Expectations and Concerns for Korea-China FTA

The unexplored but inescapable path. This is what an FTA with China means for Korea. Its influence will be unprecedented and greater than that of any other FTA that Seoul has concluded so far. With Korea's trade dependence on China reaching over 25%, it's fair to say that the success of the Korean economy depends on how well it adapts to the new FTA paradigm. Since the 1980s, China has always been at the center of the changing international trade environment. Having recently emerged as the world's second-largest economy, China has provided boundless opportunity as well as occasional threats to the Korean economy. That is why Korea should prepare itself well before setting out on a new path.

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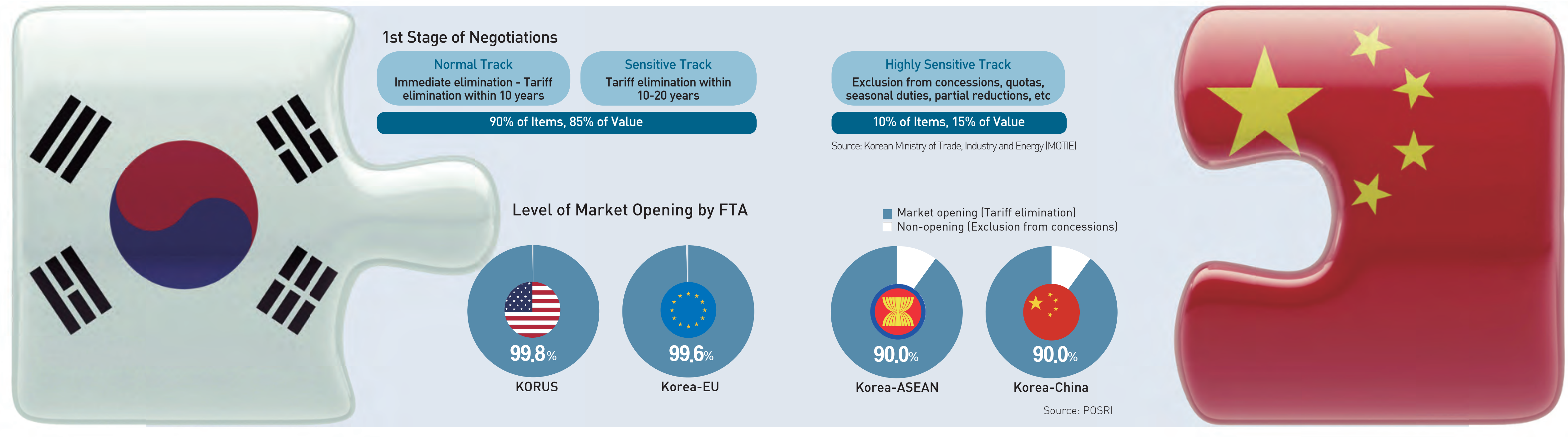
Will the FTA Help Korea Emerge as an East Asian Trading Hub and Unlock China's Domestic Market?

The winds of economic integration are blowing hard in East Asia. Talks on various "mega" free trade agreements (FTAs) are being undertaken simultaneously within the region, including the Korea-China-Japan FTA and the Regional Comprehensive Economic Partnership (RCEP) which comprises the 10 member states of ASEAN and six countries–South Korea, China, Japan, Australia, New Zealand, and India. Under the trade strategy to become a "linchpin" for regional economic integration in East Asia, Korea has joined the trend toward accelerating regional economic integration. At the center of this strategy lies the Korea-China FTA.

Two years have passed since South Korea and China launched FTA negotiations in May 2012. After 13 rounds spanning more than two years, the two countries have agreed on the overall level of market liberalization and made some progress on several areas such as norms and cooperation, services and investment. At a summit meeting held in early July between Chinese President Xi Jinping and his South Korean counterpart President Park Geun-hye, the two leaders expressed their will to finalize the stalled trade talks. Despite their strong determination, however, with conflicting views on key areas including the level of liberalization of sensitive industries, it's uncertain whether the two countries will be able to conclude their trade talks within the year.

Current status of Korea-China FTA negotiations

With economic interdependence continuously increasing between Korea and China since they established diplomatic relations in 1992, a consensus has developed on the necessity of a bilateral FTA.



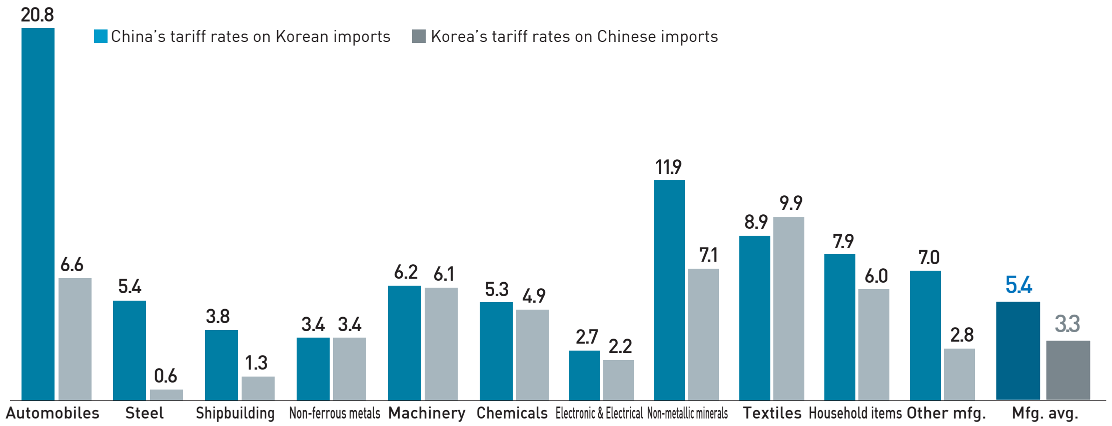
The two countries agreed to begin private-level joint research on the Korea-China FTA during high-level talks held in September 2004. After eight years of joint research and bilateral consultations, the two countries launched official FTA negotiations in May 2012 and have completed 13 rounds thus far.

Korea adopted a "request/offer" approach to negotiations for its free trade agreements with the U.S. and EU, whereby the two sides exchanged concession requests first before kicking off actual negotiations. Unlike these more conventional FTAs, the Korea-China FTA adopted a so-called "modality" approach that identifies the modality in the first stage of negotiations, such as the level of liberalization for sensitive products, in an effort to protect sensitive sectors, and enter into negotiations in the second stage on the basis of these modalities. The two countries agreed to liberalize or eliminate import tariffs on 90% of tariff lines (85% of import value) at the seventh round of FTA negotiations held in early September last year in China, finalizing the first stage of negotiations that lasted one year and four months. From Korea's perspective, the bilateral FTA has a lower level and slower pace of liberalization than any other FTA it has concluded; however, China sees it as having a relatively high level of trade liberalization.

Currently, the two countries are in the second stage of negotiations on exchanged requests and offers for their respective areas of interest. Negotiations are underway in various areas such as services, investment, and norms and cooperation. The two parties made some progress on norms and other areas so far, but they could only reaffirm their differences on major areas such as goods. As a result, the negotiations have remained at a standstill. While Korea wants early tariff reduction for high value-added industries, including petrochemicals, steel, machinery, and displays, China is reluctant to open its doors earlier to Korea's major export items due to competitiveness concerns. In addition, China wants Korea to open its agricultural and fisheries markets wider. Due to such differences, the Korea-China FTA negotiations are facing rough waters ahead.

From Korea's perspective, the bilateral FTA has a lower degree and slower pace of liberalization than any other FTA; however, China sees it as having a relatively high level of trade liberalization.

Korea-China Weighted Average Nominal Tariff Rate by Industry (Unit: %)



Source: Korean Ministry of Trade, Industry and Energy (MOTIE)

Why the Korea-China FTA?

As Korea's No. 1 trading partner, China has tremendous influence on the Korean economy. Since the two countries established diplomatic ties in 1992, their two-way trade has rapidly increased. Korea's trade with China recorded a deficit of almost USD 1 billion in 1992, but went into the black in 1993, recording a surplus of USD 62.8 billion in 2013. Korea's export dependence on China has doubled from 12.1% in 2001 to 26% in 2013. Meanwhile, the U.S. share of Korea's total exports has plunged from 21% more than ten years ago, when the U.S. was Korea's largest trade destination, to nearly 10% this year. And the gap between the U.S. and China is getting increasingly wider. China is now an important partner for Korea not only in trade but also investment. As of the end of March this year, the three leading destinations for Korea's overseas investment at the industrial level were the U.S. (19.6%), Japan (19.1%), and China (18.1%), but China accounted for almost 40% in the manufacturing sector.

Seeking to transform itself from a trade-oriented economy to one oriented toward domestic demand, China is emerging as an attractive consumer market. Although the Chinese economy has been slowing since the 2008 global financial crisis, its real GDP growth rate is projected to reach up to mid-7% in 2014-15 according to the International Monetary Fund (IMF). As China transitions from being the "world's factory" to the "world's market," the Korea-China FTA is drawing attention as a key to unlocking the country's domestic market.

The Korea-China FTA is important for other reasons: the fluctuating global economic environment and the emergence of "the era of Northeast Asia." With the diminished international standing of the U.S. and the EU and the rise of China in the aftermath of the 2008 global financial crisis and the Eurozone crisis, the Northeast Asian economic sphere is playing an increasingly important role as a new driving force for the global economy. Through their bilateral FTA, Korea and China wish to solidify their cooperative system within the region and improve their complementary roles with a view to responding actively to external change. Korea wants to take an upper hand in the industrial division of labor among Northeast Asian countries and improve its level of cooperation with China in order to maximize benefits. Meanwhile, China hopes to improve its industrial competitiveness through the bilateral FTA by forestalling the widening of U.S. and Japanese influence in East Asia, and by closing the technology gap.

As China transitions from being the "world's factory" to the "world's market," the Korea-China FTA is drawing attention as a key to unlocking China's domestic market.

Expectations for market expansion and fierce competition raise concern

Asymmetry in trade barriers between Korea and China is relatively high. In other words, China has higher tariffs and trade barriers than Korea. Korea's average nominal tariff rate on manufacturing is 3.3%, while China's is 5.4%. Tariff differences are especially large for autos, steel, and shipbuilding. In the investment sector, China also has high barriers to entry to and exit from the country, as evidenced by investment and ownership restrictions, additional requirements for investment, and other administrative procedures. If such biased terms of trade can be eased across-the-board upon conclusion of the Korea-China FTA, it would have greater ripple effects than any other FTA concluded by Korea. Taking into consideration China's economic size and market potential, Korea is expected to enjoy expanded opportunities for exports to and investment in China. Moreover, the overall trade environment is expected to improve thanks to higher price competitiveness following tariff reductions; the opening, liberalization and expansion of the investment and service sectors; reduced technical barriers to trade (TBTs) and non-tariff barriers to trade (NTBs); and reduced risk of trade friction due to the improved trade environment and enhanced transparency.

Meanwhile, concerns are mounting that Korea's economic dependence on China would become even higher, exacerbating external vulnerability. Their bilateral trade structure has been complementary so far, but China has recently gained competitiveness in line with its improved technology and policies aimed at enhancing industrial sophistication. Korea's exports to China, currently dominated by processing trade of intermediate goods and capital goods, are losing steam as Chinese technology advances rapidly.

It's also worrisome that vulnerable industries could face pressure to restructure if the Korean market, which already has a high degree of openness, opens further and wider. In the case of the agricultural and fisheries industries, the Korean market is already being threatened by cheap Chinese products, and Korea's trade deficits with China continue to increase, leading the industry to speak up against the Korea-China FTA. The Korean government has pledged to include as many as agricultural and fisheries products on the Highly Sensitive Track (HST) list of items to be excluded from tariff concessions in order to minimize damage, but China is also maintaining a tough stance in order to secure wider opening of the Korean agriculture and fisheries markets. A bumpy road clearly lies ahead for the Korea-China FTA negotiations.

Korea-China FTA, a touchstone for East Asian economic integration

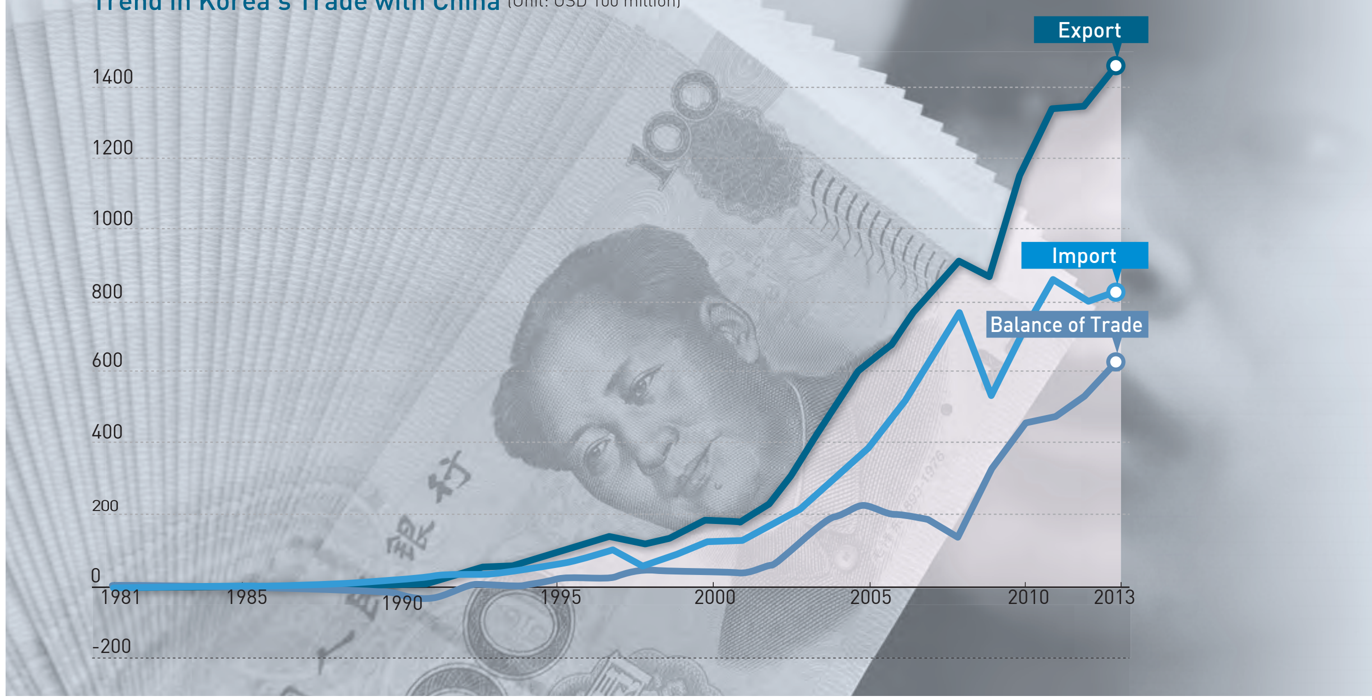
As it embodies both opportunity and risk, the Korea-China FTA holds high significance, for not only will it greatly influence the Korean economy, it will also become a barometer for the overall direction of Korea's trade policies and future strategies.

The focus of the global economy is shifting from advanced countries such as the U.S. and those in Europe, to Asia and other emerging countries, with Asia emerging as the axis of global economic growth. In competition between China and the U.S, economic integration in the East Asian region is being discussed on a multilayer basis. China is spearheading the RCEP to restrain the expansion of U.S. influence, while the U.S. is seeking to expand its reach in East Asia through the Trans-Pacific Partnership (TPP) initiative, which will include the participation of 12 countries throughout the Asia-Pacific region.

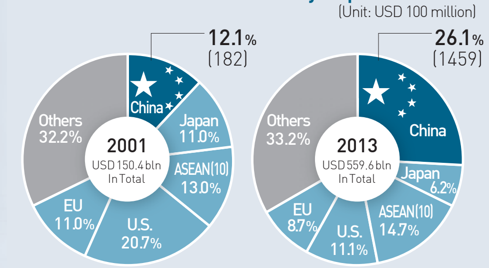
Korea has placed highest priority on concluding the Korea-China FTA, and thus has been active in negotiations for the Korea-China-Japan FTA and the RCEP. Although Korea had previously taken a vague stance toward participation in the TPP in consideration of its relations with China, it has recently changed its tune and entered into separate negotiations with member countries to join the TPP. In an effort to respond effectively to the changing global trade environment and improve its standing in the international community, the Korean government is implementing strategic FTAs and playing a pivotal role in the move toward regional integration while it also seeks a paradigm shift in trade policies. In particular, Korea, which has already concluded FTAs with mega economic zones, such as the U.S., the EU and ASEAN, hopes the FTA with China—a new axis for the world economy—would help the country emerge as a hub for economic integration in the Asia-Pacific region.

The Korea-China FTA could be an opportunity for Korea to take the upper hand not only in negotiations for bilateral trade liberalization, but also in discussions for regional integration, signifying how important and complicated the Korea-China FTA is. However, Korea must prepare measures to minimize damage to vulnerable industries in the upcoming negotiations and devise policies to support damaged industries to ease worries about the bilateral FTA and maximize economic benefits. I hope the Korea-China FTA would serve as a springboard for Korea to strengthen its cooperation with China and solidify its position as a trade hub in East Asia from the long-term perspective.

Trend in Korea's Trade with China (Unit: USD 100 million)

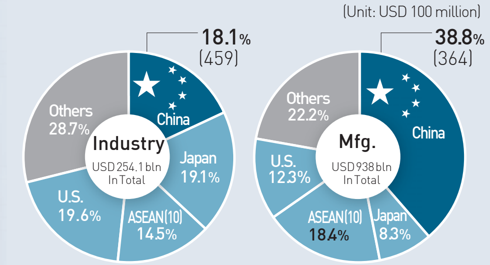


Share of Korea's Trade with Key Export Markets (Unit: USD 100 million)



Note: Parenthetical note refers to value
Source: Trade Statistics, Korea International Trade Association (KITA)

Share of Korea's Investment Destinations (Unit: USD 100 million)



Note: Parenthetical note refers to value
*As of the End of March 2014
Source: Foreign investment statistics, Korea EximBank

With Policy Flexibility, Korea Should Balance Korea-China FTA and TPP

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Chinese President Xi Jinping

U.S. President Barack Obama

In recent years, meaningful changes have taken place in the global trading system. First, in the wake of the 2008 global financial crisis China has clearly taken its place in the international community as one of the G2. Since then, China and the U.S. have maintained uneasy relations in East Asia. A subtle competition between the U.S., which seeks to restrain Beijing's expanding influence in the region, and China, which feels uneasy about Washington's intentions, has greatly influenced the East Asian competition landscape.

Second, China, which emerged as Korea's largest trading partner in the 2000s, has rapidly changed its industrial strategies and policies. In particular, as China has nurtured domestic industry as one of its major economic policies, its processing industry and related trade have taken a plunge.

Third, with the WTO Doha Round remaining at a standstill, discussions for unprecedented "mega" free trade agreements have begun. Traditionally, the EU and the U.S. have preferred multilateral trade liberalization approaches within the WTO framework over bilateral ones, but they have also initiated negotiations for the Trans-Atlantic Trade and Investment Partnership (TTIP). Even Japan, which has been sensitive to FTAs that might pressure it to open its agro-fishery market, is now actively engaged in FTA talks at the bilateral and multilateral levels.

These are three major changes in the international trade environment in the aftermath of the 2008 global financial crisis. In short, competition between countries in the global market has become fierce and the trade environment is rapidly changing. Korea is also facing the consequences of such changes. The Korea-China FTA, the Korea-China-Japan FTA, the Regional Comprehensive Economic Partnership (RCEP) conducted by ASEAN+6, and the Trans-Pacific Economic Partnership (TPP) are all part of a process that shows Korea is responding to such changes.

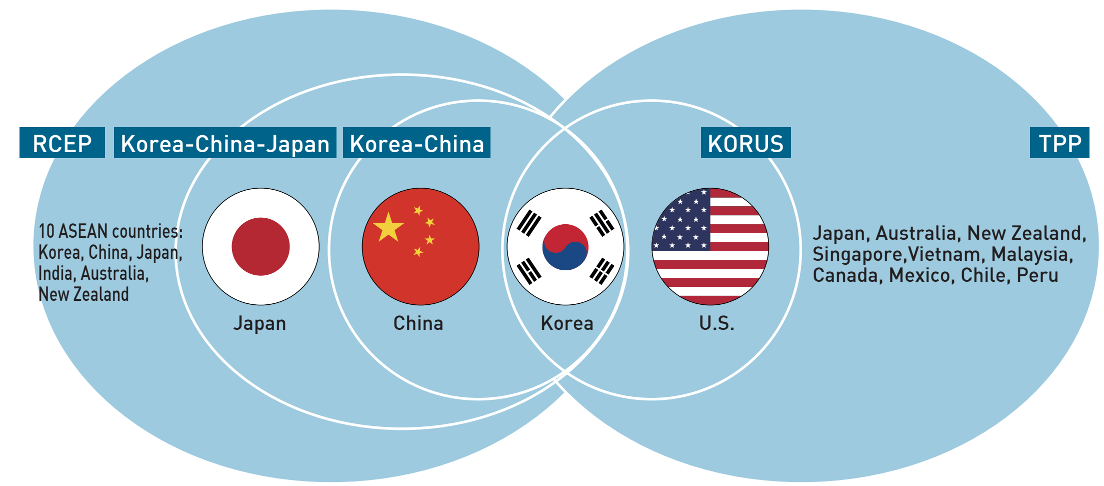
Korea-China FTA, a hot-button issue for Korean trade policy

For Korea, three of the four FTAs mentioned above—the Korea-China FTA, the Korea-China-Japan FTA, and the RCEP—are all about concluding FTAs with China. The only difference is whether they are bilateral or multilateral. Amid both expectations and anxieties, free trade agreements with China—Korea's No. 1 trading partner since the mid-2000s—have become a hot-button issue in Korean trade policies.

Korea's trade with China has increased exponentially over the past two decades. Exports to its larger Asian neighbor reached USD 145.9 billion last year, accounting for more than one-fourth of all Korean exports. However, the country's China-bound exports remain stagnant in qualitative terms. Because they are concentrated in processing trade, Korea's exports to China have a bleak future. With China implementing policies aimed at nurturing domestic industries, the share of processing trade in China's total imports fell from 39% in 2007 to 25% in 2013.

In reality, Korea still depends heavily on processing trade in its exports to China. Last year, processing trade accounted for 48% of Korea's China-bound exports, much higher than Japan's 34.8% and Hong Kong's 36.1%—Korea's competitors in the Chinese market. This suggests that Korea is failing to respond flexibly to the Asian giant's transition. In order to maintain benefits from its exports to China, Korea should devise strategies to boost its share in the Chinese domestic market. Bearing this goal in mind, Korea must implement the Korea-China FTA.

Negotiations for Economic Integration Involving East Asia



Source: Korean Ministry of Trade, Industry and Energy (MOTIE)

Diplomatic benefits—A factor in joining the TPP

Recently, the U.S.-led TPP has seen rapid growth. The U.S. is actively seeking to sign the trade pact with Asian-Pacific countries, not just because the East Asian market's importance has been underscored in the wake of the global financial crisis, but because the U.S. has the political intent to check China's economic influence in East Asia.

Korea has already sealed FTA deals with nine of the twelve TPP member countries, except Japan, Mexico, and New Zealand. It is also in free trade talks with Japan through the Korea-China-Japan FTA and the RCEP. And it is nearing conclusion of FTA talks with New Zealand, which were initiated in 2009. This suggests that the TPP may have a limited economic impact on Korea. At the same time, however, there are negative views on the TPP, because it could give Japan, which wants a free trade agreement with Korea, a way to bypass a Korea-Japan FTA.

On the other hand, some people also believe that Korea would lag behind in a regional production network if it does not participate in the TPP. They argue that Korea should decide its stance toward participating in the TPP, while also considering non-economic factors such as political and diplomatic relations.

A Tokyo citizen, holding up a placard against the TPP, participating in a protest last April.

Not a matter of choice, but a matter of balance

The TPP and the Korea-China FTA are not about choosing the right answer. They should be part of a process aimed at striking a balance and leveraging mutual relationships.

Changes, particularly competition between the U.S. and China in East Asia, are reflected in regional integration in East Asia, such as the U.S.-led TPP, China-led RCEP, Korea-China-Japan FTA, and Korea-China FTA, as well as competition to conclude FTAs with countries in East Asia. Paradoxically, FTAs initiated through competition between China and the U.S. may very well complement each other. Just as the U.S.-led TPP has facilitated China's taking of a more active approach to the Korea-China-Japan FTA or RCEP, progress in the TPP could provide a boost for the RCEP and Korea-China FTA. On the contrary, progress in Korea-China FTA talks is expected to exert positive exogenous effects on the Korea-China-Japan FTA, RCEP, and TPP. If the TPP and FTAs among East Asian countries could create complementary synergies, it would facilitate a breakthrough in Korea's FTAs with China and Japan, countries which Korea has had difficulty with in regional trade liberalization talks for diplomatic reasons, including historical and territorial conflicts.

The TPP, the Korea-China FTA, and other FTAs involving East Asian countries are not about choosing the right answer. They should be part of a process aimed at striking a balance and leveraging mutual relationships. Should Korea find itself in negotiations for more than two FTAs with any one country, it should think hard about how it will direct such competitive but complementary relationships to yield significant results. While clarifying the goals of each negotiation, Korea should be equipped with the policy flexibility and the ability to respond swiftly to the rapidly changing international trade order.

Korea-China FTA Should Level Terms of Trade for Steel

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The global steel industry is experiencing an unprecedented slump due to oversupply and high raw material prices. It's a slump that is affecting not only the steel industry, but also other industries in Korea that are now seriously considering new business models as they face new limits on growth under a shifting global competition paradigm. In the midst of transition, the steel industry cannot help but pay close attention to the possible impact of the Korea-China FTA.

A brewing crisis amid rising high-end steel imports from China

Having emerged as the world's leading steel producer in the mid-2000s, China accounted for 47% of global steel output as of last year. This means that out of the nearly 1.5 billion tons of steel produced worldwide in 2013, more than 700 million tons came from China. In contrast, Korea's steel production is only one-tenth of China's. Until the mid-2000s, Korea maintained a trade surplus in steel with China as one of its leading export items. However, Korea's steel imports from China have outstripped exports to its Asian neighbor since 2005. Last year, Korea's trade imbalance in steel with China reached USD 33.51 million or a volume of 5.37 million tons. About half of Korea's steel imports come from China, whereas its steel exports to China have plunged to 14%. Moreover, the import structure has shifted focus from flat steel products such as hot-rolled and thick plates to high-end steel products such as galvanized iron and cold-rolled products. More than ever, a sense of urgency is running rampant through the Korean steel industry in its competition with China.

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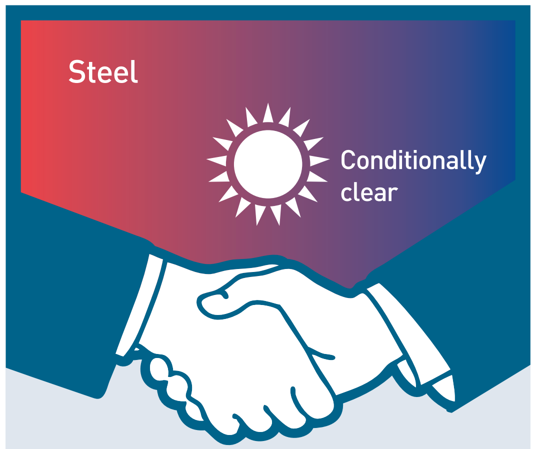

Keywords

Oversupply
Surplus Chinese steel materials

Domestic market protection
China aims to protect its high-end steel market

Competition with Japan
Will conditions of competition with Japan change?

Let's look at the bilateral terms of trade in steel. Since 2004, Korea has applied no tariffs to steel imports from China, except certain products designated for Korean small and medium-sized enterprises such as iron alloys (5% import duty), cast iron pipes (8%), and steel casting products and ingots (8%). However, China has maintained import duties on Korean steel products that ranged from 2% to 10%. In particular, an import duty of about 5% has been applied to high-end automotive steel including galvanized iron and cold-rolled products. Although China imposes no tariffs on raw steel materials imported from Korea for export production. In order to qualify for tax benefits, companies that use such raw materials must undergo stringent administrative procedures to verify their exports of finished goods. And they must also bear additional cost burdens as scraps produced in the process of manufacturing finished goods are regarded as sold in China and thus subject to tariffs. Furthermore, Chinese steel companies are expanding high-end steel production through large investments, mergers with advanced companies, and technological innovation. China's overproduction of high-end steel products, such as automotive steel, magnetic steel, high carbon steel, and high-alloy steel, has begun to spill over to neighboring countries.

Leveling uneven terms of trade for steel industry

Given that Korea has suffered a trade deficit in steel with China for more than ten years, it's hard to understand how Beijing could list steel products as sensitive in its FTA negotiations with Seoul. Facing China's price undercutting, many South Korean companies that handle wire rods, secondary wire rod processing, and thick plates have faltered and ultimately collapsed. By designating steel as a sensitive item, China may want to solve its domestic overproduction problems through the raising of protective barriers against high-end steel products for autos, machinery, and heavy equipment that have great potential for growth.

However, from the steel industry's perspective, the Korea-China FTA should at least aim to level terms of trade that have been uneven so far. In the Korea-ASEAN FTA and the Korea-India Comprehensive Economic Partnership Agreement (CEPA), the steel industry, which has been labeled as a beneficiary item, has been relatively disadvantaged. During a grace period to reduce tariffs on Korean steel products, Japan has been able to eliminate many of the tariffs on its high-end steel products. That is why Japanese brand cars are nearly ubiquitous in India and Japanese steel materials are imported tariff-free and used in gas pipeline and heavy equipment production in Indonesia. As Korean steel products continue to struggle in an uphill battle in global competition, expectations run high for the results of the Korea-China FTA negotiations.


A steel plant operated by Tangshan Iron & Steel Group [JoongAng Photo]

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Korean Auto Makers Aim at Further Localization in China

China is Negative on Market Opening

Bloomberg

Korea and China opened their 11th round of FTA negotiations in late May this year, with the two countries beginning in earnest to discuss their requests for concessions on various goods. When they launched the negotiations two years ago, the Korean government set basic principles for the Korea-China FTA, such as pushing for a comprehensive free trade agreement and consideration of sensitive areas. The Korean automobile industry is paying close attention to how such principles are reflected in the ongoing negotiations.

Chinese overcapacity is a serious concern to Korea

Since China became the world's largest auto producer and market in 2009, the Chinese auto market is massive. The country recorded auto sales of nearly 22 million units last year, surpassing both the U.S. and the EU. This amounts to about one-third of global demand. Experts predict that Chinese demand for new vehicles could reach 35 million units by 2025 and 40 million units by 2030.

But China is by no means an easy target. Global carmakers are jockeying to expand investments in the country for local production, but China also has as many as 150 indigenous carmakers. Not only local governments, but also the central government have spared no effort to support the auto industry. And Chinese local carmakers such as BYD have already produced and are selling electric vehicles.

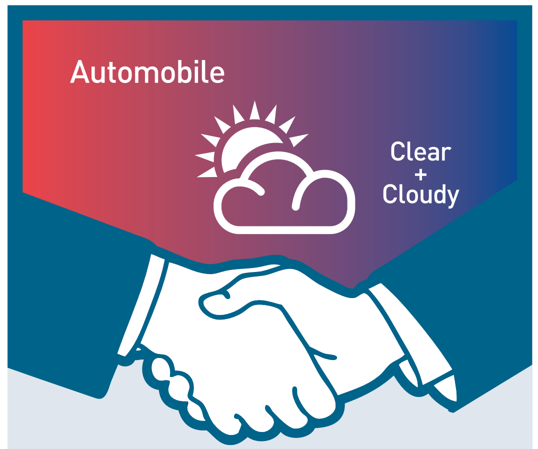
The problem is that overly ambitious investments have led to overcapacity. As of the end of last year, China had recorded a surplus capacity of 8 million vehicles, and that is projected to increase to 20 million units over the medium-to-long term. If the Chinese economy stalls and domestic demand shrinks, neighboring Korea will become the first destination for such a surplus.

China's leap-up in auto sector is quite threatening

China's major local carmakers, such as Chery, Geely, Great Wall, and BYD, are showing fast growth in their capabilities and technologies—so fast as to be seen as threatening. Chinese companies previously lacking in technologies have absorbed high tech through mergers and acquisitions of advanced foreign companies, such as the cases with Korea's Ssangyong Motor and Britain's MG Rover. More recently, Geely Automobile bought Sweden's Volvo in 2010. China is also eyeing U.S. companies involved in the electric car business, as exemplified by the acquisition of A123 Systems, a U.S. electric car battery manufacturer. Leading foreign companies in financial distress have fallen into the ready hands of Chinese companies, one after another. Under the banner of "Going Global," Chinese car makers are now rapidly expanding investments in and exports to emerging countries in Latin America, Asia, and Africa that are out of the reach of advanced countries. Now it's fair to say that China is not just a massive neighboring market for Korea, but one that also presents a threat.

So far, Korean companies have expanded production in China through localization strategies. Hyundai Motor has expanded its production capacity to 1.05 million units per year at three plants in Beijing, while Kia Motors has built three plants in Jiangsu Province with a view to producing a total of 740,000 units a year. But under their respective localization strategies, Hyundai and Kia exported only 48,000 vehicles in 2013, mainly for large vehicles that were not locally produced. Such strategies will not be changed much in the future.

The Korea-China FTA talks are now in their second stage. The Korean government plans to conclude a deal within the year. But a bumpy road lies ahead for the upcoming item-by-item negotiations. From Beijing's perspective, the Korea-China FTA is the first such deal with a car producing country. But for Seoul, it is about concluding negotiations with a big power that poses a possible threat and an opportunity at the same time. China opposes opening its auto market in order to protect local companies, and it will not easily give in on non-tariff barriers, such as its 50% ownership restriction on joint ventures in auto production and its aggressive government intervention on foreign projection to establish plants in China. Market opening should be carried out on the same level for both Korea and China while taking into account China's sensitivity to liberalization and its influence on Korea. I hope that the Korean government will fully demonstrate its negotiating power during its FTA talks with China.



Keywords

Buyback
Rising imports of Korean vehicles and auto parts produced in China

Supply Chain
More competitive car production through a complementary component supply network between Korea and China

Chinese Electric Cars
Rising imports to Korea

A worker is about to assemble a vehicle at Volvo's Chengdu plant [JoongAng Photo]

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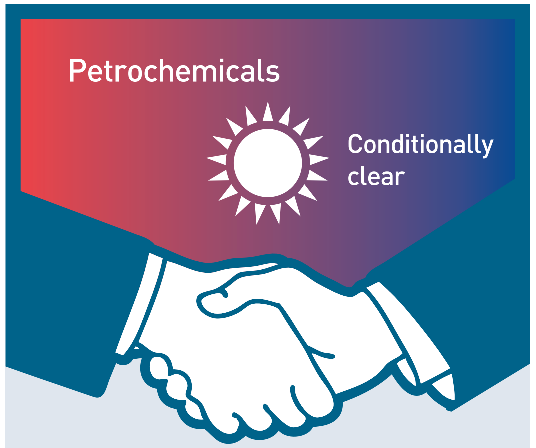
Despite Price Competitiveness, Some Korea Companies to Suffer from Influx of Chinese Products

The petrochemical industry has been drawing attention as one of the leading potential beneficiaries of the Korea-China FTA. Petrochemicals are one of Korea's major export items to China, accounting for 47% of total petrochemical exports (USD 23.5 billion out of USD 48.4 billion) and a trade surplus of USD 21.7 billion in 2013. With China's demand for petrochemical products increasing sharply in tandem with high economic growth, Korea has continued to expand its exports to China.

Recently, Korean petrochemical products have had to deal with a dual threat in the Chinese market: their price competitiveness is lower than that of cheaper materials, such as shale gas from North America and ethane from the Middle East, while their import duties are higher than those of competitors such as Taiwan and ASEAN. China already imposes no tariffs on almost all petrochemicals, except certain sensitive products—ten items including polyethylene (PE)—under the China-ASEAN FTA which entered into force in July 2005, and on some products under the China-Taiwan Economic Cooperation Framework Agreement (ECFA) which took effect in January 2011.

Exports to rise in the short term, benefits to fall in the long term

The China-Korea FTA is expected to yield a breakthrough for Korea's petrochemical exports to China. From the short-term perspective, tariff elimination under the bilateral FTA would boost the price competitiveness of Korea's polypropylene homo polymer (homo PP) and increase exports. China's self-sufficiency rate in petrochemicals is only 75% (based on synthetic resin, synthetic fiber, and synthetic rubber); therefore, China inevitably must rely on imports. If tariffs on petrochemicals, e.g., 6.5% on synthetic resin, are eliminated under the China-Korea FTA, Korean petrochemicals would be able to gain price competitiveness. In the case of homo PP, which is widely used in China, the average price of Korean imports was USD 1,601 per ton in 2013, with an additional USD 104 per ton in tariff charges at a rate of 6.5%. As PPs are similar



Keywords

Trade Increase
Robust trade through FTA

Exporter
China being shift from net importer to exporter

High Value Added
Trade increase in key materials and other high value-added products

in quality, price is the most important determining factor for imports especially when market conditions are bad.

From the long-term perspective, the benefits of the bilateral FTA will diminish slightly. Through capacity building and expansion, China is seeking to achieve price competitiveness by increasing its overall self-sufficiency rate and diversifying its use of raw materials to include coal and shale gas. Over the three-year period from 2011 to 2013, China's self-sufficiency rate for three major petrochemicals (synthetic resin, synthetic fiber, and synthetic rubber) increased by 4%, while its import growth remained stagnant at 1.3% (38-39 mt). Against this background, an influx of Chinese products to Korea has increased to such an extent that it may damage the Korean petrochemical industry. Competition is expected to become even fiercer than before, as cheap petrochemicals from the Middle East and North America command an increasing share of China's import market.

This is well supported by a survey of Korean petrochemical companies conducted in September 2013. In that survey, respondents predicted that Korean petrochemicals' local production and exports to China would rise in the short term, but become weaker in the long term (0.2% in local production and 0.4% in exports to China) if the Korea-China FTA were to take effect in 2013.

Korean petrochemicals industry in turbulent times

Korea's petrochemicals industry is in fierce competition for PP with China and emerging countries, and it is also facing turbulent times due to diversification of raw materials available on the market, such as shale gas. Korean petrochemicals companies should expand facilities and boost cost competitiveness, and increase investment in China while taking advantage of local investment regulations, such as those outlined in the Catalogue for the Guidance of Foreign Investment Industries. The industry must also shift its production structure from PP products to high-quality and high value-added products (key materials for electronics, energy, automobiles). It should also expand R&D investment at the global level with a view to securing key technologies. Now the petrochemical industry desperately needs Korean government R&D subsidies and tax benefits in order to develop high valued-added, high-performance products.


A new BTX plant operated by Hyundai Cosmo Petrochemical, a subsidiary of Hyundai Oilbank [JoongAng Photo]

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Exports of Smart Phones, Semiconductors, and Displays to Rise, While Small Home Appliances Need Protection

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On May 26th, Korea and China held their 11th round of FTA negotiations in Sichuan Province, China, to discuss sticking points ahead of the next round scheduled for July in Korea. South Korean President Park Geun-hye and Chinese President Xi Jinping had already agreed to finalize the China-Korea FTA by the end of the year at their summit meeting in March.

On opposite ends of the equation

Korea produced USD 302.6 billion worth of electronics and IT goods in 2012, an amount equal to 18.4% of China's output–the Asian giant accounted for 31% of global production the same year. Chinese companies sell a full range of products from cheap products to premium ones, while Korean companies mainly sell premium products to China. Under such circumstances, Korean companies face an uphill battle in areas other than smart phone sales, particularly in China's general home appliance market. Chinese companies such as Haier, Midea, and TCL make up 60-80% of the TV, refrigerator, and washing machine markets, whereas Korean companies hold only about a 10% market share.

Samsung Electronics' production in China is concentrated in 11 cities, including Beijing, Tianjin, and Suzhou, while LG Electronics is focused on 14 cities, including Shenyang and Shanghai. Korean exporters shipped USD 67.6 billion worth of electronics and IT to China last year, accounting for 40% of Korea's total exports. With a surplus of USD 40.9 billion, Korea registered the world's largest surplus in electronics and IT, spurred by rising exports of components for smart phones, semiconductors, and displays.

Exports of these three items are expected to increase once the Korea-China FTA is concluded. By contrast, large household appliances such as TVs, washing machines, and refrigerators, and small appliances such as mixers, vacuum cleaners, and sound equipment such as microphones and speakers are expected to fight heavy odds.

Non-tariff barriers and other obstacles

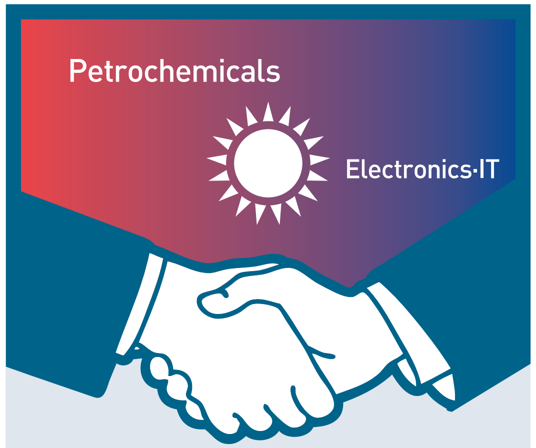
More than 80% of electronics and IT items, a total of 203, are already tariff-free under the Information Technology Agreement (ITA) among WTO member states. In this regard, the conclusion of the Korea-China FTA is not expected to significantly impact Korea's electronics and IT industries. Due to the tariff effect, however, exports of non-ITA premium appliances are expected to increase, while imports of small appliances, heating equipment, sound equipment, and accessories are likely to drop.

In July last year, the Korean government outlined its strategy to promote premium smart small appliances with a view to developing Korean small appliance companies into lean but powerful global players. To realize this strategy, the government should negotiate for the longest grace period possible for tariff concessions on small appliances.

It's also an urgent task to address China's non-tariff barriers to trade. Currently, China has no substantive examinations for registration of utility models. Without thorough preparation, Korean companies are highly likely to get involved in patent lawsuits in China. Procedures to meet global standards on certification of origin, customs clearance, and safety standard certificates should also be prepared. These should be stipulated in detail in the Korea-China FTA.

Korean electronics and IT companies should be given more opportunities to expand their entry to China. To this end, the government must expand opportunities for exhibitions and export expos in China, and establish a "one-stop" system to offer various consulting services, such as conducting prior patent examinations, resolving patent conflicts, responding to environmental restrictions, obtaining safety standard certificates, issuing certificates of origin, and verification.

An underdeveloped Korea-China FTA could become a threat to Korean companies. In order to use the agreement as a springboard for an economic stimulus, the Korean government should consider carefully the concerns of Korean companies. The government, industry, and the research community must make the most of their experiences with the KORUS FTA and KOR-EU FTA to prepare themselves for the Korea-China FTA.

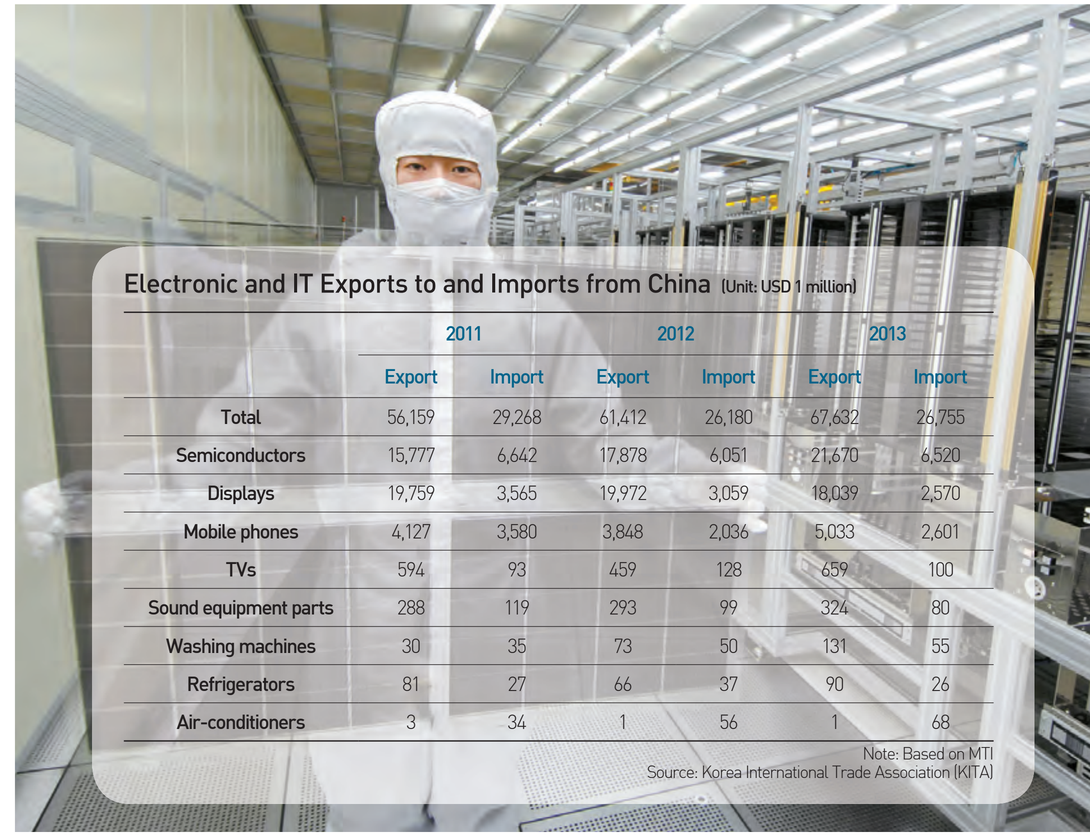


Keywords

Economic Integration
Overlapping of FTAs through Mega FTAs (TPP, RCEP)

Mutual Complementarity
Expanded imports and exports of intermediate goods

Separation of Roles
Production and R&D



Electronic and IT Exports to and Imports from China (Unit: USD 1 million)

	2011		2012		2013	
	Export	Import	Export	Import	Export	Import
Total	56,159	29,268	61,412	26,180	67,632	26,755
Semiconductors	15,777	6,642	17,878	6,051	21,670	6,520
Displays	19,759	3,565	19,972	3,059	18,039	2,570
Mobile phones	4,127	3,580	3,848	2,036	5,033	2,601
TVs	594	93	459	128	659	100
Sound equipment parts	288	119	293	99	324	80
Washing machines	30	35	73	50	131	55
Refrigerators	81	27	66	37	90	26
Air-conditioners	3	34	1	56	1	68

Note: Based on MTI
Source: Korea International Trade Association (KITA)

Korea-China FTA Could Shake Korea's Textile Industry Value Chain

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It would seem strange to describe China today as "the world's factory." Once the world leader in manufacturing due to its cheap labor, China has lost competitiveness because of wage hikes and stringent environmental regulations, and its production activity has been moving into Vietnam, Indonesia, and other Southeast Asian countries since the mid-2000s. The "move toward globalization of manufacturing for cheaper production opportunities" has been led by the textile industry, mainly by apparel makers. China, which has grown rapidly thanks to apparel exports, is seeking to implement change by improving textile production technologies, nurturing fashion brands, and developing industrial textiles. With cheap textile knockoffs, China used to hold sway over the global market, but it is now following in the footsteps of Korea, Taiwan, and Japan toward "differentiation and higher added value."

Korea sees record-high trade deficits in textile trade with China

China is now the world's largest textile producer, accounting for 70.1% of global chemical fiber production and 40.7% of global textile exports in 2012. The annual production of chemical fibers per company in China exceeds Korea's entire annual chemical fiber output. Korea's chemical fiber industry is paltry compared to China's. As of 2011, Korea's chemical fiber industry workforce (in firms with at least ten employees) amounted to only 1.7% of China's 10,175,000 workers, while its output accounted for only 4.8% of China's RMB 5.3 trillion, and its global exports amounted to merely 5.0% of China's USD 284.2 billion.


A textile plant in Jimo, Qingdao [JoongAng Photo]

China's textile industry has grown exponentially with government support since China's accession to the World Trade Organization in 2002 and the abolition of textile quotas in 2005. Meanwhile, Korea's trade deficit in textiles with China has continued to increase, hitting an all-time record of USD 3.6 billion in 2013. Korea's exports of textiles to China totaled USD 2.73 billion, accounting for 17.5% of the country's total textile exports, while its imports of Chinese textiles reached USD 5.8 billion or 48.6% of Korea's total textile imports. The Korean textile industry expects imports from China to increase if the Korea-China FTA is concluded and opens the domestic market wider.

Korea-China FTA, a shock to Korea's textile industry ecosystem

There are more than 40,000 textile companies in Korea. Most of these are micro-enterprises, or small or medium-sized businesses that maintain a symbiotic relationship in various fields, from textiles to apparel and fashion products for the domestic market and overseas exports. If textile imports surge under the Korea-China FTA, the damage arising from such an increase would not be limited to certain business sectors, but spread throughout the textile industry. If both countries experience rapid market expansion, the textile industry would undergo accelerated restructuring. Some sectors are even worried about the collapse of the domestic production base.

Korea's textile exports to China mainly involve processing before re-exportation, rather than domestic sales. Therefore, exports are not likely to increase significantly in the short term even if tariffs are eliminated under the FTA. In the case of raw materials for the processing trade, import duties are exempted when goods are exported to China or tariffs are refunded after exportation.

China deserves attention as the "world's market"

Despite the significant risks involved, one should not ignore the possibility that the Korea-China FTA could serve as an opportunity to transform the Korean textile industry. With China becoming the "world's market" in just ten years, keywords like "a population of 1.3 billion," "geographical proximity," and "the Korean Wave" will have continued relevance to Korean textile industry growth. The first step to growth starts from introspection rather than external factors. Industries are no exception. Strengthening industrial competitiveness is a fundamental solution that could mitigate damage from the FTA. At the same time, the textile industry faces many challenges: not only differentiation and high value-added, areas where it has focused its efforts thus far, but also creating global fashion brands and generating demand through development of high-tech textiles and convergence with other industries. ©

Keywords

Rising Textile Material Imports
Reduced apparel imports from China, increased imports of secondary processing materials from China

Decline in Processing Trade
Decline in processing trade to China

Cooperation
More opportunity for industry-level cooperation in textiles

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Korea Should Seize Market Opportunities with Trustworthy Produce

In the two years since Korea and China launched FTA negotiations on May 2, 2012, the two sides have held eleven rounds of talks that are now nearing their final phase. However, industries remain sharply divided in their views on the ongoing FTA negotiations, with the agricultural sector perhaps worried the most.

Korea's farming households face a threat to their existence

Once the Korea-China FTA is finalized, how will it influence Korean agriculture? In a nutshell, the agreement will yield both positive and negative impacts for Korea. One negative impact is that Korean agriculture could be threatened by rising Chinese agricultural imports. The impact of the Korea-

China FTA could not compare to that of other free trade pacts. Without even mentioning geographical proximity or similarity in food culture, it's obvious that Chinese agricultural imports would rise once the FTA takes effect.

But China is also a net agricultural importer. Since the country transitioned from net agricultural exporter to net agricultural importer in 2004, its farm sector trade deficits have increased each year. Meanwhile, Chinese agricultural experts have offered the slightly comforting analysis that any additional increase in Chinese agricultural exports to Korea will be limited even when the Korea-China FTA goes into effect.

However, agricultural trade by item and region is more meaningful to Korea than it is in the aggregate. Garden produce, such as chili peppers, garlic, onions, carrots, radish, and Korean cabbage, are the economic lifeblood for Korea's farm households. These products are generally cultivated in China's Shandong Province, which has a climate, soil, and overall agricultural environment similar to Korea's. As such agricultural produce from China is not inferior in price or quality to produce grown in Korea, it is feared that the bilateral FTA would have profound ripple effects on the Korean farm sector. And while fruits and livestock products will not be affected immediately by the FTA, these products will ultimately fall under its direct influence in the medium-to-long term.

Opportunities for China's changing food consumption patterns

One positive impact is that Korean agricultural exports to China are expected to rise. The melamine milk scandal of 2008 has sparked Chinese distrust of their own country's agricultural produce. As a series of small and large food safety scandals have broken out since, Chinese consumers' trust in local agricultural produce has plunged. By contrast, they regard imported agricultural products as safe and of good quality; therefore, demand for agricultural imports is rising rapidly. According to media reports, the value of China's agricultural imports increased by 21.8% on average each year over the past five years, while the average annual increase of Korea's agricultural exports to China reached 26.6% over the same period. Thanks to the spread of the Korean Wave, Chinese consumers' awareness of and preference for Korean farm products are rapidly growing. Such a change in China's food consumption environment is regarded as a positive sign for Korean agricultural exports to China. Once the Korea-China FTA takes effect, it could provide a fair boost to China-bound agricultural products.

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Keywords

Korean Food
Widespread consumption due to China's improved awareness of and preference for Korean food

Eco-friendliness
Eco-friendly agro products have emerged as a staple of mainstream food consumption in China

Functionality
Opportunities exist for Chinese functional agricultural products

As the Chinese government continues to tighten food safety oversight and inspections, Korea should fully understand China's food safety regulations and maintain respect for the law. The Chinese government has recently declared its commitment to realize a stringent management and supervision system to control all processes from production and processing to distribution and consumption, and impose strict punishments on violators. By making clear that it would prevent poison from reaching the dinner table and effectively protect the "safety on the tip of the tongue (确保舌头上的安全)," Beijing has reiterated its solemn pledge to resolve the food safety issue.

Korea must take different approaches to each stage of the Korea-China FTA. First, it should draw negotiation results most favorable to its farm sector in order to minimize damage. It is also an urgent task to include in the sensitive track as many agricultural items as possible that have a relatively low competitiveness. Second, Korea should maximize benefits by devising and implementing a systematic plan to increase exports. Finally, it should prepare measures for damage compensation to sustain and develop agriculture. Korea should prepare more thoroughly for the Korea-China FTA than any other FTA in the past.