FULL LIBERALIZATION OF FOREIGN EXCHANGE TRANSACTIONS AND FOREIGN INVESTMENT

On March 31, 1998, the Korean Government announced it would fully liberalize foreign exchange transactions and foreign investment. The following are the contents of the press release by the Ministry of Finance and Economy(MOFE).

The Background

- In light of the liberalization trends in both current and capital account transactions, Korea needs a new system of foreign exchange management which fits into a truly open economy.
- Korea needs to devise a new set of institutional measures to effectively deal with the increasing volume of electronic transactions, counteract against illegal transactions such as money laundering, and accomodate the international anti- corruption initiatives.
- Korea needs a new institutional framework to actively promote foreign investment as the major source of stable and long-term capital necessary to finance future growth.

Reform Policy Directions

- Full Liberalization of Foreign Exchange Transactions
  - ○ The regulatory framework for foreign exchange flows will be structured from the current partial positive-list system to a full negative-list system.
  - ○ The existing system of direct and preventive regulations will be transformed into one of ex post facto management centered around prudential supervision.
  - ○ An effective early warning system will be established as a safeguard against systemic risk of financial crisis.
- Full Liberalization of Foreign Investment
  - ○ Higher national priority will be given to foreign investment inducement as an important vehicle of job creation and technology transfer.
- Legislation of New Laws Related to Foreign Exchange Transactions and Foreign Investment
  - ○ The existing Foreign Exchange Control Act will be abolished and replaced by a new law which will adopt a full-fledged negative-list system.
  - ○ At the same time, the current Foreign Exchange Management Regulation, which consists of 512 articles in total, will be replaced by a much simplified new regulations.
  - ○ Separate restrictions related to commercial foreign loans will also be liberalized and incorporated into the new foreign exchange law.
  - ○ The current Foreign Investment and Foreign Capital Inducement Act will be replaced by the Foreign Investment Promotion Act.

Reforms in Foreign Exchange Management System

- Fully Liberalizing Foreign Exchange Transactions
  - ○ The current account transactions will be fully liberalized with only a few exceptions, for example, restrictions related to national security concerns and criminal violations.
  - ○ The capital account transactions, including overseas borrowings and investment by domestic residents and portfolio investment by foreigners, will also be fully liberalized in principle.
- Minimizing the Risk of Liberalization
  - ○ A channel for information exchange will be established among related agencies including the National Tax Administration Office, in order to prevent capital flight and international money laundering activities.
- Establishing an Effective Monitoring and Reporting System
  - ○ A new legal framework will be devised to enforce accurate and timely reporting by financial institutions on foreign exchange flows.
  - ○ The Korean government, jointly with the World Bank, will develop a comprehensive system of

monitoring foreign exchange flows, as well as an early warning system.

- Instituting a Safeguard Against Financial Market Instability
  - ○ A legal basis will be formulated to enable the government to temporarily suspend foreign exchange transactions or impose a requirement of acquiring prior government approval for transactions, in case of imminent foreign exchange crisis.
  - ○ To counteract excessive inflows of hot money, the new law will allow the government to activate the variable deposit requirement (VDR) system and foreign exchange transaction tax if they are deemed to be necessary.
- Strengthening Prudential Regulation and Supervision
  - ○ The supervisory authority will strengthen prudential regulations and supervision on the maturity structure of foreign currency borrowing and lending of financial institutions.

Reforms in Foreign Investment Promotion System

- Fully Liberalizing Foreign Investment
  - ○ Foreign investment will be fully open to all industries, except for some industries with national security concerns and cultural reasons (example: coastal fisheries, media), as well as industries subject to international negotiation for foreign investment (example: communication and shipping industries).
  - ○ Foreign ownership of land and hostile M will also be fully liberalized.
- Establishing a Investor-Oriented Supporting System
  - ○ Various foreign investment-related procedural provisions will be greatly streamlined and incorporated into one single legal framework which can support the provision of one-stop service for foreign investors.
  - ○ The approval and licensing criteria will be clearly defined, and an automatic approval system will be adopted.
    * Under the automatic approval system, foreign investment will be regarded as being approved if no official rejection is made over a certain period of time after the application.
  - ○ Korea Trade and Investment Agency (KOTRA) will be reorganized to be fully involved with foreign investment promotion, and the government will consider transferring substantial part of its legal authority to KOTRA.
- Institutional Support for Foreign Investment Promotion
  - ○ In order for the quick resolution of miscellaneous bottleneck faced by foreign investors, a trouble-shooting committee, chaired by the Vice Minister of Finance and Economy, will be established within the government.
  - ○ Tax exemptions and reductions will be provided to a wider range of industries, and the tax concession period will be extended from the current 8 years to 10 years.
  - ○ To support the local government's effort to induce foreign investment, the Foreign Investment Promotion Fund will be established.
  - ○ Local governments will be allowed to establish a free investment zone as part of their policy initiatives for foreign investment promotion.

Implementation Schedule

- Related bills will be drafted by the end of April, and are expected to be passed in the National Assembly by the end of June.
  - ○ To expedite the necessary legislation, a special committee and associated working-level task force will be established immediately within the government to draft new laws and regulations.
  - ○ Regulations and provisions contained in new laws will be put into effect in a sequential manner, depending on their feasibility. New laws will take full effect when an ancillary information and monitoring system is in place.
- In light of the vast technical requirement of reforms, a separate task force will be formed to deal with the design of information hardware and software such as the electronic foreign exchange information system. VIP