

Korea-China FTA in Its First Year and Effectuation

LEE Kyu Yub Research Fellow, Trade and Investment Policy Team, Department of International Trade (kylee@kiep.go.kr)

LEE Joun Won Senior Researcher, Trade and Investment Policy Team, Department of International Trade (jwlee2@kiep.go.kr)

CHUNG Min-Chirl Researcher, Multilateral Trade, Department of International Trade (mccchung@kiep.go.kr)

I. Introduction

On 20 December 2015, the Korea-China Free Trade Agreement (FTA) entered into force. The Korea-China FTA would have a positive impact for both economies' welfare in the long run. However, it must be pointed out that in the short run, trade flows between Korea and China might be affected by external/internal economic forces such as the recent global trade slowdown, and weak domestic economic growth and non-tariff barriers. Thus, it might be impetuous and too early to assess the economic impact on the Korean and Chinese economies just a year after the Korea-China FTA was entered into effect. Nevertheless, it would be worth examining changes that have occurred at first anniversary and exploring ways to enhance the Korea-China FTA.

II. Trade of Goods

Over the last five years, from 2011 through 2015, Korea's trade with China recorded on average 225 billion dollars and generated a trade surplus of 53 billion dollars. Trade with China accounted for 21.3% of Korea's total

trade volume. Under the Korea-China FTA, Korea and China are scheduled to be eliminated import tariffs on 92.1% and 91%, respectively, of the total number of products over twenty years. Korea protects agricultural sector heavily while China's protection is high in manufacturing sector.

A. Goods

During the first year of the Korea-China FTA, Korea's total exports and imports declined and Korea's exports to and imports from China also dropped. Specifically, Korea's exports to China decreased by 12%, and imports from China by 8%, during the ten months from January 2016 to October 2016. The decreases in the trade volume even after the Korea-China FTA can be attributed largely to the persistent global trade slowdown and weak economic growth of China and Korea.

Under the circumstances, we examined all traded products between Korea and China, which comprised approximately 6,600 goods exported to China and 8,800 goods imported from China. Three aspects after the Korea-China FTA was entered into force can be highlighted as follows. First, after the Korea-

China FTA came into effect, Korea still maintained the largest market share, at 10.8%, in China. Second, the composition of Korea's market share in China changed. By region, Korea's market share in 21 regions out of 31 expanded, ranging from 0.04% to 9.52%. Lastly, the total number of products traded between Korea and China increased after the Korea-China FTA. The number of products exported to China increased by 26 items (HS 8 digits), and the number of products imported from China also increased by 18 (HS 8 digits). In short, the increased product diversity in both exports and imports indicate that consumer's welfare improved in terms of so-called love-of-variety.¹

B. Agricultural Goods

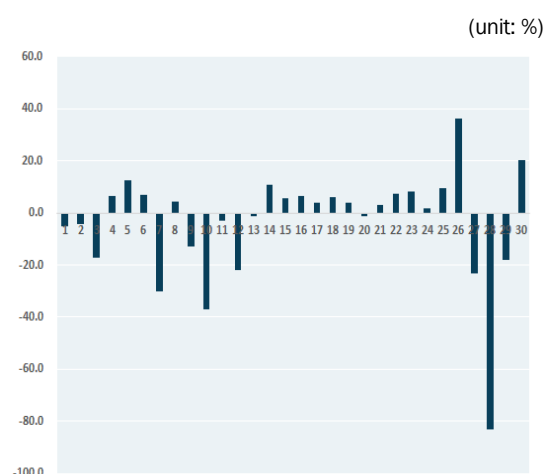
After the effectuation of the Korea-China FTA, the total amount of exports to China in agriculture, livestock, and fisheries increased by 7.8% compared to the same period of the previous year. This is greater than the growth rate of 5.5% in exports to the rest of the world, and higher than the average growth rate in exports to China of 1.9% in the five years before the FTA went into effect.² On the other hand, the total amount of imports from China in agriculture, livestock, and fisheries fell slightly from the same period before, but the decrease in the rate of growth is far less than the rate of import decrease found in the rest of the world.

C. Manufactured Goods

Despite the persistent global trade slowdown and weak China economic growth, there were a significant number of manufactured products

showing relatively positive export performance. To examine this, we select China's top thirty products (HS 4 digits) imported from Korea as of 2015. Next, we calculate two growth rates after the Korea-China FTA: the growth rate in China's imports from Korea and the growth rate in imports from the rest of the world, for a certain product. Relative growth rate calculated by comparing these two growth rates in Korea's top 30 export products shows us the performance of Korean firms in selected manufacturing industries. The "relative" growth rate can be an indicator showing how a product exported by Korea is performing in China. It turns out that seventeen out of China's top 30 products imported from Korea performed positively, judging from the relative growth rate that we calculated.

Figure 1. Relative Growth Rate of China's Top 30 Products Imported from Korea



Note: 1) The horizontal axis shows the ranking of China's top 30 products (HS 4 digits) imported from Korea.

2) The vertical axis represents the relative growth rate, which is the growth rate of China's imports from Korea minus the growth rate of China's imports from the rest of the world.

Source: Calculated by the author based on sources from the General Administration of Customs, People's Republic of China.

We further investigate the effect of the Ko-

¹ Largely, agricultural goods, chemicals, steel products contributed to the increase in the number of exported goods, while chemical goods and machinery to the increase in the number of imported goods.

² Comparisons the growth rate of exports to China with the growth rate of exports to the rest of the world *excluding* China do not change the main results qualitatively.

rea-China FTA by separating products with and without tariff reductions. We chose China's top 50 products (HS 8 digits) imported from Korea, which accounted for 71% of total imports from Korea as of 2015. We calculated, by category, the relative growth rates of China's imports, which were then compared depending on whether they were subject to tariff reductions or not.

Not surprisingly, we found that products with tariff reductions performed relatively better than products without, during the ten months from January 2016 to October 2016 after the Korea-China FTA. Out of China's top 50 products imported from Korea, 27 products were subject to tariff reductions and 23 products already enjoyed zero tariffs. Out of the 27 products with tariff cuts, 15 products (55.6%) show that the growth rate of China's imports from Korea exceeded the growth rate in China's imports from the rest of the world. In particular, chemicals, auto parts, cosmetics were the main beneficiaries of the reduced tariff after the Korea-China FTA. In contrast, out of the 23 products (43.5%) without tariff reductions, only 10 products had positive relative growth rates.

III. Digital Trade between Korea and China

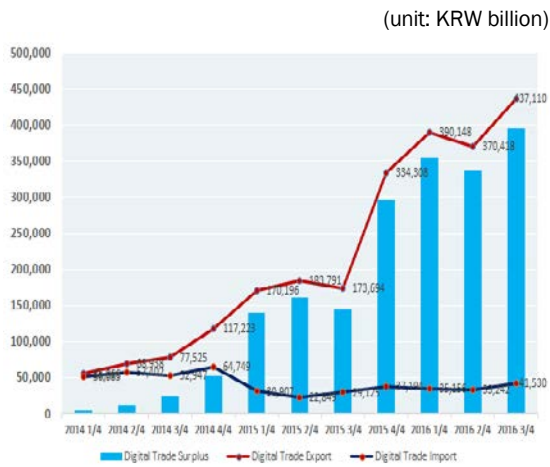
This report highlights digital trade³ between Korea and China as a distinct feature arising from the Korea-China FTA. The surge of digital trade between Korea and China might be attributed partly to several provisions includ-

ing 'Article 4.15 Express Shipments' in the Korea-China FTA. During Q1-Q3 2016, after the Korea-China FTA entered into effect, Korea's exports to China through digital trade increased dramatically compared to the same period of the year before.

The total volume of exports to China through digital trade reached a record high of KRW 1200 billion during Q1-Q3 2016, which was a 127% increase compared to the same period of the previous year. On the other hand, the total volume of digital trade imports from China during Q1-Q3 2015 was KRW 82 billion and it increased by KRW 27 billion during Q1-Q3 2016, which was a 32.6% increase. In digital trade exports to China, cosmetics increased by 165.5%, clothes and fashion-related products by 51%, children's products by 103.2%, sports and leisure products by 195.2%, and electronics by 104.4%.⁴ In digital trade imports from China, electronics increased by 96.2%, children's products by 124.6%, essential goods and car accessories by 49.8%.

³ To our best knowledge, there is no clear definition of digital trade, although there are several ones suggested by the OECD and USITC. This article uses the term as the one narrowly defined by Statistics Korea, because it only offers digital trade data which includes digital trade export/import in terms of business to consumers.

⁴ Commodities sold through digital devices are comprised of mainly consumption goods such as computers, electronics, cosmetics, children's products, etc., which implies that small and medium-sized enterprises (SMEs) have a great opportunity to engage in digital trade, generating revenues and profits. Total values in digital trade exports are smaller than the ones in traditional exports, but should be considered as relatively large to SMEs.

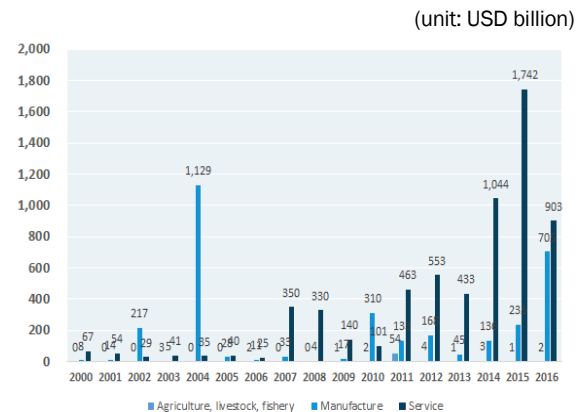
Figure 2. Digital Trade between Korea and China

Source: Calculated by the author based on data from Statistics Korea.

IV. Services and Investment

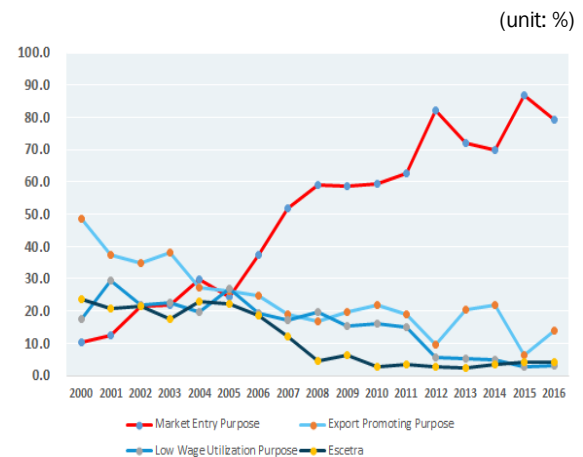
Since 2000, trade in services with China has been increasing rapidly. After negotiations began for the Korea-China FTA in 2012, the trade surplus in services with China grew. In particular, the year 2014 marked a record high of USD 7.9 billion, and the surplus remained high until 2015. Specifically, travel, transportation and intellectual property rights fees generated the trade surplus.

With respect to investment, China's investment in Korea are mostly concentrated in service industries, while Korea's investment in China are mostly concentrated in manufacturing industries. Investment by China to Korea rose dramatically after the FTA negotiations were initiated in 2012. China's investment in service sectors in Korea reached a record high of USD 1.7 billion, at 88.1%, in 2015. After the Korea-China FTA went into effect, China's investment in professionals and sciences accounted for the largest share, at 40.5%, followed by real estate at 17.6%, and print, broadcasting, and telecommunications at 17.3%.

Figure 3. China's Investment in Korea by Industry (2000-2016)

Source: Calculated by the author based on data from the Ministry of Trade, Industry and Energy.

Korea's investment in China was aimed at targeting the low wages of China in the early 2000. After mid-2000s, the main purpose of Korea's investment in China instead targeted direct entry into the Chinese market. These investments were mainly spent to build new plants in China, and the pattern continued after the Korea-China FTA.⁵

Figure 4. Korea's Investment in China by Purpose (2000-2016)

Source: Calculated by the author based on data from the Export-Import Bank.

⁵ A distinct feature of Korean investment in China is that investments in wholesale and retail sectors were carried out by small and medium sized Korean enterprises, comprising 71%, after the Korea-China FTA.

V. Implications

Korean producers across the board have become more concerned about non-tariff barriers that may be imposed on their export. This outstanding issue of non-tariff barriers needs to be addressed and resolved through the Korea-China FTA.

Trade in services and investment between Korea and China in recent years enormously expanded. Amending the provisions in Trade in Services and Investment through the subsequent negotiations, therefore, bears huge implications for both countries. The Korean government should prepare the subsequent negotiations in Trade in Services and Investment for the Korea-China FTA, which has shown no further progress since 2016 March.

In addition, digital trade between Korea and China is on a sharp rise. It is necessary for Korea and China to begin discussions on developing infrastructure and systems related to digital trade, on lifting regulatory impediments pertinent to digital trade, and on protecting consumers and enhancing transparency. Such efforts will contribute significantly to further stimulating digital trade between both countries.

To reap larger economic benefits from the Korea-China FTA in the long run, it is necessary for Korea to keep monitoring the implementation of the FTA and support the improvement of its utilization rate.

Several implications pointed out in this report stand on the basis of “*cooperation*” between Korea and China. By cooperating with each other on many implementation issues that may arise in the near future, both countries can reap greater economic benefits in the long run. KIEP