

# 南韓 FTA 政策與南韓-EU FTA 談判

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## 中文摘要

自 1990 年代末期起，南韓即開始試圖與其貿易伙伴簽訂自由貿易協定（free trade agreement, 簡稱 FTA）。南韓最近與歐洲聯盟（European Union, 簡稱 EU）完成 FTA 的簽署，這對南韓而言意義重大，因為南韓與 EU 貿易擁有最龐大的順差，而 EU 是南韓海外直接投資（foreign direct investment, 簡稱 FDI）的最大來源。此項 FTA 是典型的已開發經濟體間的全面而先進並經過審慎協商而簽署的 FTA，將有助於調和阻礙貿易的管理政策以及開放服務業市場。南韓是現今唯一擁有龐大工業能力而同時能成功地與美國和 EU 完成 FTA 的國家。

本文主旨在簡介南韓的 FTA 政策，尤其是聚焦於南韓與 EU 的 FTA 以及該協定對兩造貿易政策的衝擊。第一節將簡述南韓 FTA 政策的發展，並闡明南韓何以在 1990 年代末期開始加入 FTA 簽署熱。第二節在論述 EU 的 FTA 政策之發展，尤其著重於 EU 決定在 2000 年中期採取積極 FTA 的政策理由。第三、四節則在剖析南韓與 EU 進行 FTA 談

判的來龍去脈以及簽訂雙邊 FTA 後對南韓與 EU 兩方經濟所產生的預期影響。

# Korea's FTA Policy and Negotiating Korea-EU FTA

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## **Abstract**

Since late 90s, Korea has sought for FTA with its trade partners. Korea-EU FTA, recently finalized, is particularly important for Korea, because Korea has been recording the most important trade surplus with the EU and the investment of the latter accounts for the largest part of inward FDI to Korea. The FTA is typical example of comprehensive and advanced FTA between developed countries conceived in carefully constructed FTA policies. It contributes to harmonizing trade-impeding regulatory policies and liberalizing service markets. Korea is now the only country with large industrial capacity that negotiated successfully FTAs both with US and EU. In this sense, Korea-EU FTA provided both US and EU with occasions to converge in their FTA terms, which can make a reference case for future FTAs.

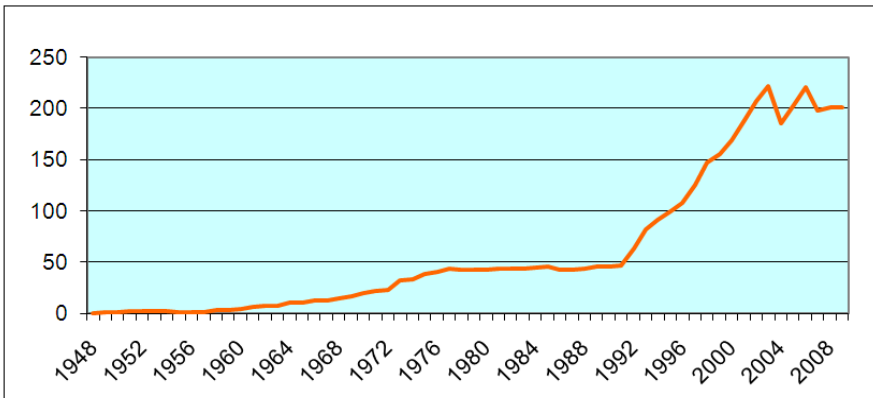
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## Introduction

Since the early 90s there has been a rapid growth in the number of regional trade agreements (RTAs). While successive rounds of negotiation in the GATT/WTO had succeeded to reduce overall tariff level in multilateral trading system, there has been an accelerating trend at same time toward bilateral trade liberalization in every part of the world. Before the establishment of WTO, only 124 RTAs, with an annual average of less than three, had been notified to the GATT. But after the establishment of WTO, 300 additional RTAs, which are mostly free trade agreements (FTAs), have been notified to the WTO as of 2009 with an average of more than twenty notifications every year. As of 2010 February, 462 RTAs has been notified and among them 271 agreements are in force.

**Figure 1. Evolution of Regional Trade Agreements (RTA) in the world**



Source: WTO

Korea is not exceptional in this FTA trend. Beginning with Korea-Chile FTA in 2004, Korea has been actively seeking for FTAs with its trading partners. Korea already implemented five FTAs and has been negotiating or preparing 23 FTAs with its trading partners. If all Korea's on-going FTA negotiations are completed, more than 90% of Korea's trade will take place in FTA framework. The most important FTA that Korea finished recently its negotiation is Korea-EU FTA initialled on October 15 2009.

**[Table 1] Korea's FTA (as of April 2010)**

Implemented (date of entry into effect)	Singed or finalized	Under negotiation	Under study or preparation
Korea-Chile (01/04/2004)	Korea-US (Signed, 30/06/2007)	Korea-Canada	Korea-Japan
Korea-Singapore (02/03/2006)		Korea-Mexico	Korea-China
Korea-EFTA (01/09/2006)		Korea-GCC	Korea-China- Japan
Korea-ASEAN (good, 01/06/2007)		Korea-Australia	Korea- MERCOSUR
Korea-ASEAN (Investment, 01/09/2009)		Korea-New Zealand	Korea-Russia
Korea-ASEAN (Service, 01/05/2010)		Korea-Peru	Korea-Israel
		Korea- Colombia	Korea-SACU
		Korea-Turkey	

Source: Ministry of Foreign Affairs and Trade, Korea (2010)

Currently, the EU is Korea's the second important trading partners after China and Korea has been recording the most important trade surplus with the EU. The EU is the single largest foreign investor in Korea, accounting for 68% of total inward FDI that Korea hosted in 2008. In this context, Korea-EU FTA is very important in Korea's trade policy.

The purpose of this paper is to overview the Korea's FTA policy in focusing Korea-EU FTA with special attention to what Korea-EU FTA brings about for trade policy of both Korea and EU. The first section overviews development of Korea's FTA policy. Particularly, we argue why Korea have begun to ride on FTA "*bandwagon*" since the late 90s. The second section discusses development of EU's FTA policy, focusing on reasons that the EU decided to take active FTA policy since middle 2000. The third and fourth sections portrays the negotiations of Korea-EU FTA and main outcome with its expected implications on the economies of Korea and the EU.

## **1. Korea's trade policy on FTA**

### **1.1. Changes in Korean trade policy towards FTA**

Korea's trade policies experienced major change since mid 90s in the wake of East Asian financial crisis. In the past, Korea used to give priority to the multilateral trading system and had not shown particular interest on regional grouping as trade policy except limited cases. Korea has been always been an ardent supporter of the multilateral trading system. It is only since late 90s that Korea has

shown active engagement in FTA policy. Why did Korea turn to FTA? There are external circumstances which pushed Korea to move on FTA negotiations.

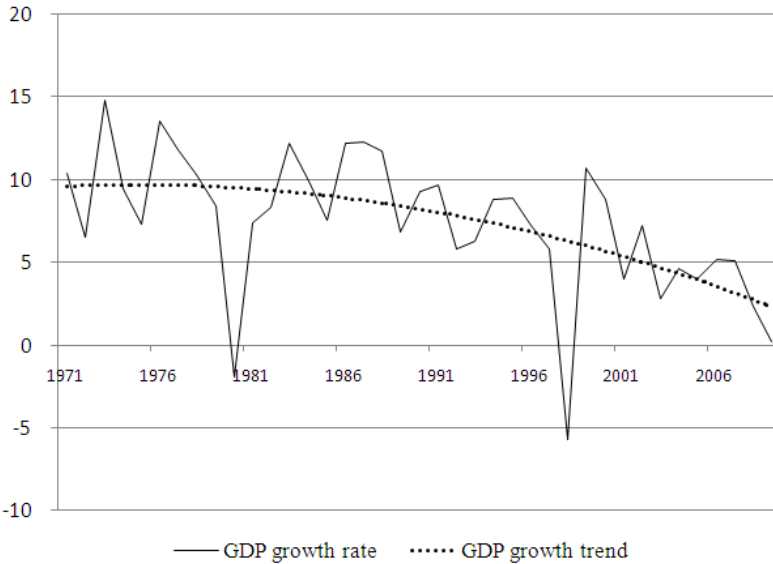
First, ongoing Doha Development Agenda (DDA) began to lose its momentum for trade liberalization with Singapore issues, especially since the Ministerial Conference in Cancun in 2003. As export-oriented economy, Korea was one of countries who took the most advantage of trade liberalization in the framework of GATT/WTO. As DDA has slowed down with its less expected outcomes, it was increasingly necessary for Korea to seek for market access beyond the multilateral framework. In Korean policy circles and business society, bilateral FTAs were considered increasingly as alternative way to secure market access in main trade partners.

Second, many developing countries had turned to regionalism to use FTAs as their development strategy since late 90s. In this context, emerged a shared view that Korean firms would be disadvantaged in global competition, unless Korea concludes FTAs with its trading partners. This led Korea to enter into FTA race, which termed often, "*bandwagon effect*" or "*domino effect*".

Third, since 90s, new developing economies such as BRICs – Brazil, Russia, India and China - have caught the attention of Korean policy makers. Especially the emerging China has been good opportunities for Korean economy in general, because China became the most important Korean trading partner. But emerging China was considered as threat as well. China was hardly affected by

economic turmoil that most of its neighbour experienced during East Asian financial crisis and it consolidated its position as world factory. China is the world's largest recipient of FDI and much of the investment is aimed at export-oriented production. The economic expansion of China in trade and FDI has been threat to neighbouring countries especially to Korea.

**[Figure 1] Korea's economic growth rate in 1971-2009 (%)**



Source: National Statistics Office, Korea

With these reasons related to changes in international contexts, there were arguments in favour of FTA which reflected domestic situations of Korean economy. The first



argument concerns slowdown of Korean economic growth. Korea achieved growth miracle from late 60s to mid 90s. But the growth of Korean economy has weakened since the East Asian Crisis in late 90s. Annual growth rate was 9% on average throughout 80s but it fell down to 5.7% in 90s and since 2000, it has stagnated around 3.5%. In this context, it has been necessary to find new momentum for growth. FTA began to be considered as proper policy to boost economic growth through increase in exports and inward investment from foreign investors.

The second argument was that Korea has asymmetric industrial structure in terms of productivity. Korea's manufacture industries became quite robust and Korean companies record one of the highest performances in the global market. But when it comes to Korea's service industries, Korea has completely different picture. Service industries in Korea account for 67% of total employment but its share in GDP is 58% which is very low level, compared to OECD countries. Korea's service sectors are characterized by small and family type companies which are highly concentrated on hotel and catering sectors. In order to improve the productivity in Korean service sectors, policy makers recognized increasingly the role of competition resulting from opening Korean service market. Liberalizing service sectors allow foreign investor to come to Korea which can contribute eventually to increasing competitiveness of Korea's service industries, despite of short-term adjustment cost.

**[Table 2] International comparison of labour productivity based on purchasing power parity (2006)**

	Korea	Germany	United Kingdom	France	Luxembourg	Czech Rep.	Poland
Service	100 (100)	168 (226)	146 (213)	192 (251)	289 (378)	109 (61)	117 (75)
§ Retailing, Restaurant and hotel	100 (100)	221 (298)	227 (331)	284 (372)	320 (419)	212 (118)	265 (170)
§ Distribution and telecommunication	100 (100)	114 (153)	138 (201)	132 (173)	262 (343)	100 (56)	86 (55)
§ Financial, estate and business service	100 (100)	149 (201)	128 (186)	177 (232)	233 (305)	75 (42)	104 (67)
§ health and education	100 (100)	144 (194)	124 (182)	156 (204)	201 (263)	88 (49)	92 (59)
Manufacture	100 (100)	91 (123)	98 (143)	100 (161)	105 (167)	68 (82)	53 (89)

Note: Labour productivities are adjusted with reference to Korean labour productivity as 100. The values in parenthesis are calculated using US dollars instead of PPP.

Source: OECD, Korean Productivity Centre

## 1.2. Development of Korea's FTA policy

Korea's FTA policy dates back to late 90s. In November 1998, the inter-ministerial meeting on the foreign economic policy (chaired by the Prime Minister) declared that Korea would start negotiations to push for

FTA. Chile was chosen as the first FTA partner in consideration. Mains reasons Korea gave preference to Chile were as following: first, Chile was one of highly open countries in terms of trade policy in South America and it had been already negotiating FTAs with its several trade partners including US. Second, Chile's trade structure was rather complementary to that of Korea. For agriculture which is the most sensitive sectors that Korea has always kept defensive stance on, market opening to Chilean products was regarded less problematic, because of seasonal difference. Third, Chile sought for FTA with Korea.

**[Table 3] FTA Roadmap and principles in FTA policy**

1. Multiple-track FTAs	Seek for multiple-track FTAs with major trade partners in strategic and active way in order that Korea can catch up with countries who have been already on FTA race
2. Advanced and comprehensive FTAs	Look for advanced and comprehensive FTAs which include investment, service, intellectual property, competition and government procurement in order to maximize effects of FTAs.
3. Transparent procedure in preparing FTA policy	Bring forward concrete blueprints on every FTA on perspective and organize public hearings in order that the Government can get public support and confidence on its trade policy.
4. Diplomatic consideration in FTA policy	Take into consideration not only economic factors but also political and diplomatic factors.

Source: Ministry of Foreign Affairs and Trade, Korea (2003)

Korean Government started negotiating with Chile in December 1999 and the negotiation was finalized in October 2002. Trade with Chile accounted for very small part in Korea's total trade and so economic impact of the Korea-Chile FTA was expected small. However, the ratification of the FTA took 16 months in the wake of polemics involving not only political parties but also farmers' union and NGOs.

From this experience Korean Government recognized that it is necessary to build more coherent and justifiable objectives for FTA policy in order to obtain public support. With this aim, in September 2003, the Government set up "FTA Roadmap" which states coherent and concrete principles on FTA policy. Its four principles are as following: 1) multiple-track FTAs, 2) advanced and comprehensive FTAs, 3) transparent procedure in preparing FTA policy, 4) diplomatic consideration in FTA policy. With these principles, the Government selected FTAs partners in near future (negotiation in 2 years) and those for more long term perspective (negotiation in more than 3 years). [Table 4] presents the list of countries in the FTA Roadmap.

Trade with five major trade partners (US, China, Japan, EU and ASEAN) accounts for more than 90% of Korea's total trade and they were selected as medium and long-term FTA partners. Recognizing that FTA with these countries would require preparatory period, the Government fixed FTA with other small and medium economies in short term.

**[Table 4] FTA Roadmap and list of FTA partners according to time schedule**

Perspective	Countries in consideration	Remarks
Short-term (in 2 years)	Japan, Singapore	<b>Start negotiations as soon as possible according to the joint feasibility studies conducted by Government, academic institutions and industries</b>
	ASEAN, Mexico, EFTA	<b>Prepare negotiations or joint studies when appropriate conditions meets</b>
Medium and long term (in more than 3 years)	USA, EU, China	<b>Progressive approach</b>
	Israel, Peru, Panama, New Zealand, Australia	<b>Countries who have shown their intention to conclude FTAs with Korea</b>
	Canada, India	<b>FTA partners on perspective</b>

Note: Canada and India were reclassified as FTA partners of short-term

when the Roadmap was revised in May 2004

Source: Ministry of Foreign Affairs and Trade, Korea (2003)

## 2. EU's FTA policy

### 2.1. Changes in EU trade policy toward FTA

Since Treaty of Rome which defined the European Community (EC) as a customs union with a common external tariff, the EU has adopted common trade policy –

common *commercial* policy in EU's official term. The same import duties are charged on imports from third countries regardless of the country of entry. The main principles of customs law are regulated at EU level, although the customs authorities of the Member States are in charge of their application. In addition, trade remedies against unfair trade practices such as anti-dumping and countervailing measures and safeguards are adopted by the EU and imposed on the imports concerned regardless of the country of entry. Import regulations and export controls are also applicable EU-wide. The common commercial policy is based on Article 113 (which became Article 133 in the Treaty of Amsterdam) of the Treaty of Rome: *The common commercial policy shall be based on uniform principles, particularly in regard to changes in tariff rates, the conclusion of tariff and trade agreements, the achievement of uniformity in measures of liberalization, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies.*<sup>2</sup>

The EU had shown its preference to multilateral negotiations for trade issues. The official position of the EU on FTA till mid 2000 was to give clear priority to the ongoing Millennium Round in the WTO rather than bilateral FTA which might distract its attention and resources from

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<sup>2</sup> This text also served as legal basis for other external competences of the EU such as environmental protection, social rights, fisheries policy and the common agricultural policy. The Court of Justice considered that Article 113 could serve as a basis for the Generalized System of Preferences (GSP) in favor of developing countries, because the GSP scheme concerns change in common external tariffs.

trade liberalization at multilateral level. This direction of EU trade policy had been reiterated on several occasions by Pascal Lamy, then EU's trade commissioner (1999-2004).<sup>3</sup> The EU exercised a *de facto* moratorium on new FTA negotiations from 1999 to 2006. Some exceptions were FTAs with Chili, Mexico and South Africa, for which the negotiations had already started. This informal policy is closely related to the personal direction of Pascal Lamy, who put priority to a comprehensive multilateral round, but it was based on a consensus of the Member States and the Commission during the preparations for the Millennium Round.

However, the EU's stance on FTA started to change in 2003. What has led to the shift in EU policy on FTAs? We can advance following reasons which brought the EU to revise its trade policies. First, there have been the difficulties in multilateral negotiations in DDA. The Ministerial meeting in Cancun in December 2003 failed in producing agreement on major issues "Singapore issues" (government procurement, trade facilitation, investment, competition). This brought the EU to drop investment, competition and government procurement from DDA negotiations. As the DDA was expected to have limited outcome to liberalize service and non-agricultural market access (NAMA), it became clear that DDA would not bring about what the EU had been seeking for through DDA.<sup>4</sup>

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<sup>3</sup> See Lamy (2002).

<sup>4</sup> As did most of countries, the EU continued to favor multilateral negotiations. In a policy statement in November 2003, the Commission expressed that the DDA remained the priority despite of difficulties. But it articulated that FTAs would not be excluded in

Second, there has been considerable change in US attitude on FTA. In 1990s US trade policy put clearly priority on multilateral negotiations on trade issues in the framework of the WTO. US resorted to the RTAs only occasionally in order to break the ice in WTO agenda. For instance, even though US was active proponent of CUSFTA, NAFTA and APEC, its trade policy did not strongly focus on these trade agreements and cooperation mechanism.<sup>5</sup> They are rather limited to offering examples of trade liberalization which would be used as references in multilateral trade liberalization. However, since early 2000, US Government started to consider bilateral FTAs as possible alternative to multilateral liberalization, which is qualified as "*competitive liberalization*". This new trend of US trade policy has been observed in negotiating CAFTA and KORUS FTA. Facing to this external challenge, it became harder for EU not to respond to this external challenge, because European firms would have to compete with American firms in a disadvantageous position.

Third, it has been increasingly necessary for the EU to be present in East Asian economies which had been

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principle, if they brought about clear economic benefits and, particularly in cases of region-to-region agreements.

<sup>5</sup> For example, the APEC is indicated as a desirable form of regionalism, termed as "Open regionalism" through 1990s (Bergstern 1996). But the conceptual rise of open regionalism has its origin in the protection of the multilateral trading system. An increasing number of RTAs may divide the multilateral trading system into fragmented trading blocs, which suggests that regionalism may be a "stumbling stone" to multilateralism (Deblock 2005).



achieving high economic growth. There was growing pressure from EU exporters and investors in the region for the EU to launch trade negotiations in order to take advantage of this economic burgeoning. All the more since late 90s, a number of East Asian countries started to negotiate FTAs as parts of their development policy. Despite of high economic presence in East Asia, the EU was latecomer for FTAs with East Asia. As the US shows willingness for FTAs with some countries such as Singapore and Korea, the EU had to shift priority on trade policy to this region.

## 2.2. Development of EU's FTA policy: Global Europe

In mid 2000s, EU business circles and external trade surroundings put increasingly pressure to EU for bilateral FTAs. There were increasing concerns that industries of emerging countries like India, Brazil and China would become more competitive than European ones, as their rapid economic growth overwhelmed that of European economies. In this context, the arrival of new trade commissioner, Peter Mandelson brought new point of view on bilateral FTAs. He argued that carefully constructed and ambitious bilateral agreements with carefully chosen partners could create new trade and improve the competitiveness of EU companies in key enlarging markets.<sup>6</sup>

Incorporating new objectives in external trade policy, in October 2006, the European Commission presented a

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<sup>6</sup> See Mandelson (2006).

communication, “Global Europe: Competing in the world”, later known as, “*Global Europe*”. The communication emphasizes the role of the EU’s external trade policy which contributes to EU’s competitiveness in foreign markets. While the EU remained committed to the WTO and Doha negotiations, the Communication put forward a new approach for FTAs. “*If approached with care, FTAs can build on the WTO by tackling issues which are not ready for multilateral discussion and by preparing the ground for the next level of multilateral liberalization.*”<sup>7</sup> Considering that it is hard to deal with investment, public procurement, competition and intellectual property right in the WTO, negotiating comprehensive FTAs with like-minded countries was regarded as second best options in realistic terms.

In order to select FTA partners, the European Commission proposed the key economic criteria, as following: 1) market potential (economic size and growth) 2) the levels of protection against EU exports (tariffs and non-tariff barriers) and 3) potential partners’ FTA negotiations with EU competitors (potential discriminatory impact on European firms). On the basis of these principles, the European Commission identified the ASEAN, Korea and MERCOSUR as “*priorities*”. India, Russia and the Gulf Cooperation Council (GCC) as having combinations of market potential and levels of protection which make them of direct interest to the EU despite their relatively low profile in FTA policy.

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<sup>7</sup> See European Commission (2006).

In addition to using fully economic criteria for selecting FTA partners, the Global Europe is notable in following aspects. First, it aims an ambitious and advanced FTAs. The Communication stated that new competitiveness-driven FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalization including far-reaching liberalization of services and investment. Second, ongoing or scheduled FTA negotiations with EU's competitors (implicitly US) were also taken into account. Third, the new FTAs explicitly focus on tackling non-tariff barriers through regulatory convergence and to contain strong trade facilitation provisions, intellectual property right and competition. This meant that the FTA model that the Commission wanted to construct was deep integration which seeks to harmonize trade-affecting rules. The objectives in EU's FTA policy corresponded to what Korea has been seeking for in its FTA Roadmap.

### **3. Negotiating Korea-EU FTA**

#### **3.1. Development of negotiation**

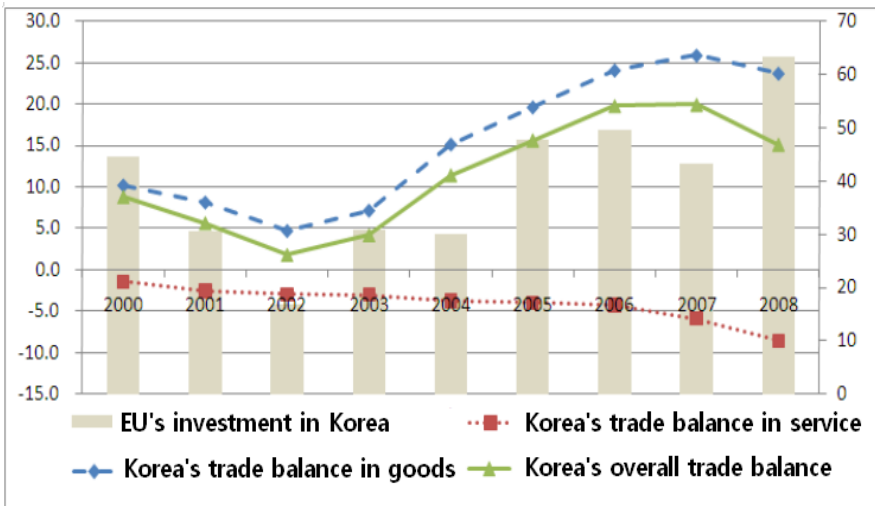
The official negotiation of FTA between Korea and the EU is launched in May 2007. In fact, both parties had organized preparatory meeting since July 2006, which hinted at EU's FTA policy had changed before official announcement of the Global Europe. In Korea's point of view, an FTA with the EU was important in that the EU is the Korea's second largest trade partners and Korea's trade (in goods) surplus with the EU is the most important than with any other trade partners. The EU is also the

most important single investor in Korea, accounting for 43% of Korea's total inward FDI on cumulative basis (1962-2008). When Korea set up FTA Roadmap in September 2003 for more coherent and concrete FTAs, the EU was included as FTA partner in line with US and China.

### [Figure 2] Korea's trade and inward FDI with the EU

(trade balance: billion US \$)

(investment: 10 million US \$)



Source: National Statistic Office, Korea

Official negotiations of Korea-EU FTA took 2 years and 2 months and the FTA was initiated on 15 October 2009. Korea already finished FTA negotiations with US and signed the deal in June 30 2007. This allowed Korean Government to have technical know-how of negotiation and a reference of an advanced FTA. The EU sought for a

comprehensive and advanced FTA with Korea which was the most advanced economy as bilateral FTA partner so far.

### [Table 5] Chronology of negotiations in Korea-EU FTA

Preparation
<ul style="list-style-type: none"> <li>▪ 15/05/2006 - Korea-EU Trade Ministerial Meeting agreed on organizing a preparatory meeting on Korea-EU FTA</li> <li>▪ 19/07/2006 - 1st Preparatory meeting on Korea-EU FTA</li> <li>▪ 26~27/09/2006 - 2nd Preparatory meeting on Korea-EU FTA</li> <li>▪ 24/11/2006 - Public hearing on Korea-EU FTA</li> <li>▪ 06/12/2006 - Consultation meeting of stakeholder on Korea-EU FTA</li> <li>▪ 01/05/2007 - Approval of Inter-Ministerial Meeting on Foreign Trade Policy</li> </ul>
Negotiation
<ul style="list-style-type: none"> <li>▪ 06/05/2007 - Declaration of opening the official negotiation</li> <li>▪ 07~11/05/2007 - 1st negotiation</li> <li>▪ 16~20/07/2007 - 2nd negotiation</li> <li>▪ 17~21/09/2007 - 3rd negotiation</li> <li>▪ 15~10/10/2007 - 4th negotiation</li> <li>▪ 19~23/11/2007 - 5th negotiation</li> <li>▪ 28/1~01/02/2008 - 6th negotiation</li> <li>▪ 12~15/05/2008 - 7th negotiation</li> <li>▪ 23~24/03/2009 - 8th negotiation</li> <li>▪ 13/07/2009 - Finalization of the FTA</li> <li>▪ 15/10/2009 - Initialing of the FTA</li> </ul>

Accordingly, the Korea-EU FTA is the most comprehensive FTA ever negotiated by the EU. Import duties are eliminated on nearly all products (97.3% of Korean products for EU market by number of items) and

service market is further liberalized than KORUS FTA (KORUS Plus). Composed of 15 Chapters, The FTA includes provisions on investments (termed as establishment due to the Commission's mandate in trade negotiation) both in services and industrial sectors, provisions on intellectual property and competition rules.

### 3.2. Difficult issues in negotiations

Two issues delayed the finalization of overall negotiation to the end; 1) duty draw back system and 2) rule of origin. Korea and EU showed a very clear divergence on duty drawback system (DDS) from the beginning. From Korea's point of view, the DDS is crucial support system, especially for small and medium enterprises (SME) that rely heavily on outsourcing to China and Southeast Asia for intermediate goods. Without DDS, any kind of FTA would not bring about tangible economic benefits to Korean firms. It seems that European negotiators sufficiently realized that DDS is important for Korean Government not only for economic background, but also for political reasons. In order to gain ground from Korean exporting firms, it was necessary for Korean Government to maintain its DDS which dated back to 1964 in Korean custom system. The problem is that the EU did not have precedent to include DDS in the previous FTA with third countries (i.e. Chile, Mexico and South America). The reason for not including DDS in FTAs can be found in trade structure of European countries which rely mainly on intra-European trade for supply of intermediate products. More developed Western European firms have taken advantage of the European enlargement toward Eastern

Europe that is less developed than the West. As a result they tend to rely less on outsourcing out of the EU and DDS is less important for them.

However, relative indifference of the European Commission on the DDS turned to be its preoccupation, as major industrial associations – especially car makers' association - showed their concerns about Korea's DDS and its positive effect on price competitiveness of Korean products. The European Automobile Manufacturers' Association (ACEA) opposed strongly to the Korea's intention to include DDS in the Korea-EU FTA. The ACEA argued that approving DDS in the framework of the Korea-EU FTA would offer a disproportionate competitive advantage to the Korean auto industry when exporting to the EU. It insisted that this would set a precedent for other FTAs the EU was scheduled for in the Global Europe.

In finalizing the negotiations, Korea and EU reached a compromise. In the final deal, the EU agreed to allow Korea to maintain current DDS (on average 8%) on Korea's export to the EU for 5 years after entry into force of the FTA. When Korea's imports of intermediate goods increase rapidly after 5 years of grace period, EU can limit DDS to 5%.

Setting a threshold of local contents in rule of origin was also one of issues that two parties have very different objectives from the beginning. As for DDS case, EU had precedent which served as a principle; EU used to set a percentage of the locally produced contents in a final product to 60% in the previous FTA with Chile, Mexico and

South Africa. This meant that in order to be qualified as “Made in Korea, Korean-produced content should exceed 60% of total value of the products concerned. Initial proposal of Korea for local content share was 35%, which was applied in the KORUS FTA. In final deal, EU agreed on reducing threshold of local contents to 45%.

#### **4. Economic implication of Korea-EU FTA for Korea**

Impact studies based on computational general equilibrium (CGE) model is the most commonly used method to evaluate possible impact of a FTA on macroeconomic performance, as well as on its sectoral effect. According to Kim et al. (2005) Korea-EU FTA will bring about considerable benefits to Korea's economy. In static model, the implementation of Korea-EU FTA will contribute to increasing Korea's GDP by 0.64~2.02% and Korea's exports by 2.11~2.62%. In capital accumulation model, Korea-EU FTA generates an increase of 2.62~4.57% in Korea's GDP and 2.11~2.62% in Korea's exports.

When it comes to the EU, the expected impact on the EU's economy is rather small in relative terms, because the EU's economy is larger by 14 times than Korea's. The implementation of Korea-EU FTA contributes to increasing EU's GDP by 0.03~0.10% in static model and 0.05~0.16% in capital accumulation model. But in absolute terms, EU is expected to gain benefits equivalent to what Korea gains.



**[Table 6] Macroeconomic impact of Korea-EU FTA on Korean economy (%)**

Scenario	Static model			Capital accumulation model		
	I	II	III	I	II	III
GDP	0.64	1.97	2.02	1.08	3.04	3.08
Income	0.67	2.11	2.16	1.01	2.92	2.96
Welfare	0.25	1.30	1.34	0.72	2.42	2.45
Exports	2.11	2.70	2.62	2.90	4.57	2.62
Imports	2.93	3.95	3.81	3.40	5.08	3.81
Terms of trade	0.36	0.66	0.67	0.21	0.30	0.32

Note: Scenario I – 100% removal of tariff on agriculture and manufacture, Scenario II: 100% removal of tariff on agriculture and manufacture and 50% removal of tariff equivalent on service, Scenario III: 50% removal of tariff on agriculture and 100% removal of tariff on manufacture and 50% removal of tariff equivalent on service.

Source: Kim et al. (2005)

From Korea's point of view, the industry taking the most advantage is automobile industry. Since EU's tariff on car is still high (10% for passenger cars and 22% for commercial vehicles) and Korea's exports to the EU are important, exports to the EU will substantially increase. However, imports from the EU will increase also, especially in large cars, considering current upward trend of imports in this category. Exports in electric/electronic products will increase especially for TV and VTR, but

increase in export in semi-conductors and telecommunication equipments will be minor, because tariffs on these items are already very low.

Imports from the EU will substantially increase in equipment and machinery, since Korea's tariffs on machinery (5.9%) is much higher than EU's (1.8%). In Korean machinery market, competition is quite strong between European, American and Japanese suppliers. Implementing the Korea-EU FTA will hamper the competitiveness of Japanese suppliers and it is expected that imports from the EU will replace those from Japan. Another sector where EU will find increase in export opportunities is chemical related sectors. Currently, EU has an important trade surplus in these sectors and Korea's tariffs (7.2%) on chemical products are higher than those of EU (4.2%).

In service sectors, it is expected that Korea will continue to have strong trade deficit with EU. Korea's service industries in legal, financial, communication and broadcasting services are less competitive than European service industries and trade deficits in these sectors will a lot increase. The EU is highly specialized in business, legal and financial services and European service suppliers will take more market share in Korea. For the time being, this trend will continue. Actually, half of service trade takes place by commercial presence (mode 3 of service trade) and EU's investment in Korea is much more important in service sectors than manufacturing industries. It is expected that EU's investment in service industries in Korea will increase.

## Conclusion

Trade policy based on FTA has been global trend in 2000s and Korea is completing FTA negotiations with its main trade partners. Korea is the only country with large industrial production capacity (within 10th in global ranking) who finalized successfully the FTA negotiations both with US and EU. In this sense, Korea-EU FTA is said that it offers the Korea's economy advantageous position vis-à-vis other countries. But this FTA policy based on "*hub and spoke*" structure may be temporary, as more countries are willing to conclude FTAs with their major trade partners. Besides, FTAs are not cure-all for economic development. Success of FTA still depends on domestic factors such as quality of institutions, labor policy and overall capacity of innovation taking advantage of trade and investment opportunities created by FTAs.

In this regard, Korea-EU FTA is particularly important for Korean side in that it address harmonization of trade-impeding regulatory policies. The examples are the scheduled elimination in automobiles and electronics. In addition to that, the Korea-EU FTA provides for some real achievements in services which go beyond existing commitments in the GATS. Although its wordings are based on GATS commitments of both parties, it includes WTO plus elements in areas such as financial services and telecommunications, maritime transport services and e-commerce.

From European perspective, Korea-EU FTA provide new grounds to the EU's trade policy in two aspects; it is the first FTA negotiated since Global Europe Initiative and also the first trade deal, for which the Lisbon Treaty will be applied for its ratification and implementation. If we attempt to advance one more new feature, the FTA is the first comprehensive FTA where the EU meets US through same FTA partner. The KORUS FTA was used as reference and previous experience for Korean side in negotiating with the EU. The texts of both FTAs are much alike in terms of coverage, mode and actual level of liberalization. This means that Korea-EU FTA provided both US and EU with occasions to converge in their FTA terms, which can make a reference case for future FTAs.

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