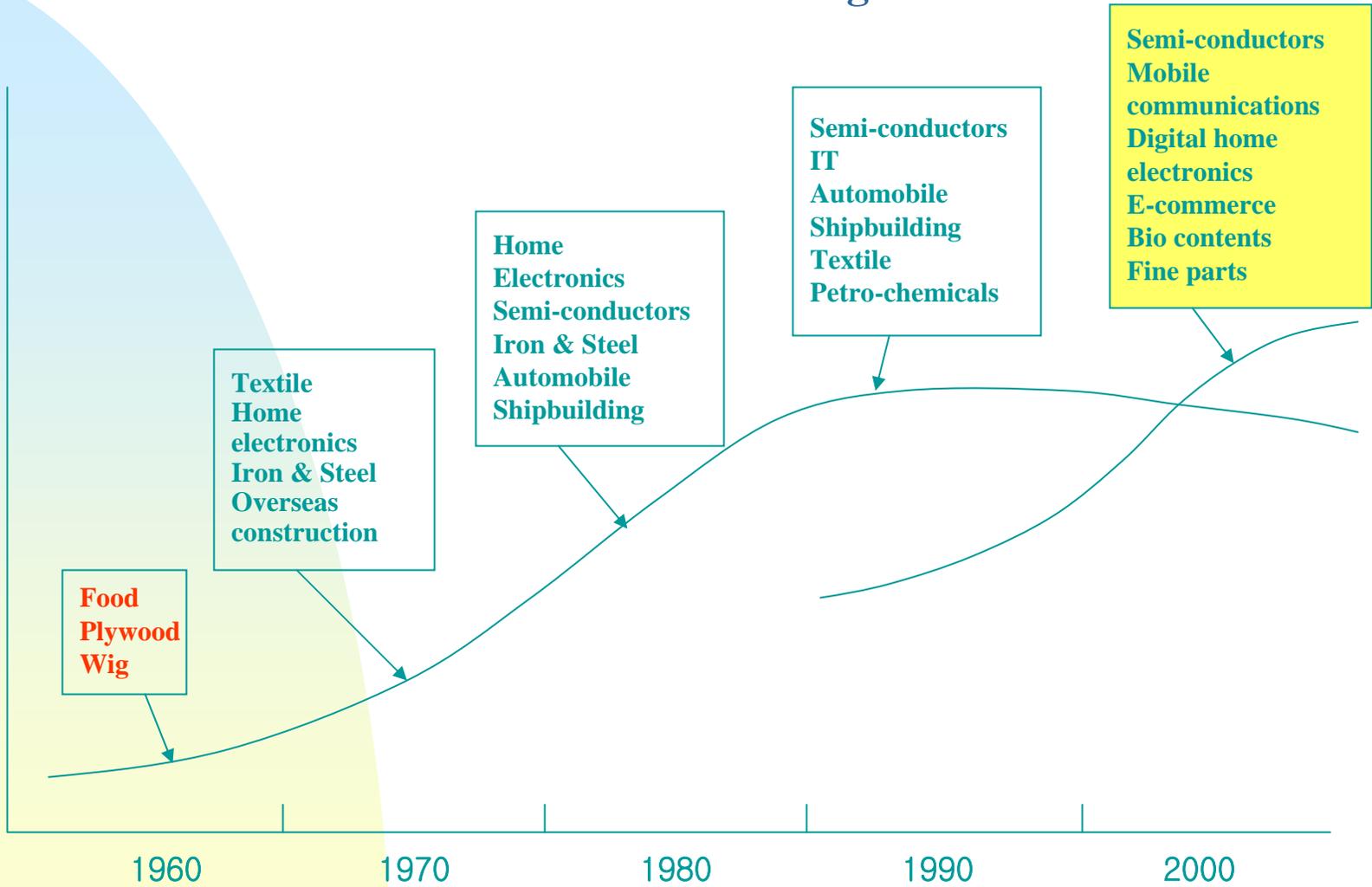


## ● Key Aspects-cont.

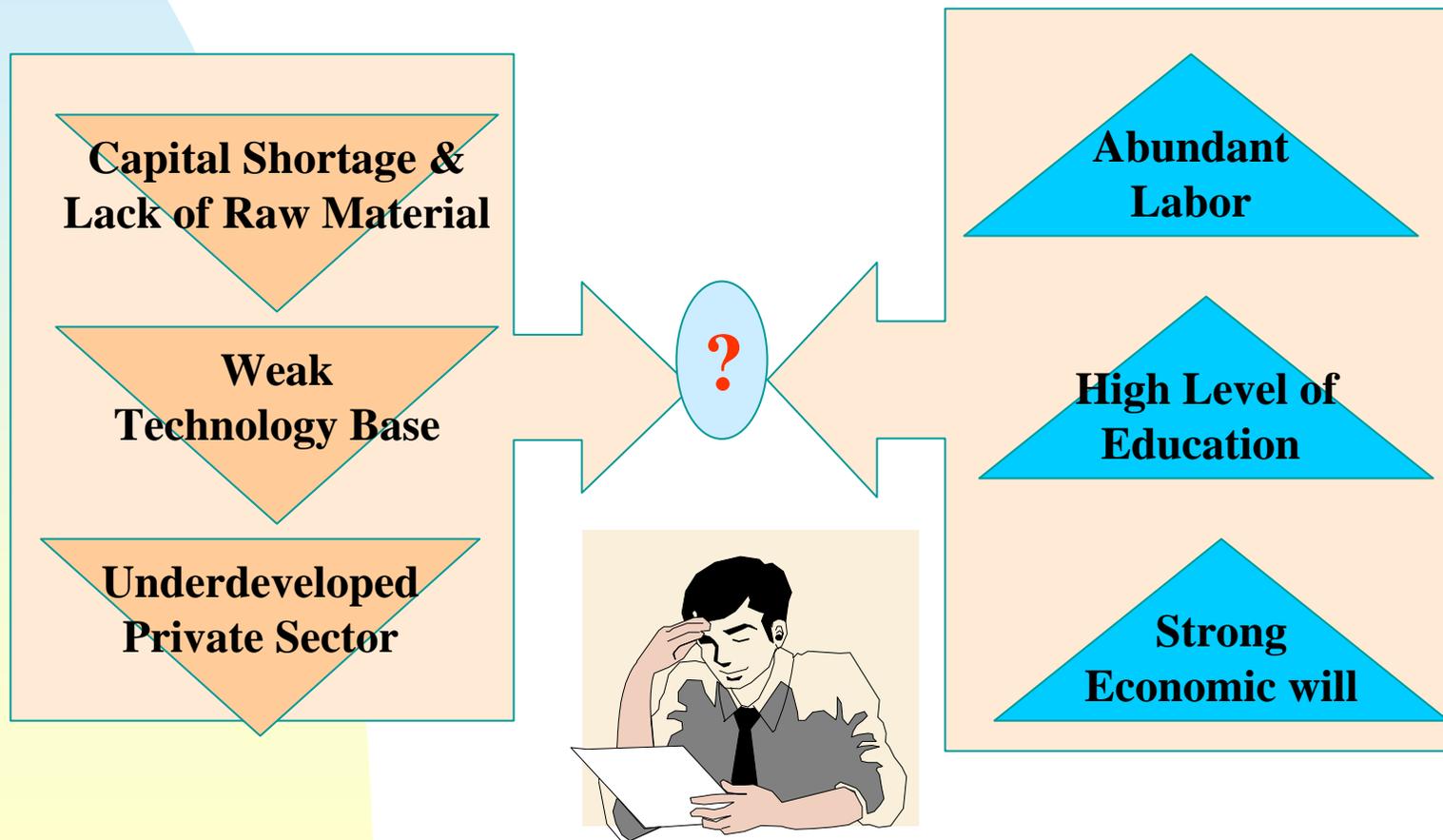
- n Service industry takes even higher share in terms of value added.
  - u In 2007, service industry (including construction) takes almost 69%.
  - u Manufacturing share continues to decline except the short period of early 2000s.



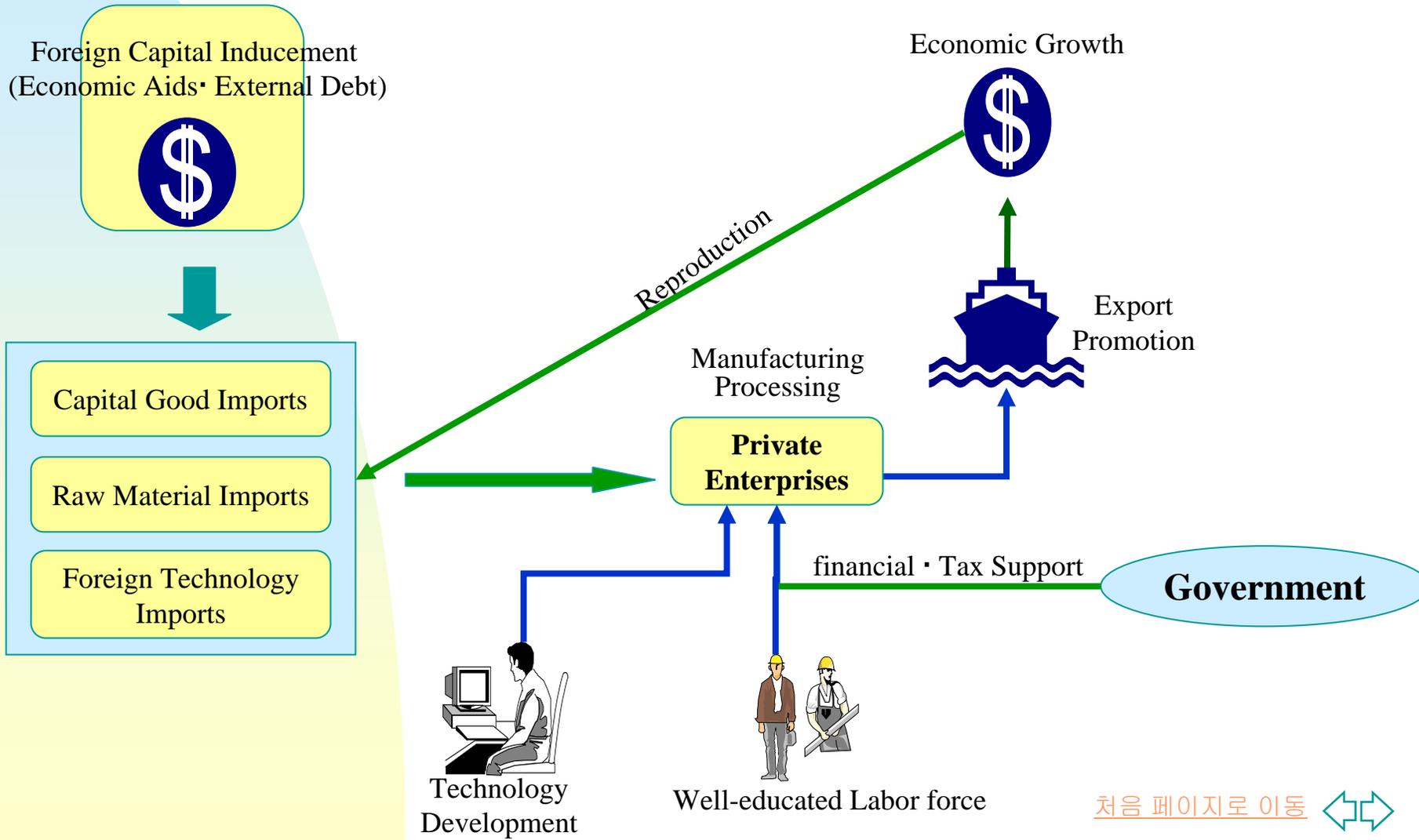
# ● Dominant Industries Under Continuous Change



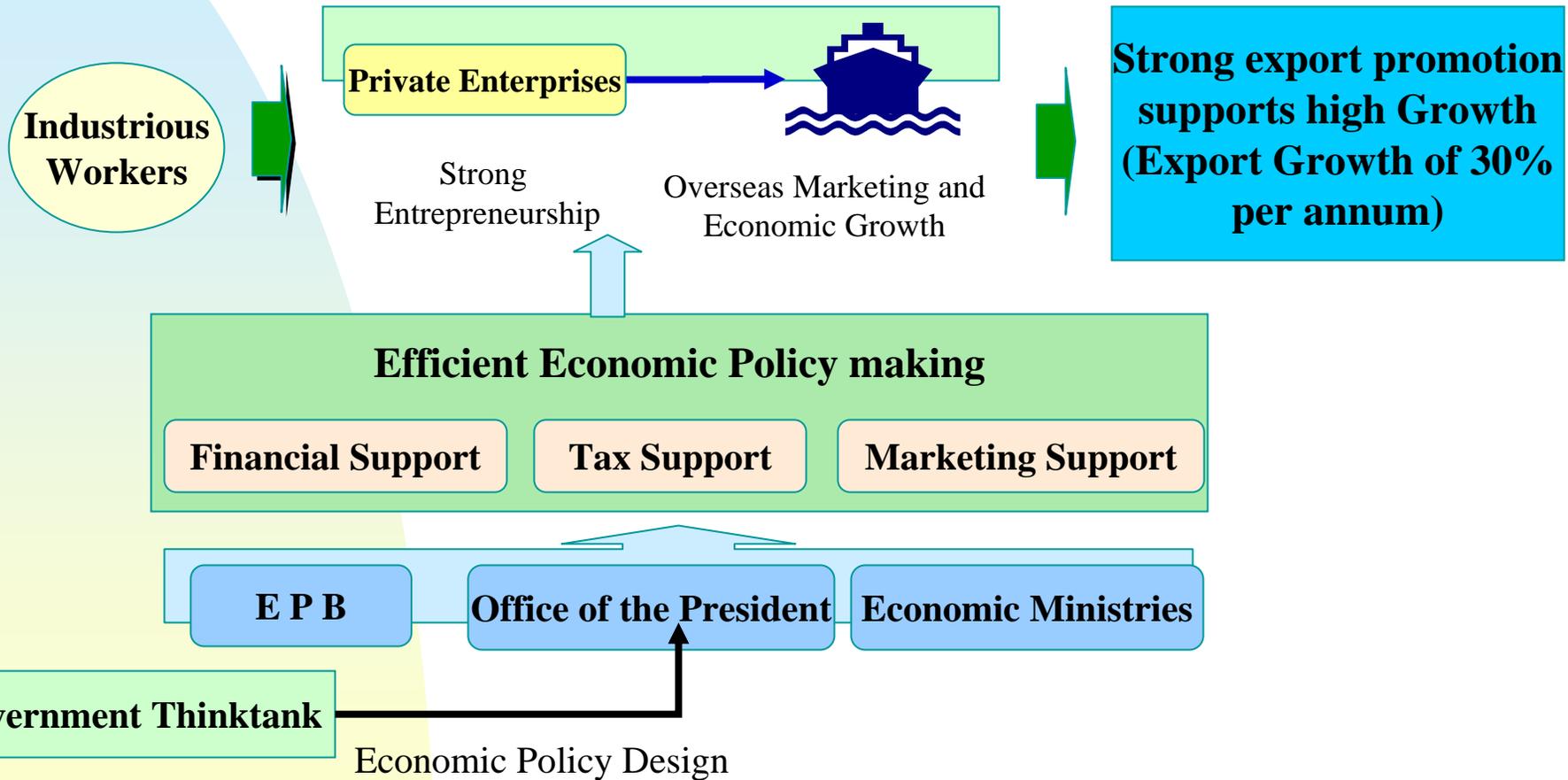
- Economic Conditions of the early 1960s



# ● Working Mechanism of Outward-looking Development Strategy



● Continued High Growth Based on Strong Entrepreneurship and Government Support



- **Trade-Growth Link has been essential in the formation of Korean major manufacturing Industries**

- n **Obsessed by Exports**

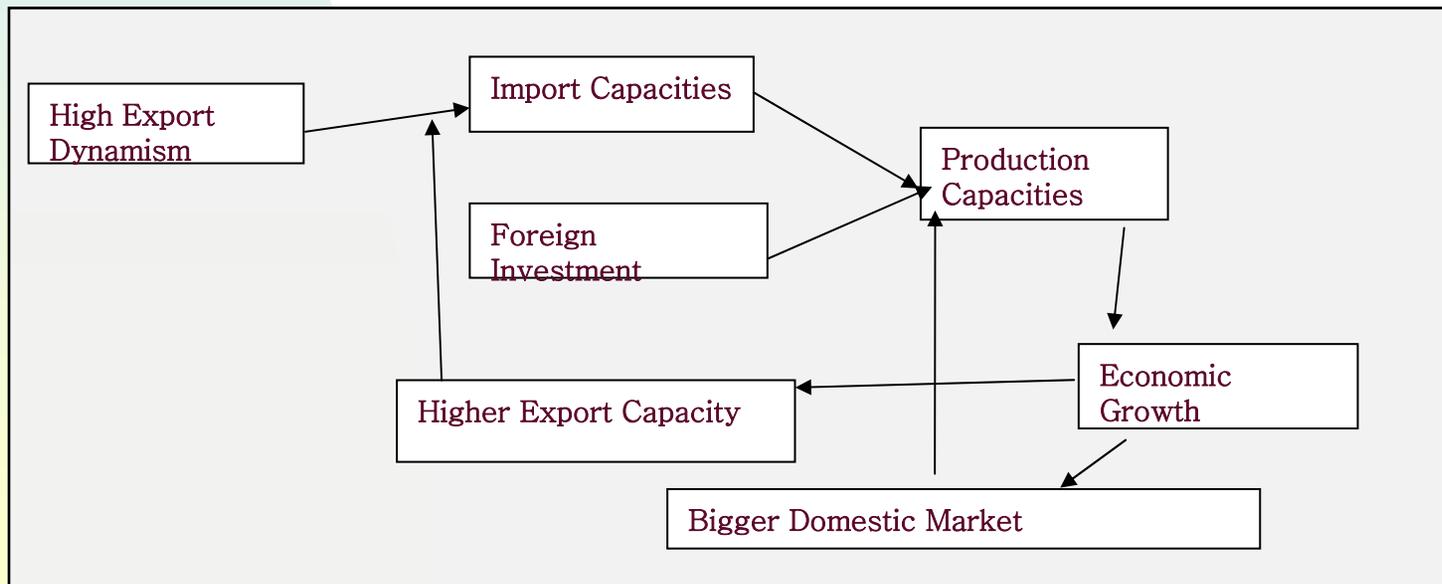
- u Why we want to trade, especially export?
    - u The most important element of the virtuous cycle is to ignite export which is necessary to enhance import capacities for future production. A desired cycle of trade and growth is simple but difficult to implement.

- **Contribution of Exports to Growth: the Korean Experience**

- **1964-69: 9.2%**
  - **1970s :29.0%**
  - **1980s :33.3%**
  - **1990s : 54.0%**

## ● An Illustration: A virtuous cycle of exports and growth

- Ignite export
- Increased import capacities increase production capacities
- Production capacities can be enhanced with FDI
- Economic growth leads to higher export capacities
- Expanded domestic demand help induce FDI
- Further production and Export capacities
- Economic achieved during the cycle



- The Origin: HCI Drives in 1970s

- n In the 1970s, Korea's exports were challenged by foreign pressures.

- u Pressure from foreign competition in light manufacturing

- u continued its export promotion and import restriction policies  
faced foreign resistance

- n HCI Drive

- u Massive Investments were directed to 8 Heavy and Chemical Industries.

- u Controversy over HCI Drive Policy

## ● Rethinking the HCI Drive

- n HCI Drive(1973-1979): dark ages?
  - u Misallocation of resources?: over capacity of HCI and damage in light industry
  - u Negative Economic (1980) and Export Growth (1979)
- n Dynamics of Comparative Change
  - u Worsening of External Balance: lack of capital and intermediate good industry
  - u Increasing Pressure from less developed Economies in labor-intensive industries
- n Be prepared for the ‘Luck’: 3 lows in 1986
  - u it’s true that the HCI drive was sub-optimal
  - u Question : Would Market Force itself have produced the present industrial structure
  - u With the benefits of 3 lows, the industry and trade structure deepened during the second half of 1980s.

## ● Pitfalls of Government-led Economic Development(1980~2000)

**Inefficient Financial System  
Due to Prolonged  
Government Intervention**

**Over-investment in  
HCI**

**Excessive Wage  
Growth**

◆ **Increased Production Cost**  
◆ **Efficiency Loss**  
◆ **Weakened Export Competitiveness**

- **1979 : Negative Export Growth for the first time since 1960**
- **1980 : Negative Economic Growth(-3.9%)**

● Recovering Growth Potential with Economic Stability

Stabilization Policy  
in the early 1980s

Budget Freeze/Cut

Phasing-out of Policy  
Loans and Interest  
Rate Deregulation

Investment  
Adjustment in HCI

Results

Disinflation

Strong Exports

High  
Economic Growth

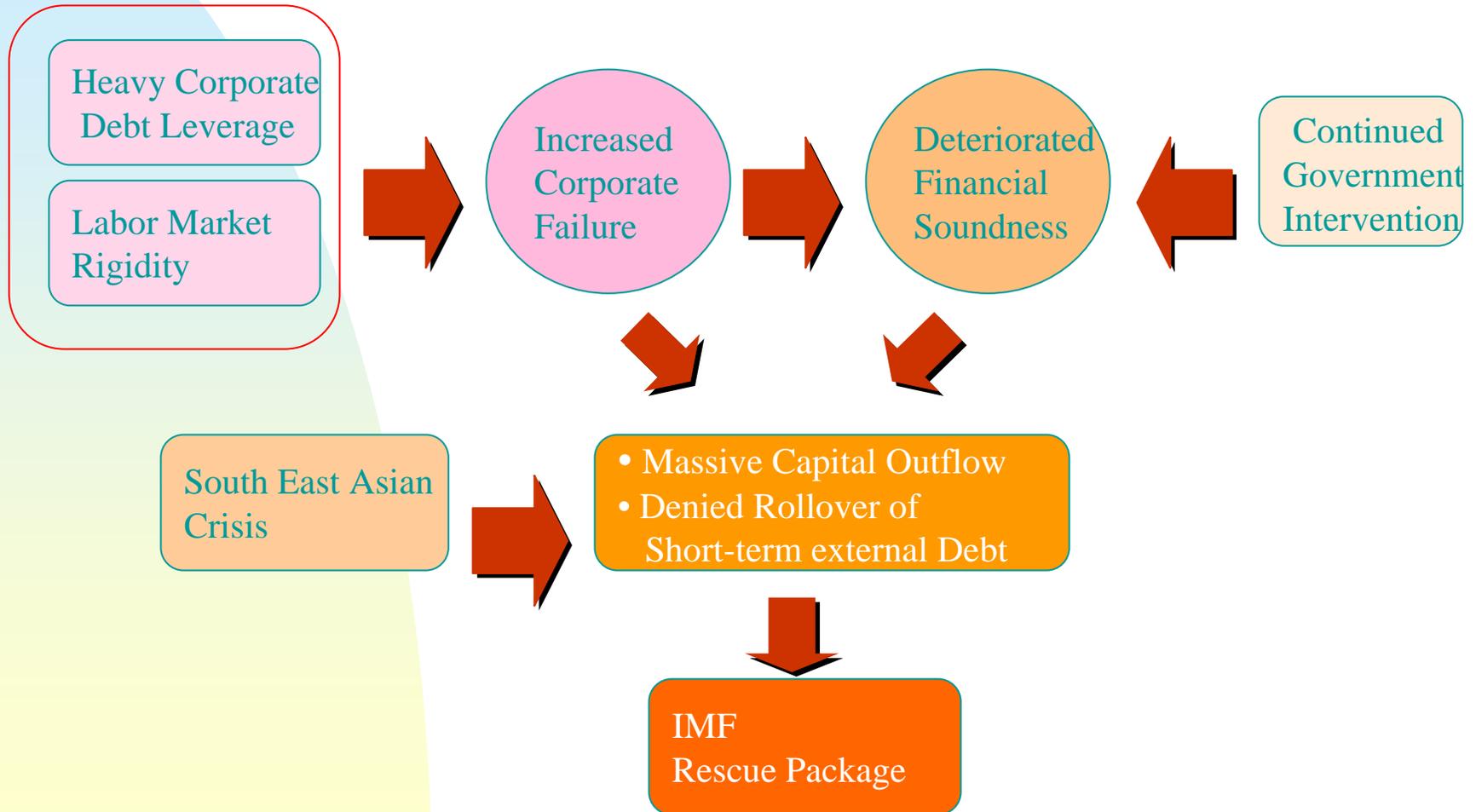
Inflation at around 3%

Current Account  
Surpluses

HCI Drive ?

GDP Growth of  
8% per annum

● Delayed Economic Reform and Financial Crisis in 1997



## ● Swift Crisis Resolution and Economic Recovery

### Crisis Resolution Measures

Full Liberalization of Capital Market

Comprehensive Economic Reform

Expansion of Social Safety Net



### Results

■ Early Graduation from the IMF Program  
( Foreign Reserves of more than US\$90 bn )

■ Rapid Economic Recovery  
( GDP Growth: 1998 -6.7% → 1999 10.7% )

■ Social Stability with Productive Welfare System

## II. TRADE POLICY of KOREA

### ● Trade Policies of Korea

	1948-1960	1961-1969	1970-1979
External Environment	<ul style="list-style-type: none"> <li>·IMF-GATT</li> <li>·Cold War Period</li> <li>·Korean War</li> </ul>	<ul style="list-style-type: none"> <li>·Kennedy Round(63-67)</li> <li>·UNCTAD: from aid to trade</li> <li>·Join GATT(67)</li> </ul>	<ul style="list-style-type: none"> <li>·Toyko Round(73-79): NTB</li> <li>·Provision of GSP</li> <li>·Korea as NICs</li> </ul>
Direction of Trade Policy	<ul style="list-style-type: none"> <li>·Ensure minimum living standard</li> <li>·Consolidating the relation with USA and international institution</li> </ul>	<ul style="list-style-type: none"> <li>·Mercantilism in trade policy</li> <li>·Export support</li> <li>·Import restriction</li> <li>·Emphasize competition</li> </ul>	<ul style="list-style-type: none"> <li>·Export promotion</li> <li>·Import substitution</li> <li>·Strong industrial policy</li> <li>·Fostering HCI</li> </ul>
Main Trade Policies	<ul style="list-style-type: none"> <li>·Acts of foreign trade(46)</li> <li>·Aid agreement with USA(48)</li> <li>·Preferential foreign exchange system(51)</li> <li>·PL(Public Law)480(55)</li> </ul>	<ul style="list-style-type: none"> <li>·1<sup>st</sup> &amp; 2<sup>nd</sup> 5 years economic development plan(61, 66)</li> <li>·Export subsidy</li> <li>·Export performance link system(63)</li> <li>·Export promotion plan(64)</li> <li>·New tariff act(67)</li> <li>·Rationalization policy of foreign capital induction(69)</li> </ul>	<ul style="list-style-type: none"> <li>·3<sup>rd</sup> &amp; 4<sup>th</sup> 5 years economic development plan(71, 76)</li> <li>·Measures for FDI inducement(71)</li> <li>·HCI fostering plan(73)</li> <li>·Flexible tariff system(73)</li> <li>·Measures for export promotion(74)</li> <li>·Intensive control system of foreign exchange(74)</li> <li>·Import liberalization plan(78)</li> </ul>

## ● Trade Policies of Korea

	1980-1989	1990-1997	1997-2008
External Environment	<ul style="list-style-type: none"> <li>-Failure of GATT</li> <li>-Delay of Uruguay Round(86-94)</li> <li>-Overuse of protective measures by DCs: Worsening trade dispute</li> <li>-Plaza Agreement: 3 lows</li> </ul>	<ul style="list-style-type: none"> <li>-Start of WTO(95): Deepening of globalization</li> <li>-Graduation of GSP</li> <li>-Member of GATT article 11 country(90)</li> <li>-Join OECD(96)</li> <li>-Financial Crisis(97)</li> <li>-Borrowing IMF fund(97)</li> </ul>	<ul style="list-style-type: none"> <li>-Global increase of FTA</li> <li>-Ineffectiveness of multilateral trading system(WTO)</li> <li>-Delay of DDA(2000-now)</li> <li>-Increasing power of BRICs</li> <li>-Rise of new trade issues</li> <li>-Global financial crisis</li> <li>-New protectionism</li> </ul>
Direction of Trade Policy	<ul style="list-style-type: none"> <li>-Changes to liberal trade regime</li> <li>-Passive trade policy</li> </ul>	<ul style="list-style-type: none"> <li>-Active globalization</li> <li>-Economic liberalization</li> <li>-Adopt global standard</li> <li>-Structural adjustment</li> <li>-International policy coordination</li> </ul>	<ul style="list-style-type: none"> <li>-Harmony between internal &amp; external negotiation</li> <li>-Reform domestic institution</li> <li>-Stabilizing resource procurement</li> <li>-Protect weak industries</li> <li>-Establish leader position in global economy</li> </ul>
Main Trade Policies	<ul style="list-style-type: none"> <li>-5th 5 years economic development plan(81)</li> <li>-Scheme for FDI inducement(80)</li> <li>-Adumbration of tariff reduction schedule(84)</li> <li>-Amendment of foreign capital induction law(84)</li> <li>-Increase import liberalization ratio(87, 93.6%)</li> <li>-Globalization of capital market(88)</li> <li>-Korean Trade Commission(87)</li> </ul>	<ul style="list-style-type: none"> <li>-Open distribution market(91)</li> <li>-Liberalization of financial sector(92)</li> <li>-Amendment of FDI system(92)</li> <li>-Loosening intensive control system of foreign exchange(93)</li> <li>-5 years plan for new economy(93)</li> <li>-Plan for internationalization of Korean currency(won)(93)</li> </ul>	<ul style="list-style-type: none"> <li>-Establish global FTA network</li> <li>-FTA roadmap</li> <li>-FTA with Chile, Singapore, EFTA, USA, EU.....</li> <li>-Increase ODA</li> <li>-Abolition of import source diversification policy(98)</li> <li>-Implementation of IMF program(98)</li> <li>-Adopt TAA(Trade Adjustment Assistant)(05)</li> <li>-Establish 'Invest Korea'(03) within KOTRA(Korea Trade Investment Promotion Agency)</li> </ul>



- Korea's Export Promotion Policy

- 1. Background

- ❑ Unsuccessful import substitution regime
      - excess capacity in the primary sector
      - price distortions unfavorable to exporters
    - ❑ Insufficient domestic market
      - low capacity utilization
      - high unemployment
    - ❑ Lacked access to the required capital
      - termination of the grant aid by the U.S.
      - rapidly rising import bill for energy
    - ❑ Shortage of natural resources

## 2. Export Promotion Schemes

### □ Incentive schemes

#### - preferential credit system

- readily available credit with preferential interest rates
- no discrimination between large conglomerates and small firms
- export credit insurance and guarantees

#### - preferential tax & tariff system

- exemption (reduction) of direct or indirect taxes
- approval of accelerated depreciation
- tariff refund

#### - import-export link system

- n Strong Positive Correlation between Exports and Economic Growth in High-growth Periods
  - n Since 2003, Growth Rates Increasingly De-linked from Exports, due mainly to “Industrial Restructuring”
    - u Booming Export Sectors  $\neq$  Economic Growth
- 
- Administrative schemes
    - operating Free Export Zones
    - establishing Korea Trade Promotion Corporation (KOTRA)
    - holding Monthly Export Promotion Meetings
    - utilizing exhibition fairs to advertise the major products

### 3. Evaluation: critical elements of Korea's success

- ❑ Adoption of bold outward-looking development strategy
  - escaped the confines of the narrow domestic market
  - forced the domestic firms to compete in the world market
  
- ❑ Active involvement of government in economic development process
  - used market indicators quite efficiently in making policy decisions and setting industry goals
  - utilized Monthly Export Promotion Meetings in solving export-related issues quickly and efficiently

## ❑ Effective utilization of Korea's natural comparative advantage

- developed labor-intensive industries
- focused on light manufacturing (textiles, plywood, footwear, etc.)
- set up the necessary foundation to move into heavy manufacturing

## ❑ Active investment in infrastructure

- modernized ports, built power plants, and constructed Seoul-Pusan expressway

## ● Role of the Export-Import Bank of Korea

### 1. Export-Import Financing and FDI/ODI Financing

#### (1) Export Financing

- Support for long term & short term export transaction

#### (2) Trade Financing

- Export & Import factoring, Purchase of export B/E(Bill of Exchange), Forfaiting, Import Loan

#### (3) FDI/ODI Financing

- Loan for FDI/ODI
- M&A financing
- Loan for ship building

#### (4) Guarantee

- Debt Guarantee
- Implementation Guarantee

## **2. ODA (Official Development Aid) and EDCF (Economic Development Cooperation Fund)**

(1) Provide ODA

(2) Provide EDCF(4,762 billion won)

## **3. IKCF (Inter-Korean Cooperation Fund)**

## **4. Information Center for Foreign Market OEIS (Overseas Economic Information System)**

### III. Lessons from Korean Experience

- n No secrete recipe, an outward orientation with strong incentives for exports and a commitment to growth through trade are the key
- n Address fundamental problems
  - Remove bottlenecks and Tackle problems of poor infrastructure
  - Stick with reforms
  - Sound macroeconomic policies
  - Economic liberalization and importance of foreign trade recognized

Remove any bias against exports

- Realistic exchange rate – incentives for exporters
- Inputs for exports at world prices

## n Leaderships

- Strong commitment from President
- Large conglomerates

## n Political stability

- Consistent policy implementation
- Long-term goals can be set

## n Policies need be closely monitored and modified if necessary

- Monthly export performance meeting chaired by President
- H&C Committee

## n Investment in human capital and R&D

## n The competition in the domestic market

- Liberalization of trade and FDI must be continued

## ● Is the Korean Model Replicable?

### n Is export promotion policy possible?

- Subject to the WTO principles: export subsidies, import substitution subsidies are prohibited
- Allowed subsidies: R&D, environment, regional development
- “Enabling Clause” for LDCs

### n Is specific sector targeting industrial policy possible? (especially for H&C sectors)

- Too much risks: financing, excess capacity in the world, foresight and ability of government, able entrepreneurs

## ● Implications for Uzbekistan

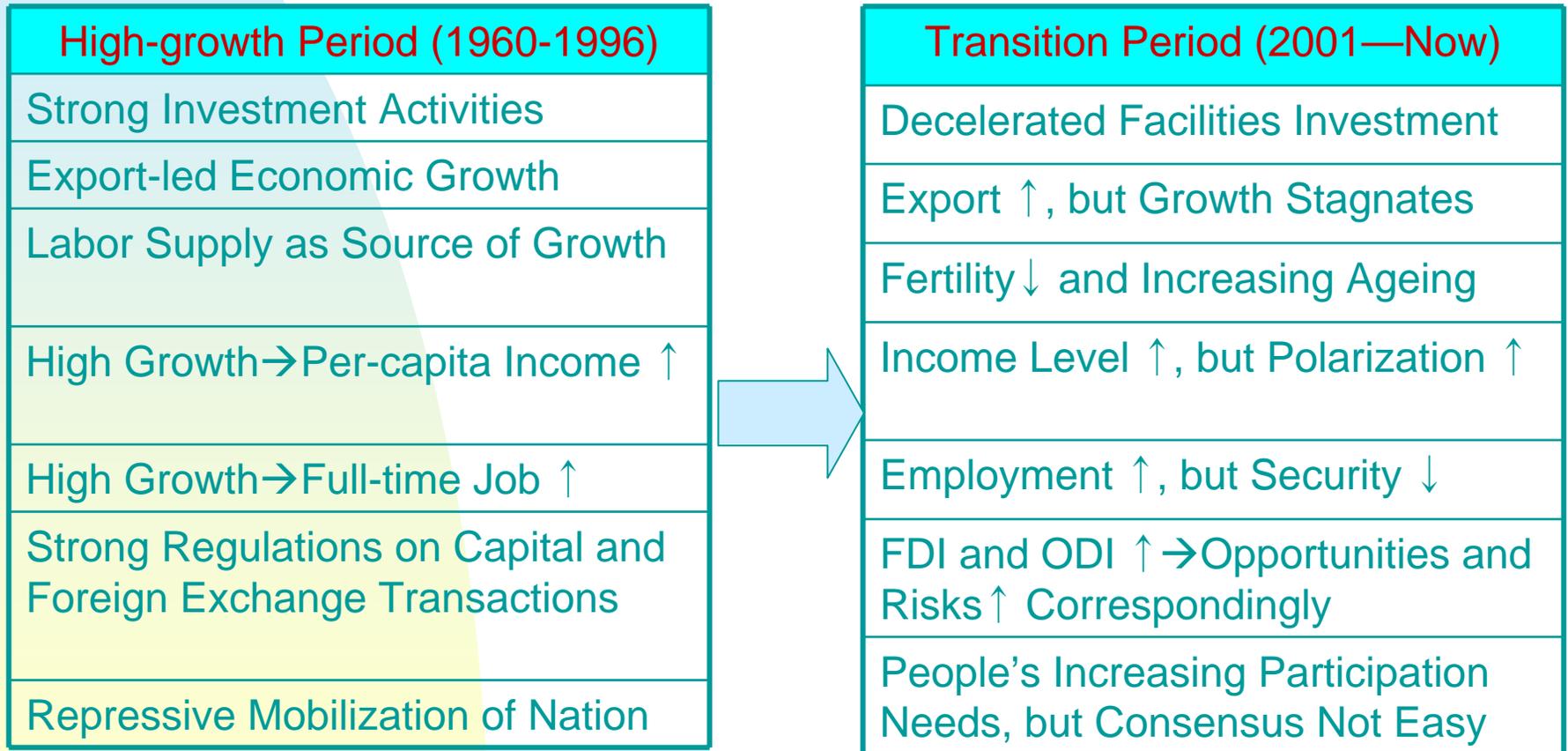
### ● Recommendations

- allow exporters to have easy and reliable access to inputs at world prices
- exempt all key inputs from import duties while raising the tariffs on others
- utilize value-added taxes, where necessary, to discriminate against uses of inputs for domestic consumption
- exempt domestic indirect taxes on intermediate goods used to produce and sell goods for exports
- exempt tariffs and indirect taxes for domestic suppliers of intermediate goods for export production.

- provide exporters with other possible incentives
  - provide preferential export credit
  - reduce direct taxes on income earned from exports
  - approve accelerated depreciation for fixed assets of major export industries
- diversify into more dynamic, processed primary products
- set annual export targets for major products and markets
- create an agency to promote exports by establishing an extensive overseas network
- establish various specialized vocational and job-training institutions to provide skilled workers required in export industries
- establish government sponsored research institutes to develop the technology required in export industries

# IV. Challenges of Korean Economy Today

## n Korean Economy Today / Major Changes



## ● **Low Investment-Low Growth Trap**

- n Sluggish Facilities Investment Continuing
  - u Despite Low Interest Rates and Expansive Economic Policy
  - u Uncertainties Due to Policy Inconsistency
  - u Prolonged Policy Bias towards Distribution rather than Productivity

## ● **Export Grows, Growth Decelerates**

- n Strong Positive Correlation between Exports and Economic Growth in High-growth Periods
- n Since 2003, Growth Rates Increasingly De-linked from Exports, due mainly to “Industrial Restructuring”
  - u Booming Export Sectors  $\neq$  Economic Growth

## ● Low Fertility and Aging Pressure Labor Markets

- n Labor Supply Traditionally an Important Determinant of Korea's Economic Development
- n But, Low Fertility and Accelerated Aging Reduce the Speed of Labor Supply
  - u Korea's Fertility Ratio (1.14 in 2004) one of the Lowest in OECD
  - u Share of the Old (over 65) 7% (2000) to Increase to 20% (2026)
  - u The Speed of Ageing (Ageing → Super-aged Society) the Fastest among Major Competitors
    - F Korea expected to become Super-aged Society within 26 Years
    - F France: 156 Years; UK: 92 Years; US: 86 Years; Japan: 36 Years
- n Financial/Fiscal Burden, as well

## ● Polarization in Distribution and Employment

### n Increasing per-capita Income ....

- u Income per-capita USD 14,612 in 2004 (Ref. USD 2,309 in 1985)
- u 35.5% of US Per-capita Income in 2004 (Ref. 13% in 1985)

### n With Increasing Polarization in Income Distribution

- u Gini Coefficient on the Increase (since AFC)
- u 0.283(1997) → 0.316(1998) → 0.312(2002) → 0.337(2006)

### n Reduced Job Security due to Increased Temporary Jobs

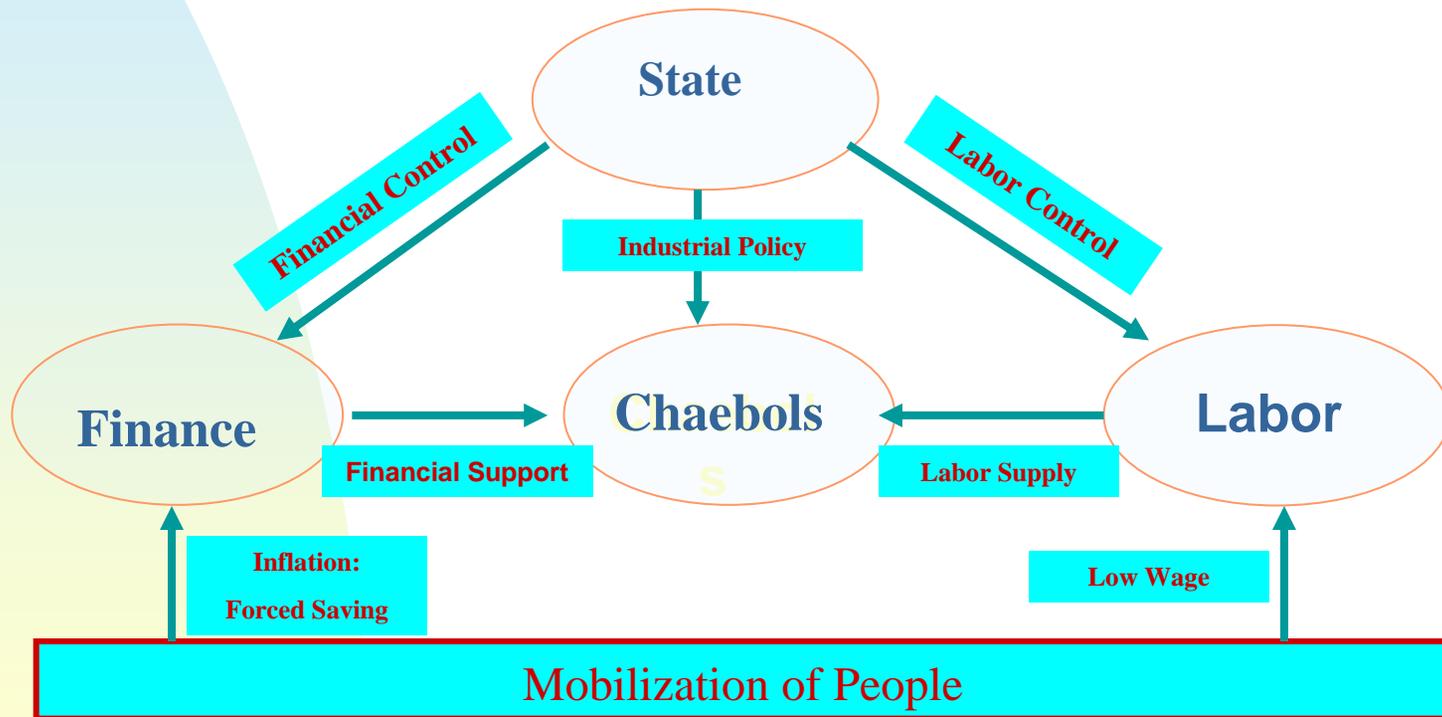
- u Temporary Employment Substantially Increased
- u Also Relatively High Unemployment in Youth and Over-Fifties

## ● Challenges and Opportunities of Globalization

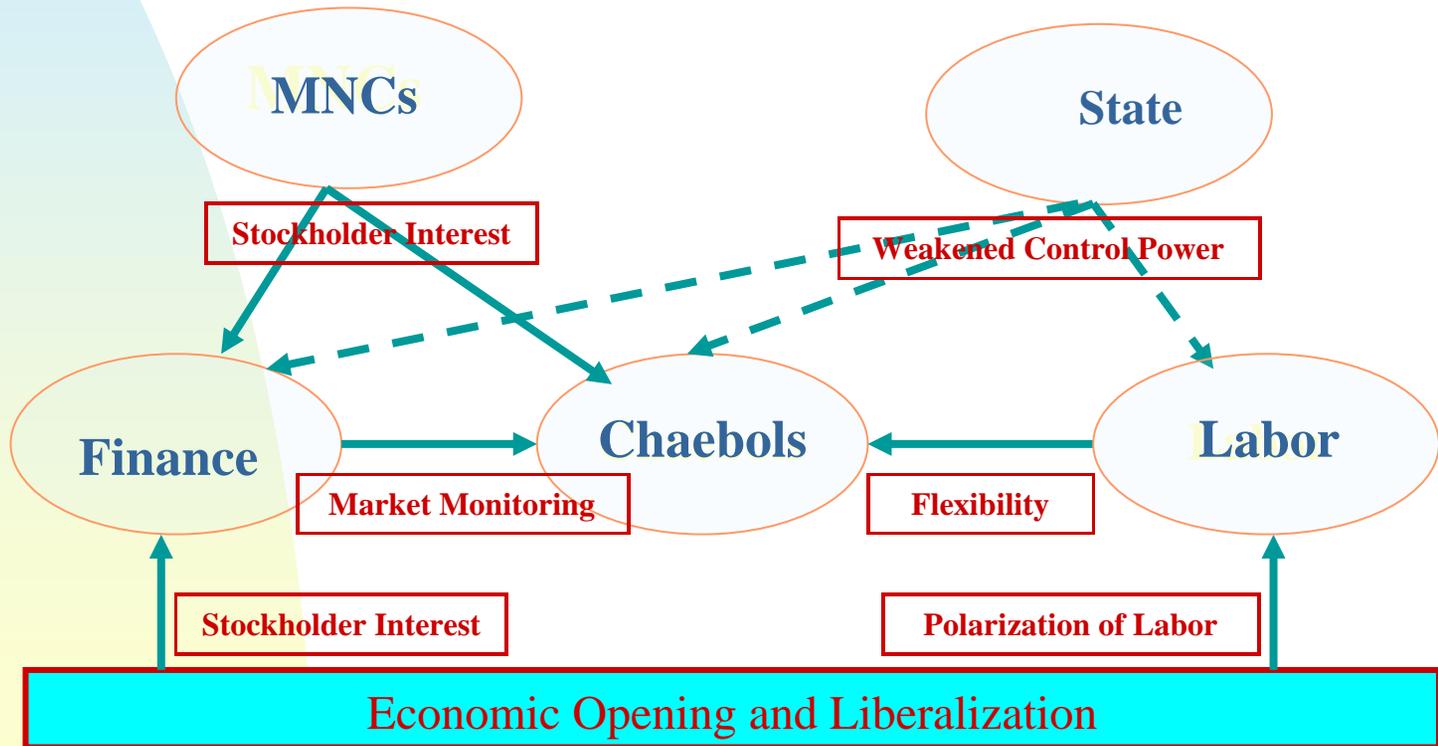
- n Strengthened Opening and Liberalization since 1997
  - u Portfolio and Direct Investments of Foreign Companies Increasing
  - u Very Recently, De-investment Observed
    - F Subprime Mortgage Crisis of US
- n Outward Direct Investment of Korean Firms also on the Rise
  - u China and Southeast Asia Favored Destination of Korean ODI
  - u SMEs Increasingly Investing into China

- **Korea's Development Model in Transition**

- n **The Era of "Export-led Economic Development"**



# n The Era of “Globalized Open Economy”



# ● Vision of the Korean Economy for the 21st Century

