

# A Legal and Policy Analysis of KRW Internationalization from the Perspective of Offshore Circulation

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## Abstract

**Purpose** – Recently, the Korean government is seeking to internationalize KRW and reduce its heavy reliance on the U.S. dollar and better cope with risks from external turbulence. However, there has been too little study on this subject in comparison with its importance. The main objective of the paper is to distinguish the discrete stages of the KRW internationalization and recognize the costs and benefits of each stage.

**Research design, data, methodology** – In order to achieve its goal, this study accomplishes a formal policy analysis based on potential factors of currency internationalization and an examination of legal practices in relation to Foreign Exchange Transaction Regulation (the Regulation).

**Results** – This study found that securing monetary policy may not be easy under liberalized capital account for a small open economy like Korea in view of the trilemma. In addition, the inherent ambiguity of the Regulation may increase the costs of KRW internationalization.

**Conclusions**—This study revealed the negative system for the control of foreign exchange of the Korean government. The excessive regulatory restrictions on foreign exchange may hinder the process of KRW internationalization. Some legal and policy reforms are needed to improve related regulation and infrastructure.

**Keywords** : KRW Internationalization, Legal Practice, Foreign Exchange Transaction Act, Policy Analysis.

**JEL Classifications** : F33, F53, G15, K22.

## 1. Introduction

Recently, the internationalization of KRW has attracted a sizable attention from the policymakers and the academics in Korea. The Korean government wants to reduce heavy reliance on the U.S. dollar and better cope with risks from external turbulence through the KRW internationalization. Generally, the internationalization of national currency is significantly influenced by the economic fundamentals such

as economic size and stable economic growth and openness to world economy. These economic fundamentals determines whether the currency will play more role in the regional and global monetary system. The more important the currency is, the demand and confidence for the currency becomes the larger.

However, the first purpose of this paper is to distinguish the discrete stages of the KRW internationalization process. While KRW internationalization process is certainly on the agenda, the stage-based strategies should be implemented, and the appropriate policies should be performed. Under this consideration, this paper put forward the stage-based comprehensive strategies which match Korea's national interest.

Secondly, based on our policy analysis, we try to recognize the costs and benefits of each stage. Overall, the internationalization process of KRW should be determined by the net benefits under the process. It is important to eliminate the financial risks and to maximize the benefits brought by the dynamic stage-based process of KRW internationalization. It is getting more and more importance to consider the costs and benefits as the KRW internationalization process proceeded.

In September 2012, Ministry of Strategy and Finance Bahk Jae-Wan said that the government is seeking to expand the use of the KRW in trade with China as part of its efforts to internationalize KRW by reducing heavy reliance on the U.S. dollar and better cope with risks from external turbulence. To that end, the government will tap into the Korea-China currency swap line, through which it lends money to Chinese firms and encourages them to settle payments for trade by using the KRW. According to him, there is no restriction on using the KRW in settling payments under the current law.

This is the first meaningful action by the government to encourage the use of KRW beyond its borders after putting the efforts on hold in the fact of the global financial crisis. The government aimed at the increase of the utilization of KRW in real transaction while, minimizing the effects of deregulation. To achieve that goal, the government will deregulate the recent practice in foreign exchange that is related to KRW funding, settlement and operation.

Therefore, there is a need to examine recent practice in foreign exchange and related legal issues. This paper focuses on legal case studies and policy analysis for each discrete stage of KRW internationalization. Based on a simple legal case studies, we found that there is the inherent ambiguity of the Foreign Exchange Transaction Regulation. To solve these problem, we make suggestions to improve related regulations and infrastructure aiming the internationalization of KRW. More concretely, this paper evaluate the con-

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sistency of foreign exchange transaction Act (the Act), foreign exchange transaction Decree (the Decree) and foreign exchange transaction Regulation (the Regulation).

It is important to notice that the KRW internationalization issue is directly related with the Foreign Exchange Transaction Act. The article 2-3 defines the scope of application of the Act as it prescribes the following. "This Act shall apply to the following matters: 2-3. Transactions by a private person having domicile or residence in a foreign country and a juristic person having its main office in a foreign country, which are denominated in the currency of the Republic of Korea or in which payment is able to be made in such currency, or other acts related thereto". In addition, article 6-1 of the Decree prescribes the following. "Sale to and purchase from non-residents of securities or bonds denominated or paid in domestic currency."

Although we examine only a few legal cases at each stage of KRW internationalization, we cannot come to a definite conclusion by a simple interpretation of the Foreign Exchange Transaction Regulation. The regulation does not seem to cover all cases effectively because of the recent practice in foreign exchange which is related with new financial products or transactions. The main reason for these discrepancy of the Foreign Exchange Transaction Act with the recent practice is partly due to the negative system for the control of foreign exchange.

Therefore, we set our third purpose to diagnose the consistency of the Act, the Decree and the Regulation. Most policymakers say that the actual quite low usage of KRW abroad is partly due to the widespread preference among businesses for the dollar and lack of demand for the won. But this paper argue that it is due to the inherent ambiguity of the foreign exchange policy. There is a severe complexity of there gulatory scheme for foreign exchange transactions and the inherent ambiguity of the Regulation. Some market participants continued to mention the lack of an offshore currency market for KRW and the operational difficulties in dealing with the currency in the onshore market.

The rest of this paper will be proceeded like this. In Chapter 2, we review some related literature. In Chapter 3, we introduce our research design and methodology briefly. In Chapter 4, we focus on some formal policy analysis and legal case studies for each discrete stage of KRW internationalization. In Chapter 5, we briefly summary our findings and conclude.

## 2. Literature Review

Recently, the issue of internationalization of KRW proceeded with the discussion of financial hub initiatives. Varapat et al. (2007) discussed the internationalization of KRW focused on the financial hub initiative launched in 2005. According to them, Korean governmental-ready increased the foundation for an international role of KRW. Korean government restructured the banking system, eased barriers between financial activities, and completed liberalization of capital account transactions. They also deepened the financial system and improved inflation performance.

Under this perspective, the potential of KRW internationalization is

relatively high. Offshore KRW circulation is relatively small for an economy with such size and high degree of openness. It is time to establish the right role and status of the KRW that corresponds with Korea's economic size, in view of the changing international monetary system and regional moves in Asia.

However, Samar et al. (2011), Baek & Oh (2012), Kim (2009), Takagi (2009), and Xu (2009) say that the efforts to creat international demand for the KRW were hampered due to established practices of pricing and invoicing trade in U.S. dollar and European currencies .

Certainly, in the proceeding of KRW internationalization process, Korea may face excessive instability in foreign exchange and domestic asset market (Lee, 2011). At the high level stage of KRW internationalization, monetary policy issue is very important in view of trillema. According to Kim & Shin (2010), Securing monetary autonomy, however, may not be easy under liberalized capital account for a small open economy like Korea. Huge capital movements can generate excessive instability in foreign exchange and asset markets. Strengthened international economic linkages may also be another factor to prevent monetary policy from being independent.

In order to reduce the risks along with the portfolio flows, Korea may allow the offshore KRW to be used by nonresidents for FDI in Korea. With respect to this issue, Park (2012) emphasize the importance of financial integration in Asia which has been induced by collective intra-regional initiatives.

For our legal case studies, we refered the discussion of Cha, et al. (2008) and Lee & Lee (2012). Wediscussed the issue with loans being advanced to non-residents by a financial institution which is not a foreign exchange bank under the Foreign Exchange Transaction Act. As a result, we found that there is a severe complexity of theregulatory scheme for foreign exchange transactions and the inherent ambiguity of the Regulation and sometimes even contradictory responses from the BOK itself.

In connection with this issue, Lee & Lee (2012) also points out the decrepencies between the Financial Investment Services and Capital Market Act and the Foreign Exchange Transaction Act. They say that the decrepencies between the two laws are evident in areas such as FX margin trading, business of foreign exchange brokerage companies, KTB swap transactions, acquisition of non-listed securities in overseas markets, and foreign exchange business operated by financial investment companies. This paper focus the last issue. In relation with this issue, we focus on a simple case study and argue on the fairness and excessive regulation for financial investment institutinos with regard to foreign exchange business in the sense that those should be ex-ante clearly defined in Foreign Exchange Transaction Act.

## 3. Research Design and Methodology

Our study on the discrete stage of KRW internationalization process is partly based on formal policy analysis. The category in these policy analysis is related to the following selected macro and financial indicators in <Table 1>. For example the category of financial

depth can be a crucial with the division of the stages of the KRW internationalization process. Low level of the financial depth corresponds to the initial stage and high level to the second stage of KRW internationalization process. The determining factor of second and third stage is related to the independency of monetary policy. The policy issues are the main concern of third stage.

More concretely, we consider the policies of offshore KRW circulation, FDI denominated in KRW, foreign exchange statistics, and exchange rate stability for the initial stage. We can analyze these policies with respect to the category of capital account openness, financial depth, economic growth, and inflation in <Table 1>. For the second stage, we consider the policies that developing domestic and external financial markets which is related to our financial depth category. Finally, we consider the policies with respect to the monetary autonomy and regional financial integration for the third stage.

For reference, <Table 1> shows that the score of Korea's currency internationalization potential belong to high class among 11 Key EMs and NIEs. The potential of KRW internationalization is high. As Varapat et al. (2007) pointed out, the offshore KRW transactions are relative small for an economy with the same size and degree of openness of Korea.

In our policy analysis, we implicitly count on the costs and benefits issues of KRW internationalization. The fact that the potential of KRW internationalization is high, is not sufficient condition for the positive net benefits. To raise the net benefits, comprehensive policy proposals are necessary.

<Table 1> Selected Macro and Financial Indicators of Currency Internationalization Potential: Key EMs and NIEs 1/

	Korea	Average	Maximum Country	Minimum Country
Macro indicators				
GDP size 2/	3.2 (3) /14	2.53	10.9 (China)	0.4
Economic growth 3/	4.2 (6)	5.25	9.5 (China)	3.6
Inflation 4/	3.3 (7)	4.29	7.2 (Russia)	2.5
Sovereign ratings 5/	A (2)	-	AAA (Hong Kong SAR, Singapore)	BBB- (Brazil, India, Turkey)
Capital account openness 6/	0.4 (5)	0.45	2.5 (Hong Kong)	-1.1(China, India, South Africa)
Total trade 7/	3.1 (1)	2.68	11 (China)	0.5 (South Africa)
Financial indicators				
Financial depth 9/	1.2 (4)	1.432	7.2 (China)	0.3 (Indonesia)
intl. debt securities 10/	...	0.09	0.2 (Hong Kong SAR)	0 (India, Indonesia)
FX market turnover 11/	0.8 (2)	0.58	1.2 (Hong Kong SAR)	0.3 (Brazil)
FX bid-ask spreads 12/	11.6 (2)	10.64	31.2 (South Africa)	1.2 (Hong Kong SAR)

1/ Selected table from Samar Maziad et al. (2011). The selected EMs and NIEs are Brazil, China, Hong Kong SAR, India, Indonesia, Korea, Mexico, Russia, Singapore, South Africa, and Turkey. The selection based on shares of global and regional GDP, and trade among EMs and NIEs.

- 2/ Share of global GDP in nominal prices, projected 2011-16 average, WEO.
- 3/ Real GDP growth, projected 2011-15 average, WEO.
- 4/ CPI inflation, projected 2011-16 average, WEO.
- 5/ Standard & Poor's Sovereign ratings, August 2011.
- 6/ Index number in 2009, Chinn and Ito (2009).
- 7/ Share of total world exports and imports of goods and services, projected 2011-16 average, WEO.
- 8/ De facto exchange rate arrangement, IMF AREAER 2010.
- 9/ Share of global financial depth in 2009. Calculated from Staff Discussion Note "The international Monetary System and Financial Deepening." IMF 2011.
- 10/Share of total international bonds and notes issues as of December 2010, BIS Quarterly Review, Table 13a and 13b. There is no data about Korea.
- 11/ Share of global FX turnover as of April 2010.
- 12/ 2006-10 average of bid-ask spread in basis points.
- 13/ Exchange rate flexibility: Floating (Brazil, India, Indonesia, Korea, Mexico, South Africa, Turkey), Crawl-like arrangement (China), Currency board (Hong Kong SAR), Other managed (Russia, Singapore)
- 14/ The number in the blanket indicates the ordinal of ranking of Korea among the 11 EMs and NIEs.

For our legal case studies, we referred the discussion of Lee & Lee (2012). Although we examine only a few legal cases at each stage of KRW internationalization, we cannot come to a definite conclusion by a simple interpretation of the Foreign Exchange Transaction Regulation. Despite the rapid revision of Foreign Exchange Transaction Act, the Decree, and the Regulation, we found that our legal issues still effective. This means that the position of the BOK and the Ministry of Strategy and Finance will not change for the time being.

## 4. Results and Discussion

### 4.1. The Initial Stage

#### 4.1.1. Policy analysis

At this stage, KRW circulates by tourist expenditure and the border trade mostly in East Asia countries. The major benefits of the KRW circulation in neighboring countries are saving transaction cost and more easy regional trade and travel (Lee, 2012). Because a small increase in money supply from Korea is sufficient for the offshore KRW circulation, the impact to macro economy seems not so serious. At this stage, while the benefits for Korea are clear, the costs are not so large.

Meanwhile, the more closer the trade relationships and the larger the trade volume, the demand for KRW of the non-residents will become larger. At this stage, the phased strategy for the foreign exchange transaction policy should be like the followings.

Firstly, constructing the official offshore KRW circulation system. Concretely, the banking system accommodate the circulation of KRW in neighboring countries based on the real transaction. We can expect to some extent that the power of the underground economy would be weakened by this official KRW circulation system. The unexpected out-

flow and inflow of foreign currency would explicitly decrease.

Secondly, comprehensive administration of the offshore KRW circulation. Strengthening the coordination is very important for the trade departments, foreign exchange administration, custom, tax administration, and tourist bureau. Each of these departments should make the coordination agreement for the KRW circulation with their trade partners. The offshore KRW circulation should be carried out under these comprehensive administration.

Thirdly, activating foreign direct investment which is denominated in KRW to neighboring countries. Because KRW has not get the full convertibility, foreign direct investment of KRW is still difficult for Korean companies. Nevertheless, thanks to the remarkable growth of the domestic industry, the investment and cooperation between domestic and foreign companies are strengthening in Asian region. Under these circumstances, the Korean government should promote Korean companies to explore the possibility for investment of KRW abroad. Bilateral negotiations such as FTA between Korean government and some neighboring countries could make it easier for the direct investment of KRW to abroad. In short, foreign direct investment of KRW is the major channel for supply of KRW to abroad.

Fourthly, reinforcement the monitoring and statistics of offshore KRW circulation. This will protect illegal activities and money laundering. Data acquisition from this reinforcement would be useful to improve the effectiveness of foreign currency management and domestic monetary policy.

Fifthly, stabilizing KRW exchange rate. The excessive volatility of KRW could become an impediment to the KRW internationalization process. So, the stability of KRW is crucial at this initial phase.

However, the offshore KRW circulation is based on real trade at this stage. The major benefits of the KRW circulation are the trade convenience, reduced exchange rate risks, KRW reputation abroad, and the experience in managing KRW cross-border circulation. Through this step, Assets denominated in KRW will be accumulated abroad through this stage. Nonresidents would hold KRW as asset. The demand for the external KRW asset market will arise and the next stage will be followed.

#### 4.1.2. Legal Case Study

Recently, a few of foreign exchange banks move in line with the government's effort to internationalize KRW and reduce heavy reliance on the U.S. dollar and better cope with risks from external turbulence. For example, Woori Bank has launched a local currency-based settlement service for companies trading with China in September 2012. This service allows Korean firms which engage in trade with China to settle transactions with KRW. The bank plans to expand such settlement systems to other Asian countries and Russia, which will add to local firms' convenience even further.

In case of foreign exchange banks, the loan made in foreign currency and loan made in KRW are available under Section 2.6 of the Regulation which prescribes as "A report to the chairman of Bank of Korea is not required in the case where foreign exchange banks advances a loan to a resident or non-resident. However, in the case where foreign exchange banks advances a loan to a non-resident with security interest or a guarantee provided by other resident, the

non-resident who wishes to borrow from such institutions should file a Report. In case of necessary, the chairman of Bank of Korea allows the chairman of tax administration to examine this Report."

In contrast, in the case of a financial institution which is not a foreign exchange bank but is authorized to carry out foreign exchange related business, the Regulation prescribes the available foreign exchange business related agencies such as Section 2-12. Each type of financial institution is prescribed from Section 2-13 to Section 2-23. For example, the available foreign exchange business related agencies are postal offices, dealing, brokerage, foreign exchange brokerage, collective investment scheme service, non-discretionary investment advisory service, discretionary investment advisory service, trust service, insurance, credit union, merchant bank, which are licensed to carry out foreign exchange related business. However, these sections of the Regulation are silent on whether these agencies could extend a loan denominated in KRW.

## 4.2. The Second Stage

### 4.2.1. The Policy Analysis

At this stage, as the KRW accumulation abroad becomes larger, the offshore lending and borrowing of KRW will rise. While the existence of offshore market for KRW will raise higher requirement for Korea with international financial market rule.

For example, MSCI Barra, continuously focused on market accessibility criteria and the limited convertibility of KRW. In particular, they continued to mention the lack of an offshore currency market for KRW and the operational difficulties in dealing with the currency in the onshore market, as sources of misalignment of currency transactions with the securities trading and settlement cycle when compared to Developed Markets.

At this stage, the existence of external KRW markets will also put significant impacts on Korea's internal financial market issues such as money supply, price level, interest rate and exchange rate, it will also. To stabilize internal and external KRW markets, the foreign exchange transaction policy should be like the followings.

Firstly, policy efforts to develop the domestic financial markets. External KRW asset markets should take internal asset markets for reference such as domestic public bond, security, and foreign exchange markets. Recently, the Korea financial market is showing a healthy growth. There is no problem of liquidity in the financial market in Korea. However, the negative influence of global factors like protectionist sentiments, global imbalances and high oil prices cannot be denied. As a result of interest liberalization process, the offshore KRW deposit and credit interest rate can be set with reference to the domestic interest rate. At this stage, the internal and external KRW interest rate will be kept at the same level.

Secondly, the strengthening of financial cooperation between Korea and neighboring countries. The borrowing and lending of KRW abroad belongs to offshore KRW business. It is determined independently of the domestic financial markets, which raise higher requirement for the management of domestic monetary policy. To achieve such policy goals, the cooperation between domestic financial markets and the

offshore financial centers is getting extremely important.

At this stage, if the policy coordination developed slowly, the accumulation of offshore KRW may be related to the underground transaction. In this case, it may threaten Korea's financial stability and Korea will pay high costs for the KRW internationalization. Stages of the KRW internationalization goes up to high level, there is no doubt the fact that Korea's macroeconomic control will be increasingly difficult.

#### 4.2.2. Legal Case Study

According to Cha, et al. (2008), for a general regulation in respect of a loan made to a non-resident by a resident, Section 7-16.1 of the Regulation prescribes as; "A report to the chairman of Bank of Korea is required in the case where a resident advances a loan to a non-resident (except where it is approved as one of the available foreign exchange related businesses for such financial institution under Chapter 2). However, amongst the reporting requirements pursuant to this Section, in the case of advancing a loan with security interest or a guarantee provided by other residents or if the loan is extended in Korean won for an amount exceeding 1 billion Korean won, the non-resident who wishes to borrow from such institutions should file a Report."

While Section 7-16.1 prescribes that residents can advance a loan to non-residents in KRW, as a general provision, Section 2 of the Regulation is silent on whether the various financial institutions related with foreign exchange business could extend a loan denominated in KRW. Therefore, whether a financial institution that is not a foreign exchange bank under the Regulation, can make a loan denominated in KRW in ambiguous.

According to Lee & Lee (2012), the BOK and the Ministry of Strategy and Finance seems to take the position that the advancing of a loan by a financial institution which is not a foreign exchange bank is not allowed under Section 2-12 of the Regulation regarding the current attempt to extend a loan denominated in KRW to a non-resident, an offshore SPC. They argue that this position seems to originate from the interpretation that Section 2-12 prescribes the scope of available foreign exchange related business for each type of financial institution and other unlisted business is not allowed.

Cha, et al. (2008) concludes that the rationales of BOK and the Ministry of Strategy and Finance is like the following (1) Any financial institution can only engage in an area of business that is listed as within the scope of available foreign exchange related business under the Section 2-12 of the Regulation, (2) Section 7-16 of the Regulation only applies to a natural person or an entity which is not a financial institution and has no relation with the scope of available foreign exchange related business, and (3) Section 2-12 is not unlawful because it is a regulation which the Ministry of Finance announced with delegation under Section 3.1.14.d of the Act and Section 14.4 of the Decree.

However, this position of the BOK and the Ministry of Strategy and Finance still leaves some doubt as to the question of whether the Act, the Decree and the Regulation should be interpreted that it prohibits a financial institution from engaging in foreign exchange transactions itself especially the advancement of a loan in KRW except

those registered foreign exchange related businesses.

Moreover, like as Lee & Lee(2012), given the integration of the business scope of each type of financial institutions under the newly legislated Financial Investment Service and Capital Market, it is unfair and excessive regulation for financial investment institutions with regard to foreign exchange business in the sense that those should be ex-ante clearly defined in Foreign Exchange Transaction Act.

### 4.3. Third Stage

#### 4.3.1. Policy Analysis

The third stage is that KRW turns into regional investment asset. The increased offshore KRW circulation constitute the offshore borrowing and lending market of KRW. As the development of this offshore KRW market, the function of KRW has developed from a mere means of transaction to the means of store of wealth. At this stage, in order to boost the motivation of nonresident to hold KRW, it is very important to set a regional currency market with KRW as the key regional currencies.

At this stage, the cross-border KRW circulation will develop a closer relationship between the KRW transaction and the convertibility under liberalized capital account. With respect to this issue, Kim & Shin (2010) examines whether Korean monetary policy is independent of U.S. monetary policy during the post-crisis period in which capital account is liberalized and floating exchange rate regime is adopted and during the pre-crisis period in which capital mobility is restricted and tightly managed exchange rate regime is adopted.

According to their discussion, for the period after capital account liberalization, monetary autonomy can be also achieved in view of the trilemma, as exchange rate stability is given up. Securing monetary autonomy, however, may not be easy under liberalized capital account for a small open economy like Korea. Huge capital movements can generate excessive instability in foreign exchange and asset markets. Strengthened international economic linkages may also be another factor to prevent monetary policy from being independent. Their empirical results show that Korean monetary policy is not independent of U.S. monetary policy for the period after capital account liberalization. Portfolio flows respond dramatically to the U.S. monetary policy, which may also keep Korean monetary policy from being independent.

In order to reduce the risks along with the portfolio flows, Korea may allow the offshore KRW to be used by nonresidents for FDI in Korea. With respect to this issue, Park (2012) emphasize the importance of financial integration in Asia which has been induced by collective intra-regional initiatives. This may include the exchange cooperation of circulation-distribution between south and north Korea (Ryu and Lee, 2012). For that integration, he include various aspects of financial integration such as increasing cross-border capital flows, establishing regional financial safety nets, and developing local currency bond markets. While Korea has made progress in financial deregulation and capital account liberalization, it has experienced sudden stops or sharp capital reversals due to external shocks and currency instability. He suggest CMIM as a regional financial safety net will

play its role as a central platform for managing regional financial arrangements. He emphasizes the importance of Korea's role in gathering regional momentum. As an honest broker for further financial institutional integration is important especially in 2012 as a co-chair country of ASEAN+3.

## 5. Conclusion

The Korean government wants to reduce heavy reliance on the U.S. dollar and better cope with risks from external turbulence through the KRW internationalization. As the KRW internationalization is a multi-stage dynamic process, the stage-based strategies should be implemented, and the appropriate policies should be performed. Overall, the internationalization process of KRW should be determined by the net benefits under the process. It is important to eliminate the financial risks and to maximize the benefits brought by the dynamic stage-based process of KRW internationalization.

To consider the stages more concretely, we divide the process by using the category of depth of financial markets and the monetary autonomy. We considered the policies with respect to offshore KRW circulation, FDI denominated in KRW, foreign exchange statistics, and exchange rate stability at the initial stage. For the second stage, we considered the development of domestic and external financial markets. Finally, for the third stage, we consider the monetary autonomy and regional financial integration. By using the selected macro and financial indicators of Samar et al. (2011), we can choose our policy considerations. So we can conclude that the first purpose of this paper is satisfied and the distinguished discrete stages of the KRW internationalization process are inherently consistent.

In our policy analysis, we implicitly count on the costs and benefits issues of KRW internationalization. The fact that the potential of KRW internationalization is high, is not sufficient condition for the positive net benefits. In reality, the elements of three stages coexist simultaneously. In this situation, there exists organic and complex relationships of the cost and benefit of each stage. So it is difficult to recognize the cost and benefit at each stage in its pure form. As a result, we can conclude that the exact recognition of the cost and benefit of each stage is difficult. But one thing is certain. The excessive regulatory restrictions on foreign exchange will suppress our benefits at each stage of KRW internationalization.

In order to check whether there is the excessive regulatory restrictions, we examine recent practice in foreign exchange and related legal issues. This paper evaluates the consistency of foreign exchange transaction Act (the Act), foreign exchange transaction Decree (the Decree) and foreign exchange transaction Regulation (the Regulation). Although we examine only a few legal cases at each stage of KRW internationalization, we cannot come to a definite conclusion by a simple interpretation of the Foreign Exchange Transaction Regulation. We found that there is the inherent ambiguity of the Foreign Exchange Transaction Regulation.

The main reason for these discrepancy of the Foreign Exchange Transaction Act with the recent practice is partly due to the adoption of a negative system for the control of foreign exchange. Even

though, policymakers claim to freely acknowledge and approve the practice in foreign exchange and leave only some exception that is subjected to regulation, they still arbitrarily introduce many new regulatory restrictions if they find it necessary.

Most policymakers say that the actual quite low usage of KRW abroad is partly due to the widespread preference among businesses for the dollar and lack of demand for the won. But this paper argues that it is due to the inherent ambiguity of the foreign exchange policy. There is a severe complexity of the regulatory scheme for foreign exchange transactions and the inherent ambiguity of the Regulation. Some market participants continued to mention the lack of an offshore currency market for KRW and the operational difficulties in dealing with the currency in the onshore market. There is a need of legal and policy reform to improve related regulation and infrastructure.

This paper is a rare study that emphasizes the importance of legal and policy analysis of KRW internationalization from the perspective of offshore circulation. The effect of this study is located in arousing the need of legal and policy reform of the recent practices in foreign exchange. However, this study provided only a simple outline of this subject. More legal case studies and specific policy analysis of KRW internationalization process should be provided. This would be remained as our next research program in the future.

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