

EVENT SUMMARY

The New South Korean Government's National Economic Agenda

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Il SaKong Presents the New South Korean Government's National Economic Agenda

Dr. Il SaKong, chairman and CEO of the Institute for Global Economics, spoke about the new South Korean government's national economic agenda at a Peterson Institute meeting on April 18, 2008. Despite the astonishing achievement of US\$20,000 per capita income, Korea still needs to grow fast to catch up with 40 countries whose incomes are higher than that of Korea. Korea's growth potential has been deteriorating in recent years. Contributions of both labor and capital to economic growth have declined. While labor's reduced role is understandable considering the aging population and shortened working hours, capital's deteriorating contribution is quite surprising. This decline is mainly due to sluggish investment in plants and equipment. It is not a coincidence that Korea's business environment is viewed as unfavorable by business communities. According to the World Bank's survey *Doing Business 2008*, Korea ranked 30 out of 178 countries.

To build a business-friendly environment, the Korean government has implemented several national economic policies.

- *Deregulation*: Industries from manufacturing to services, including financial services, will be deregulated according to global standards. The goal is to ensure a level playing field for all firms regardless of their size and nationality.
- *Tax*: The government will reduce tax rates, simplify tax laws, and promote transparency. Tax rates will be reduced from 25 to 20 percent in the next five years and from 13 to 10 percent for small and medium-sized companies during the same period.
- *Labor relations*: A big problem in Korea is the unreasonably high level of tolerance to illegal activities and disputes. This will be addressed by strict enforcement of the rule of the law. It is a promising sign that the Federation of Korean Trade Unions and Korean business associations declared that they would fully participate in the government's efforts.
- *Labor market*: In order to overcome the negative impact of the aging population and reduced working hours, female participation in the labor force needs to be encouraged. The government is making efforts to provide various incentives and better childcare services.
- *Foreign direct investment (FDI)*: According to a 2007 UN Conference on Trade and Development report, Korea ranked 115 in terms of FDI destination while its

potential for attracting FDI ranked 17. Educational, medical, and cultural services for foreigners will be improved. A major organizational reform will address the lack of consistency in Korean government's policies. President Lee Myung Bak will establish a hotline with foreign business representatives.

- *Total factor productivity* will be improved through various institutional reforms, systemic efficiency, intensified competition, and technological advancement.
- *Rule of law*: If compliance with the rule of law is improved to the Organization for Economic Cooperation and Development (OECD) level, Korea can increase its growth potential by 1 percent. The new government will ensure that rule of the law is enforced throughout the whole society.
- *Public-sector reform*: Some public entities will be either privatized or reformed soon.
- *Education*: Reform will focus on improving the quality of public education and providing diverse educational services. The government will pursue "autonomy and competition" of public schools. Investment in R&D will be increased.

With the right reform agenda and government's determination, Korea can increase its growth potential from the current 5 to 7 percent. Also, the Korea-US free trade agreement (FTA) will bring mutual benefits to the two countries.

Q&A Session

Questions from the audience included possible changes in the auto engine displacement tax, China's role in reduced FDI, Asian regional initiatives and their impact on the United States, impact of rising rice prices on economic policy toward North Korea, governance of the financial system, immigration policy, and macroeconomic policy in the face of rising inflation, and deteriorating growth outlook. SaKong answered:

- The engine displacement tax will be changed in line with auto tax provisions in the Korea-US FTA.
- Decreasing FDI in Korea is partly due to diversion of FDI to China but also due to the deteriorating business environment in Korea.
- The Asian initiatives are not negative to the United States as long as they are in line with the rules of existing multinational institutions.
- Rising rice prices are likely to affect food assistance to North Korea, but the magnitude is not clear.
- The current law prohibits large conglomerates from owning more than 4 percent of shares in banks. The government is committed to making some adjustments to this law in the future. Flexible regulation and principle- rather than rule-based supervision will make sure that all financial and nonfinancial institutions can participate in the financial sector.
- Korea will encourage immigration of skilled workers by easing laws on visas and citizenship.
- The government will address inflation through fiscal stimulation and tax reforms.