AN ASSESSMENT OF THE EU-KOREA FTA
Abstract

The free trade agreement negotiated between the EU and the Republic of Korea (EU-Korea FTA or the Agreement) is far-reaching. In terms of the scope of tariff liberalisation it goes beyond anything the EU has agreed in previous agreements. The coverage of services is also ambitious. In a range of other measures, such as the treatment of technical barriers to trade, protection of intellectual property rights including geographic indicators, as well as provisions on dispute settlement and sustainable development the Agreement breaks new ground. It therefore represents forward movement on trade at a time when multilateral negotiations in the Doha Development Agenda (DDA) continue to stagnate and international trade needs of promoting in the wake of the financial crises induced slow down.
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EXECUTIVE SUMMARY

The free trade agreement negotiated between the EU and the Republic of Korea (EU-Korea FTA or the Agreement) is far-reaching. In terms of the scope of tariff liberalisation it goes beyond anything the EU has agreed in previous agreements. The coverage of services is also ambitious. In a range of other measures, such as the treatment of technical barriers to trade, protection of intellectual property rights including geographic indicators, as well as provisions on dispute settlement and sustainable development the Agreement breaks new ground. It therefore represents forward movement on trade at a time when multilateral negotiations in the Doha Development Agenda (DDA) continue to stagnate and international trade needs of promoting in the wake of the financial crises induced slow down.

The Agreement is compatible with the letter of the WTO. The comprehensive coverage of tariffs and the pace of liberalisation and scope for services commitments leave little doubt that the Agreement is compatible with Art XXIV of the GATT and Art V of the GATS. Beyond market access provisions the rules governing non-tariff and regulatory barriers to trade are, for the most part, consistent with the provisions of the WTO. Where provisions go beyond the WTO rules, such as in the case of sector arrangements for addressing technical barriers to trade these tend to apply WTO principles. The Agreement also favours the use of agreed international standards and norms. In one or two areas of EU offensive interests the Agreement is WTO-plus, as is the case for geographic indicators (GIs) and other aspects of IPR. The impact of bilateral FTAs and thus the EU-Korea FTA on the prospects for future multilateral liberalization remains an issue of contention. Such agreements can be seen as liberalizing, but the creation of preferences can also be trade diverting and reduce the incentive for those benefiting to seek multilateral agreements.

At a time when KORUS (the Korea – US FTA) is making no progress towards ratification due to the inactive status of US trade policy, and negotiations between Korea and its other major trading partners (China, Japan and ASEAN) are still at a relatively early stage. Prompt application of the Agreement offers a window of opportunity for EU first movers on the Korea market. The EU – Korea agreement may also help frame the agenda for the current ‘generation’ of EU FTAs, such as those being negotiated with ASEAN countries, India and other partners.

The overall welfare effects of the Agreement are modest for Korea and very modest or negligible for the EU. Welfare gains for Korea of 1% of GDP have been estimated and 0.03% for the EU. The higher gains for Korea stem from the fact that there is greater protection in Korea, so that liberalisation will bring about greater benefits than in the more liberal EU. Some caution is called for when assessing the figures from quantitative studies. For example, a key study was based on the assumption that the DDA would be completed on the basis of certain assumptions on the coefficients for industrial and agricultural tariff reductions. Failure to complete the DDA means that most favoured nation tariff (MFN) rates are higher than in the models, so that the trade creation from the Agreement may be greater, as may the potential for trade diversion. The CGE models used typically also underestimate the growth effects of comprehensive FTAs that tackle regulatory and other barriers to competition. Enhanced competition within the markets results in more effective use of resources that creates growth and increases trade. Despite qualifications regarding specific estimates of the impact all the studies point to modest or very modest effects on GDP.1

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1 See section 3 below for details. This report was drafted before the report commissioned by DG Trade from CEPII/ATLASS was available. CEPII/ATLASS The Economic Impact of the Free Trade Agreement (FTA) between the European Union and Korea; report for the European Commission, May 2010. This latter report provides estimates of the impact based on the actual commitments made in the agreement and covers in particular non-tariff/regulatory barriers to trade and suggests somewhat higher gains in trade, especially for the EU and higher increases in EU GDP of 0.08%. The overall results of the later study are however broadly consistent with those assessed in this report. See Annex 2 for a detailed discussion of the CEPII study.
The trade effects of the Agreement are such that more EU sectors stand to make trade gains (increased trade surpluses with Korea) than those that stand to lose. Sectors such as business services, machinery, agri-foods, pharmaceuticals and chemicals are well placed to gain from the Agreement. The projected gain for business services is, for example, a 22% increase in exports. Indeed 70% of the EU gains are attributed to the service sector. Machinery is also expected to gain, with an estimate of 16% increase in trade. Agri-foods as well as chemicals and pharmaceuticals the EU also have a trade surplus with Korea. There is a need for some qualification of these potential gains however. First the estimated gains for services are based on some rather risky assumptions about the level of existing barriers to services. Unlike tariffs, the regulatory barriers to services trade are not readily quantified. So the figures should be treated with some caution especially in such diverse sectors as business services.

The removal of tariff barriers is also only part of the picture. Continued growth in EU exports of machinery, agri-foods, pharmaceuticals, as well as access for automobiles, will depend on a number of factors. For all EU export sectors, but in particular for automobiles, machinery and electronics and electrical equipment the effectiveness of the provisions in the Agreement in removing and preventing technical barriers to trade will be crucial. For pharmaceuticals as well as other sectors the effectiveness of the provisions on intellectual property rights will have an important bearing on the benefits of the Agreement as Korea has been a major source of counterfeit products. The agri-food sector will also benefit if the provisions on the protection of geographic indicators (GIs) can be made to work. More generally access to service and goods markets will be affected by the contestability of Korean markets. The Korean economy has been characterised by oligopolistic firm structures and cross shareholdings in the Chaebol. Similar to other economies public procurement is also not fully open to de facto competition. The provisions of the Agreement on competition and government procurement will therefore also be important.

According to the studies commissioned on the Agreement the trade gains for Korea are concentrated in automobiles, textiles and electronics, where Korea has a comparative advantage. In automobiles this is focused on the small to medium sized cars. No less than 40% of the trade gains for Korea are projected to come from the car sector. While EU car producers have had some limited success in penetrating the top end of the car range they have not been able to compete in the middle to smaller car range. The estimates of the trade effects in automobiles including those in the CEPII/ATLASS study of May 2010 do not however seem to have considered the impact of recent Korean investment in EU production plants (in the Czech Republic and Slovakia). This FDI together with the impact of the recession appear to have resulted in a drop in the value of Korea car exports to the EU between 2006 and 2009, if continued this would mean imports from Korea would be increasingly substituted by Korean production within the EU. The automobile industry has expressed concern about the continued use of duty draw back under the Agreement. While duty draw back could be seen as providing an export subsidy for Korea exporters vis-à-vis EU producers selling in the domestic market, the level of financial benefits for the Korean producers seems to be modest (around 1 to 1.5 % of the price of a car, e.g. Euro 100-150 per car worth Euro 10,000) unless one takes some fairly extreme assumptions. One modeling simulation shows European automobile production increasing in response to the agreement. Whether or not this happens will depend critically on the extent to which heightened competition stimulates increased innovation and productivity among European manufacturers.

Overall, the net employment effects of the Agreement are also small to negligible. There are also unlikely to be major shifts or displacement of workers because trade expansion will tend to be concentrated in specialised manufacturing, services and agri-food and increasingly in exchanges of technology. At the

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2 The CEPII/ATLASS study addresses both these issues specifically.
3 On this and other details of the sectoral impact see section 5 below.
4 This is based on the assumption that Korea increasingly outsources production so that the foreign content could rise from below 15% to 25% in the medium term. With permanent duty drawback this could lead to an advantage of 1.6%, which with a tariff of 8% on 80% of Korean imports.
margin there could be modest shifts from unskilled to skilled labour. There are expected to be barely any changes in real wages. Increased competition in some sectors, such as cars and textiles, is however likely to result in some (possibly locally concentrated) displacement of workers (potentially also between locations in the EU), particularly in regions specialised on small and medium sized motor vehicles. This would justify the provision of adjustment assistance under the EGAF.

As noted above the benefits for the EU will depend importantly on how successful the Agreement is in addressing technical and other regulatory barriers to trade. This was something taken into account during the negotiation of the Agreement, so that effective measures on TBTs was seen by the EU as a quid-pro-quo for tariff liberalisation. The provisions on TBTs in the agreement break new ground in that they include targeted sectoral arrangements for key sectors (automobiles, machinery, electronics and chemicals). These sectoral agreements are significant in that they provide for an acceptance by Korean regulators of equivalence and that tests for EU automobiles for compatibility with UNECE standards will be accepted in Korea as satisfying equivalent Korean standards. Korea has also agreed to use international standards. But there will be a need to monitor new technical regulations such as on CO2 emission standards. With similar provisions for machinery and electrical equipment the Agreement has arguably addressed existing TBTs and has the potential to address TBTs in the future. Working Groups have been established to monitor developments in each of the key sectors and, in another innovation in trade agreements, there is provision for independent moderators to be brought in when there is a dispute over the applicability of an international standard. However, it has to be acknowledged that while the Agreement can remove tariffs definitively it cannot guarantee complete removal of TBTs as both parties (understandably) retain their right to introduce new domestic regulations regarding health, safety and the environment. Not all Korean regulations have been harmonised with EU or international standards and not all EU regulations of the remaining technical standards are accepted by Korean authorities. On the EU side regulations seen as important in addressing legitimate policy aims, such as REACH, are also seen to be TBTs by Korean exporters. In this context it is worth noting that the TBT sectoral agreement in chemicals is weaker than in sectors in which the EU has offensive interests. There are also provisions in the sanitary and phytosanitary field aimed at easing barriers to market access due to SPS measures.

The Agreement’s provisions on IPR appear to be in line with the EU policy, articulated in the Global Europe strategy, of seeking more effective enforcement. The provisions are TRIPs plus in that they require Korea to apply a number of international conventions and introduce provisions on criminal sanctions for illegal use of IPR. The provisions on IPR are also WTO plus in the sense that they include registers for both wines and spirits and other agri-food products. This extension of protection for GIs could represent a significant breakthrough for the EU if it sets a precedent for future FTAs and perhaps ultimately multilateral agreement.

An important dimension of the Agreement is therefore the introduction of rules and disciplines to address regulatory and other non-tariff barriers to trade. This is important for the EU because access to the Korean market is probably more affected by such measures than the EU. Disciplines are only effective if they are effectively implemented and enforced. The Agreement includes an unprecedented number of working groups and committees to monitor and promote implementation. When such conciliation fails there is provision for dispute settlement that offers faster remedies than currently available at a multilateral level in the WTO.

In two areas the Agreement is rather less ambitious and does not go much beyond existing international trade and investment agreements. These are competition and government procurement. In competition the Agreement must be seen in the context of the 2009 bilateral agreement concerning cooperation on anti-competitive activities between the EU and Korea that was negotiated in parallel with the FTA. This bilateral agreement promotes cooperation in enforcement of the respective domestic competition regimes and provides for positive comity. This then is what the EU must rely upon if there is anti-competitive behaviour on the part of Chaebol in the Korean market. On the other hand there are substantive provisions on state aid,
such as on transparency of aid programmes that are WTO-plus. In government procurement both the EU and Korea are signatories to the WTO’s (plurilateral) Government Procurement Agreement and this provides the basis for the EU-Korea FTA provisions. In two respects the FTA is GPA-plus. These are the inclusion of build-operate-transfer contracts and sub-central level procurement in the scheduled commitments.

The Agreement includes provisions on sustainable development. The most important aspect of these concerns labour standards, where the parties agree to comply with those ILO core labour standards that they have ratified. It should be noted that Korea has not ratified key Conventions (87 on the free of association, 98 on the right to organize and free collective bargaining, or 29 and 105 on forced labour). The Agreement does however, include provisions to promote the application of core labour standards and a peer review based system for addressing issues of non-compliance. This stops short of a ‘social clause’ that would include the use of trade sanctions for non-compliance.

The overall economic impact of the agreement will be more favourable to the extent that it is accompanied by complementary measures, including in the labour market, that facilitate necessary adjustment and adaptation and enable skills to match evolving needs.

On the issue of ratification of the Agreement, there is broad support across EU member states and EU business and organised labour for the adoption of the agreement. While there are concerns about the impact of the Agreement in some sectors notably automobiles and textiles, the trade and employment effects of the Agreement in these sectors are modest compared to other ongoing structural changes in the sectors concerned. There is also support for ratification in Korea, where the Agreement has benefitted from more support than the Korea US FTA (KORUS). The political objective of the EU (Council and Commission) and the Korean government is to implement the agreement before the end of 2010. There are a number of potential commercial advantages to be gained from earlier implementation, both for specific sectors, including the automotive exporters of the EU and general first mover advantages for EU suppliers in services as well as competitive gains from early preferential access to the Korean market as KORUS is still some way off ratification and Korea is still to complete FTA negotiations with China, Japan and ASEAN. Early ratification of the Agreement would also set a precedent for the FTAs the EU is negotiating with ASEAN countries, India and Mercosur.

Early implementation of the Agreement seems likely to mean provisional application of those parts of the agreement that fall under EU exclusive competence. Although the Lisbon treaty has extended EU competence, member states are likely to argue the Agreement is a mixed agreement, because of the provisions on criminal sanctions for non-compliance with IPR and elements of the protocol on cultural cooperation. The European Commission appears to favour a ratification sequence in which the Council would authorize signature of the agreement followed by a request for the EP to grant its consent, provisional application, and then ratification by the 27 member states. The European Parliament cannot make its consent conditional on any renegotiation of the Agreement, but can seek flanking measures such as in the form of the bilateral safeguard regulation or provisions on trade adjustment assistance.
1 THE EU – KOREA FTA IN CONTEXT

1.1 Ratification and implementation issues

Negotiations on the EU – Korea FTA were started before the Lisbon treaty was ratified but concluded after ratification. This has implications for the role of the European Parliament. Under pre-Lisbon treaty arrangements there was never any question of the Council sharing any of its powers to authorize negotiations. This meant that the EP had limited direct input into the EU’s negotiating objectives in the EU-Korea FTA. Inability to shape negotiating positions tends to considerably undermine the powers the EP when it comes to ratification. No direct say in negotiating objectives means the EP cannot indicate that its consent for any agreement will be conditional on certain aims being satisfied. In the pre-Lisbon treaty days the Commission was also not under any obligation to inform the INTA Committee of developments in negotiations on a par with the Trade Policy Committee (TPC).

With the ratification of the Lisbon Treaty the EP has enhanced powers in external trade relations, so that it has shared powers with the Council to adopt trade legislation by the ordinary legislative procedure (OLP), has unequivocal powers to grant consent for any trade agreement and the Commission is required to inform the EP (INTA Committee) of developments in trade negotiations as it does the member states in the (TPC). The EP previously had powers to give its ‘assent’ to trade agreements and major agreements have all been placed before the EP for its assent, by a simple majority. The Commission also provided the INTA committee with information on a par with what it provided to the Art 133 Committee.

1.1.1 Conditional consent to the FTA

The EP either grants its consent or not, there is no scope within the treaty or practice of EU policy for the EP to make its consent conditional on the EU negotiating improved provisions. This does not of course exclude the possibility of a political agreement between the EP and the Council and Commission on EU measures aimed at easing the costs of adjustment for those affected by the impact of the FTA with Korea or on strengthened safeguard measures as envisaged for the EU – Korea FTA.

1.1.2 Provisional application

The practice to date has been to provisionally apply trade agreements pending ratification by the member states. This has been necessary because of mixed competence in some important areas of trade policy. Thus aspects of trade in services, intellectual property rights and transport matters (such as liberalization of transport services), fell under member state competence. As ratification by the member state governments could take a considerable time, the practice has been to provisionally apply those aspects of any trade agreement that fell under EC exclusive competence.

The Treaty of Lisbon (Art 207) has brought more or less all trade and investment under EU competence. All trade in services is now EU competence as is the trade related aspects of intellectual property rights and foreign direct investment. But the EU – Korea FTA includes a number of provisions, notably criminal penalties for non-compliance with intellectual property right protection and aspects of transport, that still require the Agreement to be ratified by all 27 EU member states. The political aim of both the EU and the Korean government is to implement the Agreement during 2010. This means provisional application because ratification by all 27 member states during 2010 is unlikely to be possible, and raises the question of which EU institution shall decide on provisional application. To date the practice has been for the Council to agree to provisional application, but with its new powers under the Treaty of Lisbon the EP will wish to consider granting consent before provisional application of the Agreement.
1.2 Korea’s other FTAs

European Union suppliers of goods and services are competing in the Korean market with suppliers from other countries. When Korea negotiates FTAs with other parties this enhances the position of the EU’s competitors. Korea has in the past favoured multilateral trade policy, but since the Asian financial crisis of 1997/8 it has emerged as an active player in bilateral FTAs. To date Korea’s has three FTAs in force with Chile, EFTA (European Free Trade Association), and Singapore, in addition to a CEPA (Comprehensive Economic Partnership Agreement) with India. Korea has also signed an FTA with the US (KORUS), which awaits ratification by the US congress and the Korean parliament. With US trade policy inactive at the moment, immediate action by the US administration or Congress to ratify KORUS seems unlikely. Korea is also currently negotiating FTAs with Australia, Canada and Turkey and exploring the possibility of FTAs with China, Japan and a triangular FTA with China and Japan and supports ASEAN+3 (China, Japan, Korea) or ASEAN+6 (ASEAN + 3 + Australia, New Zealand, India).

Among the signed FTAs, the KORUS and EU-Korea FTAs are undoubtedly the most significant in that they are with Korea’s major trading partners and are comprehensive in their coverage. Before China opened up, the US was Korea’s (and East Asia’s) most important trading partner. During the last two decades or so, the US has been losing market share in trade with Korea and other Asian economies, and its trade deficits have deteriorated. Improving access and market share were therefore the main motivations of the US, which it pursued aggressively at the negotiation table. In comparison, the EU-Korea FTA is important in terms of market access for the EU, but also as a means of strengthening ties with Asia, and matching its US and Japanese competitor’s access to regional markets. For Korea the EU-Korea FTA represents reaching out to the global trading system whilst exercising credible pressure on the US as well as China and Japan. It was no coincidence that the Korea-EU talks began very soon after the US-Korea FTA was signed.

Studies of the welfare effects of an EU-Korea FTA discussed in overall terms in section 3 and in detail in section 5 below suggest that overall the EU-Korea FTA will benefit both parties, with Korea benefiting rather more. This is similar to the case of the US-Korea FTA. However, EU tariffs are generally a little higher than the US. In terms of the phasing of tariff liberalization, the pace of tariff liberalization in KORUS is initially faster than those envisaged in the EU-Korea FTA, even if some residual tariffs under KORUS are eliminated only after 10 years. Sectoral impacts from the FTAs show different patterns. The US would enjoy much greater trade gains in agri-food products than the EU from its FTA with Korea. Korea is expected to make trade gains in automobiles in both FTAs. There is slightly greater openness for manufactures in the EU-Korea FTA compared to KORUS, because the scope of abolition of tariffs is wider and liberalization takes place at a faster pace. On rules of origin, one of the most difficult areas in the EU-Korea negotiation, the EU—Korea provisions were agreed at a level, in terms of value content rules, close to that of the US-Korea FTA. In services Korea has agreed to the same degree of openness, i.e. legal and financial services, in both FTAs, but Korea offers the EU a little more in telecommunications and environment services. Unlike the US-Korea

5 The Washington Post after the interview with the South Korean president said (Hiatt, 2010), “Obama has expressed general support for increasing trade with South Korea but hasn’t committed to the pact that he and Lee inherited from their predecessors. Every analysis shows it would benefit most American consumers and industries, but it faces opposition from Ford Motor, some union leaders and some Democrats in Congress.”

6 The US-Korea FTA was signed on June 30, 2007.


8 It has been argued Jeffrey Schott (2007) that KORUS would have positive effects on the US auto industry as it will force domestic industrial reform to make the industry more competitive facing challenges brought by the FTA, but the effects of increased competition from Korean imports resulting from an FTA for both the EU and US must be seen against the massive adjustment that has and is taking place as a result of the recent recession and other structural changes in the international automobile sector.
FTA, the EU – Korea service sector negotiation went fairly smoothly, because the EU-Korea FTA opted for ‘positive’ listing of sectors to be liberalized, in contrast to the ‘negative’ listing of excluded sectors and activities in the US-Korea FTA.

1.3 Comparing the scope and pace of further market access: KORUS vs. EU-Korea

Early (within three years after the FTA is in force) tariff elimination by the KORUS works as follows: the US abolishes import tariffs for 82.2 percent of the Korean products whereas Korea abolishes 87.3 percent for the US goods. See tables 22 and 23 in the annex. The manufacturing sector shows higher rates: 91.2 percent for the Korean products imported by the US and 95.9 percent for US products imported by Korea, respectively. The agri-food sector shows the lowest rate: Korea abolishes import tariffs for 40.3 percent of imported US products, whereas the US for 59.3 percent of imported Korean agri-food products. The following table surveys tariff elimination of the two countries.

Table 1: Comparison of market access liberalisation: EU-Korea FTA and KORUS

<table>
<thead>
<tr>
<th></th>
<th>EU-Korea FTA</th>
<th>US-Korea FTA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goods</strong></td>
<td>• 7 years to completely abolish tariffs on imported manufacturing goods;</td>
<td>• 10 years to completely abolish tariffs on imported manufacturing goods;</td>
</tr>
<tr>
<td></td>
<td>• Asymmetry between the EU who abolish tariffs within 5 years and Korea within 7 years;</td>
<td>• Near symmetry between the US and Korea</td>
</tr>
<tr>
<td></td>
<td>• Early abolition of tariffs (within 3 years) by the EU on 97.3% (of tariff lines) and 96.9% (by the total value of the imports);</td>
<td>• Early abolition of tariffs (within 3 years) by the US: 92.1% (of tariff lines) and 94.6% (by the total value of the imports);</td>
</tr>
<tr>
<td></td>
<td>• EU tariff schedule: immediate elimination of tariffs (automobile parts, textiles, photocopiers, refrigerators, air-conditioners, etc.), within 3 years (medium/large passenger vehicles, tires, microwave ovens, etc.), within 5 years (small sized passenger vehicles, lorries, colour TVs, cameras, etc.), and complete elimination after 5 years</td>
<td>• US tariff schedule; immediate elimination of tariffs (passenger vehicles below 3000cc, colour TVs, LCD monitors, etc.), within 3 years (DTVs, passenger vehicles above 3000cc, golf products, etc.), within 5 years (tires, speakers, etc.), and within 10 years (microwave ovens, laundry machines, lorries, etc.)</td>
</tr>
<tr>
<td><strong>Services</strong></td>
<td>• Matches and in some cases exceeds the degree of opening in parity with the KORUS (such as in financial and legal services)</td>
<td>• Financial services, law firms, telecommunications, media, accounting and auditing, general consulting, etc.</td>
</tr>
<tr>
<td></td>
<td>• Certain areas agreed to additional opening like international satellite lines reserved for broadcast services and sewage disposal services</td>
<td>• Education and medical services not open</td>
</tr>
<tr>
<td></td>
<td>• Positive listing of sectors</td>
<td>• Negative listing (also in the Chile-Korea and Singapore-Korea FTA)</td>
</tr>
<tr>
<td>Agricultural products including meats</td>
<td>Rules of origin</td>
<td>Duty drawback</td>
</tr>
<tr>
<td>--------------------------------------</td>
<td>----------------</td>
<td>--------------</td>
</tr>
<tr>
<td>• Market opening to main agricultural products including meats, except rice</td>
<td>• Up to 45% of the components can be outsourced from outside of the country for making final manufactured goods such as automobiles;</td>
<td>• Permitted, after 5 years applicable on up to 5% of the duties.</td>
</tr>
<tr>
<td>• schedule (Korea): tariff abolition within 10 years for refrigerated pork meats, and 5 years for deep-frozen pork, etc.</td>
<td>• Kaesung designated outside the scope for the FTA, but as in KORUS there will be a study of this issue.</td>
<td></td>
</tr>
<tr>
<td>• Market opening to main agricultural products including meats, except rice</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Schedule (Korea): a variety of exceptions granted in terms of tariffs, quotas, seasonal duties, and special safeguards for controversial products</td>
<td>• abolition of long-term tariffs over 15 years for beef and deep-frozen pork</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Kaesung complex located just above the de-militarized zone in North Korea is designated as outside of the country</td>
<td></td>
</tr>
</tbody>
</table>

* The ratchet mechanism prevents a party to an FTA unilaterally reducing the level of market liberalization below that applied in the FTA.

### 1.4 Prospects for a trilateral Korea-Japan-China FTA

After the conclusion of the KORUS and EU-Korea FTA talks, a trilateral China-Japan-Korea FTA is gaining momentum. The summit meeting of the leaders of three nations held on October 10, 2009 accepted a proposal for a trilateral study group that will invite participation from industries, governments, academia and research centres. The first meeting of this group took place in Seoul on May 6-7, 2010 to adopt terms of reference for the activities of the group, review the related studies and exchange information about each country’s trade policy.

These plus 3 (from the ASEAN +3) countries are the largest economies in East Asia and account for over 80 percent of regional GDP (i.e. excluding India). They share similar cultural traditions in Confucianism and Buddhism. The recent economic success of China follows a track somewhat similar to that of Korea 30 years ago as growth is driven by low-cost labour intensive exports. Today, Korea is competing against Japan in international markets in most of its product lines, ranging from ship-building to automobiles and semiconductors. Increasingly strong economic links together with marked differences in their stages of economic development and industrial structure have raised the awareness of the potential of a FTA between the three nations.

Prior research suggests that Korea would be reluctant about the Japan-Korea FTA for fear that the dominant position of Japanese intermediate goods in Korea’s manufacturing would result in a deterioration of Korea’s trade balance with Japan. Similar concern about a deterioration of trade deficits for

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9 See an early work by Lee (2005)

10 Ministry of Foreign Affairs and Trade of Korea (2003)
China vis-à-vis Japan and Korea also militate against bilateral agreements, whereas a three way agreement may ease some of these concerns. Korea’s geographical location is central as is its intermediate position in terms of economic development and size.

China and Japan are also likely to have been influenced in favour of FTAs with Korea following the KORUS and now the EU-Korea FTA. China also views FTAs as a means of extending its power within the region, as may Japan. Korea has also maintained a very pro-FTA stance. It remains to be seen what the trilateral (plus 3) study group produces. A triangular FTA could, if it materialized, mean that the EU (and the US) might consider using Korea as a location for supplying goods and services to China and Japan.

1.5 Costs and benefits of a delayed application/ratification of the EU – Korea FTA

Concluding and ratifying FTAs typically takes quite a lot of time and political energy, as can be seen from the EU’s own experience with Mercosur and South Africa. Although the EU –Korea FTA has been negotiated fairly rapidly it is sensible to take a delay in ratification into account and consider its consequences. This section considers the short run and strategic issues in a delay of the EU – Korea FTA until at least 2011 or later but not the implications of non-ratification.

The short run economic issues of delay are essentially twofold: initial specific temporary access improvements and first-mover advantages for EU companies or specific sectors. The longer run considerations relate to the dynamics of the world trading environment, to the options of Korea in the fast-moving East – Asian economic cooperation, to the EU’s multilateral and bilateral or regional options and, not least to the place of the EU-Korea FTA in the Union’s Asia strategies.

1.5.1 Short-run economic issues

Late application would endanger or shorten temporary benefits in the form of the so-called ‘transitional quotas’ for cars from the EU currently not meeting Korean onboard diagnostic standards for monitoring emissions. These quotas will be granted by Korea for the full 2010 calendar year, even if the FTA is only implemented towards the end of 2010. Ratification in 2011 would mean the EU car industry would not benefit from this additional market access.

Delays in application may also affect opportunities for ‘first-mover advantages’ in several sectors strongly supportive of the FTA, as well as in one horizontal area. There are four sectors expecting ‘first mover advantages’ in the Korean market and the East Asian region if the FTA is applied before other important FTAs: non-electrical machinery (mechanical engineering), the chemical sector, pharmaceuticals and business services. Details are provided in the sectoral briefings in section 5. The common idea behind these ‘first mover advantages’ is that better access to the Korean market in comparative advantage EU sectors creates an edge, not so much over Korean competitors, but especially over US, Japanese or competitors from other OECD countries wishing to sell into Korea but which cannot build up critical mass, or, a steady customer base until their governments conclude a suitable FTA with Korea. A first mover advantage suggests that either ‘sunk costs’ (entry costs which cannot be recouped later) and/or economies of scale as well as image or branding generate lower costs on the local supply side and/or customer loyalty on the demand side, in the absence of rivals from other advanced countries. In other words, if Korea concludes FTAs with other trading partners competition on the Korean market will increase in such sectors, but these new competitors will be and remain at a disadvantage for many years to come. For example, if KORUS is not ratified for some years and Korea takes some years to negotiate agreements with China, Japan and ASEAN, EU companies will have a ‘window of opportunity’ to establish themselves on the Korea market. The later the application of the EU – Korea FTA the smaller the ‘window of opportunity’ for EU first movers. This reasoning hinges on the realization of the stated Korean FTA strategy. If this strategy fails due to resistance to ‘deep’ FTAs or continued non-ratification the costs of delay would be less.
The horizontal issue at stake is about standards. Asia does not have regional industrial standards. Nor is there a great tradition of aligning with ISO / IEC (world) standards although recent trends would seem to go in the right direction. It is in fact difficult to get a reliable overview of the industrial standards adhered to in Asia or in Korea in particular. For decades, many standards have been *de facto* determined by multinationals as they have been dominant in the export-led development of East and South East Asia. At first, the multinationals were predominantly Japanese, then joined by American and European ones. Gradually, health, safety, environmental and consumer protection legislation has become more important with rising income levels, but Asia lacks a regional mechanism to align practice like that in Europe or in North America (between Canada and the US). The upshot is that regulatory requirements and the technical standards ‘behind’ them exhibit no recognizable pattern. Nevertheless, in a number of sectors, American or Japanese standards have become embedded in the engineering and product development traditions and this can hinder the marketing or raise the costs of EU origin products. In sectors, where EU companies can benefit from open access under the EU – Korea FTA, standards – even when completely voluntary, that is, not linked to regulatory requirements – are a crucial issue at the initial stages of market development. The thrust is that a delay in application is likely to affect the ease with which EU companies (sectors) can influence *de facto* standard setting or support regulatory requirements with appropriate standards in Korea, and possibly beyond. Once again, a longer delay might thus cause a window-of-opportunity to be closed. Of course, it is dangerous to generalize about technical standards because of the extreme specificity in every case. Nonetheless, to give one important example, the mere idea of convincing Korea to opt for ‘performance’ standards (rather than rigid ‘design’ standards) based on European experience would significantly level the playing field by avoiding the favouring of specific models, traditions or technical solutions (industrial policy). Performance standards are merely about minimum tolerance levels or about blacklisting hazardous ingredients, etc., all for the good of health or safety, not about the nature or make of the product itself. By definition, these standards are pro-competitive. In any delay in the EU – Korea FTA, these seemingly technical matters need to be kept in mind.

1.5.2 Longer run strategic considerations

A delay of the EU – Korea FTA should also be assessed in a wider economic, political and trade-diplomatic context. The world trading environment following the crisis already shows signs of buoyancy, especially in East Asia and in South-South trade. Trade among OECD countries is recovering, too, but less rapidly. Once world trade finds itself back on the pre-crisis growth path, it might again become feasible to initiate market access negotiations with many countries and/or multilaterally.

Multilateral initiatives are unlikely to progress without political leadership from the USA and some of the BRICs. Both Korea and the EU had until recently put multilateralism before new preferential agreements. Korea held longer than most to multilateralism and the EU suspended its FTA strategy in order to signal forcefully that it wanted to give the DDA every chance. The disappointment of both trading partners about the DDA is an important reason for their willingness to conclude a ‘deep’ FTA. The EU understandably felt that the frantic FTA activity in East Asia during the last 10 years or so would sooner or later put it at a disadvantage vis-a-vis its Asian trading partners, and the US in the Asian region. This trading ‘game’ is often referred to as the “domino theory” of FTAs (Baldwin, 1994), compelling the EU to engage into “me-too” and “you-too” FTAs (Pelkmans & Brenton, 1999). The collective result of domino effects in concluding FTAs may well be worse than multilateral liberalisation, due to complexity in rules-of-origin and practically unmanageable heterogeneity in the provisions of numerous FTAs. These properties raise transaction and information costs enormously, whilst introducing distortions through the backdoor. However, without any serious prospect of a breakthrough in the DDA and without any credible leadership from (for instance) the

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11 In the APEC framework, attempts have been made to come to deeper APEC cooperation on technical standards but no significant results have been reported, as far as we know.
G-20, FTAs are the second-best. Against this general trend towards FTAs a delay by the EU in order to favour the conclusion of the DDA would have no noticeable effect.

If FTAs are the central trade instrument of the period the EU can at least shape the trade agenda through FTAs. Indeed, recently the EU / Mercosur negotiations were restarted, whilst those with India, Canada and ASEAN are ongoing. It is worth reflecting whether and to what extent the EU’s credibility in such negotiations would be affected by a serious delay in the ratification of the EU – Korea FTA. After years when bilateral FTAs were all north – south agreements there could well be a trend towards greater FTA activity among OECD countries. The EU is negotiating an FTA with Canada and has a text with Korea. There may even be a reconsideration of the evergreen topic of a NAFTA (with the US) and some EU policymakers have even asked for impact assessment studies of a range of intra-OECD FTAs\(^{12}\). Realistically, even if initiatives such as these were to be undertaken, they would take a long time, so delay in the EU – Korea FTA would not have much of a bearing unless a delay begins to be interpreted as a sign of political unwillingness to ratify.

As discussed above Korea is exploring agreements within the Asian region. If it were to move forward with these, or if the US Senate were to signal that the ratification of KORUS is no longer a problem this would immediately raise the costs of delay of the EU – Korea FTA.

Finally, the EU – Korea FTA needs to be considered in the light of an overall EU Asia strategy. Without being a ‘Pacific’ power, the EU has become quite active in East Asia in the past two decades, both economically and politically (e.g. in the Asia Security Forum). Meanwhile, the Union has elaborated an active economic diplomacy on a bilateral basis – in the absence of any progress on the multilateral front - with ASEAN as a whole or with its member countries, an FTA with India and an initialed FTA with Korea. Long-standing cooperation with Japan is good and extends to regulatory issues. For poor Asian countries, the EU already has an Everything But Arms (EBA) policy with few exceptions. The EU has developed active cooperation with China e.g. in environmental and consumer protection issues, and to some extent on IPRs, although the frictions caused by many anti-dumping cases continue. The EU’s credibility in being an active and pro-liberalisation player in Asia can be affected by a delay of the EU – Korea FTA, especially a long delay. This ‘deep’ FTA where the EU has genuinely opened up also in sectors that might be considered sensitive, will not fail to be noted by Asian business and in Asian trade diplomatic circles and might therefore set a positive precedent.

2 THE POLITICAL DEBATE ON THE EU – KOREA FTA

The perceptions analyzed in this section are those of the national and European press, different interest groups, national parliaments and the European parliament. The section makes two contributions to the overall study. First, it describes the perceptions of the actors mentioned above. Second, in combination with the macroeconomic analysis of the actual impact of the agreement summarized in section 3 below, it will help the reader judge whether these perceptions reflect the economic analysis.

2.1 The perceptions of the FTA in the EU

Summaries of the national and European press make clear that country perceptions of the Agreement vary. In Germany there has long been opposition to the EU-Korea FTA due mainly to the influence of the automobile industry. However, in its overall position, Germany now seems to have accepted the Agreement.13 German interest group opinion is divided between two camps. The textile industry and car industry strongly oppose the agreement. According to the German car industry association’s president, Mr. Wissmann, the German car industry’s exports will not profit from the agreement due to Korean regulations on CO₂ emissions. Korea does not accept the European system of on-board diagnosis (OBD) for measuring CO₂ emissions (see section 5 for details). It is also argued that exported cars from Germany would have to be adjusted to meet Korean regulations. This would be too expensive, especially considering the small size of the export market of only 30000 cars per year.14 On the other hand, the German Engineering Federation is strongly in favour of the Agreement due to its potential of quadrupling German annual exports of 2.3 billion euro. “Machine-tools, drive technology and materials handling equipment in particular will benefit” from the EU-Korea FTA according to the president of the German Engineering Federation, Dr. Wittenstein.15

Italy has maintained reservations on aspects of the negotiations and still seems to be the most critical member state.16 The opposition in Italy is again mainly due to the concerns of the car industry, which are similar to those in Germany. Especially the Italian car company Fiat S.p.A. is opposed to the deal due to concerns about increased competition for its smaller vehicles from Korean car companies such as Hyundai Motor Co. and Kia Motors Co.17

The United Kingdom seems to be generally in favour of ratifying the EU-Korea FTA. Andrew Cahn, chief executive of UK Trade and investment, welcomed the agreement in February 2010 and called for further investment in the UK by Korean firms. According to him “the EU-Korea FTA should increase trade by US$30 billion, a welcome boost in today’s economic climate” and “as trade between our two countries increases, so too will the requirement for Korean companies to establish a presence in the EU.” 18 “The potential gains of such a deal for British businesses are huge. British companies are well represented in Korea in a range of sectors. Leading investors include Tesco, Standard Chartered, ARM and Burberry to name a few.”19 Also the former British secretary of state for business, innovation and skills and former Trade Commissioner, Mr. Mandelson, welcomes the EU-Korea FTA and pointed out in October 2009: “Over the last twenty years or so, Britain has welcomed a huge number of Korean businesses - somewhere around 150”. According to Mr. Mandelson “many of them have become part of the British corporate landscape. I hope the next twenty

13 EU-South Korea: Free Trade Deal postponed at least until May, Europolitics, April, 09.
14 http://www.wiwo.de/politik-weltwirtschaft/automobilpraesident-wissmann-interveniert-beim-abkommen-mit-suedkorea-395637/
16 http://www.google.com/hostednews/afp/article/ALeqM5jCYV5lybhsWVr-T1MzIGNCFyiZFg
17 http://online.wsj.com/article/SB125561010741787333.html
18 Yonhap (South Korea), February 3, 2010 Wednesday
19 US Fed news, February, 10, Press release from the Office of United Kingdom Trade and Investment
years will bring another 150". The UK service sector also sees the Agreement as smoothing and facilitating access to the Korean market, as do the machine tools and chemicals sector in the UK. The UK financial services, pharmaceuticals and Scottish whisky producers have also lobbied strongly for ratification of the Agreement.

France is also in favour of the agreement due to opportunities for investment. This positive attitude became apparent as early as June 2008, when the minister of state for foreign trade, Mrs. Idrac, stated: “France will step up efforts for the successful conclusion of the EU-Korea free trade agreement”. She also stated that France will increase the efforts of economic reforms to make it a more attractive place for foreign investment, for example due to its advanced technology as well as research and development. As only 50 Korean firms were doing business in France, compared to 200 French companies in Korea, the FTA is seen as an opportunity to expand investment by Korean firms.

Several Eastern European countries and especially Poland are critical towards the Agreement as it will lead to decreased investment by Korean companies and increased competition from the car sector. This seems to be due to the fact that the Korean car plants in the Czech Republic and Slovakia would compete directly with existing car producers in these countries such as Fiat, Ford or Dacia.

In terms of interest groups the European automobile manufacturers’ association (ACEA) is fiercely opposed to the agreement and has been lobbying European parliament members to vote against it. A key problem for the car industry has been and remains the issue of duty drawback (see section 5.1 and annex 2). Duty drawback allows Korean manufacturers to reclaim the duties paid on imports from low-cost neighbouring countries, such as China, even after the elimination of EU customs duties. The perception is that this would be a precedent for agreements with other countries in the future. According to Ivan Hodac, Secretary General of the ACEA, “the arrangement on Duty Drawback provides a precedent to other trading partners of the EU, old as well as new ones, to ask for the same benefits. This will cause additional pressure on Europe’s economy”. Furthermore, the bilateral safeguard clause is not seen as sufficient according to the ACEA and would be very difficult to implement in its current form. Finally, the agreement does not prevent Korea from imposing new non-tariff barriers in the form of regulations in the fields of safety and environment in the future.

Another important interest group is the European Trade Union Confederation (ETUC), which stresses the importance of the inclusion of social and environmental standards. It pointed out in a memorandum to the Swedish presidency of the European Union in July 2009 that “strong chapters on sustainable development, including social and environmental standards, must be incorporated in all EU bilateral trade and association agreements, with effective provisions to ensure implementation and social partners’ involvement. This applies to the bilateral trade agreements currently being negotiated, notably with South Korea and India (…).”

There has also been criticism from other civil society NGOs on the national as well as EU level. In Germany World, Economy, Ecology & Development (WEED) argues that the agreement does not include sufficient and binding responsibilities on the social and ecological level. Furthermore, the “Aktionsbündnis Gerechter Welthandel” (Alliance for Fair World Trade) points out potentially negative consequences of the agreement.

20 S. Korea-EU FTA to boost trade by 20 pct British Minister, Thai press reports, October, 09.
21 Agence France Presse, June, 08.
22http://www.faz.net/s/Rub0E9EEF84AC1E4A389A8DC6C23161FE44/Doc--E587203B167F54FCD8894C7DF534C7868~ATpl~Ecommon~Scontent.html
23 EU and S. Korea agree to speed up free trade talks, Agence France Presse, May, 08.
25 http://www.etuc.org/a/6351?var_recherche=eu%20korea%20FTA
An assessment of the EU-Korea FTA

for human rights. A number of other national, international and European social movements oppose the EU-Korea FTA on similar grounds.

2.2 The perceptions of national parliaments and the debate in the European Parliament

The overall picture suggests that there is currently broad support for the Agreement. However, the serious debate in the European press and among different interest groups in Europe is also reflected in debates in certain national parliaments especially in Germany and Italy. In the Bundestag, the green party has mentioned concerns on labour standards. Furthermore, Die Linke Partei in Germany has stressed the importance of social, ecological and gender implications of the agreement.

In Italy, the political debate seems to be even more critical due to the concerns of the car industry. "Italy reserves the right to veto the accord if these aspects have not been dealt with," said the Italian Deputy Industry Minister, Adolfo Urso, on Italy's position on the final version of the agreement. The concerns of Italian industries, especially the car industry, are reflected in official documents issued by the Italian parliament. For example, the Italian Senate made specific reference to these concerns in a summary report issued shortly after the signing of the agreement in October 2009. According to this report, the Italian confederation of business “Confindustria” sees several major problems in the duty drawback mechanism, because it means Korean producers benefit from export subsidies. The Senate goes on to highlight that “Confindustria” demands that the affected industries’ concerns and especially the concerns of the car industry be taken into consideration during the final vote on the agreement in the European parliament and the European Council.

In conclusion, it can be stated that there is a broad consensus that the EU-Korea FTA should be adopted. However, some industry sectors and social movements, retain concerns. While these do not seem to be sufficiently strong to prevent the agreement from being applied and ratified they may have sufficient weight to call for further precision of critical aspects and possibly flanking measures.

2.3 The debate in Korea

This section is written from a Korea perspective based primarily on Korean studies, press and other documents. It provides and overview of the economic aspects of the Korea-EU FTA as seen from Korea and in particular, its critical role in supporting Korea’s recovery from the current global economic crisis, as well as in sustaining economic growth in Korea’s export-driven economy. An overview of the overall economic impact of the Korea-EU FTA on the Korean economy is also provided in the section. Section 2.3.2 provides a comparative analysis of the EU-Korea FTA with the KORUS. Section 2.3.3 starts with an analysis of the progress, or lack or progress so far, regarding the ratification of the Korea-US FTA in the US and Korea. The factors that are expected to affect the prospects of the ratification of the Korea-EU FTA are also considered in this section.

2.3.1 The Economic importance of the Korea-EU FTA in the short and long run

28 Inside U.S. Trade, december, 09.
29 http://dipbt.bundestag.de/dip21/btd/16/065/1606556.pdf
30 http://dipbt.bundestag.de/dip21/btd/16/086/1608617.pdf
31 http://www.google.com/hostednews/afp/article/ALeqM5jcYV5IybhsWVr-T1MzIGNCFyiZFg
32 http://www.senato.it/documenti/repository/lavori/affarieuropei/schede_informative/Scheda%20di%20sintesi%20accordo%20UE-Corea.pdf
The Korea-EU FTA is expected to realize a host of positive economic benefits by acting as a catalyst for economic recovery from the current global economic recession. It is also seen as a critical step in Korea’s FTA strategy to expand its FTA network in order to support Korea’s export-driven economy going forward. Moreover, the Korea-EU FTA is seen to be an important strategic step towards diversifying Korea’s export market, in particular, veering away from excessive economic dependence on China. The following section looks at each of these points in turn.

The current global economic slowdown has seen a rise in protectionist sentiment, which had spurred concerns that it would hamper Korea’s economic recovery. Against this backdrop, the Agreement is seen to be a crucial opportunity for promoting trade and for aiding Korea’s economic recovery process. As the Minister for Trade Ewa Bjorling of Sweden, and the Korean Minister for Trade Kim Jong-Hoon both stressed, the Korea-EU FTA would bring important benefits to the economies of both the EU and Korea, creating new opportunities for exports and growth at a time of economic contraction, and that the FTA would send a strong signal against protectionism globally (MOFAT 2009). Given Korea’s relatively high degree of dependence on exports to sustain economic growth, the Agreement has been welcomed, especially amongst key business groups.

The EU, which is the largest economic bloc in the world economy, is Korea’s largest trade partner after China. Korea has its largest trade surplus in trade with the EU, US$18bn compared to its surplus with China of US$15bn in 2008. With the simultaneous increase in two-way trade through the Korea-EU FTA, Korea’s trade surplus with the EU is expected to continue. Korea is not a major export market for the EU (representing less than 3% of EU trade). Moreover, considering that the EU’s average industrial tariff rate is approximately 4.2% (higher than the US average of 3.5% and Japan’s 3.1%), tariff reductions are expected to contribute to increasing exports and eventually bring more gains to the overall economy.34

The Korean estimates of overall economic effects of the Korea-EU FTA on the Korean economy in terms of GDP and public welfare are expected to be larger than those from the KORUS (see Table 2). It is estimated that the Korea-EU FTA will increase GDP by 3.08%, higher than the KORUS’s 1.28%, and raise consumer surplus by 2.45%, higher than the latter’s 0.56%.35 (Note these figures appear high compared to the models reported in section 3) In trade, the Korea-EU FTA is expected to increase both exports and imports. Thus, the impact of the Korea-EU FTA on the trade balance is expected to be limited. The Korea-EU FTA is likely to increase Korea’s trade surplus with the EU by about US$130 million, whereas the KORUS was expected to contribute to boosting the nation’s trade surplus by US$1.96 billion. In addition, the major sectors affected by the two FTAs differ. The impact of the KORUS is expected to loom large on non-tradable sectors (such as direct investment, learning effect and technology transfer), while gains from the Korea-EU FTA are expected to arise through trade. (SERI 2009:12-13) Korea’s flagship export items, especially automobiles, are expected to benefit the most, while, on the EU side, the industries of refined chemicals, parts and materials and large automobiles are expected to be the largest beneficiaries. In the more politically sensitive agricultural sector, Korea is expected to experience an increase in imports of pork and wine. In addition, EU firms are likely make forays in services such as finance, environment and telecommunication. (SERI 2009:2). A more detailed analysis of the expected sectoral impact of the Korea-EU FTA is provided in section 3.3.4 (Expected impact of the Korean-EU FTA on Korean Exports to the EU).

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33 Joint press release by the Minister for Trade Ewa Bjorling of Sweden, currently holding the EU presidency, and the Korean Minister for Trade Kim Jong-Hoon, Ministry of Foreign Affairs and Trade, Korea
34 ‘The Korea-EU FTA: Issues and Strategies’ Samsung Economic Research Institute, Sep 2007, p5
35 However, the economic effects of Korea-US could be higher. According to the official data from the special comment of the National Assembly on the Korea-US FTA, GDP is expected to grow by 6.0% and consumer welfare by 2.9% if growth effects are included.
Table 2: A comparison of the Economic Effects of Korea-EU FTA and Korea-US FTA

<table>
<thead>
<tr>
<th>Classification</th>
<th>Korea-EU FTA</th>
<th>Korea-US FTA</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>3.08%</td>
<td>1.28%</td>
</tr>
<tr>
<td>Welfare growth</td>
<td>2.45%</td>
<td>0.56%</td>
</tr>
<tr>
<td>Growth in trade balance with the world</td>
<td>US$130 million</td>
<td>US$1.96 billion</td>
</tr>
<tr>
<td>Growth in exports</td>
<td>US$6.47 billion</td>
<td>US$2.34 billion</td>
</tr>
<tr>
<td>Growth in imports</td>
<td>US$6.34 billion</td>
<td>US$380 million</td>
</tr>
</tbody>
</table>

Note: 1) Increases in GDP and consumer welfare do not consider capital accumulation model (long-term) and production increase effect.

2) Trade balance and exports and imports are based on short-term static model for the Korea-EU FTA and on a 10-year average for the KOR-US FTA.

Korea Institute for International Economic Policy and others (April 30 2007)

*Analysis on Economic Effect of KOR-EU FTA*.
Data from special committee of National Assembly on KORUS FTA

The KORUS was also seen as an important strategic step towards diversifying Korea’s foreign trade destinations away from excessive economic dependence on China. Exports to China (including Hong Kong) had shown a dramatic increase since the late 1980s making it Korea’s largest export market due to China’s insatiable appetite for parts and raw material. Under these conditions, there are growing concerns that unfavourable changes in Chinese policies or internal conditions may have dire consequences for the Korean economy. In fact, export growth to China in the last two years had slowed. High dependence on exports to China has been seen as leaving Korea vulnerable to exogenous shocks emanating from China and it was seen to be desirable for Korea to reclaim market share within the US to reduce its export dependency on China.37 The Korea-EU FTA is also seen to be a step towards diversifying Korea’s export market and reduce the level of dependence on the US. Political and economic cooperation with the EU is also seen as a balancing force in the international community, particularly in Northeast Asia.38

2.3.2 Comparing the Korean views on KORUS with the Korea-EU FTA

Compared to the KORUS, the Korea-EU FTA has benefited from relatively favourable domestic circumstances. Public opinion on the Korea-EU FTA was more favourable than on KORUS. Although Korea stood to benefit substantially from the Korea-US FTA overall, the Korea-US FTA aroused controversy and

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36 Table adapted from ‘KOREA-EU FTA: Major Features and Implications’ Samsung Economic Research Institute Aug 2009, pp.13
provoked vocal opposition from its inception. Well-organized mass public opposition spread as the US made ‘must-have’ demands, including resumption of imports of US beef, the inclusion of investor-state dispute (ISD) settlement provisions right at the outset of negotiations. Critics of the KORUS claimed it would damage the agricultural sector, exacerbate income inequality and infringe national sovereignty, and that the negotiations were opaque and that the public had the right to know about the details of the negotiation process.

In comparison the Korea-EU FTA is seen to have made greater progress on sensitive issues because more time was taken to negotiate and there was a focus on the four main areas of goods, services and investment, other rules and sustainable development rather than the 17 topics in KORUS. The use of positive listing of services in the Korea-EU FTA negotiations on services also allowed for more flexibility.

Support from Korean business leaders remains strong for both the KORUS and the Korea-EU FTA. The heads of the nation’s six major business lobbying groups issued a statement urging the ratification of the KORUS in Korea. Industry strongly welcomed the Korea-EU FTA, based on expectations that it may bolster profits and limit restructuring costs since the two sides have many mutually complementary industries. Another factor behind the industry’s enthusiasm was that the EU is more generous in technology transfers than the US and East Asian countries (SERI 2009:12).

Prospects for the ratification of the KORUS and Korea-EU FTA

The KORUS was initialled on March 31st 2007 to get inside the Trade Promotion Authority deadline in the US and subsequently signed on 30th June 2007, but still awaits ratification in the legislatures of both countries. Democrats in the United States saw major problems with the Bush administration-negotiated FTA, citing in particular the auto clauses as significant impediments to its passage. Koreans, who were hopeful that President Barack Obama would act on the agreement in his first year in office, despite campaign rhetoric to the contrary, grew increasingly frustrated as no such sign was forthcoming from the White House. When Koreans asked where the FTA rated in Washington, they were constantly told that much bigger issues (healthcare reform, and the war in Afghanistan) took precedence.

Many doubt that the Obama administration has the will and resources to face another legislative war so soon after the debilitating process of passing the controversial health care reform. Moreover, support within the U.S. Democratic Party is not expected to be easy to win, particularly after the global financial crisis, the near collapse of the U.S. auto industry and rising U.S. unemployment, which have intensified the Democrats’ traditional skepticism of trade deals. An imbalance in auto trade and South Korean restrictions on U.S. beef shipments are seen to be the main remaining hurdles to the deal’s ratification.

Korean Trade Minister Kim Jong-hoon, who served as Seoul’s chief negotiator for KORUS said “I had expected the deal to be ratified within one year after it was signed… The delay in the ratification of the deal is very regrettable.” Kim predicted Congress would take action toward ratifying the trade pact after the midterm elections in November 2010. “It would be difficult for the free trade deal to be ratified by U.S.

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43 then-Senator Barack Obama campaigned for the presidency with strong support from traditional Democratic constituencies like labor unions, who generally oppose free trade. He promised a departure from Bush administration trade policies and the adoption of new trade principles that would put American jobs first.
44 ‘A New Life for the Korea-U.S. FTA?’ Chosun Ilbo Column by Victor Cha, George Town University, Feb. 10, 2010
Congress before November,” Kim said. “But after that there will be no major hurdles for Congress to move toward ratification.”

Amidst such uncertainty in the US, Korea’s ruling Grand National Party along with major business lobbies has been strongly pushing to ratify the KORUS in Korea, while the main opposition United Democratic Party is arguing that discussions of the deal should be delayed, at least until there are signs of progress towards US ratification. The Democratic Party in the US wanted the Obama administration to request a renegotiation of KORUS, mainly to ensure better access to the Korean market for U.S. cars. During his presidential campaign, Obama argued the accord was “badly flawed,” citing a wide imbalance in automobile trade. But in Korea the Grand National Party said it could not renegotiate and urged the US Democratic Party to change tack. Korean trade officials have also ruled out any renegotiation and expressed hopes that the new U.S. government will support the deal. Experts have argued Korea should stick to the “principle” and ratify the agreement, but “some argue that (Korea) might be humiliated if the United States requests renegotiations after we ratify the FTA first. But from a strategic point of view, the ratification from our side in advance will definitely impose pressure on the Obama administration.”

2.3.3 The Korea-EU FTA

Korea and the EU expressed a desire to conclude the Korea-EU FTA in early 2010, reaffirming their commitment to the entry into force of the Agreement in 2010 (MOFAT 2010). There was subsequently some slippage owing mainly to delays in translation, but the Ministry of Foreign Affairs and Trade (MOFAT) reiterated that this would not pose significant problems for the agreement entering into force by year end. According to Korean Minister for Trade, Kim Jong-hoon, once the European Commission passes on the translated versions of the Agreement to the European Council on March 29 2010, it is expected to take a further few weeks for the European Council to review the Agreements, but this would not lead to any changes in the substance of the pact, which should be provisionally implemented by October as previously planned.

The business-oriented Grand National Party has strongly supported EU-Korea negotiations. During the concluding phase of the Korea-EU negotiations, the United Democratic Party expressed the view that the prospects for ratifying the Korea-EU FTA are brighter than those for the KorUS, even given that there are some contentious issues. The United Democratic Party has subsequently expressed conditional support for the Korea-EU FTA, in contrast to its position in late 2008 when it actively supported the FTA.

The prospects of the ratification of the Korea-EU FTA in Korea depend on the following. First, as noted above there is a growing perception that ratification of the Korea-EU FTA would help the economic recovery process in Korea. Second, a prompt ratification is seen to be necessary for Korea to benefit from the first mover advantage it may gain, compared to other east or south East Asian countries negotiating with the EU, from access to the EU. This argument is based of Korea’s experience with the Korea-Chile FTA, where the effects of the FTA in terms of increased exports to Chile declined as the China-Chile and Japan

45 Interview with Yonhap News Agency (Joongang Daily 3 April 2010)
46 Korea’s chief free trade negotiator Lee Hye-min, who said in a press briefing that “there will be no renegotiation”
48 MOFAT Press release ‘Formal Signing of the Korea-EU FTA’ 2010-02-10
49 Arirang news ‘Signing of Korea-EU FTA Postponed to May’ Mar. 18, 2010
Yeonhap News ‘김종훈 “한-EU FTA 본서명 내달 힘들 듯”’ 2010-03-17
50 Chosun Ilbo ‘민주당, 조건부 찬성’ 2009.03.25
Chile FTA subsequently came into force.  Third, ratification of the Korea-EU trade agreement could also serve to promote ratification of the KORUS.  The Koreans believe that it will be difficult for the U.S. to sit back and continue to delay ratification of KORUS once the Korea-EU agreement is finalized. For example, that Korea and the EU have managed to find agreement on automobile trade, a significant sticking point to passage of the KORUS in the US, may encourage the U.S. to ratify the deal. Finally, completion of the Korea-EU FTA is expected to have a positive influence on pending trade agreements with China and Japan which are under consideration as well as numerous FTAs currently under negotiation.

2.3.4 Major Winners and Losers: Sectoral Analysis

The Korea-EU FTA is expected to spur an increase in bilateral trade between the two sides, paving the way for Korea to gain a larger share in the industrial goods market, and for the EU to widen its inroads in the service market and some manufacturing areas. Once the FTA comes into force it is expected to contribute to an increase in Korea’s exports to the EU by 12.8 billion Euros, clearing the way for Korea to increase its share in the EU market by up to 3.9% (Copenhagen Economics 2007). By industry, automobiles (5.24 billion Euros) are expected to benefit most from the FTA, followed by electronics (1.73 billion Euros), textiles (1.18 billion Euros), other machinery (730 million Euros) and apparel (520 million Euros).

**Expected Impact of the Korea-EU FTA on Korean Exports to the EU**

As can be seen in chart 1 items with high export weights (representing export competitiveness) and high tariff rates (representing the impact of price reduction) are expected to benefit most (first quadrant). Items with high export weight and those that face low tariffs are expected to see an increase in market share (second quadrant). Items with low export weights and high tariff rates are expected to enjoy an increase in exports due to enhanced price competitiveness (fourth quadrant). However, items with low export weights and tariff rates are expected to see only a limited increase in exports (third quadrant). This is illustrated below.

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51 Korea Trade-Investment Promotion Agency (KOTRA) '한-칠 FTA 5주년 성과와 시사점' Global Issue Report 09-006, 2009
52 This is seen as a key obstacle. In the US, the automobile and organized labour were critical about the FTA, particularly, automakers such as Ford and Chrysler opposed the FTA, while unions criticizes it as infringement on the basic rights of Korean workers and an obstacle to further domestic employment (SERI 2007:14).
54 These countries include Canada, Mexico, GCC, Australia, New Zealand, Peru, Columbia and Turkey.
55 Analysis adapted from ‘KOREA-EU FTA: Major Features and Implications’ Samsung Economic Research Institute Aug 2009
An assessment of the EU-Korea FTA

Chart 1: Weights in Exports to the EU and the level of Tariff Rates (2008)

<table>
<thead>
<tr>
<th>II</th>
<th>Ships</th>
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<tbody>
<tr>
<td>III</td>
<td>Wireless Telecommunication Devices</td>
</tr>
<tr>
<td>IV</td>
<td>Cars</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>I</th>
<th>LCD</th>
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</thead>
<tbody>
<tr>
<td>III</td>
<td>Textiles</td>
</tr>
<tr>
<td>IV</td>
<td>Industrial Machinery</td>
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</tbody>
</table>

III | Semiconductors |
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<th></th>
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<tbody>
<tr>
<td></td>
<td>Computers</td>
</tr>
<tr>
<td></td>
<td>Steels</td>
</tr>
</tbody>
</table>

Note: 1) X axis refers to a 4.2% average tariff rate and Y axis refers to a 7.0% average portion of total exports (MTI3 or four digit of HS Classification).
2) Red, pink and blue colors refer to exports amount worth over US$7 billion, US$3 to 4 billion, less than US$2 billion, respectively.
Source: National Statistical Office, KOSIS.

The Korean auto industry is expected to benefit the most under the Korea-EU FTA partly because the EU imposes relatively high tariff rates, 10% on autos (2% higher than that of Korea) and 4.5% on auto parts. Under the Agreement, tariff rates on automobiles with engine displacements of over 1.5 litres will be scrapped within three years and tariffs on autos with engine displacements of below 1.5 litres within five years. Currently, autos and auto parts are the third-largest export items following ships and wireless telecommunication devices, accounting for 13.0% of total exports to the EU\(^\text{56}\). However, the direct effects of tariff removals on autos are not expected to be large due to growth in local manufacturing in the EU. Ships and wireless telecommunication equipments are not expected to benefit directly from reductions in tariff rates, but are expected to increase as they are already competitive in the EU market. Items such as petrochemicals and machinery with low export weights and high tariff rates are expected to benefit the most from tariff reductions.

**Expected Impact of the Korea-EU FTA on Korean Imports from the EU**

Likewise, imports from the EU are expected to increase, particularly items with high import weights (representing competitiveness in the Korean market) and high tariff rates (due to expected price reduction effects) as can be seen in Chart 2.\(^\text{57}\) By quadrant, refined chemicals, pharmaceuticals, industrial machinery and the auto parts industries in Korea are expected to be hit hard by the Korea-EU FTA as these industries consist of small- and medium-sized companies and used to enjoy protection from higher tariff rates.

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\(^{56}\) Exports of autos and auto parts increased from US$2.94 billion in 1998 to US$7.62 billion in 2008 for an average annual increase of 10.0%.

\(^{57}\) Items with high import weights and tariff rates will see a sharp rise in exports (the first quadrant). Items with high import weights and low tariff rates will also see their income increase (the second quadrant). Items with relatively low import weights and high tariff rates will see an increase in imports due to enhanced price competitiveness. Items with low import weights and tariff rates is not expected to benefit from tariff elimination (third quadrant).
Chart 2: Weights in Imports from the EU and the level of Tariff Rates (2008)

Imports of refined chemicals and auto parts products account for 8.3% and 5.4% of total imports from the EU17. From 1999 to 2008 imports of these products increased 13.1% and 14.7% annually on average. EU products that constitute a low proportion of total imports, but are subject to high tariff rates are expected to see an increase. If a 7% average tariff rate is scrapped, the domestic general machinery market is expected to be eroded by the Agreement. The domestic automobile market will experience heated competition due to formidable price competitiveness of EU-made vehicles, especially in the luxury car segment. In 2008, cars from the EU accounted for 53% of Korea’s import car market and mid- and large autos with over 1.5 litre engine displacements, in particular, take up an overwhelmingly large part of Korea’s imported auto market. Moreover, since tariffs on automobiles with over 1.5 litre engine displacements will be the first to be removed, EU mid- and full-sized models are expected to benefit earlier than small cars. EU-made cars are expected to be attractive to consumers who had been buying inexpensive, mid- and full-size Japanese cars.

The Korea-EU FTA is expected to improve Korea’s deficits with Japan. Korea’s current account deficit with Japan peaked to US$32.7 billion in 2008 due to its high dependence on Japanese parts and materials. A record high trade deficit with Japan is mainly attributable to an increase in parts and material imports by Korean companies that lack core technologies and superior production facilities. The EU parts and material industry, which is superior to Japan’s in terms of export competitiveness, are expected to partly replace Japanese parts and materials. Moreover, imports of EU parts and materials are on the rise. Up to now, EU parts and materials have enjoyed a higher global market share than Japan, but much less recognition in Korea. Given that in eight out of 12 segments of parts and materials, the EU is judged to have superior export competitiveness to Japan, this should help improve Korea’s trade deficit with Japan.

Imports of EU’s agricultural produces are expected to rise significantly. Though sensitive goods such as grains and vegetables will be less affected, some of EU’s competitive processed agricultural products will benefit from tariff reductions. Subsequently, increased imports of these products are likely to hurt Korean farmers in sectors such as frozen pork belly, other pork cuts, dairy products, grapes and kiwis. In particular, tariff reductions will help to expand EU pork’s dominance in Korea’s pork market where there is competition among EU, US, Canadian and Chilean suppliers. In 2008, market shares in Korea’s imported pork market are as follows: EU (44.2%), US (28.6%), Canada (14.5%) and Chile (10.2%). Since EU pork could
also replace Korean pork in the long run, the Korean government has introduced adjustment measures for domestic pig breeders.

The EU has a fairly competitive service sector and demanded Korea open its service market. Korea has seen continuously increasing deficits in service account since 1999. Unlike Korea, most EU countries excluding Germany have seen their service account surplus widening and Korea-EU FTA is seen as providing a good opportunity to increase their market share in Korea. Legal services, finance, telecommunication, environment and energy sectors fall under this group. On the EU side, its exports to Korea are also expected to pick up, centering on the areas of business service, transportation, other service, medical, cosmetics, precision machinery and refined chemicals. (SERI 2009)
3  AN OVERALL ECONOMIC AND COMMERCIAL ASSESSMENT

3.1  Effects on Income and Trade

Economic studies based on CGE modeling of an FTA between the EU and Korea are broadly consistent in finding that the overall gains are significant but not large for Korea and relatively modest for the EU. A study by Copenhagen Economics and J.F. Francois (Copenhagen, 2007) thus finds that a comprehensive FTA (with extensive provisions but less than totally free trade) would yield a GDP increase of 1.01% (4.3 billion euro) for Korea and 0.03% (2.2 billion euro) for the EU. As a benchmark comparison, a full FTA would yield a 2.32% increase for Korea and 0.05% for the EU. Other recent studies give a comparable result, showing GDP gains for Korea of 2.0% (KIEP in 2005), 2.3% (Pukyong in 2006) and 2.1% (SIA Investment Model in 2007).

In relation to trade flows, it is expected that the FTA - under which Korea will phase out tariffs on 96% of imports from the EU within three years and 99% of Korean exports will enter the EU duty-free – will boost EU exports to Korea by some 19 billion euro (or 48%) and Korean exports to the EU by some 13 billion (36%).

The relatively modest impact on GDP is consistent with the fact that both the EU and Korea have open economies and are already highly integrated into the world economy. Moreover, for the EU, Korea is a relatively small market. An increase in the EU’s share of Korean imports of 16 percentage points, at the higher end of the modeling simulations, would represent an increase in the EU’s share of global exports of only 0.7%. The modest results are also consistent with the extensive literature on preferential trade agreements which finds that quantitative analyses, whether ex post econometric studies or ex ante computable general equilibrium (CGE) models, tend to find relatively limited impact on economic growth but with greater impact in CGE models that assume imperfect competition and increasing returns to scale (Heydon and Woolcock, page 220).

Beyond the broad aggregates, however, it is possible to differentiate effects among different sectors. The largest trade impacts for the EU are found within business services (22% of the total increase in the value of Korean imports from EU25), machinery (16% of the gain) and processed food (11%). For Korea, motor vehicles account for 40% of the total increase in EU25 imports from Korea, followed by electrical machinery (13.5%) and textiles (9%).

It is estimated (Copenhagen, 2007) that some 70% of EU gains are attributable to the liberalisation of trade in services and that EU exports will increase by 40-60% in the areas of wholesale and retail trade, transport services, communications, financial services and other business services. The relative importance of service gains is explained by Korea’s growing demand for service inputs to economic growth and the fact that the Korean service sector is highly protected by non-tariff barriers. Also in the modeling, barriers to trade in services are assumed to be real resource costs, compared with tariffs and quotas in other sectors which generate tariff revenue and quota rents.

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58 This section is an assessment of quantitative and qualitative studies available in March and April 2010. An addendum covering the CEPII/ATLASS study is provided in annex 2.

59 The Copenhagen study uses the imperfect competition variant of the GTAP model. The Copenhagen and Pukyong studies are in the same family of CGE models, though Pukyong has dynamics added and is without imperfect competition. Pukyong does not cover services liberalisation and therefore the similarity of GDP gains to the Copenhagen study is probably fortuitous (CEPS, 2007). The KIEP model is based on perfect competition and constant returns to scale.

60 The May 2010 CEPII/ATLASS study for the European Commission estimates larger export gains for the EU of between Euro 33bn and 41 bn and larger imports from Korea of up to Euro 34bn. See annex 1 for details.
All studies agree that the Korean motor vehicle industry will benefit more from the FTA than its EU counterpart. The studies differ, however, in their assessment of the effect on the EU industry. While the Copenhagen study shows a 1% contraction in EU output as a result of the agreement, a study by IBM Belgium (IBM, 2008), which allows for some dynamic elements, finds an expansion, albeit modest, of EU output of 0.04%. This increase is explained by three factors: lower automotive prices in both economies, and hence increased demand; some displacement from third-country suppliers; and, most importantly, increased productivity in the automotive sectors in both countries in response to heightened competition. Whichever of these studies turns out to be closer to the mark will depend on how the industry responds to the changes foreshadowed by the FTA, but there is extensive empirical evidence of increased innovation and hence increased productivity in the motor vehicle sector (and many other sectors) prompted by market opening and a more competitive environment. The Copenhagen Business School study also does not seem to account for the impact of Korean investment in automobile plants into the Czech Republic and Slovakia that seem to have contributed to a marked recent reduction in Korean exports to the EU. See section 5.1 below.

All studies find gains for the EU agricultural and processed foods sectors. It is suggested (IBM, 2008) that increased EU exports of cereals and beef are likely to have only a modest impact on Korea and that much greater adjustment will occur in Korea as a result of the implementation of KORUS and conclusion of the Doha Development Agenda. Similarly, the impact of increased EU exports of pork, horticultural products and processed food is likely to be modest, while increased EU exports of wines and spirits are likely to mainly affect third-country imports into Korea.

### 3.2 Social Impact

There are unlikely to be large inter-industry shifts in output and employment that could lead to disruption of labour markets at either a national or regional level in either the EU or Korea as a result of implementation of the FTA. More specifically:

- There are unlikely to be major sectoral shifts or displacement of workers that will cause significant dislocation of labour markets for specific socioeconomic groups or for particular regions.
- The FTA will lead neither to significant expansion of employment of low-income groups nor to significant job losses in groups vulnerable to job loss because of low social and economic mobility. The reason is that trade expansion between the EU and Korea will focus on specialised manufactures, services and, increasingly, the exchange of technology. At the margin, there will be a modest net shift in demand to skilled workers from unskilled workers, especially in the EU. Real wages in Europe will barely change.
- Incremental impacts on employment levels in the EU automotive industry are likely to be limited if, in the implementation of the agreement, tariff reductions are phased sufficiently to allow time for adjustment (see below).
- Over time, there will be modest productivity gains with potential benefits of longer-term real wage gains.

No serious issues with respect to core labour standards are likely to arise. Korea is not a signatory to some of the core ILO conventions related to freedom of association and forced labour, but it is a signatory to some of the newer ILO conventions for worker safety and has made commitments to the decent work agenda. Moreover, the standards under the ILO agreements are clear and can be used as the basis for bilateral cooperation on labour matters.

Labour rights issues will require close monitoring for trade involving products from the Democratic Peoples Republic of Korea (DPRK) or North Korea and specifically the particular case of the Kaesong
Industrial Complex. This is essentially a matter for the rules of origin for qualifying products under the FTA and involves a careful balancing of, on the one hand, the concerns of various groups in the EU about unfair competition from imports produced by workers who are subject to various forms of social control and, on the other hand, the goal of improving the economic status of some part of the population of the DPRK and thus contributing to peace on the peninsula, while also ensuring that concerns about core labour standards do not become captive to protectionist sentiment. The Protocol on Rules of Origin under the draft text of the EU-Korea FTA provides (Annex IV) for the establishment of a Committee on Outward Processing Zones on the Korean Peninsula, which shall meet not less than once a year to review whether conditions prevailing in the zones are appropriate. Thus the EU – Korea FTA deals with the issue of processing zones in North Korea in the same way as KORUS did by deferring the issue.

3.3 Environmental Impact

The small increase in economic growth and the associated increase in production and trade as a result of the EU-Korea FTA will tend to increase energy use in both the EU and Korea and to increase the use of energy in transportation. However, offsetting this will be the fact that potential benefits of increased productivity and enhanced technology especially in relation to environmental goods and services could translate into the development of, and increased use and diffusion of, clean technologies. Moreover, improving the investment climate and enhancing the protection of intellectual property rights will provide benefits in terms of investment and innovation in clean technologies.

In short, the EU-Korea FTA is not foreseen to have significant adverse environmental effects as the projected expansion of trade is not predicted to use resources that are poorly managed or to increase production that will lead to the expansion of pollution or to other negative environmental externalities.

3.4 Issues of Interpretation: Some Cautionary Notes

Four factors are likely to bear importantly on the accuracy of any assessment of the impact of the EU-Korea FTA: limits to CGE modeling; uncertainties in the trading system; future challenges facing the EU and Korea; and the way in which the FTA will be implemented. Each will be considered, briefly, in turn.

The results outlined above are likely to underestimate rather than overestimate the potential gains from the FTA insofar as they rely on CGE modeling techniques. This is because some of the more important scale effects of the FTA such as the reduction of nontariff barriers, increased investment flows, pro-competitive action and the stimulus to innovation and productivity are not well captured in these models. In short, the models tend to underestimate intra-industry responses and dynamic adjustments to economic integration.61 At the same time, certain assumptions built into the economic simulations, and which bear upon uncertainties in the international trading system, are likely to have both underestimation and overestimation effects. Importantly, the analysis tends to include in the baseline scenario the assumption of a successfully concluded Doha Development Agenda. As a result, MFN tariffs are estimated as being lower than is actually the case and therefore the difference between FTA preferential rates and MFN rates is smaller than in reality. This will tend both to underestimate opportunities for, welfare-increasing, trade creation (as domestic production is replaced by more efficient FTA partner production), but also to underestimate the risk of, welfare-decreasing, trade diversion (as efficient third-country production is displaced by less efficient production of the FTA partner). The underestimation of trade-diverting effects is compounded by the fact that the baseline scenario also has built in the assumption that certain other preferential trade agreements, including the as yet unsigned US-Korea FTA, are operational.

61 This finding is confirmed in the CEPII/ATLASS study that seeks to encompass such effect and finds somewhat larger gains.
How these various elements of under- and over-estimation will balance out is difficult to say, a priori. But their impact will, in any event, not affect the overall assessment that the effects of the EU-Korea FTA are likely to be relatively modest, particularly for the EU. Moreover, both the EU and Korea face a number of future challenges that will require a measure of adjustment and adaptation far greater than that arising from the bilateral FTA, not least:

There will be a need to respond to growing competition from the emerging economies, particularly China, India and the countries of ASEAN. This response will lead to a relative shift in EU and Korean demand for skilled compared with unskilled workers - a shift that is likely to far outstrip the comparable effect of the EU-Korea FTA.

In both the EU and Korea there will be a need to respond to the aging of the workforce.

And industry in both countries, not least the automotive sector, will need to respond to the challenge of increasing energy prices and limits to carbon emissions.

The fourth factor bearing on the likely impact of the EU-Korea FTA is the way in which the agreement is actually implemented. From an EU perspective, the effectiveness of the FTA will depend importantly on the extent to which it is able to address both non-tariff and regulatory barriers and the limits to the contestability of the Korean market embodied in the regulatory environment, the dominant role of the chaebols and restriction on investment in both goods and services.

Each of the four factors briefly mentioned here will warrant close monitoring. In addition, however, two steps can be taken that will help maximise the potential for gain from the FTA: the determination of specific guidelines for optimal implementation; and the introduction of flanking measures that would accompany the implementation of the agreement.

### 3.5 Optimising implementation

Without seeking to duplicate the more detailed discussion elsewhere in this study of the FTA-related policy issues, this section briefly highlights some of the policy measures that have been identified (IBM, 2008 and CEPS, 2007) and that will help provide guidelines for effective implementation of the agreement.

- **Phasing of Reductions in Barriers**: Slower phasing out of tariffs on automobiles and some of the more sensitive processed agri-food products. The provisions in the draft text of the EU-Korea FTA which would, under the EU Schedule, allow a phasing out of motor vehicle tariffs, for example, over a period of five years would seem to meet this particular guideline, bearing in mind that an unduly long transition would be likely to inhibit necessary innovation and adaptation in response to a more competitive environment.

- **Quicker phasing out of barriers** to trade in environmental goods and services, some agri-food products such as wines and spirits, and pharmaceutical products. The provisions in the draft text which would, under the Korean Schedule, allow an immediate phasing out of tariffs on wine would seem to be consistent with this guideline, as would those allowing for a limited (three year) transition in respect of machinery for the treatment of waste water.

- **Rules of Origin**: Relaxation of content requirements for sectors where there are low MFN barriers and less dispersion in third country tariff structures such as Information and Communications Technology products. Scope exists within the Protocol on Rules of Origin (Article 33 of Title VIII, Final Provisions) for the Trade Committee to amend provisions of the Protocol.

- **Cumulation of content** for the purpose of rules of origin between the EU and Korea in order to facilitate intra-industry trade. The Protocol on Rules of Origin includes provisions (Article 3) dealing with cumulation.
- **Non-tariff measures**: A strong dispute settlement mechanism to help ensure effective implementation of disciplines relating to non-tariff measures. Annex 14A of the Dispute Settlement Mechanism provides for a Mediation Mechanism to facilitate the finding of mutually agreed solutions to non-tariff measures adversely affecting trade between the Parties.

- **SPS and Technical Regulations and Standards**: Use of international standards for Sanitary and Phytosanitary measures and technical regulations. SPS Article 5.6 provides that the Parties will cooperate in the development of international standards while also cooperating to develop a common understanding on the application of international standards with a view to minimising their negative effects on trade between them. Under Article 4.4 of Technical Regulations, Parties agree to use relevant international standards (where these are found to be appropriate). Use of bilateral approaches to resolving SPS issues within the FTA. Article 5.10 provides for the establishment of a Committee on Sanitary and Phytosanitary measures to provide a forum for the discussion of problems arising.

- **Mutual recognition of conformity assessment and accreditation procedures** for technical regulations and standards. Article 4.6 recognises the scope for the mutual acceptance of the results of conformity assessment procedures.

- With regard to technical barriers to trade the Agreement establishes both horizontal as well as vertical **working groups on selected sensitive sectors**. These together with the use of independent moderators, rights for industry to initiate investigations and quicker dispute settlement offer a means of addressing TBTs on an ongoing basis.

- **Intellectual Property Rights**: Stronger enforcement of the protection of Geographical Indications. Sub-section C of the FTA draft text provides for extensive, strong protection of geographic indications, including for wines and spirits (perhaps helping to explain why increased EU exports to Korea of wines and spirits are expected to be at the expense of third-country suppliers?).

- **Investment**: Reduced limits or controls on the level of equity participation by EU investors in Korean companies or by Korean investors in EU companies. Under Article 8.2, Parties shall not introduce any new restrictions on the movement of capital and shall not make the existing arrangements more restrictive. Parties may hold consultations to further facilitate the movement of capital between them. In respect of trade in services, under Article 7.11, Parties shall not impose maximum percentage limits on foreign shareholdings unless explicitly specified in Annex 7-A.

- **Sustainable development**: Cooperation on core labour standards and the decent work agenda, including in areas where the core ILO conventions are not yet ratified. Under the FTA, the Parties have agreed to cooperate on trade-related aspects of the ILO Decent Work Agenda, including on the inter-linkages between trade and full and productive employment, labour market adjustment and core labour standards.

- **Common commitments to multilateral environmental conventions**: Under Article 13.15, the Parties recognise the value of international environmental governance and commit to consulting and cooperating with respect to negotiations on trade-related environmental issues of mutual interest. They also reaffirm their commitments to the effective implementation in their laws and practices of the multilateral environmental agreements to which they are a party.

### 3.6 Flanking measures

The overall economic impact of the EU-Korea FTA will be more favourable to the extent that the agreement is accompanied by complementary measures that facilitate necessary adjustment and adaptation. It has been established that the benefits of a more liberal trade regime will only be fully realised in an economy
with appropriate macroeconomic policies, efficient labour markets and a regulatory environment that facilitate the mobility of workers and the entry and exit of firms, and an education system that enables skills to match evolving needs (OECD, 2005).

The main flanking policy measures in the area of economic management should be aimed at enhancing the positive effects of investment flows, supporting better awareness among SMEs in Europe and Korea of emerging business opportunities, and supporting networking (IBM, 2008). More specifically, this will mean promoting macro-economic stability, reducing the cost of doing business and of setting up a business, and fostering a transparent and predictable regulatory environment. Opportunities may arise for enhanced cooperation on horizontal competition policies and in the amelioration of specific regulatory frameworks, including the need for improved prudential regulation in the financial services sector.

The evolution of Korean policy with respect to the chaebols will warrant particularly close attention. Under the proposed FTA text, it is provided (Chapter Eleven) that Parties shall maintain comprehensive laws which effectively address restrictive agreements, concerted practices and abuse of dominance by one or more enterprises, and which provide effective control of concentrations between enterprises. Cooperation between the EU and Korea will be conducted within the framework of the agreement of 23 May 2009 on cooperation on anti-competitive activities.

Within the framework of active labour market policies, there will be a need to promote lifelong learning, ensuring that skills development and retraining enable the workforce to respond to changing needs and encouraging the retention of older workers. While the growth of service industries will increase employment opportunities for women, improved educational and employment opportunities for women would nevertheless support action to deal with the challenge of aging societies.

While the agreement is not expected to have adverse environmental effects, it nevertheless presents the opportunity for cooperation between the EU and Korea, within the framework of the FTA, to cooperate in the area of environmental management and regulation. Opportunities may also arise for cooperation to reduce the dependence of both the EU and Korea on carbon-based fuels and to develop and implement technologies that will reduce carbon emissions. Provisions within the FTA dealing with the protection of intellectual property rights, cooperation between the EU and Korea on the development of standards and technical regulations, and the liberalisation of trade in environmental goods and services can all be built upon in this regard.

### 3.7 Timing Considerations

Should it be decided to ratify the draft EU-Korea FTA, there would appear to be no compelling arguments in favour of delaying such ratification for tactical or strategic advantage, whether in relation to other pending Korean preferential agreements or in relation to the Doha Development Agenda.

**Other Pending Korean Agreements**

It can be argued that the EU would gain by allowing other countries to conclude FTAs with Korea ahead of it and so benefit from whatever concessions these other countries might obtain. This might be seen as applying particularly to the pending agreement between the United States and Korea (KORUS), given US negotiating clout. This argument is bolstered by the finding from the Copenhagen study (Copenhagen, 2007) that any loss of market share arising from other countries going first would be compensated by an increase in the total size of Korean imports from the world (the “income effect”) such that the value of EU

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62 See also section 1.5
exports to Korea would increase even if Korea engaged in FTAs with others, including the United States, and not with the EU.

Against this line of argument, however, it seems unlikely, looking at the outcome of the two sets of negotiations, that the United States would obtain under KORUS significant gains additional to those on offer under EU-Korea. And were it to do so there is no guarantee that those gains would automatically flow on (via MFN treatment) to other countries. Moreover, the Copenhagen finding in respect of the income effect does not apply to agriculture and processed foods, where the income effect would not be strong enough to compensate for the loss of market share. It is worth recalling that the EU experienced severe market share losses in Mexico as a result of NAFTA.

On balance therefore there would seem to be advantage for the EU, should it decide to ratify the EU-Korea FTA, not to delay implementation, and so:

Benefit from the EU’s own-liberalisation under the agreement.

Benefit from whatever first-mover advantages might exist.

Minimise the risk that other countries, in particular the United States, succeed in setting a precedent by having their own standards and technical requirements incorporated into prior agreements. Both the United States and Korea tend to apply their own standards (and conformity assessment measures) in a national way (CEPS, 2007).

**The Doha Development Agenda**

In the case of the DDA, it might be argued that in order not to divert trade policy expertise away from multilateral efforts and in order to avoid signalling a lower priority to those efforts, implementation of bilateral agreements, including the EU-Korea FTA, be deferred until the future of the Doha Round is more assured.

But it can equally be argued that, in the spirit of “competitive liberalisation” as formulated by the United States, preferential agreements provide a spur to multilateral efforts as countries seek to moderate the distorting effects of preferential agreements by reducing MFN tariffs and strengthening WTO rule-making. In reality, regrettably, the differences underlying DDA stalemate remain entrenched and have so far been largely impervious to the steady proliferation of preferential trade agreements. Again, should it be decided to ratify the EU-Korea FTA, there would appear to be no compelling reason, on DDA grounds, not to proceed to prompt implementation.
4 LEGAL ASSESSMENT

4.1 Compatibility with WTO obligations

This section provides a brief analysis of the Agreement against the backdrop of WTO obligations and, where appropriate, makes comparative references to other FTAs.

The key to a free trade agreement (FTA) is that the trading partners offer each other more favourable treatment. This approach would normally contravene the most fundamental WTO obligation, the most-favoured nation treatment obligation (MFN), according to which any advantage one WTO Member grants to another WTO Member must be granted immediately and unconditionally to all other Members. The WTO legal order, however, provides for exceptions, set out in Art. XXIV of the GATT and the Understanding on Art. XXIV as well as Art. V of the GATS, subject to certain conditions. Generally speaking, WTO rules aim to ensure that regional trade agreements create more trade than they divert. WTO Members pursuing regional integration agreements are required to notify the other Members of their intention in order to allow for a discussion of the agreement from a legal, political and economic perspective in the WTO Committee on Regional Trade Agreements (CRTA). This political process does not preclude review of the abovementioned conditions in WTO dispute settlement, however, as has been clarified in WTO case law.

The EU–Korea Agreement has been notified both under Art. XXIV of the GATT and Art. V of the GATS.

Art. XXIV of the GATT applies to customs unions, free trade areas and interim agreements necessary for the formation of customs unions or free trade areas. The EU-Korea FTA qualifies as a free trade area under Art. XXIV:8(b) of the GATT. The requirements of the definition of a free trade area are: (1) a group of two or more countries in which (2) the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the members. There is no agreed definition of substantially all trade in the WTO but the coverage of the EU–Korea FTA with 99% for the EU and 94% for Korea and provisions to eliminate NTBs means there can be little doubt that it meets these requirements. Under Art XXIV tariffs should also be phased out immediately or in a reasonable period. The existing interpretation of the Art XXIV is that a reasonable transition period for liberalization is 10 years. The EU–Korea agreement meets this criterion as well as that Art. XXIV:5(b) of the GATT that mandates that the duties and regulations of commerce applied after the formation must not be higher or more restrictive than those applied before the formation of the free trade area. There is no agreement in the WTO on the interpretation of Art XXIV: 5 to regulatory or non-tariff measures.

Art. V of the GATS, which deals with preferential agreements in services stipulates ‘substantial sectoral coverage.’ This requirement as is elaborated in a footnote to the provision, should be understood as relating to the number of sectors, volume of trade affected and modes of supply and agreements should not provide for the a priori exclusion of any of the four modes of supply. As with Art XXIV of the GATT there is disagreement among the WTO Members as to the exact scope of this obligation. The reference to

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63 This obligation is set out in Art. I:1 of the GATT (for trade in goods) and Art. II:1 of the GATS (trade in services).
64 Art. XXIV:7(a) of the GATT.
65 Appellate Body Report, Turkey-Textiles, para. 60.
66 The term ‘substantially all the trade’ has been interpreted in WTO jurisprudence as meaning not the same as all the trade, but something considerably more than merely some of the trade; compare: Appellate Body Report, Turkey-Textiles, para 48.
67 See footnote to Art. V:1(a) of the GATS; the modes of supply are: ‘cross border supply’, ‘consumption aboard’, ‘commercial presence’, and ‘presence of natural persons’ (comp. Art. I:2(a) to (d) of the GATS); especially investment and labour mobility should not be a priori excluded.
68 Some observers have advocated a redrafting of Art. V of the GATS, see e.g.: Feketekuty 2000.
the ‘number of sectors’ indicates that not all sectors must be covered. However, it is clear that the number of exceptions must be limited as the purpose of Art. V is to allow for ambitious liberalisation at the regional level, while at the same time guarding against undermining the MFN obligation by engaging in minor preferential trade agreements.  

The use of a positive list approach to services liberalisation in the EU-Korea agreement, rather than a negative list approach (unlike e.g. the draft KORUS), might be seen as risking non-compliance with the requirement of Art V GATS in that positive listing is generally held to be less comprehensive than negative listing. But both approaches to services liberalisation have been used in FTAs in the past and can in principle provide the same level of liberalisation. As noted above the positive list approach pursued in the Agreement has the advantage that it is more flexible as to the level and pace of liberalisation commitments. The sectoral coverage of the EU –Korea FTA is significantly GATS plus and by far the most ambitious in services of any FTA concluded by the EU. The most important sectors have been included, so that the Agreement would probably take the hurdle of Art. V:1(a) of the GATS. In addition, as the rules of origin are rather liberal, and non-parties will in many cases be to benefit. Art. V:6 of the GATS requires such liberal rules of origin and so limits the extent to which WTO Members can discriminate through preferential agreements.

GATS Art. V:1(b) (like Art XXIV of the GATT) requires that ‘substantially all discrimination’ is eliminated, which appears to be unproblematic for the EU-Korea FTA as according to Art. V:2 of the GATS, the evaluation of an agreement’s consistency with Art. V:1(b) of the GATS may also take into account its relationship with a wider process of economic integration including tariff liberalization in goods. Finally, Art. V:4 of the GATS (‘barriers to trade’ requirement) mandates that the agreement must be designed to facilitate the trade between the parties and must not, in respect of any other WTO Member outside the agreement, raise the overall level of barriers to trade in services (within the respective sectors) compared to the situation prior to the agreement. In light of the above, there are no indications that this might be the case.

In sum, the EU Korea FTA qualifies as an FTA under the WTO and appears to meet all the legal requires, at least as well as and in most cases far better than many other FTAs.

4.2 Dispute Settlement (Chapter 14)

The DS Chapter of the Agreement has been referred to as the “most substantial breakthrough” in the FTA. The Chapter as far as trade in goods is concerned, is modeled on provisions in bilateral Agreements concluded by the US. The wording of the provisions is roughly based on the WTO Rules (Understanding on the Settlement of Disputes, DSU) and uses much of the same regulatory tools used in the WTO context.

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69 According to the Panel in Canada-Autos, para. 10.271.
72 Fink and Jansen, Services provisions in regional trade agreements: stumbling or building blocks for multilateral trade liberalisation?, conference paper (2007), available under: http://www.wto.org/english/tratop_e/region_e/conference_sept07_e.htm, p. 21; the authors argue that the main source of discrimination from regional services liberalisation lies in preferential regulatory cooperation agreements if these accompany regional integration; these are, however not covered by Art. V of the GATS.
73 Art. V:6 of the GATS reads: “A service supplier of any other Member that is a juridical person constituted under the laws of a party […] shall be entitled to treatment granted under such agreement, provided that it engages in substantive business operations in the territory of the parties to such agreement.”
Like the DSU, the Agreement provides for mandatory consultation\textsuperscript{74}, expresses a preference for mutually agreed solutions\textsuperscript{75} and provides for the authorisation of proportionate sanctions after a reasonable period for compliance\textsuperscript{76}. As in the WTO, measures taken to comply can be reviewed in an arbitration procedure in case the Parties disagree about the consistency of a measure taken to comply with the Agreement.

A significant difference between the Agreement and the WTO rules is that the timeframes are substantially reduced, even to half the duration of WTO proceedings\textsuperscript{77} and can be further reduced in cases of urgency.\textsuperscript{78} A final ruling in a dispute on a sensitive sector such as cars, would only take a maximum 75 days compared to 141 days under KORUS. KORUS, however, includes stronger remedy provisions which allow for a ‘snap-back’ of tariffs to MFN levels, while under the EU-Korea Agreement remedies are subject to the same DS rules as other sectors. The mechanism for NTBs also follows an accelerated procedure. A key provision for the EU industry is that the FTA provides for a speeding up of timeframes for disputes over NTBs regarding motor vehicles, auto parts and the Duty Drawback Clause.

The Agreement also provides for effective enforcement provisions such as the possibility to temporarily revert to pre-Agreement MFN tariffs in certain cases of violations.\textsuperscript{79} This provision, which had been pushed by some EU Member States, is again likely to be used mostly for the automotive and consumer goods sectors. From a WTO viewpoint this is not problematic, as the other WTO Members suffer no disadvantages when Korea is subjected to the same MFN duty applicable to the other Members.

The Chapter furthermore explicitly provides that the hearings of arbitration panels shall, as a rule, be open to the public\textsuperscript{80} and that the submission of \textit{amicus curiae} briefs (submissions by private parties such as industry associations or unions and other NGOs) shall be permissible\textsuperscript{81}. The EU has long favoured such greater transparency in the WTO.\textsuperscript{82} Regarding non-tariff measures\textsuperscript{83}, a mediation mechanism has been included for the first time. Under this procedure, a mediator provides a non-binding advisory opinion to solve market access problems. The introduction of such a mediation procedure for non-tariff measures is also currently under discussion in the WTO.\textsuperscript{84} The FTA dispute settlement can, as in other aspects of the FTA, serve as a testing ground for reform negotiations in the WTO.

Social and environmental clauses can also be subject to a panel dispute, but the rulings are not binding in these cases. This is a difference with the draft KORUS FTA, under which labour and environment provisions are subject to the same binding dispute settlement as the trade provisions.

\textsuperscript{74} Art. 14.3 of the Agreement.
\textsuperscript{75} Artt. 14.3 and 14.13 of the Agreement.
\textsuperscript{76} Artt. 14.8 to 14.12 of the Agreement.
\textsuperscript{77} According to Art. 12.8 of the DSU the general time limit for panel proceedings is six months (in no case longer than 9 months, Art. 12.9 DSU), in cases of urgency including perishable or seasonal goods it can be reduced to 3 months. Under the Agreement, the general time limit is only 120 days (in no case longer than 150 days) and 60 days (in no case longer than 75 days) in cases of urgency, Art. 14.7 of the Agreement.
\textsuperscript{78} Art. 14.7.2 and ANNEX 14-B, Art. 12 of the Agreement.
\textsuperscript{79} Art. 14.11.3 of the Agreement.
\textsuperscript{80} ANNEX 14-B Art. 7.7 of the Agreement.
\textsuperscript{81} ANNEX 14-B Art. 11 of the Agreement.
\textsuperscript{82} The Appellate Body in \textit{US-Shrimp} accepted \textit{amicus curiae} briefs, in \textit{EC-Asbestos}, however, the Appelate Body was widely criticized for the adoption of an additional procedure to consider these briefs; public hearings have been held on several occasions at the WTO with the EU and the US strong advocates of this practice, especially the large emerging economies opposing it.
\textsuperscript{83} In Annex 14-A of the Agreement.
\textsuperscript{84} Comp. the reference in ANNEX 14-A, footnote 3, to the proposal made by the EU and a number of other countries in this regard.
Finally, the DS Chapter provides for an exclusivity clause in order to avoid a duplication of proceedings and forum shopping in disputes. This exclusivity clause, in Art. 14.19 of the Agreement, appears somewhat problematic from a WTO viewpoint. It is unclear how the WTO would view such a clause if a Party that has signed such a clause nonetheless brings a case to the WTO. So far, no WTO panel or the Appellate Body have had to decide whether such clauses could undermine the jurisdiction of the WTO, but the issue is currently being examined by a WTO Panel as part of the US-Tuna dispute and one must expect the WTO will be loath to accept such a clause. The clause in the EU-Korea FTA shows a slight difference to the wording of similar clauses under MERCOSUR and NAFTA, which previously came up in WTO proceedings, as it only mentions that once a dispute settlement proceeding has been initiated in either forum, no challenge in the other forum may take place at the same time (rather than saying the party is precluded from resorting to the other forum). In the EU Korea FTA, subsequent proceedings are not precluded, but the scope for their initiation is narrowed in the case of 'identical obligations' in order to avoid duplication. While it is clearly desirable for a costly and largely unnecessary duplication of proceedings to be avoided, this wording may be problematic because under the WTO DSU, no WTO member can be precluded from bringing a dispute. Even where obligations are facially identical, it can still be argued that the legal basis on which an FTA arbitration panel has decided (namely FTA rules and not WTO rules) is different and that the WTO DS organs cannot be barred from examining a measure. WTO DS organs have exclusive (a dispute over WTO rules cannot be brought anywhere else) and compulsory (Members must resort to WTO dispute settlement when a violation of WTO rules is alleged) jurisdiction over agreements covered by the WTO.87 Needless to say this problem only arises if one of the Parties chooses not to abide by the clause and seeks review under WTO dispute settlement provisions.

4.3 EU LAW AND THE EU – KOREA FTA

4.3.1 Role of European Parliament after the Lisbon Treaty

The FTA will be a first test for the new procedure after the Treaty of Lisbon under which the Parliament’s role becomes more important. Consent of the Parliament is now the rule rather than the exception. Under the new Art. 218(10) TFEU, the Parliament must be “immediately and fully informed at all stages of the procedure”. This goes further than the former Art. 300(2) EC, which stipulated that “the European Parliament shall be immediately and fully informed of any decision under this paragraph concerning the provisional application or the suspension of agreements, or the establishment of the Community position in a body set up by an agreement”. The obligation to inform the Parliament would therefore include a prior notification by the Commission of its intention to propose (a Council decision on) provisional application under Art. 218(5) TFEU. According to Art. 218(6)(a) TFEU, the Council must obtain the consent of the Parliament prior to adopting the decision to conclude the agreement. The Parliament’s consent is not required for the provisional application on which the Council can decide alone. If the Parliament, however, refuses to give its consent to the agreement, the agreement cannot be concluded and provisional application has to be terminated. The Parliament can therefore exert pressure on the Commission to avoid proposing provisional application without hearing the Parliament first.88 The Treaty does not provide for a possibility

85 The Panel in Argentina-Poultry dealt with the MERCOSUR Protocol of Olivos, the Appellate Body in Mexico-Soft Drinks dealt with the clause under NAFTA; in both cases the question could be avoided, as the Protocol of Olivos had not yet entered into force and the clause under NAFTA had not been ‘exercised’ by the Mexico.
86 Much depends also on the question, to which extent WTO panels and the Appellate Body will embrace public international law principles such as res judicata and estoppel and how these principles will be interpreted.
87 Article 23.1 of the DSU.
88 It appears from recent statements by Trade Commissioner Karel de Gucht that the Parliament will therefore first be heard.
for the Parliament to give conditional consent. So, in principle, if the Parliament refuses its consent, the agreement cannot be concluded and would probably have to be re-negotiated. The Parliament can also request the opinion of the Court of Justice as to the compatibility of an agreement with EU law (Art. 218(11) TFEU).}

In the case of mixed agreements, which partially fall under the competence of the Member States, in addition to the Parliament’s consent, ratification by the national parliaments would be necessary prior to the decision to conclude the agreement by the Council. The Lisbon Treaty (Art. 207 TFEU) has in principle removed mixed competence for all trade agreements. The only remaining areas of mixed competence are non-trade related intellectual property rights and issues relating to transport policy. As noted above the EU-Korea FTA does appear to contain aspects which will require ratification by Member State parliaments.

### 4.3.2 Legal issues relating to the bilateral safeguard clause in the Agreement

The EU-Korea Agreement incorporates a bilateral safeguard clause, which provides for the re-imposition of the MFN rate when, as a result of trade liberalization, imports take place in such increased quantities that injury or a threat thereof is caused to the EU industry. This clause has to be incorporated into EU law in which the procedure and the rights of interested parties will be specified. Naturally, this implementing legislation must itself be in conformity with both WTO rules and EU law.

The proposed implementing regulation meets the requirements of the relevant WTO provisions. The investigation must meet the criteria set out in Art. XIX of the GATT and Art. 2, 3, 4 and 5 of the Agreement on safeguards. In particular, Art. 3 of the Agreement on Safeguards allows the application of safeguard measures only following an investigation by the competent authorities (of the WTO Member applying the measure) pursuant of procedures previously established and made public in consonance with Art. X of the GATT; this investigation must include reasonable notice and appropriate means for interested parties to submit their views. The proposed Regulation sets out a procedure which provides for a notice for interested parties and allows them to express their views and also ensures the confidentiality of the information submitted and that the application of a safeguard measure is limited in time. The special conditions for the imposition of provisional safeguard measures are in line with Art. 6 of the WTO Agreement on Safeguards, as they require critical circumstances and set out a maximum application of 200 days. The proposal is also in line with the requirements of EU law. The competence flows from Art. 207 (2) TFEU (common commercial policy) as the Regulation is mandated by WTO law.

### 4.3.3 Other international conventions

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89 As under the former Art. 300(6) EC.

90 See on this issue (and also to the criminal provisions in the Chapter on IP) below, Sector Specific Analysis II.

91 For example, crimal sanctions for non-compliance with IPR, transport provisions and possibly the co-production issue regarding the Protocol on Cultural Cooperation, as explained below.


94 Art. X of the GATT requires that no trade regulations are enforced before they have been officially published.

95 Art. 3 (3) and (4) of the proposed Regulation.

96 Art. 4 (6) of the proposed Regulation.

97 See Art. 9 of the proposed Regulation, as mandated by Art. 3.2 of the Agreement on Safeguards.

98 Art. 8 of the proposed Regulation.
Protocol on Cultural Cooperation and the UNESCO Convention

The Protocol on Cultural Cooperation aims to implement the UNESCO Convention on the protection and promotion of cultural expressions\textsuperscript{100} as well as to implement the Audiovisual Media Services Directive (AVMS)\textsuperscript{101}. This Protocol will come into force only at such a point as Korea ratifies the UNESCO Convention. However, there are some who call for ratification prior to commencing negotiations of a Protocol.

Although the Protocol aims to be independent from other parts of the EU-Korea FTA, since the EU’s stance excludes audiovisual services from trade provisions of trade agreements, there are concerns that since the Protocol was negotiated concurrently with the FTA, the cultural cooperation provisions are not separate from the trade negotiations. The fear here is that the Protocol would not become a hidden trade instrument.

The Protocol focuses on the audiovisual sector, which results in an unbalanced Protocol. Three out of ten Articles\textsuperscript{102} are devoted to the audiovisual sector reducing the importance of other issues covered by the Protocol such as cultural exchange and dialogue.\textsuperscript{103} Since cultural exchanges are the main tool used in addressing cultural cooperation in bilateral relationships, this emphasis on the audiovisual sector is disproportionate. The Protocol only addresses cultural industries, cultural goods and services and good practices in IPR. These cultural exchanges focus on trade facilities and are narrower than the current practice based on exchanges of performing artists.

Although the Protocol wants to facilitate the entrance of artists and other cultural professionals\textsuperscript{104} into the EU market, it does not address the visa and work contract problems for artists since the EU has no competence in this matter and it is rather Member State competence thus reducing the impact of Article 4.

A major feature of the Protocol is the requirement of strict reciprocity and balance between the EU and Korea in the audiovisual sector. In particular in audiovisual cooperation, this balance is to take account of Korea’s level of development and the level of Korea’s policies promoting cultural content. A concern here, however, is that there has not been a preliminary examination of the cultural and audiovisual landscape in Korea. Furthermore, there is also no indication that a review of these levels would be carried out. Although the EU intends to extend preferential treatment for a developed country, this is not required by the UNESCO convention. It is considered by some that the inclusion of co-produced works in the European broadcasting quotas should only be extended to countries whose cultural and audiovisual industries are still in development and this is not the case for Korea.

The criteria that delineate eligible co-productions are of a general nature. There are no concrete figures on the maximum and levels required for eligibility for co-production. Nor is there an established timeframe for the negotiation of the Protocol on cultural cooperation with Korea. It is also questionable whether the EU can regulate decisions or the decision process to implement bilateral agreements on co-production. The EU has no funding or competency for co-production. Audiovisual co-productions are the exclusive competence of the Member States and the decision to conclude bilateral agreements remains with the Member State in question. This gives the impression that the provisions dealing with co-production are

\textsuperscript{99} Art. 5 (1) and (3) of the proposed Regulation.

\textsuperscript{100} Implementation in particular of Article 20 and Article 12 of the Convention which require Parties to take its provisions into account when entering into international obligations and to strengthen their bilateral, regional and international cooperation to promote the diversity of cultural expressions, respectively.

\textsuperscript{101} 2007/65/EC.

\textsuperscript{102} Articles 5 to 7 of the Protocol on Cultural Cooperation.

\textsuperscript{103} Article 2 of the Protocol on Cultural Cooperation.

\textsuperscript{104} Article 4 of the Protocol on Cultural Cooperation.
merely intended to attract Korea to the Protocol by alluding to potential increased EU market access for Korean audiovisual products due to co-production agreements.

The Protocol has poor provisions on the performing arts as it is limited to acquiring programmes, joint production and developing international theatre technologies.\textsuperscript{105} The protection of cultural heritage sites and historic monuments is also very poor.\textsuperscript{106} The Protocol as it is currently framed remains controversial and it is questionable as to whether it would serve as a template for future agreements on cultural cooperation.

\textsuperscript{105} Article 8 of the Protocol on Cultural Cooperation.  
\textsuperscript{106} Article 10 of the Protocol on Cultural Cooperation.
5  IMPACT ON SPECIFIC INDUSTRIAL SECTORS

This section provides more detailed information of the impact on specific sectors and is intended as a complement to the general assessment of the economic and commercial effects of the EU-Korea FTA (the Agreement) given in section 3 above. The section also draws on the mainly quantitative studies by KIEP (2005), Francois / Copenhagen Economics (2007) and IBM SIA (2008) the mainly qualitative CEPS/KIEP (2007) analysis of Non Tariff Barriers to Trade (NTBs) and the Prognos (2008, 2009) studies that contain a (simplistic) quantitative exercise on the potential impact for the EU-Korea FTA focused on the case of Germany.

Table 3: Overview of the scope and form of the empirical studies

<table>
<thead>
<tr>
<th>Study</th>
<th>Nature of the study</th>
<th>Data aggregation</th>
<th>Timing for the analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Quantitative</td>
<td>Qualitative</td>
<td>EU economy</td>
</tr>
<tr>
<td>KIEP (2005)</td>
<td>GTAP standard analysis but with capital accumulation effects included</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Francois / Copenhagen Economics (2007)</td>
<td>GTAP analysis with 'imperfect competition variant'</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>CEPS/KIEP (2007)</td>
<td>NTBs analysis</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>IBM SIA (2008)</td>
<td>GTAP standard analysis</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Prognos (2008)</td>
<td>Mainly qualitative analysis</td>
<td>German economy mainly (to some extent only)</td>
<td>X</td>
</tr>
<tr>
<td>Prognos (2009)</td>
<td>Mainly qualitative analysis</td>
<td>German economy mainly (to some extent only)</td>
<td>X</td>
</tr>
</tbody>
</table>

None of the above mentioned studies take into consideration the effect of the current economic crisis, with the exception of Prognos (2009). There is also the CEPII/ATLASS quantitative study based on the final outcome of the agreement that includes an assessment restrictions on services trade and NTBs, and tends to focus on a number of key sectors such as the automotive sector. See annex 2 for a discussion of these findings that appeared after this report was completed.

Table 4 offers an overview of both the trade and political significance of the different sectors during the FTA negotiations.

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107 Standard version of GTAP analysis means that Perfect competition and Armington assumption are set about the relative attractiveness of goods coming from different countries.
Table 4: Overview the implications for key sectors and their sensitivity in the EU

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Trade</th>
<th>Opportunity (offensive)/Threat (defensive)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Exports</td>
<td>Imports</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>Euro 1.4bn in 2009</td>
<td>€ 3.3 bn in 2009</td>
</tr>
<tr>
<td>Pharmaceutical products (and medical devices)</td>
<td>€ 1 bn in 2009 EU comparative advantage</td>
<td>€ 0.71 bn in 2009</td>
</tr>
<tr>
<td>Machinery (here: only mechanical engineering)</td>
<td>This sector and the machinery industry boasts strong comparative advantages with total exports of 6 billion Euro in 2008. Trade surplus Euro 3.1 bn in most sub-sectors of mechanical engineering, exports significantly exceed imports. This is particularly true for machine and precision tools.</td>
<td>Total imports of 2.9 bn Euro in 2008</td>
</tr>
<tr>
<td>Consumer electronics</td>
<td>This sector is the third most important export sector of Korea to the EU. However Korea has a comparative advantage and in 2009 the EU’s total trade deficit was over €12 billion. Trade flows dropped by roughly 35% between 2007 and 2009 (drop in consumption further to the crisis)</td>
<td></td>
</tr>
<tr>
<td>Agricultural products</td>
<td>€ 1,261.6 mn in 2008 (4.9% of EU total)</td>
<td>In 2008 Korea’s agricultural exports</td>
</tr>
</tbody>
</table>

108 These are only broad classifications. There can clearly be offensive and defensive interests within the same sector.

109 Medical devices were not included in the analysis due to lack of data.
exports to the country, the majority being in ‘Food and Drink’ products. The EU is currently the third exporter of foodstuffs to Korea behind the United States and China. The largest EU exports to Korea are meat-based products, alcoholic beverages (wine and spirits), vegetable oils, processed food and dairy products.

Korea has a comparative advantage for textile and clothing products vis-à-vis EU Member States. EU trade deficit amounted to €137 mn in 2008, with imports of €733 mn.

<table>
<thead>
<tr>
<th>Textile &amp; Clothing</th>
<th>Services:</th>
<th>Legal services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea ranked 15th among the largest EU partner and has a comparative advantage over the EU</td>
<td>The EU enjoys a comparative advantage in seven sectors: Travel, Construction, Communications, Insurance, Financial, Computer and information, and Personal, cultural, recreational services. Korea and the EU have similar competitiveness in other business services and Royalties and license fees.</td>
<td>The EU has overall comparative advantage in services. Exports amounted to €7.2 bn in 2007</td>
</tr>
</tbody>
</table>

The EU is currently the third exporter of foodstuffs to Korea behind the United States and China. The largest EU exports to Korea are meat-based products, alcoholic beverages (wine and spirits), vegetable oils, processed food and dairy products.

Korea has a comparative advantage for textile and clothing products vis-à-vis EU Member States. EU trade deficit amounted to €137 mn in 2008, with imports of €733 mn.

<table>
<thead>
<tr>
<th>Telecommunication</th>
<th>The current</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offensive</td>
<td></td>
</tr>
</tbody>
</table>
An assessment of the EU-Korea FTA

regulatory framework overseeing the Korean financial services sector is highly discriminatory against foreign services suppliers.

Korea ranked 15th among the largest EU partners. The current regulatory framework overseeing the Korean financial services sector is highly discriminatory against foreign services suppliers.

Table 4 shows the EU has a comparative advantage over Korea in a number of sectors such as pharmaceuticals, chemicals, machinery (i.e. mechanical engineering), food and drinks and overall for the services sectors, although the EU has a trade deficit in transport services. Korea enjoys a comparative advantage over the EU in consumer electronics and motor vehicles, as well as textile and clothing, tyres, rubber and plastics.

5.1 Motor vehicles

The automotive sector is of major importance to the EU economy. General pressures on the industry (overcapacities, consolidation, emission restrictions) in addition to the depreciation of the Korean Won, fierce competition from Korean producers and a relatively closed Korean market have contributed to a large (but recently significantly diminished) EU deficit in the automotive trade with Korea. The recent decline of the deficit is neither due to a huge increase of EU car exports to Korea (though recently, these exports did increase considerably) nor to a sudden loss of competitiveness of Korean cars in the EU, but largely to Korean FDI in the Union. Two factories (in the Czech Republic and in Slovakia by Hyundai and KIA) followed by some suppliers will soon have a capacity of 600 000 cars, which nearly matches the total sales of Korean cars in the EU in 2007 (i.e. before the crisis). With such FDI within the EU, EU tariffs on Korean exports will play a significantly diminished role.

Studies of estimated gains and losses from the EU-Korea FTA show that Korean producers of motor vehicles benefiting and the EU deficit in automotive trade increasing. However, none of the quantitative studies appear to have taken the new Korean FDI in the EU into account. Studies differ with respect to output and employment effects, where the effects on the EU range from moderately negative to neutral and for Korea from very large to moderately positive. Market share gains for Korean exporters in the EU predicted by the various studies are hard to interpret in the light of the recent FDI and might merely lead to a reshuffling of EU production and employment (especially Central European small cars) at the margin.

As noted above ACEA has emphasised its discontent with the EU-Korea FTA which it regards as unbalanced to the advantage of Korean producers of motor vehicles. ACEA wanted a longer tariff reduction period and is against the duty drawback regime as well as weakened rules of origin. ACEA is not convinced that EU market access to Korea will actually improve (other than on paper). ACEA demands alterations of the FTA and a thorough impact assessment.
5.1.1 EU / Korea trade flows and what determines them

The automotive sector is of major importance to and a backbone of the EU economy. According to ACEA, the European industry produced nearly 20 million motor vehicles in 2007 (amounting to 27 percent of world production) and is a major employer. Excluding (including) suppliers, 2.2 (12.1) million jobs depend on the industry, which amounted to 6.5% of EU manufacturing industry (6% of total employment) in 2005. When suppliers are included, about 16 percent of value added in the manufacturing sector derive from the EU automotive sector.

Graph 1: Bilateral motor vehicles trade: 1999-2009

Generally, the motor vehicle sector has come under pressure from a variety of developments in recent years, e.g. increasing overcapacities and resulting consolidation in Europe and worldwide, lower emission standards, and eventually the severe impact of the financial crisis. On top of this, competitive pressures from emerging markets, particularly from Korea, have been rising. Traditionally, the EU motor vehicle sector has had a relatively strong comparative advantage – and this is still true in the higher value and premium segments.

However, Korea has over time also developed a significant comparative advantage. More than 70% of cars produced in Korea (around 2.5 of 3.5 million) were exported in 2008, while imports are only in the order of 60,000. The Korean comparative advantage was traditionally mainly in the production of small to mid sized cars. But as lower cost suppliers such as China, India and others have also entered this low end segment, Korea – faced with rising labour and production costs and pushed into a kind of sandwich position between low and high end producers - has also moved more and more into mid-sized and higher value cars (CEPS/KIEP, 2007, automotive annex). Moreover, due to the cost pressures (but also for market access reasons) Korean producers (e.g. Hyundai) have moved production to low cost countries such as China, where according to Hyundai, capacities of 600,000 cars are planned. In addition to these structural economic trends, which have tended to make Korean producers more competitive, the Korean Won depreciated by more than 25 percent since between mid 2005 and mid 2007.  

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110 This was in part due to the rise of the Euro against the dollar, which has recently been reversed somewhat.
These factors – together with the fact that Korean market access is severely hampered by non tariff barriers\(^{111}\) - are the main reasons for the huge deficit of € 5.828 bn in 2007 in the automotive trade balance between the EU and Korea (see Graph 1, above).\(^{112}\) EU 2007 automotive exports to Korea amounted to € 1.769 bn, while EU imports from Korea were € 7.598 bn - a relation between EU exports and imports of more than 1 to 4. The Korean share in total EU automotive imports was around 19%, while Korea attracted only around 7 to 8% of EU automotive exports. As Graph 1 shows, this trade imbalance has diminished sharply recently. While EU 2009 automotive exports to Korea held up rather well at € 1.383 bn, EU imports from Korea declined dramatically to € 3.330 bn Euro, bringing down the trade deficit to € 1.947 bn (around one-third of the 2007 deficit!).

One reason for this decline could be the impact of the financial crisis (given lower price elasticities for EU premium cars and higher ones for Korean cars). Another prominent reason is the FDI by Korean producers in the EU, i.e. Hyundai in the Czech Republic and Kia in Slovakia (and also an increasing number of Korean suppliers). These two factories together are planned to have a capacity of 600,000 car per year (Credit Suisse, 2009),\(^{113}\) Which nearly matches the Korea imports in 2007 of around 700,000 cars. In future one can therefore expect Korean domestic production in the EU to increasingly replace imports. Credit Suisse estimates show that Korean suppliers increased their market share in the EU to 4% in 2009 from 3.3% in 2008 whilst imports declined from 550,000 to 455,000 and the number of cars produced in the EU rose from around 150,000 2008 to 280,000 in 2009.

\(^{111}\) According to KAIDA, a Korean automotive import organisation, still around the turn of the millennium the Korean market was basically closed for imports, which amounted only to 0.26% of domestic sales in 1999. In the meantime, this share has risen to 6% in 2008 (5% in 2009 probably due to the crisis impact). Correspondingly, absolute numbers of imported cars sold in Korea increased form 2,400 in 1999 to 61,600 in 2008 (61,000 in 2009).

\(^{112}\) There is some confusion on trade measured in terms of car units (which present only a part of automotive trade). According to Credit Suisse (2009) (relying obviously on data from ACEA), EU exports to Korea amounted to 28,000 (mostly high value vehicles) while the EU imported 692,000 cars from Korea in 2007. For 2008 the EU Commission mentions EU imports of 37,000 versus EU exports of 440,000 cars (COM – Trade Fact Sheet – EU-Korea FTA, December 2009). Compared to 2005, COM to an increase of 78 percent for EU exports and a decline of EU imports from Korea of 37 percent. KITA (Korea International Trade Association, relying on data provided from KAMA – Korea Automobile Manufacturers Association) mentions EU exports of close to 41,000 cars in 2008 (40,000 in 2009) amounting to about 50% of Korean car imports. Moreover, KITA roughly breaks down an number (alleged by others) of more than 700,000 cars exported from Korea to the EU in 2009 in three parts: about 300,000 genuine exports from Korea, close to 270,000 Korean cars manufactured in the EU and about 175,000 cars of Korean brands produced in third countries (e.g. India) and exported to the EU.

\(^{113}\) On the other side, Renault (teaming up with Samsung) has invested in Korea with an envisaged capacity of 250,000 by 2010 (Wikipedia: Renault Samsung Motors). KITA (Korea International Trade Association) states that nearly 137,000 cars were sold by Renault Samsung in 2009.
### Table 5: Effect of the EU-Korean FTA on Korean EU-25 imports of motor vehicles

In Francois / Copenhagen Economics

<table>
<thead>
<tr>
<th></th>
<th>Value of Korean Imports from EU-25 in million EUR</th>
<th>Absolute change from baseline in million EUR</th>
<th>Change from baseline in percent</th>
<th>Share of total import, increase in percent</th>
<th>EU share of total Korean imports in percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Motor Vehicles</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>1,433</td>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
</tr>
<tr>
<td>Partial 1 FTA</td>
<td>2,180</td>
<td>747</td>
<td>52</td>
<td>4</td>
<td>30.4</td>
</tr>
<tr>
<td>Partial 2 FTA</td>
<td>2,165</td>
<td>732</td>
<td>51</td>
<td>2</td>
<td>30.4</td>
</tr>
<tr>
<td>Full FTA</td>
<td>2,285</td>
<td>852</td>
<td>59</td>
<td>1</td>
<td>31.9</td>
</tr>
<tr>
<td><strong>Total merchandise trade</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>40,032</td>
<td></td>
<td></td>
<td></td>
<td>14.7</td>
</tr>
<tr>
<td>Partial 1 FTA</td>
<td>59,147</td>
<td>19,115</td>
<td>48</td>
<td>20.5</td>
<td></td>
</tr>
<tr>
<td>Partial 2 FTA</td>
<td>70,816</td>
<td>30,784</td>
<td>77</td>
<td>23.6</td>
<td></td>
</tr>
<tr>
<td>Full FTA</td>
<td>101,426</td>
<td>61,394</td>
<td>153</td>
<td>31.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Francois/Copenhagen Economics (2007)

Simulations show only limited increases of EU motor vehicle exports: between 750 million EUR and 850 million EUR compared to the baseline scenario which (among other assumptions) includes a successful conclusion of the DDA and Korean FTAs with other trading partners like the US, Japan, China, India, ASEAN, EFTA and Canada. As this baseline is very optimistic in terms of access for the Korean market for the EU’s competitors, the FTA should give marginally better results for the EU. The absolute rise in EU exports is between 51% and 59% (over the baseline). The share of Korean motor vehicle imports from the EU in total Korean motor vehicle imports from all countries is envisaged to increase by about around 8 to 10 percentage points. On the EU import side, Francois / Copenhagen Economics expects the EU-Korea FTA to lead to much larger increases. Data is, however, only presented with regard to the Partial 1 scenario under which motor vehicles are estimated to account for 41% of the total increase of Korean exports (€ 5.2 bn) over all sectors of € 12.8 bn. Table 6 compares the figures from Francois / Copenhagen Economics with the KIEP and Prognos.

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114 It might appear striking that the expected percentage increase of EU motor vehicle exports to Korea (51% to 59%) is higher than in the mechanical engineering machinery sector (40% to 56%). This is likely due to a relatively low base level of motor vehicle exports.

115 Copenhagen Economics has employed a CGE-model, while KIEP’s analysis is based on price elasticities of imports. Prognos only refers to trade between Germany and Korea, but the results still provide useful information to assess the possible impact of the FTA, because Prognos also considered the impact of the financial crisis in an alternative scenario.
Table 6:  Trade effects of FTA on motor vehicles: comparison of expected impacts

<table>
<thead>
<tr>
<th>Increase of exports to Korea (Korean import increase)</th>
<th>For EU</th>
<th>For EU</th>
<th>For Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Francois/Copenhagen (Partial 2 / Partial 1 FTA)</td>
<td>KIEP</td>
<td>Prognos (base case / crisis adjusted)</td>
</tr>
<tr>
<td>Absolute change</td>
<td>732 / 747 (million EUR)</td>
<td>125 (million $)</td>
<td>900 / 855 (million $)</td>
</tr>
<tr>
<td>Percentage change</td>
<td>51% / 52%</td>
<td>5%</td>
<td>59% / 56%</td>
</tr>
<tr>
<td>Increase of Korean exports (EU/German import increase)</td>
<td>In EU</td>
<td>In EU</td>
<td>In Germany</td>
</tr>
<tr>
<td></td>
<td>Francois/Copenhagen (Partial 1 FTA)</td>
<td>KIEP</td>
<td>Prognos</td>
</tr>
<tr>
<td>Absolute change</td>
<td>5,248 (million EUR)</td>
<td>1,077 (million $)</td>
<td>984 / 935 (million $)</td>
</tr>
<tr>
<td>Percentage change</td>
<td>n.a.</td>
<td>15%</td>
<td>62% / 59%</td>
</tr>
<tr>
<td>Share in abs. change</td>
<td>41%</td>
<td>63%</td>
<td>n.a.</td>
</tr>
<tr>
<td>Change of EU Trade surplus/deficit</td>
<td>For EU</td>
<td>For EU</td>
<td>For Germany</td>
</tr>
<tr>
<td></td>
<td>Francois/Copenhagen (Partial 1 FTA)</td>
<td>KIEP</td>
<td>Prognos</td>
</tr>
<tr>
<td>Absolute change</td>
<td>-4,401 (million EUR)</td>
<td>-952 (million $)</td>
<td>-84 / -80 (million $)</td>
</tr>
</tbody>
</table>

There are slight differences between the exact automotive subsectors covered: (Francois/Copenhagen Economics: motor vehicles, KIEP and Prognos: HS 87: automobile and parts) Copenhagen Economics data on export increases for Korea is only available for the Partial 1 FTA scenario.

Prognos uses results of Francois/Copenhagen Economics (Full FTA scenario) for German exports to Korea and Partial 1 FTA for Korean exports to EU.


The KIEP study features the lowest trade impact with only about a fifth of those displayed by Francois / Copenhagen Economics. One important reason for this is the crucial role of services liberalisation which – in Francois / Copenhagen Economics – greatly helps to improve car producers’ efficiency in Korea (services make up a significant part of the value-added in cars), which is not modelled in KIEP. The similarity between the percentage changes between Francois / Copenhagen Economics and Prognos is due to the fact that Prognos derived the results for Germany from Francois / Copenhagen Economics.

More important, however, is that all studies come to broadly the following conclusions:

Korean motor vehicle exports to the EU grow (much) more in absolute terms than EU exports to Korea. There is an increasing deficit for the EU in motor vehicle trade with Korea. The rise of the deficit is particularly large in the study of Copenhagen Economics (4.4 billion EUR). [Note that the recent FDI by Korea in the EU is not taken into account] and

Francois / Copenhagen Economics and KIEP (no comparable data available from Prognos) agree that the major part of the Korean export increase to the EU is likely to stem from motor vehicles.
5.1.2 Output and employment effects

The projected trade impact feeds into the expected results on output and employment of the EU-Korea FTA. Here, findings by Francois / Copenhagen Economics, KIEP and the IBM/ SIA study are presented in table below— all use CGE modelling. The estimates of the KIEP study is presented in the table 7 due to the fact that the analysis was carried out for old and new EU member states separately.

Table 7: EU output and employment effects in motor vehicles: comparison of simulation in Francois / Copenhagen (C) and IBM / SIA studies.

<table>
<thead>
<tr>
<th>Contribution to total due to liberalisation in</th>
<th>Agriculture in case of Partial 1,2 / Trade facilitation in case of full FTA</th>
<th>Manufacturing in case of Partial 1,2 / General import protection in case of full FTA</th>
<th>Services</th>
<th>Total</th>
<th>Memorandum: Total effects for Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Output</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>-0.7</td>
<td>-0.1</td>
<td>-0.9</td>
<td>16.4</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>-0.7</td>
<td>-0.3</td>
<td>-1.1</td>
<td>18.9</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>-0.1</td>
<td>-0.9</td>
<td>-0.8</td>
<td>-1.7</td>
<td>28.8</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~ +0.04</td>
<td>~ +1.6</td>
<td>~ +0.04</td>
<td>~ 1.6</td>
<td></td>
</tr>
<tr>
<td>IBM / SIA (long term effect)</td>
<td></td>
<td></td>
<td>~ +0.04</td>
<td>~ 6</td>
<td></td>
</tr>
<tr>
<td>Skilled Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.9</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>-0.3</td>
<td>-0.1</td>
<td>-0.4</td>
<td>5.9</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>0.0</td>
<td>-0.3</td>
<td>-0.3</td>
<td>-0.7</td>
<td>8.9</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~ -0.05</td>
<td>~ +1.4</td>
<td>~ -0.05</td>
<td>~ 1.4</td>
<td></td>
</tr>
<tr>
<td>Unskilled Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>-0.3</td>
<td>0.0</td>
<td>-0.3</td>
<td>15.8</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>-0.8</td>
<td>-0.3</td>
<td>-1.1</td>
<td>18.3</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>-0.1</td>
<td>-0.9</td>
<td>-0.7</td>
<td>-1.8</td>
<td>27.8</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~ -0.05</td>
<td>~ +1.4</td>
<td>~ -0.05</td>
<td>~ 1.4</td>
<td></td>
</tr>
</tbody>
</table>

Rounding differences

Motor vehicles: cars, lorries, trailers and semi-trailers (sectoral classification of GTAP database)

IBM / SIA data: no exact data provided, numbers roughly estimated from figures 6.3, 6.4, 6.5, long term impact (p. 128)


The IBM / SIA study and Francois / Copenhagen Economics / KIEP arrive at significantly different conclusions about the effect of the EU-Korea FTA on output and employment. Francois / Copenhagen Economics finds (albeit small) declines of output and (mainly) unskilled employment, with losses being higher under more far-reaching liberalisation scenarios. Moreover, tariff liberalisation in general or in the manufacturing sector as well as lower service trade barriers both contribute to the declines. Due to higher service trade barriers in Korea, which might however be overestimated by Copenhagen Economics (IBM /
SIA, 2008, p. 100-105), Korean producers benefit more than the EU from service trade liberalisation, because a more efficient service sector also enhances the competitiveness of manufacturing industries using business services as inputs. On the other hand, in Korea jobs and production are (in most scenarios) expected to increase significantly – with higher gains in more far-reaching liberalisation scenarios. In contrast, the IBM / SIA study only finds very limited effects for the EU and much smaller results for Korea. The results of the KIEP study (only on output, see table 8) for Korea are similar to the IBM / SIA long term effect, but also clearly negative for the EU. Possible sources of these divergences in estimates are differences in sector definitions, in market structure assumptions, in trade barriers in the baseline scenario and in the modelling of the service sector impacts.

### Table 8: EU output & employment effects of the FTA on motor vehicles: KIEP study

<table>
<thead>
<tr>
<th>Change in percent</th>
<th>Korea</th>
<th>Old EU Member States</th>
<th>New EU Member States</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Static Model</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario I</td>
<td>6.06</td>
<td>-0.38</td>
<td>-0.39</td>
</tr>
<tr>
<td>Scenario II</td>
<td>4.98</td>
<td>-0.32</td>
<td>-0.32</td>
</tr>
<tr>
<td>Scenario III</td>
<td>4.97</td>
<td>-0.31</td>
<td>-0.30</td>
</tr>
<tr>
<td><strong>Capital accumulation model</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario I</td>
<td>6.55</td>
<td>-0.37</td>
<td>-0.38</td>
</tr>
<tr>
<td>Scenario II</td>
<td>6.12</td>
<td>-0.28</td>
<td>-0.27</td>
</tr>
<tr>
<td>Scenario III</td>
<td>6.09</td>
<td>-0.27</td>
<td>-0.24</td>
</tr>
</tbody>
</table>

Motor vehicles: cars, lorries, trailers and semi-trailers (sectoral classification of GTAP database)
Source: KIEP (2005)

The IBM / SIA study has also undertaken a microeconomic impact analysis (see table 9). The baseline scenario (without an EU-Korea FTA) already foresees negative output effects which are not quantified in the study however. In a low impact scenario – which was considered more likely by the authors of the IBM / SIA study – the negative effects on EU production are limited. Assumptions include, among others, a longer tariff phase out (not quantified), an elimination or reduction of duty drawback schemes, escalating transport costs for Korean exports, a relatively effective European industry response to increased Korean competition, and a high degree of displacement of EU imports from Japan by rising EU imports from Korea. In the high impact scenario, where more pessimistic assumptions are made, the negative impact on EU motor vehicle production is much more sizeable: more than 330,000 cars. In relation to the EU-27 motor vehicle production in 2007 of close to 20 million vehicles in 2007 (according to ACEA), this amounts to a decline of more than 1.5 percent.
Table 9: Microeconomic analysis by IBM / SIA study on EU motor vehicle production and trade with Korea

<table>
<thead>
<tr>
<th>Future baseline scenario without EU-Korea FTA</th>
<th>Impact scenarios of EU-Korea FTA</th>
<th>Memorandum: Base level</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High impact</td>
<td>Low impact</td>
</tr>
<tr>
<td>Change up to 2010/2011</td>
<td></td>
<td>(Absolute level 2006/2007)</td>
</tr>
<tr>
<td>1,000 cars</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Increase in EU exports to Korea 2 6 10 (below 40)
minus increase in EU imports from Korea 160 400 100 (740)
plus displacement of EU imports from Japan 60 30
= =
Net effect on EU car production -334 -60

Change up to 2010/2011 change in recent years up to 2006/2007

Annual growth rate
Increase in EU exports to Korea ~5% ~15% ~25% >10%
Increase in EU imports from Korea ~5% ~15% 10-20 %
Displacement of EU imports from Japan (as a share of EU import increase from Korea) 15% 30%

Japanese share in EU imports in 2006: 15%
For assumptions, see note 116.

5.1.3 Positioning of business stakeholders in the motor vehicles sector

The industry’s expectations on the impact of the EU-Korea FTA on exports, market shares, employment, etc. were gathered mainly from ACEA by means of a questionnaire and a personal interview.

– Exports

116 Assumptions of IBM / SIA:
Future base scenario: with conclusion of Doha-round, implementation of KORUS-FTA, KOR-Japan FTA. This generates competitive disadvantages for EU exports to Korea. Decline of growth rate of EU imports from Korea due to slow overall EU car sales growth forecast of 1% annually.

High impact scenario: modest EU export increase (over base case), strong impact on imports from Korea, proportional displacement of Japanese imports, less effective European industry response, rules of origin allow 65% foreign content in Korea, continued Euro strength.

Low impact scenario: stronger EU export increase (over base case), weaker impact on imports from Korea due to decelerated tariff phase-out by EU and escalating logistic costs due to higher energy prices, larger displacement of Japanese imports, more effective European industry response, rules of origin allow only 40% foreign content in Korea, Korean duty drawback scheme eliminated or scaled back.

IBM/SIA considered the low impact scenario more likely.
Source: Trade SIA (2008)
An assessment of the EU-Korea FTA

- Increase of EU exports to Korea: very small
- Increase of EU imports from Korea: very significant
- Market shares
- Gain of EU in Korea: very small
- Gain of Korea in EU: significant increase
- Employment:
  - moderate decrease
  - specification: production and probably also employment losses for EU producers due to higher Korean imports and market shares in a relatively stagnant motor vehicles market. Losses concentrated in small and mid-sized cars and in countries in Southern and Central Europe. Countries mainly affected by competitive Korean imports are: Czech Republic, France, Hungary, Italy, Poland, Portugal, Romania, Slovakia, Slovenia, and Spain. This applies to both loss of employment for EU OEMs (production, logistics, dealership) and sub-contactors. [Again it should be noted that the Korean FDI in the Czech Republic and Slovakia, which brings jobs and extra output, does not seem to have been taken into account here].
- Investment and relocation:
  - little short term impact of the FTA on investment decisions
  - specifications:
    - in the medium term, higher cost pressures due to the FTA could force EU producers to relocate (additional parts of) their productions to lower cost countries.
    - the closure of the Opel plant in Antwerp and new investments in the GM plants in South Korea were mentioned, while it was acknowledged that the direct causal link to the EU Korea FTA was difficult to establish because of the general necessity for GM to optimise its existing production facility network.

5.1.4 The detail of the ACEA position

ACEA complains that EU concessions in the automotive sector have been used by the EU Commission as a bargaining chip to the detriment of the domestic car industry. ACEA has therefore lobbied for the following alterations of the FTA (see below) as well as a thorough impact assessment. If these steps do not lead to a satisfactory outcome, the motor vehicle industry would not support ratification. On tariffs ACEA supports the elimination of Korean tariffs in the motor vehicles sector. However, this step is regarded insufficient to significantly enhance market access of EU business due to the importance of non tariff barriers in Korea (see below). The timing of EU tariff elimination is criticised as being too quick, and ACEA favoured a 7 year phase-in compared to the 3 years for larger passenger cars (engine size >1,500 cc) and 5 years for smaller passenger cars (engine size < 1,500 cc) provided in the FTA. Allowing permanent duty drawbacks in the FTA is considered to provide an unfair advantage for Korean exporters when they compete with domestic producers within the EU – and a dangerous precedent for future FTAs. In addition, ACEA fears that the special clause on duty drawback (DDBSC) will not be effective. ACEA continues to ask that the duty drawback should not apply longer than 5 years, once the import duties on vehicles have been eliminated.

The relaxation of rules of origin for motor vehicles (from 40% to 45% foreign content) is also criticised as an unfair competitive advantage for Korea. Moreover, it is criticised as an unnecessary deviation from the
standard rule of 40% foreign content and as creating a possible precedent for future FTAs (see annex 2 on duty drawbacks and their effects in euros per car). ACEA supports the general bilateral safeguard clause (GSGC), but is pressing for strong rules to ensure its effectiveness and insists on the implementation of the GSGC when the FTA enters into force. ACEA also wants effective industry participation in the process of invoking this clause.

Concerning NTBs and regulatory issues, ACEA acknowledges that the EU-Korea FTA breaks new ground and goes further than the KORUS FTA in some aspects, e.g. the unconditioned acceptance of OBD Euro 6 standards. Moreover, ACEA generally supports the establishment of a “Working Group on motor vehicles and parts” as well as the accelerated bilateral dispute settlement procedure. But ACEA argues that not all Korean regulations have been harmonised with EU or international standards and not all EU regulations of the remaining technical standards are accepted by Korean authorities. Moreover, ACEA complains that there remain loopholes in the new rules and fears that new NTBs could still be created through health, safety and environmental regulations. ACEA argues that tackling such NTBs could be very difficult despite the above mentioned new institutional arrangements. Concretely, Korea plans a significant reduction of allowed CO2 emission for motor vehicle fleets, which could pose grave problems for EU exporters particularly of premium cars. ACEA insists on solving this issue before the FTA is ratified. In general, whenever the EU negotiates an FTA, ACEA is in favour of global harmonisation using UN ECE Regulations 1958. This should be also the target for the Commission and Council. Mutual recognition or harmonisation of certain product standards is supported, provided they are based on UN ECE Regulations.

117 The transitional export quotas for EU producers under the FTA in case of Euro 5 OBD standards or in case of derogations from Korean emission standards (which COM presents as additional market access due to the FTA) are accepted, despite the fact that they are considered too limited.

118 Additional NTBs in Korea, which cannot be elaborated upon here, concern time demanding registration procedures, parallel “grey market” imports with limited guarantees which could pose a threat to the reputation of EU producers, and the so called Capital Region Act on regional emission limits (Prognos, 2008). In general, specific NTBs in Korea pose a grave problem to the industry, because high adaptation costs can be spread only on a very limited number of cars due to the small Korean import volume of motor vehicles.

119 COM (Trade Fact Sheet December 2009, p.8) states that it has obtained the assurance from Korean authorities that “this new legislation will not reduce the advantages that the EU car industry could get from the FTA in terms of increased market access and that EU stakeholders will be consulted before any legal draft is tabled”.

49
5.2 Pharmaceuticals and the EU/Korea FTA

Pharmaceuticals is a comparative advantage sector for the EU, also vis-à-vis to Korea. EU exports to Korea amounted to €1,007 mn against €71 mn of imports in 2009. The relatively low tariffs do not represent a cause of concern and will be removed by the FTA. Traditionally, NTBs have represented the main issue for pharmaceuticals sector. The FTA deals with the given specific provisions for pharmaceuticals and medical devices in the text of the agreement (i.e. ‘Access to innovation’ and ‘Ethical Business Practice’). EU industry supports the FTA.

5.2.1 EU-Korea Trade flows

The following graph on pharmaceutical trade flows between EU and South Korea shows that EU has been a net exporter of pharmaceuticals over the last two decades. The trade balance in 2009 amounted to €936 mn, resulting from exports to Korea of €1,007 mn and imports of €71 mn. Very similar levels were attained by the trade balance both in 2008 (€937 mn) and in 2007 (€946 mn). Overall and after a first period of low growth in years from late ‘80s to early ‘90s, exports of pharmaceuticals from EU to Korea have been growing at a very high rate, doubling their absolute values with respect to the baseline year (1998) in 2002 when the registered increase in exports amounted to 126% (i.e. €550 mn). This happened in the aftermath of the East-Asian crisis (1997). The graph shows a boom in EU exports in the years after the Dot-Com crisis, registering a boost equal to 89% up to 2007 (i.e. €479 mn) when compared with the 2003 figure (i.e. €540 mn). These figures show the strong comparative advantages for pharmaceuticals that the European Union towards Korea, with tiny EU imports (€71 mn in 2009).

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120 The graph has been kindly provided by CEFIC.
121 Data comes from Eurostat, Comext, SITC, statistical regime 4.
The Prognos study (2008) offers a breakdown of the 10 biggest EU pharmaceuticals exporting countries to Korea in 2005.

### Table 10: Share of the exports to Korea

<table>
<thead>
<tr>
<th>Exporters country</th>
<th>EU Mio $</th>
<th>Share of the total country exports to Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>154</td>
<td>5%</td>
</tr>
<tr>
<td>France</td>
<td>145</td>
<td>5%</td>
</tr>
<tr>
<td>Belgium</td>
<td>142</td>
<td>12%</td>
</tr>
<tr>
<td>Germany</td>
<td>128</td>
<td>1%</td>
</tr>
<tr>
<td>Italy</td>
<td>91</td>
<td>4%</td>
</tr>
<tr>
<td>Ireland</td>
<td>45</td>
<td>7%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>34</td>
<td>1%</td>
</tr>
<tr>
<td>Sweden</td>
<td>27</td>
<td>3%</td>
</tr>
<tr>
<td>Spain</td>
<td>17</td>
<td>3%</td>
</tr>
<tr>
<td>Denmark</td>
<td>14</td>
<td>3%</td>
</tr>
</tbody>
</table>

Source: Prognos study (2008)

The table shows us that, while UK and France export more than Belgium in absolute value, Belgian exports show a much higher share in the country total exports towards Korea in the 2005 EU sample.
5.2.2 Economic studies on the impacts of the FTA

The six studies already available on the impact of the EU-Korea FTA do not provide us with much insight on the impact on the pharmaceuticals sector. This lack of information is due to the fact that either (and often) pharmaceuticals are not disaggregated from the broader chemicals category, hence results cannot be meaningfully used\textsuperscript{122} or in other cases, pharmaceuticals represent the object of the study, but no quantitative simulation is run for them.

In the second category of studies, both CEPS/KIEP (2007) and IBM (2008) focus on pharmaceuticals and emphasise the importance of non-tariff barriers for the sector. The issues of concern fall into three categories: pricing and re-pricing, including minimum price guarantee for innovative drugs (also known as A-7 pricing) and re-pricing systems (Triennial Re-pricing and Actual Transaction Pricing); the introduction of a positive list system and intellectual property rights issues. They also stress that "Regarding the cosmetics sector, the EU claims that Korea's appropriateness and safety tests and the introduction of the functional cosmetics system (2001) are blocking the entry of EU pharmaceuticals into the Korean market". The IBM study considers the same NTB issues as in the CEPS/KIEP one.

Finally, the Prognos (2008, 2009) studies criticise the Copenhagen Economics findings on the impact on output.\textsuperscript{123} For instance, Copenhagen Economics (2007) found that the output effects for the chemical sector 'at large' would be minimal for EU, i.e. -0.16\%, whereas Prognos found a strikingly opposite result in which expected additional output for the pharmaceutical sector separately considered would be 95\% for Germany alone. Nevertheless, the Prognos (2008) authors also introduce, in an updated version of their study in March 2009, a discussion over possible ways in which trade could be affected by the current economic crisis. They explain the crisis could indeed lower FTA potentials (i.e. compared to their previous study) and they indicate sectoral ranges for such decreases. However, no estimation for such dangers is specifically presented for the pharmaceuticals sector.

5.2.3 Positioning of stakeholders in pharmaceuticals

The European Federation of Pharmaceutical Industries and Associations (EFPIA) considers the EU-Korea FTA as very positive for its sector for several reasons. First, the agreement provides the pharmaceuticals sector with the main (legal) protection EFPIA have been asking for since 1999 on the issues of pricing and reimbursement\textsuperscript{124}. Art.2 of Annex 2-D of the FTA specifically provides that the Korean authorities will introduce new rules to align their practices with certain international standards (which they has studiously avoided to accept in the past). Second, the FTA introduces a more secure regulatory environment for European firms, through a better recognition of the value of innovative products. Finally, EFPIA judges the compromise on IPR, an issue of some concern for the sector for many years, as satisfactory. Interestingly,

\textsuperscript{122} Both KIEP (2005) and Copenhagen Economics (2007), for instance, use the GTAP 2001 database and include in their analysis only broad sector classification. These are the 'petrochemical' category for the former study and the 'chemicals, rubber and plastic' category for the latter study. Finally, Prognos (2008, 2009) studies also run a quantitative analysis for pharmaceuticals, but firstly their quantitative exercise cannot really be comparable to other studies on the subject and secondly, the analysis is mainly focused on Germany and only occasionally on EU as a whole.

\textsuperscript{123} This critique was also made by IBM (2008) : "Some of the simulated output impacts are, frankly, surprising to us (e.g. Sugar, Beverages) while others, due to the highly aggregated sectoral combinations that were used, and particular assumptions made in of the modeling process by Copenhagen Economics, not particularly useful as a guide to real world impacts (Other Machinery, Other Business Services). Others, e.g. Trade, Transport and Communications, are a direct corollary to the anticipated expansion in trade volumes, and not particularly interesting in their own right." (pp.93)

\textsuperscript{124} See Annex 2-D devoted to 'Pharmaceuticals Products and Medical Devices"
EFPIA believes that EU interests were adversely affected in some aspects of the negotiations by what the US had negotiated in KORUS.125

5.3 Chemicals

Chemicals sector is a prominent export sector of the EU and its imports from Korea are also far from trivial. Although there are some non-tariff barrier issues, neither the latter nor tariffs represent a major problem on either side. The FTA should be able to deal effectively with these, subject to the inevitable detail for subsectors typical for such a large and diversified industry. Tariff free trade in chemicals between the two trading partners will have beneficial effects on the (costs and quality of) inputs for many other industries since most chemicals are intermediate goods (at times, with large shares in overall value-added). Services liberalisation through the FTA is likely to benefit Korean chemical producers in particular (some of which are EU-owned) since services constitute a significant input and the (protected) Korean are currently less efficient than EU business services.

5.3.1 Trade patterns in chemicals

In 2008 the EU ran a trade surplus with Korea of € 1.817 bn, resulting from exports to Korea of € 3.449 bn and imports of € 1.632 bn. Graphs 3 and 4 below show respectively the EU exports and imports over the last 21 years.126 Apart from cyclical influences, such as the 1997 Asian financial crisis (1997) and the aftermath of the dot-com crisis (2002/3), one observes a steady growth of mutual trade over two decades. EU exports are relatively strong in basic inorganics, petrochemicals and specialty chemicals, whereas Korean exports to the EU are concentrated in polymers and petrochemicals. In consumer chemicals the EU exports are also of some importance, against virtually none from Korea. Pharmaceuticals are dealt with separately above, as requested by the EP.

125 EFPIA mentioned for instance that in the case of some pharmaceuticals a protection for the duration of 10 years would have been their goal, but the European Commission could not reach this target since Korea had already and previously negotiated a duration of 5 years with the U.S.

126 These Graphs have kindly been provided by CEFIC; and are based on Eurostat.
EU companies have invested in Korea. This may well be of crucial importance to understand the nature of economic intercourse in chemicals, since (worldwide) some 45% of chemicals output is traded and most of that (35%) is traded across borders but *intra*-firm. This might mean that trade flows depend, in the medium to longer run, more on corporate strategy related to (say) the entire East Asian economy than on trade barriers between the EU and Korea as such. If so, the FTA would be merely a secondary factor. Data on sectoral FDI (both stocks and flows) from the various EU countries are often incomplete due to confidentiality or other reasons. Countries such as the Netherlands, the UK, Germany and France had...
significant overall FDI in Korea, but often via joint ventures (a possible sign that FDI in Korea might not be so easy). German chemical (and pharmaceutical) FDI in 2004 amounted to a stock of €378. It is therefore possible EU-Korean trade flows in chemicals are partially determined by intra-firm trade and is a function of comparative advantages for distinct types of chemicals and sales opportunities (especially to other industrial sectors) in East Asia. In that light, the other potential Korean FTAs (with Japan and China and possibly ASEAN) might accentuate a first-mover advantage of EU companies operating via Korea.

5.3.2 Summary of findings on chemical from the economic studies on the FTA impact

For chemicals, the degree of detailed guidance from the studies is quite limited. The quantitative studies (Francois [2007], KIEP [2005], Pukyong [2006] and to some extent Prognos [2008]) have high degrees of aggregation, and they also differ in this aggregation\textsuperscript{127}. The two qualitative studies do not deal with chemicals in any detail except for non-tariff barriers.

After all these caveats, the results are as follows. In Francois (2007) there are 3 scenarios: partial 1, partial 2 and the full FTA (with e.g. no services barriers left whatsoever). In all three, the (relatively low) tariffs for chemicals go to zero. Sectoral output of chemicals in the EU will slightly decline after the FTA (0.5% in the full FTA) compared to the baseline but the reason for that is the large improvement of chemicals' competitiveness in Korea, in turn due to the services liberalisation! As we shall see, EU exports will increase. The baseline in Francois suggests a worse outcome (for the EU) than the trade status quo\textsuperscript{128}. But if the FTA is ratified and the baseline is corrected for so far unfulfilled assumptions and if one assumes a moderate impact of services on chemical companies performance, the EU would undoubtedly gain.

The trade effects are positive. First, if one assumes that Korea does not conclude a range of 7 FTAs with other partners assumed in the study, the EU's market share would go up from the baseline 14.7\% (all goods and services) to 17.5\%. With conclusion of the EU / Korea FTA EU market share goes up to 20.5\% (partial 1), or to 23.6\% (partial 2) or even to 31.1\% (full FTA). In euro terms, EU exports of manufacturing exports would increase by some 35\% - 37\% (partial 1 or 2). For chemicals, market share goes up by 6 percentage points, a 33\% rise of EU exports worth €1.1 bn. Francois does not report the specific impact on EU imports of chemicals. This is regrettable because EU exports of 'petrochemicals' are expected by Francois not to be affected much, whereas one might reasonably expect Korean exports of petrochemicals to the EU (€450 mn in 2008) to increase\textsuperscript{129}.

Prognos (2008) has no rigorous simulation but does provide an estimate (based on business interviews) of the 'market potential' in chemicals for German exports (a leader in this sector) that foresees a slight

\textsuperscript{127} Note that these quantitative simulation studies employ different definitions of 'chemicals'. One reason is aggregation of subsectors: thus, KIEP has 15 and Francois 36 sectors. Another reason is a lack of precision in terminology of sectors. KIEP (2005) grossly errs when they use the label "petrochemicals" for HS 27 – 40, that is, all chemicals including pharma, petroleum and its products, fertilizers, pesticides, various intermediates, plastics, rubber and rubber products. This leads to the impossibility to compare 'petrochemicals' in Francois (the narrow subsector) with 'petrochemicals' in KIEP. In Prognos, Korean exports to the EU in 'plastics' (a €1 billion-plus) turn out to be 'polymeres', which is the semi-finished product. MEPs will appreciate that the background of all this is the focus on aggregate models with a minimisation of the already enormous data absorption needed.

\textsuperscript{128} The authors assumed Doha to be 'in' the baseline and accepted the daring supposition of Korea having concluded and ratified no less than 7 FTAs (including those with the US, and with China and with Japan, all of which would prompt a deterioration of some degree for the EU in Korea, and none of which is in force.)

\textsuperscript{129} However, KIEP (2005, table 3-23) provides a tiny Korean export effect for all chemicals, erroneously called 'petrochemicals', of merely 2\%.
decrease in exports (nearly 8%), essentially due to the costs of distance, but holds that German FDI to Korea will increase with a view to supply chemicals throughout East Asia, in particular China\textsuperscript{130}.

KIEP (2005) simulates an EU import effect of just 2 % against an EU export effect of 4.1 % for all chemicals.

5.3.3 Positioning of stakeholders in chemicals

CEFIC is clearly positive about the FTA as signed on 15 October 2009. In a News Release of 15 October 2009 the chemical industry speaks about its 'great satisfaction at the initialising' of the FTA. CEFIC hopes that this FTA 'will mark the beginning of a potential new wave of FTAs'. In further correspondence, CEFIC urges MEPs "to support the earliest possible entry into force of" the FTA "in order to reap the economic benefits that it will bring to Europe". CEFIC welcomes the dismantling of chemical tariffs and the simplification of the rules of origin. The speed they favour hinges on an expected first-mover advantage, given the fact that the US / Korea FTA is still not ratified. Interestingly, CEFIC quotes the US International Trade Commission expecting a 5 % decline in US chemical exports to Korea as a result of the EU / Korea FTA.

If one were to disaggregate the chemicals sector into 5 subsectors (polymers, petrochemicals, basic inorganics, specialty chemicals and consumer chemicals – excluding pharma here), CEFIC's analysis indicates that the EU position vis-a-vis Korea is strong in petrochemicals, basic inorganics and specialty chemicals, but weak in polymers (Korean exports to the EU being large) and under threat in consumer chemicals (where the EU enjoys a considerable trade surplus but competitiveness is waning).

5.4 Machinery

The mechanical engineering industry is a strategic sector for the EU due to strong comparative advantages. The 2008 EU exports to Korea amounted to € 6 bn, yielding a trade surplus of no less than € 3.1 bn. Studies show that the FTA should strongly benefit EU exporters of non electrical machinery (mainly mechanical engineering machinery) with a significant increase in the EU's trade surplus. The various studies estimate only small effects on EU output with two studies suggesting negative and one positive effects. For Korea, there are moderate moderate negative effects. Business stakeholders in the mechanical engineering sector also expect large positive effects for EU exporters to Korea and only relatively small gains for Korean producers in the EU and therefore strongly support the FTA (including the specifications on duty drawback, rules of origin, and non-tariff barriers) and call for a rapid ratification and implementation.

5.4.1 EU / Korea trade flows

The machinery sector (here: only mechanical engineering)\textsuperscript{131} is of great importance to the EU economy. With a turnover in the EU-25 of nearly Euro 630 billion in 2008 (€ 480 bn in 2009 due to the crisis) the industry directly provides 3.3 million jobs and accounts for around 10% of manufacturing employment (2008). The EU economy is highly specialised in the sector and the machinery industry boasts strong comparative advantages with total exports of Euro 413 billion and total imports of 271 billion Euro in 2008 (HS 84 excluding ICT and white goods). This also applies to EU-Korean trade in mechanical engineering goods. Looking at 2008 data – and leaving out the crisis impact – EU exports to Korea amounted to 6 billion Euro, and imports from Korea to 2.9 billion Euro, which results in an impressive trade surplus of 3.1 billion

\textsuperscript{130} Note that this concerns chemicals without pharmaceuticals in it; for pharma, they expect a market potential of no less than 95 % more than 2006 EU exports.

\textsuperscript{131} As consumer electronics and thus an important part of electrical machinery is covered in another sector analysis, this section focuses on mechanical engineering machinery, which is a sector whose voice plays an important role in the EU-Korean FTA. If this sector was taken together with electrical machinery, it would be very difficult to find a clear position of this combined industry, as the electrical machinery is generally less pronounced and also slightly defensive towards the FTA.
Euro. Also in most sub-sectors of mechanical engineering, exports significantly exceed imports. This is particularly true for machine and precision tools.

Graph 5: EU - Korea Trade in mechanical engineering goods

In contrast to other EU business sectors the EU machinery industry also stresses the strategic aspects of the EU-Korea FTA. It sees considerable competitive disadvantages in the fact that machinery companies in EFTA countries already benefit from lower Korean tariffs due to the EFTA-Korea FTA. More disadvantages and possibly significant market share losses would be expected, if Japan and the US respectively implemented FTAs with Korea and the EU-Korea FTA was not ratified and implemented. On the other hand, an early implementation of the EU-Korea FTA could – in the view of the machine tool industry - provide certain first-mover advantages in comparison to Japanese or US firms, if these did not benefit from reductions of tariffs and non-tariff barriers. All in all, the mechanical engineering industry is a strategic sector for the EU in the sense that an EU-Korea FTA promises large benefits while at the same time posing only a very limited degree of adjustment problems.

5.4.2 Economic studies on the impact of the FTA

Trade effects

The studies of Francois /Copenhagen Economics, KIEP, IBM / SIA and Prognos (for Germany) provide substantial information of possible gains and losses of the EU-Korea FTA for the machinery sector.

First, the FTA impact on trade will be summarized, before the implied effects on production and employment are presented. The studies do not simulate the effects of the actual FTA as signalled in October 2009 but work with stylized assumptions about a FTA or with several scenarios. Only Francois / Copenhagen economics has three scenarios: partial 1, partial 2 and a full FTA (see beginning of section for detail). The partial FTA2 is probably closest to the signalled FTA (see table 11).
Table 11: Effect of the EU-Korean FTA on Korean non-electric machinery imports from EU-25

<table>
<thead>
<tr>
<th></th>
<th>Value of Korean imports from EU 25 in million EUR</th>
<th>Absolute change from baseline in million EUR</th>
<th>Change from baseline in percent</th>
<th>Share of total Korean import, increase in percent</th>
<th>EU share of total Korean imports in percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-electrical machinery</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>7,603</td>
<td></td>
<td></td>
<td></td>
<td>15.5</td>
</tr>
<tr>
<td>Partial 1 FTA</td>
<td>10,668</td>
<td>3,065</td>
<td>40</td>
<td>16</td>
<td>20.6</td>
</tr>
<tr>
<td>Partial 2 FTA</td>
<td>10,797</td>
<td>3,194</td>
<td>42</td>
<td>10</td>
<td>20.3</td>
</tr>
<tr>
<td>Full FTA</td>
<td>11,881</td>
<td>4,278</td>
<td>56</td>
<td>7</td>
<td>21.9</td>
</tr>
<tr>
<td>Total merchandise trade</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline</td>
<td>40,032</td>
<td></td>
<td></td>
<td></td>
<td>14.7</td>
</tr>
<tr>
<td>Partial 1 FTA</td>
<td>59,147</td>
<td>19,115</td>
<td>48</td>
<td></td>
<td>20.5</td>
</tr>
<tr>
<td>Partial 2 FTA</td>
<td>70,816</td>
<td>30,784</td>
<td>77</td>
<td></td>
<td>23.6</td>
</tr>
<tr>
<td>Full FTA</td>
<td>101,426</td>
<td>61,394</td>
<td>153</td>
<td></td>
<td>31.1</td>
</tr>
</tbody>
</table>

Source: Francois / Copenhagen Economics

The simulations suggest large absolute increases in EU machinery exports of between € 3.1 bn and € 4.3 bn compared to the baseline scenario, which (among other assumptions) includes a successful conclusion of the DDA and the conclusion of Korean FTAs with other trading partners like the US, Japan, China, India, ASEAN, EFTA and Canada. Since this baseline is too optimistic with regard to access of competitors, the FTA should give marginally better results for the EU. The absolute rise in EU exports corresponds to a percentage increase of between 40% and 56 % (over the baseline). The share of Korean machinery imports from the EU in total Korean machinery imports from all countries is envisaged to increase by about 5 to 6 percentage points.

On the EU import side, Francois / Copenhagen Economics expect the EU-Korea FTA to lead to much smaller increases. Data are, however, only presented with regard to the Partial 1 scenario. Non electrical machinery is simulated to account for 5.7% of the total increase of imports from Korea over all sectors of 12.8 billion EUR. This amounts in absolute terms to an increase of Euro 730 million.

In table 11, the trade impact from Francois / Copenhagen Economics is compared to other studies, namely KIEP and Prognos, which do not feature different scenarios. 132

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132 Copenhagen Economics has employed a CGE-model, while KIEP’s analysis is based on price elasticities of imports. Prognos only refers to trade between Germany and Korea, but the results still provide useful information to assess the possible impact of the FTA. Prognos' results for German exports to Korea derive from a market potential comparison with Mexico, while EU imports from Korea are taken from Francois / Copenhagen Economics (broken down to Germany). Prognos also considered the impact of the financial crisis in an alternative scenario.
### Table 12: Effect of the EU-Korean FTA on Korean non-electric machinery imports form EU-25

<table>
<thead>
<tr>
<th>Increase of exports to Korea (Korean import increase)</th>
<th>For EU</th>
<th>For EU</th>
<th>For Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absolute change</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Francois / Copenhagen (Partial 2 / Partial 1 FTA)</td>
<td></td>
<td>KIEP</td>
<td>Prognos (base case / crisis adjusted)</td>
</tr>
<tr>
<td>Absolute change</td>
<td>3,194 / 3,065 (million EUR)</td>
<td>386 (million $)</td>
<td>7,500 / 7,125 (million $)</td>
</tr>
<tr>
<td>Percentage change</td>
<td>42 % / 40 %</td>
<td>5 %</td>
<td>249 % / 236 %</td>
</tr>
<tr>
<td>Increase of Korean export (EU/German import increase)</td>
<td>In EU</td>
<td>In EU</td>
<td>In Germany</td>
</tr>
<tr>
<td>Absolute change</td>
<td>730 (million EUR)</td>
<td>$ 83 (million $)</td>
<td>219 / 208 (million $)</td>
</tr>
<tr>
<td>Percentage change</td>
<td>n.a.</td>
<td>2 %</td>
<td>13 % / 12 %</td>
</tr>
<tr>
<td>Share in abs. change</td>
<td>5.7 %</td>
<td>4.9 %</td>
<td>n.a.</td>
</tr>
<tr>
<td>Increase of trade surplus for EU</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Absolute change</td>
<td>2,335 (million EUR)</td>
<td>303 (million $)</td>
<td>7,281 / 6,917 (million $)</td>
</tr>
</tbody>
</table>

There are slight differences between the exact machinery subsectors covered (Copenhagen Economics: non electrical machinery, KIEP: machinery (HS 84, excl. 8471, 8473) and precision instruments (HS 90-92), Prognos: HS 84, HS 93).

Francois / Copenhagen Economics data on export increase of Korea only available in the Partial 1 FTA scenario.

Prognos’ results rely on a market potential comparison to Mexico for German exports and for Korean exports on the findings of Copenhagen Economics (Partial 1 FTA).


The KIEP study finds the lowest trade impact: only little more than 10 percent of those displayed by Francois / Copenhagen Economics. On the other hand, Prognos’ trade expansion results for Germany are far larger than Francois / Copenhagen Economics’ findings for the EU total: respectively, 40 % increase against no less than 250 % (the latter for Germany only). However, there are also some similarities:

- All studies find machinery exports to Korea will grow far more than imports from Korea,
- The trade surplus increases, albeit to different degrees. The rise is particularly large in case of the Prognos study (for Germany).
- The shares of the increase of Korean machinery export in the total Korean export increase are of similar magnitude (no comparable data available from Prognos).

Thus, EU exporters of other non electrical machinery (which is mainly mechanical engineering machinery) would benefit more than Korean exporters and the already existing trade surplus would most likely increase.
Output and employment effects

The projected trade impact feeds into the expected results on output and employment of the EU-Korea FTA. Here, findings by Francois / Copenhagen Economics, KIEP and the IBM / SIA study can be compared – all use CGE modelling (see table 13). The KIEP study is presented in table 14 due to the fact that the analysis is carried out for old and new EU members separately.

Table 13: EU output and employment effect in non-electrical machinery: Comparison of simulated effects

(Francois/ Copenhagen (see C in the table) & IBM / SIA). Change over baseline in percent

<table>
<thead>
<tr>
<th>Contribution to total due to liberalisation in</th>
<th>Manufacturing in case of Partial 1,2</th>
<th>General import protection in case of full FTA</th>
<th>Services</th>
<th>Total</th>
<th>Memorandum: Total effects for Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture in case of Partial 1,2 / Trade facilitation in case of full FTA</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Output</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>0.2</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>0.2</td>
<td>-0.4</td>
<td>-0.2</td>
<td>3.1</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>0.0</td>
<td>0.2</td>
<td>-0.8</td>
<td>-0.5</td>
<td>10.6</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~0</td>
<td>~1.1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Skilled Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>0.1</td>
<td>-0.1</td>
<td>-0.1</td>
<td>1.3</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>0.0</td>
<td>0.1</td>
<td>-0.3</td>
<td>-0.2</td>
<td>4.1</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~ -0.1</td>
<td>~ +0.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unskilled Employment</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C: Partial 1 FTA</td>
<td>0.0</td>
<td>0.1</td>
<td>-0.1</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>C: Partial 2 FTA</td>
<td>0.0</td>
<td>0.3</td>
<td>-0.4</td>
<td>-0.1</td>
<td>2.8</td>
</tr>
<tr>
<td>C: Full FTA</td>
<td>0.0</td>
<td>0.3</td>
<td>-0.8</td>
<td>-0.5</td>
<td>9.7</td>
</tr>
<tr>
<td>IBM / SIA</td>
<td>~ -0.1</td>
<td>~ +0.7</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Rounding differences

Machinery: other than electronic equipment, according to GTAP sectoral classification

IBM / SIA data: no exact data provided, numbers estimated from figures 6.3, 6.4, 6.5


The IBM / SIA study and Francois / Copenhagen Economics (apart from the unrealistic full FTA scenario) both find only very minor, but mostly slightly negative impacts for the EU on output as well as on skilled and unskilled employment in the machinery sector. On the other hand, in Korea employment and

133 Regarding the Francois / Copenhagen Economics study, this appears surprising due to the expected substantial increase in the trade surplus for the EU in machinery products.
production are (in most scenarios) expected to increase – the gains being higher for more far-reaching liberalisation scenarios.

The slight projected losses for the EU are entirely due to the service liberalisation, while tariff reductions (in general or only in manufacturing) exert a small positive effect on output and employment. Due to higher service trade barriers in Korea, which might however be overestimated by Copenhagen Economics (TRADE SIA, 2008, p. 100-105), Korea benefits more than the EU from service trade liberalisation, because a more efficient service sector also enhances the competitiveness of manufacturing industries which use business services as inputs.

There is a contrast with the findings of KIEP. While the KIEP study also finds very small effects for the EU, these are clearly positive – and not negative as in the former studies. Moreover, in contrast to the former studies the production effects for Korea are simulated to be negative in all but one scenario. Among the possible sources for the divergences are differences in market structure assumptions, in trade barriers in the baseline scenario and in the modelling of the service sector impacts.

**Table 14: EU output & employment FTA effects on non-electrical machinery: KIEP study**

Change over baseline in percent

<table>
<thead>
<tr>
<th></th>
<th>Korea</th>
<th>Previous EU Member States</th>
<th>New EU Member States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Static Model</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario I</td>
<td>-0.96</td>
<td>0.12</td>
<td>0.07</td>
</tr>
<tr>
<td>Scenario II</td>
<td>-2.77</td>
<td>0.05</td>
<td>0.06</td>
</tr>
<tr>
<td>Scenario III</td>
<td>-2.77</td>
<td>0.07</td>
<td>0.10</td>
</tr>
<tr>
<td>Capital accumulation model</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scenario I</td>
<td>0.01</td>
<td>0.15</td>
<td>0.10</td>
</tr>
<tr>
<td>Scenario II</td>
<td>-0.56</td>
<td>0.15</td>
<td>0.15</td>
</tr>
<tr>
<td>Scenario III</td>
<td>-0.59</td>
<td>0.17</td>
<td>0.19</td>
</tr>
</tbody>
</table>

Machinery: other than electronic equipment, according to GTAP sectoral classification

Source: KIEP (2005)

### 5.4.3 Positioning of stakeholders in non-electrical machinery

Three Industry associations were consulted, namely Orgalime (European Mechanical, Electrical, Electronic, Metalworking & Metal Articles Industries association), Cecimo (European machine tools association) and VDMA (German mechanical engineering industries association). In addition to providing information like press releases and background knowledge the latter two organisations have answered a questionnaire. Their expectations of gains and losses are presented in the following:

- **Exports**

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134 This most likely also pertains to employment, not estimated in the KIEP study.
135 These divergent results for the non electrical machinery sector are not explained in the comparison with the KIEP study presented by Francois / Copenhagen Economics (p. 47-49).
136 Orgalime did not answer the questionnaire as this organisation presents a wide variety of subsectors with partly different views.
An assessment of the EU-Korea FTA

- Increase of EU exports to Korea: significant (CECIMO) / very significant (VDMA).
- Increase of EU imports from Korea: small (CECIMO) / none (VDMA)
- Market shares
  - Gain of EU in Korea: medium (CECIMO) / significant (VDMA)
  - Gain of Korea in EU: medium (CECIMO) / small (VDMA)
- Employment: no unanimous opinion of whether an employment effect exists and about its possible extent.

5.4.4 A critical assessment of the FTA negotiations

The mechanical engineering sector strongly supports the outcome of the FTA and calls for a rapid ratification and implementation.
- The extent and timing of tariff elimination is supported.
- Allowing duty drawbacks in the FTA is considered to be of little relevance for the industry. Instead it was considered a bargaining chip to achieve larger concessions from the Korean side, where the DDB was regarded a “deal breaker”.
- Rules of origin are considered to be favourable to the EU by CECIMO. In general, however, the sector prefers uniformity of rules or origin across different FTAs in order to avoid massively increasing transaction costs due to the ‘spaghetti bowl’ phenomenon (inconsistencies between FTAs with distinct origin rules cancelling benefits for inputs and prompting giant paper work).
- The mediation procedure of chapter 3 of the FTA is supported by CECIMO
- The TBT chapter of the FTA on machinery products is supported. In general NTBs are of relatively limited relevance to the mechanical engineering industry. Moreover, CECIMO lauds Korean cooperation in international standardisation bodies. However, there are a small number of NTBs bothering EU businesses in this sector. Therefore, CECIMO asks for mutual recognition of certification and the use of international standards.

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137 This section relies on the same information from the above mentioned business organisations.
138 Most mechanical engineering goods face a tariff of 8% in Korea. According to VDMA more than 90 percent of the tariff lines (HS 84 heading excluding white goods and ICT goods) are eliminated upon the entry into force, the biggest part of the rest after 3 years and the remaining lines after 5 or 7 years. According to calculations from the European Commission, this amounts to € 450 mn of annual savings in duty payments of machineries – this number, however, also includes electrical machinery.
139 The industry has criticised for some time already the administrative burdensome and costly Korean requirement of the Korean High Pressure Gas Safety Control Law to obtain a “manufacturer license”, which is independent of the acceptance of technical standards and certification for the respective products. More recently, some irritation has arisen about a notification of the Korean Communication Commission that certain EU manufacturers of machine tools should certify all their machines according to Korean laws for electromagnetic compatibility, despite the fact that these machines are certified according to EU law. Moreover, it is pointed out that the respective law has been in place for several years already and that the new and different enforcement poses a highly unwelcome source of potential mistrust at a time when the EU-Korea FTA is in the process of ratification.
The machinery industry supports the general bilateral safeguard clause, but wants to improve the transparency of required information to start and implement the clause whilst strengthening the rules for participation of the industry.

5.5 Consumer electronics

Electronic goods sector, mainly consumer electronics, is the third most important export sector of Korea to the EU, along with machinery and automobiles. Currently, the EU faces a large trade deficit with Korea in consumer electronics; €13 bn in the crisis and €20 bn in 2007. With modest tariff barriers for consumer electronics, what inhibits trade are various non-tariff barriers. Non-tariff barriers affecting EU exports include the lack of use of international standards in Korea and (prior to the FTA) a refusal of mutual recognition of certification of EU electronic products on Korean requirements. The consumer electronics industry perspective is that the extent to which the FTA will result in the removal of significant NTBs is unclear. Because of this, industry organizations in this sector have been hesitant to take a position on the FTA.

5.5.1 Overview of consumer electronics trade flows

Bilateral consumer electronic trade flows have historically been dominated by Korea. In 2007, Korea exported over six times the value of consumer electronics to the EU as it imported. As the graph below shows, trade flows dropped by roughly 35% between 2007 and 2009. This is due to reductions in consumption as a consequence of the financial crisis.

Consumer electronics comprises office machines, telecommunications, household electrical machinery, and photographic equipment. The EU has a trade deficit with Korea in each of these categories. In 2009 the EU’s total trade deficit was over €12 billion. Such a huge deficit is evidence of comparative disadvantage which raises the question whether an FTA would significantly change overall trade flows. By far the largest trade deficit is in telecommunications equipment (€6.8 billion in 2009).

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141 For exact components of ‘consumer electronics’ see the following SITC Rev 3 codes: 75, 76, 775, 776, 778, 88
An overview of the results of impact studies for consumer electronics

There are three studies that evaluate EU-Korea consumer electronics trade: CEPS, IBM, and Jong-Hwan Ko et al. In each study, the importance of the industry is emphasized. Each study also notes that while tariff barriers exist in certain areas, trade is mainly inhibited by non-tariff barriers.

The CEPS study offers a breakdown of the tariff structure of Korean electronics. As the table below shows, prior to the FTA the highest tariff rates were for computers (6%) and general electrical equipment (5.8%). In terms of imports, the table shows that 9.75% of all Korean home appliances imports and 10.46% of all Korean telecommunications equipment imports come from the EU. The removal of these tariffs will likely result in increased trade flows in these sectors.

Table 15: Tariff Structure for Korean Electronics

<table>
<thead>
<tr>
<th>Tariff Structure of Korean Electronics</th>
<th>Tariff Rate</th>
<th>Range</th>
<th>% of each group against Korea's total imports</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>EU25</td>
<td>EU15</td>
</tr>
<tr>
<td>Electrical and electronic equipment</td>
<td>5.8</td>
<td>0 - 13</td>
<td>7.86</td>
</tr>
<tr>
<td>Semiconductors</td>
<td>5.5</td>
<td>1 - 13</td>
<td>5.89</td>
</tr>
<tr>
<td>Telecommunications equipment</td>
<td>5.5</td>
<td>2 - 13</td>
<td>9.75</td>
</tr>
<tr>
<td>Home appliances</td>
<td>5.5</td>
<td>3 - 13</td>
<td>10.46</td>
</tr>
<tr>
<td>Computers</td>
<td>6</td>
<td>4 - 13</td>
<td>7.25</td>
</tr>
</tbody>
</table>

Source: Adapted from CEPS Report, 2007
On the EU side, tariff barriers exist on the most sensitive electronics products such as TV sets, video recorders and LCD monitors. The FTA will remove duties on these products only in year five of the agreement.\(^\text{142}\)

Both the IBM and the CEPS studies underline that the largest impediments are technical barriers to trade, especially a lack of recognition of international standards (e.g. IEC), a refusal to engage in mutual recognition of EU conformity assessment based on Korean requirements and problems of classification.\(^\text{143}\)

As discussed in sector 7.3 this there is a sector/vertical agreement on TBTs in electrical and electronics.

One of the sector specific annexes included in the FTA regards consumer electronics. The Annex recognizes that exporters of consumer electronics and household appliances are obliged to duplicate cumbersome and expensive testing and certification procedures in order to sell in Korea. The annex highlights the increased use of international standards and the elimination of third party certification as a result of the negotiations. Specifically, the FTA will dismantle Korea’s factory inspections as well as certification and duplicative testing requirements. EU exporters will be able to conduct safety testing in the EU thereby removing significant regulatory and financial burdens. With regard to electrical safety, for a very limited list of 53 items (covering around 15% of EU exports), Korea shall have the possibility to continue with a third-party certification regime if it can show on a product specific basis that allowing supplier’s declarations of conformity would create risks for human health and safety.\(^\text{144}\)

The Jong-Hwan Ko et al. study states that Korea’s electronics exports will benefit from an FTA with domestic output rising by 2.1% by 2017. Part of this rise is due to increases in capital stocks from additional foreign direct investment coming from the EU.\(^\text{145}\) The study did not include an analysis of the trade effects on EU electronics exports.

### 5.5.3 Positioning of stakeholders in consumer electronics

DIGITALEUROPE has not taken a formal position on the overall conclusion of the EU-Korea FTA.\(^\text{146}\) Part of the reason for this may be that DIGITALEUROPE has non-European firms as members, and so there are likely conflicting views within the organization regarding the benefits of an FTA. The organization has, however, written two position papers. The first was written during the negotiations. It stated that lowering EU tariff and non-tariff barriers would put European firms at a competitive disadvantage given that Korea is such a strong exporter, and its domestic market is so closed due to NTBs. Thus, any FTA that involves reductions in EU trade restrictions must also ensure an opening of the Korean market through a simultaneous removal of tariff and non-tariff barriers.\(^\text{147}\) The organization also emphasized that it would not support any relaxation of preferential rules of origin that resulted in an increase of the use of 'non-
originating’ materials or components in the end products, as this could give Korean firms an increased opportunity to penetrate the EU market.148

The second position paper was written following the negotiations. It stated that the EU TV assembly industry has concerns over the unique position that the FTA gives Korean manufacturers with a presence in the EU. According to this paper, the FTA will give Korean producers in the EU a duty free supply of LCD/Plasma modules from Korea while TV assemblers that rely on non-Korean LCD/Plasma modules (which face a 5% tariff) will be at a disadvantage.

Orgalime has not taken an official position on the FTA either. There are two reasons for this. First, the organization was in close talks with the Commission throughout the negotiations and so it did not feel the need to write an overall position paper. Second, Orgalime is comprised of a diverse group of members that had conflicting views regarding the FTA. While the mechanical engineering industry (which enjoys a trade surplus with Korea) supported the overall FTA, consumer electronics firms were more cautious as they feel the overall trade effects will be unknown for some time.

5.6 Agricultural products (and food and drink industries)

There is significant protection for agriculture, food and beverages in the EU and Korea, with Korean protection distinctly higher than in the EU. It is no therefore no surprise that agriculture accounts for less than 3% of bilateral trade,1 with each side specializing in different segments of the industry. The overall effects of the FTA on agriculture trade flows will be minimal. Although the overall effects on domestic producers will be low, there will be certain segments of the Korean market which are not saturated in which consumers will benefit as prices fall. Despite the small effects, the FTA is important for the EU agriculture industry for two reasons. First, tariff reductions will result in cost savings for certain important segments like spirits and pork. Second, the FTA keeps the EU competitive compared to other countries like the United States and Chile, which have also signed FTAs with Korea (although not ratified in the case of the US).

5.6.1 Overview of agri-food trade flows

As the Korean economy has modernized rapidly, the country’s share of agriculture as a percentage of GDP has dropped from 10.7% to 3.2%.1 On the EU side, agriculture already represents less than 3% of GDP. Of this amount, 99% of firms constitute SMEs (small or medium sized enterprises) but turnover is split 50-50 between SMEs and large agri-food corporations.1 In 2008 Korea’s agricultural exports to the EU were €378.2 million, that is, only 1% of the country’s total exports to the EU. EU’s agri-food exports to Korea amounted to €1,261.6 million or 4.9% of EU total exports to the country,1 the majority being in ‘Food and Drink’ products.

As the graph on agri-food trade flows shows, EU exports have consistently been some 6-8 times larger than Korea’s exports to the EU. While Korea’s exports have remained fairly stagnant, the EU’s exports to Korea have increased by roughly 40% since 2003. Note that the 2008 results are lower than 2007. This is primarily because European food and drink exports are generally in high value-added products like spirits, which were consumed in lower levels due to the financial crisis.

148 “DIGITALEUROPE’s position paper on the impact of the EU-Korea FTA on the supply of LCD/Plasma modules for EU production” Published on DIGITALEUROPE Website. (April 14 2010)
The EU is currently the third exporter of foodstuffs to Korea behind the United States and China. The largest EU exports to Korea are meat-based products, alcoholic beverages (wine and spirits), vegetable oils, processed food and dairy products. The United Kingdom is the leading EU exporter to Korea, with exports of over €200 million in 2006 (mainly, whisky). France is the second largest exporter specializing in meat, dairy products and wine.1

5.6.2 Overview of the economic impact studies for food and drink

To date there are four studies that contain sectoral assessments of the effects of an EU-Korea FTA on agri-food trade. They conclude that although tariff levels are not insignificant, adjustment costs are not likely to be important for either side. As the table below shows, agri-food tariff protection by Korea is almost double that of the EU (28% vs. 15%).1 It should be noted that Korea still enjoys “developing country” status in the WTO as far as agri-food is concerned, and thus the country is exempt from significant reductions in agricultural protection in WTO agreements.

Table 16: EU - Korea protection

<table>
<thead>
<tr>
<th>EU Protection</th>
<th>Korea Protection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture and Processed foods</td>
<td>14.9</td>
</tr>
<tr>
<td>Grains</td>
<td>43.4</td>
</tr>
<tr>
<td>Horticulture</td>
<td>22.9</td>
</tr>
<tr>
<td>Oil Seeds</td>
<td>0</td>
</tr>
<tr>
<td>Sugar</td>
<td>14.4</td>
</tr>
<tr>
<td>Natural Fibres</td>
<td>0</td>
</tr>
<tr>
<td>Beef</td>
<td>0.1</td>
</tr>
<tr>
<td>Dairy Products</td>
<td>12.4</td>
</tr>
<tr>
<td>Vegetable Oils</td>
<td>11.9</td>
</tr>
<tr>
<td>Beverages and Tobacco</td>
<td>24.3</td>
</tr>
</tbody>
</table>

Source: Adapted from Copenhagen Economics p. 16

According to Copenhagen Economics, real income effects of a deep FTA in the agricultural sector (that is, removing tariffs) would only be €0.1 billion (compared to €0.2 billion for manufacturing and €3.9 billion for services).1 Similarly, using dynamic CGE modeling, Jong-Hwan Ko et al finds that a deep FTA would expect
Korea to experience “expanded output in most industries with the exception of agriculture, forestry and fisheries”.1

There are two reasons agri-foods will not be significantly affected by an FTA. First, overall agri-food trade flows, as well as the importance of agricultural production in each economy, are relatively low. Second, the two countries tend to produce different agricultural products. For example, as the CEPS study notes, the EU is not a major rice exporter and is not concerned with Korea’s high protection of rice. Likewise, on the Korean side, consumers pay roughly three to four times the world price for bacon and the belly part of pork. In addition to high protection, part of this price discrepancy is due to the fact that Korean supplies of pork products are lagging far behind demand.1 Considering this, an FTA could benefit Korean consumers of pork by lowering food prices, while not significantly harming domestic producers in this sector.

The IBM study takes a slightly different perspective on agri-food. It notes that both in Korea and the EU, the social role of farming is sensitive, and social impacts are likely to result from any trade impact.1 As much of the primary workforce in both regions earns relatively low wages and farmers are older, they may be more susceptible to adjustment costs. Thus, although agri-food may not be economically important for either side, its political sensitivity and social importance increases the relevance of the industry. Despite this, the study admits that the EU-Korea FTA is not expected to have much of an effect on the agriculture as the Korea-US FTA.1 This conclusion hinges on the nature of the products traded. As the study notes, the EU is expected to expand exports of alcoholic beverages and processed foodstuffs such as cheese. On the Korean side, any increases in exports are expected to be small, and concentrated in non-sensitive segments such as ramyon (instant noodles) and kimchi.1

5.6.3 Positioning of stakeholders in Agri-food

Overall, European industry is satisfied with the FTA. Although they do not foresee huge increases in overall exports, the completion of the FTA is an important part of maintaining the competitiveness of European exports compared to those of other countries having completed FTAs with Korea – namely the United States and Chile.1 Specifically, European meat (mainly pork), cheese and spirit exporters are supportive of the agreement. The spirits industry has estimated it will save roughly €400 million in duties over the next 10 years.1 With respect to cheese, although producers are facing longer implementation periods for tariff reductions, these periods are comparable to what was given to the United States in its FTA.1 Overall, EU business claims European agri-food exporters will save €380 million annually on duties for agri-food products thanks to the agreement.1

Although European industry is satisfied with the overall agreement, there are three areas of disappointment. First, the sugar and starch industry is concerned that lowering tariffs for Korean exports could result in re-export of sugar products from neighboring China. It should be noted that the EU sugar industry is defensive towards most FTAs. Second, Surimi producers in the EU are unhappy that Korean firms have been given increased access to the EU market due to a change in the tariff quota. Surimi production, however, represents only a fraction of overall EU agricultural production. Last, some feel the language in the SPS part of the agreement is rather weak with respect to pre-listing and principal of origination of outbreaks of diseases. These issues have not been resolved in the agreement. Instead, it was decided to create a committee to discuss issues in these two areas. Pre-listing involves having items, already having been checked and approved in the EU, automatically admitted into the Korean market. The ‘principle of origination’ refers to tracing an outbreak or disease to its original location, and in so doing, not affecting the entire EU. Industry associations do admit, however, that the language in the SPS component of the EU-Korea FTA is stronger than that of the US Korea FTA.
5.7 Textiles and Clothing

Textile and Clothing in the EU has a comparative disadvantage vis à vis to Korea. In 2008 the EU deficit in the sector resulted from € 596 million exports and € 733 millions imports. Moreover, studies show that the impact of the FTA on EU sectoral output will be minimal, but negative and the EU deficit in the sector will increase by 1.5%. The tariffs, that remain quite high in Korea represents a concern from the EU point of view. Non tariff barriers to trade also represent an issue of concern for the Textile and Clothing sector. Both studies and the EU industry consider that special attention has to be paid to Rules of Origin and EU Trade Defence Instruments.

5.7.1 EU-Korea Trade flows

As CEPS (2007) study shows, Korea has a comparative advantage for textile and clothing products vis à vis EU Member States. This finding is further confirmed by KIEP (2005), which shows that Korea has a higher Revealed Comparative Advantage (RCA) index with respect to selected EU Member States in this sector (i.e. 1.58% versus 0.70 and 0.57 of France and Germany respectively, for instance). Data collected on Textile and Clothing trade flows between EU and Korea show that EU has traditionally been a net importer of those products. Nevertheless, the graph below shows that he EU trade deficit has been decreasing overtime, almost halving its value in 2004 with respect to 1999 (i.e. from 1312 million euros to 790 millions euros) and it amounted only to 137 million euros in 2008. One suspects that, given rapid Korean economic growth, the Korean comparative advantage vis à vis Asian competitors is melting away, thereby shrinking the sector to segments in which the EU is also competitive still. Indeed only imports decrease whereas EU exports stay the same.

Graph 8: EU Textile and Clothing trade with Korea

Source: Eurostat, Comext, Statistical regime 4

5.7.2 An overview of the impact studies for textiles and clothing

Both KIEP (2005) and Copenhagen Economics (2007) studies contain quantitative estimates of the effects of an FTA on industry production, exports, market share and employment. The latter study starts with a definition of the level of market protection in both countries, showing that, with tariffs equal to 10% and

149 With the only exception of Italy that register a RCA of 3.14 in clothing and textile sector, thus revealing Italy’s unique industrial characteristics of achieving added value in traditional labour intensive sectors.
12% for textile and clothing respectively, Korean protection is currently greater than that of the EU, where tariffs applied against Korean imports are 8.6% for textile and 11% for Clothing.

In Copenhagen Economics (2007), there is no indication of how EU exports to Korea or EU imports from Korea will change. However it is possible that major producers like India and China and other major developing country producers will affect the baseline as the Copenhagen study has assumed this for manufacturing in general. It might be assumed that where these producers are competitive (e.g. in basic textile and clothing manufacturing), both the EU exports to Korea, but also the EU imports from Korea will be lower than in 2005 or 2006150.

The Copenhagen study estimates of the impact of the FTA on sectoral output are shown in the following table.

Table 17: Estimated effects of the FTA on output of textiles and clothing: percentage change from baseline

<table>
<thead>
<tr>
<th>SECTORS</th>
<th>part. 1 EU</th>
<th>part. 1 Korea</th>
<th>part. 2 EU</th>
<th>part. 2 Korea</th>
<th>full EU</th>
<th>full Korea</th>
</tr>
</thead>
<tbody>
<tr>
<td>Textile</td>
<td>-0.27</td>
<td>1.45</td>
<td>-0.35</td>
<td>1.25</td>
<td>-0.61</td>
<td>0.93</td>
</tr>
<tr>
<td>Clothing</td>
<td>-0.01</td>
<td>2.21</td>
<td>-0.08</td>
<td>2.27</td>
<td>-0.25</td>
<td>2.87</td>
</tr>
</tbody>
</table>

Sectoral output effects in Francois/Copenhagen, three scenarios

As the table shows the effects on the EU are very similar in both the first two scenarios. The total sectoral decrease in output for textiles would be 0.61% and for clothing 0.25% but there is a need to qualify these results. First, there is no FDI in the Francois simulation so the (small) decline of textile and clothing outputs as compared to the baseline is not caused by FDI / trade substitution. Second, the baseline assumes a significant lowering of Korean tariffs vis-à-vis all developing countries and for some major OECD competitors (e.g. the U.S. and Japan) via FTAs. Thus, one would expect these baseline assumptions to exaggerate the losses/disadvantages for the EU. Ratification of the EU / Korea FTA could be expected (other things being equal) to increase EU exports and output of textile and clothing not decrease them. But as will be shown below, NTBs will tend to limit exports and thus output of textiles and clothing. 151 According to Copenhagen Economics there will however, be clear increases in Korea’s market share in textiles and clothing (9.2% of sector share of total Korean trade impact in partial 1 scenario).

Turning now to KIEP (2005) study, the impact of an EU-Korea FTA translate into a decrease of the EU industrial production in all three scenarios envisaged by their model (i.e. 0.00, -0.03 and 0.01 for scenario I, scenario II and scenario III respectively). The authors stress that the change in industrial production for Korea is much bigger for the textile and clothing sector, in the capital accumulation (i.e. not static) model. At the same time the value of the EU industrial production stays more or less the same. KIEP (2005) also estimated the export and import effects as an increase of 2.9% for exports and 3.4% for imports. The EU trade balance is estimated to increase by 1.5% in the textile and clothing sector.

As noted above, some studies, such as IBM/SIA (2008), CEPS (2007) and partly again KIEP (2005) outline the importance of NTBs for this sector. IBM/SIA (2008) especially states that because ‘Korea has a comparative advantage over the EU in the textiles area, and therefore EU barriers are the most significant issue. Foremost among these would be the rules of origin applying to these products that are developed’. The importance of the regulation of the rules of Origin is also stressed by CEPS (2007) and KIEP (2005). IBM/SIA (2008) further outlines the importance of strengthening EU trade defence instruments.

150 This is in particular what seems to be suggested by EURATEX.
5.7.3 Positioning of stakeholders in textile and clothing

On several occasions EURATEX has expressed great concern about the EU-South Korea Agreement\textsuperscript{152}. These relate in particular to the monitoring and implementation of commitments by Korea.

EURATEX believes that the efficiency and real value of the implementation measures and remedies will depend very much on the cooperation on the part of South Korean authorities and the engagement of EU businesses. Their concerns lay mainly on the speed in the collection of trade statistics needed to timely check cases in which either the bilateral safeguard clause (chapter 3 of the FTA on Trade Remedies) or the drawback clause (protocol on the Rule of Origin) can be applied. According to EURATEX, those trade statistics "need to be regular, updated and include data on trade flows between South Korean and the EU but also between South Korea and its main trade partners for finished and semi-finished products". Furthermore, in the wording of EURATEX, “industry needs to have access online to quota utilization levels”\textsuperscript{153}. However it is essential to ensure that conditions for obtaining the derogations are met and to achieve this objective the cooperation from South Korean Authorities is absolutely necessary”. Furthermore, EURATEX sees the derogations from Rules of Origin as a problem in that they create a precedent, which can be used by the EU’s other trading partners in future FTAs. Moreover, such derogations are seen as potentially representing a source of uncertainty and confusion among economic operators, as well as among enforcement and monitoring authorities\textsuperscript{154}.

EURATEX also regrets there is no Working Group for Textiles & Clothing that could address implementation issues. EURATEX therefore expects problems arising in the sector to be dealt within the Committee on Trade in Goods and the Customs Committee. They stress however that successful monitoring and enforcement processes requires good and regular cooperation between EU and South Korean authorities and industries as well as between the EU industry and Commission services. The latter is seen as the best way of ensuring immediate action in cases of non-application of the FTA in areas sensitive for the Textile and Clothing sector (i.e. Rules of Origin Derogations and DDB).

5.7.4 Services

The services sector’s share of Korean GDP has been growing steadily for the past 20 years. This growth, however, is not reflected in the share of services in Korea’s external trade or in current EU-Korea trade relations\textsuperscript{155}. In fact, while Korea accounts for 2.4% of bilateral trade in goods, it only accounts for 1.3% of EU-Korea trade in services. As highlighted by existing impact assessment studies on an EU-Korea FTA, the

\textsuperscript{152} This is the position emerging in the different memos sent by EURATEX to the European Commission during 2009 and early in January 2010.

\textsuperscript{153} In order to be able to monitor the Derogations of the Rules of Origin.

\textsuperscript{154} Euratex noted that the precedent concern about setting a precedent was confirmed by the experience with the Andean FTA- Peru and Colombia- once more there are Quota Derogations to EU Rules of Origin and the EU is currently negotiating another FTA with Central America and again the outcome will be a considerable number of Derogations to EU Rules of Origin.

\textsuperscript{155} Trade in services is to be understood as the services consumed through one of the following modes of supply: Cross-border (Mode 1) refers to services supplied from the territory of one country into the territory of another; Consumption abroad (Mode 2) refers to services supplied in the territory of a country to the consumers of another; Commercial presence (Mode 3) refers to services supplied through any type of business or professional establishment from one country in the territory of another (i.e. FDI); and, finally temporary presence of natural persons (Mode 4) refers to services supplied by nationals of a country in the territory of another. A consequence of the specificities of trade in services is the fact that services producers often have to be in physical (or virtual) proximity with foreign consumers. This implies that although border measures (e.g tariffs) can affect the delivery of some services, in most cases services trade liberalization implies increasing market access and promoting national treatment. This is mainly achieved by harmonizing and easing behind the border measures, i.e. regulatory barriers.
main reason for this bilateral under-trade is the high Korean barriers to trade in services. As these studies show, reducing these barriers is fundamental to enhance the real income effects that an FTA would bring to the EU and Korea. A further conclusion of these studies is that, in the EU, the main winner from a EU-Korea FTA would be the business services sector. Interviews with EU services representatives have confirmed these expectations: all sectors surveyed in this research are in favour of a swift ratification of the EU-Korea FTA.

5.7.5 EU-Korea Services Trade

The contribution of the services sector to Korean GDP has been growing rapidly for the past 20 years. According to the World Bank, while the services sector constituted a mere 47.5% of Korean GDP in 1988, in 2006 their GDP share rose to over 57%. This increase has been achieved mainly at the expense of the agricultural sector, whose share plummeted from over 10% of GDP in 1988 to 3.2% in 2006, with industry accounting for the rest.

As with most countries around the world, however, this evolution has not been reflected in Korea’s services trade flows. Until the mid 1990s, this was largely explained by the lower tradability of services and the high barriers to trade. However, since the advent of the information and communication technology revolution in the late 1990s and early 2000s, and the elimination of capital flow restrictions, services have become increasingly tradable, leading to a rapid growth of trade in services worldwide.

Graph 9: EU trade in services with Korea

In 2007, total EU services exports to Korea amounted to €7.2 billion up from €6.7 billion in 2006, which represents a growth of 8% in one year alone. Yet these figures merely represent 1.4% of the EU’s total services exports but 20% of Korea’s total services imports. EU services imports have also increased, but at a slower rate. According to Eurostat, between 2003 and 2007, the net surplus of trade in services between the EU and Korea has been more than 66% and the trade balance has improved by 100%.156

In 2007, the main contributor to the EU’s trade surplus was business services, accounting for €1.1 billion; transport services, accounting €0.8 billion; and royalties and license fees, which accounted for €0.6 billion.

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156 Eurostat, Statistics in Focus (N° 31/2009) on “Trade in services with Korea – Surplus for EU in 2007”.
of the €3.2 billion surplus. In 2007, Korea ranked among the EU’s top 15 largest trading partners in 8 services sectors: transportation services, financial services, communication services, audiovisual services, royalties services, other commercial and business services, and personal, cultural and recreational services.\(^{157}\)

Notwithstanding these developments, bilateral trade between the EU and Korea has remained relatively under-developed. According to the European Services Forum, although EU trade in services with Korea has risen, this bilateral trade is still growing more slowly than the EU’s trade in services with the rest of the world. Furthermore, while Korea represents 2.4% of EU trade in goods, it only accounts for 1.3% of EU trade in services.

There is wide agreement among experts that the main reason for these low figures is the restrictive and discriminatory regulatory framework in the Korean services sector. These regulations often constitute insurmountable trade barriers for European exporters. The reduction of these barriers, many studies argue, would have a positive impact on trade flows and on real income in the EU and Korea.

5.7.6 Existing Studies

A common conclusion from the existing impact assessment studies on an EU-Korea FTA is the centrality of the services sector in the agreement’s overall economic impact. Of these studies, KIEP (2005) and Copenhagen Economics and François (2007)’s quantitative studies are of particular importance in shedding light on the reasons for such findings. Notwithstanding their different methodological approaches\(^{158}\), these studies find that the liberalization of the Korean services sector causes overall economic welfare effects to be much higher in both the EU and Korea.

Overall the aggregate real income effects are relatively small, however. François /Copenhagen Economics (2007), for instance, find that the income effect for the EU would be between €1.2 and 4.2 billion (between 0.01 and 0.05% of GDP) and for Korea between €2.5 and 10 billion (0.58 and 2.32% of GDP). A further conclusion of both studies is that the majority of total welfare benefits from a FTA will accrue to Korea.

There are two main reasons for this asymmetry in future welfare distribution, according to François /Copenhagen Economics (2007). First, the trade barriers protecting the Korean economy are considerably higher than those in the EU. The reduction of these barriers will improve resource allocation, increase the services sector’s efficiency and reduce production costs. As such, given its higher level of trade barriers, this effect should be larger in Korea than in the EU.

A further reason for this disparity lies in the decomposition of real income effects. Often overlooked is the fact that services are a crucial input in the production of other economic sectors. Consequently, the price reduction of services engendered by the sector’s enhanced efficiency would necessarily spill over into other economic sectors. This mechanism contributes to increasing the competitiveness of Korean industry

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\(^{158}\) For KIEP (2005), the economic effects are based on three different scenarios. Scenario 1 assumes a complete reduction of tariffs in the agricultural and manufacturing sectors. Scenario 2 assumes the removal of tariffs in the agricultural and manufacturing sector, and 50% reduction of services barriers to trade. Scenario 3 assumes a complete reduction in the manufacturing sector, a 50% reduction of tariffs in the agricultural sector, and 50% reduction of barriers to trade in services.

Copenhagen Economics and François (2007) also model three different scenarios. A Partial 1 FTA assumes 40% tariff reductions in food goods, full bilateral tariff reductions in non-food goods, 25% reduction in services barriers and no improvement in trade facilitation. A Partial 2 FTA assumes 40% tariff reductions in food goods, full bilateral tariff reductions in non-food goods, 50% reduction in services barriers, and no improvement in trade facilitation. A Partial 3 FTA assumes a full FTA, i.e. full bilateral tariff reductions in food and non-food, and unrestricted access for services as well as trade facilitation accounting for 1% of value of trade.
across the board, and along with it the competition faced by European exports in Korea. By increasing the efficiency of Korean industry, the liberalization of the Korean services sector may impinge on the benefit that lower tariffs would bring to European exporters.159

As such, while the EU clearly benefits from a one-off effect of the liberalization of the Korean services sector—given its overall comparative advantage in services160—Korea benefits doubly from it.161 Existing impact assessment studies conclude that the European services sector, and in particular financial, business and other business services, are the main winners from the FTA (considering both EU and Korean total benefits).

5.8 Stakeholder Positions

After consultation with EU services representatives and the European Services Forum, we find that the services sector is overwhelmingly in favour of a swift ratification of the agreement.

5.8.1 Transport services

The European transportation services sector is in favour of the ratification of the EU-Korea FTA. According to CEPS and KIEP (2007), South Korea is generally more competitive in offering transportation service than is the EU. Nevertheless, with the exception of other transport, maritime and air transport, suppliers have seen their exports to Korea rise sharply in the past 5 years. Despite Korea's competitive advantage, the FTA succeeds in improving both market access and national treatment for European maritime, road and auxiliary air transport service providers, both in absolute terms (compared to the status quo) and relatively (compared with KorUS).

In particular, commitments on Maritime Transport (which are not included in KorUS) and important commitments on road transport give European services providers a competitive edge over their American competitors. The dedicated chapter includes commitments which give European transport services providers the right to transport by road their containerized freight to its ultimate destination. Furthermore, the EU secured Auxiliary Air Transport Commitments from their Korean counterparts which match the advantages secured by the US in KorUS and give airlines the option of operating their own ground services. Even though the agreement does not include provisions similar to an open-sky agreement, it includes beneficial provisions for the air transportation sector.

5.8.2 Legal services

The European Legal Services sector is in favour of the ratification of the EU-Korea FTA.

By international standards, the Korean legal sector remains underdeveloped.162 Foreign lawyers practicing in Korea currently face severe restrictions. For instance, only Korean licensed lawyers can provide legal services or own a law firm. Furthermore, all foreign licensed lawyers must operate under the title of

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159 François / Copenhagen Economics (2007).
160 According to CEPS and KIEP (2007), Korea has a comparative advantage in only 1 services sector (transportation) out of 10, while the EU has a comparative advantage in 7: Travel, Construction, Communications, Insurance, Financial, Computer and information, and Personal, cultural, recreational services. Korea and the EU have similar competitiveness in other business services and Royalties and license fees.
161 François / Copenhagen Economics (2007). KIEP (2005), on the other hand, find a slight expansion of the Korean services sector after its liberalization.
162 In 2004 there were some 258 law firms in Korea and 6,273 certified lawyers. The scene has been rapidly changing since the early 2000s however. Law offices are becoming larger and more specialized.
“Foreign Legal Consultant”. All this creates near-prohibitive barriers for EU law firms wishing to operate in the Korean legal services market.

The FTA will be beneficial to European Legal services. The agreement considerably improves national treatment and market access for EU lawyers (Mode 4) and EU law firms (Mode 3). According to the European Services Forum, only a few countries in the world grant the concessions obtained by the EU to foreign law firms.163 These changes will not only provide EU lawyers and law firms with important new opportunities, but it also give them an important competitive edge over American lawyers in advising Korean multinational businesses. EU licensed lawyers will be permitted to advise on foreign (non-Korean) law and provide advice on global legal questions. South Korea will also allow for European licensed lawyers to use their home title instead of the more restrictive “Foreign Legal Consultant” title. The changes in Korean regulations will also allow EU law firms to offer a single point of contact in international legal issues to Korean clients.164 Five years after the entry in force of the FTA, European law firms will be permitted to invest in local law firms as well as to hire Korean licensed lawyers providing legal services to South Korean and international clients using their home country brand name.

5.8.3 Telecommunication services

The European Telecommunication Services sector is in favour of the ratification of the EU-Korea FTA. Currently, South Korea limits foreign direct investment in license-based telecommunications operations to 49% and requires approval by the Ministry for Information and Communication for all investments above 15%. Furthermore, European telecommunication companies face de facto discrimination, such as domestic preference in government procurement practices, not based on legal provisions (CEPS, 2006). The EU-Korea FTA fully addresses these concerns. Two years after the entry into force of the FTA, European operators will be allowed to own 100% of a subsidiary (as in KorUS), provided this investment is made through a locally registered company and not a branch (matching KorUS). More importantly, the agreement grants European companies other benefits, such as non-discriminatory access to Korea’s public telecommunications network and new safeguards to help protect the choice of technology. By requiring that Korea assure transparency in its telecoms regulatory process and ensure that its main regulator does not hold financial interests in, or constitute a supplier of, public telecommunications services, the agreement will considerably increase the ability and cost-efficiency of European telecoms providers to operate in Korea. It also includes important Mode 1 commitments in telecommunications services, such as cost-oriented interconnection, dialling parity, competitive safeguards and resale commitments.165

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163 Once ratified, the agreement will liberalize the Korean market in three phases. During the first phase (when the agreement comes into force), EU law firms will be permitted to open a representative office in Korea and EU licensed lawyers will be allowed to become advisors on the law of the jurisdiction from which they received their qualification as well as to act as consultants on public international law. During the second stage of implementation (2 years after the entry into force of the agreement), EU representative offices will be permitted to conclude cooperation agreements with Koran law firms to deal with cases of a hybrid domestic/foreign legal nature. The last implementation phase (5 years after the entry into force of the agreement) will allow EU law firms to establish joint ventures with Korean law firms and employ Korean licensed lawyers.

164 For instance, EU law firms will be allowed to market their global Intellectual Property Rights, trademark or other business services to Korean clients.

165 See Sub-Section D of Chapter 7 of the agreement.
Finally, the EU secured cross border commitments on satellite broadcasting. This will allow suppliers to circumvent the current requirement that all satellite broadcasters utilize a Korea-based satellite. This constitutes an important gain for the telecommunication industry.

5.8.4 Financial Services

The Financial Services sector is in favour of the ratification of the EU-Korea FTA.

The regulatory framework for the Korean financial services sector has remained highly discriminatory. There are restrictions across the entire financial services sector (including banking, insurance and securities), including restrictions on the cross-border processing of customer data. The FTA makes important progress towards removing discrimination against EU suppliers. Moreover, unlike in KorUS, these changes will apply to all “financial services suppliers”, a term which includes banks, insurers, asset managers and rating agencies.\(^{166}\)

The agreement has an important impact on market access, too. Two years after the entry into force of the agreement, EU financial services suppliers will be able to transfer and process data on Korean clients abroad. Costs savings from these provisions alone are expected to measure in tens of millions of Euros for EU financial services. Korea has also agreed to adopt a “negative list” approach to commitments on financial services, so that all remaining restrictions are itemised (whereas those not listed are deemed free of restriction). This assures greater transparency and predictability of the future business environment in Korea. Other commitments secured by the EU include: relaxation of rules on foreign currency reserves; improvements in the regime of bankassurance; more transparency in regulatory procedures; equal regulatory treatment for private insurers and the insurance department of the Korean Post; and an improved dispute settlement mechanism. All these improvements will permit EU financial services suppliers to establish or acquire financial services businesses in Korea. This will allow EU firms to supply a complete range of financial services to Korean clients on a retail basis.\(^{167}\)

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\(^{166}\) This gives the opportunity to data transfer and processing companies to take advantage of commitments in the agreement.

\(^{167}\) Mode 1 (cross border) improvements include: portfolio management services for Korean investment funds and offshore advisory and auxiliary services (credit rating, credit reference & investigation, fund administration, indirect investment vehicle appraisal, bond appraisal for securities issued in Korea).
6 CHAPTER BY CHAPTER ANALYSIS OF THE FTA

6.1 Introduction

This section assesses the EU-Korea FTA in the context of the European Commission’s Global Europe strategy. According to this Strategy, European FTAs must be less guided by political concerns—such as the motivations behind the ACP agreements—and more focused on securing enhanced market access for European exporters of goods and services. As such, the EU-Korea FTA negotiations aimed to prioritise market access where, absent an agreement, high tariffs and regulatory barriers existed. The objective implicit in this strategy is to negotiate FTAs, which are commercially driven and achieve greater trade liberalization than what has been achieved in previous FTAs or in the WTO. In other words, the agreement needs to be at least WTO Plus, which entails addressing not only market access, but also enhancing national treatment by tackling behind the border trade barriers, such as rules, regulations and standards (deep integration).

For comparison purposes, this section uses as a benchmark both European and Korean multilateral commitments, and other important EU FTAs, such as EU-Chile and EU-Cariform. While comparison with WTO commitments facilitates the assessment of how commercially ambitious the EU-Korea agreement is, comparisons with these ambitious EU FTAs allow the reader to place the agreement within the context of the evolution of European bilateral trade policymaking. Although the EU-Korea FTA stops short from fulfilling all its potential, the agreement is a significant improvement over WTO texts and previous EU-FTAs.

This section aims to provide a contextual rather than an exhaustive overview of the agreement and is divided into twelve parts: national treatment and market access for goods; technical barriers to trade (TBT); sanitary and phytosanitary measures (SPS); custom and trade facilitation; intellectual property rights (IPRs); competition policy; fight against anti-competitive practices, state aid and subsidies; transparency issues; public procurement; trade and sustainable development; and rules of origin and the duty-drawback.

6.2 National Treatment and Market Access for Goods

The EU-Korea FTA achievements in terms of national treatment and market access are broadly compatible with the ambitions set by the Global Europe strategy. Custom duties and sector-specific technical barriers to trade (TBTs) have been considerably reduced when compared to EU and South Korean WTO commitments. These FTA commitments are also—to say the least—broadly on par with what the EU achieved in its EU-Chile and EU-Cariform agreements. For analytical purposes it is useful to differentiate between the positive, but expected, reduction in tariffs lines from the more ambitious advances in sector-specific TBTs.

6.2.1 Custom Duties

Absent the EU-Korea agreement, the Korean market would be protected by relatively high MFN tariff barriers averaging 6.8% in the industrial sector and a massive 48% in the agriculture. For its part, the EU binds 100% of its tariff levels at an average bound and applied MFN tariff rate of 5.2%. Tariffs in the agricultural sector are considerably higher and average 15.4%. The EU-Korea FTA successfully addresses this situation.

168 With the collapse of the World Trade Organization’s Doha Round of multilateral trade talks in 2006, the EU abandoned its moratorium on negotiating bilateral trade agreements, with a new priority of negotiating bilateral trade agreements with emerging markets. This strategy has substituted what was previously the “multilateralism only” strategy.
**Industrial goods:**

The EU-Korea text on industrial goods goes well beyond the parties’ WTO commitments. The agreement contains provisions ensuring a substantial reduction of European and Korean custom duties and its coverage of industrial tariffs is nearly 100%. Upon entry into force of the agreement, 90.7% of Korean tariffs in industrial products will be eliminated. This share will increase to 95.8% within three years and 100% within seven years of the agreement’s entry into force. For its part the EU has offered near complete tariff liberalisation for industrial goods upon entry into force of the agreement—with some sensitive sectors, such as automotive, as important exceptions being liberalized over a periods up to 7 years.

The agreement also offers clear improvements on the EU’s existing FTAs. For instance, unlike other EU FTAs that exclude sensitive sectors by employing a negative list to schedule commitments, the Agreement does not exclude any industrial sector. As regards transition periods for industrial goods, the EU-Korea agreement’s longest transitional period is 7 year, which is shorter than other EU FTAs. In the EU, the main beneficiaries of lower Korean tariffs will be the machinery and appliances sectors. These sectors are expected so save up to 450 million euros in tariffs. Another important beneficiary is the chemical industry, which is expected to save 143 million euros. According to the Korean International Trade Association, other EU sectors benefiting from tariff reductions are the textiles, the glass, leather and fur, footwear, iron and steel and optical instruments sectors. These sectors will see over 90% of their exports entry Korea duty free upon the agreements entry into force.

**Agricultural goods**

As with industrial goods, the EU-Korea agreement goes beyond the parties’ WTO commitments. Multilaterally, both the EU and Korea have an a priori defensive stance in agricultural negotiations. While the EU often justifies its defensiveness by reference to its Common Agricultural Policy (CAP), Korea supports its position by underlining its food security concerns. Bilaterally, as a general rule the EU’s preferred coverage for agricultural tariffs varies according to its counterparty’s competitiveness in the sector. Unlike their positions in the multilateral forum, the EU and Korea were relatively forthcoming during the agricultural negotiations of the EU-Korea agreement.

Both parties eliminate a considerable share of their agricultural tariff lines. Close to 100% of the EU and Korea’s agricultural tariff lines are in fact covered. As with the EU-Cariforum agreement, the EU accepted some exclusions and long transition periods (20 years). These exclusions include, for instance, the right

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169 Even with a negative list approach, it is still common to exclude certain sensitive goods from scheduling commitments.

170 In the case of sensitive manufactured products, it is common to have longer transition periods (eg. eight years).

171 As already discussed in Section 6, the EU-Korea FTA includes a bilateral safeguard clause. In the case of import surges related to the implementation of the agreement, the clause allows the importing country to raise the preferential tariff line back to its MFN applied level.

172 KITA (2010)

173 The EU often excludes a significant number of agricultural tariff lines form its bilateral negotiations. These protected goods include (but are not limited to): beef, sheep, goats, poultry, dairy, rice, barley, certain fruits and vegetables, rice sugar, wine and tobacco.

174 In the past, the EU has offered a certain degree of asymmetry to emerging and developing FTA partners. The EU-Cariforum agreement is a case in point. The EU has accepted a number of exclusions from Cariforum partners on the grounds of “food security”. The practice in other FTAs (e.g. in EuroMed and EPAs) has been to include a safeguard clause that allows developing countries to protect infant industries.
An assessment of the EU-Korea FTA

for Korea to keep a 754.4% tariff line on Ginseng tail. But such exclusions are few in number and are in areas of relatively little importance to EU producers.

Finally, an important innovation over previous EU FTAs has been the creation of a more flexible safeguard mechanism for agricultural goods. This mechanism suspends preferential reductions or increases tariffs (up to the MFN rate) in the event of a significant surge of imports related to the preferential elimination of tariffs (see section 6.7 below).

The agreement looks particularly important for EU producers when one takes into account the broader Korean FTA policy context. Indeed, without the EU-Korea FTA, EU exporters would find it increasingly difficult to compete in the Korean market. This because American, Australian, New Zealand, Canadian and Chilean agricultural exporters, to name only a few, would (or, in some cases, are soon likely to) benefit from preferential access to the Korean market while EU exporters would face high Korean MFN tariffs.

6.2.2 Sector-Specific Technical Barriers to Trade

Sector-specific TBTs commitments in the EU-Korea FTA constitute a substantial improvement over WTO and existing EU FTA commitments. The EU-Korea FTA is the EU’s first FTA to include targeted measures on TBTs in manufactured goods. These are crucial to enhancing national treatment for EU exports in Korea. Whether through substantial provisions (such as in the electronics and automotives sectors) or through “best-endeavor” commitments (as in pharmaceuticals and chemicals), the sector-specific TBT texts are seen by specialists as an important stepping stone and template for the negotiation of sector-specific TBT provisions in future EU FTA negotiations.

Electronics

The EU-Korea agreement is a positive step towards regulatory harmonization in the electronic industry. Two elements are worthy of attention. First, the agreement requires the use of international standards bodies (such as ISO, IEC and ITU). Second, the agreement eliminates duplicative testing for health and safety standards. This is achieved by the text’s requirement for health and safety standards to be assessed based on the supplier’s declaration of conformity. 175

The agreement contains built-in flexibilities, not least to accommodate some aspects of the highly divergent and trade restrictive Korean standards and certification framework. Korea, for instance, will be allowed to continue to require third party certification during a 3 years transitional period. Even in these cases, however, European test results will be recognized by Korea. In the specific case of electrical safety, the EU and Korea agreed to a list of 53 items (covering about 15% of EU exports) over which Korea is allowed to retain a third party certification regime if it can prove that the supplier’s declaration of conformity would create risks for human health and safety. Notwithstanding these caveats, the electronics-specific TBT provisions in the EU-Korea agreement are highly beneficial for EU exports (by eventually granting them national treatment) and reflect non-negligible mutual trust on the parties’ certification frameworks.

Automotive

The main features are a legally binding adoption of international yet EU-dominated UNECE standards (esp. Annex 2-C for automobiles), self-declaration of conformity and the elimination of double testing requirements for accreditation. The Agreement provides for a harmonization of some of the standards in automobile safety to European standards over time rather than providing an exemption as secured by the US automotive industry in the draft KORUS FTA. The Agreement commits Korea to recognizing the UNECE

175 The agreement implies therefore that, except for a limited group of goods, the agreement eliminates third party certification.
core safety standards as equivalent to Korean standards and to harmonize regulations pertaining to an additional 29 standards with UNECE rules within five years. For all the standards not subject to harmonization or equivalence, Korea committed itself to ensuring that they are not applied in a manner which limits market access. Any new standard must be based on UNECE standards.

The agreement binds these commitments by introducing for the first time a special accelerated dispute settlement system and an arbitration panel for the automotive sector. In this dispute settlement system, the timeframe foreseen for a ruling will be reduced from 120 to 75 days, which is a considerable improvement over past bilateral and multilateral achievements. Finally, the implementation of the commitments undertaken in the agreement will be monitored by a Working Group, which will meet at least once a year.

**Pharmaceuticals and medical devices**

Albeit less ambitious than the electronics and automotive specific TBT provisions, the agreement reached on pharmaceuticals and medical devices is very positive. The main focus of this section is to create procedures to increase the transparency of the process on listing for public reimbursement. More specifically, it ensures basic transparency, non-discrimination, and proof of scientific evidence in the rules for listing and pricing practices for reimbursement.176 The section also addresses the need for further cooperation and information exchange through the establishment of a working group on pharmaceuticals.

**Chemicals**

Of all the sections dealt with specifically in the TBT chapter of the EU-Korea agreement, the section on Chemicals is by far the weakest. The overall objective of this section is to foster transparency in the rulemaking process for the import of chemical products. In order to reach this objective, the section foresees the creation of a working group that will meet at least every two years.

### 6.3 Technical Barriers to Trade – general provisions

While regulations are fundamental to correcting market failures, and are therefore essential to the smooth functioning of a market economy, one finds that they can still be used for the purpose of protecting domestic industries from foreign competition. In this context, commitments on technical barriers to trade in bilateral and multilateral agreements seek to lay down rules and guidelines with the purpose of minimizing regulatory discrimination, and thereby enhancing national treatment status for foreign suppliers.

While the internal EU regime for TBTs covers all levels of government, provisions in its FTAs tend to be equivalent to the more modest WTO rules. As a general rule, the EU has moved away from its ambitious past attempts to negotiate mutual recognition agreements. Instead, EU FTAs seek to promote the use of international standards and the effective enforcement of the existing agreements. Thus, even if the TBT chapter of the EU-Korea FTA breaks new ground with its new sector-specific rules, its general TBT provisions are based on principles set out in the WTO Agreement on TBTs. Despite such limited ambitions, its provisions on transparency, labeling and standardization are nonetheless worth noting.

On transparency, the general TBT section of the EU-Korea agreement is broadly in line with what it has achieved in other FTAs and the WTO.177 It ensures that, upon request, the parties will provide information

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176 The clauses specify that the importer must “make available judicial, quasi-judicial or administrative tribunals, or independent review process.”

177 The EU-Cariforum agreement for instance includes important provisions on transparency. Its Article 48 requests not only application of TBT provisions on transparency, but also the disclosure of regulatory changes in areas relevant to trade at an early stage of the process.
regarding the objective, legal base and rationale behind new technical regulations. This implies creating mechanisms, such as public websites, to diffuse information on technical regulations to the other party’s economic operators. Furthermore, institutions from one party will be allowed to take part in the formal public consultative process regarding changes in technical regulations on the part of the other party. Similar requirements shall be established for standards and conformity assessments procedures.178 (See section 6.8).

On labelling, the parties are required to minimize the marking or labeling requirements based on their relevancy for consumers. Furthermore, no prior approval, registration or certification shall be required. A clear improvement over other EU FTAs and commitments taken in the WTO is the creation of a TBT Coordinator.179 This institutional innovation will be responsible for monitoring the implementation of the agreement and for fostering cooperation between the parties—mainly through the creation of working groups—to ensure the smooth functioning of the FTA’s TBT provisions.

Finally, as regards enforcement measures, the EU-Korea agreement broadly follows the general approach of other FTAs. It makes use of a joint committee for TBT measures for consultation and conciliation purposes. In the case of failure, the agreement refers the parties to the WTO dispute settlement body.

6.4 Sanitary and Phytosanitary Measures (SPS)

Sanitary and Phytosanitary measures (SPS) can be understood as regulations on the safety and health standards for food produce. The EU’s general approach to SPS provides more scope for intervention when science is inconclusive than in WTO or US approaches. In this sense, one could say that the EU’s objectives are generally WTO-minus. The EU errs on the side of precaution and control rather than adopting a position whereby products are regarded as safe unless proven otherwise.180 This approach is sometimes seen to be at odds with the science-based approach to risk assessment and management on which the WTO agreement on SPS is based. As such, the EU prefers that SPS measures not be subject to the FTA’s dispute settlement mechanism—a preference confirmed in the EU-Korea agreement. So far, the most extensive EU FTA provisions and procedural disciplines in SPS are the ones included in the EU-Chile FTA.

Broadly speaking, the EU-Korea FTA is comparable in its ambition with other EU FTAs and can be seen as fulfilling the EU’s objectives at the outset of the negotiations. Albeit slightly less ambitious than the EU-Chile FTA (given its overall reference to the WTO’s SPS agreement), the EU-Korea agreement includes many of its innovations. For instance, the EU-Korea SPS chapter contains the same provisions on animal welfare. These refer to the exchange of information and development of common international standards, in particular regarding the stunning and slaughter of animals. This inclusion is in accordance with the EU’s objectives on developing common international approaches to the treatment of animals and of complying with related World Organization for Animal Health standards. There are also provisions aimed at promoting the principle of regionalization, in which risk is assessed on a regional basis rather than a national or for that matter EU wide basis.

178 This implies exchange of information about the standardization process, on conformity assessment procedures for specific products, on accreditation policy, etc.

179 In the case of Korea, the TBT Coordinator shall be the Korean Agency for Technology and Standards or its successor. In the case of the EU, the TBT Coordinator shall be nominated by the EU and notified to Korea no later than one month after the entry into force of the Agreement.

180 Since the sanitary crisis of the 1990s, risk assessment has been carried out by the European Food Authority and risk management by the Commission. In their dealings, both institutions take into account the principles of proportionality, the use of less restrictive measures, non-discrimination, and an assessment of costs and benefits.
An interesting feature of the EU-Korea FTA SPS chapter is the absence of explicit language on the EU’s “precautionary principle”. This principle, however, is included in the social and environmental chapter of the FTA. Its absence from the SPS chapter therefore has no real impact on the ability of the EU to pursue its preferred SPS policies. It is worth noting, that if one sees the chapter as lacking ambition, this broadly reflects both sides’ converging interests.

6.5 Customs and Trade facilitation

Customs and trade facilitation can be defined as the simplification, standardization, modernization and harmonization of trade related procedures. In international negotiations, this implies reducing transaction costs via supply chain initiatives, capacity building, and custom modernization. Most EU FTAs include chapters or sections on customs procedures and administration.

As in other EU-FTAs, the EU-Korea agreement’s chapter on trade facilitation contains rules on electronic clearance, custom cooperation, streamlined administration, expedited procedures, confidential data handling, transparency and predictability in custom procedures, and risk management. The text is based on the International Convention on the Simplification and Harmonisation of Customs Procedures of 1999.

It is worth noting however that as in other EU FTAs, these rules tend to outline the framework for further consultations rather than include substantive commitments. In this sense, the EU-Korea FTA does not go beyond other EU FTAs. Furthermore, many of these provisions are, by their very nature, implemented in an MFN fashion. As such, while the EU-Korea FTA achievements in trade facilitation are comparable to other EU FTAs, it does not go farther than other multilateral initiatives.

6.6 Intellectual property rights (IPR)

The sector-specific analysis of the IPR and geographical indications (GIs) is primarily based on a comparison to other EU agreements, both to older ones as well as future agreements where there are draft IP chapters available, in particular the CARIFORUM-EC EPA, the draft EU-India FTA, the draft EU-Canada CETA, and the draft EU-Colombia-Peru FTA. By highlighting the major trends and differences, potential problems are identified.

The EU-South Korea Free Trade Agreement is one of the first bilateral trade agreement in which the explicit TRIPS-plus mandate of the ‘Global Europe’ strategy has been incorporated. The only other agreement concluded since ‘Global Europe’ that contains a considerable IP chapter is the EC – CARIFORUM EPA. Other countries/regions are currently negotiating FTAs with the EU in which similar IP provisions are expected: India, Colombia and Peru, and Canada. There are a number of features of the TRIPS-plus mandate and the EU-South Korea FTA worth mentioning; (i) similar to the United States, the EU uses a prototype IP chapter,

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182 Consolidated draft text 9th September 2008, Negotiations with India, Date: 7 November 2008 [hereinafter draft EU-India FTA], available at http://www.bilaterals.org/texts_Goods_SPS_IPR_feb2009.pdf (07.05.10). Note that this text reflects the EU proposal for the IP chapter; India has not agreed to the draft yet and has indicated to propose several amendments to the EU proposal.


184 Draft EU-Colombia-Peru Free Trade Agreement, as agreed upon on March 30, 2010, [hereinafter draft EU-Colombia-Peru FTA], available at http://www.bilaterals.org/spip.php?article17138 (07.05.10).

185 See European Commission, Global Europe: competing in the world (Communication, External Trade, 2006).
(ii) the EU-Korea FTA covers more aspects of IP than previous European bilateral agreements, (iii) with rules for each aspect, and (iv) many provisions, such as protection of copyright in the digital environment or industrial designs as well as enforcement measures are identical to current EC legislation. These provisions in the Agreement represent a significant shift towards a more offensive approach on the part of the EU in IP that shows clear similarities with the approach that the United States has adopted in its free trade agreements.

The IP chapter is divided into three main sections covering general provisions, and two very detailed sections on standards and enforcement with 69 articles in total. This is a remarkable increase in the amount of provisions compared to any of the other (draft) IP chapters included in European bilateral trade agreements: while the agreements before the launch of the ‘Global Europe’ strategy contained an average of one or two articles and one annex on intellectual property issues, more recent (draft) agreements count approximately 35 articles.

The section on IPR standards covers seven substantive areas 1) copyright and related rights, 2) trademarks, 3) geographical indications, 4) designs, 5) patents, 6) plant variety rights and 7) genetic resources, traditional knowledge and folklore. The level of detail reflected in these provisions is very high in the sections on copyright and related rights, and GI, followed by the provisions on patents and designs. There is considerably less detail for trademarks, plant variety rights and genetic resources, traditional knowledge and folklore.

**Copyright and related rights**

Korea will be under an obligation to protect technological protection measures (TPMs) and rights management information (RMI). TPMs are technologies or devices that control the access to and reproduction of digital works, such as DVDs. RMI is information, which identifies the work and the work’s author. Korea is obliged adopt national legislation to comply with the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, which grant protection against the circumvention of any TPM and against the removal or alteration of RMI. Articles 10.12 and 10.13 of the IP chapter also require the parties to comply with provisions that are almost identical to Arts 6 and 7 of the EU Information Society Directive. Art 10.6 also prescribes duration of authors’ rights of not less than the life of the author plus 70 years and Article 10.7 states that the rights of broadcasting organizations shall expire not less than 50 years after the first transmission of the broadcast. These standards are also in line with existing EU provisions.

The EU-Korea FTA clearly goes beyond the CARIFORUM-EC EPA, which only specified international agreements the parties need to comply with as well as the cooperation on collective management rights. The EU-South Korea FTA adds the duration of authors’ rights and the rights of broadcasting organizations, the exchange of views on protecting artists’ resale right and limitations and exceptions. The drafts of other future EU FTAs suggest the EU Korea FTA will be the model for the future.

**Geographical indications (GIs)**

Next to enforcement the section on GIs is the most extensive. It covers; a) recognition of GIs listed in Annexes to the agreement, b) elements of registration, c) scope of protection, d) exceptions, e) the relationship with trademarks, and f) the establishment of a working group on GIs. These issues were also

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187 The draft EU-Canada CETA deals next to the duration of authors’ rights and related rights and the protection of TPMs and DMI with a number of rights of authors explicitly. Articles 5.6 to 5.11 specify such different rights in detail.
been addressed in the CARIFORUM-EC EPA, but not in the same detail. The model for future FTAs. Again EU – Korea appears to be the model for future FTAs. On recognition the Agreement covers both agri-food products in Annex 10-A and wines and spirits Annex 10-B, with some 110 indications for wines and spirits protected by the EU and 60 GIs agri-food products. Korea has also listed 63 GIs in Annex 10-A but only 1 spirit. Recognizing each others GI is a common element in agreements on geographical indications. However, compared to the draft EU-India FTA, the EU-Korea FTA lacks the indication that the GIs listed in the annexes will only be recognized after having completed an objection procedure as well as an examination of a summary of the specifications listed. Articles 10.18.3 and 10.18.4 of the EU-Korea FTA merely mention the examination of a summary of the specifications and do not refer to the completion of an objection procedure. Such a procedure, however, seems necessary and useful as otherwise both parties miss the opportunity to assess whether the GIs of the other party comply with their own rules and are not in conflict with existing GIs.

In addition to recognizing each others’ GIs the parties also agree on elements for registration and control. This is an entirely new feature of the IP section compared to previous European agreements. Article 10.18.6 of the EU-Korea FTA includes six elements: a) a register listing GIs, b) an administrative process verifying GIs, c) a requirement that a registered name shall correspond to a specific product, d) control provisions applying to production, e) legal provisions assuring that any operator who markets the agricultural product in conformity with the specification may use the registered name, and f) an objection procedure. The Protocol contained in the draft EU-India FTA includes the same elements as well as other provisions addressing the exceptions to protecting GIs.

The scope of protection granted to GIs listed matches the additional protection of Article 23 of the TRIPS Agreement but extends it to agri-foods. There exception for generic terms is included as in the CARIFORUM-EC EPA, but not in the draft EU-India FTA. In the draft EU-Colombia-Peru FTA, most exceptions are missing.

The relationship of GIs to trademarks has already been touched upon in the context of the exception guaranteed by Article 24.5 of TRIPS and reflected in Article 10.21.5 of the EU-Korea FTA. This exception deals with the registration or application of a trademark prior to the protection of a GI. In such a case, the trademark may continued to be used. Where the TRIPS Agreement explicitly requires that the trademark must have been registered in good faith and that this provision applies to trademarks that are identical with or similar to the GI, both conditions are not included in the EU-South Korea FTA.

Another situation arises when a trademark is applied for after the date of application for protection of the GI for a like good. In this case, according to Article 10.23.1 of the EU-Korea FTA, the registration of the trademark shall be refused. One important conflict rule between GIs and trademarks has been left out: this is the obligation to refuse a GI in the case of a reputed or well-known trademark if the protection of such GI is liable to mislead consumers as to the true origin or identity of the product. This exception has been

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188 See Article 145 of the CARIFORUM-EC EPA. While the issues addressed are almost identical, the level of detail and the scope of the provisions is much less, clearly illustrated by the obligation for CARIFORUM countries to establish a system of protection of GIs by 2014.
189 See Article 7 of the draft EU-India FTA which mainly reflects the same provisions as the EU-South Korea FTA. In the draft EU-Canada CETA, the article on the protection of GIs is not yet available. Articles 13 until 20 of the draft EU-Peru Colombia FTA address most issues of GI protection also covered in the EU-South Korea FTA. It however seems to be less demanding as it does not include a list of elements for registration.
190 See Article 10.18.3 and 10.18.4 as well as Article 10.19 of the EU-South Korea FTA.
191 See Article 145 C.1 of the CARIFORUM-EC EPA.
192 See Article 7.3 of the draft EU-India FTA.
193 Also Article 145.D.4 of the CARIFORUM-EC EPA provides for registration in good faith.
included in the CARIFORUM-EC EPA, the draft EU-India FTA and the draft EU-Colombia-Peru FTA. It is unclear why the EU-South Korea FTA does not include this rule.

The EU-Korea Agreement establishes a working group on GIs for the purpose of intensifying co-operation between the Parties. To that end, the working group may decide to modify the annexes in order to add or to remove individual GIs. There are similar provisions in the draft EU-India FTA.

**Designs**

On protection of industrial designs the EU – Korea Agreement builds on the CARIFORUM-EC EPA, the TRIPs and especially EU legislation with several provisions being taken directly from the Council Directive on the Legal Protection of Designs. Surprisingly the EU- Korea FTA does not contain provisions on the definition of industrial designs or on commitments to become party to the Geneva Act to the Hague Agreement. Apart from this the requirements for protection laid down in Article 10.27 of the EU- Korea FTA are almost identical to those in these other agreements. Furthermore, the requirements for the protection of unregistered designs, the rights conferred to registered and unregistered designs as well as the exceptions thereto do not seem to pose any problems. These are very similar to the respective provisions in the three (draft) agreements named above and mainly reflect the TRIPS standard. What is striking in this section of the IP chapter is the term of protection for registered designs. The EU- Korea FTA increases the term required to 15 years compared to 10 years in the TRIPS Agreement and is differs from the protection contained in Directive 98/71, which requires a minimum of 5 years renewable for periods of five years up to a maximum of 25 years from the date of filing. So unless renewal under the EU legislation is automatic there is greater protection under the EU – Korea FTA than EU domestic legislation.

**Patents**

The EU- Korea FTA is the first EU bilateral to contain detailed provisions on patent protection. These extend patent rights and introduce data exclusivity protection. This trend is confirmed in the other draft FTAs and follows the model of US FTAs. The EU Korea FTA the parties recognize the Doha Declaration on the TRIPS Agreement and Public Health and agree to contribute to the implementation of the Decision of the WTO General Council of 30 August 2003 on paragraph 6 of the Declaration, as well as the Protocol amending the TRIPS Agreement. This provision has been introduced since the CARIFORUM-EC EPA and is

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194 See Article 145.D.1 of the CARIFORUM-EC EPA.
195 See Article 7.3.3 of the draft EU-India FTA.
196 See Article 17.2 of the draft EU-Colombia-Peru FTA.
197 See Article 10.25.1 of the EU-South Korea FTA.
198 See Article 10.25.3 of the EU-South Korea FTA.
199 See Article 7.5.3 of the draft EU-India FTA. Note that in that agreement, the body is not called working group but Joint Committee.
201 See Articles 10.28, 10.29 and 10.31 of the EU-South Korea FTA.
202 See Articles 8.3.5, 8.4 and 8.5 of the draft EU-India FTA, Articles 8.4, 8.5 and 8.7 of the draft EU-Canada CETA, Articles 146.B.4, 146.C and 146.D of the CARIFORUM-EC EPA and Article 26.1 and 26.2 of the TRIPS Agreement. Note that the TRIPS Agreement does not differentiate between protection of registered or unregistered designs and therefore leaves it up to Member States to grant the protection they find suitable.
203 The same protection is contained in Article 8.6.1 of the draft EU-India FTA and the draft EU-Canada CETA, and Article 146.E.1 of the CARIFORUM-EC EPA.
204 The IP chapter in the CARIFORUM-EC EPA, which is the last agreement concluded before the EU-South Korea FTA, does not include detailed patent standards.
205 See Article 10.34 of the EU-South Korea Agreement.
included in draft future FTAs. The two instruments address the need to preserve the flexibilities of the TRIPS Agreement with regard to patents on pharmaceutical drugs and establish clear rules with regard to the freedom of countries to issue compulsory licenses in order to import essential medicine into countries with insufficient manufacturing capacities.

With regard to patent terms the EU-Korea FTA provides for an effective term that takes account of delays in registering a patent. Patent holders must be compensated “for the reduction in the effective patent life as the result of the first authorisation to place the product on their respective markets.” The compensation may not exceed five years. This maximum threshold is longer than that in US FTAs which is four years. The patent term recognized by the TRIPS Agreement lasts 20 years. This is the nominal term of protection that foresees 20 years of protection regardless of delays in registering a product.

**Enforcement of intellectual property provisions**

The EU-Korea FTA goes well beyond previous bilaterals in which the EU made do with TRIPs type enforcement. This policy is in line with the EU Strategy for the Enforcement of Intellectual Property Rights in Third Countries and is being pursued in the other ongoing FTA negotiations. The model for this approach is the Enforcement Directive 2004/48. The provision are TRIPs – plus include criminal enforcement measures, the liability of online service providers and border measures. The criminal enforcement measures are novel and are not even included in EU domestic rules, although the extended EU competence under the Lisbon Treaty may change this. The EU is also negotiating the Anti-Counterfeiting Trade Agreement (ACTA), which would require the EU to introduce criminal enforcement measure. The EU-Korea FTA provisions on criminal enforcement will in effect be partly covered by the proposed EU criminal enforcement directive and the draft ACTA.

**Conclusion**

206 See Article 147.8 of the CARIFORUM-EC EPA, Article 9.2 of the draft EU-India FTA and Article 3 of the draft EU-Canada CETA. Note that recent US free trade agreements also affirm the parties’ commitment to the Doha Declaration. See Article 15.12 of the US-Panama TPA; Article 16.13 of the US-Peru TPA.

207 See Article 10.35.2 of the EU-South Korea FTA. Note that the respective Article 9.3 of the draft EU-India FTA and Article 9.2 of the draft EU-Canada CETA are formulated slightly differently, however provide for the same obligation to extend the duration of the patent in case of the shortening of the effective patent term by maximum five years.

208 See Article 18.8.6(a) of the US-South Korea FTA. Note that this provisions refers to the delay in the granting procedure, another possibility of extending the patent term provided for by United States FTAs. The respective equivalent to Article 10.35.2 of the EU-South Korea FTA is Article 18.8.6(b) which refers to the delay in the marketing approval procedure. This provision, however, does not contain a minimum threshold for unreasonable delay.

209 See Article 33 of the TRIPS Agreement.

210 Note that Article 62(2) of the TRIPS Agreement requires members to ensure that these procedures permit the grant or approval within a reasonable period of time so as to avoid the unwarranted curtailment of the period of protection. The article does not specify further what a reasonable period of time is and what compensation a patent holder should get in case of unwarranted curtailment.


213 See Articles 10.54 until 10.67 of the EU-South Korea FTA.

The IP chapter of the EU-Korea FTA reflects the new trend followed by the EU to include TRIPS-plus provisions in bilateral trade agreements that are also proposed in draft future FTAs. A number of its provisions are completely new, such as the aspects of GI registration, longer duration of protection for registered designs, provisions on the protection of undisclosed data and the extension of the patent term, and criminal enforcement measures.

6.7 Competition Policy

Since the exclusion of the Singapore Issues (of which competition policy was part) from the DDA, the EU has used bilateral FTAs as a means of promoting its views on competition policy.215 This promotion, however, has only been partially successful since the formal inclusion of substantive provisions on competition has not yet made much headway. Consequently, as in other international competition agreements, the competition provisions in EU FTAs have overwhelmingly focused on enforcement cooperation rather than on the creation of new substantive measures. The EU-Korea FTA broadly follows this pattern.

Substantive Measures:

As a general rule, EU FTAs require that the parties have a (effective) national competition or anti-trust policy. At the core of this requirement is the prohibition of cartels.216 Unlike the EU-Cariforum agreement where an explicit reference is made to the “incompatibility” of cartels with the agreement, the EU-Korea FTA makes no reference to substantive provisions. Instead, it limits itself in making reference to the parties’ national competition laws. However, the absence of substantive provisions and the relative shortness of the EU-Korea chapter on competition can be largely explained by the existence of the parallel agreement on competition between the parties.217

An important provision in the EU-Korea FTA is the inclusion of disciplines on subsidies.218 Even if these provisions are of a best endeavor nature, there is obligation—i.e. the parties are legally bound—to ensure a degree of transparency219 in the distribution of subsidies.220 Although this provision is not an innovation, the EU is not always successful in its attempts to include it in FTAs. Within the provision’s framework, the parties are required to provide an annual report on “the total amount, type and the sectoral distribution of subsidies which are specific and may affect international trade”. This constitutes an important

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215 Broadly defined, competition policy covers all restrictive business practices (RBPs), which include horizontal agreements or collusion, vertical agreements and merger controls. Generally, when applied to public enterprises, rules and guidelines require these companies to operate according to commercial criteria, which in essence also imply regulating state subsidy policies.

216 Cartels can be defined as agreements between producers to influence prices or output. These agreements thus have a significant impact on trade but do not create improved productivity. Broadly speaking, the case against horizontal agreements—i.e. agreements between competitors—seems to be stronger than against vertical agreements—i.e., agreements between suppliers—since some economies are more vertically integrated than others.

217 Signed in 2009

218 The inclusion of this provision in the EU-Korea agreement is an improvement over past policies because, even if the EU has made reference to state subsidies in its FTAs with its neighbours and a few developing countries, it has overall made reference to the WTO Agreement on Subsidies and Countervailing Duties. Public monopolies and the need to ensure that these do not distort competition are included in the EU-CARIFORUM agreement.

219 Rules on transparency can include: statutory (de jure) rules; application of competition law (such as decisions and guidelines handed down by courts or competition authorities); and notification on investigations initiated by the national competition authorities.

220 Article 11.12 obliges both parties to report annually “the total amount, types and the sectoral distribution of subsidies which are specific and may affect international trade”.

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improvement over WTO texts and other EU-FTAs since it gives European companies valuable information during the creation and implementation of their business strategies.

**Cooperation in Enforcement**

The core of most international agreements on competition, including the bilateral EU-Korea agreement, is cooperation on enforcement of national and regional competition laws. This cooperation usually takes two forms: either a negative or positive comity. In negative (or traditional) comity, competition authorities are required to incorporate the interests of third parties in any investigation. In the EU-Korea bilateral competition agreement, the parties agree to take into account the other party’s interest when enforcing a competition law that has the potential of affecting the latter’s markets. The parties further agree that competition authorities must provide their counterparts with the opportunity to provide comments on domestic rules and guidelines, and that these comments should not be disregarded. Positive comity provides the Commission or the Korean competition authority with the opportunity to request that their counterparts investigate anti-competitive practices. The agreement further stipulates that, although the competition authority is not obliged to act upon these requests, it is obliged to inform the requesting competition authority of its decision. These provisions reinstate the existing competition agreement between the EU and Korea.

### 6.8 Trade remedies

Trade remedies are at the centre of any strategy against anti-competitive trade practices. They can be broadly defined as a punitive suspension of MFN or preferential tariffs and duties in the presence of trade distorting “unfair foreign pricing” and government subsidies. There are three major trade remedies: anti-dumping and countervailing duties, and safeguards. The latter, even if not justified by trade distorting practices, is implemented through the same channels as anti-dumping and countervailing duties. What changes is the justification for, rather than the means of, a suspension of MFN or preferential treatment.

Overall, EU-FTA provisions on trade remedies broadly follow the WTO provisions for anti-dumping and countervailing duties, and safeguards. Unlike Chile, the EU does not try to include provisions to suppress anti-dumping actions between the parties. Furthermore, the EU usually excludes trade remedies from the FTA’s dispute settlement mechanism. Although the EU-Korea agreement by and large follows general EU FTA practice, two provisions go beyond current policies and are therefore worthy of attention.

First, the agreement creates a Working Group responsible for overseeing and encouraging trade remedy cooperation. Its main function is to serve as a forum for cooperation and exchange of information. This provision is seen as an important precedent for the negotiation of future FTAs in Asia.

Second, as regards safeguard provisions, the EU-Korea agreement goes beyond the WTO text—even if it refers to it as its overarching framework—by giving more consideration to the FTA partner. As already discussed elsewhere, the EU-Korea agreement’s safeguard mechanism constitutes an important improvement over other EU FTAs, and is of particular importance for the European automotive industry. Even if previous notification is required, provisional safeguard measures are permitted “[i]n critical circumstances where delay would cause damage that would be difficult to repair […]” As such, bilateral safeguard measures are allowed if there is “preliminary determination that […] imports […] from the other Party have increased as the result of the reduction or elimination of a customs duty […], and such imports cause serious injury […] to the domestic industry.”

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221 Although Chile has suppressed anti-dumping actions in its agreement with Canada, both the EU-Chile and EU-Cariforum reaffirm anti-dumping rights. Even if in the EU-Cariforum agreement the parties are required to seek “constructive remedies”, and there is a requirement for the EU to notify Cariforum members before it adopts a definitive anti-dumping duty, antidumping rights are clearly stated.
Unlike other EU FTAs, the safeguard provisions for agricultural goods are relatively more lenient than for industrial goods. An important difference from the industrial goods text is that notification can be made after entry into force of the measure. The agreement also provides a precise definition of the “trigger” levels for the implementation of a measure. As with industrial goods, the ceiling for the safeguard measures is the base tariff rate that served as a basis for negotiations.

Finally, the agreement requires the creation of a process of consultation to discuss compensation for the implementation of a safeguard measure. In the absence of compensation, the party against which the safeguard measure is implemented is allowed to resort to the suspension of “substantially equivalent concessions”. These improvements over other EU-FTAs are seen by many as a template for future EU FTA negotiations.

**Transparency Issues**

Transparency in economic regulatory frameworks and government procurement has been a priority for the EU in its FTA negotiations. The EU-Korea FTA reaffirms EU commitments in the WTO, and provides important improvements over other EU-FTAs and the WTO text. Overall, the agreement ensures that information and justification for regulations and regulatory changes are made available for all interested parties in a non-discriminatory fashion. For this, the EU-Korea FTA also requires that parties establish contact points for enquiries to ensure that information about government regulation is available to all interested parties in a non-discriminatory fashion.

The agreement also states that the parties will endeavor to provide sufficient time between the publication and implementation of regulations and regulatory changes. The EU-Korea text contains a best endeavours commitment that interested parties will have a “reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action (...)” and that this procedure should be in accordance with the law.

The agreement foresees the creation of impartial and independent judicial, quasi-judicial or administrative tribunals or procedures in order to review and/or correct administrative action. These tribunals must ensure that all parties have a “reasonable opportunity to support or defend their respective positions”. Finally, the decisions of such tribunals will be legally binding on the authorities. An interesting feature of the EU-Korea FTA agreement is a framework for the exchange of information and promotion of best practices in order to promote quality and performance on the part of regulators.

As mentioned in Section 1.2, an innovation of the EU-Korea agreement over other EU FTAs and the WTO text are the transparency provisions regarding government subsidies and sector specific TBTs. In the latter, transparency in subsidy allocation becomes mandatory. As in the sector-specific TBT chapter, transparency is encouraged by the creation of working groups to supervise the implementation of commitments and mechanisms to secure and facilitate the diffusion of information on regulatory changes.

**6.9 Public Procurement**

Since the Doha round of multilateral trade negotiations failed to include transparency in public procurement (as one of the Singapore Issues), the EU has persistently sought to include public procurement provisions in its FTAs. The rationale behind this practice is twofold. First, more transparent and competitive public procurement procedures are fundamental to increasing market access for EU exporters. Second, opening public procurement markets to foreign competition is a means of enhancing economic efficiency and development for parties to an FTA. The most popular agreement on public procurement is the WTO Government Procurement Agreement (GPA), which, as a general rule, the EU uses as a framework for its FTAs with emerging markets.
Since Korea is a signatory of the WTO GPA, the EU-Korea provisions on government procurement are kept relatively short. In fact, EU-Korea GPA provisions are shorter than in the EU-CARIFORUM agreement. Nonetheless, this agreement contains some improvements over both the WTO text and the framework used by the EU in negotiations with developing countries. For instance, despite Korea’s status as a developing country in the WTO, the EU-Korea agreement stipulates that it will not be allowed to benefit from special and differential treatment. Furthermore, on top of agreeing to implement the current revised GPA text in the WTO (updated in 2007), the parties also commit to extend the agreement’s coverage to build-operate-transfer (BOT) contracts. For the first time in EU FTAs, these contracts will be subject to the same national treatment, non-discrimination, and transparency disciplines as other areas of public procurement.

6.10 Trade and Sustainable Development

Unlike most FTAs concluded by the US, the EU Korea FTA does not include a special chapter on environment, but some rather weak best endeavour-type clauses on environmental protection and sustainable development. The Article on environment mainly mandates efforts to effectively implement the environmental conventions which the Parties have signed and to cooperate in future negotiations. Interestingly, the FTA for the first time includes a reference to the UNFCCC and the Kyoto Protocol.

There is also reference in Chapter 13 to multilateral labour standards and agreements. This includes a commitment to recognise full and productive employment and decent work for all as a key element of sustainable development and a commitment to promote the development of international trade in a way that is conducive to full and productive employment and decent work for all men, women and young people.

The Agreement calls for an effective implementation of the ILO Conventions which the Parties have ratified. The language and content of some of the commitments remain weak. An example is the wording “the Parties will make efforts towards ratifying the fundamental ILO Conventions” as opposed to an obligation to ratify (Korea has not ratified Conventions 87, 98, 29 and 105 on right of association, collective bargaining and two on forced labour). In addition, the possibilities of sanctions are limited, as no binding DS decisions will be taken in this area (see above). In calling for an effective implementation of all conventions identified as up to date by the ILO, however, the Agreement goes beyond core labour standards.

The Agreement also embodies an ILO like institutional mechanism to promote compliance with labour standards. A Committee on Trade and Sustainable Development will be established to serve as a contact point between the Parties for the purpose of implementing the Chapter. The Committee shall meet within the first year of the entry into force and henceforth as appropriate. Furthermore, provision is made for

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222 This information, however, is not legally binding.
223 The EU-Carifom agreement is seen by specialists as an all-encompassing template for public procurement provisions in EU-FTAs with developing countries.
225 Art. 13.5 of the FTA.
226 Art. 13.6 of the FTA.
227 Art. 13.5.3 of the FTA.
228 Art. 13.4 of the Agreement.
229 Article 13.4.2 of the Agreement.
230 Art. 13.4.3 of the Agreement.
government consultations and an advisory Panel of Experts. The Panel can seek information from domestic advisory groups or the ILO.

If core labour standards are violated, the institutional mechanisms can notify such violations in a kind of naming and shaming exercise, but the legal value of these arrangements remains unclear. However, civil society can play a role as a watchdog, which is clearly promoted by the Agreement.

Trade unions appear to have given a positive response to the Agreement and seem to view it as a step in the right direction. For the first time references to decent work, core labour standards and the ILO have been included in an FTA which is already an achievement.

In addition, under the a Civil society dialogue mechanism, a Civil Society Forum will meet once a year and members of domestic Advisory Groups will meet Civil Society Forum in order to conduct a dialogue on sustainable development aspects of the trade relations. The actual operation of the Forum is to be determined by the Committee on Trade and Sustainable Development. Some important questions remain unsolved, e.g. the financing of the Forum.

**Rules of Origin**

The EU approach to rules of origin (ROOs) has been far from parsimonious. Its ROOs have tended to be complex and restrictive (particularly for labour intensive goods). There has been no across the board approach and the requirements have often been product specific. The underlying reasons for this state of affairs can be traced to the EU’s application of its complicated PanEuro model to ROOs, which has been the basis for EU-FTA ROOs since 1997.\(^{231}\)

Since 2005, however, the overall ambition has been to reform this approach. In this context, the EU’s main objective in the EU-Korea FTA negotiations was to simplify the EU’s standard ROOs. As such, when negotiating the agreement, the parties decided to abide by two key principles: first, that the benefits from tariff reductions should not be encroached by overly complex ROOs; and second, that the two parties’ commitments to lower tariffs should not benefit third party exports. This is not to say that the parties agreed on the desired level of stringency of the agreement’s ROOs, however: while Korea pushed for more liberal ROOs, the EU demanded the more stringent rules it usually requires of higher income emerging markets.

As a result, even if the EU-Korea agreement shows a slight shift towards a more liberal approach to ROOs,\(^{232}\) the agreement falls significantly short of creating a parsimonious template for future EU FTA negotiations. Whereas other EU FTAs include (as a general rule of thumb) the requirement that 60% of the value of a product should be created in the FTA partner, the EU-Korea FTA requires 55% of this value.\(^{233}\) This only

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\(^{231}\) While harmonized across the various EU agreements the PanEuro system remains complex. In 60 percent of cases it uses CTH (HS 4 level change of tariff heading) but in 25 percent per cent of cases there is also a value content criterion. Some 20 percent of products require specific processes to be completed to obtain originating status (technical requirements). The restrictiveness of certain rules of origin criteria is mitigated by an either/or option. This means that exporters can for certain products (but not all) choose between two different criteria to confer origin status. There are two options for the administration of ROO under the PanEuro system. Certificates of origin can be issued by a competent agency (e.g. customs authority) or by an invoice declaration for ‘approved exporters’ with a recognized record of good administration. In such cases the importer is liable for any false declaration or incorrect certification and must pay the full tariff unless any irregularity is corrected within 30 days.

\(^{232}\) This being said, the EU-Korea agreement is the agreement with the most stringent ROOs signed by Korea has signed thus far.

\(^{233}\) For comparison purposes, the China-Hong Kong CEPA allows for 30% local value-added (FOB) in most manufacturing products, and ASEAN and Japan ROOs tend to settle for 40% local content. The ASEAN Free Trade Area (AFTA) and the China-ASEAN FTA have ROOs with across-the-board 40% local content (Dreyer and All, 2010 (forthcoming)).
remains a rule of thumb, however; the ROOs in the EU-Korea agreement are no less complex than in other EU FTAs since this agreement does not present an across-the-board approach. Instead, requirements are product specific.

**Duty Drawback**

As a general rule, the EU does not allow duty drawbacks in its FTAs since they are seen as creating competitive distortions. Given staunch Korean support for such measures, this issue was one of the major stumbling blocks during the EU-Korea FTA negotiations. In the end, the EU made (for the first time) an exception and permitted the inclusion of the provision in the agreement.

There are, however, some caveats. If the duty drawback mechanism is allowed in the EU-Korea agreement, it remains nonetheless permanently capped. As such, no potential expansion of sourcing from abroad (for instance, from China) will lead to a rise in duty drawbacks. Importantly, this provision effectively prevents drawbacks from creating further distortions or being abused.

Furthermore, the duty drawback clause is to be revised five years after entry into force of the agreement. The agreement stipulates that if “there is evidence of a change in sourcing patterns (…) which may have a negative effect on competition for domestic producers of like or directly competitive products”, the importing party is allowed to request a limitation on duty drawbacks. Finally, the chapter includes detailed rules for the establishment of evidence and for a binding arbitration procedure in case of disagreement, which further reduces the risks of competitive distortion potentially created by these policies.

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234 Duty draw-back is defined as the repayment of tariffs on imported components that are then subsequently used in the production of a product for export to the EU.

235 In the case of the EU-Chile Association Agreement drawback use was to be phased out in 5 years. In the case of the EU-CARIFORUM EPA drawback is not permitted.

236 The change of sourcing patterns will be assessed on the basis of whether “the rate of increase of dutiable imports into a Party of materials incorporated into a particular product from countries with which no free trade agreement is in force is significantly greater than the rate of increase of exports to the other Party of the product incorporating such materials”. Exceptions are made if these imports are for domestic consumption or of high value-added, therefore not altering the price structure.
7 ECONOMIC GAINS & LOSSES ACROSS EU COUNTRIES & EMPLOYMENT EFFECTS (COUNTRIES/ SECTORS)

The existing studies are unhelpful in providing the EP with the requested analysis on this point. Thus, Francois / Copenhagen Economics does not give results per EU country since the EU is regarded as a single economy. Neither is this the case for IBM-SIA. Prognos is solely about Germany. KIEP (2005) deals essentially with Korea. CEPS / KIEP (2007) does not add its own quantitative analysis or simulation.

Perhaps it is useful to note that the Francois / Copenhagen study is already quite ambitious in terms of data gathering and equilibrium analysis. Although the EU is seen as one, it explicitly incorporates many other countries or regions in the world economy (so that it can analyze the Doha effects as well as other FTAs Korea might wish to conclude). In addition, it has no less than 36 industrial, agri-food and services sectors (for instance, KIEP has 15 sectors). This is brought into a complex general equilibrium framework (CGE) based on fairly detailed input-output tables of 2001 amongst all these sectors and countries. Sectors are also distinguished as to more or less competitive market structure. Altogether, this leads to a highly powered data absorption and calculation process. Imposing another 27 EU countries specifically would not be easy, to say the least.

We shall limit this section therefore to the simulated income effects and employment effects, where available. The overall conclusion, however, is clear: since Korea is relatively small for the EU economy (the latter GNP being some 15 – 18 times bigger than the former) and only some sectors will be more than marginally affected, the FTA will not engender significant income effects in the EU. Also overall employment effects are very modest. It is conceivable that in very few instances the combination of regional and sectoral effects will yield noticeable negative as well as positive effects on jobs (other things equal). Even so, these changes will be experienced over the medium run and (when negative) are likely not to outweigh natural exit patterns of workers from companies.

Table 18: FTA Effects on GDP (% from the base case)

<table>
<thead>
<tr>
<th>Model</th>
<th>Impact on Korea</th>
<th>Impact on EU25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pukyong (2006)</td>
<td>GTAP Armitinght</td>
<td>2.3%</td>
</tr>
<tr>
<td>KIEP (2005)</td>
<td>GTAP Armitinght</td>
<td>2.0%</td>
</tr>
<tr>
<td>Copenhagen Economics (2007)</td>
<td>GTAP with Imperfect Competition</td>
<td>2.4%</td>
</tr>
<tr>
<td>SIA GTAP (2007)</td>
<td>GTAP Armitinght</td>
<td>0.2%</td>
</tr>
<tr>
<td>SIA GTAP (2007)</td>
<td>GTAP Adjusted Elasticities</td>
<td>0.6%</td>
</tr>
<tr>
<td>SIA Investment Model (2007)</td>
<td>Econometric Panel Estimation</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

Source: IBM SIA (2008)

As the table above shows, distinct quantitative analyses do not yield a noticeable effect of the FTA on EU income: either 0 % or, in one case, 0.1 %. As a result, the impact on employment is also negligible as the following table, taken from IBM/ SIA (p. 85), shows.
It is slightly different when the analysis goes sectoral. In Francois / Copenhagen Economics, the partial 2 scenario is probably closest to the FTA as signalled now. Table 20 (from this source) shows selected sectors with either negative or positive output effects which are measurable. Apart from motor vehicles (again Korean FDI in Central Europe subsequent to the base period is not taken into account) and (electrical and other) machinery, effects are not much different from zero. In some services effects are positive but very small, yet, the indirect effect of service liberalisation on industrial sectors (due to greater Korean competitiveness) is slightly negative. The same study finds no noticeable effects on wages of skilled or unskilled workers in the EU, overall.

Table 20: Trade liberalisation measure

<table>
<thead>
<tr>
<th>Sector</th>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Services</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>other processed foods</td>
<td>0.4</td>
<td>0.0</td>
<td>-0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>motor vehicles</td>
<td>0.0</td>
<td>-0.7</td>
<td>-0.3</td>
<td>-1.1</td>
</tr>
<tr>
<td>electrical machinery</td>
<td>0.0</td>
<td>-0.1</td>
<td>-0.5</td>
<td>-0.6</td>
</tr>
<tr>
<td>transport</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td>communications</td>
<td>0.0</td>
<td>0.0</td>
<td>0.2</td>
<td>0.2</td>
</tr>
<tr>
<td>other business services</td>
<td>0.0</td>
<td>0.0</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>other machinery</td>
<td>0.0</td>
<td>0.2</td>
<td>-0.4</td>
<td>-0.2</td>
</tr>
</tbody>
</table>

Source: Model simulations
Note: The results are from the partial 2 trade agreement scenario. All results are reported for a baseline including a full Doha-round and other Korean FTAs. The parts do not exactly sum to the total, due to rounding errors.

Source: Copenhagen Economics (2007)

In the Appendices of Francois / Copenhagen Economics, more detail is found. Focusing on the partial 2 scenario again, and noting that the services impact in this study might be exaggerated, the sectoral output changes higher than 0.15 % can be mentioned. The negative effects are in textiles (not clothing), chemicals (almost entirely due to the services impact), iron & steel, non-ferrous metals, motor vehicles (the biggest with -1.08 %), electrical machinery, other machinery and other manufactures. The positive effects in
transport, communications, and business services (the largest); many positive instances are reported but most of them are smaller than 0.15 %.

The same exercise can be done for employment simulations. For unskilled labour, sectors with negative job effects larger than 0.1 % include: textiles, iron & steel, non-ferrous metals, motor vehicles (largest with – 1.1 %) and electrical machinery and those with positive employment effects other processed foods, transport, communications, and other business services. Many sectors report zero or 0.1 %. For skilled labour, sectors with negative job effects larger than 0.1 % include: iron & steel, motor vehicles (the largest with – 0.4 %) and electrical machinery but none with positive effects although many sectors score zero or plus/minus 0.1 %. In the calculations of IBM/SIA (2008), the variation of Francois’ model brings to similar results - both in terms of changes in outputs and employment - as it shown by the following two graphs.

**Graph 10: Change in industry output with a FTA between EU 25 and Korea**

![Graph showing changes in industry output with a FTA between EU 25 and Korea](source: TAC)

The bar graph in the above graph shows that the variation of industry outputs from the EU perspective is indeed very small across industries.
Graph 11: Impact on the Unskilled Labour with a FTA in EU25 and Korea

Similarly, the effect of the EU-Korea FTA on unskilled labour is almost negligible across EU industries.

7.1 Rebalancing measures and adjustment assistance

In the previous section, it is shown that economic simulation of the FTA - in various studies - points to mere selected (indeed few) and small sectoral output losses, no significant threats to employment or the unlikelihood of major job losses. The principal reason is that Korea – EU trade (or, for that matter, two way FDI) is already fairly free (except in agri-food) whilst the economic weight of the bilateral economic exchange between the two is, for the EU, relatively small. Changes in what already amounts to a relatively small economic impact are much smaller still and would not normally cause significant adjustment pressures for the EU economy as a whole.

However, several sectors suffer from comparative disadvantages to some extent and their full exposure to Korean competition in the Union will prompt faster and greater adjustment than without it. On the one hand, it is good to recognize this and appreciate the anxieties of the workers and management in such sectors, mainly, motor vehicles, electrical machinery and textiles. On the other hand, these adjustment pressures ought to be considered in a much wider context:

- incorporating the structural change which comparative disadvantage sectors undergo anyway, with or without this FTA
- taking into account the drastic consequences of the recent financial and economic crisis (with falls in output amounting to a very large multiple in one year of any simulated fall on output due to the EU – Korea FTA over a range of years together)
- corporate strategies going beyond mere lay-offs of workers and pushing labour-saving technologies, i.e. consolidations via mergers and acquisitions to bolster competitiveness in niche markets, a deeper division-of-labour with companies in Central Europe thereby better meeting Korean (and other) import competition, reshuffling the range of products so as to focus more on
those where market shares are robust, and other entrepreneurial responses possibly requiring reskilling and adaptation of the workforce.

Altogether, as noted before, it is likely that negative socio-economic consequences that can be attributed to the EU – Korea FTA (and not or not mainly to structural change or severe cyclical turbulence) is going to be minimal. One understands the anxiety in the three sectors mentioned because the FTA is presumably regarded as yet another adjustment pressure on top of already painful contractions or adaptations. It is the classical role of 'trade adjustment assistance' to soften the pain and reducing the costs of adaptation of those temporarily losing out from trade liberalisation initiatives, which, overall, are in the European public interest. Knowing that, overall, the EU is likely to gain from the FTA, it is entirely rational (and no less social) to spend some of this overall gain on those having to adapt so as to help them re-skill for other sectors or to assist in upgrading their human capital without themselves having to pay the costs exactly at a moment when those workers can least afford it.

The EU has two Funds available for such purposes: the European Social Fund (ESF) and the European Globalisation Adjustment Fund (EGAF). Although the ESF began in 1958 as an adjustment fund to smoothen adjustment to the sharp and rapid reduction of tariffs in the then common market, it has meanwhile developed into a Fund which systematically supports the increase of the Union’s capacity to create more good jobs and to provide people with the skills to fill them. Its remit is mainly about anticipated change, not directly dependent on new trade initiatives. Thus, one can regard it as a one of the (few) tools at EU level for the EU employment strategy. Most other ways to soften the costs of adjustment are retained by Member States as part and parcel of their welfare states, social rights and policies. Of course, some Member State may take initiatives to support regions affected or indeed other so-called (potential) "beneficiaries" of the ESF, but this would have to be embedded in structural reasons for adaptation, not specifically the EU– Korea FTA as such. It is not impossible that the needs of workers hit by the eventual consequences of the FTA overlap with the needs which are fundable under the ESF.

The EGAF is a different Fund. Its aim is to provide support for workers made redundant as a consequence of major structural changes in world trade patterns (that is, globalisation, including re-location of plants). As the Annual Report over 2008 237 states, the Fund ‘was designed as a means to reconcile the overall long-term benefits of open trade in terms of growth and employment with the short-term adverse effects which globalisation might have… on the employment of the most vulnerable and least qualified workers.’ (p. 2). Therefore, it would seem that, in principle, a case can be made to employ the resources of the EGAF for adjustment assistance in order to ‘reconcile’ open trade with Korea and possible short-term adverse effects falling on certain workers. It is a typical instance of ‘active labour market policy' helping workers from job to job. Whereas usually this is a Member State policy, here it is a Member State initiative supported – after scrutiny for eligibility – at the EU level.

Until recently, The EGAF was little used, for a simple reason. Until the crisis the EU was doing well in the boom and holding its own in many markets worldwide. Of the few instances where support was given, there are three cases from the car sector: one in Spain [588 workers in Castilla y Leon and Aragon ] and two in France [respectively, 366 workers from PSA and 267 workers from Renault ]. Meanwhile, the EGAF regulation has been revised 238 in order to extend its operations to redundancies resulting from the crisis. The criteria have also been relaxed so that the threshold is no longer 1000 but 500 workers, funding can extend over 24 (and not 12) months and the co-financing rate has been stretched from 50 % to 65 %. If and insofar as the EU – Korea FTA would indeed lead to redundancies a strong case could be made for the use of the EGAF. Nevertheless, in all three sectors, other and far more powerful competitive pressures than those arising from this FTA play a role and none of these are new. Moreover, the devastating effects of the

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crisis are only slowly being overcome today (the revised EGAF may actually be helpful if a link can be demonstrated). This all means that the attribution of redundancies, solely or even principally, to the EU – Korea FTA will not be easy. In the car sector, where the impact might be more severe, there is the additional complication that the Korean FDI in the Czech Republic and in Slovakia (see section 5.1 above). The case of inward investment in the automotive sector illustrates how the EU internal market and globalisation are inextricably linked. The EGAF can probably be employed in this instance as long as the eligibility criteria are met. Yet, one has to remain cautious. The Korean FDI in the EU will strengthen their presence in small cars, first of all, but at the same time, due to reasons of climate change and pressures on personal income in many EU countries, one might suspect a structural shift towards demand for smaller cars in the EU. If and insofar as such a structural shift would take place, it is not impossible that the EU would be capable of accommodating both the locally produced Korean output (replacing imports from Korea) and the small cars produced by EU-owned automotive producers. Moreover, one cannot neglect that the Czech Republic and Slovakia will witness the creation of some 25 000 jobs directly and indirectly, presumably with some positive demand spill-over to other EU countries as well. Linking job losses in the car industry to the FTA itself – rather than to intra-EU competition from plants owned by Korean companies - will now become much harder.

8 CONCLUSIONS AND RECOMMENDATIONS

The bilateral FTA negotiated between the EU and the Republic of Korea is comprehensive in coverage and constitutes an advance on previous EU FTAs. As such it offers a means of furthering market opening and increased trade at a time when multilateral negotiations are stalled and there is a case for trade growth to support the economic recovery post the 2008/2009 recession.

The impact of the FTA would be to enhance trade and to make a small contribution to wealth creation. The most recent study commissioned by DG Trade suggests an increase of EU exports of between Euro 30 and 40 bn and Korean exports to the EU of about Euro 20bn. As this study includes an assessment of the gains from removing non-tariff barriers, barriers to services trade and growth effects, the estimates would seem to be reasonable. In terms of the wealth creation, the gain for the EU seems likely to be less than 0.1% of GDP and for Korea less than 1% of GDP. The wealth creation effects are greater for Korea than the EU because Korea’s economy is smaller and the levels of trade protection in Korea are generally higher. Increased trade will be of a broadly intra-industry nature due to Korea’s relatively high level of development. The adjustment costs in the EU (and Korea) due to the Agreement are likely to be quite limited compared to those caused by other factors. The trade and economic gains from the FTA would therefore justify the use of EU instruments, such as the European Globalisation Adjustment Fund (EGAF) to mitigate adjustment costs incurred.

The Agreement includes extensive tariff liberalisation, but as importantly is also includes innovative, WTO – plus provisions on technical barriers to trade TBTs, GATS plus and KORUS-plus services access for EU suppliers and TRIPs - plus provisions on intellectual property, such as in the field of geographic indicators. These provisions are all backed up by strong dispute settlement and are important because the gains for the EU will only be fully realised if non-tariff and regulatory barriers to market access in Korea can be adequately addressed in the years after tariff liberalisation has taken place.

Studies suggest the main trade gains for Korea will be in the automotive and perhaps the textiles and clothing sectors. With regard to the former the impact of increased competition will be felt in countries and companies that specialize in small or medium priced automobile production. None of the studies, including the most recent study published by the Commission in May 2010, includes an assessment of the effects of Korean foreign direct investment in the Czech Republic and Slovakia, which can be expected to replace a large share of Korean imports. The continuation of duty draw back will have an impact on the
An assessment of the EU-Korea FTA

The competitiveness of Korea products on the EU market, but this will be modest, especially when set against the backdrop of other factors affecting the automobile sector in the EU.

The Agreement therefore represents a comprehensive model for future EU FTAs across a wide range of issues including sustainable development, where the provisions on labour standards in particular are a modest but real advance on previous FTAs and WTO provisions.

Given that Korea is negotiating a number of FTAs with other trading partners, such as China and Japan, and has already negotiated KORUS with the United States, there is a case for early application of the agreement in order to maximise first mover and market access gains for a number of EU producers.

9 ANNEXES

Annex 1: Note on CEPII/ATLASS Study for the European Commission of May 2010

This new study by CEPII/ATLASS is essentially a quantitative one, based on the FTA as initialled. It employs a more in-depth (and to some extent technically novel) empirical analytical approach of the FTA. Therefore, it has value-added for all serious students of the FTA.

For MEPs, what matters mostly are the results and some basic qualifications needed to put the study in perspective. The technicality of this new work is such that only advanced economists can comprehend and judge the approaches.

The overall results for GDP (EU as well as Korea) are close to those of the leading previous study, Francois / Copenhagen (2007): a very small gain for the EU (0.08 %) and a somewhat larger but still modest gain for Korea (0.84 %). This is reassuring because the methods in arriving at these results are quite distinct. The study adds ‘welfare gains’ of 1.12 % for Korea and almost none for the EU (0.02 %).

However, the effects on bilateral trade are different in a number of ways. It would seem that the crucial (but by no means the only) difference between Francois / Copenhagen and Decreux et al, 2010 is the great attention paid by the latter to NTBs and their impact. Decreux et al calculate the tariff equivalent of NTBs [as the % on top of the price of imports at the border, caused by all the costs of NTBs, as if it were a tariff] for a range of goods sectors, which is not done at all by Francois, and the sectoral differentiation of tariff equivalents of services NTBs, where Francois only inserts a simply derived tariff equivalent for all services together. The techniques employed here are new.

The relevance for MEPs is that the EU – Korea FTA turns around the removal or reduction of NTBs in the key sectors, far more than tariff removal (except in some specific subsectors). Thus, insofar as this new method is appropriately applied, reasonably reliable estimates of the impact of NTBs (hence, also of their removal) is of much greater importance than tariffs, in order to get a good idea of the economic impact of the FTA.

Previous studies, often based on Francois too, would typically first list the quantitative effects, with some comments or variation, and subsequently proceed with a qualitative / descriptive discussion of the NTBs such as restrictive regulation, standards, discrimination, anti-competitive status-quo, etc. This way, it is next to impossible to gauge what the approximate effects will be of the “depth” of the new-generation FTA, precisely where it matters most: NTBs in cars, machinery, pharmaceuticals, agri-food and selected services.

For those interested, see table 3.18 (p. 70) of Decreux, which compares the protection of the EU and Korea in a range of goods and services sectors, all in terms of tariff equivalents, with the Francois study. In goods the EU protection between the two studies differs little (again with exceptions where NTBs are used in the

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239 The landmark article is from Kee, Nicita & Olarreaga, 2009, Economic Journal, pp. 172 ff; called KNO method in the study.
EU e.g. dairy) but the contrast for Korea is striking (precisely because Francois employs only tariffs which Korea has reduced to fairly low levels). In services, the (Francois) EU tariff equivalent is 17 % for all of them together, whereas they are differentiated over 10 subsectors in Decreux and most of them are higher than Francois’ average. For Korea the (Francois) services average is 46 % (called too high in IBM SIA, without giving hard, verifiable reasons) and the Decreux tariff equivalents are both higher and lower than Francois – overall probably similar but this differentiation provides a better basis for estimates. From this comparison, it follows directly that Decreux is bound to generate (much) stronger export results for the EU in goods (than Francois) insofar as the FTA will indeed remove or drastically reduce these NTBs.

Therefore, Francois and Decreux differ considerably when it comes to trade effects: EU exports in Decreux would increase by at least € 33 bn (in a range of up to € 41 bn) against only € 19 bn in Francois, and this export boost does not occur mainly in business or other services, but in goods sectors. EU imports also increase more but the difference is less (€ 23 bn vs. € 16 bn). When it comes to EU sectoral production effects, the Decreux study gives either less negative or slightly (more) positive results than Francois, with a single exception: textiles (where the study simulates – 2.1 % output, but with the caveat that origin rules could not be incorporated – and this happens to be key in this sector; the FTA is restrictive here, hence, this output effect is exaggerated). Note that the EU – Korea trade deficit (for the EU) would shrink considerably in Decreux.

Some sectoral results are remarkable. Chapter 4 is devoted entirely to cars and trucks. What matters there are NTBs and much effort is spent on describing these in detail. The difference with previous studies is that the FTA is now known. In cars this is (almost) all about NTBs. Decreux simulates a whopping EU export increase of over 400 % (€ 8 bn) to Korea due to vanishing NTBs. On the EU export side, this might be overestimated if and insofar as origin rules also play a role here. On the EU import side, the study does note the recent Korean FDI - which, our Consortium stresses, may prompt far-reaching changes in the bilateral trade picture; indeed, already does! ; see Graph 1 in our section 5.1.1 – but fails to incorporate this FDI in their analysis. This is a weakness of the study, misleadingly causing the Koreans to increase (simulated) car exports to the EU with no less than 131 %, although one can already observe a steep decline of Korean exports (substituted by intra-EU output from Korean plants) in actual practice.

Due to the removal of NTBs, some other sectors also show large export boosts to Korea in the study, in particular machinery and electronic equipment (some 65 %) as well as agri-food exports (even higher or much higher, dependent on the product).

The technical aspects of the study seem to be of little relevance for the EP / INTA Ctee. Still, it is good to note that this study is technically more refined than any other one before, that (non-tariff) barriers are better incorporated, that the actual FTA (as initialled) has been followed faithfully where possible (which is admirable in itself), that tariff removal is calculated at highly disaggregated (HS 6 digits) level which gives precision, that service restrictions are listed in some detail based on GATS commitment schedules or reports, and that a special chapter has been devoted to the car sector (even though the efforts spent are unfortunately undermined by not paying nearly enough attention to the FDI by Korean companies in the Union).

For the main conclusions of our Consortium report to the EP, few if any consequences seem to follow from the publication of the new study. If anything, the new study would tend to make it even less problematic

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240 Also, in chemicals. It is not clear why; perhaps REACH is regarded as a major NTB; or it is due to subsectors such as pesticides, cosmetics and pharmaceuticals which are heavily regulated. The study is silent here.

241 Despite the explicit claim that a form of FDI is incorporated in the modelling approach more generally.

242 In part, by relying on a more sophisticated CGE model called MIRAGE, in part by a new method (based on the ‘trade cost’ literature) to estimate NTBs costs, in part by incorporating terms-of-trade effects unlike previous studies.
than we already concluded to support the FTA and its early ratification. The authors themselves suggest an overestimate of EU textile imports as simulated (due to the origin rules not being in the model). Above, we have noted that the EU car imports’ increase from Korea in the report are not credible and, in fact, will be (and are today already) far lower than in 2007. More likely, they will continue to decline! Many other sectors can expect opportunities for export increases whereas imports will increase but not so strongly (since EU tariffs are mostly low and NTBs far more insignificant than in Korea except in agri-food).

Annex 2: Evaluating stakeholder arguments on the controversial issues of duty drawback (DDB) and rules of origin

In the following, arguments of ACEA, the EU Commission DG TRADE (COM), and of BUSINESSEUROPE are presented, explained and evaluated in order to clarify these complex issues. First general aspects concerning DDB are considered before the empirical relevance of DDB and the significance of the special clause on DDB are evaluated. Finally, the issue concerning rules of origin is briefly raised.

General arguments on DDB

The most important general argument of ACEA against allowing DDB in the EU-Korea FTA refers to the competitive distortions induced by this mechanism.243 European producers selling their products in the domestic market have to pay tariffs on foreign inputs, while Korean exporters to the EU get the tariff outlays on their foreign inputs refunded and thus obtain an alleged unfair competitive advantage. Moreover, it is criticised that by allowing DDB, third countries indirectly obtain duty free access for their intermediate goods to the EU und thus unintendedly get the same advantages as the FTA partner country.

The Commission clearly acknowledges these disadvantages in a study co-authored by DG TRADE and DG TAXUD (The future of ‘Duty Drawback’ in the rules of origin of EU Free Trade Agreements). However in this publication and other statements, COM presents several qualifying arguments. These arguments are evaluated here from an academic viewpoint, which in part entails presenting counter arguments of ACEA:

- It is correct - as COM points out - that EU exporters also benefit from DDB when exporting to Korea. However, exports of motor vehicles to Korea are smaller than Korean exports to the EU. Moreover, the country with higher external tariffs on foreign inputs, in this case Korea, benefits more than EU exporters compared to a situation when DDB was prohibited. In addition, the competitive disadvantage for EU producers (only) selling their products in the domestic market remains unaffected by this argument.

- It is also true that DDB exists already before (independent of the FTA), so that allowing this mechanism does not present a new benefit. However, without the FTA, the use of DDB by Korean producers is hardly relevant for EU producers of motor vehicles because they are protected by the EU external tariff which over-compensates the DDB advantage for Korea. When this external tariff is eliminated, the full distortionary effect of DDB is felt by EU producers.

- It is pointed out by COM that the EU is the only significant trading partner which still insists on prohibiting DDB, while the US is said to have abandoned this practice in recent FTAs. ACEA, however, states that the US concluded most of its recent FTA with developing countries, that in the FTAs with Chile and Mexico DDB was only granted with limits, and that the US allowed DDB in the KORUS FTA only due to strong pressure from Korea. ACEA also informed the author that US manufacturers ask for improvements in the KORUS FTA and are looking at opening the DDB issue.

243 No consideration is given here to arguments concerning the allowance or prohibition to use DDB vis-à-vis developing countries.
COM correctly points out that prohibiting DDB represents a disadvantage for the partner country. Yet, this is just the mirror argument of the competitive disadvantage to the EU domestic producers when DDB is allowed.

However, this last aspect closely relates to the general DDB policy COM intends to follow in the future (The future of ‘Duty Drawback’ in the rules of origin of EU Free Trade Agreements), because the threat of prohibiting DDB and the implied disadvantage to a potential FTA partner country can be used as a leverage or bargaining chip to obtain valuable market access concessions. Thus, COM considers it acceptable under certain conditions to allow DDB, if the implied competitive disadvantage to EU domestic producers is balanced by broader benefits obtained by the FTA. This evaluation should - according to COM - be made on a case-by-case basis and should rely on an assessment of the impact of allowing or prohibiting DDB. DDB could thus be allowed, if the general ambition of the FTA meets the market access interests of EU industry and if rules of origin overall fulfil the need of EU industry.

This political and strategic position is not further evaluated here, as it very much depends on the concrete interpretation on what is acceptable as broader benefit and thus leaves ample room for discretion. It should only be pointed out that this strategy carries the danger of playing out different industry interests against each other, as has happened in the case of the EU-Korea FTA.

Taking this view by the Commission into account, ACEA fears that permanently granting DDB (at an early stage of negotiations) to an OECD country like South Korea, creates dangerous precedents for ongoing and future FTA negotiations e.g. with India, Singapore, Canada, etc. COM (EU-Korea FTA – Q&A on duty drawback and rules of origin), however, has stated that the allowing DDB in the EU-Korea FTA should not be considered as a precedent for other FTAs.

**Empirical relevance of DDB**

Apart from the general pros and cons of DDB, it is important to quantify the competitive disadvantage implied by allowing DDB in the EU-Korea FTA. Different empirical estimates circulate in the public debate and range between less than 100 Euro, 320 Euro and 1,300 Euro. In order to understand how these numbers are calculated and how they can be evaluated, a basic framework is useful.

The table ‘Empirical Relevance of DDB - An Overview’ presents different trade policy arrangements that can be used to calculate the extent of competitive disadvantages. First the country scenarios A and B for the EU are compared to country scenario E for Korea.
### Table 21: Empirical Relevance of DDB – An overview

<table>
<thead>
<tr>
<th>Country scenario</th>
<th>Country of producer</th>
<th>Foreign input share</th>
<th>Average duty on foreign inputs</th>
<th>Share of foreign inputs taxed at this rate*</th>
<th>Calculation of multiplicative factor</th>
<th>EU price of Korean imports / of domestic EU production in EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Status quo</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>EU</td>
<td>5.7 %</td>
<td>5%</td>
<td>0.057x0.05=0.00285=0.285%</td>
<td>0.00285 = 0.285%</td>
<td>10,028.50</td>
</tr>
<tr>
<td>B</td>
<td>EU</td>
<td>5.7 %</td>
<td>5%</td>
<td>0.057x0.05=0.00285=0.285%</td>
<td>0.002852 = 0.285%</td>
<td>15,042.75</td>
</tr>
<tr>
<td>C</td>
<td>EU</td>
<td>11.4 %</td>
<td>5%</td>
<td>0.114x0.05=0.0057=0.57%</td>
<td>0.0057 = 0.57%</td>
<td>10,057.00</td>
</tr>
<tr>
<td>D</td>
<td>EU</td>
<td>11.4 %</td>
<td>5%</td>
<td>0.114x0.05=0.0057=0.57%</td>
<td>0.0057 = 0.57%</td>
<td>15,085.50</td>
</tr>
<tr>
<td>E</td>
<td>Korea</td>
<td>15%</td>
<td>8%</td>
<td>0.15x0.08x0.6=0.0072=0.72%</td>
<td>0.0072 = 0.72%</td>
<td>10,072.00</td>
</tr>
<tr>
<td>F</td>
<td>Korea</td>
<td>40%</td>
<td>8%</td>
<td>0.4x0.08=0.032=3.2%</td>
<td>0.032 = 3.2%</td>
<td>10,320.00</td>
</tr>
<tr>
<td>G</td>
<td>Korea</td>
<td>15%</td>
<td>5%</td>
<td>0.15x0.05x0.6=0.0045=0.45%</td>
<td>0.0045 = 0.45%</td>
<td>10,045.00</td>
</tr>
<tr>
<td>H</td>
<td>Korea</td>
<td>40%</td>
<td>5%</td>
<td>0.4x0.05=0.02=2%</td>
<td>0.02 = 2%</td>
<td>10,200.00</td>
</tr>
</tbody>
</table>

| World scenarios  |                     |                     |                               |                                          |                                     |                                                            |
|------------------|---------------------|---------------------|-------------------------------|------------------------------------------|                                     |                                                            |
| (2) World with duties |                   |                     |                               |                                          |                                     |                                                            |
| (3) Envisaged    |                     |                     |                               |                                          |                                     |                                                            |
| Duty free world  | No EU-Korea FTA:    |                     |                               |                                          |                                     |                                                            |
| A                | EU                  | 5.7 %               | 5%                            | 0.057x0.05=0.00285=0.285%              | 0.00285 = 0.285%                   | 10,028.50                                                  |
| B                | EU                  | 5.7 %               | 5%                            | 0.057x0.05=0.00285=0.285%              | 0.002852 = 0.285%                 | 15,042.75                                                  |
| C                | EU                  | 11.4 %              | 5%                            | 0.114x0.05=0.0057=0.57%               | 0.0057 = 0.57%                    | 10,057.00                                                  |
| D                | EU                  | 11.4 %              | 5%                            | 0.114x0.05=0.0057=0.57%               | 0.0057 = 0.57%                    | 15,085.50                                                  |
| E                | Korea               | 15%                 | 8%                            | 0.15x0.08x0.6=0.0072=0.72%            | 0.0072 = 0.72%                    | 10,072.00                                                  |
| F                | Korea               | 40%                 | 8%                            | 0.4x0.08=0.032=3.2%                   | 0.032 = 3.2%                     | 10,320.00                                                  |
| G                | Korea               | 15%                 | 5%                            | 0.15x0.05x0.6=0.0045=0.45%            | 0.0045 = 0.45%                   | 10,045.00                                                  |
| H                | Korea               | 40%                 | 5%                            | 0.4x0.05=0.02=2%                     | 0.02 = 2%                        | 10,200.00                                                  |

* COM assumes that 60% percent of imports of parts is subject to duties, i.e. from partners that do not have preferential access to the Korean market. This assumption has not been verified by the authors. Source: own presentation
World scenario 1: Duty free world: As a basic benchmark case it is useful to assume a world without tariffs, where the domestic sales prices for a small/medium car of the EU and Korea are standardised to be 10,000 Euro each (or in an alternative version 10,000 for Korea and 15,000 for a mid sized car in the EU). Abstracting from transport costs, the Korean car also costs 10,000 Euro in the EU, so that in this scenario there are no competitive distortions in the EU market.

World scenario 2 (status quo): As an alternative benchmark scenario, a world with tariffs and DDB but without an EU-Korea FTA is assumed. Here, Korean exporters of motor vehicles face the external tariff of 10% on average, and European car producers have to pay duties on the foreign inputs. COM has calculated (from the GTAP database and based on latest available 2004 figures) that the share of total imported inputs (not only traditional car parts) in the EU production of motor vehicles and parts amounts to 5.7% and that the weighted tariff on these inputs (taking into account EU’s preferential arrangement) is 5% (COM – untitled note). Multiplying both factors leads to a multiplicative factor of 0.00285 or 0.285%.

Thus, in this scenario, a Korean car costs 11,000 Euro in the EU (scenario E2) and competes with a European car priced at 10,029 Euro (scenario A2) or 15,043 Euro (scenario B2).

World scenario 3: FTA with DDB allowed (as envisaged): In this scenario Korean producers are refunded for their tariff expenses on foreign inputs. Thus, they can offer their cars at 10,000 Euros in the EU (scenario E3). However, EU producers selling in the domestic market do not get a duty drawback, so that an EU car would cost 10,029 Euro (scenario A3) or 15,043 Euro (scenario B3). Comparing both scenarios to the Korean price in scenario E3 (10,000 Euro), COM (EU-Korea FTA – Q&A on duty drawback and rules of origin and in an untitled supplementary note) calculates the competitive disadvantage for an EU car of 10,000 Euro to be 29 Euro (or 0.29%) and for an EU car of 15,000 Euro to be 43 Euro. COM explains that this small effect is due to the relatively low EU foreign input share and tariffs.

COM also provides a scenario where the foreign input share of EU producers doubles from 5.7% to 11.4% (country scenarios C, D). In this case the competitive disadvantage – as defined here – amounts to 57 Euro (0.57%) for an EU car of 10,000 Euro (scenario C3) or to 86 Euro for an EU car of 15,000 Euro (scenario D3).

World scenario 4: FTA with prohibition of DDB: In this scenario it is assumed that – as ACEA would prefer it – DDB is prohibited. The price for Korean cars thus is higher in the EU than in scenario 3 where DDB is allowed. The foreign input share of Korean car producers is assumed to be 15%, which lies at the upper bound of the current COM estimate of 10%-15%. The duty paid on the main part of these inputs amounts to 8%. COM estimates that only 60 percent of Korean imports of parts are subject to these duties, i.e. are imported from partners that do not have preferential access to the Korean market. This assumption has not been verified by the author. Multiplying 15% with 8% and 60% results in a multiplicative factor of 0.0072 or 0.72%. A Korean car thus has a price of 10,072 Euro in the EU market (scenario E4) and competes with a European car priced at 10,029 Euro (scenario A4) or 15,043 Euro (scenario B4). If one assumes, however, that the import share of Korean producers rises to 40% (as allowed by the envisaged new rules of origin under the FTA) and all Korean foreign inputs face tariffs of 8% on average, the Korean price rises to 10,320 Euro (scenario F3).

These calculations are behind the above mentioned numbers of less than 100 Euro (COM – Trade Fact Sheet EU-Korea Free Trade Agreement December 2009) and 320 Euro (ACEA – The EU is negotiating an FTA with

244 In the case of the EU car price of 15,000 Euro, the competitive disadvantage on top of the already existing price difference of 5,000 Euro is referred to.
245 Moreover, COM (untitled note) also assumes in an additional scenario that the average EU tariff on imported inputs is reduced from 5% to 2.6%. This would half the competitive disadvantages in country scenarios A to D, but is not presented in table 21. In addition, COM (EU-Korea FTA – Q&A on duty drawback and rules of origin) quantifies the current value of duty drawback for Korea at 199 million Euro, which represents 1/8 of the gains to EU of 1.6 billion Euro. However, the underlying assumptions are not laid open.
South Korea – Facts and figures) as quantifications of the competitive disadvantage to domestic EU producers. Here the benchmark scenario for the comparison to calculate the disadvantage is the world scenario 3 – a world with the EU-Korea FTA, where DDB is allowed and a Korean car would cost 10,000 Euro (see above).

- COM’s calculation is represented by country scenario E and results in a competitive advantage of 72 Euro (10,072 of scenario E4 minus 10,000 of scenario E3 = 72 Euro, or 0.72%).
- Likewise, ACEA’s calculation is represented by the comparison of the Korean car prices in scenarios F4 (10,320 Euro) and F3 (10,000) and results in a competitive advantage of 320 Euro or 3.2%.246

However, this scenario is only partly realistic, as the special clause of DDB would most likely be invoked, if the Korean input share was to rise to such a degree. Assuming the clause is effective (see below), the refundable amount of duties would be limited to 5% (instead of 8%). Thus, in scenario H4, a Korean car would cost 10,200 Euro (instead of 10,320) in the EU market and the competitive advantage – as defined above – would amount to 200 Euro or 2%. If the Korean foreign input share rose to 45%, the competitive disadvantage would be 225 Euro in case of the refund limit of the special clause on DDB.

COM suggests that Korea plans to liberalise its DDB system (EU-Korea FTA – Q&A on duty drawback and rules of origin). Thus, scenario G assumes (as above under COM assumptions) a 15% Korean foreign input share and an assumed voluntary reduction of the refundable duty to 5% in Korea paid on 60% of imported inputs. Under these conditions, the competitive disadvantage is reduced to 45 Euro (0.45%).

An ACEA press release of 8 July, 2009 seems to suggest that the competitive advantage of Korean exporters even amounts to 1,500 Euro.247 Here, the gain from the reduction of the EU external tariff of 10% per car of 10,000 Euro (1,000 Euro – comparison of scenarios E2 to E3) is added to an alleged competitive disadvantage of 500 Euro due to DDB (see last footnote). This suggestion cannot be held up. As COM (EU-Korea FTA – Q&A on duty drawback and rules of origin) also points out, the maximum benefit for Korean producers is 1,000 Euro (difference between world scenario 2 and 4). If DDB was prohibited, this advantage would be reduced (from 1,000 Euro in world scenario 3 to between 680 Euro (1,000-320 Euro) in scenario F4 or 955 Euro (1000-45 Euro) in scenario G4). Allowing DDB only provides Korean exporters with the full benefits of the FTA, but with no additional advantage.

All in all, this analysis has shown that the competitive disadvantage for EU producers can be calculated in fundamentally different ways. Evaluating which way is correct is not straightforward. It depends on the benchmark for comparison.

- If the envisaged effect of allowing DDB in the EU-Korea FTA is compared to a world without tariffs, as economists would find it optimal, the calculations under scenarios A3 or B3 are relevant. In this case, the competitive disadvantage to EU producers would be very limited and amount to only 0.29% - or 0.57% under alternative assumptions of country scenarios C3 and D3.
- If, however, as is politically more relevant and realistic, the benchmark scenario is an EU-Korea FTA where DDB was prohibited, then the calculations under world scenario 4 have to be chosen. In the scenarios according to COM assumptions (scenarios E4, G4), i.e. with a current Korean foreign input

246 In a press release of 8 July, 2009, ACEA mentions a competitive disadvantage of 500 Euro per car, without providing underlying assumptions apart from a seemingly assumed Korean foreign input share of 50%. This calculation has not been verified.

247 COM (EU-Korea FTA – Q&A on duty drawback and rules of origin) refers to an (by the automotive industry) alleged Korean advantage of 1,300 and qualifies this contention with the following arguments.
shares of 15%, the competitive disadvantage for EU producers of allowing DDB, would also be limited to far less than 100 Euro for a car of 10,000 Euro value (or far less than 1%).248

It matters, however, whether the Korean foreign input share rises to 40% (or above), as assumed in the pessimistic scenario of ACEA (scenario F4). In this case, the competitive disadvantage would rise to more than 3%, which would surely be of higher relevance in the highly competitive market of small sized cars. A certain – but very difficult to quantify - rise of Korean foreign sourcing does indeed appear plausible in the medium term, as cost pressures are rising in the country. Thus, the incentive increases to relocate parts of the production chain to lower cost countries, as Western European car producers did already in the past by offshoring production to CEE-countries.249

Moreover, it becomes obvious that the special clause on DDB – in a pessimistic scenario of 40% Korean foreign input share – would still lead to a competitive disadvantage of 2% of production value for EU producers (scenario H4).250

The whole issue of competitive advantages due to DDB will, however, be reduced in its general relevance, because Korean producers will increasingly supply the EU market from their new factories in CEE. In this case, there is a level playing field, because Hyundai and Kia in general have to pay the same import duties on the foreign inputs as EU producers. Only the fact, that they might be more oriented towards sourcing from suppliers in Korea (compared to domestic EU producers) may limit their tariff expenditures on inputs to a certain degree.

The special clause on DDB

ACEA criticises the sanction of the special clause as too lax, as Korean producers would still get a duty refund of 5% (instead of around 8%). The above calculations have shown that this can be relevant, if the Korean foreign input share increases strongly. However, ACEA acknowledges that the special clause still provides a certain, if their view insufficient, backstop. Yet, it is criticised that the clause does not apply from the start of the FTA, but only enters into force five years after the FTA. COM explains this with the fact, that only after 5 years tariffs will be completely eliminated, but points out that the reference period for measuring an increase in foreign sourcing will be the time before the FTA enters into force.

In addition, ACEA strongly fears that the special clause will be ineffective and not thoroughly used by COM. At this point also BUSINESS EUROPE comes into play (see text box 1 p.114). Both ACEA and BUSINESSEUROPE request strong disciplines and binding obligations that COM invokes and implements the special clause on DDB in case of need and justification, and they insist on sufficient industry participation in this procedure.251

248 If COM’s assumption that only 60% of Korean foreign inputs are taxed at 8% and the remaining share enters Korea duty free, then the disadvantage would be considerably below 100 Euro per car (worth 10,000 euro).
249 On the other hand, there could be political pressure in Korea to keep production in the country in order to support domestic employment. However, despite the relatively high government influence in the economy and in the large companies, it is questionable whether these firms would accept the resulting competitive disadvantages of such a strategy.
250 Should Korean foreign sourcing rise to 30% the disadvantage would amount to 1.5% of production value.
251 For additional demands, see text box 1 p.114 on the views of BUSINESSEUROPE.
BUSINESSEUROPE: View on DDB and rules of origin

BUSINESSEUROPE believes the Korea FTA will deliver significant benefits for EU industry and supports ratification under the condition that the agreement is accompanied by strong implementing measures.\textsuperscript{252} It notes however, that the DDB issue is a controversial element for parts of the business community. BUSINESSEUROPE therefore argues for/requests improvements to be made to the mechanisms but only if they can be made within the terms and procedures of the FTA.

The objective of these improvements should minimise the negative impact of the DDB on EU industries, particularly the motor vehicles sector. Therefore, BUSINESSEUROPE asks for a robust and transparent mechanism to deal with this issue. This concerns mainly the special clause regarding DDB (entering into force only 5 years after the FTA entered into force) and the general bilateral safeguard clause.

Concerning the special clause on DDB, the EU Commission is requested to

- robustly employ this mechanism,
- broaden the scope of monitored tariff lines by including further automotive components and textile products for which rules of origin derogations have been made.
- start monitoring Korea's imports of relevant parts from entry into force,
- share these statistics (as well as statistics of Korean trade with its major trading partners) with the business community as quickly as possible,
- establish a complaint procedure for business (as in the case of the general safeguard).

Before the special clause can be used, and in case that after the use is allowed the special clause proves ineffective, Business Europe argues to use the general bilateral safeguard clause to counter possible distortions resulting from a combination of tariff elimination and DDB. The Commission should also consider verifiable industry data on the impact of DDB and the industry complaint procedure (which is requested for the general bilateral safeguard in general) should apply equally to possible safeguard sanctions concerning the impact of DDB.

On rules of origin, BUSINESSEUROPE leaves it to the textiles sector to comment on the implementation mechanisms for the derogations in their sector but supports their view that full cooperation between Korean and European authorities will be vital to make what seems like a burdensome system function properly. In addition, and in line with BUSINESSEUROPE’s broad support for ratifying the agreement as it stands, is does not seek any modification of what has been agreed on rules of origin.

In supporting the special clause, COM (EU-Korea FTA – Q&A on duty drawback and rules of origin) points to the transparent framework to trigger the mechanism, to an accelerated internal procedure of decision making among EU institutions and, in case of disagreement with Korea, to the availability of a rapid and binding arbitration mechanism. Moreover, COM gives various assurances with regard to the above mentioned fears (see the COM documents in the annex for more details). For example, COM states that it will monitor closely relevant statistics, share this data on automobiles trade (and some other sectors) on a bimonthly basis and invoke the special clause, once certain quantitative thresholds have been exceeded. Before the lapse of the five year period COM agrees, as requested by ACEA and BUSINESSEUROPE, to use the

\textsuperscript{252} This view, however, is not shared by Confindustria.
general bilateral safeguard clause to counter possible competitive distortions. Furthermore, it can be added that the special clause lays the burden of proof on Korea to prove that an increase of the Korean foreign input share does not feed into the exports to the EU.

Rules of origin

The relevance of less strict rules of origin for the motor vehicles sector (a rise of allowed foreign content from 40% to 45%) is criticised ACEA as encouraging a further aggravation of the competitive disadvantage for EU producers, particularly in the low price segment. COM (EU-Korea FTA – Q&A on duty drawback and rules of origin) points, among some other aspects, to the currently relatively low Korean foreign input share of 10%-15%, sees no reason to expect a sudden increase towards levels close to the limit and informs that Koreans wanted much higher shares and that the KORUS FTA and other FTAs include similar limits. However, and as mentioned before, ACEA fears that cost pressures in Korea could significantly strengthen the incentive for Korean producers to change sourcing strategies and to relocate or increase sourcing from low cost countries such as China. Moreover, ACEA criticises the deviation from standard rules as unnecessary and fears that this could be a precedent for future FTAs.
### Annex 3: Table 22 - US Tariff liberalisation under KORUS

**Table 22: US Tariff liberalisation under KORUS**

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Fisheries</th>
<th>Manufacturing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immediate abolition</td>
<td>1,065(58.7)</td>
<td>106(85.5)</td>
<td>7,457(87.0)</td>
<td>8,628(82.1)</td>
</tr>
<tr>
<td>2 years</td>
<td>10(0.6)</td>
<td>-</td>
<td>-</td>
<td>10(0.1)</td>
</tr>
<tr>
<td>3 years</td>
<td>-</td>
<td>3(2.4)</td>
<td>357(4.2)</td>
<td>360(3.4)</td>
</tr>
<tr>
<td>5 years</td>
<td>401(22.1)</td>
<td>3(2.4)</td>
<td>342(4.0)</td>
<td>746(7.1)</td>
</tr>
<tr>
<td>7 years</td>
<td>92(5.1)</td>
<td>-</td>
<td>-</td>
<td>92(0.9)</td>
</tr>
<tr>
<td>10 years</td>
<td>154(8.5)</td>
<td>12(9.7)</td>
<td>395(4.6)</td>
<td>561(5.3)</td>
</tr>
<tr>
<td>Over 10 years</td>
<td>91(5.0)</td>
<td>-</td>
<td>17(0.2)</td>
<td>108(1.0)</td>
</tr>
<tr>
<td>Total</td>
<td>1,813(100)</td>
<td>124(100)</td>
<td>8,568(100)</td>
<td>10,505(100)</td>
</tr>
</tbody>
</table>

Notes: The numbers are of tariff lines/products and percentage of these within the sector (in parenthesis) There is no item that the FTA does not cover. 1) Sum of products whose import tariffs are going to be abolished 6 or 7 years after effectuation of the FTA.

### Annex 4: Table 23 - Korean Tariff liberalisation under KORUS

**Table 23: Korean Tariff liberalisation under KORUS**

<table>
<thead>
<tr>
<th></th>
<th>Agriculture</th>
<th>Fisheries</th>
<th>Manufacturing</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Immediate abolition</td>
<td>578(37.8)</td>
<td>52(18.6)</td>
<td>8,431(89.2)</td>
<td>9,061(80.5)</td>
</tr>
<tr>
<td>Within 3 years 1)</td>
<td>39(2.5)</td>
<td>92(32.9)</td>
<td>634(6.7)</td>
<td>765(6.8)</td>
</tr>
<tr>
<td>5 years</td>
<td>317(20.7)</td>
<td>132(47.1)</td>
<td>60(0.6)</td>
<td>509(4.5)</td>
</tr>
<tr>
<td>7 years 2)</td>
<td>64(4.2)</td>
<td>-</td>
<td>-</td>
<td>64(0.6)</td>
</tr>
<tr>
<td>10 years</td>
<td>333(21.8)</td>
<td>-</td>
<td>325(3.4)</td>
<td>658(5.8)</td>
</tr>
<tr>
<td>Over 10 years</td>
<td>184(12.0)</td>
<td>4(1.4)</td>
<td>-</td>
<td>188(1.7)</td>
</tr>
<tr>
<td>Total</td>
<td>1,515(99.0)</td>
<td>280(100)</td>
<td>9,450(100)</td>
<td>11,245(99.9)</td>
</tr>
<tr>
<td>Excluded from FTA</td>
<td>16(1.0)</td>
<td>-</td>
<td>-</td>
<td>16(0.1)</td>
</tr>
<tr>
<td>Grand total</td>
<td>1,531(100)</td>
<td>280(100)</td>
<td>9,450(100)</td>
<td>11,261(100)</td>
</tr>
</tbody>
</table>

Notes:
1) Sum of the number of products whose import tariffs are going to be abolished 2 and 3 years after effectuation of the FTA.
2) Same as the previous Table plus the number of products whose import tariffs are going to be abolished by January 1 2004.
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Prognos (2008, 2009)


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