Regulatory Reform in Korea

The Role of Competition Policy in Regulatory Reform

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FOREWORD

Regulatory reform has emerged as an important policy area in OECD and non-OECD countries. For regulatory reforms to be beneficial, the regulatory regimes need to be transparent, coherent, and comprehensive, spanning from establishing the appropriate institutional framework to liberalising network industries, advocating and enforcing competition policy and law and opening external and internal markets to trade and investment.

This report on *The Role of Competition Policy in Regulatory Reform* analyses the institutional set-up and use of policy instruments in Korea. It also includes the country-specific policy recommendations developed by the OECD during the review process.

The report was prepared for *The OECD Review of Regulatory Reform in Korea* published in 2000. The Review is one of a series of country reports carried out under the OECD's Regulatory Reform Programme, in response to the 1997 mandate by OECD Ministers.

Since then, the OECD has assessed regulatory policies in 16 member countries as part of its Regulatory Reform programme. The Programme aims at assisting governments to improve regulatory quality — that is, to reform regulations to foster competition, innovation, economic growth and important social objectives. It assesses country's progresses relative to the principles endorsed by member countries in the 1997 *OECD Report on Regulatory Reform.*

The country reviews follow a multi-disciplinary approach and focus on the government's capacity to manage regulatory reform, on competition policy and enforcement, on market openness, specific sectors such as telecommunications, and on the domestic macro-economic context.

This report was prepared by Michael Wise in the Directorate for Financial and Fiscal Affairs of the OECD. It benefited from extensive comments provided by colleagues throughout the OECD Secretariat, as well as close consultations with a wide range of government officials, parliamentarians, business and trade union representatives, consumer groups, and academic experts in Korea. The report was peer-reviewed by the 30 member countries of the OECD. It is published under the authority of the OECD Secretary-General.

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Executive Summary

Background Report on The Role of Competition Policy in Regulatory Reform

Competition policy must be integrated into the general policy framework for regulation. Competition policy is central to regulatory reform, because its principles and analysis provide a benchmark for assessing the quality of economic and social regulations, as well as motivate the application of the laws that protect competition. Moreover, as regulatory reform stimulates structural change, vigorous enforcement of competition policy is needed to prevent private market abuses from reversing the benefits of reform. A complement to competition enforcement is competition advocacy, the promotion of competitive, market principles in policy and regulatory processes.

Competition policy and enforcement have promoted two fundamental aspects of reform in Korea: increased reliance on markets rather than central government direction to drive growth and increased openness and transparency of public institutions and major private enterprises. Korea's independent competition agency, the Korea Fair Trade Commission (KFTC), plays a central role in major reform efforts, and it has stepped up its enforcement activity in recent years. Korea's conception of the multiple purposes of competition policy—to promote balanced development and fairness as well as free competition and efficiency—has developed along with the program of reforms over the last two decades. The basic competition law, the Monopoly Regulation and Fair Trade Act (MRFTA), covers all of the principal competition policy problems -- collusion, monopoly, mergers, and unfair practices. In addition, the KFTC is responsible for issues of contract fairness and consumer protection. Most statutory exemptions have now been eliminated, although the application of competition principles to sectors being deregulated is still being worked out. The KFTC's enforcement tools and powers are generally adequate to prevent or correct anti-competitive practices and conditions.

The most prominent competition policy issue in Korea today is establishing an environment in which the *chaebol* compete on equal terms with other market actors. The principal criticisms of these diversified industrial groups—that ownership structures, finances, and management are not transparent enough, that their huge size and the perception that they are "too big to fail" distort financial markets and indeed the entire economy, and that the complex web of internal financial and other ties magnifies, rather than reduces, the risk of catastrophic failure—are not themselves issues of competition policy. Concerns are also expressed about conventional competition policy issues such as market domination, exclusion, and discrimination. A high priority for the KFTC recently has been to detect and punish "undue" internal transactions within the *chaebol*. Although many of the concerns have more to do with corporate governance and financial prudence than with competition policy, the KFTC may be well-placed to deal with them, because of its enforcement tools and experience. Since 1986, the MRFTA has given the KFTC powers to regulate the *chaebols'* corporate and investment structures. Major reforms of corporate law and finance are now under way and new agencies such as the FSC have been established to specialise in those subjects. Because of the magnitude of the problem, the extent of the crisis, and the scope of the changes, it may be some time before these reforms take full effect. As they do, the KFTC should be able to concentrate on policing distortions of the competitive process.

The KFTC's independent position has not hampered its participation in reform, because the KFTC's status provides direct access to the policy process. The KFTC has promoted important steps to make competition policy universal by reducing exemptions and special treatments. Other reforms have scaled back potentially intrusive regulatory roles of the KFTC itself, for example, by ending the KFTC's practice of issuing a list annually identifying dominant firms whose prices and conduct would receive special scrutiny.

The KFTC should build on its solid institutional and policy base to ensure that principles of competition, rather than central direction, govern the relations between the Korean state and the market. It should focus its resources to emphasise the policy goal of efficiency, a direction evidenced already by its significantly increased attention to horizontal issues. Here, the KFTC may need additional powers to gather information. In dealing with the conduct of the *chaebols* and with actions to restructure market relationships, the KFTC's principal concern should be correcting problems of anti-competitive exclusion and dominance.

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1. FOUNDATIONS OF COMPETITION POLICY

Korea's competition policy institutions developed as its economic policy has shifted since the early 1980s from central direction toward reliance on markets. The roots of those institutions, and the problems they address, are in the earlier, development era. Even now, the purposes of competition policy are broad enough to support programs like those of the previous period, of structural intervention and regulation, as well as those of market-based reform. Adapting institutions to the present tasks will mean shifting the emphasis among the many elements of Korea's competition policies.

Competition policy grew out of an environment of state-led growth, and now must deal with the* chaebol *structures and practices inherited from that period.

Competition policy played little role in the era of state-led development of the 1960s and 1970s. Although the economy's forms were those of markets and private investment, many markets were controlled, directed, and protected. Investment was targeted, as the government tried to allocate resources directly through systems of control such as business licenses. The national goal was rapid economic development, so the government assigned top priority to industrial and trade policies intended to maximise investment and market share.

Box 1. **Competition policy's roles in regulatory reform**

In addition to the threshold, general issue, whether regulatory policy is **consistent** with the conception and purpose of competition policy, there are four particular ways in which competition policy and regulatory problems interact:

- Regulation can **contradict** competition policy. Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price co-ordination, prevented advertising or other avenues of competition, or required territorial market division. Other examples include laws banning sales below costs, which purport to promote competition but are often interpreted in anti-competitive ways, and the very broad category of regulations that restrict competition more than is necessary to achieve the regulatory goals. When such regulations are changed or removed, firms affected must change their habits and expectations.

- Regulation can **replace** competition policy. Especially where monopoly has appeared inevitable, regulation may try to control market power directly, by setting prices and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise in support of regulation, that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.

- Regulation can **reproduce** competition policy. Rules and regulators may have tried to prevent co-ordination or abuse in an industry, just as competition policy does. For example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. Different regulators may apply different standards, though, and changes in regulatory institutions may reveal that seemingly duplicate policies may have led to different practical outcomes.

- Regulation can **use** competition policy methods. Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Co-ordination may be necessary, to ensure that these instruments work as intended in the context of competition law requirements.

The primary vehicle for investment and development of that era, the conglomerate structure known in Korean as *chaebol*, has emerged as a primary subject of competition policy today. The *chaebols* are historical products of the period of government-led rapid economic growth (OECD CLP, 1996). The *chaebols* originated in manufacturing, after the post-war disposition of confiscated assets, to favoured parties at preferential prices. Other political and policy favours followed. In Korea's development program,

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the *chaebol* structures offered some advantages, notably accumulation of capital and capacity for mediating resource transfers in the absence of developed factor markets. They expanded most rapidly during the 1970s, a period of particularly interventionist policy in the "heavy and chemical industry drive."

In structure and behaviour, the *chaebols* appear similar to Japanese *zaibatsu* and to German *Konzern,* but their particular collection of characteristics may be uniquely Korean. These characteristics are ownership structures leading to *de facto* control by an individual or family (often based ultimately on equity holdings that are actually quite small), complex financial relationships and inter-company shareholdings, diversification of subsidiaries across many businesses, and in those businesses, leading positions in concentrated markets. Practically all large private companies are parts of *chaebols*. They are Korea's representative form of business organisation, embodying both the historic problems and the historic successes of its economy: cohabitation of politics and business, government favours, speculation, and closed management by insiders, along with strong, centrally directed economic growth and economic development.

As Korea's market environment opened more in the 1980s, weaknesses in this economic organisation became evident. Pervasive central direction had rewarded size and market share, rather than innovation, adaptability, or even profitability. As the latter have become more important, the focus on size has become a liability. The government-business relationship also came under closer scrutiny. Government support and direction for the major firms fostered a public impression that businesses did not deserve their success, for it was achieved through official favour. Efforts to control supposed *chaebol* abuse go back to 1961, when "profiteers" were punished. In 1974, the *chaebols* were required to improve their financial structures and permit their subsidiaries to go public. The later effort was part of a program to develop institutions like the stock market. But most measures, including decrees in 1980 purporting to liquidate land holdings and rationalise the *chaebol* structures, were one-time shock therapy and lacked institutional continuity (Lee, 1998, pp. 3, 364-65).

The *chaebols* were not the only important issue, of course. In the 1970s, Korea had to deal with the shocks caused by the oil cartel and by changes in its government and its relationship with the United States. One effort was the Monopoly Regulation and Price Stabilisation Act of 1975. Despite the two themes in its title, application of the law focused on controlling prices (Lee, 1998, pp. 40-42). It was not until the early 1980s that Korea's policy outlook shifted toward competitive markets.

The 1975 Act was largely replaced by the Monopoly Regulation and Fair Trade Act, the current, comprehensive antimonopoly law, adopted in December 1980. The MRFTA marked a significant departure from the tradition of a government-led economy to a market economy based on private initiative and competition. But the price-control tradition and experience coloured the MRFTA's early application. Price stability was still a policy concern. Recognising that most Korean industries were concentrated, the MRFTA prohibited undue pricing by monopolies and parallel price increases by oligopolies. (The categories were, and are, defined solely in terms of market share and structure, rather than actual competitive conditions, though.) Responsibility for this new law was given to a new agency, the Korea Fair Trade Commission, within the powerful Economic Planning Board.

Despite the efforts to change course, habits of central direction persisted. The Industrial Development Act of 1986 replaced several industry-specific regulatory acts but still provided for indicative rationalisation plans and differentiated between the treatment of "sunrise" and "sunset" industries. A 1988 KFTC survey showed that economic regulations remained pervasive. Reform efforts in the 1980s were mostly limited to reducing "red tape" for existing firms, not eliminating economic regulation of price and entry that inhibited competition. The government paid special regulatory attention to prices in concentrated industries, where market leaders were to report price changes in advance—pursuant to informal administrative guidance, not legal obligation. Indeed, the Economic Planning Board monitored prices until 1993, and reportedly used the process to stabilise prices.

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Beginning in 1988, the government decisively to deregulate, eliminating some manufacturing and import license requirements, liberalising some controlled prices, and relaxing constraints on retail location and operation. Later in 1988, competition policy enforcement intensified, and a Task Force for Economic Autonomy and Competition was established to review existing regulations and recommend changes. In 1990, the Committee for Administrative Deregulation was set up, headed by the Prime Minister. It was succeeded in 1993 by the Deregulation Committee, headed by the Vice-Minister of the Economic Planning Board. Issues addressed included rules about plant establishment, construction, land use, customs clearance, foreign investment, environment, and distribution. Sectors studied included transport, distribution, construction, finance, stock brokerage and insurance, pharmaceuticals and cosmetics, food and beverages, alcoholic beverages, fisheries, energy, and services such as advertising and telecommunications (Lee, 1998, pp. 19-22, 118-19).

In 1994, the government abandoned the five-year plan system and abolished the Economic Planning Board that had been responsible for it; the Board and the Ministry of Finance were merged into a new Ministry of Finance and Economy. Another result of the re-organisation was that the KFTC emerged as a separate and now independent body. In 1990, decision-making power in competition law-related matters had already been shifted from the Minister of the Economic Planning Board to the KFTC Chair, thus giving the KFTC independence in its enforcement decisions.

Competition policy and institutions have thus emerged step by step since the 1980s. Much has been done to remove the structure of anti-competitive regulation. But much remains to be done. Some sectors remain highly concentrated, where potential competition was limited because of regulation of entry, pricing, and imports. New market-oriented policies are applied by institutions that emerged from the tradition of central direction. There remain concerns that non-transparent regulation persists, motivated sometimes by pre-reform concerns about industrial-policy, and that competition policy too has been used as a collateral tool to accomplish other purposes.

The top goals of Korean competition policy, in practice, are preventing concentration of "economic power" and promoting "balanced development": both could encourage more intervention than may be necessary.

The MRFTA's stated purpose is to encourage fair and free competition by prohibiting abuse of market-dominant positions, preventing excessive concentration of economic power, and regulating improper concerted activities and unfair business practices, thereby stimulating creative business activities, protecting consumers and promoting the balanced development of the national economy (Article 1).[1] This statutory statement implies that competition policy in Korea has three ultimate goals: innovation and dynamic efficiency, consumer protection, and balanced economic development. The competition that will accomplish the three principal goals must be both "free" and "fair." And ensuring that, in turn, depends on enforcing the rules. The first set of these rules listed in the statute, about preventing abuse of dominance and concentrated "economic power," has until recently been the most important.

As is common in other OECD countries, the KFTC states that efficiency and consumer welfare are the ultimate goals of competition policy. The word "efficiency" appears nowhere in the statute, although it is used in several parts of the enforcement decree. The KFTC asserts that promoting free competition throughout the economy will stimulate business and satisfy consumer needs, contributing in the long run to economic efficiency and consumer welfare. When enforcing laws aimed at economic efficiency and consumer welfare may conflict with other goals, notably the protection of SMEs, the KFTC says that it would place higher priority on economic efficiency and consumer welfare (KFTC 1999*a*, §1). Thus, the KFTC has taken enforcement action against concerted efforts by small businesses (acting through a trade association) to prevent efficient, low-price competition, and it has rejected complaints that large stores' customer-convenience measures are devices to lure customers unfairly.

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"Free" competition is taken to mean competitive industrial structure, that is, the absence of excessive concentration and barriers to entry, rather than pure rivalry (KFTC 1999*a*, §1). Thus the notion of free competition is connected to the traditionally most important goals, of controlling abuse and prohibiting the excessive concentration of economic power. In this usage, "economic power" appears to be broader than the common conception of market power as the ability to raise price above competitive levels or exclude competitors. The "free competition" theme may also encompass concerns about aggregate concentration in terms of firms' shares of the national economy as a whole and the concentration of personal wealth, as well as shares of defined markets.

Fairness is a criterion in all three acts that the KFTC is responsible for. The MRFTA calls for "fair and free" competition. The Fair Subcontract Transactions Act calls for "a fair order for subcontracting so that contractors and subcontractors may enjoy balanced development on an equal footing in a mutually complementary manner." And the Regulation of Adhesion Contracts Act instructs the KFTC to protect consumers by preventing adhesion contracts containing unfair terms and conditions that constitute abuse of their negotiating position. A leading Korean expert on competition policy contends that "fair" competition must be understood as a moral conception. That is, all economic actors—including the government itself—should abide by the same set of rules, which should be set by broad, national consensus. By comparison, "free" competition is a mode of conduct, the pursuit of individual, private interest, made possible by protecting rights of property and freedom of contract. The two criteria, "fair" and "free", cannot be separated, and it is the competition law that connects them. That law removes the government from the marketplace, but it also makes individuals dependent on themselves, not the government. The notion of "fairness" is applied to correct imbalances in bargaining power, so that all parties are viable participants in the market economy (Lee, 1998, pp. 10, 213).

The goal of "balanced development of the national economy" also appears in the purposes of all three laws. This goal is taken to be the basis for the KFTC's concentration on aspects of *chaebol* behaviour and structure and protection of the interests of small and medium sized enterprises against "unfair" competition from larger firms. The KFTC maintains that the "balanced development" goal is a lower priority than promoting economic efficiency and consumer welfare, but in terms of resources and attention, it appears to rank first (KFTC, 1999*a*, §1). The content of this goal is ambiguous. It seems to be enlisted both to justify attacks on aggregate concentration, along several dimensions, and in order to support rules about transactional fairness and equity in bargaining relationships.

Competition policy is key to regulatory reform; because economic and political reforms are intertwined, the government has used competition policy tools to implement* chaebol *policies as well.

The President's policy manifesto for reform links political and economic goals, emphasising the connection between economic freedom and political democracy (MOFE, 1999, Chapter 2). It notes that consolidation of the market economy requires not only economic freedom and competition, but also accountability. Because sound development of a market economy requires the security of economic freedom and a fair and transparent competitive environment, it declares that unwarranted political and bureaucratic influence and monopolistic and anti-competitive behaviour must both be eliminated. Those themes explain why competition policy efforts in reform have focused so much on the various *chaebol* issues, including not only the transparency and accountability of the *chaebols* themselves, but also the transparency and accountability of the regulatory interventions to deal with them.

There is a widespread belief, both within Korea and outside it, that there is some kind of *chaebol* "problem" that must be solved; however, there is less agreement about the nature of the problem. Moreover, it is generally believed in Korea that the *chaebol* situation there is utterly unique. Most mainstream Korean economists agree that something needs to be done, although some have reservations about applying interventionist regulation that contradicts reform's market-based principles.

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The *chaebol* "problem," however it is characterised, is not uniform. A decade ago there were over 60 *chaebols* subject to special regulation. The number has declined slightly because some have failed. But their overall position in the economy has remained stable. Despite policies aimed at reducing concentration since 1987, the share of the top 30 *chaebols* in the manufacturing and mining sector has remained at about one-third. Because they are not as prominent in service sectors, the *chaebols'* share of total GDP is lower: for the top 30, about 16%, and for the top five, about 9% (OECD CLP, 1996). It is generally recognised that the *chaebols* fall into two classes, a small number of very large ones (usually considered to be five), and everyone else. The principal problem of the top five is that they have been considered too big to fail, and this perception significantly distorted economic and investor behaviour. A sign of change is that in 1999 one of the largest, and most indebted, Daewoo, was in the process of being broken up and its viable subsidiaries restructured and spun off.

The *chaebols* have been the target of major reforms in corporate governance and finance, which accelerated after the 1997 financial crisis. These reforms are aimed ultimately at what may be the *chaebols'* most problematic and unique feature, the family-based linkage through which a handful of people, usually the founder and close relatives, control the subsidiaries from a foundation of quite small equity holdings. In this setting, business and investment decisions may be guided by non-market incentives such as maintaining power and control, rather than operating efficiently and competitively. "Monarchical" leadership by the group chairman went unchallenged by auditors or outside directors, while highly leveraged financial structures were supported by within-group debt guarantees that obscured and magnified risks.

To correct excessive insider power in the *chaebol* structure, the groups were required as of January 1999 to have outside directors. Liability for auditors is increased, and controlling shareholders are now subject to personal liability. Shareholders' rights have been improved, as the minimum shareholdings to inspect books or file derivative actions have been reduced. Minority shareholders may elect representatives where cumulative voting is allowed; it is not required, though. A shareholder activist organisation is now vindicating these rights through suits to hold firms accountable for criminal or wasteful insider dealing and to ensure election of outside directors. Some firms have resisted shareholder activism, though, by such devices as holding all of their annual meetings on the same day. But some minority shareholder suits have succeeded, and the risk of liability is being taken seriously. To increase transparency and reduce leverage, the top 30 *chaebols* must have combined balance sheets for 1999, and debt-equity ratios are to be reduced below 200%.

Several KFTC-administered regulations aimed at the *chaebols* have addressed issues of corporate and financial forms (in contrast to conduct or structures with more direct effects on competition (Arts. 10-12). Regulations limit debt guarantees among group members, both to reduce the *chaebols'* advantage in obtaining financing and to prevent bankruptcy among a few affiliates from spreading, leading to a demand for government rescue (Lee, 1998, pp. 360-64). New intra-group guarantees were prohibited as of 1998, (OECD CLP, 1996) and existing guarantees must be cleared by March 2000 (Article 10-3). In addition, the MRFTA prohibited holding companies (Article 8), regulated shareholdings within business groups (Article 9), limited large business groups' shareholdings in other companies (Article 10), and prevented finance company members of those groups from voting their shares in other group members (Article 11). Direct inter-company shareholding has been prohibited since a 1986 amendment to the MRFTA. But that kind of investment relationship was rarely used, while one-way direct investment between group members has been allowed, leading to chains of indirect investment that also consolidate control in small holdings (KFTC, 1999*b*). Rules limiting the *chaebols'* capital investment in other companies were used to control their structure, and they were occasionally modified to assist SMEs (OECD, 1998*a*). Some of these prohibitions and rules, including the ban on holding companies and the investment limits, were relaxed or eliminated in early 1999. Holding companies are now permitted in principle, but few have actually appeared in fact, since they are subject to stringent limitations to prevent using them to duplicate or perpetuate the *chaebol* structures.[2]

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The *chaebol* structures may have led to more conventional competition concerns, too. The *chaebols* have had advantages in access to resources such as capital and manpower, and they may also have had product market advantages, too, in consumer recognition and credibility. Those advantages may have been enough to discourage or eliminate efficient independent firms. The larger *chaebols* may have had a greater capacity for unfair methods such as foreclosure, vertical price squeezing, reciprocal dealing, entrenchment, and cross-subsidisation. At least, the non-transparency of financial flows within the groups made it more difficult to detect such tactics. Product diversification may have given them some advantage of stability. Their precarious financial structures and linkages may have had the opposite effect, except to the extent that they demanded government intervention and thus amounted to an exit barrier (Lee, 1998, pp. 358-59).

The KFTC contends that the *chaebols* have relied on undue in-house transactions, cross capital investment, and cross guarantees to prevent failing firms from exiting the market. This has allegedly distorted the balanced allocation of financial resources, prevented the balanced development of small and medium sized enterprises, and reduced the efficiency of the economy as a whole. Prohibiting "undue" transactions in shares, real estate, and loans among *chaebol* affiliates has become a major KFTC priority (OECD CLP, 1996). The KFTC believes its role is to ensure the infrastructure of a market economy, not just with respect to the rules of market behaviour, but also in the spheres of corporate governance and consumer information. Recognising that a *chaebol* might not monopolise a particular market, the KFTC nonetheless believes that the groups raise larger issues of monopoly in the economy. The KFTC believes that their internal links, to insulate insiders from market forces, result in an external diseconomy, shifting the risks to the outside shareholders and the economy at large (KFTC, 1999*b*).

One of the most difficult and controversial issues is the allegation that the *chaebols* are too diversified. The only sure way to test this claim is in the market itself. In various ways, the government has taken an interest in seeing that the *chaebols* reduce their diversification and concentrate on two core industries—three, for the largest groups. The latest form this has taken is the so-called "Big Deals," in which some of the top *chaebols* are rearranging their holdings with each other to leave only one or two major firms in key sectors in Korea. The reason typically given to justify this is to reduce over-capacity. But the result may be industries that are too highly concentrated. That condition may lead to future competition problems, which may difficult for the KFTC to deal with.

Box 2. **The "Big Deals"**[3]

The Big Deals were conceived as part of a solution to excess capacity and high debt to equity ratios—and, for some, a concern about "excess competition." Their effects on market concentration and competition will require careful monitoring. In August 1998, the Ministry of Trade, Industry and Energy identified ten industries that were in need of restructuring to reduce excess capacity. Plans were announced in September 1998 to reorganise the operations of the top five *chaebols* in five of these areas, and two more were added later: semiconductors, power-generating equipment, petrochemicals, aircraft manufacturing, railroad vehicles, ship engines and oil refining. In each industry, major producers would be combined to leave one or two Korean companies.

In December 1998, agreements were reached among the government, the *chaebols*, and their creditor banks to accelerate restructuring, after the government rejected several of the proposals to implement the plans announced in September. The agreements specified each group's core businesses and the number of subsidiaries, specified the divisions of ownership in the successor companies, provided for foreign investment participation in three of the deals, and committed to reducing the new companies' debt to equity ratio below 200%. To encourage action, the government announced that it would reduce or exempt taxes resulting from the deals. And agreement on an eighth Big Deal was also reached, the swap of Samsung's car company for Daewoo's electronics business.

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Semiconductors: Samsung will remain independent, while LG Semiconductor would be combined with Hyundai Electronics, under the latter's management. This deal was finalised in January 1999, and approved by the KFTC, on the grounds that, although this created the largest maker of DRAM chips in the world, its market share did not reach the 50% threshold.

Cars and trucks: Hyundai will remain independent, while Daewoo would take over Samsung's operations. Hyundai had already acquired Kia Motors; in 1999 the KFTC approved that transaction, which gave Hyundai more than half of the domestic auto market and a virtual monopoly of the truck market, because the acquired firm was failing. But it did impose a condition, that truck prices in Korea increase at a rate no higher than prices for export. The Daewoo-Samsung combination broke down as Daewoo's financial situation deteriorated. The other part of that "swap" transaction, Samsung's taking over Daewoo's electronics operations, also failed to materialise.

Power generating equipment: Hyundai Heavy Industries would remain independent, while Samsung's operation would be taken over by Korea Heavy Industries & Construction Co (Hanjung, which was set for privatisation in 1999).

Petrochemicals: Hyundai and Samsung operations would be combined under new, third-party management, and five other groups, SG, LG, Daelim, Lotte, and Hanwha would contribute their operations to a second major firm. The proposed five-firm combination could not be worked out, though.

Aerospace: Samsung, Daewoo, and Hyundai would combine their operations under new third-party management. The new firm, Korea Aerospace Industries, was set to start operation in October 1999, pending bank financing and perhaps foreign partnership investment.

Railroad vehicles: Hyundai's operations would remain independent, while those of Daewoo and Hanjin would be combined under new, third party management.

Ship engines: Hyundai's operations would remain independent, while Samsung's would be taken over by Hanjung.

Oil refining: Hyundai Oil Co. would take over the operations of Hanwha Energy Co., while SK, LG, and Ssanyong would continue in their joint operation.

As the *chaebols'* financial structure and resources have become an increasing concern, so has the issue of their interests in financial institutions. Unlike similar institutions in Japan and Germany, the *chaebols* did not grow up around major banks. Their share ownership in major banks was capped, at 5%, and other individual shareholders could not own more than 4% of a bank. Since then there have been substantial changes in the banking market, as the crisis led to government control. Foreign and domestic interests have been allowed to acquire strategic stakes in banks, but the government exercises supervision to ensure that the *chaebols* do not control the sector. But the *chaebols* are creating links with investment banks and non-bank financial institutions. One regulatory concern is that these institutions could be used to evade controls on internal investments and debt guarantees and ratios. A competition policy concern is the potential use of investment bank holdings to control competitors through shareholdings (KFTC, 1999*b*).

Although reform of the *chaebol* system has attracted the most attention, other vital steps to promote greater market competition and restructuring have been the reforms that opened up Korea to imports and foreign investment. Policies of export promotion and import control had been changing for a decade when Korea joined the OECD in 1996, but remnants lingered, particularly in the "diversification" system targeted at Japan, which was abolished in mid-1999. Rules were changed to permit foreign take-overs of domestic firms. Industrial sectors were opened for foreign investment in May, 1998, and restrictions on hostile mergers and acquisitions were removed at that time.

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Meanwhile, the breadth of competition policy was confirmed by the Omnibus Cartel Repeal Act in February 1999, which removed legal exemptions for 20 cartels under 18 different laws (KFTC, 1999*a*, §1). Other amendments strengthened the rules against horizontal collusion and reduced the KFTC's role as monitor of dominant firm prices and conduct.

2. SUBSTANTIVE ISSUES: CONTENT OF THE COMPETITION LAW

If regulatory reform is to yield its full benefits, the competition law must be effective in protecting the public interest in markets where regulatory reform enhances the scope for competition. The MRFTA is a sound substantive foundation for reform based on market principles. The legal criteria and available sanctions under the MRFTA are generally adequate to cover competition problems, including those that may have been required or encouraged by regulation or that may appear as regulatory structures change. Some of its structural criteria may need to be examined more closely, though. Its extensive regulations of corporate and financial structures, which have played a central role in *chaebol* control, are unusual in the competition laws of OECD Member countries. In other respects, Korea's law closely resembles those of other OECD countries.

Box 3. **The competition policy toolkit**

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements**, is often subdivided for analytic purposes into two groups: "horizontal" agreements among firms that do the same things, and "vertical" agreements among firms at different stages of production or distribution. The second category is termed "**monopolisation**" in some laws, and "**abuse of dominant position**" in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called "**mergers**" or "**concentrations**," usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates.

Agreements may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output, and preventing entry or innovation. The most troublesome **horizontal** agreements are those that prevent rivalry about the fundamental dynamics of market competition, price and output. Most contemporary competition laws treat naked agreements to fix prices, limit output, rig bids, or divide markets very harshly. To enforce such agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research, and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

Vertical agreements try to control aspects of distribution. The reasons for concern are the same—that the agreements might lead to increased prices, lower quantity (or poorer quality), or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors. In others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier's product, or they can protect distributors from competition or prevent entry by other suppliers. Depending on the circumstances, agreements about product combinations, such as requiring distributors to carry full lines or tying different products together, can either facilitate or discourage introduction of new products. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies, and about rights to intellectual property such as trademarks.

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Abuse of dominance or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output; it may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics by which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some abuse of dominance systems, charging unreasonably high prices can be a violation of the law.

Merger control tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition, and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

The most serious kinds of horizontal agreements are now subject to virtually* per se *treatment.

The basic prohibition against agreements restricting competition is in Article 19 of the MRFTA. Eight types of restrictive agreement are specified, from fixing prices and terms, restricting production or trade, restricting territories, and forming joint ventures, to hindering other enterprises. Contracts to achieve these ends are null and void. Agreements can be inferred from circumstances; at least, the absence of an express agreement is not necessarily a defence (Article 19). Sanctions include orders to cease the offending act and take corrective measures (Article 21), and surcharges of up to 5% of sales revenue during the period of violation (Article 22). Criminal fines up to W 200 million can be imposed, and the law also provides, in theory, for imprisonment for up to three years (Article 66(1)9).

The legal standard changed in 1999, from a general "rule of reason" to something approaching *per se* treatment. Before, an agreement violated the law if it was a "substantial" restriction of competition. After the February, 1999 amendment, the test is whether the agreement is an "unjustifiable" restriction of competition. It was evidently possible under the previous rule to defend an agreement on the grounds that it had relatively little actual effect, although there was no presumption linking market shares and effects (KFTC, 1999*a*, §8). Now, it appears possible to argue in defence that a restriction is justified by some other policy, but it is no longer possible to defend on the grounds that the anti-competitive effect was minimal. The text of the statute does not quite state a true *per se* rule, which would attach liability to particular kinds of conduct without regard to showing either actual effects or purported justifications. But in practice, the KFTC may rule out the possibility of justification for the clearest horizontal agreements about price and output.

Whether other policies justify a restraint is normally determined in the process of granting exemptions. The statutory grounds for exemption give the KFTC substantial discretionary power. Article 19 permits the KFTC to authorise agreements that are aimed at rationalising an industry, overcoming economic depression, improving industrial structure, enhancing the competitiveness of SMEs, or rationalising terms of trade. The KFTC may also authorise agreements for research and technology development ventures. These considerations are not defences to enforcement actions; rather, the exemptions are applied only through a process of prior application to the KFTC. Criteria for authorising collaborative acts are set out in the enforcement decree. The KFTC may, for example, permit "depression cartels" to boost prices and control output, if four conditions are met (KFTC 1999*a*, §8): demand has

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declined steadily for a long period, resulting in chronic over-supply, and there is no prospect that this situation will change; the price has remained below average production cost for a considerable time; many firms in the industry are likely to fail because of the decline; and the situation cannot be overcome through rationalisation. All of these exemptions are subject to the general caveat, that the collaboration must not exceed what is necessary to achieve the proper purpose, there is no threat of unreasonable harm to the interests of consumers or other enterprises, the collaboration does not discriminate unreasonably against participating enterprises, and withdrawal from the collaboration is not unreasonably restricted (MRFTA Enforcement Decree, Article 29). The conditions are evidently applied strictly. At present, no exemptions from Article 19 are in force, although several were authorised in the 1980s and early 1990s (KFTC, 1999*a*, §8).

Trade associations must comply with the statute's principal prohibitions. Trade associations must not engage in the restrictive acts prohibited by Article 19, limit the number of enterprises in a market, unreasonably restrain the business activities of their members, induce their members to engage in unfair practices, or engage in any unfair practices themselves (Article 26). Trade associations had been used to control and limit competition. Industries set up associations in the 60s and the 70s that could control their own membership and hence limit or block the entry of new firms into an industry. Often, the KFTC's only recourse was advocacy to the relevant ministries, because statutory authorisation meant that the associations enjoyed exemptions from the MRFTA (OECD CLP, 1997). A KFTC enforcement program in the 1990s has systematically reviewed trade association rules and proposals to establish new associations, to identify and eliminate anti-competitive elements.

Some of the enforcement program against horizontal restraints has been motivated by economic analysis. The KFTC has been looking for anti-competitive agreements where industry conditions suggest they are likely to be found. One recent result was a finding of market division in the steel industry, which was enforced by a pattern of exclusive dealing with sales agencies and scrap dealers. Surcharges of W 16 billion were imposed on 18 firms (KFTC, 1999*b*). Similar investigations are pending in other major industrial sectors.

After prices were liberalised in the 1990s, the KFTC examined developments in the markets affected, to be sure that industry co-ordination did not perpetuate the previous non-competitive pattern. Markets examined included telecoms fees, bank interest rates, bank commission rates, security brokerage fees, insurance premiums, petrochemicals, cement, and iron bars. Competition had developed in telecoms fees and bank interest rates, but not in the others, due to market structure or conditions that were not conducive to price competition. Some prodding from the KFTC was necessary, too. In October 1992, when the finance ministry liberalised bank commission rates, 32 banks raised rates jointly. Again in December 1997, when the daily exchange rate fluctuation band was abolished, banks raised margins together. On both occasions, the KFTC challenged the joint action and imposed surcharges (KFTC, 1999*a*, §8). Breaking up price fixing in the video rental business yielded a tangible consumer benefit: prices dropped to one-quarter or even one-tenth of the previous levels, and the price drop has led to a shakeout in the industry (KFTC, 1999*b*).

Bid rigging has also been a major target. In the last five years, the KFTC has issued orders or imposed surcharges in 23 bid-rigging cases, all of them involving public procurement, and more than half of them in the last two years. In addition to the sanctions imposed, the participants are barred from participating in future bids (OECD CLP, 1999).

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Rules about vertical agreements include a potentially flexible approach to resale price maintenance.

Some vertical restraints are covered by Article 19's prohibition of restrictive agreements, and most others are covered by Article 23's prohibition of unfair business practices. Unfair business practices are described generally as those that may undermine fair trade. They are detailed both in the statute and in implementing regulations. Particular rules address tying arrangements, exclusive dealing agreements and territorial or customer restraints. The general statutory clause also enables the KFTC to address other practices that may harm fair trade, applying a "rule of reason" approach that balances pro-competitive and anti-competitive effects (KFTC, 1999*a*, §9). Some of the items included in Article 23, such as discrimination and refusal to deal, might be considered abuse of dominance, if the party engaged in the practice is in a dominant position.

A separate section of the law, Article 29, expressly prohibits resale price maintenance, thus appearing to treat it as illegal *per se*. But case-by-case exemptions can be granted, if a product's uniformity and quality are readily apparent, it is in daily use by consumers, and there is free competition in its sale and purchase. Exemptions must be obtained in advance, and contracts setting resale prices must be filed with the KFTC (MRFTA, Article 29.2, Article 30). The exemption in effect permits RPM for branded consumer products where there is significant inter-brand competition. The KFTC has on occasion found it necessary to limit this exemption; in 1985, for example, the KFTC withdrew the exemption for cosmetics and medical products, finding that the consumer harm was greater than the benefit. In addition, there is a general exemption for printed literary works (KFTC, 1999*a*, §9; KFTC 1999*d*).

The KFTC is moving away from a purely structural approach to abuse of dominance.

The prohibition against abuse of market dominating positions is the first substantive provision in the statute. Its form displays the law's origin in price-control measures, as the listing of prohibited types of abuse begins with unreasonable pricing, followed by unreasonable control of sales or services, interference with other enterprises, hindering entry of new competition, and otherwise threatening substantially to restrain competition or harm consumer interests (Article 3-2). Sanctions include orders to roll back prices and cease offending activity and to announce the violation publicly (Article 5). In addition, the KFTC can impose surcharges, which are collected by the National Tax Administration (Article 6). The KFTC imposes heavier sanctions against abuse of dominance than against unfair business practices generally. The KFTC does not, however, have the power to impose structural remedies such as dissolution or divestiture. But it does have a general power to establish and enforce measures to promote competition in markets characterised by long-standing monopoly or oligopoly structure, and the power to advise other government agencies about the need to strengthen competition or establish more competitive market structures (Article 3).

The statutory definition of "market dominating enterprise" no longer depends solely on market shares and structure. "Market-dominant enterprise" is now defined to mean a supplier (or buyer) that has the power to determine, maintain, or alter price, volume, quality or other terms in a relevant market, either on its own or with others. The definition itself provides that determining whether a firm is market-dominant calls for assessing its market share, the existence and scope of entry barriers, and the comparative size of competing enterprises. And it exempts completely any firm with annual turnover (or purchases) in the relevant market less than W 1 billion (Article 2.7). Although market share thresholds no longer appear in the law's definition, they remain in the law's substantive section. Two market share standards could apply. A single firm is presumed to be dominant if its market share is 50% or more. If the combined market share of two or three firms is 75% or more, each of them is treated as dominant (unless its share is less than 10%) (Article 4; KFTC, 1999*a*, §10). The statute's principle of market definition in this context does not set out or imply an analytic method based on characteristics of demand or supply, but rather is simply "the same or similar commodity or service" (Article 2.7).

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The KFTC in the past issued a list each year identifying firms in market dominating positions (Article 4, deleted in 1999). This provided some guidance about the statute's interpretation and application. And the process put the listed firms on notice that their behaviour, and their prices, could be subject to special scrutiny. In preparing this list, the KFTC could make clear what it considered to be a market, and it could in theory use some judgement and discretion in omitting firms that were not likely to abuse market-dominant positions. The KFTC announced it would not list firms whose markets have no barriers to entry or that had neither increased prices nor violated the MRFTA in the previous two years (OECD, 1998*a*). No firms were actually dropped from the list for these reasons in the last three years, although about 20 firms applied for removal (KFTC, 1999*c*). Thus, despite the possibility of flexibility and judgement, it appears that the standards were applied formalistically. As of 1999, the KFTC will no longer be issuing this list, though, as the statutory authority was repealed. In the future, determinations of dominance will be made case-by-case in considering particular allegations of abuse.

Eliminating the annual listing is another step away from the historic application of the law as a means to control prices. In principle, abuse through unreasonable pricing can be demonstrated either by prices rising significantly (or dropping insignificantly) for a considerable period of time without justifiable reason related to supply and demand or changes in costs, or excessive sales and general overhead expenses compared to those normally incurred the same or similar businesses (MRFTA Enforcement Decree, Article 5). But the KFTC has taken no formal corrective actions to control pricing since the early 1990s. Pre-notification of price changes has evidently been discontinued, even pursuant to administrative guidance, and formal rules against parallel pricing in oligopolies were dropped many years ago. Despite the absence of orders on the subject, the KFTC's reports into the mid-1990s indicated a strong and continuous concern to monitor supply and demand conditions and prevent undue price increases (OECD CLP, 1996).

Table 1. **Actions against abuse of dominance**

Classification		Total	81–92	93	94	95	96	97
Type of abuse of dominance	Price abuse	3	3	-	-	-	-	-
	Interference with other businesses	19	12	2	1	1	1	2
	Interference in market entry	2	2	-	-	-	-	-
	Other acts likely to restrain competition	2	-	-	-	2	-	-
Type of corrective measure	Order	15	9	2	1	1	1	1
	Recommendation	5	3	-	-	-	-	-
	Warning	6	5	-	-	-	-	1
Total		26	17	2	1	3	1	2

Source: OECD CLP, 1998*a*.

Applying the law to problems of network monopolies is becoming a KFTC priority (KFTC 1999*a*, §10). For example, the KFTC took action against a 1996 effort by Korea Telecom to prevent a telephone manufacturer from developing phones that would connect automatically to its competitor. The KFTC also sanctioned Korea Telecom for-requiring exclusivity commitments as a condition for granting PCS companies access to its fibre optic network. In 1998, MRFTA surcharges against public enterprises for abuse of dominance violations totalled W 2.15 billion (KFTC, 1999*a*, §3, §10).

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Chaebol regulation is sui generis, rather than an application of general principles about abuse of dominance.

Because a purpose of the MRFTA is to attack excessive concentration, it would be useful to understand what kinds of concentration issues are posed by the *chaebols*. Some of the common diagnoses and prescriptions appear inconsistent with a concern about excessive concentration in conventionally defined markets. They have been criticised for excessive diversification, even though that condition, if pursued and maintained by all the *chaebols*, could tend to lead to lower, rather than higher, market concentration. The continuing efforts to make the groups consolidate and concentrate on "core" businesses would also tend to increase, not decrease, concentration. Focusing management attention and eliminating high-cost excess capacity could of course make the firms and the economy more efficient, even though more concentrated.

There is no publicly available data showing how the *chaebols'* holdings contribute to market by market concentration. The KFTC's raw data are not public. The KFTC's annual listing of market dominant enterprises, based on that data, provides some insights into the structure of Korean industry. For 1998, the KFTC designated 311 firms as dominant, in 128 markets. These designations, made at the end of 1997, were based on 1996 market shares. The statute's structural criteria for dominance imply that, if there is a dominant firm in an industry, then the HHI in that industry is at least 1900 and quite likely is much higher. Thus, the data show there are probably many highly concentrated industries in Korea. The data may not be based on economic markets, though, and they do not show the relationship between concentration and *chaebol* status. The top 30 *chaebol* reportedly account for about 42% of turnover in these sectors with market-dominant enterprises.

Table 2. **Korean industries with "market-dominant enterprises"**

Year	One market-dominant enterprise	Two market-dominant enterprises	Three or more market-dominant enterprises (90% or more)	Total
1997	24	41	64 (26)	129
1998	21	44	63 (23)	128

Source: OECD CLP, 1998*a.*

The major *chaebols* are more heavily involved in the larger, concentrated industries, which are the most highly capital intensive ones. Indeed, capital intensity may be the single most important factor affecting *chaebol* performance. A regression analysis found that, compared to capital intensity, a *chaebol's* overall size or diversification and the shares and structures of particular markets had little effect on its output or efficiency (Lee, 1998, pp. 381-84). Production of most of the 3 200 manufacturing and mining products in the KSIC classification is highly concentrated (three-firm concentration over 75%, implying an HHI of about 2 000 or higher), but most of those are small industries. *Chaebol* subsidiaries focus on the largest industries. Members of *chaebols* have, collectively, shares over 70% in about 40% of the larger industries (those over W 500 billion). And in about 40% of those large industries, *chaebol* subsidiaries occupy the top three places (Lee, 1998, pp. 336-40).

No special rules would be necessary to deal with competition problems related to concentration in particular markets, because the other provisions of the MRFTA should be able to address particular problems. The *chaebols* have had integrated internal distribution systems, but general rules against exclusive dealing should be adequate to prevent foreclosure problems. The KFTC has taken actions about vertical exclusive distribution agreements within *chaebol* structures that hamper entry by other firms. And distribution channels are likely to open up in response to foreign investment and development of new methods. There have been some allegations of market foreclosure through tying or reciprocity, such as

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demands on employees and suppliers that they buy the other products made by the group. But little law enforcement action has been taken based on these kinds of claims. Predation, in conventional senses, does not seem to be an issue. There is no evident pattern of the *chaebols* using predatory tactics. The few KFTC cases dealt with price cuts that were not long-term or targeted at entrants; that is, the cuts could not be considered predatory.

It may be that there is something about the *chaebol* form that makes it difficult to detect competition problems or to apply effective remedies. A feature that might make it more difficult to identify or remedy problems is the groups' participation in many different industries. The *chaebols* are generally diversified, and the largest ones are the most diversified. The extent of diversification may be exaggerated in popular reports, though. In the early 1990s, each of the top five *chaebols* did most of its business in its core 2-digit industry, even though each was involved in an average of over 140 different (3-digit) industries (Lee, 1998, pp. 336-40).

Diversification is at the root of claims that the *chaebols* have unfair financial and commercial advantages because group members deal with each other directly at allegedly "undue" prices or terms. This in-house trading could amount to discrimination in terms of trade or prices. It is said to permit the groups to capitalise on superior positions in the market to support affiliates or to enhance competitiveness. Whether a transaction is "undue" depends on the KFTC's judgement about whether it is consistent with what would be expected in an arms' length transaction. The KFTC has launched several broad investigations, which have been backed since early 1999 by the power to obtain detailed data about finances and transactions. In 1998, the KFTC reached, and published, about 20-30 decisions on this issue (KFTC, 1999*b*). The KFTC itself once described the goal of investigating and regulating undue in-house trading as to enhance firm specialisation and secure independent management, more than to address identified competition policy problems (OECD CLP, 1996). The KFTC is attacking allegedly undue transactions even where the *chaebol* member has a small sectoral market share. Conceivably, there could be long-term competition concerns that market share does not capture, that a *chaebol* member could take unfair advantage of the group's resources and connections to make demands for exclusive dealing, tying, or reciprocity, and thus grow quickly. But to the extent the problem is imprudent investment or business decisions, a better discipline in the long run would be independent outside directors or auditors, rather than law enforcement methods (Jang, 1999).

Merger enforcement tools are complex and flexible, but have been little used until recently.

The basic test for merger control is whether the transaction will substantially restrict competition in a relevant market. The MRFTA covers horizontal, vertical, and conglomerate combinations, the last category being particularly significant in the context of *chaebol* regulation. Consolidations subject to KFTC review include stock acquisitions, business transfers, true mergers, interlocking directorates among large enterprises, and establishment of joint ventures.

A complex, structure-based test is applied to identify anti-competitive effects [Article 7(4)]. A merger is presumed to violate the law if it creates a firm that meets either of the tests for being a market-dominating enterprise, provided that two additional conditions are met. First, the combined firm must be the largest firm in an industry. Second, it must be significantly larger than the next largest firm (in particular, the difference between the combined firm's share and that of the second largest firm will be 25% or more of the new firm's market share). The criteria imply a post-merger HHI threshold of about 2 200 (at least 2 500, if based on the single-firm test). Another presumptive rule tends to prevent large firms from entering into competition with smaller firms through acquisitions. In a market where the collective share of small and medium sized enterprises exceeds two-thirds, an acquisition by a large firm is presumed to substantially restrain competition if it would give the large firm a market share over 5%

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(Article 7(4).2). This rule evidently applies even if the target market is highly concentrated. By preventing a large firm from entering to compete against an incumbent dominant (though "small") firm, the presumption appears to implement the statutory purpose of "balanced development" rather than free competition or efficiency.

The relevant product market is defined principally on the basis of cross elasticity of demand. The circumstances of the market and the participants are also considered. The geographic market is usually taken to be the nation, unless supply is limited to a smaller area. The KFTC has been trying to apply the market definition methods of the US agencies' Merger Guidelines (KFTC, 1999*b*). In assessing the likelihood of entry, legal entry barriers, minimum capital requirement, and technology are taken into account. Firms that can enter without substantial change to their existing facilities may be included in the market (KFTC, 1999*a*, §11).

Efficiency and failing-firm provisions were added to the law in 1999. The KFTC may approve an otherwise anti-competitive combination if the benefits of efficiency outweigh the harm from reduced competition, or if the combination involves a firm that is otherwise non-viable (KFTC, 1999*a*, §11). Previously, the law gave the KFTC discretion to permit a combination if it was necessary for rationalising an industry or for strengthening international competitiveness, but those provisions were repealed in February 1999.

For transactions involving financial institutions, the KFTC shares review authority with the Financial Supervisory Commission (FSC). In this process, the FSC may make the final decision, based on considerations of the integrity of the financial system and soundness of financial institutions. But the FSC action reflects and incorporates the KFTC's view about likely competitive effects. In some other sectors, notably telecoms, broadcasting, and transport, the Ministry of Information and Communications or the Ministry of Transport has authority to approve or deny license transfers on the grounds of compliance with other regulatory policies, such as quality and safety. That authority gives those ministries concurrent, veto powers over merger transactions along with the KFTC's power based on competition policy (KFTC, 1999*a*, §11).

Notification requirements are based on the size of the firms. Any covered transaction involving a company with assets or sales over W 2 trillion must be reported in advance. The report is to be filed within 30 days after the contract is signed. Any covered transaction involving a company with assets or sales over W 100 billion must be reported within 30 days after it is consummated. A firm that fails to file a timely report is subject to surcharges of up to W 100 million (Article 69-2). Within thirty days after the report is filed, the KFTC must notify its decision, unless unavoidable circumstances prevent it from doing so. Mergers that fall below the size threshold at which notification is required are in effect presumed not to restrain competition, but they may in theory be investigated and corrected if they do (KFTC, 1999*a*, §11).

Very few formal actions about mergers are reported. From 1981 to 1995, the KFTC reviewed 2 949 combinations (three-fifths of them conglomerate), and took formal action against just three (Lee, 1998, p. 159). Since that period, the KFTC blocked one merger in 1996 and one in 1997. Firms typically consult with the KFTC in advance, and they abandon problematic transactions without making a filing, so there is rarely an occasion for a public challenge. In 1995, a chemical firm's take-over of two other companies was abandoned after the KFTC indicated it would disapprove; in 1997, the same thing happened to a proposed merger in refractory products (KFTC, 1999*b*). The KFTC staff recognises that the merger review system historically was weak, but there are some signs that it is becoming stronger. In 1998, 486 combinations were notified to the KFTC, of which 204 submitted a pre-merger notification. Of these, four received an in-depth review, leading to corrective orders in three cases. The orders disclose a continuing penchant for regulatory intervention, though. A clean divestiture was ordered only in one case. In another, the remedy was price control: the combined firm was ordered to keep its domestic prices for the

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relevant product (batteries) within a specified percentage of consumer prices in foreign markets. And in the third, the remedy was to limit output: the new firm was subjected to a market share ceiling for period of time, to give other firms some time to adjust (KFTC, 1999*a*, §11).

Merger control will be an important KFTC tool in the process of *chaebol* restructuring. It will be particularly important in addressing the so-called "big deals," many of which appear to create dominant positions if the market is limited to Korea. The KFTC takes the position that it will take whatever action is necessary if and when the proposed or rumoured transactions become real and come under the KFTC's jurisdiction as mergers or acquisitions. But in practice, because of the deals' high profile, it may be unrealistic to expect the KFTC to act aggressively. Some cases involving *chaebol* restructuring and rationalisation have already come up. A three-firm combination involving rolling stock was authorised because the firms were failing. The "big deal" combination of semiconductor manufacturing assets between LG and Hyundai was approved, even though the firm became the largest producer of memory chips in the world, because the combined share (of a market defined to include imports into Korea) does not exceed the law's 50% presumptive threshold (KFTC, 1999*b*).

Unfair competition and related issues, such as equity in subcontract relationships, are a relatively high priority.

Among the subjects of the MRFTA's general prohibition of "unfair practices" are several kinds of conduct that could be considered traditional forms of unfair competition: false or misleading advertising, unfair practices, predatory pricing, and abuse of economic dominance (Article 23(1)). The enforcement decree specifies some further details (KFTC, 1999*a*, §12). Trademark abuse and passing-off are subject to a separate law, the Unfair Competition Prevention Law, which is administered by the Ministry of Commerce, Industry and Energy. Victims of deception, misrepresentation, or unjustifiable interference in business need not rely only on the KFTC for relief, but may file private lawsuits for damages.

For the most part, the detailed rules about unfair business practices are all subject to the standard of "unreasonableness." This could permit flexibility to apply the rules in a generally pro-competitive way. But some aspects of the rules could be used to inhibit innovation and efficiency. For example, the rule about "unfair luring of customers" prohibits offering a customer gains that are "unjust or excessive in light of normal business practice"; it would be unfortunate if this were applied to prevent a firm from offering a much better deal than its competitors ever had before (KFTC, 1995, Article 4.1). The rule about comparative advertising prohibits comparisons that include only the aspects of the advertiser's product that are better than its competitors'. But requiring comparisons to be so inclusive could discourage firms from making them, which would deprive consumers of useful information.

The KFTC's guides for applying the "unfair business practice" law had the potential for restricting competition, too. But the KFTC has taken some steps to reduce that risk. The guides about discount sales imposed tight controls that probably discouraged discounting more than they prevented deception. Unsurprisingly, while limits remained in effect, the opening of the domestic distribution market in 1997 did not lead to much competition. So the KFTC revised the guides to remove limits on discount sales, except for the 20-day period for maintaining the initial prices (OECD, 1998*a*). And the KFTC's guides about gift offers were relaxed to exempt many businesses (manufacturers with annual revenues below W 10 billion and other businesses with annual revenues below W 1 billion), abolish the limit on the total value of a gift with purchase, and extend the rule to cover new entrants' promotion of new products (OECD, 1998*a*).

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Deceptive advertising is an unfair practice under the MRFTA. Firms and trade associations may issue "fair competition codes" to prevent "unreasonable inducement of customers" or false or misleading advertising, and they may request KFTC clearance to ensure that their codes do not violate the law by coercing customers to deal with their members (Article 23(4)-(5)).

The KFTC administers special, detailed fair competition rules for contracting. As a result, one large section of the KFTC serves as a kind of sectoral agency responsible for the construction industry. This is one of several aspects of competition-related laws that are designed to protect the interests of smaller businesses. The contracting law is aimed at equalising bargaining positions by establishing and protecting contract rights. The Act was revised in 1996 to provide guarantees for subcontract payments and surcharges for enforcement. The Enforcement Decree was also revised, to limit payment guarantees to smaller projects and those considered financially sound according to the Korea Construction Financial Co-operative. The KFTC thus enforces a program of industry self-regulation to protect smaller firms (OECD, 1998*a*). Yet those small firms are reportedly reluctant to complain about abuses, for fear of retaliation.[4]

The KFTC has responsibility for explicit consumer protection missions, including unfair contract terms and deception.

Korea's competition policy recognises the mutual reinforcement between protecting consumer interests and promoting competition. Stronger competition reduces prices and increases choices, while assurance of accurate information and product quality and safety encourages consumers to make the choices that stimulate healthy competition (KFTC, 1999*a*, §13).

The KFTC has two explicit consumer protection mandates. One concerns deceptive advertising, which is treated as an unfair business practice. The KFTC can order firms to correct false advertisements and representations that mislead consumers. The KFTC has issued some industry-specific guidelines detailing what kinds of representations or omissions could be considered deceptive (OECD, 1998*a*). The general terms of the MRFTA and its implementing guides have been succeeded, as of July 1999, by a new Fair Labelling and Advertising Act, which includes disclosure and substantiation requirements (KFTC, 1999*a*, §13). This act is still administered by the KFTC.

In addition, the KFTC administers a law regulating the terms in contracts of adhesion. The premise of the act is that firms using these "take-it-or-leave-it" contracts with large numbers of less-informed parties have a social responsibility to set fair terms and conditions, taking into account not only their own interests but also those of their customers. The law generally prohibits contract terms that are unfair or contrary to the principle of trust and good faith, such as clauses that customers would have difficulty anticipating or that are simply unreasonably unfavourable to them. The law singles out clauses under which the seller attempts to avoid liability for intentional wrongdoing or gross negligence, unreasonably limits its liability or warranty obligations, sets excessive liquidated damages, impairs the customer's freedom to terminate, permits the enterprise to avoid its obligation, denies customers' remedies or other options or permits the enterprise to divulge confidential information, presumes the customer's intent, or limits customers' rights to rely on agents or to sue (Adhesion Contracts Act, Arts. 6-14). To implement the law, the KFTC has prepared or approved model contracts covering many kinds of transactions in finance, insurance, real estate, and health care services (KFTC, 1999*a*, §13; OECD CLP, 1996).

Maintaining consistency between competition and consumer policies calls for some advocacy intervention. Rules that ostensibly protect safety, enhance product quality, or stabilise prices can also stifle competition and bar entry. The KFTC, as a member of the Economic Cabinet, is in a position to oppose impractical regulations that risk jeopardising competition (KFTC, 1999*a*, §13). Consumer-related

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responsibilities are shared by several government bodies: the Consumer Protection Board, the Ministry of Commerce, Industry and Energy, the Ministry of Health and Welfare, the Ministry of Construction and Transportation, and others. Policies are co-ordinated through the Consumer Protection Policy Review Committee, bringing together officials from these agencies and representatives of consumer groups. The KFTC is a member (KFTC, 1999*a*, §13).

The KFTC maintains contacts with the Consumer Protection Board and private consumer protection groups, for mutual referral of matters that fall under each others' jurisdictions. The KFTC has designated consumer protection groups as Fair Trade Monitors, in May 1999, and plans to hold more regular consultations with them (KFTC, 1999*a*, §13).

Box 4. **Comparisons between the competition laws of Korea and Japan**

Korea's substantive laws and processes are very much like Japan's. Differences in outcomes are probably explained by differences in institutional histories and in the priorities that the governments have given to competition policy.

Agreements: Korea's rule about restrictive agreements has recently been strengthened, and Japan too has moved toward a more *per se* approach. Korean law is based on the possibility of hindering fair trade, while Japanese law focuses more on likely effect on competition.

Vertical restraints: Both statutes contain a separate, explicit prohibition of resale price maintenance. Japan's prohibition is more absolute, where Korea's sets out general conditions for exemption; both exempt copyrighted works.

Dominance: Korea uses the concept of abuse of dominance, where Japan has rules about "private monopolisation" and "monopolistic situations". The structural standards are similar, treating a market share of 50% or more as the threshold of concern.

Merger control: The process is the same in each country, namely a practice of informal consultation and resolution of issues in advance of formal notification, so there are virtually no contested cases and few public decisions. The market concentration rules differ greatly, though; Japan's guidelines set out several different tests, not all of them purely structural, and could lead to action against mergers with HHI levels of about 1 500 or even lower. Korea's standard can lead to a virtual "safe harbour" threshold at a relatively high HHI of about 2 500. Korea's law now includes provisions about efficiencies and failing companies; Japan has similar provisions in its guidelines.

Investment controls: Both countries had prohibited holding companies, and both have recently lifted or relaxed that prohibition. In Japan, a firm's holdings of another company's shares within a group cannot exceed the firm's own capital or net assets. Korea has similar limits. In Korea, the principal concern has been with cross-holdings among the members within a group; in Japan, it has been with the holdings of the firm at the top of the pyramid.

Unfair competition: The bulk of the substantive law in both countries is set out in lists of unfair practices. The lists are substantially the same, in Article 2(9) of Japan's Antimonopoly Act and Article 23(1) of the MRFTA. And the Fair Trade Commissions in both countries enforce laws about deceptive advertising and use of marketing practices such as premium offers and administer special laws about subcontracting.

3. INSTITUTIONAL ISSUES: ENFORCEMENT STRUCTURES AND PRACTICES

Increased reliance on markets instead of central direction requires a competition authority capable of acting vigorously to prevent abuses in developing markets. The KFTC has indeed become more vigorous. Its priorities still show a preoccupation with issues of structure and fairness, but attention to problems of horizontal collusion has increased significantly.

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The central competition policy institution, the KFTC, is both independent and well-placed.

The Korea Fair Trade Commission is an independent body, in that it reports directly to the Prime Minister and is thus in principle free of direct influence from other ministries (Article 35). The KFTC is established by the MRFTA, in contrast to other ministries that are established under the Government Organisation Act. Its basic responsibilities are applying the substantive provisions of the MRFTA and several other statutes, and consulting and co-ordinating about the actions and rules of other government bodies that relate to policies to promote competition or that suppress competition (Article 36).

The Commissioners of the KFTC are appointed by the President of Korea, based on recommendations from the KFTC chair. Commissioners serve three-year terms, which can be renewed once (Article 39). There are nine members (including the chairman and vice-chairman), four of whom are "non-standing" commissioners who retain positions outside of public employment. Historically, the standing commissioners have all come from within the staff of the KFTC or its predecessor agency (KFTC, 1999*b*). Qualifications are set by statute: prior experience as a public official in monopoly and fair trade issues, or 15 years experience as a judge, lawyer, or prosecutor, or 15 years academic experience in law, economics, or business administration, or 15 years of business or consumer protection experience (Article 37(2)). The chairman and vice-chairman are considered to be "political appointees," although they enjoy tenure protection (KFTC, 1999*b*). The others have the status of government officials (Article 37(3)). Commissioners may be removed from office involuntarily only for incapacity or after criminal conviction for wrongdoing (Article 40).

Since 1996, the KFTC chair has had the status of a minister. The chairman may thus participate in cabinet meetings and meetings of the economic ministers. The KFTC vice chairman has the status of a vice-minister and may participate in government meetings at that level. This direct, face-to-face contact with other ministries and agencies has strengthened the KFTC's advocacy role. By law, ministries are to consult in advance with the KFTC about measures that may restrict competition (Article 63). Before the KFTC leadership was given ministerial rank, ministries did not consult as systematically as they should have (OECD CLP, 1997).

Enforcement processes are adequate, although more power to collect evidence would be welcome, and the criminal sanctions may not be effective.

The KFTC may initiate an investigation if it believes that there has been a violation of the law, or in response to a complaint (Article 49). Complaints are subject to a preliminary review by the Secretariat or the Regional Offices, which initiate investigations of the complaints that state claims under the relevant statutes. The staff may close the matter if it finds no evidence of violation, or may issue a warning if the violation is minor; the KFTC must respond to all complaints in some fashion, however. If the violation is serious and warrants formal correction, the staff either recommends a negotiated, voluntary resolution or refers the matter to the KFTC for deliberation and decision (KFTC, 1999*a*, §15).

The KFTC's investigative powers were rudimentary, but they have been strengthened some recently. The KFTC may summon parties for testimony and engage expert witnesses, and it may conduct on-site investigations (Article 50). When investigating "undue transactions" among *chaebol* firms, it may now request detailed data about the firms' finances and transactions; that power was added in February 1999 (Article 50(5)). Information and assistance from other agencies may be requested, but not required (Article 64). And there are no procedures for obtaining court orders to obtain information in investigations (KFTC, 1999*a*, §14). Administrative fines are the only sanction for failure to comply with investigative requests. The amounts are small enough that large firms may elect to pay the fines rather than give the KFTC the information (Article 69-2; KFTC, 1999*b*). To overcome some of these limitations and encourage

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disclosure, the KFTC has had a leniency programme. On at least one occasion, surcharges were not imposed on a member of a cartel who reported it to the KFTC. In addition to offering lighter penalties to parties who inform on their partners in restrictive agreements, the KFTC might also agree not to refer their violations for criminal prosecution (OECD CLP, 1996; KFTC 1999*b*; Article 22-2). The KFTC sometimes refers cases for criminal prosecution because the prosecutor has more powers to obtain evidence (KFTC, 1999*b*). A 1997 report proposed several ways to address the weaknesses, including appointing KFTC personnel as special judicial officers, using the prosecutor's search and seizure powers, giving the KFTC compulsory investigation powers, and strengthening sanctions against non-compliance (OECD, 1998*a*).

Targets of investigation have the right to present their case to the KFTC. Proceedings are open to the public, in principle, although they may be closed if necessary to protect business confidentiality. The KFTC may decide there is no violation, or it may send a matter back for further investigation (KFTC, 1999*a*, §15). If it finds a violation, the range of remedies is wide. The KFTC may issue a warning, a recommendation for correction, an order for correction, an order to pay a surcharge, or a request for indictment. The KFTC's decisions (and its other documents and guidelines) are made available on its internet home page and on-line services (KFTC, 1999*a*, §15).

Parties may file objections to the decision at the KFTC within 30 days. If such an objection is filed, the General Counsel is responsible for conducting a re-investigation, and the KFTC is to re-deliberate the case within 90 days. The defendant need not object at the KFTC, but may instead appeal directly by filing an administrative suit at the Seoul High Court. A further, and final, appeal can be taken to the Supreme Court (KFTC, 1999*a*, §15; Arts. 53-55) In the last few years, the KFTC has prevailed (in whole or in part) in about 70% of the appeals.

Financial and criminal penalties can be substantial. Surcharges are computed as a proportion of the average sales revenue for the three years preceding the decision. Before 1997, they were based on total revenues during the period of violation (OECD, 1998*a*). The law provides for several degrees of criminal penalty as well, ranging from fines (W 200 million) up to three years imprisonment (Arts. 66-68). But the penal sanctions have evidently never been applied, though. In a 1999 bid rigging case, referred for prosecution because the KFTC could not obtain the necessary evidence, the court imposed a fine of W 100 million but no prison term. In general, Korean courts, like those in Japan and the Nordic countries, are reportedly lenient in cases of economic violations (KFTC, 1999*b*).

Private actions and criminal enforcement are possible, but rare.

Victims of acts that violate the competition law may claim compensation for damages, either under the MRFTA or under the Civil Code (Article 56; Civil Code, Article 750). The disadvantage of claiming compensation pursuant to the MRFTA is that the victim can only claim compensation after a KFTC order becomes final, but the advantage is that the defendant cannot avoid liability on the grounds of lack of negligence or intent to harm. By contrast, the advantage of filing under the Civil Code is that the parties need not wait until the KFTC has issued an order; however, the plaintiff does need to prove negligence or intent to harm (Arts. 56-57; KFTC, 1999*a*, §20).

No one has yet succeeded in a private case, though, and only a few have been attempted. One problem is the difficulty of proving damages, in the detail that the courts demand. Another problem is that parties generally do not have clear evidence showing a causal relationship between the competition law violation and their damage. And of course the cost of litigation is probably a deterrent, too. To facilitate private actions, the law was recently amended so that courts can obtain the KFTC's records and evidence (KFTC, 1999*a*, §20; Article 56-2). But this avenue has not been used. The government's reform "manifesto" promises to set up a legal mechanism for firms to demand compensation for damages caused by competitors' anti-competitive conduct (MOFE, 1999, Chapter 3).

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There is no power to appeal a KFTC decision rejecting a complaint. The KFTC is required to notify a party who files a complaint about the outcome of the matter, including a decision not to pursue it. But the complainant may only request reconsideration of that decision; it cannot be appealed to a court (KFTC, 1999*a*, §20).

Criminal prosecution is a supplement to KFTC processes. Criminal matters are all referrals from the KFTC; that is, the prosecutor does not take action independently (Article 71). A significant number of matters are referred for prosecution. Most of the referrals are made under the "unfair practices" rules, rather than the prohibition against restrictive, horizontal agreements. Over the five year period 1994-1998, the annual number of referrals nearly tripled, from 13 to 37, but half of them were about subcontract violations, and only a handful—three in 1998—were about horizontal collusion. One reason for referral is stronger enforcement: tying and subcontract violations are typically referred where the conduct has been repeated or the violators do not comply with KFTC orders.

Box 5. **Alternatives to the FTC**

The provisions for private and criminal relief in Korea are similar to those of some other OECD countries. Criminal cases depend on a referral from the KFTC. Parties may obtain damages after a KFTC order becomes final, or they may bring a more difficult suit under the Civil Code. Parties are likely to have trouble proving causation and damages, though. As a result, private cases in these settings are rarely brought and rarely successful. This can frustrate relief, if a court will not overrule an agency decision declining to pursue a complaint. The lack of practical alternatives in Korea is offset, though, by the fact that the KFTC takes enforcement action in a much larger number of cases.

International contracts are no longer subject to special scrutiny, and international trade impacts are considered in competition analysis.

Historically, an important means of applying competition policy to situations with an international dimension was the special MRFTA provision about international contracts. It is a separate violation for an international contract to provide for acts that would violate Articles 19 (collaboration), 23 (unfair practices) or 29 (resale price maintenance) of the MRFTA (Article 32). At one time, all international contracts had to be reported to the KFTC or its predecessor; since 1995, however, the KFTC reviews contracts only on the parties' request (or in response to a complaint). The enforcement decree, revised in 1997, details some kinds of contract terms that would violate the law and others that would not. Subjects include distribution agencies, industrial and intellectual property, copyrights, franchises, joint research and development, and other joint ventures (OECD, 1998*a*; OECD CLP, 1996). Parallel imports are generally encouraged, and the KFTC clarified its Guidelines in July 1997 to make that more explicit. It is a violation of the MRFTA to obstruct the purchase of original products from foreign distribution channels, to restrain sellers from dealing in parallel imports, or to suspend supply or refuse to deal with sellers who handle parallel imports (OECD, 1998*a*).

The effects of international trade are considered in enforcement decisions, but as a formal matter geographic markets are defined within Korea because supply from elsewhere is subject to practical and legal uncertainties. The KFTC considers the degree of market openness, as well as market share, when reviewing a merger or determining market dominance. If the market is liberalised and the relevant product is easily imported, or if imported products are increasing their share in the market, the KFTC concludes that the anti-competitive effect in the domestic market is minor (KFTC, 1999*a*, §18). In determining the likelihood of new entry, the KFTC may also consider the possibility of supply from overseas. When the share of imports and exports is already high, the KFTC is more likely to consider competition from foreign sources (KFTC, 1999*a*, §18).

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The KFTC does not rule out the possibility of applying Korean law to anti-competitive conduct by foreign firms outside Korea which has a direct and substantial impact on markets or consumers in Korea. But so far, the KFTC has not done so. In the past, Korea has disfavoured the doctrine of extraterritorial effect (Lee, 1998, p. 155).

The KFTC supports a multilateral, co-operative framework for competition policy and enforcement (KFTC, 1999*a*, §19). The KFTC has no bilateral agreements with enforcement agencies of other countries. Short of formal agreements, the KFTC has held bilateral consultations with the competition agencies of the US, France, and Japan (KFTC 1999*a*, §18). There are no special regulations for obtaining information or reporting when a foreign company engages in a merger or acquisition with a Korean company. For other matters involving foreign firms, the KFTC's powers to obtain information are generally limited to the territory of Korea, and thus information must be sought from subsidiaries doing business in Korea. Otherwise, investigation is limited to written inquiries and responses (KFTC, 1999*a*, §18).

Most export cartels have been eliminated. Until 1999, the Ministry of Commerce, Industry and Energy (MOCIE) had far-reaching authority to "maintain order" in the import and export market. In February 1999, the Omnibus Cartel Repeal Act limited MOCIE's co-ordinating power to exports of military equipment and compliance with inter-governmental agreements. Moreover, the same Act abolished the power of the Minister of Construction and Transportation to co-ordinate bidding in foreign markets (KFTC 1999*a*, §19). International trade regulation and relief are the responsibility of the Ministry of Finance and Economy and the Trade Commission within MOCIE; the KFTC has not been involved in that process (KFTC 1999*a*, §18).

Resources are increasing, and are increasingly targeted on horizontal issues.

The higher priority of competition policy in Korea in this decade is reflected in the allocation of resources. In five years, the budget tripled and personnel increased 60%. Some of the increase in budget and employees, though, results from government-wide functional changes in 1994 (KFTC, 1999*a*, §16). About one-fourth of the staff (95 persons, in the regional offices and the headquarters, accounting for 7 out of the 22 policy and enforcement sections) is occupied with consumer protection and subcontracting regulation.

Table 3. **Trends in competition policy resources**

	Person-years	Budget (W 100M)
1998	410	164
1997	422	184
1996	381	146
1995	341	105
1994	279	80
1993	254	64

Source: KFTC 1999*a*, §16; KFTC 1999*d*.

The proportion of enforcement activity aimed at horizontal agreements increased substantially in 1996 and 1997. One reason is simply that more resources were available, because when the KFTC became independent it added more investigators. Many actions in 1998 targeted firms' collective efforts to fix prices during the currency crisis. Financial sanctions rose in 1995 because the surcharge rate for unfair practices was raised, and in 1998 because more cases were brought with stricter sanctions (KFTC, 1999*a*, §17).

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Table 4. **Trends in competition policy actions**

	Horizontal agreements	Vertical agreements	Abuse of dominance	Mergers	Unfair competition
1998: matters opened	224	24	12	31	949
Sanctions or orders sought			649		
Orders or sanctions imposed	117	13	4	3	238
Total sanctions imposed (1000 W)	32 965 513	1 985 590	1 308 200	0	10 012 176
1997: matters opened	116	22	6	55	898
Sanctions or orders sought			424		
Orders or sanctions imposed	66	8	2	0	289
Total sanctions imposed (1000 W)	1 092 105	0	0	0	98 441
1996: matters opened	144	22	3	41	867
Sanctions or orders sought			576		
Orders or sanctions imposed	69	7	1	1	231
Total sanctions imposed (1000 W)	14 512 851	0	1 014 000	0	748 105
1995: matters opened	91	23	4	23	470
Sanctions or orders sought			769		
Orders or sanctions imposed	36	16	3	0	206
Total sanctions imposed (1000 W)	1 030 382	190 000	0	0	3 698 538
1994: matters opened	86	16	1	14	409
Sanctions or orders sought			632		
Orders or sanctions imposed	25	13	1	0	192
Total sanctions imposed (1000 W)	398 841	0	0	0	2 176 143

Source: KFTC 1999*a*, §17.

The KFTC handles a large number of cases under the special laws about subcontracts. In 1997, there were 534 unfair subcontract matters, an increase of nearly 10% over the previous year. Most of these were payment disputes, though, of which about 60% were mediated, under the law, by a trade association's dispute settlement committee. In addition, the KFTC reviewed over 400 contracts under the Adhesion Contracts Act, a total that was also nearly a 10% increase from the previous year. Most were real estate contracts and insurance policies, and more than half were dismissed without action. But the proportion that received some corrective order increased over the previous year, in part because the KFTC reviewed a much larger number on its own authority, and consumers, increasingly aware of this remedy, submitted more for review too (OECD, 1998*a*).

4. LIMITS OF COMPETITION POLICY: EXEMPTIONS AND SPECIAL REGULATORY REGIMES

Whether competition policy can provide a suitable framework for broad-based regulatory reform is partly determined by the extent and justification for general exemptions or special treatment for types of enterprises or actions.

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The most important general exemptions are numerous programs to protect small and medium sized businesses.

The MRFTA does not apply to acts "conducted in accordance with any Act or any decree to such Act." (Article 58) Thus, in principle exemptions must be based upon statutory authority. Private conduct pursuant to a government official's discretionary instructions is not exempted. There were, however, a large number of particular exemptions authorised by statute. Among other things, these statutes permitted professionals to fix their fees and permitted a number of cartels and joint projects by trade associations and co-operatives. In February 1999, the Omnibus Cartel Repeal Act eliminated the statutory authority for 20 of these cartels (KFTC, 1999*a*, §2). Some of those repeals are effective immediately, and some will be phased in over a period of years.

The MRFTA applies to both public and private enterprises. Its application to many public enterprises is limited, though, because the enterprises are regulated utility monopolies in electric power, telecoms and gas. Thus, their pricing, being subject to regulation, would not lead to action under the MRFTA. But the KFTC might challenge other anti-competitive conduct, such as exclusion or discrimination in favour of a subsidiary or partner firm, or imposing monopsony terms on suppliers. And if a public enterprise is in a market-dominating position, it could violate the law if it refused to provide access to its facilities (KFTC, 1999*a*, §3).

Several aspects of Korean competition policy are designed to protect the interests of small and medium sized businesses. Indeed, a justification offered for the controls on the *chaebols* is to protect small businesses, both in their dealings with the larger firms as customers and suppliers, and against unfair competition from firms with deep pockets or other advantages, particularly unfair assistance between *chaebol* subsidiaries and cheap financing facilitated by intra-group debt guarantees. In addition, the MRFTA provides two kinds of exemptions that were specifically drafted to protect SMEs. One could permit otherwise illegal restrictive agreements, and the other exempts the activities of certain co-operatives.

To strengthen SME competitiveness, case-by-case exemptions may be granted from Article 19's prohibition of unfair collaborative acts (Article 19(2) 6). Conditions for this exemption are set out in the enforcement decree. All parties must be SMEs. The applicants must demonstrate the expected improvement in productivity, quality, technology, and negotiating power, and must show that, without the proposed agreement, it would be difficult for them to compete efficiently with large enterprises. As of March 1999, the KFTC had not authorised any such exemptions (KFTC, 1999*a*, §4)

In addition, co-operatives composed of SME's may enjoy what appears to be a statutory exemption (Article 60). The purpose of the co-operative (or federation of co-operatives) must be to provide mutual aid among small businesses or consumers. The co-operative must be established voluntarily, and its members must be able to join or withdraw from it freely. Members must have equal voting rights, and if the co-operative distributes profits to its members, limits on profit distribution must be set in the by-laws. The exemption may have been included in the law simply to demonstrate concern about SME problems, for it has little practical effect (KFTC, 1999*b*). Even if a co-operative fulfils the requirements, the MRFTA would still apply to any of its activities that constituted unfair business practices or that had the effect of unfairly raising prices by substantially limiting competition (KFTC, 1999*a*, §4).

Perhaps in response to concerns and complaints about unfair competition from large business groups, there are several programs to promote and protect the interests of SMEs—which means nearly every non-*chaebol* business, since 99% of Korean enterprises qualify as SMEs, and about 75% of the workforce is employed by SMEs. Some of these programs erect potentially damaging barriers to competition. The Basic Act for Small- and Medium-Sized Firms defines the classifications, based on employment and assets, on which eligibility for other programs depends. Changing the definitions, by industry, is an indirect way to grant or withhold preferences to particular sectors. The list of "SME" co-

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operatives includes not only artisan-scale industries, but also firms in industries such as consumer electronics, industrial gases, paper and paperboard, pipe manufacturing, shipbuilding, foundries, glass, and steel fabrication. One of the problems of SMEs is said to be difficulty in obtaining financing, because private lending and investment are all absorbed by the *chaebols*. To compensate, there are several large-scale subsidy and credit-guarantee programs for SMEs. Banks are required (by a Bank of Korea regulation) to issue from 35 to 60% of new unsecured loans to SMEs.

Large firms are barred by law[5] from entering sectors that have been reserved for SMEs. In principle, the protected sectors were selected on the grounds that smaller enterprises would be more efficient than large ones in those sectors. But if production at smaller scale is in fact more efficient, it is unclear why a large firm would even want to enter, and thus, why protection is needed. If smaller firms would indeed be more efficient in the sector, then a law preventing entry by firms that would be inefficient there is otiose. If there is a legitimate concern, it might be that larger Korean firms would not recognise their own inefficiency, because of poor intra-group management oversight and complex financial structures, and hence would crowd out more efficient competitors. And perhaps the protected status could be a means of forestalling unfair competition and permitting small enterprises to get a toe-hold. But this protection has inevitably undermined efficiencies of integrated production and has permitted SMEs to relax their own competition and efficiency in these sectors. It also protected some large firms that were already incumbents when the sectors became protected. The number of protected sectors increased from 23 in 1979 to 237 in 1989. As late as 1994, 19 000 SMEs were engaged in these protected sectors. But the number of protected sectors has been cut to 88, and there are evidently intentions, or even plans, to reduce the number still further.

Small enterprises also have advantages in selling to the government. The government and public enterprises are required to buy certain products from industry cartels, which are identified by the Small and Medium Business Administration. Rather than invite open, competitive bidding, the agencies must negotiate with the co-operatives of SMEs. Each co-operative may determine the price and allocate amounts among its member companies. This protection is being cut back, but not eliminated, pursuant to the 1999 Omnibus Cartel Repeal Act. The government intends to cut the number of products subject to mandatory group negotiations. As of 1998, the total number of products was 258; by the end of 2001, it is expected to fall to 103 (KFTC, 1999*a*, §7 (attachment)).

The subcontract law is also intended to assist SMEs in their position as subcontractors to prime contractors with economic power. Although unfair practices in that relationship could also be addressed as abuse of a dominant position, the subcontract law is considered a more efficient way to apply those same principles to recurring problems. The subcontract act prohibits unreasonable delays in payments to subcontractors, unreasonable refusals to receive (or unreasonable delays in receiving) subcontracted goods, unreasonable return of products, and unreasonable reduction of subcontract prices (KFTC, 1999*a*, §4).

Sector-specific exclusions, rules and exemptions

In principle, the MRFTA now applies to all industries, with no sectoral exceptions. The implicit exceptions for a few industries, such as agriculture, fisheries, forestry and mining, were abolished in February 1999. The statute's definition of "enterprise" had included a listing of business sectors that the law covered, which has been deleted (Article 2.1). Despite these repeals, some cartels remain protected by the operation of particular statutes. A justification for some of them is strengthening the negotiating power of primary producers. Thus joint sale and purchase by co-operative federations in the agricultural, fishery, forestry and livestock industries and contract farming among ginseng producers and processing businesses are exempted by law (KFTC, 1999*a*, §2).

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Other government agencies apply sectoral regulations that affect competition issues. The Korea Communications Commission is responsible for some issues in telecoms, and the FSC is responsible for some in the financial sector. The justifications offered for separate responsibilities are the need for technical expertise in telecoms, and the concern for institutional soundness in finance. In each sector, the KFTC retains a role, though. For example, the KFTC would address collusion about network prices or interest rates and commissions. Indeed, the KFTC has taken action against fixed commissions for bank cashiers cheques. Determining which agency has jurisdiction over a problem calls for continued *ad hoc* consultations between the KFTC and these two commissions (KFTC, 1999*a*, §5).

Professions

Fees for many professional occupations had been determined by agreement of the associations and then approved by the relevant ministries. Ministry approval conferred exemption from the MRFTA. For example, lawyers' fees had been set by rules of the Korea Bar Association, which were endorsed by the Ministry of Justice pursuant to Articles 19 and 63 of the Lawyers Act. A lawyer's failure to charge the specified fees could lead to up to two years suspension from practice and a fine of up to W 5 million. The rules established fee ceilings, which tended to become the fee standards. The profession resisted repeal, claiming that there should be competition for better quality, rather than for lower prices. Others claimed that competition was not appropriate because consumers cannot determine differences in the quality of services, so they cannot bargain effectively to get an appropriate price.

The 1999 Omnibus Cartel Repeal Act has limited or eliminated the exemptions. Statutory authority to approve price agreements has now been repealed for lawyers, customs brokers, licensed tax accountants, accountants, administrative scriveners, patent lawyers, certified labour services, veterinarians and architects. Most of these repeals were immediately effective, but the lawyers' cartels are to be abolished as of January 2000 (KFTC 1999*a*, §7 (attachment)).

Although fees will no longer be controlled, other constraints may remain. Restrictions on advertising may no longer be exempted. Indeed, the new advertising law provides that "trade associations, unless provided otherwise by law, must not restrict labelling or advertising activities of the enterprises belonging to the association." (OECD CLP, 1999*b*). The KFTC proposes to be sure consumers are aware of market prices for professional services, by supporting a survey by the Korea Chamber of Commerce, the Korea Trade Association, and consumer groups. In the legal sector, it is anticipated that constraints on advertising will be relaxed, and entry barriers will be lowered by increasing the number who pass the bar exam. The bar exam has been used to control entry, rather than to measure ability. The economic ministries, including the KFTC, have urged the profession to eliminate this barrier, and the profession has agreed to raise the number of annual admissions from 300 to 700.

Publications

The only sectoral exemption set out in the competition law itself permits resale price maintenance for publications (Article 29). The exemption is intended to promote creativity by encouraging firms to market cultural products whose sales prospects are uncertain. The scope of the exemption is determined by the enforcement decree, prepared by the KFTC in consultation with the Ministry of Culture and Tourism. The latest revision of the decree, in March 1999, reduced the exemption's scope, by limiting it to printed works (including electronically "printed" ones), (KFTC, 1999*a*, §5). Previously, it covered all works that were protected under the Copyright Act. To give the industry time to adjust, though, this change will not actually take effect until the end of 2002 (KFTC, 1999*d*).

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Financial services and insurance

The KFTC's competition policy role in assessing mergers among financial institutions is advisory, because the Financial Supervisory Commission has final authority to approve mergers of financial institutions pursuant to the Act on Structural Adjustment of Financial Institutions. The FSC must consult with the KFTC, and the FSC decision must reflect the KFTC's advice about competition issues. Five FSC officials supervise mergers among financial institutions (KFTC, 1999*a*, §5).

Insurance companies have customarily set premiums jointly, based on rates established by the Insurance Development Institute. The Institute's rates incorporated both the net premium, to cover risk, and the loading premiums, to cover operational costs and profits. Under the 1999 Omnibus Cartel Repeal Act, the Institute's rates must set out only the net premium, beginning in the year 2000. Each insurance company must determine its loading premium independently, which should encourage flexibility and competition (KFTC, 1999*a*, §7 (attachment)). Permitting the Institute to in effect fix the risk premiums inhibits competition, too, though. It should be sufficient for the industry to share information about risk experience, and then leave it up to individual firms to set their premiums independently.

Construction

The Minister of Construction and Transportation had been authorised to hand-pick a bidder for an offshore construction project or to select construction companies and assist them in entering other countries or regions. The rationale for this authority was to prevent excessive competition among Korean firms for that business. This authority was eliminated in the 1999 Omnibus Cartel Repeal Act. Repeal is expected to eliminate potential trade disputes and give competitive companies more opportunities to enter overseas markets (KFTC, 1999*a*, §7 (attachment)).

Intellectual property

To provide incentives for innovation and ultimately promote competition, legitimate exercise of intellectual property rights under the Copyright Act, the Patent Act, the Utility Model Act, the Design Act and the Trademark Act is exempted from the MRFTA (Article 59). Conduct that constitutes abuse of intellectual property rights, however, may not be exempt (KFTC, 1999*a*, §5).

Telecommunications[6]

In telecoms, a special sectoral regulator deals with some of the most significant competition problems that involve the historic network monopoly providers. The Korea Communications Commission regulates technical aspects of anti-competitive conduct concerning network interconnection, facilities and misuse of information acquired from a shared network.[7] Other kinds of anti-competitive conduct not named in the telecoms legislation remain under the KFTC's jurisdiction (KFTC, 1999*a*, §5). The telecoms legislation provides for consultations between the KFTC and the Ministry of Information and Communications, but it is not clear that there is a similar process for consultation or co-ordination between the KFTC and the KCC, to ensure that its decisions are consistent with the KFTC's decisions about similar problems in other sectors. The treatment of dominance seems to differ, with the telecoms regulators declining to find dominance in some settings that appear to fit the MRFTA's criteria, for example.

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Rice wine

Before 1988, the National Tax Agency regulated manufacturing, distribution and advertising of these products in ways that prevented competition. Licenses for manufacturing and distribution had not been issued since 1976. Supply was still restricted to the administrative districts of cities or counties where the breweries are located. As a result, brewers have local market power. Under the 1999 Omnibus Cartel Repeal Act, the territorial restraints will be eliminated in 2001 (KFTC, 1999*a*, §7 (attachment)). For the most popular product, *soju*, the NTA used quotas and local purchase requirements to effectively divide the country into separate regions, whose producers, with local market power, did not compete with each other in different regions. In 1992, the quota system was abolished, but some restraints remained in place (Lee, 1998, pp. 22-24).

Ocean shipping

Liner conferences, authorised by the maritime law, are exempt from the competition law's prohibition of restrictive agreements, by application of Article 58, because exemption is consistent with the practices of other countries, and because it is believed that in these circumstances co-operation increases economic efficiency (KFTC, 1999*b*; KFTC, 1999*a*, §2).

Road transport

This sector was identified as in need of reform in the early 1990s. Regulations controlling territories were violated, yet still left low-profit routes under-served. At that time, reforms included steps to improve the system of approvals and to relax the criteria for introducing or changing routes (Lee, 1998, pp. 32-33). In mid-1999, more fundamental reforms were implemented. The widespread reliance on private trucking was an indication of how inefficient and non-competitive the for-hire system had become. Regulation of rates and routes was eliminated. Control over entry was relaxed, to eliminate economic tests; now, entry is based only on fitness. Scale requirements are being eliminated. At the outset, the minimum number of trucks a firm must have to provide national route service was 25. By the end of 1999, that number was to be reduced to five, and the plan was to reduce it eventually to one.

5. COMPETITION ADVOCACY FOR REGULATORY REFORM

Statutory requirements for inter-agency consultation appear comprehensive. Other government agencies are to consult in advance with the KFTC, or advise the KFTC of the particulars, when they intend to issue an act, decree or order that would restrain competition, by authorising conduct that would otherwise constitute an illegal collaboration or that would limit the number of firms in the market (Article 63). The consultation process appears to have improved after the KFTC became independent, and again when its chairman's status was raised. When the KFTC was still part of the Economic Planning Board, it could not express its views directly. Now, as a central administrative agency, it can do so without having its views filtered by other economic ministries (OECD CLP, 1996). The chairman and the vice chairman can present the KFTC's views in person, in deliberations at the ministerial and vice-ministerial level. The KFTC chairman is also one of the four members of the Economic Ministries Council, which advises about regulations that are the responsibility of the Ministry of Finance and Economy.

The consultation requirement, and hence the authority for competition advocacy, has been in the law since it was adopted in 1980. In 1980, the KFTC's Ad Hoc Committee for Deregulation identified 18 heavily regulated industries where it believed reforms could improve competition; these included alcoholic beverages, maritime and land transport, and financial services. Between 1981 and 1990, the KFTC handled

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450 matters dealing with anti-competitive government regulations (KFTC, 1999*a*, §1). The KFTC was the agency responsible for economic deregulation between 1988 and 1992. Accomplishments in that period include reducing the number of medical and pharmaceutical items subject to the "Standard Resale Price System" and relaxing the limits on distance between gas stations. In 1993, the task of supervising deregulation was given to another part of the Economic Planning Board. But the KFTC resumed this work when it became an independent agency in 1994. In 1995, the KFTC reviewed nearly 300 laws and decrees. Issues included restrictions on entry or market territory, maximum prices, cartels in the construction, customs clearance, transportation, and insurance businesses, subcontract limits on construction companies, and allocation of prime time television and radio advertising (OECD CLP, 1996).

The workload increased and the KFTC's success rate improved. Of the 93 proposals on which the KFTC offered views in 1995, the KFTC says that 61 ended up reflecting its opinion (OECD CLP, 1997). In 1997, the number of proposals reviewed exceeded 400. The KFTC offered an opinion on 139 of those, and its views were reflected in 106, or over 75%. In addition, the KFTC expressed its opinion on 18 cases at economic-related ministerial and vice-ministerial meetings in 1997, and its opinion was reflected in 13 of them (OECD, 1998*a*). Most other OECD competition agencies that have tried to judge their own successes report that their views prevail about one third of the time, but they are rejected about one-third of the time, and accepted only in part about one-third of the time. The KFTC's apparently superior success rate may be due in part to its institutional status, both when it was a part of the powerful Economic Planning Board and then when it became an independent agency with ministerial rank.

In addition, the KFTC and its chairman have played key roles in the deregulation process. The KFTC Chairman assumed the presidency of the inter-ministry Committee of Economic Regulatory Reform in April 1997. A task force attached to this Committee, including three staff detailed from the KFTC, made over a hundred proposals for reform, focusing on nine "core" sectors. As of March, 1999, most of them had been implemented, and others are working through the legislative process (KFTC, 1999*a*, §7). The regulatory reform project was transferred to the Prime Minister's office in part because the scope of the effort was expanded beyond economic regulation to the non-economic issues that had previously been handed by the Administrative Reform Agency. The KFTC continues to analyse competition issues in regulated industries and volunteers its proposals to the relevant ministries and, when appropriate, to the Regulatory Reform Committee (KFTC, 1999*a*, §6). But because of the shift in attention and focus, there has been some concern that there is less scope now than before for competition-policy input in reform deliberations (KFTC, 1999*b*). The KFTC now has a permanent position on the current Deregulation Committee.

The KFTC has a separate division, the Competition and Deregulation Division, that is wholly devoted to competition advocacy. The division consists of nine members: one director, one assistant director and seven officers. Other divisions are also involved in consultations or analyses of market structure in connection with regulatory proposals, so quantifying the resources devoted to advocacy is difficult.

Some other advocacy successes include:

- Eliminating suggested retail prices, to discourage resale price maintenance.
- Eliminating mandatory membership and membership payments to trade associations.
- Liberalising domestic air fares, for both scheduled and charter service.
- Deregulating fees for telecoms services, and changing the approval system to a reporting system (except for local telephone service).

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– Reducing entry restrictions in the sale of electric power, so private generators can enter through simple registration, rather than licensing, and have more opportunities for direct supply to end users.

– Eliminating some of the anti-competitive “small business” protections, such as regulations that prevented larger firms from operating livestock businesses.

Sometimes advocacy does not prevail. Efforts to allow retail shops to sell over-the-counter, non-prescription drugs failed because of opposition from the association of pharmacists. The KFTC criticised the anti-competitive features of a proposed system for joint management of liquefied petroleum gas containers, but the ministry decided that the system was required for safety reasons.

6. CONCLUSIONS AND POLICY OPTIONS

General assessment of current strengths and weaknesses

Commitment to market principles at the highest political levels is today providing strong support for competition policies. Market principles are being integrated into important policy regimes outside the technical field of competition policy itself, notably in the financial sector and corporate governance and in reforms that are opening markets to trade and lowering barriers to foreign investment. Responses to the 1997 currency crisis show increasing willingness to rely on the market rather than the government to correct business failures. Most notably, as one of the five largest *chaebols*, Daewoo, struggled with insolvency in 1999, it became increasingly likely that the group would no longer be treated as “too big to fail,” but instead creditors and owners were going to have to work out a restructuring.

The trend is in the right direction, and sustained efforts by many parts of the government have accomplished much. But the commitment is not equally strong everywhere. While the substance of policy moves toward increasing reliance on markets, methods of implementation still appear to resort to central controls. Government endorsement of the “big deals” risks creating new moral hazard problems that may slow development of the market in the sectors affected. Industry still reportedly gets instructions through administrative guidance, although now this guidance is typically unwritten. Still, if a firm ignores oral advice, it may find itself under more formal pressure. In this regard, the Korean government should be careful by refraining from involvement in the transactions of businesses not to undermine the decision-making independence of the competition agency.

In this complex environment, determined and pro-active competition policy institutions are essential, to underpin the consistency and sustainability of market-oriented policies. The KFTC has been at the centre of economic regulatory reform since it was created. The practice of giving the KFTC important roles and high-level policy access helps ensure that competition principles provide a framework for decisions in specific sectors and policy areas. Here, Korea ranks highly among OECD Member countries.

In addition, the competition agency has been principally responsible for reform of the *chaebols*, since the 1986 MRFTA revisions that made market structure an issue and authorised the KFTC to enforce the rules about investment and corporate structures. This program of reform assigned a high priority to the statutory goal of “balanced development.” The KFTC has recently tried to shift attention toward more conventional competition issues, but it maintains 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. This mixture of competition policy with other goals has led to the continued use of methods that may need to be re-examined, now that Korea has adopted other, related reforms concerning corporate governance and finance. General oversight of group investments and transactions might be expected in a program of central direction and control, but is unusual in a program of competition law enforcement. The KFTC contends that its close supervision of “undue” transactions is a temporary, transition tactic, which is necessary under

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current conditions to help ensure that capital markets develop and function. It thus recognises that in the long run, competition enforcement methods should focus on situations where there is likely to be a demonstrable effect on market competition.

Overall, the KFTC has become increasingly strong in the last couple of years. Some observers note that the agency is adopting a more prosecutorial attitude. The KFTC is imposing much higher penalties, and in response many companies are protesting, taking appeals to court. About 20-30% of the KFTC's cases are going to court now because of the high fines.

Increasing resources and enforcement activity are evidence of competition policies' growing role in the Korean economy. The policy focus is shifting to more sophisticated and difficult issues. Recent amendments to the law increase the flexibility in dealing with dominance, by removing deceptively simple structural rules from the statutory definition, and by eliminating the annual listing of dominant firms, which carried an implication that these firms might be subject to indirect price-control pressure. The structural tests remain in the law, though, to be used in *ex post* assessments of legality. Concerning horizontal restraints, which are usually considered the most serious and difficult competition issue in developed economies, the law has been amended to erect a stronger presumption against them, and enforcement attention has shifted strongly toward horizontal issues in the last few years. No doubt many of the targets of these cases are smaller firms, as many KFTC cartel cases have aimed more at associations of SMEs, as well as at larger industrial firms. The KFTC may thus be stepping on some toes in bringing these cases. But it is also establishing the principle of consistency—as long as it is also going after larger companies that do the same things.

The KFTC faces some technical problems that deserve attention. Its powers to obtain evidence are not backed by effective judicial sanctions. To get evidence, it is sometimes necessary to refer cases for prosecution, to take advantage of the prosecutors' greater powers. But for the need for the additional powers, many of these matters might not otherwise be appropriate for criminal processes and penalties. If the KFTC rejects a demand for relief, there is no place to go either to appeal that decision or to seek relief independently. The KFTC has been relatively active, so there may not be a large number of disappointed complainants. But providing now for a stronger right of private action or an effective ability to appeal a decision rejecting a complaint could fill that gap before it becomes a problem.

Repeal of many remaining exemptions, so that competition policy applies nearly universally, further shows that competition policy is becoming accepted as a central principle. Some exemptions remain, though, and others are being phased out only over several years. Most professions are now exposed to more competition and can no longer prevent truthful advertising. But the legal profession still controls entry based on numbers, not qualifications, and the limits are being lifted, slowly, rather than eliminated completely. Special privileges for small business, particularly the "protected sectors" that larger firms cannot enter and the law reserving certain government purchases for small business cartels, are inconsistent with a general support for competition policy.

Deregulation efforts proceed for several major infrastructure sectors, but for some the pace is slow. In electric power, gas, and rails, much is being planned, but implementation is still in process. In telecoms and in electric power, the respective roles of the KFTC and the sectoral regulators have not been defined clearly yet. The KFTC has, though, helped discipline cross-subsidisation between competitive and non-competitive functions. Some of its recent actions about "undue" intra-group transactions have targeted enterprises such as KEPCO.

As the *chaebols* reorganise their assets and foreign investment increases, the KFTC is dealing with more mergers. The substantive rules applied may need to be re-considered. The structural test for dominance is relatively permissive. That may be appropriate for dealing with a claim about existing

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dominance, but it may not be appropriate for dealing with mergers that might create dominant positions. Under this test, the KFTC would find presumptively acceptable the creation of a firm with a 50% market share in an industry with a post-acquisition HHI over 3 000; that is quite concentrated. Yet in the other direction, the merger standards prohibit larger firms from making acquisitions larger than "toe-holds" in markets where the other firms are "small" businesses. This degree of protection may lead to inefficient allocation of resources. It might be thought to promote small businesses. But although it could protect small businesses from large-scale competition, it also prevents small business owners from profiting by selling out to larger ones.

Resource allocation reflects the importance of the campaign to regulate the *chaebol's* internal transactions. The FTC has launched several dragnet investigations, demanding all documents and electronic files from the relevant parts of the *chaebols*. Companies have resisted supplying this information. Meanwhile, the personnel working on this are not available to do more sophisticated economic analysis of mergers and real monopolisation problems.

The KFTC also spends a high proportion of its staff and other resources on unfair competition matters, including overseeing the rules protecting subcontractors as well as the consumer-protection issues of deceptive advertising and onerous terms in contracts of adhesion. Here, the KFTC may well be implementing public-supported policy priorities. One challenge in competition policy has been the public's expectation that the government will be a protector, either of consumers or of industries. That can lead to rules that impair efficiency. It may be a transition phenomenon now, as people are becoming more familiar with the performance, benefits, and responsibilities of open market competition.

The dynamic view: the pace and direction of change

Incorporating competition principles in the national regulatory system is an ongoing process. Reform continues in many dimensions, and the market-oriented direction may now have been ratified by Korea's recovery from the currency crisis. That experience should reinforce and perhaps even accelerate the adoption of further reforms, including turning attention now to further reform in the infrastructure sectors that remain inefficient and non-competitive. More attention should be paid to relationships between general competition law and sectoral regulators, so that competition policy does not become fragmented and inconsistent among sectors.

The KFTC's policies and priorities appear to be moving in the right directions. But it would be good for it to ease its way out of the function of regulating and protecting business segments, as the *chaebol* issue becomes resolved and those groups are restructured to respond more to general market and investment incentives. And some internal restructuring may be needed, to concentrate the KFTC's resources on the different kinds of problems raised by investigating major firms' horizontal problems.

Policy options for consideration[8]

Competition policy attention and resources should move, over time, toward emphasising measures that are clearly related to "efficiency" goals, consistent with the customary role played by competition authorities in OECD countries. The KFTC should continue to shift its resources and personnel toward horizontal problems and bid rigging, while it continues, in the short-term, to focus attention on intra-group transactions that may have effects on competition in markets. The shift toward investigating identifiable competition issues would help counter concerns that the KFTC might be used to implement interventionist government policies. 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. Consideration is needed to finding other means of dealing with issues about contract fairness that do not result from competition problems.

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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. Measures that might be considered include the power to seek a court order for access to documents or information.

The use of essentially the same structural standards for abuse of dominance and for mergers should be reconsidered. Situations and policy goals may differ between correcting an existing situation and preventing new problems. The current standards permit formation through merger of quite substantial firms in concentrated industry structures. And the market-share criteria, being essentially formalistic, may inhibit sensitive application of policies motivated by efficiency.

Protectionist measures that prevent potentially efficient competitors from entry into sectors reserved for "small" business, that apply stricter structural tests to discourage large firms from acquisitions in the protected "small business" sectors, and that reserve some aspects of government procurement to cartels of "small" businesses, should be eliminated.

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. To give parties standing to seek court review of KFTC decisions not to pursue complaints may be more difficult, because it would require a more significant change in Korean law. The quota on new lawyers should be eliminated. These steps would apply more resources to competition policy issues, expand the base of support for it, and enlist other institutions in developing important policy principles. Broader rights of private action, more effectively vindicated, would signify that competition policy creates basic legal rights for market actors and is not just a technical regulatory speciality.

Managing regulatory reform

Rapid changes, and the very magnitude and speed of Korea's crisis and recovery, make the lesson for reform complex. Much of the impetus for change has come from the top. Some aspects appear to have broad support, but for others the degree of support is less clear. And support from some aspects of reform, such as disciplining the *chaebols*, may not necessarily constitute support for other aspects of market-based reform. Business groups opposed the 1996 strengthening of the competition law; they were thus in favour of removing regulations that inhibited their initiative, but not of stronger enforcement of laws that controlled their market power. Some of their concerns were met, though, by eliminating rules to control equity investment and inter-company shareholdings in business groups. And although the KFTC appears to have a good position in policy debate, within the government other ministries have objected to the KFTC's exposing the anti-competitive elements and effects of other laws and regulations (Lee, 1998, pp. 187-88, 201).

The difficulties due to the *chaebol* system may also have tended to undermine popular support for market institutions and competition. Such suspicion would be unfortunate, for market-based approaches could be the best means of addressing the concerns. Democratisation and increased transparency should encourage the *chaebols* to open up their closed structures and weaken the links between business and political and government favour. Increasing participation by foreign firms too should lead to a business climate more in accord with global standards. Indeed, these developments represent an opportunity for the *chaebols* to reform their own inefficient, excessively centralised management and complex and inflexible financial structures. Ultimately, structures and conduct should be governed by enduring general principles, such as competition law, with a minimum of direct government intervention (Lee, 1998, pp. 344, 360, 366-76).

For market-based approaches to work, it must be clear that the government is committed to them, and that it will no longer resort to the traditional practice of direct intervention. The KFTC has an opportunity itself to make that choice clear. Much of the KFTC's resources are devoted to regulating

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chaebols. Because of Korea's historic situation, in which aspects of the groups' structures have hampered the development of transparent and flexible market institutions, a principal purpose of the KFTC's regulation has been to foster development of those institutions, rather than to address effects in particular economic markets. Thus, the KFTC has been responsible for aspects of regulation of corporate and financial structures that are not usually considered part of competition policy. The KFTC can help emphasise how policy toward the *chaebols* can focus on making markets work, by moving to concentrate attention on those internal transactions, debt guarantees, and cross shareholdings that represent specifically identifiable competition problems. And it can continue to use its powers of persuasion to try to prevent other parts of the government from controlling the *chaebols'* market entry and exit for reasons that are not founded in competition policy.

The roots of the market distortions caused by the *chaebols* lie in decades of government policies, as well as in private behaviour that the policies encouraged or tolerated. Solutions based on reforms to corporate governance and financial and securities markets will be less effective, if investors believe it is the government's decisions that matter, rather than those of the firms' management. To the extent that the *chaebol* "problem" is moral hazard problem, a principal means of addressing it must be by cutting back on support for the management of firms that are unsuccessful in fair competition, as well as ensuring that the government is not involved in investment or restructuring decisions that could raise new moral hazard risks.

The reform program now underway in Korea links the development of market competition and democratic institutions and attributes many of Korea's economic difficulties to failures of transparent, responsive government and non-competitive market conditions (MOFE, 1999, Chapter 3). The challenge Korea faces is to vindicate both reform principles, by eliminating monopolistic and anti-competitive behaviour, especially where that was encouraged and protected by political and bureaucratic influence.

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NOTES

1. Statutory citations throughout are to the MRFTA unless otherwise noted.

2. A holding company may not have a debt to equity ratio over 100%, may not include second-tier subsidiaries, and may not have both financial and non-financial subsidiaries; in addition, it must own a majority of each of its subsidiaries (30%, for listed companies) and if it includes affiliates of the top 30 *chaebols*, it must eliminate debt guarantees between subsidiaries.

3. The events and proposals described here have been reported in the Korean business press; *see generally* issues of the Korea Times internet edition, www.koreatimes.co.kr, from mid-1998 to date.

4. The association of small and medium sized businesses cites this concern in arguing for the power to investigate and report problems to the KFTC under conditions that preserve the complainants' anonymity.

5. Act for Co-ordinating Business Areas of Small and Medium-Sized Firms.

6. Competition issues in telecoms reform are covered in detail in the background report on Regulatory Reform in the Telecommunications Industry.

7. Framework Act on Telecommunications Business, Article 63-3.

8. These options follow generally the relevant recommendations of OECD (1997):

   4. Review and strengthen where necessary the scope, effectiveness and enforcement of competition policy.

      - Eliminate sectoral gaps in coverage of competition law, unless evidence suggests that compelling public interests cannot be served in better ways.
      - Enforce competition law vigorously where collusive behaviour, abuse of dominant position, or anti-competitive mergers risk frustrating reform.
      - Provide competition authorities with the authority and capacity to advocate reform.

   5. Reform economic regulations in all sectors to stimulate competition, and eliminate them except where clear evidence demonstrates that they are the best way to serve broad public interests.

      - Review as a high priority those aspects of economic regulations that restrict entry, exit, pricing, output, normal commercial practices and forms of business organisation.
      - Promote efficiency and the transition to effective competition where economic regulations continue to be needed because of potential for abuse of market power. In particular: (i) separate potentially competitive activities from regulated utility networks, and otherwise restructure as needed to reduce the market power of incumbents; (ii) guarantee access to essential network facilities to all market entrants on a transparent and non-discriminatory basis; (iii) use price caps and other mechanisms to encourage efficiency gains when price controls are needed during the transition to competition.

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