

END OF IMPORT SOURCE DIVERSIFICATION SYSTEM AND ITS EFFECTS

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The Content and Subject of the System

Starting from July 1, 1999, the two-decade-old import source diversification system (ISDS), a ban which virtually blocked the entry of Japanese products into the Korean market, has been lifted and the Korean market is open to the Japan-originated imports. The number of items allowed to enter Korea is 16 in three categories, namely automobiles/auto parts, electronic goods and machinery products. Items including automobiles, auto parts, color television sets with 25" or bigger screens, VCRs, mobile handsets, construction machinery, numerically controlled (NC) lathes

and machining centers are now free from import restriction. Considering that there is a sizable domestic market for these liberalized items and, more importantly, that they are products in which the Japanese have a cutting edge in the world market, the end of the ISDS is expected to have a bigger impact than other liberalization measures in the past.

The size of the domestic market for these recently-liberalized items is 10.6 trillion won (\$7.5 billion), based on 1998 statistics. The automobile market is the biggest (4.6 trillion won), followed by auto parts and tire market (2.6 trillion won), mobile handset market (1.6 trillion won) and color TV and VCR market

Table 1. Market Size of Liberalized Goods

Category	Items	Size of domestic market (bil. won)	Imported goods' market share (%)
Automobiles and auto parts	Vehicle (4 types)	4,586.1	0.3
	Jeep	408.6	n.a
	Gas engine parts	893.8	16.1
	Other auto parts	1,140.4	16.3
	Vehicle tire	583.0	5.8
Electronics	Color TV (25" or bigger)	343.9	2.4
	VCR	385.6	4.4
	Mobile handset	1,642.4	3.6
	Electronic rice cooker	28.8	0.2
	Compact-type camera	109.8	33.0
Machinery	Excavator	226.8	6.1
	NC lathe	133.2	9.5
	Machining center	94.4	28.2
	Total	10,576.8	-

Source: KITA(Korea International Trade Association).

(729.5 billion won). In 1999, the economic recovery is expected to expand the market size of these liberalized items up to 13.45 trillion won (approximately \$11 billion).

Meanwhile, the dependency rate on imports of these particular items varies depending on items. Imported auto parts or machinery goods take up relatively bigger shares (9.5% to 28.2%) of the domestic market, whereas other

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imported items except for compact-type cameras occupy less than 5% of the domestic market. Compact-type cameras show the highest market share of 33.0%. Some of the products banned by the ISDS have been allowed to be imported from Japan even before July, on

condition that such items are used for export purposes or that are not indigenously producible. Thus, save for compact-type cameras, the market penetration by Japan-originated imported products can be considered at an immaterial level.

Consequences of Previous Liberalization

The effects of this year's deregulation can be better foretold from the previous cases of import liberalization. At the end of 1998, 32 items were freed from the ISDS; among the total imports of these items, the proportion of Japanese-made items rose from 26.7% in 1996 to 33.3% during the first four months of 1999. Imports of these items reached \$174.22 million from January to April of 1999 alone, falling short of the amount of the entire year 1996. The increased proportion of the Japanese products shows that in the Korean market the Japanese products are

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A detailed look shows that the rate of market dominance by Japanese products is fast, especially in luxury consumer goods and machineries in which the Japanese command global competitiveness. For instance, NC milling machines' share rose from 41.1% to 91.4%; VCRs' rose from 53.9% to 91.4%. Meanwhile, items falling under the category of intermediate goods have not shown any significant changes from the status quo. This is because even under the ISDS, intermediate goods have been allowed to be imported whenever Korean domestic businesses needed them. It is not easy to switch the import sources of intermediate goods to another so quickly because of the compatibility problem in the course of production.

The Impact of Liberalization Measures

Automobiles

Estimated average price (after consumption tax) of Japanese automobiles is double that of the domestically produced vehicles, particularly passenger cars and semi-luxury sedans, while 1.5 times in the case of luxury sedans. Due to this price gap, the market penetration of Japanese automobiles will be made mainly in the luxury sedan market.

In particular, the U.S.- and Europe-made luxury sedans, which virtually monopolized the imported car market in Korea, will vie intensely with their Japanese counterparts from the second half of 1999. Many experts forecast that the short-term strategy by the Japanese automakers would aim at the imported car market rather than the Korean-made automobile market. In the long run, the Japanese strategy would seek to replace

Korean automakers' market shares. The market share of imported cars was the highest in 1996 with 1.5%; this is expected to jump over 4.5% by 2005, 50% of which will be enjoyed by the Japanese cars.

Electronic Products

For the medium-price range products, the quality of Korean products is competitive with that of the Japanese ones, hence lowering the possibility of Japanese penetration. Luxury items tell a different story: Korean consumers' strong preference of Japanese brands may well give away the market to Japanese manufacturers.

The market penetration of Japanese TV sets is expected to remain at a moderate level, as Japanese-brand color TV sets manufactured in other Asian countries on an OEM (original equipment manufacturer) basis have already been imported. Well-aware of this situation, Japanese companies are most likely to focus their sales on sophisticated products, such as wide-screen/projection, flat-screen and digital TV sets. When digital broadcasting begins in 2001, imports of Japanese TV sets will increase substantially.

Imports of Japanese VCRs may show poor performance, since the technology gap between Korean and Japanese products is negligible considering the fact that Korean goods have a bigger share in the world market. Korean mobile handsets are competitive with foreign ones in terms of technology. Moreover, different transmitting systems between Korea and Japan will naturally limit the entry of Japanese handsets. What should be noted is that aggressive product development by Japanese companies can capture more market shares, backed by the excellent (rechargeable) battery technologies.

The high quality of Japanese compact-type cameras, coupled with Korean consumers' strong preference of high price products, will bring about fast and deep market penetration. Professional-use cameras with separable

lenses are an exemplary case: liberalized at the end of 1998, the Japanese-made cameras have threateningly taken over almost the entire market in just four months. A similar story is expected to come from compact-type cameras; more than 60% of the domestic market is expected to be dominated by those from Japan by 2004.

Machineries

The domestic market for construction equipment is large enough for Japanese manufacturers to pursue aggressive market penetration strategies. Japanese products have high competitiveness in quality and product variety; if, based on geographical advantage, Japanese manufacturers build far-reaching distribution networks in Korea, the domestic market may be highly vulnerable. The year 2004's market share of the Japanese firms is forecast to be 15%.

The Japanese NC horizontal lathes and machining centers are globally competitive, holding 40% of the world market. Lagging far behind in technology and already importing a massive number of finished goods and their parts, the Korean market will be swarmed with Japanese goods rapidly. When the import ban on NC milling machines and injection-molding machines was lifted in January this year, they have taken 91.9% and 73.5% of the entire imported goods market in Korea, respectively. At the initial stage, these products are expected to replace European or U.S. products; in the long run, the Japanese products are forecast to retain more than 20% of the domestic market. **VIP**

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