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From Fast Follower to Innovation Leader: Restructuring South Korea's Technology Regulation

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South Korea stands at a crossroads as its restrictive "positive regulation" and "shadow regulations" stifle innovation in AI, crypto, and mobility tech, allowing China to race ahead. Korea must modernize this framework or risk losing its position as a global innovation leader.

KEY TAKEAWAYS

- Korea's dual-constraint regulatory framework—a combination of "positive regulation" and informal "shadow regulations"—was instrumental during the manufacturing era, but it now threatens Korea's potential to emerge as a global innovation leader.
- While U.S. and Chinese tech firms rapidly scale new services, Korea's system freezes innovation until regulatory frameworks catch up. It is particularly damaging in sectors where first-mover advantages and network effects determine market leadership.
- This pattern killed TADA's mobility service, is forcing crypto firms overseas, and now threatens AI development.
- Despite leading R&D investment globally as a share of GDP, Korea's innovation ecosystem shows alarming signs of deterioration. Major platforms have hemorrhaged $50 billion in value, and Korea ranks second to last in start-up opportunity perception.
- Korea must shift from its restrictive framework to a "negative regulation" system that allows innovation by default. An administration-agnostic "control tower" with cross-agency authority can coordinate tech policy and prevent regulatory fragmentation.
- McKinsey projects regulatory modernization would boost Korean GDP by $1 trillion by 2040. Whereas, without reform, the OECD warns of Korea's growth potential would fall to last place among members by 2031.

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INTRODUCTION

South Korea faces a critical inflection point regarding its technology economy. The impeachment crisis surrounding President Yoon has shaken investor confidence, while U.S. President Donald Trump promises of aggressive trade measures against South Korea have amplified economic uncertainties. But even without this crisis, South Korea faces a more structural endemic challenge: South Korea's innovation capacity is hobbled by its restrictive regulatory framework, compounded by a corporate sector increasingly reluctant to take technological risks. The timing couldn't be worse. While global competitors, especially China, advance in artificial intelligence (AI), semiconductors, cryptocurrency, space technology, autonomous vehicles, and robotics, South Korea's regulatory paralysis and political instability risk excluding it from the next wave of digital innovation.

South Korea's regulatory environment is uniquely restrictive due to the interplay between its formal positive regulation system and extensive shadow regulation practices. The positive regulation system requires explicit permission for business activities, creating the first layer of control. Under this framework, businesses must assume risk when attempting anything not explicitly permitted by law—unlike the U.S. negative regulation system that only specifies what cannot be done.

This base system is then supplemented by pervasive shadow regulations—informal regulatory practices that influence business decisions without formal legal basis. These shadow regulations manifest themselves through administrative guidance, unofficial interpretations, and informal communications from regulatory authorities. The cryptocurrency industry illustrates this perfectly: While the Specific Financial Transaction Act doesn't formally restrict corporate real-name account issuance, financial authorities have "guided" banks not to issue such accounts to corporations, effectively limiting the industry to basic exchange services for domestic users only.

The interaction between these systems creates a particularly challenging environment for innovation. Even when activities are technically permitted under positive regulation, shadow regulations can expand regulatory control, limiting risk-taking. The TADA ride-sharing service

illustrates this dynamic: Despite court rulings finding its service legal under existing law, political pressure and informal regulatory resistance ultimately led to restrictive legislation.

This dual-layer system means South Korean businesses face restrictions both from what is explicitly not permitted (positive regulation) and from what regulators informally discourage (shadow regulation). The result is a regulatory environment that, while technically rule-based, creates significant uncertainty and barriers for innovative businesses attempting to enter new markets or develop new services.

South Korea's regulatory framework—combining positive regulation with shadow practices—was well-suited for the nation's historical catch-up development model. When the goal was to follow established technological paths and manufacturing processes, the system effectively channeled resources and coordinated industrial development. Regulators could study existing success cases from advanced economies, establish clear permitted activities, and guide businesses along proven development trajectories.

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However, this same regulatory structure has become a major impediment as South Korea attempts to transition from a fast follower to a global innovation leader, particularly in digital sectors. In emerging technologies such as AI, cryptocurrency, or novel platform business models, there are no established playbooks to follow. While traditional manufacturing innovation follows relatively predictable paths, digital innovation often creates entirely new business models and market categories. The cryptocurrency industry exemplifies this challenge: While South Korea has emerged as a major consumer market, its regulatory system has prevented the emergence of innovative crypto businesses beyond basic exchange services. Unlike jurisdictions with negative regulation that allow experimentation unless specifically prohibited, South Korea's system effectively freezes innovation until regulatory frameworks catch up, particularly damaging in fields where first-mover advantages and network effects often determine global market leadership.

This regulatory environment has profoundly impacted entrepreneurial spirit. South Korean companies hesitate to innovate due to an overwhelming fear of failure. Entrepreneurs now prioritize short-term performance over risk-taking innovation, creating a culture of incremental improvement rather than disruptive change. According to the "2023/2024 Global Report: 25 Years and Growing," published by the Global Entrepreneurship Monitor, fear of failure stands as one of the most significant deterrents to business creation worldwide.[1] Alarmingly, South Korea ranks near the bottom, better than only Iran, in the proportion of adults who perceive viable local start-up opportunities—underscoring deep-seated structural and cultural constraints on entrepreneurial activity.

This dynamic explains the South Korean paradox: Despite its leadership in global research and development (R&D) spending—investing 4.96 percent of gross domestic product (GDP) in 2023, the second highest in the world—South Korea continues to lag behind in technology entrepreneurship. Unless South Korea wants to follow a long slow path of innovation and competitiveness stagnation, if not decline, changing this system needs to be a top priority of the

government. And that means, among other things, moving the positive and shadow regulatory systems away from being a conservative, innovation-limiting force.

SOUTH KOREA'S CRYPTO EXODUS: HOW REGULATORY BARRIERS ARE DRIVING INNOVATION ABROAD

Cryptocurrency is one of the few areas where South Korea has shown prominence in the global technology industry. However, under the pretext of investor protection, South Korean authorities have effectively stifled the industry's growth. While South Korean regulators have focused solely on restrictions rather than fostering innovation and economic growth, the nation appears to be losing a vital growth engine. South Korean crypto enterprises are experiencing significant migration to competing jurisdictions such as Dubai and Singapore, leaving behind only a massive consumer market with limited innovation potential.

South Korea stands as a technological powerhouse and a significant player in the global cryptocurrency landscape, driven by widespread Internet access, attractiveness as an investment asset offering higher returns than real estate at lower amounts, and a tech-savvy population. According to Kaiko data, since 2017, South Korea has remained one of the largest markets in the crypto space.[2] South Korea's won (KRW) has consistently been a top-two currency in global fiat volumes. Combining accounts from the country's top five exchanges—Upbit, Bithumb, Coinone, Korbit, and Gopax—domestic virtual asset investors total 15.59 million. While this figure includes duplicate counting of individuals with accounts at multiple exchanges, it effectively means one in three South Koreans invest in virtual assets.

While South Korean consumers have a significant presence in the global crypto industry, South Korea's presence as an industry player is minimal.

The scale of virtual asset investment not only encompasses investor numbers but also overwhelms the South Korean stock market. In November 2024, the daily average trading value at domestic virtual asset exchanges reached KRW 14.9 trillion. This is comparable to the combined amount of KOSPI (9.9214 trillion KRW) and KOSDAQ (KRW 6.9703 trillion) during the same month. It's common to hear that Upbit, a South Korean cryptocurrency exchange, consistently maintains daily trading volumes around KRW 2 trillion, surpassing the trading volume of Coinbase, the U.S. cryptocurrency exchange.

While South Korean consumers have a significant presence in the global crypto industry, South Korea's presence as an industry player is minimal. Its restrictive regulatory framework has limited the industry to basic exchange services. Businesses must operate according to current laws, and if operators want to do something not explicitly stated in law, they must obtain permission from the Financial Services Commission (FSC), South Korea's virtual asset regulatory authority.[3] South Korea's positive regulation system fundamentally mismatches the dynamic nature of the crypto industry. While leading sectors and technologies in crypto evolve weekly, South Korean businesses must wait months or years for explicit regulatory permission to innovate. The virtual asset market's nature means that leading sectors, or "meta," change constantly, but updates to "what can be done" are very slow.

Currently, cryptocurrency exchanges are among the meaningful revenue-generating crypto businesses, but even these can only operate within South Korea. Their services require domestic bank accounts and domestically issued phone numbers, making it practically impossible for foreign users to register. The FSC announced in its "2025 Major Business Promotion Plan" on January 8 that it will pursue second-phase virtual asset laws regulating issuance and distribution this year, but as the name suggests, it remains focused on restrictions and maintains the "positive" approach of "don't do anything unless I say so."[4]

On January 15, the Virtual Asset Committee under the FSC discussed stablecoins at its second meeting, but only reached agreement that stablecoins should be handled under a separate regulatory framework rather than comprehensive virtual asset legislation. No bills regarding stablecoins have been introduced in the National Assembly.[5]

In a press release on February 13, the FSC announced that it will gradually approve the issuance of corporate virtual asset real-name accounts (hereafter referred to as "corporate accounts") for cashing out, starting in the first half of this year. While this is standard practice overseas, South Korean companies had to wait for the FSC's decision.[6]

Now companies are calling for guidelines on stablecoins, exchange-issued tokens, disclosures, and the establishment of a self-regulatory organization. They also seek regulatory updates on foreign exchange rules and taxation to facilitate general corporations' participation in virtual assets. However, there is no clear timeline for when these changes will happen. Bitcoin spot ETFs, now permitted in the United States, remain a distant prospect in South Korea.

The United States operates under a negative regulatory system wherein everything is essentially permitted unless specifically prohibited by law. This approach creates space for innovation by default—entrepreneurs and businesses can proceed with new ideas unless they encounter explicit legal restrictions. The system is built on the premise that market forces and innovation should be allowed to operate freely, with regulation serving primarily to prevent harm rather than direct activity.

Even when companies find ways to operate within regulatory gaps and prove their legality through court decisions, political pressure and industry lobbying can lead to new restrictions that retroactively prohibit these innovations.

REGULATORY BARRIERS IN ACTION: SOUTH KOREA'S RIDE-SHARING DILEMMA

TADA's case demonstrates how South Korea's regulatory framework creates barriers to platform innovation. The company took a calculated risk in South Korea's positive regulation environment, similar to Uber's approach in other markets. With no specific regulations for ride-sharing services (as it was a new industry), TADA attempted to navigate around existing transportation laws by utilizing a provision for 11-seat van rentals. While Uber succeeded with similar regulatory risk-taking in the U.S. market, TADA's outcome in South Korea proved drastically different, highlighting the unique challenges of South Korea's regulatory environment.

Unlike in the United States where ride-sharing services could operate while regulations evolved, South Korea's positive regulation system required explicit permission for new business models. In 2018, TADA launched by utilizing a regulatory gap in the Passenger Transport Service Act—

providing an 11-seat van rental service with drivers. This approach was necessary because taxi licenses were expensive and quantity-restricted, effectively blocking gig economy workers from entering the market.

The case illustrates both layers of South Korea's regulatory system at work. Under the positive regulation framework, TADA tried to operate within existing laws while consulting with transportation ministry officials—a common practice under South Korea's shadow regulation system. Despite winning legal battles, with all three courts ruling TADA's service legal under existing laws, political pressure from the taxi industry led to the passage of the "TADA Prohibition Law" in March 2020, just before a general election.

The government's response to TADA evolved under political pressure. Initially, the Ministry of Land, Infrastructure and Transport attempted to incorporate TADA into the regulatory framework through compromise measures. Even the Korea Fair Trade Commission opposed the TADA Prohibition Law, arguing that it could harm market competition and consumer welfare. Public opinion strongly favored TADA, with 49 percent of South Koreans supporting its service in a December 2019 survey.[7] However, facing intense pressure from the taxi industry, including protests and tragic incidents of self-immolation by taxi drivers, the government ultimately yielded to political considerations. The ruling and opposition parties unanimously passed the TADA Prohibition Law, prioritizing taxi industry protection over innovation and consumer preference.

This outcome reveals how South Korea's dual regulatory structure impacts innovation: Even when companies find ways to operate within regulatory gaps and prove their legality through court decisions, political pressure and industry lobbying can lead to new restrictions that retroactively prohibit these innovations. The TADA case has become a symbol of how South Korea's regulatory system, while effective for past industrial development, now constrains the emergence of innovative business models.

AI INDUSTRY AT A CROSSROADS

The TADA case exemplifies a recurring pattern in South Korea's approach to regulating innovative technologies. This pattern of restrictive regulation stifling innovation, first seen in mobility services and cryptocurrency, now threatens to repeat itself in AI. South Korea is now following the EU in passing comprehensive AI legislation, with the AI Framework Act scheduled to take effect in January 2026.[8]

This approach demands careful consideration to avoid perpetuating South Korea's problematic regulatory paradigm of intertwining positive and shadow regulatory systems. The rapid advancement of AI technology means enforcement decrees could become outdated even before implementation, potentially stifling AI innovation, just as occurred in the mobility and cryptocurrency sectors.

The AI Framework Act appears to be evolving from its original focus on industry promotion toward a heavily regulatory framework centered on risk management. The law designates various critical systems as "high-impact AI" when they significantly impact human life, physical safety, and fundamental rights. The regulatory burden on operators is substantial—high-impact AI providers must notify users in advance, mark AI-generated content, and comply with regular government oversight. These requirements, while important for safety, could slow innovation and deployment of AI technologies.

The regulatory landscape is becoming increasingly complex, with multiple government departments developing their own AI-related regulations. Rather than this overlapping approach mirroring the EU, South Korea needs a unified framework that relies on existing sector-specific regulations where possible, implementing AI-specific regulations only for truly novel risks. This could position South Korea as a global model for balanced AI innovation.

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According to the Center for Data Innovation's analysis, AI-specific regulation is warranted only in four critical areas: government surveillance and law enforcement, high-stakes decision-making systems affecting human safety, AI-enabled fraud prevention, and critical infrastructure systems.[9] Many other AI applications can be effectively governed through existing regulatory frameworks. Data privacy, content moderation, financial services, and intellectual property issues can be managed through current laws. Furthermore, several areas are better addressed through non-regulatory approaches: Workplace AI adoption should be guided by industry standards, AI bias issues through technical standards and testing, and energy usage and security concerns through voluntary industry commitments and public-private collaboration.

THE WINDOW FOR ACTION IS CLOSING

South Korea's meteoric rise from the ruins of war to a technological powerhouse has long been celebrated as the "Miracle on the Han River." But that miracle is showing signs of age. We're witnessing the limits of South Korea's traditional economic model. The very systems that enabled its past success are now impediments to its future growth. As the nation's tech giants stumble and its demographic crisis deepens, South Korea faces a critical choice: Reinvent its economy or risk following Japan's path to prolonged stagnation.

The numbers tell a stark story. In the past year alone, the collective market value of South Korea's leading tech platforms—including Kakao, Naver, and Coupang—has hemorrhaged more than $50 billion. Due to the absence of policy and corporate profit momentum, South Korean stocks are decoupling from global markets. On December 30, 2024, KOSPI declined for six consecutive months, showing its longest downturn since the 2008 global financial crisis. According to the National Pension Service Fund Management Office, the domestic stock return rate for the National Pension Fund was -0.87 percent as of the end of October, contrasting with overseas stocks' returns of 26.52 percent.[10]

The warning signs are impossible to ignore. South Korea's fertility rate has plummeted to 0.72, the world's lowest, and by 2030, one in four South Koreans will be over 65, creating a demographic cliff that threatens to overwhelm the pension system and strangle economic growth.[11] While its workforce clocks the longest hours among developed nations—1,915 annually—it produces just 71 percent that of G7 productivity levels.[12]

Specifically, South Korean workers generate approximately 62 to 65 percent of the output per hour compared with their American counterparts, highlighting a stark productivity challenge despite grueling work schedules. South Korea's venture capital per GDP is one-fifth of American

levels, while its market capitalization-to-GDP ratio (9.5 percent) lags far behind that of the United States (25.0 percent) and United Kingdom (20.6 percent).[13]

The Korea Development Institute projects that the nation's potential growth rate, currently around 3 percent, will drop to the mid-1 percent range by the 2030s. The Organization for Economic Cooperation and Development's (OECD's) forecast is even bleaker: South Korea could rank last among member nations in growth potential by 2031.[14]

THE SOUTH KOREAN ECONOMIC MIRACLE NEEDS A SECOND ACT

Yet, transformation remains possible. McKinsey estimates that South Korea could add $1 trillion to its GDP by 2040 through bold structural reforms, requiring doubled small and medium-sized enterprise (SME) productivity and expanded globally competitive corporations.[15] South Korea possesses formidable advantages—world-class infrastructure, an educated workforce, deep technological expertise—and is a strong R&D performer. But these assets need to be able to be used to drive commercial innovation, especially in new industries and by new companies.

1. **The transformation must begin by dismantling South Korea's positive regulatory system and its pervasive system of shadow regulations.** South Korea's positive regulatory system was designed for the manufacturing era, which impedes digital innovation. The pervasive system of shadow regulations encompasses informal practices that create uncertainty even without formal restrictions. Eliminating them requires increased transparency and accountability, with all regulatory guidelines formally documented and subject to public scrutiny.

   Empirical evidence increasingly demonstrates the substantial economic costs of excessive regulation on business operations and growth. According to World Bank data, senior managers in France spend 20 percent of their time on regulatory compliance, while German businesses typically wait 122 days for operating licenses and Dutch firms require about a month for import licenses.[16] Considerable empirical evidence shows that reforming anticompetitive regulations in markets for goods and services, as measured by the OECD indicators of product market regulation (PMR), can boost total factor productivity. South Korea has streamlined regulations over time and performs around the OECD average on the composite PMR indicator; however, out of 15 sub-indicators of regulatory barriers to competition, South Korea is at or close to OECD best practice in three, underperforming the OECD average in seven, and far behind OECD best practice in five.[17] Previous OECD economic surveys have argued that regulations should shift to a comprehensive green-light ("negative-list") principle, with activities allowed unless explicitly prohibited.[18]

2. **For emerging technologies such as AI and cryptocurrency, regulation should start minimally and expand gradually based on evidence.** The rapid advancement of technology means enforcement decrees could become outdated even before implementation, potentially stifling AI innovation, just as occurred in the mobility and cryptocurrency sectors. Several developed economies have successfully navigated similar regulatory transitions. Japan's Financial Services Agency transformed its approach to fintech regulation in 2017, moving from restrictive oversight to a principles-based framework that fostered innovation while maintaining stability.[19] Singapore expanded its regulatory sandbox in 2024 to support

experimentation and innovation by fintech and blockchain companies. The Monetary Authority of Singapore provided clear guidelines for digital payment service providers, positioning itself as a strategic gateway connecting Eastern and Western markets. The United Kingdom's Financial Conduct Authority established one of the first regulatory sandbox programs in 2016, with its approach to fintech innovation becoming an influential model studied by other regulators.

Regulating technologies simply because one can is misguided. Before rushing to impose rules, South Korea needs to identify real problems that markets can't fix on their own. If specific risks emerge, regulators should focus narrowly on those issues while carefully weighing the trade-offs. The goal should be protecting the public without stifling innovations that could benefit society.

3. **A "control tower" with private sector expertise is essential—not necessarily a government committee, but potentially housed within universities or research institutes.** This entity would maintain continuity regardless of political transitions and have real authority to oversee innovative technology industries across government departments. South Korea has traditionally relied on temporary presidential committees whose influence wanes as presidential terms progress. The Moon administration's 4th Industrial Revolution Committee was dissolved when the Yoon administration took office in 2022. While the Yoon administration introduced the Digital Platform Government Committee as a successor and launched the Presidential AI Committee in September 2024, these remain advisory bodies without enforcement power. The control tower must transcend mere consultative roles, wielding robust policymaking and implementation authority to drive substantive institutional transformation.

   The United States offers an instructive model with its Office of Science and Technology Policy (OSTP), established in 1976, which oversees federal science and technology innovation policy and budget. The Trump administration laid groundwork with the American AI Initiative in 2019, which the Biden administration built upon with enhanced regulatory oversight. In 2021, OSTP created the National AI Initiative Office as a central hub, enabling private sector and academic participation in AI policy development with federal cooperation.

4. **This control tower should be an independent institution with substantial authority to ensure political independence.** Its primary mission must be promoting "economic growth through innovation," with the power to coordinate and override individual ministry regulations when necessary. This approach would help prevent the fragmentation seen in current AI regulation efforts, where multiple departments are creating overlapping rules without unified direction.

But this task is about more than creation of a new entity; it involves reorienting South Korean culture to be more accepting and even embracing of Schumpeterian disruptive innovation. As one study of the role of national culture in innovation states, "Without a change in government policy, countries with cultures negatively predisposed to innovation may not be able to grow economically and compete effectively with more innovative societies."[20]

For a nation that once amazed the world with its rapid industrialization, this challenge is formidable but not insurmountable. As other nations accelerate their innovation policies, South Korea faces a moment of truth: Embrace creative destruction through bold institutional reform now or risk long-term relative techno-economic decline. The question is not whether South Korea can change, but whether it will choose to do so before it's too late.

About the Author

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