

Economy case studies

KOREA: BETTER BUSINESS REGULATION AND IMPROVED COMPETITIVENESS

Rapid growth over the past 3 decades transformed Korea into the world's 13th largest economy.¹ Exports were a big driver of that growth, which averaged 6.4% a year between 1981 and 2009.² Exports and imports together amounted to 83% of GDP in 2007, and by 2008 Korea had become the world's 7th largest trader.³ But the economy's heavy reliance on foreign trade made it especially vulnerable to the global economic crisis of 2008–09. During the height of the crisis, in the fall of 2008, the economy contracted by 15% as exports, hit by poor credit conditions and declining investor confidence, plunged by 34%.⁴

The government's policy response to the global economic crisis recognized the larger role played by small and medium-size enterprises, especially in employment—in contrast to before the 1997–98 East Asian financial crisis, when the large conglomerates known as *chaebol* dominated. At the end of 2008 Korea's 3 million small and medium-size enterprises accounted for 99.9% of all companies in the economy, almost 90% of employment and about 50% of production.⁵ In the wake of the crisis the government took steps to reduce the tax and regulatory burden on these businesses, building on reforms begun earlier in the decade.

Many of the reforms of business regulation, such as the launch of an online system for business registration and the introduction of an electronic single window to facilitate trade, reflect Korea's broader push toward e-government. A road map adopted in 2003 to create the "world's best open e-government" included targets such as putting 85% of public services online.⁶ Korea's advanced e-government provided the foundation for

implementing several of the recent reforms in business regulation.

The institutional framework

In 2008 newly elected President Lee Myung-bak established the Presidential Council on National Competitiveness with a broad mandate to revive the economy by improving Korea's competitiveness. Regulatory reform was identified as 1 of 4 pillars for the initiative, along with public sector innovation, investment promotion, and legal and institutional advancement.

The council's ambition in 2008 was "to achieve a potential economic growth rate of 6–7% and a national competitiveness rank of 15 globally by 2012."⁷ The council noted early on that of the economy's 5,189 business regulations, 800 (15%) had not been revised in the 10 years since 1998. In an effort to bring regulations up to date, the council applied sunset clauses to more than 600 regulations and 3,500 administrative rules.⁸

For the past 3 years the council has been holding meetings twice a month to discuss Korea's competitiveness strategy, bringing together representatives from the Employers Federation, trade unions, the Chamber of Commerce, the Federation of SMEs, the Ministry of Strategy and Finance, academia and the private sector. The Ministry of Strategy and Finance is responsible for improving the business environment by planning and implementing economic regulation, simplifying administrative procedures and reducing related costs. The Small & Medium Business Administration, created in 1996, focuses on promoting small and medium-size enterprises as the backbone of the economy.⁹

To further support the reform initiative, in 2008 the government, in collaboration with

the Korean Chamber of Commerce, established the public-private Regulatory Reform Task Force to monitor and resolve difficulties faced by businesses. Every year the council reports statistics on the issues the task force investigates and resolves through cooperation with relevant authorities.¹⁰

Multipronged regulatory reform

In recent years Korea has been implementing reforms that affect several areas of business regulation, including taxation, trade, investor protections, bankruptcy and business registration.

Lower and simpler taxes

As part of a stimulus package following the global crisis, Korea accelerated its 5-year corporate income tax reduction program to a 3-year program. It reduced the highest corporate tax rate from 25% to 22% in 2009, and the lowest rate from 11% to 10% in 2010. The plan is to further reduce the highest rate in 2012, from 22% to 20%.

Korea also undertook efforts to lighten the administrative burden of taxes. In 1997 it had already implemented a system allowing taxpayers to file taxes electronically.¹¹ In 2002 it launched a new one, the Hometax system.¹² In 2010, thanks to increased use of the new system, the time to comply with tax obligations was reduced by 14% as measured by *Doing Business*. In parallel with introducing online taxation, Korea reorganized its tax administration, shifting from an organization by type of tax (such as personal income tax and corporate income tax) to one by tax function (collection, audit and so on). The introduction of online taxation and the functional reorganization of tax administration have substantially reduced the need for informal contact between government officials and taxpayers.

In 2010 and 2011 Korea took further steps to ease the administrative burden of taxes. It amended the Local Tax Law twice in 2010 to merge 4 local taxes into 2. And effective January 1, 2011, it made the National Health Insurance Corporation the consolidated collector for pension, health, unemployment and industrial accident insurance payments. This allows joint filing and payment for 4 different labor taxes and contributions.

As Korea started to recover from the crisis, the revenue collected from corporate income tax rose, exceeding the 2008 level in both 2009 and 2010. The number of companies registered for corporate income tax also rose, increasing by 7% from 2008 to 2009 and by 10% from 2009 to 2010.

Easier trade

In 2008 the Korea Customs Service launched a comprehensive reform plan aimed at establishing the world's best customs clearance system.¹³ By 2009 the agency had moved from an "E-customs system"—an electronic data interchange system with access for subscribers only—to a "U-customs system"—a global internet-based customs portal linking financial institutions, customs agencies, logistics companies and 23 government agencies.¹⁴

This international single window, known as UNI-PASS, allows importers and exporters to handle customs declarations and other trade-related requirements from anywhere at any time. UNI-PASS is one of the world's few 100% electronic clearance portals. Its introduction reduced the average time to export from 11 days to 8, and the average time to import from 10 days to 8, as measured by *Doing Business 2009*. The Korea Customs Service estimates that it spent about \$7.7 million in total on the single window in 2006–10, generating cost savings of about \$70.5 million in 2010 alone.¹⁵

Greater protections for investors and creditors

Already in 2005 Korea had begun to adopt a range of measures to improve corporate governance, including supporting the nascent shareholder rights movement by giving minority shareholders more rights. Korea's class action law came into effect in

January 2005. Minority investors can now file class actions for negligent external audits of a listed company, for insider trading and market manipulation and for false disclosure in the prospectuses or quarterly, semiannual and annual reports of listed companies.

In October 2009 Korea amended its 2006 bankruptcy law in an effort to keep more companies operating during the global economic crisis. By the second half of 2008 both export and domestic companies had begun to feel the effect of the decline in international demand due to the global crisis and rising oil prices.¹⁶ Much as it had done after the East Asian financial crisis, Korea modified its bankruptcy law to favor restructuring over liquidation, launched workout plans to save ailing financial institutions and enhanced transparency among foreign and domestic creditors—a strategy that according to research helped to gradually revive investor confidence.¹⁷

Under Korea's new bankruptcy law, creditors lending money to distressed companies receive "superpriority" over other secured creditors. This makes it easier for such companies to obtain new loans and continue operating. The law also encourages reorganization by simplifying rules and allowing management to stay onboard to administer the company's turnaround—while balancing creditors' interests by allowing them to establish creditors' committees during bankruptcy.¹⁸

By 2010 more companies were able to continue operating. The number of reorganization filings in Korea rose from 366 in 2008 to 630 in 2010 (table 3.1). More important, the number of companies that kept operating after filing for reorganization increased from 73 in 2008 to 223 in 2010, while the number filing for liquidation grew by much less (from 191 in 2008 to 253 in 2010).

Easier and cheaper business start-up

In 2009 Korea made starting a business easier, particularly for joint stock companies, or *jusik hoesa*, which account for more than 90% of Korean companies.¹⁹ For these companies the minimum capital requirement was abolished, and the cost to start a business reduced from 17% of income per capita to 14.57%. Since 2009 notaries have no longer been required, strict time limits have applied for value added tax registration, and entrepreneurs have been able to pay registration taxes online. Online payment is very accessible in Korea, which has the world's highest wireless broadband penetration rate.²⁰

In February 2010 Korea made start-up even easier and less costly through an online system, Start-BizOnline, which is managed by the Small & Medium Business Administration.²¹ In the past, entrepreneurs starting a company had to manually fill out more than 30 forms and visit 6 different agencies—which led 96% of company founders to hire a lawyer as their agent. Now they enter information once, and the online system automatically distributes it. Entrepreneurs can use the system to

TABLE 3.1 Reorganization and liquidation filings in the Republic of Korea, 2008–10

| Year | Companies filing for reorganization | | Companies that kept operating after filing for reorganization | | Companies filing for liquidation | |
|------|-------------------------------------|--------------|---|--------------|----------------------------------|--------------|
| | Seoul | All of Korea | Seoul | All of Korea | Seoul | All of Korea |
| 2008 | 111 | 366 | 11 | 73 | 74 | 191 |
| 2009 | 192 | 669 | 54 | 257 | 122 | 226 |
| 2010 | 155 | 630 | 35 | 223 | 122 | 253 |

Source: Ministry of Justice of Korea.

TABLE 3.2 New companies registering and exiting in the Republic of Korea, 2008–10

| Year | Jusik hoesa registering | | Jusik hoesa exiting | | Yuhan hoesa registering | | Yuhan hoesa exiting | |
|------|-------------------------|--------------|---------------------|--------------|-------------------------|--------------|---------------------|--------------|
| | Seoul | All of Korea | Seoul | All of Korea | Seoul | All of Korea | Seoul | All of Korea |
| 2008 | 17,567 | 47,739 | 10,801 | 26,175 | 538 | 2,766 | 284 | 359 |
| 2009 | 19,313 | 52,976 | 12,344 | 29,783 | 998 | 3,361 | 224 | 295 |
| 2010 | 20,789 | 57,828 | 15,062 | 35,795 | 838 | 2,765 | 276 | 383 |

Note: Jusik hoesa are joint stock companies. Yuhan hoesa are limited liability companies.

Source: Supreme Court of Korea.

conduct name searches, register a company, pay local taxes and the corporate registration tax—and more.

As Korea started recovering from the crisis, the number of newly registered joint stock companies began steadily increasing. It grew by about 9% between 2009 and 2010 (table 3.2). More than a third of the new companies are located in Seoul.

Besides making start-up easier for all companies, Korea plans to relax or abolish many industry-specific barriers to entry, in an effort to promote new business and revitalize the economy. For example, it will no longer restrict businesses selling petroleum to operate only in a specific region.²²

Smoother permitting

Korea also strengthened construction permitting, updating its building code in 2005/06. In May 2006 small construction projects were exempted from the requirement to apply for an advance building permit.²³ This allows regulators to focus their energy on the more complex projects.

In 2010 Korea started a general licensing reform (this does not yet apply to matters such as construction permitting). Until recently Korean licensing laws had “prohibition of a license” as the principle and “permission for license” as the exception. Permission became the principle in 2010.²⁴ The goal for the coming years is to establish a licensing council, a one-stop shop that will bring together all administrative agencies and process applications within 20 days as a general rule.

Conclusion

In 2010, as the world economy slowly recovered from the crisis, Korea’s growth rate reached 6.1%, the highest among OECD members and up sharply from the 0.2% rate in 2009.²⁵ The government aims to continue the regulatory reform process. At the October 2010 meeting of the Presidential Council on National Competitiveness, President Lee Myung-bak said, “In the process of recovery of the world economy, the competition will be fiercer. Therefore, we need to make an effort to be more competitive. We have to endeavor to make a country good for enterprise and investment.”

NOTES

1. Based on 2010 GDP measured by purchasing power parity (PPP) exchange rates. Data are from the International Monetary Fund, World Economic Outlook Database, <http://www.imf.org/>.
2. World Bank, World Development Indicators database, <http://data.worldbank.org/>.
3. World Bank, World Development Indicators database, <http://data.worldbank.org/>. The OECD average for exports and imports is about 50% of GDP.
4. See Bernanke (2009, p. 15); and Asian Development Bank (2009, pp. 172-76).
5. Small & Medium Business Administration, “Statistics,” <http://eng.smba.go.kr/> (accessed July 2011).
6. Between 2003 and 2007, 31 new e-government initiatives were implemented. In 2010 Korea ranked number 1 globally on the United Nations E-government Development Index (United Nations Department of Economic and Social Affairs 2010).
7. PCNC (2009) cites Korea’s “national competitiveness ranking on IMD’s World Competitiveness Yearbook (31 out of 55 in 2008), WEF’s Global Competitiveness report (13 out of 134) and WBG’s Doing Business report (23 out of 178)” (p. 11).
8. PCNC 2011.
9. Small & Medium Business Administration, <http://eng.smba.go.kr/>.
10. The statistics are included in annual reports of the Presidential Council on National Competitiveness. In 2009 the task force undertook on-site inspections of companies in 30 areas and held 67 sectoral meetings, revealing 785 issues. It resolved 559 issues through cooperation with relevant authorities.
11. In 2009, 95% of corporate income tax returns, 80% of individual income tax returns and 78% of value added tax returns were filed electronically.
12. The Hometax system is available at <http://www.hometax.go.kr>.
13. Korea Customs Service 2009b.
14. The U-customs system is being used as a model by several economies seeking to improve their trade systems, including Dominica and Ecuador.
15. The cost of the single window fell after the initial investment in 2006. The share of Korean export and import transactions processed through the single window increased from about 67% in 2009 to about 92% in 2010 (Korea Customs Service 2009a, 2010).
16. Kim 2009, p. 279.
17. See Cirmizi, Klapper and Uttamchandani (2010); and Oh and Haliday (2009).
18. See Eunjai Lee and Wan Shik Lee, “Restructuring and Insolvency: South Korea,” <http://www.practicallaw.com/>.
19. About 10% of companies are small or medium-size limited liability companies, or *yuhan hoesa*. In 2006–09 an average of 2,500 new *yuhan hoesa* a year were created in Korea.
20. OECD 2010.
21. <http://www.startbiz.go.kr>.
22. PCNC 2011, p. 14.
23. World Bank 2006b.
24. PCNC 2011.
25. See PCNC (2011), which cites International Monetary Fund data on 2010 growth rates in major economies.