

2005 Summaries of Research Reports



Korea Institute for International Economic Policy



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P olicy Analyses

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05-01

Korea–Japan FTA: Toward a Model Case for East Asian Economic Integration

Choong Yong AHN, Inkyo CHEONG, Yukiko FUKAGAWA, and Takatoshi ITO
eds. (Feb. 2005)

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USD 12

The year 2005, the target year for Japan and Korea to conclude their FTA, will be the 40th anniversary of the establishment of diplomatic ties after their painful history. During the last four decades, Japan–Korea relations have matured gradually, promoted in part by miraculous development and catch-up by the Korean economy. In 1996, Korea became an OECD member, the second country in Asia following Japan. As an OECD member, Korea is expected to share common global responsibilities to promote economic growth and liberalization. Although the Korean economy was hit by the Asian financial crisis in 1997, Korea surprised the world by instigating a comprehensive structural reform and subsequent speedy economic recovery led by a strong political will and swift business initiatives. Korea has accomplished the IMF conditionality, while receiving the IMF financial assistance package.

The idea of a Japan–Korea FTA was born from the need to strengthen bilateral linkages between the two adjacent economies. Many economists in the region started to regard the WTO-consistent Japan–Korea FTA as a win-win strategy for both countries due to their strong economic relationship in terms of production, investment, and trade.

Not only does the Japan–Korea FTA symbolize the mature economic and political relationship between the two countries, but also it is expected to lead and contribute to economic integration among East

Asian countries. Since both countries are advanced in terms of market system maturity, the Japan–Korea FTA is expected to set a model for high–standard Asian FTAs, including comprehensive coverage of goods and services, free flow of capital, and Intellectual Property Right (IPR) protection. Unlike integration in Europe, which was triggered by political motivation, East Asian integration, with such diversities in economic size and development stage, will continue to be led by market developments, while probably maintaining the tradition of voluntary cooperation. Indeed the tendency of avoiding a strictly–binding cooperation like in APEC was the reflection of political intricacy of diverse economies, including leadership issues for integration.

Theoretical and empirical studies on a Japan–Korea FTA in this volume suggest that great potential benefits from bilateral economic integration can be realized, once the FTA helps realize deep integration between the two countries. In order to build a high–quality FTA, comprehensive coverage of goods and services and a proper institutional framework must be in order. Major points by authors in this volume are as follows.

First, many discussions recommend broader coverage in the Japan–Korea FTA, beyond the WTO agenda. Both countries should achieve comprehensive trade liberalization consistent with the GATT Article 24. Agricultural sectors are heavily protected by tariffs in the two countries. Fukao discusses possible problems with Non–Tariff Measures (NTM) both in Japan and Korea, and suggests that market access is an important issue. Y.H. Kim also supports the broader approach for market access including sanitary and phyto–sanitary measures (SPS), technical barriers to trade (TBT), and the distribution system in both countries, and stresses that solving NTM should not be considered a precondition for an FTA negotiation but rather a good subject to be resolved by FTA negotiations.

In addition to market access, Kimura stresses the importance in deregulating service sectors, such as transportation, logistics, tourism,

education, culture and entertainment. J.D. Kim suggests a strategic role of the service sector including movement of natural persons for deep and substantial integration. Honma argues that the agricultural sector, in which both Japan and Korea was not internationally competitive, should not be excluded, and that any reform in line with market liberalization is necessary. Song stresses the importance of general market access, including SPS, MRA and others in Japan in addition to tariff reduction.

Second, some analyses are also carried on the impact of deeper integration. Using Computerized General Equilibrium (CGE) model, Urata and Abe find that the economic effect will be more positive in a Custom Union (CU) rather than in an FTA. Allowing for an adjustment period for the agricultural sector in Japan and machinery sector in Korea, they suggest gradual progress from an FTA to a CU. Measuring PPP on goods and services, Ito also supports better impact on trade expansion and consumers' benefits in a CU rather than in an FTA. From a financial aspect, Shin and Wang use an Error Correction model and concludes that there is a positive contribution to trade by exchange rate stabilization between Yen and Won, implying financial cooperation enhancement for deeper integration.

Third, broad and deep integration requires a well-designed framework and modality for the agreement beyond an APEC type "voluntarism". Based on the evaluation of the Japan–Singapore Economic Partnership Agreement (JSEPA), Ogawa suggests even more comprehensive coverage for the Japan–Korea FTA than JSEPA. Services, capital movement, natural person's movement, trade enhancement, IT and financial cooperation should be contained in the Japan–Korea FTA. Starting from three principles of comprehensiveness, total liberalization, and WTO consistency, Ahn discusses a possible modality including asymmetric tariff reduction in Korea, GATS-plus-alpha liberalization in services, WTO-plus-alpha in IPR and government procurement, trade remedy and dispute settlement, and concludes that the Japan–Korea FTA should provide a model for future intra-East Asian FTAs.

Since most Asian countries still enjoy the Enabling Clauses in the WTO and the GATT Article 24, there is a risk that an FTA in Asia would become a low-quality FTA. A high-quality FTA should liberalize “substantially all trade” in a regional trade agreement. Another risk is that proliferation of FTAs with different standards and a complex rule of origins would mean trade diversion effects outweigh trade creation effects. In particular, a complex rule of origins would generate substantial transaction costs. Considering the fact that the East Asian region has relied heavily on outside markets as export destinations as well as on foreign direct investment from other regions, the market needs confidence that the prospects for explicit and deep integration will lead to trade creation effects. Japan–Korea FTA is expected to set a high-standard bottom line explicitly to prevent the so-called FTA “Spaghetti bowl” effect.

Finally, both Japan and Korea recently enjoy extremely friendly neighbor relations symbolized by the successful co-hosting of the World Cup in 2000 and recently exploding cultural exchanges. The bilateral FTA is likely to contribute to the on-going trust building process via deepening economic linkages through market forces. The increased friendly relations might provide a momentum to leave the past history behind and create a new forward-looking relationship. Ito and Fukagawa discuss an evolutionary change of Japan’s FTA strategy, and argues that Korea is a high priority strategic partner for Japan because the bilateral relationship makes it possible to take advantage of dynamic economic efficiency, high-standard modality and common trade policy for better bargaining to the rest of the world. Using the CGE model, Cheong agrees to the view that the positive economic impact on Korea will be realized, especially in mid- and long-term, but claims that Korea still needs convincing rationales for the inevitable cost of immediate structural adjustment due to a Japan–Korea FTA. It is often said that many Koreans fear that as a result of the FTA Korea’s ever-increasing trade deficit against Japan might be aggravated given the asymmetric tariff structure and Korea’s structural dependence on Japanese parts and components.

Of course, the bilateral deficits do not represent any anomaly or loss of competitiveness, only comparative advantage. Nevertheless, Korea's part and component industries feel very sensitive about the Korea–Japan FTA and wish to produce a win–win outcome for the two countries. Some of Korea's negative public opinion against the FTA with Japan is also triggered by long–standing mistrust in general due to historical legacies.

As Korea is at a disadvantage in industrial competitiveness, it seems to be taking a cautious approach to preparing a tariff concession proposal for an FTA with Japan based on the estimated damages on sensitive industries in market access for automobiles, machinery, and household electronics. Although the mid to long–term dynamic gains are based on economies of scale and capital accumulation effects, adjustment of industrial structure and inflows of foreign direct investment are uncertain in some aspects. However, these economic gains will be eventually determined by Korea's endeavors toward improving its economic and trade rules, fostering a pro–competitive environment, facilitating technological innovation, reducing business costs and developing Korea as a FTA hub by concluding a number of FTAs with major trading partners.

On Japan's side, Japan has to show her seriousness about the strategic value of a Japan–Korea partnership, including efforts to go beyond their shared history. Various diplomatic considerations should be reflected in the cooperation programs, including movement of natural persons which may stimulate the interests and understanding on the Japanese market. Better understanding on how markets work in Japan may contribute to overcoming the unnecessary fear on the part of the Korean industry. A win–win FTA negotiation between the two countries should also be regarded as a great opportunity to build up mutual trust between the two countries, and go beyond the history issue.

05-02

Feasibility and Economic Effects of a Korea-U.S. FTA

Junkyu Lee and Hongshik Lee (Dec. 2005)

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USD 7

This study begins with a motivation that both economic and non-economic effects should be considered in order to increase the feasibility of a Korea-U.S. FTA from the Korean perspective. This study also begins with a motivation to help successful Korea-U.S. FTA negotiations by writing the research in English. The English written study on the feasibility and economic effects of a Korea-U.S. FTA is expected to contribute to increasing the understanding of issues and effects of an FTA and to helping negotiators move along with efficient negotiations for the both countries.

Following on the motivations, this study includes U.S. FTA strategy and trade policy, comparison with Korean FTA strategy, economic relations, competitiveness analysis, Korean macroeconomic and service industry effects, and political economy of a Korea-U.S. FTA. This study has a contribution of including economic and non-economic analysis in an integrated and extensive approach with a Korean perspective. This study is the first-year publication of a three-year research project on a Korea-U.S. FTA. In the following years, a more industry-by-industry approach will be employed.

Regionalism and multilateral trade systems have become central themes in trade agreements. In January 2005, 170 RTAs were approved under GATT/WTO and the number is expected to expand to 300 by the end of 2005. As the world market becomes more open for international

trade and investment, voluntary and active liberalization of the market will help strengthen the global economy. The possibility of being left out in this trend, it has prompted Korea to decide to engage in FTA talks and negotiations with Chile, Singapore, Japan, ASEAN, Canada, and the United States as a defensive measure. FTA negotiations with the United States, one of Korea's largest export markets, are an increasingly necessary and desirable way to strengthen the Korean economy as the world trade and investment system becomes more globalized.

Regarding the United States' FTA strategy, it lies in a multilateral trade system under WTO rule, but it also pursues political and trading benefits through regional or bilateral FTAs. U.S. trade policy-making process with respect to FTAs is often complex and subject to politicization. The complexity and politicization of the U.S. trade policy-making process can to some extent be a great challenge for Korea. Thus, Korea must use all available political resources to successfully move FTA negotiations along. Korea should launch a number of diplomatic initiatives to secure its reputation within the executive branch, Congress and even the U.S. public via the media both before and throughout FTA negotiations.

Korea needs to be prepared for several issues that may be raised by the United States over the course of negotiations. First is the transparency of the Korean policy-making system. Second is the TRIPS plus approach used in many U.S. FTAs, which is another serious challenge for Korea. Third, the relationship between trade and labor, as well as that of trade and environment is one of the most controversial issues in U.S. FTA negotiations.

There are obstacles to a Korea-U.S. FTA because U.S. has highly competitive agriculture, manufacturing, and service industries both with the world and with Korea. Therefore, it cannot avoid the fact that a Korea-U.S. FTA would usher in various effects and changes to the Korean economy. A Korea-U.S. FTA would probably bring about a withdrawal of inefficient domestic industries. The legal, medical, educational,

and visual and auditory service sectors will be pressured to liberalize more than other service sectors, and these service sectors will experience significant changes.

There are bilateral trade issues between Korea and the United States to move forward to engage in FTA negotiations. Those are the Korean screen quota system, the Korean import ban on U.S. beef, Korean labor flexibility, the Korean regulatory environment and the U.S. visa waiver for Korea. Other industrial issues are the Korean pharmaceutical system, Korean automobile imports, Korea's strengthening of its Intellectual Property Rights protection, Korean telecommunications policy, and Korean financial services.

Successful launch of an FTA negotiation between Korea and the U.S. will bring significant gains to Korea and the United States. Economically, Korean and U.S. industries tend to be more complementary in nature. If a Korea-U.S. FTA is concluded, this complementary trade pattern and higher intra-industry trend between Korea and the United States would provide a significantly positive opportunity for long-term and dynamic economic growth for both countries. CGE analysis shows that Korean GDP will grow at 0.42–1.99% depending on the scenarios. Elasticity analysis reveals that the effect of a Korea-U.S. FTA on trade would be a 4.4% increase in Korean manufacturing exports to the United States and a 4.8% increase in Korean manufacturing imports from the United States. Also, liberalization of the manufacturing sector is likely to improve domestic production, and liberalization in the service industry will be a developing platform for the Korean service industry. It is expected that the service industries will gain increased output and employment. In particular, in terms of output, construction, and education, the public and social sectors show the largest gains.

Non-economic gains of a Korea-U.S. FTA are to strengthen and broaden the Korea-U.S. security alliance, reflecting an FTA's broadening of the two nations' common interests. Also with a Korea-U.S. FTA, it is expected to lessen current Seoul-Washington tensions over dealings with

Pyongyang. However, FTA should not be expected to fundamentally alter security relations within the Asia–Pacific region. A Korea–U.S. FTA would, by reinforcing an important relationship, promote constructive U.S. engagement in East Asia. It would strengthen Korea’s capacity to serve as a regional economic hub, and could enhance Korea’s strategic role as a middle power bringing larger powers together. Presumably, the FTA deal with the United States would make Korea a stronger and more attractive partner for others as well as shift Korea’s future FTA priorities.

Opportunity cost of not having a Korea–U.S. FTA should not be underestimated. The U.S. market is the world’s largest market, and other countries will seize upon any opportunities for growth while Korea hesitates. The opportunity cost may include losing gains from trade, losing efficiency, and losing investments. Also, an FTA would send a strong signal to world investors of a strengthened relationship, both economically and militarily, the value of which is difficult to estimate numerically. Another opportunity cost is heavy Korean and American dependence on the Chinese economy. A Korea–U.S. FTA would be able to function as a balance between both economies so as to decrease dependence on the Chinese economy and decrease the potential for dependency on any specific country.

Finally, this study leads to an affirmative research conclusion. Economic and non–economic gains are greatly large to Korea from a Korea–U.S. FTA. Once the FTA negotiation begins between Korea and the United States, it surely has to conclude the FTA successfully. A free trade agreement between these two important trading nations will prove to be a winner for both, constructive for East Asia and the world and will leave a meaningful step in the world trade history.

05-03

Economic Effects of a Korea–China FTA and Policy Implications (I)

Hongshik Lee, Hyejoon Im, Inkoo Lee, Backhoon Song, and Soonchan Park
(Dec. 2005)

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USD 7

Growing dependence on trade blocs in the global economy (creating more regionalism) puts pressure on Korea, whose international economic activities comprise more than 70 percent of its GDP, to create or join an active trade bloc. In other words, if Korea does not enter the global FTA network, Korea will face disadvantages. If Korea's major trading partners conclude FTAs with other nations and regions, Korean products will become relatively more expensive and lose price competitiveness in these markets because of the relatively higher tariff rates imposed on Korean products. These effects will be especially traumatic to Korea if its competitors conclude FTAs with Korea's major trading partners.

An FTA with China is a key issue of economic cooperation in order to confront soaring Chinese competitiveness in international markets. A Korea–China FTA will allow Korea easy access to a huge market and reduce the one-sided safeguards of the Chinese government, which will in turn improve Korea's balance of trade. In addition, it is expected that the economic growth of China can play an important role in Korea's economic growth through a high degree of specialization of industry structure, and improvement of efficiency of investment toward China.

In this regard, the Korea Institute for International Economic Policy (KIEP) and the Development Research Center of State Council (DRC) in China concluded a MOU to begin joint research for analyzing the overall

effects of a Korea–China FTA in 2005. In accordance with the provisions of the MOU, this paper analyzes the potential economic effects of a Korea–China FTA.

As this research paper is the first output of our joint study with the Development Research Center of State Council in China, it mainly focuses on FTA strategies in China and macroeconomic effects of a Korea–China FTA, including the FDI effect. It is necessary to estimate the scale of economic benefits from a macroeconomic perspective in order to analyze the feasibility of an FTA. In the second project in 2006, however, we will more pay attention to specific industries and hope to suggest useful policy measures to the government and industries. We employ the widely used Global Trade Analysis Project (GTAP) model as our basic model. We analyzed the quantitative effects of an FTA by using two CGE models. One is a static CGE model that captures the short-run effects whereas the other captures the static effects as well as the capital accumulation effects through higher saving and investment induced by static gains. The potential economic effects from a Korea–China FTA analyzed in Chapter 3 imply that both Korea and China will experience positive effects from an FTA. It is estimated that the GDP of Korea and China will increase 2.4 to 3.1 percent and 0.4 to 0.6 percent respectively, due to resource reallocation to sectors where comparative advantages exist. Korea's exports and imports are expected to grow by 4.7 to 4.8 percent and 5.1 to 5.2 percent, respectively. When we consider the capital accumulation effects, they increase from 5.4 to 5.5 percent and 5.8 to 5.9 percent. China's exports and imports are expected to increase from 3.5 to 3.6 percent and 4.7 to 4.8 percent respectively. They increase from 3.7 to 3.8 percent and from 4.9 to 5.0 percent in the capital accumulation model.

Based on the historic outward FDI data of OECD countries, we have predicted that the effects of a Korea–China FTA on FDI both from each other and the rest of the world would be positive. That is, an FTA would increase FDI from an OECD member country by about 14 to 21 percent. In

addition, an FTA would increase FDI from non-member countries by about 28 to 32 percent. Therefore, an FTA would bring more FDI from not only insiders but also from outsiders.

Next, using survey data of 298 Korean subsidiaries operating in China, we analyzed their structure of input supplies and final sales. We found a positive correlation (0.14 to 0.18) between the locations of input supplies and sales. Many Korean subsidiaries operating in China would be affected by the tariff reduction from a Korea–China FTA. It is shown that only 10 percent of firms would not be affected by tariff elimination while 78.9 percent of them would benefit from an FTA because they would be exempted from Chinese tariffs when importing raw materials from Korea. Furthermore, 55 percent of them would benefit from an FTA since they would be exempted from Korean tariffs when exporting their final goods to Korea, and 45 percent of firms would benefit twice if they imported raw materials from Korea and then exported the final goods back to Korea.

Finally, trade is induced by the investment of Korean firms in China. From our survey data, we found that US\$756 million was created by trade from Korean subsidiaries in China. Since the actual total amount of investments that these subsidiaries carried is US\$980 million, the induced trade balance per dollar is 0.77 dollars, which implies that every dollar invested in China results in a trade surplus of 77 cents. Therefore, the total induced trade can be extrapolated to be US\$4,521 million.

As we saw above, there are positive effects of an FTA with China on GDP, net exports, and FDI in Korea. However, the magnitude of the positive effects in our empirical results do not enable us to predict the exact amount of the effects of a Korea–China FTA; they could be higher or lower depending on the prior efforts of both the Korean government and individual firms. However, we should keep in mind that there will be positive effects and we should focus on how we can maximize those economic effects. To do so, we need to analyze the effect of a bilateral FTA with China by industry. Without examining the industrial effects of an

FTA, we would not be able to suggest the proper policy implications for firms or industries that might confront new circumstances from an FTA. Even though this work is to be done in the second project in 2006, we can suggest three main policy implications based on the preliminary findings of our paper.

First, in relation to China's FTA policy, on the political side, China has entered into a rivalry with Japan over leadership for the East-Asia region, with Japan attempting to control the rise of China. This is reflected by the fact that China is actively promoting economic cooperation with ASEAN and Korea in an attempt to hold back the rapid expansion of FTAs between Japan and other countries in this region. Considering China's approach toward FTAs from a political economic perspective, we suggest that Korea actively pursue multi-track FTA talks with its major trading partners including not only China but also Japan and the United States. It is worth noting that China has agreed to an EHP with ASEAN on relatively unfavorable terms for China in the agriculture sector. Therefore, as China's strategic intentions should be viewed in light of acquiring leadership in East Asia, it is not surprising that multi-track FTA talks will enable Korea to enhance its strategic ability when negotiating a bilateral FTA with China.

Second, according to the competitiveness analysis we used in this paper, Korea appears to be competitive in chemicals, leather and paper products, machinery, and metal products compared to China. One thing that should be emphasized is that it will be impossible for China to emerge as an economic powerhouse without contributions made by foreign-invested enterprises operating in China. Foreign-invested enterprises are actually major exporters in China, thereby aiding China's competitive rise. On the other hand, Korea's competitiveness in the aforementioned industries implies that Korea has strategic room for negotiations with China. For example, Korea may want to agree on relatively unfavorable terms in the textile sector in exchange for favorable terms in the agricultural sector. By doing so, Korea would be able to

minimize sensitive agricultural issues and export its textile products to the world market.

Third, an FTA would lead more Korean firms to invest in China to reap the benefits of no-tariffs on imports of inputs from Korea and exports of final goods to Korea. Off-shoring of low productive manufacturing to China or to the ASEAN countries is not necessarily harmful, as has been often argued. Instead, we would be better off by encouraging it. The Korean government should try harder to attract FDI but it needs to focus its FDI promotion efforts in specific areas. As inward FDI creates new jobs and increases production, it should help fill the void left by Korean firms' investments in China. As it is argued in this study, a Korea-China FTA would provide an opportunity to attract more FDI from non-member countries as well as from China. In particular, FDI from non-member countries would be mainly motivated to serve markets, not only the Korean market but also the Chinese market. Foreign firms that are interested in investing in Korea are no longer the ones that make use of cheaper labor. If cheap labor mattered most, they would invest in China. Foreign firms that a Korea-China FTA would attract are the ones that aim at serving both the Korean and Chinese markets and, at the same time, and at taking advantage of a sophisticated supply chain, highly skilled labor, and good infrastructure in Korea. Although Korea's current FDI policies, such as tax incentives and cash grants to foreign investors, appear to be quite comprehensive, there still remains much room for improvement in the business and living environment for foreign investors.

In the second project, we will provide a more detailed analysis of the effects of a Korea-China FTA on industry sectors by improving on drawbacks found in this paper. We will define each country's sensitive items. We will then analyze the economic effects of an FTA between Korea and China on these items and set up strategies to reduce the possible negative effect on those industries.

05-04

Rationale for a China–Japan–Korea FTA and Its Impact on the Korean Economy

Chang Jae Lee et al. (Dec. 2005)

ISBN 89-322-1246-5/A5/124pp.

USD 7

This volume summarizes the results of a series of cooperative research efforts on “The Implications of an FTA between China, Japan and Korea (CJK FTA) for the Korean Economy,” undertaken under the auspices of the National Research Council for Economics, Humanities and Social Sciences in 2005. Cooperative research on the implications of a CJK FTA on the Korean economy has been ongoing since 2003.

Based on the research of the previous two years, the research in 2005 focused on the economic effects of a CJK FTA on the Korean economy including the manufacturing, agriculture, fishery, and service sectors. In addition, the rationale for a CJK FTA was also discussed.

With regard to the rationale for a CJK FTA, apart from the economic benefits that arise from an FTA between increasingly dependant economies and a response to the worldwide rise of economic regionalism, this study highlights a set of reasons for a CJK FTA by reversing conventional thinking. In fact, starting from commonly invoked obstacles to a CJK FTA, this study argues that a CJK FTA could reduce political tension in the region, liberalize worldwide trade, and overcome domestic interest groups for a more competitive economy.

According to the computable general equilibrium (CGE) simulation results, the Korean economy will benefit the most from a CJK FTA in terms of GDP growth and welfare. For instance, the macroeconomic effects of a CJK FTA in terms of GDP growth will be 5.14 percent for

Korea, 1.54 percent for China and 1.21 percent for Japan. Furthermore, the simulation shows that the macroeconomic benefits from a CJK FTA for the Korean economy are greater than the sum of the benefits from a Korea–Japan FTA and a Korea–China FTA.

In this volume, the economic effects of a CJK FTA on Korea's manufacturing industries such as electronics, automobiles, general machinery, textiles, steel and petrochemicals, as well as agriculture, are analyzed, and, in particular, sensitive products are identified. Additionally, implications of a CJK FTA on the Korean fisheries and services sectors as a whole are analyzed.



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05-01

The Analysis of Major European Eco-labels and Their Implications for Exports

Chang-in Yoon and Jae-hyup Lee (May 2005)

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Environmental labelling may be categorized in many ways: mandatory labelling and voluntary labelling (in terms of binding degree), national environmental labelling and international labelling (in terms of scope of application), and Process and Production Methods (PPMs) labelling and Non-Process and Production Methods labelling (in terms of PPMs). For the purpose of our study, we have divided it into three categories: the government-initiated mandatory, the government-initiated voluntary and the private-initiated voluntary environmental labelling.

Issues on environmental labelling is currently under discussion in many international organizations, including the International Organization for Standardization (ISO) where the international environmental management standards such as ISO 14000 series are made. The ISO 14020 series include the voluntary eco-labelling schemes based on the Life Cycle Assessment (LCA), environmental self-declaration and the environmental performance indicators. Within the WTO, the Committee on Trade and Environment (CTE) is the main forum for discussion. One key issue in the CTE is the applicability of the provisions of the Agreement on TBT (Technical Barriers to Trade) to the environmental labelling that is designed to indicate the PPMs of the product, instead of the product itself. Another issue is whether the notification provision under the Agreement on TBT may also be applicable.

At the CTE discussion, the European Union has argued that clarification

is necessary as to whether Non-Product related PPMs are governed by WTO rules. The United States, on the other hand, interprets that the Agreement on TBT applies to Non-Product related PPMs and therefore the environmental labelling is governed by the TBT Agreement. Developing countries do not agree with these advanced countries' views. They argue that discrimination according to PPMs should not be allowed in the name of improving extraterritorial environment. They insist on the increase of transparency and assistance to developing countries' capacity-building with due consideration of their different environmental and societal needs. In this regard, Korea is of the view that Non-Product related PPMs are not subject to the scope of the Agreement on TBT.

The European Union started discussing community environmental policy after concluding the Treaty of Rome that created the European Economic Community (EEC) in 1957. At the Paris Summit in 1972, coinciding with the United Nations Conference on the Human Environment in Stockholm, the head of nine member states of the EU agreed on establishing the community environmental policy by declaring that economic growth is not an end in itself. Accordingly, the Ministerial Council adopted the first Environmental Action Programme in 1973. The purpose of the EU environmental policy is stated in the EU Charter. Article 2 mentions 'balanced and sustainable development, and high level of environmental protection and improvement' as one of the purposes in creating the EU. In addition, Article 249 of the EU Charter lists regulation, directives, decision, recommendations, and opinions as major forms of community-lawmaking.

Organizations related to the EU environmental policy include the Board of Directors, Committees, European Parliament, International Court of Justice, Economic and Social Committee, and European Environmental Agency. The EU states the precautionary principle, polluter-pays principle, supplementarity and integrity principle as general principles of environmental policy and rules. EU member countries can take stricter domestic measures than those adopted by the EU. These measures must

be consistent with Article 176 and be reported to the Committee. In addition to environmental labelling, the EU implements diverse environmental policies such as environmental taxes, environmental audits, CE marks, packaging and packaging wastes regulations.

Environmental labelling schemes of the EU, Germany and Nordic countries are operated under similar forms and procedures. The EU scheme (Eco-label) was first introduced in 1992. Standards for 21 product groups have already been developed and standards for 4 product groups are under development. The EU's Eco-label is certified in accordance with the LCA. The scope of certification has been expanded over time and now covers services as well as products.

Germany is the first country that established the environmental labelling scheme, the Blue Angel in 1977. It selects product groups based on potential reduction or prevention of negative effects of products to the environment. As of 2003, there are 3,788 products in 88 product groups that are certified. Generally manufacturers submit suggestions to the Environmental Agency even though individuals, companies or organizations can submit new suggestions as well. Once the standards of certification for each product groups are made, they are in effect for three years.

Nordic Swan was created by the Nordic Council of Ministers in 1989 and is now being applied to Norway, Sweden, Finland, Iceland and Denmark. There are 2,800 certified products in 145 product groups. Nordic Swan is the first joint environmental labelling scheme developed by multiple countries. It is operated by the Nordic Council and the National Committee. All three environmental labels mentioned above include production-related requirements in their eco-label criteria.

OECD examined the effects of environmental label programs in 1997. According to the study, eco-labelling programs have been more successful in countries or regions that possess a higher level of consumer awareness of environmentally preferable products and therefore a consumer demand for eco-labelled products. Overall, eco-labelling has only been relatively successful with the individual consumer. Eco-labels, however, may have

an important impact when retailers specify they want to stock products with eco-labels or when they become a tool in identifying environmentally preferable products for government procurement and institutional purchasing.

Information gathered during the course of the study, recognizing data limitations, did not reveal hard evidence of change in trade flows arising from selected eco-labelling programs. However, fears and concerns have been voiced as to potential effects. Taking a look at the effect of eco-labels to trade, about 30% of the companies in EU, Germany and Nordic countries that have won environmental certification are foreign companies or multinational companies.

In case of the eco-label, Blue Angel, in Germany, domestic products have to fulfill all the legal criteria of relevant administrative organizations to win eco-label certification. However, foreign companies exporting to Germany do not necessarily need to satisfy those criteria. In addition, the result of survey questioned the awareness of eco-labels showed about 30% in Germany and 75% in Nordic countries and about 30% of those people who responded answered that they are willing to pay more to buy the eco-labelled products.

With this literature review, an empirical study was implemented. The purposes were to evaluate the awareness of eco-labels, the impact of the eco-labels on their exports, their intention to win the certification and so on. Survey questionnaires were sent to 206 member companies of KITA (Korea International Trade Association), which had exported at least 20,000 dollars during 2003 to European countries operating Eco-label, Blue Angel and Nordic Swan.

Since it would not be meaningful to take samples from general trading companies to find the impacts of the eco-labels on their exports, the questionnaires were sent to the members of KITA, which exported more than 20,000 dollars from September 30 in 2003 to Oct. 1 in 2004. During the period of October 18~29, 2004 the questionnaires were disseminated and collected by fax, and inconsistencies were corrected by directly

speaking to the respondents, 105 questionnaires were collected out of 206 samples (50.1% in terms of responding rate) and were analyzed by SAS software.

The general profile of the exporting companies to the areas which are operating the eco-labels could be described as a trading company with about 131 employees that export about 32% of its total export. And about 42% of the companies don't know about the existence of eco-labels and about 93% of them are regard the eco-labels as having no impact on their exports. As a result, awareness level about eco-labels among the exporting companies seems to be low compared with the general expectation and there seems to no negative effects induced by the eco-labels as of November 2004.

There are only three Korean companies that have received the certifications of Eco-Label, Blue Angel or Nordic Swan. The number of companies that have won the labels is quite below the average of 19.3 companies of Western European countries. Kumho Tire Inc. Co., Hankook Tire Co. Ltd. and LG Electronics are the Korean companies that have won the certifications, the first two both in tires from the Nordic Swan and the last one in refrigerator group from Eco-label Flower and in monitor group from Blue Angel.

There seems to be no significant negative impacts of the major European eco-labels on the exports of the trading companies examined in this research, however, it is strongly recommended to develop activities to raise the awareness of the eco-labels and to adopt environmental management. Nowadays, the environmental protection is strengthening especially in the EU regions and the ratification of the Kyoto-protocol would sooner or later enforce the frequent use of eco-labels related to energy efficiency. For this purpose, the role of KITA should be emphasized possibly in association with the Small Business Administration.

05-02

India's Foreign Economic Policy and the Way of Reinforcing Economic Cooperation between Korea and India

Tae Hwan Yoo, Yoon Jung Choi, M. Pant, and V. Balaji (Aug. 2005)

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India is getting worldwide attention for its remarkable current economic growth which is partly driven by its active reform and opening economic policy after the foreign exchange crisis in July 1991. Since then, India has achieved a more than average 6 percent economic growth and developed a more solid and sound economic structure. Its monsoon dependent agriculture sector decreased its proportion in overall economy to less than 20 percent, while the IT-led service sector assumed about 55% of India's total GDP. India has made its economy's fundamentals strong enough to maintain less than 5% inflation rate, show favorable balance of trade since 2000, lower its public finance deficit around 5% of GDP, retain foreign exchange reserves over 100 billion dollar, and so forth. All of the above prove India's growth is not temporary due to a favorable business cycle, instead it is a long-term state. It seems that India finally succeeded in transforming itself from an autarkic economic regime to an open market-led economy. India's successful transition to a market economy and an unprecedented leap to tertiary industries gives many economists an optimistic view about the sustainability of India's robust economic development. India can provide anew economic growth model for many developing countries, by focusing more on the service sector and IT industry, rather than on the primary and manufacturing

sector preoccupied by competitive incumbents from all over the world.

India's overseas economic policy is aimed at improving the quality of life through self-sufficiency from its independence in 1947. Using the 1991 foreign exchange crisis as momentum, India has taken a range of reform measures on its long-stand close economy regime to liberalize trade and ease economic restriction. Since then the main goal of India's trade policy has been to achieve stable and robust economic growth by integrating India's economy into the world economy. The Indian government hopes to quickly achieve that goal by pursuing sustainable economic growth with pre-existing raw materials and capital goods or securing source of supply, developing technology for promoting efficiency, achieving goods of international level quality and sufficient supply, and so on. Despite the astonishing performance so far, India still lacks a completely open economy, efficient resource allocation, and confidence in the market's function mainly due to the government's excessive intervention to protect domestic industries.

Korea and India are important trading partners. India is Korea's 11th export partner, 26th import partner, and bilateral trade volume recorded 5.48 billion dollar in 2004. Analysis of relative advantage of export industries and goods using ESI, TSI, RCA, and MCA shows that both countries' core export industries and main trade commodities are complementary. India has relative advantage on some industrial products such as agricultural and marine products, textile and chemical engineering, and Korea has relative advantage on manufacturing goods.

Korea is India's 5th FDI donator, and has 132 accumulated investment declaration cases and recorded 1.05 billion dollar of investment declaration volume. Promising fields for Korean industries are automobile and parts, steel, petrochemistry, and textile in manufacture and IT, communications, construction, infrastructure, and natural resources exploitation in service. India's investment to Korea also has rapidly increased. In March 2004 Tata group of India took over Daewoo Commercial Vehicle, and IT industries are planning to enter the Korean

market.

The result of CGE Model analysis based on trade in 2000 shows that with tariff removal, Korea's export to India increased by about 2,8 billion dollar while India's export to Korea slightly increased about 0,5 billion dollar. And results of CGE model analysis and Gravity model analysis put together show increase of bilateral trade volume by around 24% to 172%.

Given the great potential of India's economic growth and of the encouraging partnership between the two countries, Korea and India need to further extend their economic cooperation. By establishing a promising partnership, Korea and India can achieve trade diversification and set out (editor's note— are you sure dispose is the right word?) strategic base for South Asia and East Asia, respectively. As a first step, the governments of Korea and India agreed to form a Joint Study Group to conduct a feasibility study for a Comprehensive Economic Partnership Agreement between Korea and India in 2004. The possible increase of India's trade deficit with Korea can make the negotiations for the Korea-India CEPA difficult. Opening service market, including movement of labor force, can be another critical drawback to ratifying the Korea-India CEPA. Korea, therefore, needs to make a more practical strategy to strengthen economic partnership with India. Korea can take into account a PTA with India as an alternative to the CEPA on FTA plus level, along with the expansion of Bangkok Agreement or GSP.

05-03

WTO Discussions on Technical Barriers to Trade and Policy Implications

Sang-yi Nam (Sep. 2005)

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Along with the rapid reduction of traditional trade barriers such as tariffs and quotas, institutional factors including technical regulations have proliferated and increased their impact on international trade. Other factors that have impacted upon technical regulations include technical progress, and increased interests in welfare such as safety, health and environmental protection. Technical regulations are not dominated by developed countries or by some high-tech products. They are applied virtually to any product that is traded between countries and diffused from developed countries to developing countries in various regions like Southeast Asia, Central and South America, and Eastern Europe. Even in the multilateral trade system of GATT and the WTO where trade barriers other than tariffs are not allowed in principle, technical regulations are allowed based on the legitimate objectives such as national security requirements; prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. Technical regulations are allowed to lay down on product characteristics or their related processes and production methods. Korean products encounter various technical barriers to trade (TBT) when accessing foreign markets. Major TBT in developed countries consist of excessive technical and labeling requirements, discriminatory treatments, whereas those in developing ones are non-consistent with international standards, lack transparency or excessive time and costs

in conformity assessment procedures. Trade barriers related to technical regulations have dynamic characteristics, developing and proliferating with rapid development of technology. They are applicable at the border, during distribution, use and disposal. Even with these trends, our domestic awareness and preparedness for TBT are neither satisfactory nor active in both government ministries and private sector except in a few large enterprises. To meet the TBT in foreign countries, the government needs to have expertise in many factors such as technology understanding, adjustment of domestic interests among different groups, multilateral and bilateral negotiations. However, human resources are very limited, not to mention the fact that systematic and cooperative activities among the related government ministries are weak. Regarding the dynamic nature of TBT, it is urgent to enhance domestic awareness and preparedness. It is important to establish close relationships between government and private industries, especially, industry associations for small and medium enterprises since most of TBT can be identifiable in the actual process of market access to foreign countries. To deal with TBT, we need to consider not only their short run direct impact on trade and competitiveness of our products but also their potential impact in the long run. There is also need for balanced views on TBT of foreign countries in that they can primarily form trade barriers and also be used as a reference to improve domestic technical regulations. We have to pay more attention to notifications to the committee on TBT by other WTO members since they are the last chance to discuss in multilateral trade system before being implemented. MRAs, which are recognized as an ultimate solution for TBT, should be pursued with the proliferation of regional trade agreements (RTAs) / free trade agreements (FTAs). Suppliers' declaration on conformity (SDoC) needs to be discussed and introduced as a practical and short run solution. We need to participate actively in the process of discussing and establishing international standards, for example, in the area of information and telecommunications, in international standardizing

organizations such as ISO and IEC. Reflecting our status in the international economy, we have to contribute to the building capacity of developing countries in the area of TBT to implement multilateral rules and regulations.

05-04

The Economic Effects of a China–Japan–Korea FTA and Implications for the Korean Economy

Chang Jae Lee et al. (Dec. 2005)

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This volume summarizes the result of a series of cooperative research on “The Implications of an FTA between China, Japan and Korea (CJK FTA) for the Korean Economy,” undertaken under the auspices of the National Research Council for Economics, Humanities and Social Sciences in 2005. Cooperative research on the implications of a CJK FTA for the Korean economy has been ongoing since 2003.

The 2005 research continued the work done in the previous two years and focused on analyzing the economic effects of a CJK FTA on the Korean economy, including the manufacturing, agriculture, fishery, and service sectors. The research then attempts to provide some policy implications for the Korean economy in preparation for a CJK FTA. In addition, the rationale for a CJK FTA and future tasks needed to form a CJK FTA were also discussed.

With regards to the rationale for a CJK FTA, apart from the economic benefits coming from an FTA between increasingly dependant economies and response to the worldwide rise of economic regionalism, this study highlights a set of reasons for a CJK FTA by reversing the traditional way of thinking. In fact, starting from commonly invoked obstacles to a CJK FTA, this study argues that a CJK FTA could reduce political tensions in the region, liberalize worldwide trade and overcome domestic interest groups for a more competitive economy.

According to our computable general equilibrium (CGE) simulation

results, the Korean economy will benefit the most from a CJK FTA in terms of GDP growth and welfare. For instance, the macro-economic effects of a CJK FTA in terms of GDP growth will be 5.14 percent for Korea, 1.54 percent for China and 1.21 percent for Japan. Furthermore, the simulation shows that the macro-economic benefits from a CJK FTA for the Korean economy will be greater than the sum of a Korea-Japan FTA and a Korea-China FTA.

In this volume, the economic effects of a CJK FTA on Korea's manufacturing industries such as electronics, automobiles, general machinery, textiles, steel and petrochemicals, as well as agriculture, are analyzed, and sensitive products are identified. Furthermore, concrete tasks for each sector to prepare for a CJK FTA are also proposed. Additionally, implications of a CJK FTA for the Korean fishery and service sectors as a whole are analyzed.

05-05

China–Japan–Korea FTA: Strategies for Korea's Manufacturing Sector

Bak–Soo Kim et al. (Dec. 2005)

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USD 12

China has been integrating its market into the world market, most notably after its accession to the WTO in 2001. Accompanying China's open door policy has been the rapid growth of intra–regional trade between China, Japan and Korea (hereafter CJK). Between 2000 and 2004, the growth rate of Korea's intra–regional trade with China and Japan increased twofold, compared to its trade with the rest of the world. During the same period, Japan's intra–regional trade also grew five–fold compared to its extra–regional trade. It has been widely recognized that Korea and Japan tend to export intermediate products to China, which are then used there for export–processing activities. Through this international division of production, China has become the third largest trading country in the world, just after the United States and Germany.

In the rapid expansion of intra–regional trade between CJK, manufacturing products have played a key role accounting for about 90 percent of their trade. This report analyses six major manufacturing industries that include the electronics, automobile, general machinery, textile, iron and steel, and petrochemical industries. Currently, these six industries constitute three–fourths of Korea and Japan's total exports to China, and two–thirds of China's total exports to Korea and Japan. Even though CJK have yet to enter into an FTA, CJK's economic relations seem to be in the process of a de facto FTA in terms of trade growth, investment expansion, and trade barrier reductions. In this respect, an

analysis of Korea's strategies for the manufacturing sector is very important in order to cope with the changing economic environment in this region.

Because the products of these six industries are too diverse to be collectively analysed, this report focuses on sensitive products under the HS 4- or 6-digit level in the six major Korean industries, which are selected using the Trade Specialization (TSI) indexes, export growth rates, and the Revealed Comparative Advantage (RCA) indexes of Korean products. Sensitive products are defined as Korea's weakly competitive products compared to the same category of products from China and Japan, with basically a TSI of -0.3 to -0.9 . These sensitive products will be strongly affected by a CJK FTA and growing economic interdependence between CJK in the present and future.

Korea's sensitive products consists mainly of parts, components and materials, whose technology levels are situated between Japan's highly technology-intensive products and China's middle- and low-technology products. Nevertheless, it is noteworthy that Chinese products tend to be more competitive not only in final consumer goods, but also in parts and components of the manufacturing sector.

We hope that Korea's position in a CJK FTA will not be one of defense from Japanese products in the Korean market, but of offense in the Chinese market. Even though the policy directions for each industry will be different according to level of development, technology, and trade structure, common characteristics are the development of core and original technology, expansion of R&D investment, development of new products, new processes and new designs, cooperation between large firms and small- and medium-sized firms, and facilitation of industrial restructuring. These measures are the Korean strategies not only for a CJK FTA, but also for the further development of Korea's manufacturing sectors.

05-06

China–Japan–Korea FTA: Effects on and Policy Implications for the Korean Agricultural sector

Chang–Soo Lee, Ji–Hyun Park, and Yong–Taek Kim (Dec. 2005)

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USD 10

This study is the third–year result of a three–year series of cooperative research on “The Implications of an FTA between China, Japan and Korea (CJK FTA): the Agricultural Sector,” undertaken under the auspices of the National Research Council for Economics, Humanities and Social Sciences. This report analyses the effects of a CJK FTA on the Korean agricultural sector under the framework of the computable general equilibrium (CGE) model, neglected in the second–year report, and looks at policy implications for the Korean economy, including policy strategies and action plans to cope with a CJK FTA. The first report analyzed the agricultural production structure of the three countries and the trade structure between them. The second–year report analyzed the economic impact of an FTA on the agricultural sector, utilizing the analytical framework of the partial equilibrium model, focusing on the specialization effects of an FTA, thus neglecting feedback effects of the macro–economy.

According to the CGE simulation result, the Korean agriculture sector will be damaged by a CJK FTA in terms of production growth and welfare, but the analysis says that these reductions will be less than expected because of the trade–increasing effects of an FTA. The productions of grains (excepting rice), crops, vegetables, and fruits will

decrease about 47.26 percent, 15.84 percent, and 3.60 percent, respectively, in the zero-tariffification scenario using the medium-run capital accumulation model.

NAFTA's ten-year history can also provide us with indications that agricultural products with comparative disadvantages would not be fully hit by the developments of specialization between FTA partner countries, and that small countries would experience more benefits from FTAs than large countries, due to increased access to large markets.

Based on the CGE simulation results and NAFTA, this report presents seven strategies and/or action plans for the Korean agricultural sector in facing the challenges and opportunities from a CJK FTA. They are:

- the protection of sensitive agricultural products and a compensation scheme for agriculture-based income,
- strategies to differentiate Korean agricultural products from imported ones, emphasizing high-quality, safety, and organic products,
- the exporting of agricultural products into niche markets of partner countries,
- a strategy for investing in China and the construction of cooperative processes,
- strategies for increasing the shares of non-agricultural incomes in farmers' total income, and
- enhancing the innovative roles of farmers and the farmers' association in the production and distribution as well as agro-businesses.

05-07

Economic Implications of a China-Japan-Korea FTA in the Service Sector

Chang-In Yoon (Dec. 2005)

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USD 10

1. Introduction

Services are widely differing economic product activities distinct from manufacturing, mining and agriculture. The term encompasses a broad range of industries that provide basic economic infrastructure (communications, transport, distribution, energy-related services, construction, water supply, sanitation and sewerage services, waste collection and disposal), financial infrastructure (banking, insurance, financial markets), business support (advertising, marketing, computer services, professional services), or needed social infrastructure (education, health and social services).

The intangibility, with the characteristics of simultaneous consumption and production, also contributed to the belief that services were essentially non-tradable. As a result, the pre-Uruguay Round GATT framework applies only to trade in goods, reflecting traditional assumptions that services are not easily tradable. Services were neglected by the international trading system for so long, given that they account for more than 60% of employment and production in advanced countries and for a major and growing share in virtually all countries. Assumptions in regard to traditional thinking that services are not easily tradable have come into question for a variety of reasons.

In particular, technological developments and the removal or loosening

of substantial limits on domestic competition via regulatory reform made a breakthrough for international transactions of services or service trade. Many services transactions such as international banking or insurance make it possible to conduct trade without physical proximity between the provider and consumer of the service. In almost all countries, state monopolistic services such as telecommunications and transportation service were liberalized at least partially and opened to international competition.

The past two decades have seen a growing trend towards the outsourcing of business related services, such as R&D and development, financing or logistics. Services have been contracted to existing specialized service providers, or are provided by a newly created firm or spin-off from a manufacturing firm that can provide the services at lower cost or higher quality. Services industries function as “bridges for innovation” not only for the services sector, but notably also for services—using manufacturing industries. The interdependent relationship between manufacturing industries and the service industries is deepening. The production of a car, for instance, would not be possible without service activities such as market research, technical research and development and design, human resource management, and consulting services. Moreover, a car is often sold in a package that includes financing, which may be provided directly by the car producer or indirectly by way of subcontracting.

Almost all RTAs (Regional Trade Agreements) are adopting services liberalization agreements, and GATS 2000 service negotiations are undergoing. The performances of CJK (China, Japan, and Korea) in services trade are not as good as those in goods trade. For the past 10 consecutive years, CJK have imported more services than they exported. Moreover, manufacturing industries cannot create more value without the advance of services. So, it would be meaningful to check the current situation in which CJK are placing in terms of international trade in services and find some implications from the liberalization of CJK

services market under the umbrella of a CJK FTA, which is the objective of this research report.

2. Service economy trends

Although the share of services in GDP and employment tends to rise with income, even the poorest countries now have significant shares. In 2001, service sectors accounted for 45% of GDP in low-income economies; 57% in middle-income; and almost 71% in high-income. And trade in services is thought to account for only about 20~25% of world trade. Services activities in low-and middle-income countries have been expanding faster than GDP for the last two decades, and represent on average 5~10% points more of GDP than in the early 1980s. An implication of this continuous shift toward services is that the overall growth of productivity in the economy will be increasingly determined by what happens in the service sector.

The Services sector in China, Japan and Korea account for approximately 33.5%, 68.3% and 62.6% of total economic output, 24.6%, 63.9% and 62.3% of total workforce, and 10.9%, 19.3% and 16.4% of total trade respectively. Services account for more than 60% of gross domestic product and employment in both Japan and Korea, while below 30% in China, which seems to low comparing that of developing countries.

In the area of international trade in services, China also reports lower percentage than those of Japan and Korea. The service sector of the OECD accounts for roughly 70% of all jobs and value added in the OECD area, and contributes close to 15% to their total exports. To see the trends of the service economy visually, Table 1 was converted to Table 2 by dividing all the percentages by Japan's counterpart. With the same weights to the three areas of the indices, the average was calculated. If the trends to service economy of Japan is '1', Korea's trends seem to stand at about 0.91 and China at about 0.47 on the average. And the U.S.A. is about 1.2.

3. Comparison of Comparative Advantages of CJK's Service Sectors

Services were among the fastest growing components of world trade over the last three decades, particularly in the 1980s. From 1980–1990, the average annual growth rate of services exports was 8%, compared to 5.7% for merchandise exports. The performance of services trade was particularly impressive in the second half of the 1980s, with an average growth rate of 15.5% per annum. However, thereafter the record is mixed. At the aggregate level, services and merchandise trade have evolved in a roughly similar way since 1990 (both growing at 6.6% per annum), leaving the share of trade in services in international trade stagnant, at around a fifth of all cross-border trade.

Advanced countries are the leading exporting countries. Top five countries account for 40.5% and 40.4% in both export and import respectively. Japan and China are within the top 10 countries in both export and import. Import market shares, however, are a bit higher than those of the two countries, and this is also true for Korea.

CJK has imported more services than it has exported for the past ten years without any exception, with the trade deficit of approximately from 500 to 600 million dollars per year. In 2003, CJK's services export and import took 8.4% and 11.2% of the world trade in services respectively, and trade deficit was 501 million US dollars. Through this Table, one can say that CJK's dependence on foreign services is chronic.

Since there are no detailed trade statistics about services among countries as in the trade of goods, it is impossible to directly compare comparative advantages of service sectors country by country. One way to compare competitive advantages among CJK is to calculate the TSI (Trade Specialization Index) and RCA (Revealed Comparative Advantage) against the world by using the international service trade statistics such as IMF BOP statistics, which records exports and imports of international trade in services by sectors, and use them as proxies for the strength of service sectors for each country. International transactions in services are defined by the IMF Balance of Payments Manual as the economic

output of intangible commodities that may be produced, transferred, and consumed at the same time.

As a first step, it would be worthwhile to compare the strength of CJK's goods and service sectors together against the world before the comparison of individual services sectors to see whether CJK's services are competitive in the world setting. RCAs(Revealed Comparative Advantage) were computed for CJK and the top four services exporting countries such as the U.S.A., U.K., Germany and France, which is useful in judging the comparative advantages of a certain product or services in the world export market.

CJK's RCAs in goods are higher than those of the top three countries. Only Germany is on the same level with Japan and Korea. On the contrary, the reverse situation is occurring in services. CJK are strong in goods, however, weak in services. Table 6 shows that one of the tasks CJK have to solve urgently is to enhance their strength in services.

The next step is to compare advantages of individual services sectors using the Trade Specialization Index (TSI), RCA, and average growth rate over a period of ten years (1994~2003).

However, it was not easy to compare those services such as communication, construction, computer and information services, and other business services. For these service sectors, RCA of each sector was given more emphasis than TSI, since the former compares the world share of country's individual services to the average share of services in the world. At the same time, the growth rates of the related industries were also considered.

The final evaluation of the comparative advantages of the service sectors shows that Japan is strong in 5, China in 4 and Korea in 1 sector (s). Japan has comparative advantages in five sectors, construction, finance, computer and information, patent and licensing fees and personal entertainment sectors. China has comparative advantage in travel, communication, insurance and other businesses. And Korea maintains comparative advantage in transportation services.

Grade was given according to the ranks evaluated to find a statistical indicator that shows the general picture of the relative strength of services of the three countries. For each services sector three points was given for the highest country, two points for the second and one point for the last one. A simple calculation, without any weights for the sectors, gives Japan the highest score '23', then China '20' and finally Korea '20'.

4. Barriers and Sensitive Sectors of Services

Services have long operated in politically sensitive economic sectors and as such have been heavily regulated. In most countries of the world, for example, governments own and directly or indirectly control the communications infrastructure and services. Other services industries such as banking and insurance are either government owned or highly regulated in most countries. Furthermore, such regulation frequently discriminates against foreign service providers. Restrictions may take the form of discriminatory licensing procedures, discriminatory taxation, and denial of the ability to establish branches or subsidiaries.

One of the areas in which protectionism is particularly strong is telecommunications and information. Restrictions on international information flows become serious in light of the growing importance of telecommunications and computer services. In addition, information-intensive service industries, such as banking and insurance cannot function without reliable, unrestricted communications links. Furthermore, barriers against the flow of services are putting a brake on the development of some of the most dynamic sectors of an increasingly interdependent world economy, including information industries, finance and communications. These actions at the same time threaten the growth of international trade, and in the process work against structural changes that have been the source of growth within domestic economies.

Undoubtedly, there are still many kinds of barriers or brakes among CJK, and stocktaking of the barriers could belong to one of the further

studies. Here, a question arises, “what sectors or sub-sectors are sensitive to CJK?” Since the GATS adopted the positive list approach, the schedule of specific commitments lists only the sectors or sub-sectors that each country liberalizes. The sensitive areas were traced by way of identifying those sectors or sub-sectors, which were not listed on the schedule.

In the business services, services provided by midwives, nurses, physiotherapists and paramedical personnel are not liberalized in common. Japan and Korea are closing their services market for medical, dental services and not allowing the movement of natural persons, and China and Japan are reluctant to open veterinary services. CJK seem to be too conservative to open the sub-sectors in the communication services. China does not list postal or telecommunication services except value-add and audiovisual services. Korea does not list postal services, motion picture projection, and radio and television (transmission) services in audiovisual services. And Japan does not list radio and television services.

Only in Korea is primary and secondary education services restricted. All the sub-sectors in Health Related and Social services are closed in both China and Korea, while Japan opens her hospital services market. Both China and Korea do not liberalize the services market, ‘News agency, Libraries, archives, museums and other cultural services’ in the ‘Recreational, cultural and sporting’ sector.

5. Conclusion

Of late, attention has shifted to the most dynamic segment of the service sector, producer services. Producer services, banking; finance; insurance; business services such as various professional services, research, advertising, marketing, consulting or data processing; transportation; storage; and communication services are used in the intermediate production of manufactured goods and other services. Demand for these activities results largely from the economic transactions

of other industries. Producer services are thus facilitators of other businesses, both international and domestic, and thus are important for CJK which have comparative advantages in goods trade over the rest of the world.

For the past ten years, CJK have experienced consecutive trade surplus in goods trade, while maintaining wide trade deficit in services trade. And not only the trends of CJK towards service economies but also the comparison of comparative advantages of services sectors with advanced countries confirm that there are considerable gaps in the level of services sectors. CJK must be in a situation to strengthen their services industry. And the only viable strategy for the sustainable development of CJK might be the opening to the world.

The primary effect of protection in services is to reduce the supply of certain services and thereby force domestic demand towards more expensive, domestically produced services. Protection reduces supply and raises prices directly because of the higher costs of domestic producers. Increases in the price of inputs due to protection will in many cases translate into a tax on the production of exportable and import-competing goods and services

At present, CJK are trying to make the services industries be competitively strong and to improve their market economic system to promote the growth of service industry through the liberalization of services sectors. The elimination of monopoly, liberalization of prices, human resources development, and the introduction of competition in services industries are being emphasized.

According to the Schedule of Specific Commitments offered recently by CJK to the WTO GATS negotiations, sensitive sectors look like the sectors such as health related and social services, radio and television services in audiovisual services, and recreational, cultural and sporting. These sectors are not the sectors directly related to manufacturing and international trade. Therefore, producer services sectors can be chosen for the application of the liberalization of services.

As opposed to goods trade, the economics of regional cooperation suggests that there are circumstances in which benefits from plurilateral cooperation could be higher than gains from multilateral liberalization in the areas of services without generating trade diversion. It is the case of deeper regulatory cooperation in the form of harmonization and mutual recognition, which naturally takes place among a group of similar countries. Regulatory cooperation may be feasible and in many cases more desirable among a subset of countries like CJK than globally. Already, there are fewer restrictions on the short-term movement of people across borders to provide or receive services.

In summary, it would be feasible to consider and study the liberalization of services sectors proactively. The stronger competition associated with regional services trade, with similar cultural background, can reduce costs and prices, increase efficiency and innovation, and broaden the range of services being offered. It can also reduce the fragmentation of services markets. More productive services sector can also be the foundation for the better performance of other sectors, notably the manufacturing sector, as this increasingly relies on support and inputs from efficient and cost-effective producer services. FTA on services among CJK might help them in strengthening their respective comparative advantage in services.

05-08

The Economic Effects of Korea-U.S. FTA on the Korean Agricultural Sector

Chang-Soo Lee, Ji-Hyun Park, and Oh-Bok Kwon (Dec. 2005)

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USD 10

This study is the first-year product of research on “The Implications of a Korea-US FTA: the Agricultural Sector,” undertaken under the auspices of the National Research Council for Economics, Humanities and Social Sciences. The focus of this report is the impact of an FTA on the Korean agricultural sector, and subsequent policy implications for the Korean economy. This is done under the framework of the computable general equilibrium (CGE) model, after analyzing the agricultural trade and the competitiveness of agricultural products between the two countries. Agricultural issues that will arise during Korea-U.S. FTA negotiations and Korea’s policy strategies and action plans for an FTA will be investigated in detail next year.

According to the CGE simulation results, the Korean agriculture sector will be damaged by a Korea-U.S. FTA in terms of both production output and welfare reductions to the Korean agricultural sector, but the analysis shows that these reductions will be less severe than expected, due to the trade-increasing effects of FTAs. The production amounts of grains (excepting rice), crops, and meats will decrease about 720, 960 and 780 million dollars, respectively, in the zero-tariffication scenario (Scenario 1) using the medium-run capital accumulation model. In Scenario 2, with tariff reductions of 70 percent in sensitive products in the same model, they will decrease about 490, 730, and 820 million dollars, respectively.

The production amounts of sensitive agricultural products such as

meats (beef and pork) and crops (corn, nuts and vegetable oils) are analyzed using trade indices such as RCA and TSI.

NAFTA's ten-year history also tells us that agricultural products with comparative disadvantages will not be fully hit by the developments of specialization between FTA partner countries, and that small countries will experience more benefits from FTAs than large countries, due to increased access to large markets.

Previous FTA negotiations and concessions made between the United States and Australia and Central American countries are analyzed to predict implications for the Korean agricultural sector, with special emphasis on the treatment of sensitive agricultural products. The priority of a Korea-U.S. FTA in relation to the expected impacts of a Korea-China, Korea-Japan, and Korea-ASEAN FTA (on Korea's agricultural sector as well as the macro-economy), one of the major concerns of this study, is analyzed.

Based on NAFTA and our CGE simulation results, this study concludes that expected damages from a Korea-U.S. FTA on Korea's agricultural sector would not be critical. This arises from the dominance of the trade-increasing effects of FTAs, which would provide opportunities for Korea's noncompetitive products over the developments of specialization in the trade of agricultural products.

05-09

An Analysis on the Economic Effects of a Korea–EU FTA and Policy Implications on the Korean Economy

Heungchong Kim et al. (Dec. 2005)

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USD 10

This study analyzes the economic feasibility of a Korea–EU FTA and derives policy implications to the Korean Economy. This study addresses the following questions: would the Korea–EU FTA contribute to welfare–improvement of the two parties, and if so, by how much, what kind of bilateral trade issues would emerge during the FTA negotiations, and what kind of policy consideration is necessary before the negotiations start.

The study begins with a comprehensive analysis on the economic and trade relations between Korea and EU to evaluate the feasibility of the Korea–EU FTA. Despite the conspicuous development of the recent trade and investment achievements between the two parties, the trade potential is evaluated to be large, so that we can recognize both as a strategic partner for the FTA. It has been said that the industrial structures of Korea and EU are complementary, implying that the cost of structural reform due to the FTA would not be so high while the effects of welfare improvement would be substantial.

The analysis in Chapter 2, however, shows that the two do have competing industries such as automobiles, machinery, steel/metal, and textile/clothing. Korean agriculture, processed food, mineral products, wood pulp/paper, cement/glass, precision instruments and apparatus,

and other manufacturing goods are shown to be sensitive to EU competition, while EU has absolute advantage over Korea in livestock and wood products. Further, there are many bilateral trade issues between the two parties, some of which are not yet resolved. Some of these issues such as import barrier to automobiles, pricing in pharmaceuticals, shipbuilding, etc. will become critical if and when the FTA negotiations start.

Chapter 3 reports the results of the quantitative analysis to evaluate the economic feasibility of the Korea–EU FTA. The updated GTAP database for the CGE analysis, which covers twenty-five member countries of the EU, is adopted. The CGE analysis simulates results including service industries under the realistic situations of 50% opening of agriculture and service industries. In addition to the CGE analysis, regression analysis for the derivation of price elasticity of export/import is adopted to estimate short-term effects of the FTA on trade. The effects on trade in services have been analyzed in more detail, including effects on employment since trade in services must be particularly important in the FTA negotiation between Korea and EU.

The above analysis shows that a Korea–EU FTA would result in substantial improvement in GDP, income, trade and welfare of both parties. Under the realistic assumption of “full opening of manufacturing and 50% opening of agriculture and service,” Korea–EU FTA would increase Korea’s GDP by KRW 15 trillion (2.02%) in the short-term, and by KRW 24 trillion (3.08%) in the long-term. Per capita GDP of Korea is anticipated to increase by KRW 350 thousand (2.16%) in the short-term and by KRW 480 thousand (2.96%) in the long-term. Korea’s export would increase by US\$ 6.5 billion (2.62%) in the short-term and US\$11.0 billion (4.47%) in the long-term, and its import would increase by US\$ 6.3 billion (3.81%) in the short-term and US\$8.2 billion (4.92%) in the long-term. The number of jobs is estimated to increase by 300 thousand (1.81%) in the short-term and 597 thousand (3.58%) in the long-term. The job creating in service sector explains the major portion of the total

number of job increase. The impact of GDP increase in the Korea–EU FTA may not be stronger than other FTAs including the Korea–US FTA or Korea–ASEAN FTA, but the costs of structural adjustments is estimated to be substantially lower than the other two FTAs mentioned above, which shows that EU would be one of the attractive partners for FTA for Korea.

EU may also benefit a lot through Korea–EU FTA. Korea–EU FTA may increase the GDPs of Germany, France and UK by about 0.1%, which roughly amount to US\$ 1.5~2 billion. The new EU member states would benefit through increase of FDI from Korea and abroad, although their direct welfare improvement due to the FTA would not be as large as that of old member states or Korea.

Based upon the results of Chapter 2 and 3, Chapter 4 provides policy implications to the Korean economy in a qualitative approach. The study emphasizes the importance of EU's unique characteristic as an economic union. This is a difference Korea must consider when negotiating a FTA with EU. The study argues that EU's Common Commercial Policy, its FTA policy, some characteristics of the EU market such as the degree of service market integration, Korea's FTA policy, and bilateral trade agenda are among the major policy agenda for consideration when Korea negotiates a FTA with EU.

The policy implications of the analysis on the issues are follows:

EU's Common Commercial Policy (CCP) is one of the major common policies of EU which provides the European Commission with the mandate that the Commission should play the representative role in FTA negotiations with non-member states, including Korea. It would be important to note, however, that there is no clear-cut division of coverage between the CCP of the Commission and member states' authority, and thus there still remains gray area. The division of work between the Commission and member states needs to be clarified. The ambiguity in the Common Commercial Policy due to incomplete integration of the internal market would weaken EU's negotiation power. In particular thorough investigation on the new member states' implementation of the *Acquis*

Communautaire and Common Commercial Policy is required, to understand what is happening now in EU.

EU's FTA has weighed more on establishing FTA with neighboring countries and developing countries with colonial ties with the EU member states. Recently, however, a new trend has emerged. EU has started to establish trade preferential agreements with other non-European countries. Among these, EU's FTAs with Mexico and Chile needs to be noted in particular. The two FTAs are composed of three parts; political dialogue, trade and cooperation. They are comprehensive in terms of coverage, and the trade liberalization schemes are progressive and reciprocal. It should be noted, however, that agricultural industries in EU are still protected and the degree of liberation achieved varies among the FTAs. It is interesting to note that there are separate agreements for wine and spirit, and that EU's FTA do not usually require a Bilateral Investment Treaty (BIT).

The EU market is huge and is becoming increasingly integrated, which is attractive for non-member countries trading with EU. Although growth rates of the EU member economies have not been so high, the purchasing power of EU has been increasing. This peculiar phenomenon has been attributed to increased efficiencies following market integration. However, the services market has not been fully integrated, and this is one of the major barriers for free movement of services across member states. Korea needs to get the full status of national treatment in providing services in EU.

EU would be severely disadvantaged by Korea's FTA with big economies including the US and Japan. The industrial structures of Japan and the US is quite similar with that of EU, so that Korea-US FTA and Korea-Japan FTA would have negative impacts on the EU member economies and Korea-EU economic relations. We find that Korea-US and Korea-Japan FTAs would create substantial trade diversion effects on EU, and EU's production and trade would decrease after the conclusion of such FTAs. It is found that a Korea-US FTA would be

more burdensome to EU than a Korea–Japan FTA. Therefore, when considering Korea’s recent FTA policy, Korea is also an attractive FTA partner for EU.

05-10

How to Achieve Bogor Goals: Action Plans and Economic Impacts

Sangkyom Kim, Innwon Park, Soonchan Park, and Sung-Hoon Park
(Dec. 2005)

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USD 7

The 13th APEC Economic Leaders' Meeting, held in Busan in November 2005, adopted the "Busan Roadmap to the Bogor Goals." The Busan Roadmap contains six strategies and specific ways to implement the Bogor goal as follows: support for a multilateral trading system, the strengthening of collective and individual actions, the promotion of high-quality FTAs/RTAs, a Busan business agenda, a strategic approach to capacity building, and the pathfinder approach. As part of efforts to identify more concrete strategies to achieving the Bogor Goals, nine possible scenarios were analyzed based on following five approaches: 1) trade facilitation, 2) tariff reduction through a linear cut, 3) tariff reduction through the Swiss Formula, 4) a combination of trade facilitation and trade liberalization, and 5) the expected adoption of Korea's timetable to that of an industrialized economy. Moreover, by examining the outcome of the "Mid-term Stocktake of Progress towards the Bogor Goals" report, we found some strategic implications in pursuing the Bogor Goals. This research employed the "Computable General Equilibrium (CGE) Model" in order to measure each scenario quantitatively, and also introduced the "Trade Facilitation Index" based on the Gravity Model and survey data.

First of all, this research shows that barriers in the area of tariffs, non-tariffs, investment and services have been dramatically reduced since the Bogor Declaration in 1994, which suggests that APEC's trade

liberalization efforts in the past ten years have generally been successful. However, it is worth noticing that APEC member economies have been encouraged to put more effort to improve overall policy transparency and enhance the predictability. In the same context, this research paper reaffirms that APEC has been well focused on behind-the-border issues as part of efforts to achieve trade liberalization.

There are several expected effects, mainly on GDP, from each scenario. First, the outcome of the forecast suggests that more than 85% of tariff needs to be reduced in order to achieve equivalent economic effects generated by 50 percent increase in trade facilitation. Second, the research outcome shows that trade liberalization activities through both trade facilitation and the Swiss Formula will result in the greatest increases in GDP overall in the APEC economies, with a 3.39% GDP increase in Korea. Third, our forecasts also indicate that economic effects of tariff reduction by means of the Swiss Formula surpassed the one through a linear cut in terms of potential GDP increases. For example, Korea would experience a 2.07% GDP increase in the case of the Swiss Formula, as opposed to a 1.14% increase from a linear cut. It is worth noting that most industrialized economies and developing economies in Latin America would experience the opposite. When it comes to positive effects, the difference was significantly large between the two formulas, while differences in the negative effects are relatively small. Fourth, all of our forecasts indicate that developing economies, especially those in Northeast Asia, will gain more profits through promoting trade liberalization and trade facilitation than industrialized economies.

Above outcomes provide us with some strategies APEC and Korea can utilize to better cooperate with other APEC member economies and promote APEC's development. First, in terms of GDP and welfare growth, our quantitative measurements show that trade facilitation based on open regionalism and deeper integration principles will result in more positive effects in the APEC economies than tariff reduction. Therefore, our

research outcome suggests that APEC member economies should more actively promote trade facilitation as a primary means to achieve the Bogor Goals. As suggested in the Busan Roadmap, APEC member economies are encouraged to take concrete action in four areas—customs, standards and conformance, business mobility, and e-commerce—to achieve an additional 5% reduction in transaction costs by 2010. Moreover, according to our research outcome, policy makers should be advised that structural and regulatory reforms are to be implemented to promote a more business-friendly environment. Second, the outcome of forecast suggests that provided that APEC member economies reach consensus on tariff reduction schedule, concrete action plans should be based on the Swiss Formula, which will bring greater economic benefits than the one through a linear cut. Third, our research outcome well supports the current agreed timetable to achieving free trade and investment in the APEC region, with the industrialized economies by 2010, and the developing economies by 2020. Our forecasts also suggest that the prospective benefits would decrease if the same deadline were applied to all member economies, without taking into account the differing levels of economic development. Therefore, it is recommended that APEC member economies discuss ways to promote trade facilitation and concrete action plans while maintaining the current timetable. Fourth, as suggested before, trade liberalization and facilitation efforts should be simultaneously applied in order to effectively reach the Bogor Goals. Fifth, it is also suggested that if Korea achieves the Goals by 2010, the country will experience greater GDP increases. For example, forecast of our scenario of combining 50% increase in trade facilitation and tariff reduction by the Swiss Formula illustrates that Korea will experience a 3.37% GDP increase if listed as an industrialized economy, and a 2.76% GDP increase if listed as a developing economy. In this context, it is concluded that Korea should take more concrete actions to conduct structural reforms and to improve competitiveness in order to be closer to reach the Bogor Goals. Also, Korea should be more open to

sharing its experiences in economic developments in the past forty years with other developing economies in APEC, which will contribute to their poverty relief efforts and sustainable economic growth in the APEC region.

05-11

The Causes and Effects for Capital Outflows in Korea

Deok Ryong Yoon et al. (Dec. 2005)

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USD 10

Global integration of capital markets, Korea's trade surplus, and continuous capital accumulation have raised the need for policy change to keep capital within the domestic market to allow for capital outflow into foreign market. To meet this need, Korea has established a plan for capital liberalization and has implemented the plan continuously according to the given schedule. This research analyzes recent capital outflow after the capital liberalization to find out the impact on the Korean economy and the trend of capital outflow etc. It also analyzes what drives capital outflow from Korea and what determines the destination of Korea's investment. Another important topic in this research work is the analysis on foreign cases of capital flight to draw possible implications for Korea.

Important results of these analyses can be summarized as follows:

The main characteristics of Korea's recent capital outflow since April 1999, when the first liberalization measures were introduced, is the rapid increase of remittance and capital transfer via official routes. Most of the capital transfer seems to be in the form of investment seeking higher profit in foreign countries while unofficial capital outflow has decreased. This implies that capital liberalization normalizes international capital transaction. The negative impact which reduced domestic economic growth rate was estimated to be about 0.08~0.12% per year. Capital outflow has been higher in the period of economic boom than in other periods, which implies that Korea's surplus capital seeks substitutive

investment destinations or internationalization of producing center.

The factor that causes capital outflow seems not to be the gap of profit rate; the profit rate of capital in Korea is estimated to be higher than in the US. The capital outflow of Korea is affected by institutional factors not by the profit rate of capital. However, property rights did not cause the capital outflow because the capital liberalization expanded property rights through the extension of disposal area. The more probable factor accounting for the pull out of capital must be attributed to other institutional weaknesses like ineffective education system and unstable political environment.

The advancement of Korea's financial capital into foreign countries shows a trend to prefer regions with high trade volume with Korea and regions having easy access to necessary information. This shows that the financial indicators like information and development level of financial markets have a close relation with real market indicators. However, there is also a difference between real capital and financial capital in determining investment destination. Foreign loans by banks have an especially strong relation with trade making a clear discrimination from foreign direct investment. Regarding investment destination, the US represents strong domination in FDI as well as in financial loans into foreign countries while the Korea's trade relation with East Asian countries is getting stronger weight. This implies that financial investors still depend on established information networks on the US capital market instead of building new information networks on the East Asian market. The retarded restructuring of investment structure and excessive dependency on the US market shows a possible weakness of Korea's investment against shocks from outside the region.

Capital flight may occur in those countries fragile to economic crisis due to high foreign debt because capital prefers regions with low risk and high yield. Countries like Indonesia and Philippines have a high probability of capital flight because the high inflation rate in these countries reduces the real interest rate. Capital flight may occur in China too

because of high risks associated with possible capital liberalization in China.

The research results show that the capital liberalization of Korea contributed to the normalization of capital flow and reduces illegal capital transaction. The trend of capital outflow can be assessed to be not so strong. The capital outflow of Korea is caused not by the low profitability but by non-economic institutional problems. The dependency on the US capital market still remains strong. East Asian countries are not free from capital flight and Korea should prepare for possible capital flight and the ensuing macroeconomic instability in this region.

As a conclusion, the research results show that Korea's capital liberalization and allowance of capital outflow will bring more profit than cost as far as Korea attempts to modernize the financial system and manage stable economic growth.

05-12

Exchange Rate Policies under Inflation Targeting in Korea

Eun Kyung Kim and Yonghyup Oh (Dec. 2005)

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USD 5

This report reviews theoretical developments on inflation targeting, evaluates the way it has been managed in Korea, and tries to find its link with Korea's exchange rate policies. Introduced officially in late 1990s, inflation targeting has been one of the key macroeconomic means exercised by Bank of Korea. Exchange rates, an important information variable under the inflation targeting, can be more volatile in a small open economy under inflation targeting than under exchange rate targeting. On the other hand inflation targeting enables policy makers to set up more clear monetary targets and reduce uncertainty around future money market developments, which is expected to reduce exchange rate volatility in a long run. Our empirical study indicates despite a short time horizon of the study that Korea exhibits features that seem more like inflation targeting in a closed economy since interest rates react more significantly to inflation and output than exchange rates. Further Korea's central bank seems to care output growth at least as much as inflation. This not being contradictory to theoretical predictions of the inflation targeting regime, a stronger policy coordination between the central bank and ministry of finance is much needed.

05-13

Optimal Monetary Policy in a Small Open Economies

Doo Yong Yang, Yong Seung Jung, and Chae-Shick Chung (Dec. 2005)

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USD 5

There are many small open economies that have recently been employing inflation targeting as a medium-term monetary policy target. In addition, inflation targeting comes with a free-floating exchange rate regime because it is advantageous in mitigating external shocks. However, in the process of inflation targeting there arise some conflicts between the pressures of and exchange rate stability and higher inflation, especially cost-push inflation.

This work tries to analyze the national welfare and the gap between exchange rate and inflation stability. To do so, the paper employs new open macroeconomic models to shed light on the aforementioned sensitive issues. According to our analysis we find that 1.) exchange rate targeting is less desirable than inflation targeting policy in terms of social welfare comparison, and 2.) if Taylor rules are considered, whether exchange rate stability under an inflation targeting policy should be sought, or whether exchange rates should be left to the market and concentration be focused on output and inflation, depends on the degree of economic openness. If an economy is more open, it might be that the exchange rate plays a more important role in increasing social welfare within an inflation targeting framework. In general, based on our assumptions and model specifications, the study finds that we should focus on domestic factors rather than foreign factors in small open economies such as Korea.

05-14

The Demand for and Optimal Management of International Reserves in Korea

Deok Ryong Yoon and Yeongseop Rhee (Dec, 2005)

ISBN 89-322-1234-1/A5/60pp.

USD 5

In this paper we provide empirical interpretations for the build up and active management of international reserves in Korea.

Empirical investigation shows that after the Asian crisis, higher foreigners' portfolio investment and higher short term external debt are significantly associated with higher hoarding of international reserves. These variables are all related with the uncertainty increase due to the rapid integration of Korea with the global financial system after the crisis. This is consistent with the view that the crisis has led to a drastic change in attitude towards short-term capital movement, and a new policy that attempts to mitigate the exposure to hot money by increasing international reserves in tandem with foreigners' portfolio investment and short term debt in Korea. The variable associated with the mercantilist motive does not appear statistically significant.

Various approaches to the appropriate quantity of international reserves mostly underpredict the actual reserve holdings of Korea, which may suggest that Korea accumulates international reserves more than needed. Excess reserves can cause social cost and make the Korea's financial market vulnerable to the US market because they are mainly used into less productive assets such as US long term securities. To resolve the problems caused by excess reserves, alternative uses need to be encouraged and regional monetary cooperation needs to be strengthened. However, the management of international reserves, especially

in Korea, also needs to consider that the appropriateness of international reserves can be affected by many other factors such as rapid transformation of Korea's financial markets, the Korean peninsula problem, and regional monetary cooperation.

05-15

Gradual Strategy to Form a Northeast Asian Economic Community

Chang Jae Lee et al, (Dec. 2005)

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USD 7

Although Trade and investment among Northeast Asian countries have substantially increased since the 1990s, although there has not been any significant progress in terms of institutionalization of regional economic cooperation. On the other hand, In spite of many discussions and institutional efforts to enhance cooperation in energy development, railway construction, and the environment, few tangible results have been realized. Another key characteristic of Northeast Asian economic cooperation can be found in its international political constraints. Political tension among Northeast Asian countries, partly due to historical matters, has been exacerbated recently.

A Northeast Asian economic community has generally been regarded as the ultimate vision for Northeast Asian economic cooperation. However, due to the remoteness and opaqueness of the concept of a Northeast Asian economic community, it would not be useful to promote Northeast Asian economic cooperation.

In this context, this study aims to propose an "Organization for Northeast Asian Economic Cooperation (ONAEC)." Initiative Unlike Europe, a supra-national entity is not likely in the foreseeable future in Northeast Asia. Therefore, it seems realistic to pursue the goal of establishing a regional economic cooperation entity among the Northeast Asian countries. Because the current international political environment makes this difficult, this study suggests the formation of economic cooperation

councils on a sectoral basis, such as a Northeast Asian Energy Council, a Northeast Asian Railroad Council and a Northeast Asian Environment Council, before establishing a Council for Northeast Asian Economic Cooperation, which would cover overall regional economic cooperation.

Apart from a Council for Northeast Asian Economic Cooperation, an ONAEC would consist of a Northeast Asia Free Trade Agreement (FTA), which would make it a substantial regional economic cooperative entity rather than a mere regional economic cooperation consultative body. A Northeast Asia FTA could be formed gradually, starting from a FTA between China, Japan and Korea. Then, Russia could join them to form a Northeast Asia FTA, and other Northeast Asian countries would follow.

The membership of an ONAEC would be inclusive and gradual. For instance, the United States would be able to participate in a Northeast Asian Energy Council, and Japan may not join a Northeast Asian Railroad Council in the beginning.

The ONEAC Initiative foresees forming Northeast Asian Sectoral Councils in 2012–15 before establishing a Council for Northeast Asian Economic Cooperation in 2015–2020, and wants to conclude a CJK FTA by 2012 before forming a Northeast Asia FTA by 2020, thus establishing the ONEAC by 2020.

05-16

The Evolution of ASEAN Plus Three Framework and Its Future Challenges

Yul Kwon et al. (Dec. 2005)

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USD 10

There has been a growing trend toward regionalism in East Asia since the 1997 financial crisis. In addition, increasing regionalism elsewhere has made it necessary for East Asia to focus more on securing common regional interests in the multilateral trading arena. This trend toward East Asian economic integration has been accelerating under the ASEAN Plus Three (APT) framework.

The APT framework is an important element for fostering East Asian regionalism. The APT leaders at the Manila summit in November 1999 agreed on broad economic cooperation, and resolved to promote economic linkages among East Asian countries toward integrating the ASEAN region with China, Japan and the Republic of Korea (hereafter CJK).

The APT framework has a multi-layered structure, consisting of three levels: ASEAN+3, ASEAN+1, and CJK. The APT summit has been held annually and ministerial meetings in foreign affairs, economics and finance were established permanently in 2002 to discuss various issues and regional cooperative programs. Eight ministerial meetings have been held so far, including the Senior Officials Meeting (SOM) and Senior Economic Officials Meeting (SEOM). Moreover, the establishment of diverse cooperative channels such as the East Asia Vision Group (EAVG), the East Asia Study Group (EASG) and the Vice Finance Ministerial meetings has strengthened systematic fundamentals for

intra-regional cooperation.

As a consequence, the EASG was inaugurated in 2001 and the final EASG report encompassed 26 projects, including 17 short-term projects and nine mid-to-long-term research plans. As a means to further strengthen cooperation, the EASG recommended that the annual APT summit meetings be developed into the East Asian Summit (EAS) and also advocated the formation of an East Asian Free Trade Area.

However, the APT process has already been overshadowed by the ASEAN-China initiative towards a comprehensive economic cooperation agreement, which includes the free trade agreement (FTA) that was signed in 2002. After China agreed to the FTA with ASEAN, Japan, confronted with losing its position of leadership on East Asian economic cooperation, eagerly pursued general cooperation with ASEAN and promptly agreed to an FTA with Singapore. In addition, the Japanese government hosted a Japan-ASEAN summit in December 2003 and held the Japan-ASEAN commemorative summit as a prelude to firmer economic relations with ASEAN.

As shown in the process of its FTA negotiations with China, ASEAN has tried to woo Japan, Korea and India into establishing closer economic partnership with economies in Southeast Asia. Interestingly, regional integration under the ASEAN+1 process may provide an important building block for establishing an East Asian integrated market. Although APT countries have taken different standpoints on the EAFTA, they held the common belief that an EAFTA would help boost intra-regional trade and investment as suggested by the East Asia Study Group (EASG).

The first East Asia Summit (EAS) took place in December 2005 with high hopes that it will break new ground in East Asian community building. While the original decision by APT leaders in 2002 was for EAS to evolve out of the APT summit, competition between major countries for leadership prompted the sudden decision to launch EAS earlier than anticipated and to invite Australia, New Zealand and India. These

unexpected developments drew much attention to the future scope and timetable of the East Asian community.

This leaves the question of identifying the nature of EAS. The participation of Australia, New Zealand and India in the enlarged summit has been under debate for months, as it may weaken common regional identity. Thus, clear distinctions must be made between various regional cooperation frameworks. To avoid duplicating agendas and develop a distinctive EAS, it is desirable that the APT framework serves to promote economic and financial cooperation in the region, leaving EAS to focus on diplomatic and security cooperation.

In terms of the regional cooperation frameworks that currently coexist in East Asia, Korea should exploit each and every one, be they small or large, including EAS, ASEAN+3, and ASEAN+1. Korea should contribute to building a collective security system in East Asia by promoting EAS to the level of diplomatic and security cooperation, while developing APEC into an OECD for the Asia–Pacific region. Then, ASEAN+3 would evolve into an East Asian Free Trade Area (EAFTA) in trade and strengthen the Chiang Mai initiative in finance.

05-17

The Increase of North Korea's Economic Dependence on China and Its Implications of South Korea

Myung-Chul Cho et al. (Dec. 2005)

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USD 10

North Korea has remarkably increased the economic dependence on China because Soviet Union was broken down and Western countries have taken economic sanctions against North Korea. Especially from 90s, North Korea and China have been drawing closer and in 2000s, have expanded their relationship in all economic sectors such as trade, investment, and assistances. China is the first trade partner for fifteen years and becomes the first investor in North Korea from 2004. The situation that the relationship between two countries is sharply developed could be positively evaluated in terms of North Korea's economy rehabilitation. However, it could be also worried that this relationship would raise more dependence on China and would make North Korean economy be subject to Chinese economy structurally.

In fact, North Korea has largely increased the foreign trade dependence on China compared with other nations. It means that North Korea has become much closer with China in the area of economic relationship. North Korea's economic dependence on China can be clearly observed in trade, investment, and assistances sector. At first, in the case of trade sector, North Korea's total trade volume was 3,554million dollars in 2004 and, if excluding the trade between North and South Korea, it reached 2,857million dollars. The amount of trade

with China was reached 1,385million dollars. This amount is become 39% of total amount of external trade and 48,7% except trade with South Korea. In 2004, North Korea's total amount of trade was increased to 19,5% compared with in 1993 and in the same time, the amount of trade with China was increased up to 35,4%. Thus, China has greatly contributed to North Korea's trade. Second, in the case of investment sector, in 2004, China invested 173,5million dollars to North Korea and increased one hundred thirtyfold of investment compared with 1,3million dollars in 2003. From 2000s, some Chinese companies began to invest to the border areas in North Korea and particularly in 2004, North Korea has held public investor offerings in several provinces of China. Third, in the case of assistances sector, China has decreased assistances to North Korea that was at the peak of 69million and 1,290thousand dollars in 2001. However, China has tended to assist North Korea informally rather than formally.

This report analyzes using times series data from 1996 to 2003 to investigate effects on North Korea's economic growth caused by trade between North Korea and China. The result shows that, if increasing 1% of trade with China, North Korea' would increase 0,485% of total trade amount, 0,112% of economic growth rate, and 0,198% of national income. However, these estimates are evaluated based on the date in 2004. When considering China's high economic growth rate and intensification of economic cooperation between two countries, North Korea's economic growth rate and income would be affected from China.

In fact, North Korea is a quite isolated country so it is hard to grasp the role of China in domestic economic activities by and large. we interviewed 165 North Korean defectors and carried out a survey of economic dependence on China. This report shows North Korea seriously depends on China most economic area such as production, transportation, sales, and finance.

Economic dependence on China can partly help North Korea's urgent economic difficulties and divide the burden of assistance from South

Korea. However, in other aspect, it can be negatively effected for expansion of inter-Koreas economic cooperation and integration of two Korea's economies. Hence, it is necessary to positively approach toward role of China for North Korean economy and prepare policy measures to maximize positive effects with the open mind. At the same time, we should make effort to decrease North Korea's dependence on China by strengthening inter-Koreas economic relationship. Finally, it would be difficult to reduce North Korea's sustainable dependence on China without quantitative and qualitative development of inter-Koreas economic cooperation.

05-18

Development of China's Firms and Industries-The Impacts on Korea

Mansoo Jee et al. (Dec. 2005)

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USD 10

As the bilateral economic relations between Korea and China are deepening, China becomes one of the most important factors, which has major influences on the future of Korean economy. Those influences are divided by three categories, the opportunities, the threats, and the risks.

Among those influences, this research focus on the threats China brings about. And we define those threats as 1) the import substitution in China's market by Chinese industry and 2) export market competition by 'made in China'. Both of these two kinds of threats arise from same source, the development of China's industries.

Previous researches have provided the changes of various trade related indices to figure out the extent and speed of China's threats. In this research, we not only examined the changes in trade but also looked into the changes in China's industrial policy, the internal structure of its main industries, and the growths and activities of China's big firms. With these more comprehensive approaches, we try to identify exactly where China's threats come from.

As to trade, we examined recent changes in China's foreign trade, Korea-China bilateral trade, and their growing collision in the global market. Major part of China's foreign trade is processing, so it should depend on imported intermediate goods. But in the industries like steel and petrochemical, domestic production is growing very fast and begins to substitute imports. At the same time China's export items are also

upgrading with very high speed, especially the shares of electrics and electronics are growing very fast.

But industrial policy didn't do bigger role in this process. Since China's reform in 1978, China's industrial policies have been focusing the restructuring of inefficient, traditional industries, which had been built under socialist economy. Our research concludes that the market power rather than government's industrial policy will derive the development of China's industries in the future.

We looked into some of China's industries in detail, like steel, petrochemical, auto, and electronics (home appliances, mobile communication, PC, semiconductor). Internal structures of China's major industries can be characterized by the strong presence of foreign capital. Especially their high-end, technology intensive, export-oriented area, foreign owned enterprises including Korean joint ventures are playing a major role.

It means so called 'China's threats' on Korean economy actually comes from the foreign joint ventures that is acquiring China's cheap input factors such as unskilled labor and land into their global production networks. The electronics industry is the best example, where the competition between Korea and China in global market seems to be most intense.

The growth of China's big firms is also regarded as the key players of China's threats. Even though 15 Chinese firms listed in 'Fortune 500' in 2005, only two of them are in the manufacturing sector. Chinese top manufacturing enterprises in major industries still are smaller in their scale, less efficient in the per-capita performances, strongly domestic market oriented, and weak in the R&A ability compared with their global counterparts.

With these findings, we can say that China's threat on Korean economy should be regarded not only as a consequence of the development of China's industry, but also as a consequence of the building of global production networks which utilizing China as a low cost production platform.

05-19

Strategies for Promoting Exports of Companies in Gaeseong Industrial Complex

Myung-Chul Cho et al. (Dec. 2005)

ISBN 89-322-1239-2/A5/180pp.

USD 7

The Gaeseong Industrial Complex project commenced on August 22, 2000 when Hyundai Asan and the North's Asia-Pacific Committee and the National Economic Cooperation Federation signed an agreement on the development. The two Koreas have adopted agreements on customs, communications and quarantine relevant to the Gaeseong Industrial Complex.

In 2005, Geaseong Industrial Complex is faced with not only having a sound system but also building up a market for products. It has merits such as a favorable location, cheap and skilled labor, and a tax favor. In the same time, it would be limited to produce and export because it is an industrial complex in North Korea.

Especially in the case of Geaseong Industrial Complex products being considered as a North Korean product, it would be limited to export. There is no international criterion of origin thus it is necessary to check a criterion of origin of major countries. Concerning that countries have different criteria of origin, the majority of Geaseong Industrial Complex products would be considered as a North Korean product. The reason is that companies in the Industrial Complex import raw materials from South Korea or third countries and produce goods in the site. If its products are considered as a North Korean product, it should be imposed higher tariffs than competing countries. North Korea is not a member of WTO so cannot be granted MFN (Most Favored nation treatment).

In addition, since Gaeseong Industrial Complex is located in North Korea, multilateral export regulations are limiting export of these products. Those regulations do not restrict directly to foreign export of Gaeseong Industrial Complex but become an indirect factor to restrict to taking out key equipments like experimental instruments, electronic instruments, and measuring instruments related to production.

It is also considered bilateral economic regulations. Particularly US is imposing the highest tariff rate of 'Column 2' on North Korean products and establishing import permission system under which North Korean products cannot be imported to US without notice or permission of Office of Foreign Assets (OFAC). Canada is also imposing 35% of General Tariff (GT) on all North Korean products.

Those limitations cannot be resolved in short-term period. Thus companies in Gaeseong Industrial Complex have to find a favorable market for North Korean goods. Actually EU market is the most accessible one among three world markets; US, Japan and EU. EU does not impose different tariff rates on two Koreas. Also, based on the premise that the economic and trade relation between North Korea and EU will improve, GSP (Generalized System of Preference) implementation can be expected. Furthermore, each company has to develop marketing strategies for each product to fit for each market conditions. This report chooses eight range products based on types of tenant companies of Gaeseong Industrial Complex and possibilities of products' export, introduces strategies for each range product and analyses its market condition.

In long-term perspective, it can be supposed the period in which factors regulating exports in short-term would be dissolved in this period. As increasing tenant companies into Gaeseong Industrial Complex, the total production would increase and foreign markets would be placed more weight. Since US market entry becomes full scale, they would also expand to export to the global market. Thus, from a mid to long-term perspective, key strategies for companies in the Industrial Complex would

be to establish an effective marketing strategies. In long-term, the companies need 1) to set up marketing strategies for developed countries; US, Japan, 2) to cooperate with other companies, 3) to expand foreign circulation market, and 3) find a way to open up new markets; Russia, inland areas in China. To support them, the government should 1) expand and improve physical distribution facilities, 2) standardize shipping documents, customs clearance, quarantine, and import export control, 3) abolish the list of restricted exports needed the prior approval, 4) persuade North Korea to join WTO.

05-20

Japan's IPR Strategy and its Policy Implication

Sung-Chun Jung (Dec. 2005)

ISBN 89-322-1240-6/A5/210pp.

USD 10

Japanese government has been trying to reform its Intellectual Property Rights System since the early 1990's. In particular, prime minister Koizumi started IPR reform right after he had taken office in 2001. Now Japan's IPR system has been changed from its old form and is expected to improve the efficiency of public R&D investment to contribute to enhancing Japan's economic competitiveness.

On the contrary, our country's IPR system has a lot of systematic challenges and problems. The purpose of this report is to introduce Japanese government's IPR policy reform and Japanese companies' IPR strategy through which this report will suggest some IPR policy package for Korean government and companies respectively.

The research areas of this report are composed of mainly two parts. The first part is Japanese government's public policy for IPR system. Since Koizumi Cabinet, Japanese government has accelerated the speed of reforming of IPR system. This report has surveyed why this IPR reform policy took place and what was the background of the reform. This report has also introduced the concrete policy programs in detail.

The second part is Japanese companies' IPR strategy. Japanese many companies have been troubled from the beginning of 1980's by IPR-related disputes with the U.S companies. The Japanese company got many lessons from this experience. I investigated the present conditions of an IPR strategy of Japanese companies and was going to extract the

lesson that Korean companies should learn from there.

The main policy suggestions for Korean government are as follows. Firstly, the Korean government has to get the administrative system to reform IPR system ready. To do this, it is necessary to establish a new committee that investigates present conditions of Korean IPR system and takes out a prescription. Secondly, it is also necessary to introduce the life cycle management system of intellectual property rights. I suggested some specific agenda, including the reform of university and public research institutes.

The policy suggestions for Korean companies are as follows. Firstly, it is an urgent problem to reinforce the IPR management system of Korean companies. When I compared Korean companies' IPR management system with that of Japanese companies, the IPR management system of Korean companies was very weak. Secondly, personnel training engaged in IPR management is very important. Lastly, Korean companies have to make more efforts to strengthen international cooperation. It is necessary to establish a new cross-sectoral IPR association that forms internal and external networks to promote institutional reform and international cooperation.

05-21

A Study on Economic Aids toward North Korea after Resolving Nuclear Crisis

Myung-Chul Cho et al. (Dec. 2005)

ISBN 89-322-1241-4/A5/284pp.

USD 10

As increasing a possibility of peaceful and diplomatic settlement of the North Korean nuclear project through the recent round of six-party talks, it has been raised a discussion about economic aid programs toward North Korea after resolving nuke crisis. Under the premise that the nuclear crisis is peacefully resolved, various economic aid and cooperation projects could be conducted with international assistance, helping North Korea's economy rehabilitation and economic transition in the long run. At this juncture, South Korea should play the leading role in coordinating the aid projects from international community in order to distribute resource effectively and strengthening cooperative relation with international organization to set up mid- and long-term strategies of the economic aid. It would be absolutely necessary when considering that huge resources should be needed for rebuilding the North Korea Economy.

This report analyzes foreign economic aid system and its operating system of US, Japan, China, Russia, EU and international organizations which could provide relatively big financial and technical assistant during the period of resolving process. Also, it searches international and multilateral aids with priority given to bilateral aids.

First of all, the future economic aid of US will have many positive effects on the North Korean Economy. Direct effect of US aid for North Korean economy could be trivial in comparison with indirect effect of it.

The scale of US economic aids is the most biggest one in the world. However, US aid targets all countries in the world, so US would not allocate a big part of economic aids to North Korea. Indirect effect made in North Korea-US relation will make an important contribution toward North Korean Economy. This Progress will subsequently strengthen North Korea's economic relations with other neighboring countries. Foreign direct investment will accompany the transfer of technology as provide export markets for North Korean enterprises. Once economic interactions are developed between North Korea and the United States, momentum will grow for North Korea's open-door policy and economic reform after is exposure to external assistance has increased.

Japan could be regarded as large aid donor from North Korean side because a Japan-North Korean normalization agreement will lead Japan to provide North Korea with a large-scale economic aid as compensation for Japan's occupation of the Korean Peninsula. Although Japanese Prime Minister Junichiro Koizumi had summit talks with Kim, Jung-Il two times in North Korea and discussed pending issues, their relationship has become much worse. However, restarting their summit talks needs to resolve nuclear issues. Also considering that the estimated amount of reparations reaches \$5~10billion, the role of Japan is very important for North Korea economic aids and economic cooperation. When nuclear issues are resolved, the most feasible option for donation would be Official Development Assistance (ODA).

China is an important strategic partner for North Korea and the most influential country to encourage North Korea positive changes. Recently South Korea and world society have increased economic assistances to North Korea while China has decreased its grant aids to North Korea. Official grant aids to North Korea show big ups and downs because those aids have been given as a gift for North Korea when heads of two countries have visited each country. If nuclear issues are resolved, it is expected that China would change policies about North Korea economic aids and cooperation into 1) assistances to North Korea based on

economic benefits, 2) investment centered assistance, 3) investment assistances through business sector, 4) participation in Northeastern joint development project, and 5) assistances through international organization. With its great influence on North Korea, China needs to encourage North Korea to continue with the pragmatic economic policies from the long prospective.

Russia has endeavored to resolve nuclear issues and to improve to multilateral security in Northeast and economic cooperation system. The followings are possible assistant measures for North Korea; 1) clearing off North Korean debts given by Russia, 2) electricity supply, 3) repairing industrial equipment that were provided by Soviet Union, 4) lease of farmland in the Far East, 5) modernization of North Korean railroads and connection with trans-Siberian railway. For North Korea, the TSR (Trans-Siberian Railway)–TKR (Trans –Korean Railway) linkage project is considered one of the most important area of economic cooperation with Russia. However, Russia would hardly perform North Korea economic assistances alone and they would corporate with South Korea in many parts. Thus, to propel Russia's economic assistances to North Korea, it should not require unilateral assistances but should embody economic cooperation programs among two Koreas and Russia.

Europe's Humanitarian aid to North Korea started in 1995, when North Korea underwent its most serious economic crisis and corresponding food shortage. The EU joined KEDO and has continuously provided substantial food aid to North Korea. Although the EU's influence on the Korean peninsula is not decisive as those of the traditional major powers – the United States, China, Japan and Russia – the EU states could play an important role in reducing current tension on the Korean Peninsula and in helping to alleviate North Korea's economic hardship. The development approach of the EU is well outlined in 'The EC-DPRK Country Strategy Paper 2001–2004', which became effective in March 2002, and 'National Indicative Programme 2002–2004 DPRK' adopted by the European Commission in July 2002. Looking through the EU's

strategy paper, it can be argued that economic assistance from EU member states will expand in scale, and the EU's support will shift its focus from humanitarian relief to technical assistance and development projects, including the restoration of the energy sector, the modernization of the transportation system, agricultural rehabilitation and market-economy education for government officials and economic professionals.

05-22

Globalization and Market Liberalization Policies: Appraisal and Challenges

Jai-Won Ryou and Hyejoon Im eds. (Dec. 2005)

ISBN 89-322-1242-2/A5/316pp.

USD 12

The series of papers in this book aim to take an objective view of the criticisms of globalization and policies of market liberalization, correct any myths associated with them, and shed light on the implications of globalization on the Korean economy.

As a representative movement against anti-globalization, the post-Washington consensus emphasizes the role of government in responding to market failure. They call for more active government intervention in globalization by the establishment of a more democratic trade regime, by the controlling of capital flows, and by the designing of selective industrial policies. In trying to fix the problems associated with globalization, it would be worthwhile to pay careful attention to the criticisms raised against globalization.

Income inequality is often placed at the center of the anti-globalization argument, though the link between the two seems to be weak. Contrary to what is commonly believed, it is found that imports in sectors that heavily employ skilled labor have increased relatively more than imports in sectors that heavily employ unskilled labor. This finding suggests that the argument that trade expansion or globalization causes income inequality between the skilled and the unskilled is not well grounded.

Given the relatively high openness of the market in Korea, particularly in manufacturing, the marginal benefits for an additional market opening would be small. However, the long-term benefits such as economies of

scale and competition effects would not be small. To reap these long-term benefits, various institutional improvements, such as greater investment in human resources and R&D, should be implemented.

Aid to industries adversely affected by trade liberalization can be justified on political, social, and economic grounds. As an example of such aid, the Korean government is introducing a program called trade adjustment assistance. However, this program needs to be incorporated in the long term into a general social safety net to address the discrimination problem in the aid criterion, and needs to focus on relaxing many regulations that have prevented any structural reforms from taking place rather than focusing on providing financial aid, which can induce a moral hazard.

Based on firm-level data, foreign investments in the Korean stock market seem to favorably affect firms' performances. These investments are relatively concentrated in large firms. Firms with a higher proportion of foreign investments show higher returns, but they do not necessarily yield high dividends. Furthermore, foreign investments do not tend to decrease investments in firms' equipment and seem to improve the ownership structure of the firms. Based on these findings, criticisms against foreign investments in the Korean stock market are hardly justified.

Any judgments on the role of foreign capital in the Korean economy should be firmly based on facts. The screening tests for foreign takeovers in the financial sector need to be tightened so that domestic financial institutes do not easily fall into the hands of the international hedge funds aiming for short-term arbitrage gains. Furthermore, international financial cooperation should be strengthened to control these hedge funds.

The main policy implications from these papers are as follows. First, Korea should keep its door open, whether in trade or in the capital market, and should promote any structural reforms in the process of market liberalization. Next, in facilitating globalization and market

liberalization, internal negotiations are as important as external ones. Internal negotiations should entail the promotion of the advantages of an open market, the establishment of a two-way communication channel between the government and various interest groups, and the coordination of differing views between departments within the government. To fully reap the benefits of financial liberalization, Korea needs to establish a global standard and advance a transparent monitoring system in its financial sector. Finally, but not lastly, Korea should invest more in human resources and R&D, which will facilitate market liberalization and in turn will lead to economic growth, and should expand the social safety net to distribute the overall economic gains from market liberalization equally to all sectors.

05-23

A Study on Anti-Money Laundering Measures for Professionals and Non-Financial Businesses in Korea

Hyungdo Ahn and Jonghyuk Kim (Dec. 2005)

ISBN 89-322-1243-0/A5/160pp.

USD 7

The FATF's Forty Recommendations, which have been endorsed by more than 130 countries, are widely accepted as the leading international anti-money laundering standards. The Recommendations recognize that certain types of non-financial businesses and professionals are vulnerable to money laundering, and ask countries to consider applying the Recommendations to the financial activities of non-financial businesses and professionals. FATF Typologies reports have regularly referred to the increasing role played by non-financial businesses and professionals in money laundering schemes in recent years.

After introducing anti-money laundering laws in 2001, Korea have has taken steps to extend the reach and breadthwidth of anti-money laundering legislation and systems to increase its their effectiveness. Korea will introduce a Currency Transactions Report and enhance Customer Due Diligence for higher risk categories beginning Jan 1, 2006.

However, these anti-money laundering measures do not apply to professionals and non-financial businesses in Korea. The professionals may assist the money launderer by acting as financial intermediaries or providing expert advice. And they may also be involved in the creation and management of companies and other legal entities or arrangements, thus providing other services that are useful to the money launderer.

This study examines the current anti-money laundering measures to for professionals and non-financial businesses forin the major foreign countries. This paper also investigates cases from the Korean prosecutory prosecution authorities. Even though there exists the limitations that the recent cases are not available, the study finds many money laundering cases related with to professionals and non-financial businesses in Korea. In addition, questionnaires and interviews are performed to obtain the opinions of professionals and non-financial businesses. Lastly, the study proposes the anti-money laundering measures for professionals and non-financial businesses in Korea.



C

onference Proceedings

05-01

Diversity in Development

Jan Joost Teunissen and Age Akkerman eds. (Feb. 2005)

ISBN 89-322-3043-9/A5/238pp.

USD 10

The economic success that East Asian economies have achieved in late 20th century is contrasted with a sluggish performances at best of economies of Latin America.

Ten commandments known collectively as the Washington Consensus is the praise for East Asian economic management, first drawn by John Williamson in 1990 and is in principal directed to Latin America as policy suggestions.

It advocates the policy stance such as fiscal discipline, a redirection of public expenditure priorities toward fields offering both high economic reforms and the potential to improve income distribution, tax reform, interest rate liberalization, competitive exchange rates, trade liberalization, liberalization of inflows of FDI, privatization, deregulation, secure property rights.

This book provides alternative visions that exist, while stressing further certain visions laid out in Washington Consensus.

It shows that critics and advocates of the Washington Consensus have diverging views, in particular fiscal prudence, the pursuit of low or at least moderate inflation, and the establishment of a well-regulated and supervised financial system are inevitably right directions.

05-02

Regionalism in Northeast Asia: Opportunities and Challenges

Hyungdo Ahn and Yong Shik Choo eds. (Nov. 2005)

ISBN 89-322-3044-7/A5/136pp.

USD 7

In light of this increasing significance of Northeast Asia and Korea in international relations, the Johns Hopkins School of Advanced International Studies (SAIS), Korea Institute for International Economic Policy (KIEP), and Maeil Business Newspaper and Maeil Business TV News co-hosted the conference entitled "Regionalism in Northeast Asia: Opportunities and Challenges," at SAIS's Kenny Auditorium on September 22, 2005. This conference was organized to address regional dynamism and its implications for a post-Cold War order in Northeast Asia. Discussions and debates were focused upon links between economic regionalism and a new security configuration. In consideration of the significance and centrality of the Korean peninsula and North Korea issues, panels held particular discussions on North Korean nuclear and energy issues, South Korea's role in economic regionalism, and implications of the US-ROK relationship for future regional security.

05-03

New Aspects of Globalization and Its Challenge to the World Economy

Heungchong Kim, Sung-Hoon Park, and Peter Gey eds. (Dec. 2005)

ISBN 89-322-3045-5/A5/278pp.

USD 10

This conference volume is an edited collection of the presentation papers for the international conference on “New Phases and Challenges in the era of Globalization: Experiences from Korea and Germany” hosted by Korea Institute for International Economic Policy, Korea-German Economic Association, and Friedrich-Ebert Foundation held in October 14, 2005.

The main title of the conference is deeply related to the recent phenomena of bi-polarization which are widespread in Korea and Germany, and the conference is evaluated to be timely and important.

Nine presentation, divided by three sessions, are composed of three sub-subjects, which are evaluations of the Chinese economy, the impact of globalization on labour market, and the impacts of financial liberalization on the world economy. Presenters highly evaluated recent achievements of the Chinese economy, but held reservation on its future development due to its weakness in financial market, feeble democracy, widening socio-economic disparity, and so on. Globalization made a great influence on labour market in terms of emerging pressure of labour mobility from under-developed countries, and this is not an exception in Korea and Germany. Capital mobility has led to gaining power of international capital, which could be one of factors of bi-polarization.



P

olicy Discussion Materials

05-01

Challenges and Future Prospects for East Asia Summit

Yul Kwon and Sooyeon Hong (Dec, 2005)

ISBN 89-322-2089-1/A5/112pp.

USD 7

The first East Asia Summit (EAS) will take place in December 2005 with high hopes that it will break new ground in East Asian cooperation and community building. Asian leaders originally agreed to hold an EAS in a mid-to long term plan for ASEAN+3 framework. However, as major countries in the region compete for the leadership, a sudden decision was made to launch the EAS earlier than expected and to invite Australia, New Zealand and India to the Summit. These unexpected developments drew much attention to the future scope and timetable of East Asian Community.

Against this backdrop, Korea Institute for International Economic Policy (KIEP) invited prominent speakers to open a seminar on Korea's Perspectives on the First East Asia Summit on November 14th, 2005. Various economic cooperation frameworks in the region including APEC, ASEAN+3 and the distinctive nature of East Asia Summit were discussed in the seminar. Speakers provided their recommendations for the Korean government to make its position and set the policy agenda for the inaugural Summit to be held in Kuala Lumpur in a month.

Speakers presented various ideas on the status and role of regional cooperation frameworks coexisting in the region as follows: Korea needs to exploit all and every regional cooperation frameworks, be they smaller or larger, including APEC, EAS, ASEAN+3, and ASEAN+1. Korea should contribute to build a collective security system in East Asia by promoting

EAS to the level of diplomatic and security cooperation framework

And they agreed that the pivotal actor in dynamic East Asia is actually the Northeast Asian countries rather than ASEAN. Therefore, Korea should keep its footing in Northeast Asia and focus on economic diplomacy between China and Japan. It should exercise persuasion on these neighboring countries by pre-coordinating major issues with them. In this context, Korea may benchmark the role of Belgium in European Community and play its role in East Asian Community as a hub country. Consideration may also be given to a twin-hub approach, where Korea in Northeast Asia and Singapore in Southeast Asia take on the role of hub country.

05-02

Present Status and Prospects for the DDA Negotiations: Preparing for the Hong Kong Ministerial Conference

Moonsung Kang, Jun Gu Kang, Ji Hyun Park, and Jeong Gon Kim

(Dec. 2005)

ISBN 89-322-2093-X/A5/161pp.

USD 7

The DDA (Doha Development Agenda) negotiations, the 9th Multilateral trade round, has focused on nine sectors including agriculture, non-agricultural market access, and services. The DDA, which has been deadlocked since failure in Cancun, recovered its momentum when the July Package was adopted in August 2004. Since then, member countries have intensified negotiations in order to reduce gaps between countries' perspective. Although most attention has been focused on farm trade, non-agricultural market access, and services, the negotiators have been at loggerheads over how to free agricultural trade, and have made little progress on the liberalization of services and industrial goods.

On December 13, the world's trade ministers gathered in Hong Kong to advance the DDA negotiations. Although progress in Hong Kong will not be easy, Korea, heavily dependent upon foreign trade, must closely observe the ministerial conference in Hong Kong and prepare for the future developments of the Doha round. Against this backdrop, the Korea Institute for International Economic Policy (KIEP) has invited prominent presenters from academia, government, and the private sectors to host a seminar on the current status and perspectives of the DDA.

In the 1st session, presenters predicted that meaningful progress in

Hong Kong is not to be expected if no apparent concurrence in agricultural negotiations were made. It was said that if the Hong Kong ministerial conference reached an agreement on modalities, the Doha round would be finished until the end of 2006; if not, the whole negotiation process would be prolonged.

Meanwhile, presenters argued that the agricultural negotiations confront tough challenges because of different positions among member countries, and are not expected to reach perfect forms of modalities. Nevertheless based on the fact that member countries nearly reached agreement on some core issues, and that the results of DDA agricultural negotiations would definitely lead Korea to an open agricultural market much wider than the Uruguay Round, presenters pointed out that Korea has to prepare more practical strategies and more effective individual commitments to minimize the width of the market opening. The present position of Korea in agricultural negotiations is summarized as follows: 1) as a basic principle, the Korean government will try to minimize the effects of the agricultural market opening on the Korean domestic market and strategically cope with changes in negotiations; 2) Korea will insist on the minimization of tariff reductions, the increase of sensitive products, and the ensuring of special products while objecting to a tariff ceiling; 3) after modalities are settled, Korea will focus on defending her status as a developing country in the stage of concession negotiations.

In the 2nd session, presenters agreed that the non-agricultural market access (NAMA) negotiations will be rough, mainly because member countries have not reached a conclusion on the exact level of coefficients for the tariff reduction formula and whether or not link the formula with special treatment for developing countries. The Swiss formula approach is very likely to be adopted, while there were arguments in the seminar that the difference of coefficients applied to developed and developing countries should be reasonably reduced in order to remove the high tariffs of some developing countries. Moreover, some presenters and discussants asserted that special treatment for

developing countries should be linked with the application of different coefficients to developed and developing countries. In addition, most presenters and discussants stressed that the non-tariff barriers issue is so important that it will require the most scrupulous discussions in the near future.

In the 3rd session, presenters affirmed that a considerable level of concurrence on the adoption of a complementary approach in the service negotiations has been reached. There was an argument that Korea should actively participate in friends groups because the pressure on market opening will be intensified, even if the Request/Offer approach is adopted. Meanwhile DDA negotiations on domestic regulations on services and the GATS are still sluggish because there is wide disagreement among members about the basic definitions of terms, methods to establish regulations, and details of regulations. Nevertheless presenters pointed out that these issues could be rapidly brought to a conclusion depending on progress made in other negotiations such as agriculture.



P

olicy References

05-01

Advanced Trading Nation: Korea's New Paradigm of Economic Development

Nakgyoon Choi et al. (Apr. 2005)

ISBN 89-322-2087-5/A5/50pp.

USD 5

Korea now needs a new development strategy, not only fit for its present economic and social conditions but also fit for the challenges of globalization. Korea has to break from the previous trade paradigm, export maximizing and import minimizing trade combined with free riding on worldwide economic liberalization. Concurrently Korea needs to create a new paradigm based on actively taking advantage of globalization as a driving force of economic development.

As a building block to conceptualize a new paradigm, we studied cases of seven countries including Netherlands, Singapore, Ireland, Germany, the UK, Japan, and the US. We focused on inducing each country's developing strategy and pattern according to analyses of their history of economic development and how they have coped with internal and external challenges.

Considering lessons from the country case study and the recent changes in the world economy as well as our special conditions, we induced five essential elements of a new paradigm the so-called 'Advanced Trading Nation.' The five elements are as follows; 1) implementation of global standard, 2) active participation in the global market, 3) effective use of global production resources, 4) upbringing of world-class industries, and 5) construction of social infrastructure friendly to market opening.

A nation that incorporates the five elements of the 'Advanced Trading Nation' has a global-standardized labor, finance, and competition system,

actively promotes both inward and outward FDI, retains strong service and parts/material industries, and intensively invests in future industries such as IT. It also possesses social infrastructure adequate for market opening policy.

Comparing Korea with other countries by each element above, Korea is mostly ahead of developing countries, but still behind most developed countries. Global standardization of economic and social institutions, promotion of global network, and establishment of open social environment are core projects in order for Korea to complete the five essential elements in the near future.

05-02

Product Collaboration of Manufacturing Industries in East Asia: Policy Implications on Korea's FTA Strategy

Jung Sil Kang (July 2005)

ISBN 89-322-2088-3/A5/62pp.

USD 5

In East Asia, efforts to integrate the regional economy were blocked by several factors including political power games, security balancing, unsettled historical grievance, and different developmental stages. However, the painful economic crisis in 1997 brought up the need for deeper economic integration within the region. Recently FTAs are on the rise in East Asia as an alternative for the multilateral trading system.

According to recent studies, Korea is competing with Japan and complementing China and ASEAN in terms of trade relationships. Thus trade creation is expected to be not significant in an FTA with Japan, but much higher trade creation and diversion is expected in the cases of China and ASEAN. These forecasts from trade competitiveness and specialization studies may explain the competition among the member countries with different factor endowments. However, they won't explain the synergy effect of collaboration especially in terms of manufacturing. Trade promotion will encourage member countries to specialize in specific products and in specific processes. Thus, production collaboration of manufacturing industries can be explained in 2 respects, production sharing and product specialization.

First, analytical result of this study shows that Korea is not actively participating in production sharing within East Asia compared to Japan

and China. That is Korea, a considerable parts exporter in the region, is less efficient in its effort to cut down on the manufacturing cost by taking advantage of the cheap assembly line in the neighboring countries.

Second, Korea showed better performance in intra-industry trade. Intra-industry trade was active by order of Kor-Jap>Kor-Chn>Jap-Chn in the Northeast Asia and Kor-ASEAN>Chn-ASEAN>Jap-ASEAN with ASEAN. Active participation in the intra-industry trade means less conflict in FTAs in terms of restructuring.

To sum up, Korea showed less efficiency in production sharing through the trade in parts and components, which might end up with lower manufacturing cost. However, Korea is in the advantageous position to strike FTA deals with neighboring East Asian countries thanks to the comparatively higher level of intra-industry trade.

The analytical result of this study suggests important implications for Korea who is currently in consideration to contract various types of FTAs within East Asia. Korea could take the lead in the regional economic integration of East Asia to the extent that FTAs promote trade in general and encourage collaboration among the member countries. It would also keep Korea on its trade heavy growth track by price-cutting cooperation mechanism within the region.

05-03

Challenges and Future Prospects for East Asia Summit

Yul Kwon and Sooyeon Hong (Dec, 2005)

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USD 7

The first East Asia Summit (EAS) will take place in December 2005 with high hopes that it will break new ground in East Asian cooperation and community building. Asian leaders originally agreed to hold an EAS in a mid- to long term plan for ASEAN+3 framework. However, as major countries in the region compete for the leadership, a sudden decision was made to launch the EAS earlier than expected and to invite Australia, New Zealand and India to the Summit. These unexpected developments drew much attention to the future scope and timetable of East Asian Community.

Against this backdrop, Korea Institute for International Economic Policy (KIEP) invited prominent speakers to open a seminar on Korea's Perspectives on the First East Asia Summit on November 14th, 2005. Various economic cooperation frameworks in the region including APEC, ASEAN+3 and the distinctive nature of East Asia Summit were discussed in the seminar. Speakers provided their recommendations for the Korean government to make its position and set the policy agenda for the inaugural Summit to be held in Kuala Lumpur in a month.

Speakers presented various ideas on the status and role of regional cooperation frameworks coexisting in the region as follows: Korea needs to exploit all and every regional cooperation frameworks, be they smaller or larger, including APEC, EAS, ASEAN+3, and ASEAN+1. Korea should contribute to build a collective security system in East Asia by promoting

EAS to the level of diplomatic and security cooperation framework

And they agreed that the pivotal actor in dynamic East Asia is actually the Northeast Asian countries rather than ASEAN. Therefore, Korea should keep its footing in Northeast Asia and focus on economic diplomacy between China and Japan. It should exercise persuasion on these neighboring countries by pre-coordinating major issues with them. In this context, Korea may benchmark the role of Belgium in European Community and play its role in East Asian Community as a hub country. Consideration may also be given to a twin-hub approach, where Korea in Northeast Asia and Singapore in Southeast Asia take on the role of hub country.

05-04

Policy Responses by Developed Countries to the Global Trend of Bipolarization

Heungchong Kim et al, (Dec. 2005)

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USD 5

This study studies policy implications of the phenomenon of “bipolarization” in contemporary Korea by providing ample case studies of developed foreign countries in terms of bipolarization and policy responses.

The phenomenon of bipolarization is a relatively new phenomenon, even in developed countries. Bipolarization has emerged as one of Korea’s major problems, as its speed is unprecedented and its scope is broad and comprehensive.

In case of the United States, worsening income distribution has been observed, and the problem of poverty is now receiving special attention. The poverty rate has been increasing since the 1990s in spite of huge efforts by the government to curb it. The US government has assisted the poverty class by providing educational assistance. The UK has seen polarized income distribution among the skilled and the unskilled. The UK government has tried to improve the quality of its higher education and lifelong education in order to increase the number of skilled workers in its society, the success of which has been evaluated as substantial. Germany’s export and import industries are also severely polarized. Rather than implementing short-term cures for facilitating domestic demand to correspond to foreign demand, the German government has tried to improve the investment environment and implement institutional reforms. Suffering from regional income gaps, so called the Mezzogiorno

problem, Italy and the EU have created and implemented many development plans for the South, only to achieve limited success. Major parts of employment in Sweden are covered by the big firms, as Sweden has employed the development strategy of supporting big firms, but policy reorientation to the SMEs through indirect assistance strategy including credit assistance is evaluated as having made a great contribution to decreasing the gap in employment between big firms and SMEs.

Implications from our case studies of developed countries are summarized as follows. First, policies of supporting the middle and lower classes and creating human capital among them is vital for middle income countries to advance to the status of advanced economy. Second, poverty policies including public assistance have limited effects on fighting polarization. Third, in order to decrease poverty, assistance to poor regions rather than to poor people is more effective. Fourth, the quality of public education needs to be improved to respond to technological demands for skilled workers. Fifth, lifelong education and re-education should be strengthened to cope with changing demand. Sixth, time, resources, and strong political leaders are essential to reducing regional income gaps. Seventh, economic policies need to be re-examined to check for bias toward big firms. Eighth, more active government roles are required to alleviate the problems that arise from bipolarization. Ninth, the derivation of social agreements in the role of government is essential under the era of a decreasing growth rate. Tenth, there should be a clear-cut division between entrepreneurial activities and public welfare.

05-05

IPRs of ASEAN and Its Members and Implications for the Korea-ASEAN FTA

Booyoung Eom (Dec. 2005)

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USD 2

Korea and ASEAN, aiming to conclude an FTA in 2006, began the first round of negotiations on February 22 to 25 and concluded the seventh round as of October 11 to 14 in 2005. It is agreed that IPR is one of the remaining issues in negotiating economic cooperation between the two entities.

Under worries that any positive effects of an FTA will be negated in the event of inadequate IPR protection, this paper analyzes the IPR policies of ASEAN and its members, and draws implications for a Korea-ASEAN FTA.

ASEAN and its members have different systems and policies regarding IPR protection. At the country level, it varies by membership to international treaties, the implementation of TRIPS, and diverse FTAs and their characteristics. At the ASEAN level, policy is characterized by cooperation-centered provisions, rather than by a single standard or harmonization.

Recently, copyright infringement on Korea's cultural products has become prominent in the Southeast region, primarily due to that region's technological disadvantage in relation to Korea. This problem has the potential to become more serious in the near future with the activation of cultural exchanges, Hanryu Yulpoong, and an increase in Korean exports to the region, following the conclusion of a Korea-ASEAN FTA. Accordingly, we need to utilize this opportunity to include IPR provisions in the agreement itself.

Here, bearing a Korea–ASEAN FTA in mind, this paper suggests the following. To begin with, considering institutional differences among ASEAN members, IPR provisions should not be more stringent than TRIPS. Moreover, because most ASEAN members are technologically disadvantaged, they do not have the incentive to protect Korean IPR. It is therefore important to create and heighten incentives by exploring and facilitating areas of cooperation, rather than by haphazardly implementing regulations. More specifically, Korea and ASEAN member countries should cooperate by selecting industries in which IPR has been seriously infringed and undertake private investigations on them, exchanging information and preparing for countermeasures at need. In addition, mutual cooperation is needed in order to promote the efficiency of lawsuits. Furthermore, cooperation could proceed in the forms of information exchange and experience sharing in technology and markets, in mutual studies and joint ventures, and in the training and exchange of experts. In particular, they should collaborate in bioengineering, utilizing the abundant regional biodiversity, and cultural products, by strengthening mutual film and drama productions.

In conclusion, IPR negotiations of the Korea–ASEAN FTA should be focused on cooperation rather than on the harmonization or unification of standards, and, in the long run, on the control of international distributions of illegal reproductions, the fundamental objective of TRIPS.

05-06

Impacts of Foreign Shocks on Domestic Macroeconomic Fluctuations

Kwon Sik Kim (Dec. 2005)

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USD 2

When evaluating the domestic economy of small-open economy, there are various potentially negative foreign shocks that must be taken into consideration. This research will focus on potentially foreign factors that have been recently raised as hot issues. Keeping in mind the sharp rise in international oil prices and Won/Yen decoupling, we have set the relevant potentially foreign shocks as 1) international oil price shocks, 2) Yen/Dollar exchange rate shocks, and 3) Won/Dollar exchange rate shocks. This paper will identify these shocks using a vector autoregression model and analyzes and compares the ripple effect that they had on the domestic economy both before and after the Asian financial crisis. The results of our analysis show that while the domestic economy before the financial crisis was affected primarily by domestic volatile shocks, after the financial crisis it has been more susceptible to international shocks like positive oil price shocks. After considering the strong influence that international oil price shocks have played in regards to domestic economic fluctuations in the period following the Asian financial crisis, policymakers must redouble their efforts in seeking ways to manage and absorb some of the shocks arising from international oil prices.

05-07

Present Status and Prospects for the DDA Negotiations: Preparing for the Hong Kong Ministerial Conference

Moonsung Kang, Jun Gu Kang, Ji Hyun Park, and Jeong Gon Kim
(Dec. 2005)

ISBN 89-322-2093-X/A5/161pp.
USD 7

The DDA (Doha Development Agenda) negotiations, the 9th Multilateral trade round, has focused on nine sectors including agriculture, non-agricultural market access, and services. The DDA, which has been deadlocked since failure in Cancun, recovered its momentum when the July Package was adopted in August 2004. Since then, member countries have intensified negotiations in order to reduce gaps between countries' perspective. Although most attention has been focused on farm trade, non-agricultural market access, and services, the negotiators have been at loggerheads over how to free agricultural trade, and have made little progress on the liberalization of services and industrial goods.

On December 13, the world's trade ministers gathered in Hong Kong to advance the DDA negotiations. Although progress in Hong Kong will not be easy, Korea, heavily dependent upon foreign trade, must closely observe the ministerial conference in Hong Kong and prepare for the future developments of the Doha round. Against this backdrop, the Korea Institute for International Economic Policy (KIEP) has invited prominent presenters from academia, government, and the private sectors to host a seminar on the current status and perspectives of the DDA.

In the 1st session, presenters predicted that meaningful progress in

Hong Kong is not to be expected if no apparent concurrence in agricultural negotiations were made. It was said that if the Hong Kong ministerial conference reached an agreement on modalities, the Doha round would be finished until the end of 2006; if not, the whole negotiation process would be prolonged.

Meanwhile, presenters argued that the agricultural negotiations confront tough challenges because of different positions among member countries, and are not expected to reach perfect forms of modalities. Nevertheless based on the fact that member countries nearly reached agreement on some core issues, and that the results of DDA agricultural negotiations would definitely lead Korea to an open agricultural market much wider than the Uruguay Round, presenters pointed out that Korea has to prepare more practical strategies and more effective individual commitments to minimize the width of the market opening. The present position of Korea in agricultural negotiations is summarized as follows: 1) as a basic principle, the Korean government will try to minimize the effects of the agricultural market opening on the Korean domestic market and strategically cope with changes in negotiations; 2) Korea will insist on the minimization of tariff reductions, the increase of sensitive products, and the ensuring of special products while objecting to a tariff ceiling; 3) after modalities are settled, Korea will focus on defending her status as a developing country in the stage of concession negotiations.

In the 2nd session, presenters agreed that the non-agricultural market access (NAMA) negotiations will be rough, mainly because member countries have not reached a conclusion on the exact level of coefficients for the tariff reduction formula and whether or not link the formula with special treatment for developing countries. The Swiss formula approach is very likely to be adopted, while there were arguments in the seminar that the difference of coefficients applied to developed and developing countries should be reasonably reduced in order to remove the high tariffs of some developing countries. Moreover, some presenters and discussants asserted that special treatment for developing countries should be linked

with the application of different coefficients to developed and developing countries. In addition, most presenters and discussants stressed that the non-tariff barriers issue is so important that it will require the most scrupulous discussions in the near future.

In the 3rd session, presenters affirmed that a considerable level of concurrence on the adoption of a complementary approach in the service negotiations has been reached. There was an argument that Korea should actively participate in friends groups because the pressure on market opening will be intensified, even if the Request/Offer approach is adopted. Meanwhile DDA negotiations on domestic regulations on services and the GATS are still sluggish because there is wide disagreement among members about the basic definitions of terms, methods to establish regulations, and details of regulations. Nevertheless presenters pointed out that these issues could be rapidly brought to a conclusion depending on progress made in other negotiations such as agriculture.

05-08

The Outlook for 2006 World Economy

Junkyu Lee ed. (Dec. 2005)

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USD 7

The world economy is evaluated to be very flexible when dealing with high-priced oil, natural disasters, and external shocks. A goal for the second and third quarters of 2006 is to have a continuous growth momentum greater than a long term trend line. Also, in the second half of 2006, the negative effects of consumption, investment, and real GDP growth are expected to increase because of the rise in worldwide interest rates.

Major issues that will affect the direction of the U.S. economy in 2006: an increase in inflation pressure due to high-priced oil, a rise in the interest rate, increasing signs of the collapse of the housing bubble, and the continuance of a twin deficit. The U.S. economy is expected to have an economic growth rate of over the average of 3.3% in 2006, thus remaining a growth engine of the global economy.

Major issues for the Chinese economy: an increase of the current account surplus, the continued possibility of a growth rate that depends on exports and imports, and a revaluation of the RMB. Due to basic government policy aimed at maintaining high economic growth, China is estimated to have attained a high growth rate of 9.3% in 2005, and is expected to reach more than 8.0% in 2006.

Important factors that affect the Japanese economy: rising oil prices and insecurity regarding foreign economies such as those of the U.S. and China. However, with a domestic-oriented growth rate, Japan is estimated to have attained 2% financial growth in 2005, and is expected to attain 1 to 2% in 2006.

Major issues for the EU: the effects of high-priced oil, the possibility of an increase in interest rates, the pressure of retrenched finance, uncertainties regarding the reform policies of major economies such as Germany and France, the issue of immigrants, and the difficulties of integration because of the rejection of the EU constitution. The EU economy is estimated to have achieved a 1.4 to 1.5% growth in 2005 which is smaller than in 2004, but is expected to achieve a 1.9 to 2.0% growth rate in 2006.

Due to the increase in interest rates, the value of the U.S. dollar continues to be strong, but may turn weak in the first quarter of 2006, because of the possibility of fixing the federal funds rate. This policy rate increase will negatively influence adjustment in the United States' housing sector, which is likely to lead to lower world economic growth.

Oil prices, with its tight supply-and-demand structure and its lack of refinery equipment, are expected to remain high through 2006. Oil prices will be decided by five variables, and those are the 2006 U.S. economy, China's introduction of a fuel tax, the nuclear issue of Iran, the insecurity of the Iraq situation, the continuation of damage from hurricane Katrina.

Lately, FTAs are also being used for various objectives such as politico-security reasons and the need to secure markets. The number of successfully concluded FTAs is expected to keep rising through 2006.

05-09

An Introduction to Domestic Regulation in GATS

Yeongkwan Song (Dec, 2005)

ISBN 89-322-2095-6/A5/66pp.

USD 5

Domestic regulations have a profound effect on services trade. A major challenge for the GATS is how to design rules that prevent the protectionist use of domestic regulations but do not deprive regulators of the freedom they need to pursue legitimate objectives. Members of the World Trade Organization (WTO) have agreed that a central task in the ongoing set of services negotiations will be to further develop rules to ensure that domestic regulations support rather than impede the opening of services markets to trade and investment. Because these rules are bound to have a significant effect on the evolution of domestic services policy, it is important that they be conducive to economically rational policymaking while preserving the regulatory autonomy required to pursue and achieve domestic policy objectives. This paper provides an introduction to the discussions of domestic regulation in the WTO and aims to develop effective strategies, from the point of view of Korea, for ongoing discussions.

05-10

The Effects of Trade Liberalization on Employment and Wage Inequality in the Korean Manufacturing Sector

Woo-Yung Kim, Soonchan Park and Chang-Soo Lee (Dec. 2005)

ISBN 89-322-2096-4/A5/116pp.

USD 7

Since 1980 when the limitations of the government-led growth strategies started to show, Korea has adopted trade liberalization policies from import substitution ones. In 1980, import liberalization ratio was 69.8% but in 2004 it became 99.9%. The average tariff rate also decreased from 23.7% in 1980 to 7.2% in 2004. Recently, through the FTAs with Chile and Singapore, it is expected that trade liberalization will further expand in Korea.

During the high growth periods with the tight labor markets, people did not care much about the effects of trade liberalization. However, after the Asian financial crisis in 1997 Korea is experiencing higher level of unemployment rate, increased labor market instability, and income polarization, which have raised serious labor market issues. This study examines the effects of trade liberalization on labor market outcomes in Korea and tries to draw some implications on labor and trade policies including FTAs.

This study presents a large literature survey including theoretical and empirical works across many countries. This survey is intended to show how trade liberalization affected labor markets in many countries and learn from them. The main part of this study is to empirically test the effects of trade liberalization on employment and income inequality in

Korea. For this purpose we estimate the various models of labor demand and income inequality using industry level data since 1988.

From estimating the labor demand models, it is found that a decrease in tariff rate or an increase in import ratio does not significantly reduce employment. Without controlling the endogeneity of the wage rate a 1% of tariff rate reduction decreases about 1.7% of employment, but using instruments for the wage rate the effect virtually disappears. A simple analysis shows that the lower is the average tariff rate, the larger is the average employment across industries. In addition, industries with low tariff rates are associated with low labor productivity and low wage rate. It may imply a positive relationship between trade liberalization and industry competitiveness.

Various measures of income inequality are regressed on tariff rate as well as other control variables. A decrease in tariff rate is not found to significantly increase income inequality measured by Gini coefficient although there is some indication that the reduction of tariff increases Gini coefficient in the light industries. On the other hand, a tariff reduction seems to have affected the skill wage differential, though the effects are found small. Using a fixed effects model a 1%p decrease in the tariff rate is estimated to increase 0.6–0.8% of the skill wage differential.

Some policy implications can be drawn from the results obtained in this study. First, trade liberalization including FTAs may not have significant negative effects on employment and income inequality. Second, it may be true that higher tariff rate is imposed on less competitive industries, so some kind of income maintenance instruments may be needed for those industries in order to expand trade liberalization. Finally, there is some evidence found in this study that trade liberalization increases the skill wage differential. FTAs and other liberalization policies are expected to increase the demand for skilled workers and hence decrease the wages of unskilled workers. Therefore, re-education and training of unskilled workers should be reinforced to increase their adaptability and hence reduce the skill wage differential.



D

iscussion Papers

05-01

A Brief Appraisal of India's Economic and Political Relations with China, Japan, ASEAN, the EU and the U.S.

Tae Hwan Yoo and V. Balaji Venkatachalam (Aug. 2005)

ISBN 89-322-4170-8/A5/104pp.

USD 7

The Indian economy because of its has been slowly but steadily reforming by opening up their economy. This reform process is responsible for the sustained an average rate of growth of about 6percent over the past two decades. With a GDP growth of 8.2 percent in 2003-04, India has emerged as one of the fastest growing economies in the world, second only to China. These facts have There has been a fundamental strength in taffected India's foreign relations and helped India attain its current status as an emerging economic, political and military power.

This paper makes an attempt to summarize the economic and political relationship that various countries and regions have had with India in the past. It also discusses how relations will evolve in the future. India has considerably strengthened its relationships with China, Japan, ASEAN, the EU and the U.S. in recent years. Relations with these countries and regions have improved because of extensive dialogue and cooperation on geo-political and multilateral issues, and also as a result of closer economic and trade links with each other. This study attempts to highlight the current and future direction of the India's relationships with China, Japan, ASEAN, the EU and the U.S.



Working Papers

05-01

Natural Resources, Governance, and Economic Growth in Africa

Bokyeong Park and Kang-Kook Lee (Aug. 2005)

ISBN 89-322-4169-4/A5/50pp.

USD 2

Contrary to conventional thoughts, development economists have provided solid evidence that abundance in natural resources has worked as a curse for economic growth. This finding is shortly called 'resource curse hypothesis'. Questions to be addressed in this paper are whether resource curse hypothesis can be proved in Africa and, if so, what its major channel is. The first and most well known channel from resource to growth is 'Dutch disease', which means the over-valuation of exchange rate that is often witnessed in countries heavily dependent on resource export hampers the development of industry.

Our hypothesis is that the governance channel is much more important in Africa than other countries because non-democratic and unstable political environments, which are closely associated with natural resources in African countries, were important factors that hindered economic growth. We find the empirical evidence for this argument using GMM considering endogeneity of governance. In Africa, natural resources are significant to governance, and the independent effect of resources on growth are dominated by indirect effect through governance, while in non-Africa we do not find this feature. In other words, African countries with richer resource endowments tended to have worse governance and, therefore, lower growth rates. Interestingly, 'Dutch disease' effect seems to be much more important channel for resources to exert a negative impact on growth in non-African countries.

Our finding shed light on the important role of resources in worsening governance, and thereby worsening economic growth in Africa. African countries should make more efforts to address bad governance structure that is usually associated with natural resources.

05-02

Financial Market Integration in East Asia: Regional or Global?

Jongkyou-Jeon, Yonghyup Oh, and Doo Yong Yang (Oct. 2005)

ISBN 89-322-4171-6/A5/54pp.

USD 5

This paper investigates how well the financial markets in East Asia are integrated with each other and compare the degree of this regional integration with the degree of integration between East Asian markets and the US market. We use three approaches: volume-based approach, asset price-based approach, and international risk sharing approach. Our results indicate that the degree of financial integration in East Asia has been recently increased, but our overall results suggest that it is due to the integration with a global market rather than regional integration. Regional features seem to be weak and there is no pulling, or anchor, market in the region that would match the advanced market such as the US. Though global integration is not a force that competes with regional integration, there seems no strong sign that lessons from the crisis in 1997-1998 have been transformed into a creation of an effective market mechanism in East Asia. The lack of success in policy coordination among East Asian countries seems a fact despite efforts made.

05-03

Have Efficiency and Integration Progressed in Real Capital Markets of Europe and North America During 1988–1999?

Yonghyup Oh (Oct. 2005)

ISBN 89-322-4172-4/A5/40pp.

USD 2

This paper examines the progress of efficiency and integration in real capital markets of 10 European countries and the US–Canadian market in the pre-EMU period from 1988:1993 to 1994:1999. Using a CAPM framework and the Chow test with extensive firm level return data, we find for both markets that market efficiency shows signs of improvement, but the degree of integration became weaker in the late 1990s. The latter effect is more pronounced in European capital markets. As EMU launched in 1999, these results are somewhat surprising, and they may suggest that integration in real capital markets evaluated at a micro-level could show quite different features from those obtained at a macro-level. These results also have implications to East Asian markets. The current move toward a more integrated capital market zone in East Asia requires policy makers as well as market participants to review whether more emphasis should be placed on market driven initiatives which are different from the European case.

05-04

A Roadmap for the Asian Exchange Rate Mechanism

Gongpil Choi and Deok Ryong Yoon (Dec. 2005)

ISBN 89-322-4173-2/A5/46pp.

USD 2

Given the increasing importance of capital market development for financial stability and multilateral cooperation for sustained growth, a country's choice of exchange rate regime is hardly trivial. Instead of relying on a series of individually managed floats, it would be better for each country to target its currency against a basket of other currencies. A still much better alternative would be to form a regional block, which would tie Asian currencies together and create a regional currency while allowing them to float against major currencies. Whether the type is an individual peg to a tailored basket or a multilateral peg to a common basket remains to be determined. Under any plausible scenario, some type of regional currency needs to be developed to promote an environment suitable for financial and monetary cooperation that is, in turn, conducive to capital market development. Since conditions in the region are increasingly favorable for an OCA (Optimal Currency Area), such cooperation would be mutually beneficial as well as globally desirable.

The imperatives for regional cooperation to achieve sovereign stability in an interconnected setting are now strong due to (1) markets that are too small and narrow to withstand various shocks, (2) inability of institutions and policies to satisfy certain requirements given different economic backgrounds, and (3) lack of coordination to bring together necessary elements to achieve regional stability. The goals for regional

cooperation arise from the desire to promote (1) intra-regional trade, (2) financial stability, and (3) the long-term capital market. The trade aspect is usually emphasized in the literature, but the financial side is often overlooked. Balance sheet effects are dominant features of the emerging market business cycle: debt servicing capability is directly related with exchange rate changes. Also, the original sin needs to be examined more carefully since the lack of risk sharing capability in the region contributes to the current global imbalance. How do we cope with all these problems? The answer is to consolidate regional efforts that are expected to promote the long-term capital market, enhance financial stability, and promote intra-regional trade.

This paper asserts that the objective can be fulfilled by seeking a coordinated move toward the AERM, a multilateral effort to stabilize exchange rates over the medium term and fulfill the above mentioned requirements in an increasingly globalized environment. The first step is to create a regional currency, the ACU (Asian Currency Unit), a basket of intra-regional currencies. This is essentially the same approach taken by Europe. Even though (1) the ACU is essential to promote the long-term capital market and contributes to intra-regional trade and (2) common pegging to the ACU is required to preserve intra-regional trade, there is no guarantee that it would be less susceptible to changes in G-3 fluctuations, suggesting the need for further monitoring by the governing institution. A basket numeraire or common basket is the more realistic option of stepping forward from the current individual peg to a tailored basket of currencies based on trade weights. However, these observations ignore the fundamental sources of exchange rate instability: the original sin or mismatch of institutions and policies of sovereignty with the economic boundaries. Therefore, a move toward an intermediate regime and a common basket are more suitable for Asian countries.

To put these together, first, it is important that we pool our efforts to create the ACU and use it as a parallel currency. This would help diversify risks regionally and globally, which would facilitate the global

adjustment. Second, the ACU can be created by using excess foreign reserves as a special fund that can issue convertible ACUs. Third, the organizing body would monitor and help stabilize the value of the ACU over the intermediate run.

05-05

Exchange Rates, Shocks and Inter-Dependency in East Asia: Lessons from a Multinational Model

Sophie Saglio, Yonghyup Oh, and Jacques Mazier (Dec. 2005)

ISBN 89-322-4174-0/A5/90pp.

USD 5

This paper presents a simple macroeconomic model of international interdependency describing Korea, Japan, China, and the rest of East Asia in their relations with the United States and the rest of the world. The model includes both a foreign trade block and an internal demand block analysing demand formation and the price-wage-employment adjustment process. Exchange rates are fixed, but can be manipulated exogenously. The main features of the East Asian trade structures are integrated into the model, and foreign trade price elasticities are higher for Korea and China and smaller for Japan.

The model also analyses East Asian interdependency using symmetric and asymmetric shocks. We found that China would be the most affected by a slowdown in the US economy and Japan the least, that a global slowdown would influence Korea the most and Japan the least, and that a devaluation of the dollar would have a stronger negative impact on Korea and China and less so on Japan. On the whole, Japan appears to be less influenced by external shocks.

Facing an asymmetric negative demand shock, China, and to a lesser extent, Korea, would be more reactive than Japan due to larger trade openness and higher foreign trade price elasticity. Japan would experience a longer period of lower growth and deflation, which could be connected

to the stagnation of the Japanese economy that began in the 1990s.

These findings may be able to provide valuable lessons regarding the future of an exchange rate regime in East Asia. A revaluation of the yuan would induce a deflationist trend in China and would clearly have a negative impact on growth. This pleads in favour of a progressive revaluation policy. A revaluation of the won would also take its toll on Korean growth with little impact on the other Asian countries. The Japanese economy would be less affected by a revaluation of the yen, but the effects of the resulting recession would be more enduring. This impact of the yen revaluation can also be related to the aforementioned Japanese stagnation.

In terms of the creation of an area of stabilised exchange rates between won, yen and other currencies, a set of simulations comparing adjustment mechanisms between East Asian countries, with or without the possibility of monetary adjustment, plainly shows the cost of renunciation to exchange rate adjustment. This pleads for a sufficiently flexible regime that stabilises exchange rates, but permits limited monetary adjustments in cases of necessity.

05-06

Exchange Rate System in India: Recent Reforms, Central Bank Policies and Fundamental Determinants of the Rupee–Dollar Rates

Vivekanand Jayakumar, Tae Hwon Yoo, and Yoon Jung Choi (Dec, 2005)

ISBN 89–322–4175–9/A5/102pp.

USD 5

We provide an in–depth analysis of the exchange rate reform program undertaken by India in recent years. The actions of India’s central bank, the Reserve Bank of India (RBI), during this key reform period are evaluated in this study as well. In addition, this paper, using a sector price differential model, analyzes the fundamental determinants of the Indian rupee–U.S. dollar exchange rates. Lately, Indian policymakers and Reserve Bank officials appear to have taken steps designed to increase the overall credibility of the exchange rate regime. Our analysis suggests that the reform policies have generally been quite effective. We also feel that the RBI should adopt further liberalization program, being mindful, however, of the potential for severe exchange rate volatility and monetary instability in the face of increasing capital mobility and international integration.



O_{ECD} Study Series

05-01

Korea's Currency Crisis and Regulations on Merchant Banking Corporations

Doo-Yull Choi (Dec. 2005)

ISBN 89-322-8026-6/A5/94pp.

USD 5

This study investigates the financial regulatory and supervisory system of Korea's Merchant Banking Corporations before the 1997 currency crisis, which is regarded to have played a pivotal role in the deterioration of the country's financial system.

The results of this study show that even with the diversified supervision system, the consolidation function of financial supervision among supervisory bodies of Korea's Merchant Banking Corporations had proven to have been extremely weak, leaving many gray areas of supervision. This study also shows that prudential regulations and financial supervision were out-of-date and lacked rigor in many aspects such as entry requirements, capital adequacy, credit concentration and connected lending, liquidities on foreign currency assets and liabilities, investments in off shore foreign currency securities, and risk managements, etc.

Behind such lack of consolidation amongst the supervisory bodies and outdated loose regulations lay an anachronistic cognitive paradigm, which regarded each financial business area as separate and financial institutions' foreign exchange business and domestic currency business as totally independent of each other, even in the age of capital market and capital flow liberalization.

It argues that the unconsolidated supervision and outdated prudential regulations coupled with loose supervision appear to have been a major

factor that led to the deterioration of the management of Korea's Merchant Banking Corporations, thereby causing vulnerability in Korea's overall financial system especially prior to the outbreak of the currency crisis.



APEC Study Series



05-01

APEC After Busan: New Direction

Andrew Elek (Nov. 2005)

ISBN 89-322-0044-0/A5/114pp.

USD 7

The 2005 review of progress towards free and open trade and investment offers APEC leaders the opportunity to give the process new purpose and direction.

The mid-term stocktake of the Bogor goals demonstrates that, since 1994, APEC economies have moved significantly closer to the vision of free and open trade and investment. Average tariffs are considerably lower, often at or close to zero. There are now only a few quantitative restrictions on trade. People and capital are moving more freely around the region. More efficient customs procedures, progress towards paperless trading, mutual recognition of standards and other practical arrangements to facilitate trade and investment are already saving billions of dollars per year.

During the past decade, the APEC region has led the world in terms of opening itself to international trade and investment. It has increased its share of global output and trade. APEC leaders can take pride in what has been achieved, but many important challenges remain.

The East Asia summit process is about to commence at a time when, as in the 1980s, there are severe trade tensions across the Pacific. A viable process of trans-Pacific cooperation, engaging the United States more deeply in APEC, is essential to resolving these tensions. The World Trade Organization (WTO), which APEC was set up to defend and strengthen, is threatened by the proliferation of preferential trading arrangements. APEC leadership is required to buttress the multilateral trading system upon which members' prosperity depends.

Despite the extensive liberalisation that has been undertaken by Asia Pacific economies, border protection of sensitive products remains high and the objective of eliminating border barriers to trade by 2010 may be out of reach for some developed economies. Even if all tariffs were to be cut to zero, that would not mean free trade. There is extensive resort to contingent protection, such as anti-dumping and countervailing subsidies. These measures are now a more serious obstacle to free trade than most of the remaining border barriers. They are a symptom of underlying problems caused by different approaches to competition policy, tax relief and subsidies for selected producers.

Resolving these problems requires more attention to a wide range of behind-the-border issues. This points to an important shift in the focus of APEC's economic reform agenda. To approach free and open trade and investment APEC governments will need to tackle many of the issues addressed by the European Union's Single Market Agenda, but they will need to do so in an innovative and more flexible way.

The Bogor goals have provided APEC with a strong sense of direction. At the same time, the challenge of sustaining that drive has become more complex than envisaged in 1994. Progress is no longer a straightforward, albeit politically difficult, matter of overcoming protectionist sentiments.

The scope and composition of international economic transactions has changed dramatically. This is reflected in significant changes in the nature of impediments to international movements of goods, services, finance, people and information. The very concept of completely free and open international commerce is under challenge from terrorists, from potential pandemics and, in a very different way, from advances in technology. New technology can serve to reduce transaction costs, but new technology also keeps raising new issues to be dealt with.

Against this background, the Bogor goals need to be revamped. The concept of free and open trade and investment is an ideal. Like a perfect market, it can be approached but never quite reached. Whenever one

kind of barrier is lowered, new ones will challenge APEC economies.

The Bogor vision of free and open trade and investment remains the appropriate reference point for APEC. But in 2005, it is no longer enough to reaffirm a general commitment to achieve free and open trade and investment as soon as possible. Sustaining and accelerating progress requires more than a restatement of good intentions. The time has come to set new directions and ambitious, but realistic, timetables to reach well-defined milestones for progress.

The Busan Roadmap seeks to meet this challenge. It is based on an objective assessment of the experience to date. It accepts the reality that a voluntary process is the only viable option for cooperation in the diverse Asia Pacific region. And it aims to promote free and open trade and investment in ways which are consistent with the powerful advantages, as well as the limits, of voluntary cooperation.

APEC is not a negotiating forum. APEC governments will not reach the Bogor goals just to make each other happy. APEC's task is to reinforce the commitment of individual members to implement policies needed to create more open and efficient economies. To sustain this commitment, Asia Pacific governments need to perceive such reforms to be in their own interests; consultations and capacity-building within the APEC process are vital in helping them to do so.

Some APEC economies are considerably closer to various dimensions of free and open trade and investment than others. This suggests it is time to move away from uniform targets for large, diverse groups of economies. Balance between ambitious and realistic milestones to measure progress is more likely to be achieved if timetables are set economy by economy, and in a way which respects diversity. Timetables should be consistent with the different priorities of economies and their capacity for progress. The capacity of each economy to make headway will depend on the extent to which others cooperate to enhance their capacity. APEC economies can support each other's efforts by sharing information, experience, expertise and technology and helping to mobilise

resources for capacity-building.

If future APEC hosts remain committed to the Busan Roadmap and its targets are selected carefully, then Asia Pacific economies should be able to continue to be able to record success after success in the coming years. That will reinforce the APEC process as a means of promoting prosperity, mutual understanding and a sense of community in the region.

The emphasis of the Busan Roadmap is on addressing behind-the-border issues to help create open and efficient markets, domestic as well as international. Open and efficient markets are necessary for promoting mutually beneficial economic integration. The centrepiece of the roadmap is the Busan Business Agenda for facilitating trade and investment. This comprehensive business facilitation program builds on APEC's Shanghai Accord of 2001 and the subsequent successful implementation of APEC's Trade Facilitation Action Plan.

The Business Agenda responds to the more complex and integrated business environment of the 21st century. The agenda also answers calls by the APEC Business Advisory Council for APEC governments to take concerted action to deal with behind-the-border issues: these include customs procedures, standards and conformance, business mobility, e-commerce, secure trade logistics, transparency and anti-corruption, intellectual property rights, sound financial systems and competition policy.

APEC is already making progress on these matters, since governments are aware that cooperative efforts can lead to all round benefits by reducing the costs and risks of international commerce. Facilitating trade and investment depends on the capacity to design and implement appropriate cooperative arrangements. Accordingly, the roadmap calls for a strategic new approach to capacity-building that is linked directly with the Busan Business Agenda.

A greater focus on non-border impediments to economic integration does not mean abandoning trade liberalisation. Getting rid of the entrenched protection of sensitive products will need successful WTO

negotiations. But there is scope for further concerted unilateral decision-making among APEC governments to reduce less sensitive border barriers, to support WTO negotiations and to address obstacles to trade which are not yet on the WTO agenda.

APEC governments should be able to identify and act on shared interests to liberalise trade and investment in services, including international transport, capital flows and business-related travel. In some cases, liberalisation may need further rounds of WTO negotiations. It should also be possible to build on APEC's successful initiative to ensure WTO-wide free trade in information technology products, with a view to preventing the emergence of more sensitive products in the future.

The second half of the paper identifies some priorities for the next two years. Foremost among these is continued commitment to the Busan Roadmap.

The 2005 meetings offer the opportunity to make a crucial and timely input to the Hong Kong meeting of WTO ministers to advance the Doha Development Agenda as well as to set the stage for synergy between APEC and the East Asia summit process. The meetings also provide an opportunity to move decisively away from preoccupation with entrenched vested interests in sunset industries of the past century and seizing the many opportunities to deal with behind-the-border issues which now pose the most significant costs and risks for the bulk of international commerce.

By the time APEC leaders meet in Viet Nam in 2006, it should be possible to set economy-specific, ambitious and realistic targets for various aspects of the Busan Roadmap. The year 2006 is also a vital opportunity to create an effective strategy for mobilising the resources needed to back the implementation of the roadmap. It is already agreed that APEC should not become a development agency. But APEC leaders should be able to catalyse investments to facilitate trade and investment from international financial institutions and the private sector, provided APEC leaders can set clear priorities for capacity-building. The year of

Viet Nam provides the opportunity to cement effective partnerships with multilateral development agencies and the private sector.

There will be a lot left to do in 2007. That year might usefully be seen as an opportunity to sustain the momentum in the direction set in 2005, partly by implementing reform of APEC structures.

Looking further ahead, progress towards free and open trade and investment will continue to depend on finding opportunities to reduce costs and risks of international commerce; opportunities which are perceived to be mutually beneficial to the economies involved.

There are many opportunities for mutually beneficial co-operative action. The paper describes a range of options to move closer to a vision of a much more open Asia Pacific region, where business can operate more confidently in a gradually more consistent operating environment characterised by:

- no, or negligible, border barriers;
- transparency, best practice, and consistency of regulations;
- national treatment of investment;
- well-managed financial systems;
- mutual recognition of standards;
- paperless commerce;
- free movement of business people and capital;
- best practice logistics and
- affordable access to the internet for all APEC communities.

Most of these ideals have been advocated by the APEC Business Advisory Council for some years; APEC can develop consultative and cooperative approaches to move closer to them, similar to the approach taken in other fields, such as the threat of pandemics, natural disasters, and terrorism.

APEC as such does not make decisions. Its role is to encourage APEC governments to make the decisions needed to move in these directions. This will require flexibility, together with respect for diversity.

Some APEC economies will reach milestones along the Busan Roadmap at different times, but they can set examples for, and share their experience with, each other. Although different policies are needed for diverse economies, most reforms to promote free and open trade and investment represent movement towards broad principles of transparency, predictability, accountability and non-discrimination. These form the basis of the APEC Principles to Enhance Competition and Regulatory Reform. Those principles can serve as a useful reference point for the design of policies and institutions by individual economies, with the support of other APEC member economies, to promote open, efficient and integrated markets in the region.

05-02

A Renewed Vision for APEC: Meeting New Challenges and Grasping New Opportunities

John McKay (Nov. 2005)

ISBN 89-322-0045-9/A5/75pp.

USD 7

APEC can be proud of some solid achievements since it was founded in 1989, but now is a very useful time to evaluate the precise nature of its contributions and to attempt to define a new vision for the organisation. There is now only five years until 2010, by which time the developed economies have agreed to meet their Bogor goals. There is a further 10 years until the developing economies are supposed to have reached a similar goal, but in many cases there is still a great deal to do before reaching that standard. So, there is some urgency about the matter, and this is reflected in the creation of the mid-term review process within APEC. My task here is related, but rather different. Many things have changed in the Asia Pacific region in the last decade and a half, and this is an appropriate time to ask whether the structures and processes that have been established within APEC are still the most appropriate for the complex tasks at hand. More importantly perhaps, I want to ask whether the goals and the focus established by APEC for its activities are now appropriate for the new regional and global context. This is not an easy task, and it requires much detailed analysis and creative thought, and the aim here is to make an initial contribution to this vital task.

In the report, I evaluate what APEC has achieved since its foundation, looking at the mainstream trade and investment agenda as well as some broader contributions to the welfare and development of the region. But I

then go on to argue that the challenges facing the region have been transformed significantly in recent years, and this has enormous implications for the role of APEC in the future. After considering a number of possible scenarios for APEC's future I conclude that:

- APEC grew out of some specific conditions as they existed in the late 1980s, and to a large extent this very time-specific agenda continues to dominate APEC's thinking. We should expect then that as the regional and global environments have been transformed since then APEC should seek to adapt or even transform its focus to meet these new challenges. In fact this has not happened nearly enough, and now is an appropriate time to consider a radically different or expanded agenda.

- APEC has, however, made some significant contributions to the welfare and development of the region. The main trade and investment core of APEC's activities have been useful, but there have been other important initiatives. The institution of annual Leaders' meetings has been particularly noteworthy, and this feature makes APEC unique, although now is perhaps the time to make more effective use of these unique summits.

- Many features of the Asia Pacific region have changed dramatically since 1989. Many of the old problems still remain and some important new ones have emerged. These issues present a formidable challenge to APEC, and mean that its success is now more important than ever.

- The other regional organisations, notably ASEAN and the ARF, are facing severe problems of their own, and this puts even more pressure on APEC to succeed and perhaps move into new areas. The emergence of ASEAN Plus Three is an important feature of the region, presenting particular dilemmas for APEC, but also offering some opportunities.

- The Bogor goals still have some relevance in their own right and as a contribution to the broader multilateral trade liberalisation effort, and should be retained as an element of the APEC agenda. However, in my view they may need to be updated and re-defined, and a range of other activities need to be added to the APEC work programme.

● A redefinition of APEC to create a kind of Asia Pacific OECD has some very attractive features. The region has a real need for the upgraded research, monitoring, information and policy capacities that would be created. There are some real problems with this proposal, however, notably the limitations on the human resource capacity and funding available to APEC at present.

● There is a real need for a substantial effort to build a more effective bridge across the Pacific. While US involvement in the region is strong, the relationship is in constant need of updating and renewal. Relations between Asia and the rest of the Americas are also important. APEC is the only organisation that could fulfil such a role. There are significant political barriers to such a move, however.

● APEC has already highlighted the new human security agenda as one of its important sets of activities. The fight against terrorism is a key element here. This area of its activities needs to be expanded, but once again there are significant resource constraints that need to be addressed.

● The extent to which APEC should attempt to grapple with the more traditional security issues facing the region is one of the most contentious issues facing the organisation. In some senses, APEC is already a de facto security forum, most importantly through the annual Leaders' meeting. After considering the arguments for and against the expansion of such a role I argue that it would probably be desirable, partly because of the dearth of contributions in this area from other organisations, notably the ARF which seems to be in a state of steady and serious decline. However, the political problems of acknowledging this area as an explicit APEC activity seem to be just too strong at present, and it may be better to let APEC continue to contribute here without making too much noise in public.

● The idea of trying to create a more comprehensive Asia Pacific community with APEC at its core is, I believe, the most attractive option currently available. Such a community would combine the best features of

an OECD-like role, would continue to support the Bogor goals, would try to unite the two sides of the Pacific, and would play a central role in facing the security problems of all kinds in the region. The resources needed for such a programme would be well in excess of those currently available to APEC, and this question would have to be addressed at an early stage. A first step in this community building effort might be to set up an Asia Pacific version of the East Asia Vision Group to consider how such a vision could be defined in more detail and how it might be implemented.

- APEC needs to consider the difficult question of whether the membership of the organisation should be expanded to include a number of economies already keen to join. To a large degree, I argue, the answer to this question depends on just what kind of future vision is accepted for APEC's future.



CNAEC Research Series

05-01

Korea and the Dual Chinese Challenge

Françoise NICOLAS (Apr. 2005)

ISBN 89-322-5059-6/A5/66pp.

USD 5

The economic rise of China and its integration into the globalization process is undoubtedly one of the most important developments of the past decades. The resulting change in the global balance of economic activities has far-reaching implications for the world as a whole and for neighboring emerging economies in particular, with Korea as a case in point. The objective of the paper is to examine the exact nature of the Chinese challenge for Korea, and assess what may be the most appropriate response to mitigate the risks and maximize the potential benefits associated with it.

The paper starts by providing a comprehensive description of the major changes implied by the rise of China and argues that they give rise to a dual challenge for Korea. First, the paper assesses China's new role in the regional supply chain and the resulting change in the competitive game being played in the region. Based on an analysis of the trade and FDI flows in the region over the past decade, it highlights the differentiated impact on Newly Industrialized Economies, such as South Korea, and on less advanced economies such as Malaysia, Indonesia or Thailand. The paper goes on arguing that the recent changes in China's stance toward its neighbors and its apparent resolve to become a regional leader further compound the challenge raised by the new conditions prevailing on the Asian competitive scene.

The next section takes a prospective stance and examines the steps that Korea can (and should) take to face the dual challenge posed by the rise of China. It examines first the measures that can be put in place

at firms' as well as at the Government level in order to enhance Korea's competitiveness, stressing in particular the need for further structural reforms. The establishment of the Japan–Korea FTA, now in the final stage of negotiations, is shown to be a potentially powerful instrument to that end. The paper also suggests that this FTA has to be associated with other arrangements with China and ASEAN, if Korea wants to keep some leverage over the future of the East Asian integration process.

05-02

Did Efficiency Improve? Megamergers in the Japanese Banking Sector

Kimie Harada (June 2005)

ISBN 89-322-5060-X/A5/66pp.

USD 5

This paper examines the technical efficiency implications of Japanese city banks to evaluate their pre-and post-consolidation efficiency. Using a sample from the period of 1999 to 2003, we consider questions such as whether efficiency improved after consolidation and whether consolidation of two weak banks created a strong bank.

The study has some significant findings. First, average technical efficiency scores worsened in the late 1990s compared with the estimates of earlier literature. Second, larger banks exhibited higher scores, especially in the late 1990s. The findings supported our hypotheses that consolidation of healthy and unhealthy banks would not create healthy banks and that consolidations between weak banks would not strengthen them. Finally, it is also suggested that banks acted with short-term horizons when they included adjustable sub-items like other business income in their income.

05-03

Measuring the Efficiency of Banks: Successful Mergers in the Korean Banking Sector

Kimie Harada (June 2005)

ISBN 89-322-5061-8/A5/64pp.

USD 5

This paper investigates how the Korean banking sector has published reform, with a focus on mergers and acquisitions of banks. It examines the technical efficiency implications of Korean banks to evaluate their pre- and post-consolidation efficiency. Using a sample from the period 1996 to 2003, we consider two hypotheses: whether banks with high foreign ownership perform better than domestic banks, and whether bigger banks or banks under a holding company improve their efficiencies and become more competitive.

The study has some significant findings. Average bank scale efficiency deteriorated until 1998, then gradually improved to 2003. Banks with high foreign ownership performed better than other banks. Bank holding companies' efficiency level fell temporarily after compulsory or voluntary mergers, but they still enjoyed high efficiency scores even after becoming larger.

05-04

Industrial Structural Interdependency in Northeast Asia: An International Input–Output Analytical Approach

Sumio Kuribayashi (Dec. 2005)

ISBN 89–322–5062–6/A5/38pp.

USD 2

When one attempts to put the enhanced economic cooperation among the Northeast Asian countries (NEA) into perspective, it is necessary to understand industrial linkages among the countries concerned. For this purpose, this paper intends to compile a simple NEA (North Korea, South Korea, China, Japan and Mongolia) regional I–O table for 2002. On this basis, this paper attempts to work out basic simulations in order to clarify the structure of dependency of North Korea on the economies in Northeast Asia.

05-05

The Illusive Quest for an Asian Common Currency: Economic Mirage or Realpolitik?

James H. Chan-Lee (Dec. 2005)

ISBN 89-322-5063-4/A5/50pp.

USD 5

The Asian Financial crisis underscored the folly of running fixed exchange rates, with an independent monetary policy, open capital accounts and volatile capital flows. Interest in an Asian Common Currency is growing, but the needed political commitment, institutions and market-based financial systems are absent. This paper benchmarks the quality of institutions and financial systems to assess the enigmatic roles of the Renminbi and Yen. A prioritized policy-matrix focused on building institutions and robust banking systems are outlined. Accelerated trade liberalization, economic co-operation and political integration are crucial before a joint float or a common currency can be envisaged realistically.

05-06

The Development of Three Chinese Northeast Provinces and New Conceive of Sino-Korea Economic Cooperation(in korean)

Reu Ming (Dec. 2005)

ISBN 89-322-5064-2/A5/32pp.

USD 2

The fourth generation of Chinese leadership — since coming to the power in March 2003—has clearly stated that they have been interested in the transform-adjustment and development of the three Chinese northeastern provinces — trying to become them into the fourth growing point of economic increasing. On hearing this news, not only the people of Chinese northeastern provinces feel delighted, but also the South Korean people, who are neighbour of Chinese northeastern provinces, think it is a good opportunity and challenge. Firstly, this paper makes a statement on the economic history, on the reason of declining and on the stratagem background of development of the three Chinese northeastern provinces. Secondly, the paper also sets forth the developing plans for the three Chinese northeastern provinces of the center government. Thirdly, the author has brought out her own point of view concerning the problems of developing the three Chinese northeastern provinces. At last, the author bring us the question how to grasp the developing chance under the case of win-win for the three Chinese northeastern provinces and South Korea. At the meanwhile, the author gives her attitude on the forms and models of Sino-Korean economic cooperation in the development of the three Chinese northeastern provinces.

05-07

An East Asian Single Market?

Lessons from the European Union

Simon Hix and Hae-Won Jun (Dec, 2005)

ISBN 89-322-5065-0/A5/56pp.

USD 5

Regional economic integration has been one of the most significant developments in the global political economy in the last twenty years. However, East Asia is an exception where institutionalized economic integration has progressed slowly. What we do in this paper is to consider the possibility of economic integration in East Asia from the perspective of the single market in Europe. The European experience demonstrates that creating a single market is primarily an exercise in market regulation, and that creating a single market requires a convergence of socio-economic preferences and sufficiently independent courts and the rule of law. However, these starting conditions are necessary but not sufficient. What is also required is the delegation of significant agenda-setting and enforcement powers to independent regulatory agents. If designed carefully, a single market in East Asia would lead to further trade integration between the members, industrial consolidation in certain sectors, and higher growth rates and more jobs. An East Asian single market organization might also produce significant political benefits, such as an arena for promoting political integration and resolving disputes, and the spread of democratic government and free markets in the region.

05-08

The Impact of FDI from South Korea to China on Bilateral Trade

Liu Xiangfeng (2005, 12)

ISBN 89-322-5066/A5/46pp.

USD 2

The purpose of this paper is to identify the major effects of South Korean FDI to China on their bilateral trade. The paper investigates the influence of South Korean companies investing in China for processing trade. South Korean FDI has positive effects on bilateral trade, especially on exports to China. Meanwhile, processing trade plays a significant role in bilateral trade, and has been chiefly responsible for China's trade deficit with South Korea. It is notable that Korean FDI in China is closely associated with export-oriented processing and assembly industries with labor-intensive characteristics. Now confronted with overall economic internationalization, making better use of foreign capital and optimizing the export structure is an urgent task for China. China should work to develop goods that have a competitive advantage, support top export enterprises and increase the export volume of machinery, electronics and high-tech goods. The Chinese government should enthusiastically encourage Korean companies to invest in and build a foundation for the export of high-tech goods to achieve this.



R

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05-01

The Current Status of Turkish Economy and the Economic Cooperation between Korea and Turkey

Cheol-Won Lee (Apr. 2005)

ISBN 89-322-6078-8/A5/64pp.

USD 5

The Economic situation in Turkey is gradually reviving thanks to multiple factors such as high-speed growth rate, decrease of interest rate led by currency depreciation, and the slowing down of the inflation rate. However much of the economic reform agenda is still pending including the huge burden of public debt. Red tapes in the bureaucratic system, high commission rate and side costs are regarded as impediments to potential economic growth. In addition, the still growing inflation rate, currency exchange risk, and high interest rate which all result in financial burden, heavy corporation tax, and burdensome electricity cost are hindering Korean firms from entering the Turkish market.

Korean companies need to pay more attention to the enhancement of the import process for textile products accompanied by strengthened customs inspection. Since Turkey is a member of the customs union with the EU, any form of economic cooperation with non-member country should be assessed preliminarily by the EU. Those factors are definitely slowing down the process of economic cooperation and discouraging trade promotion between Korea and Turkey. However, even after considering those negative economic preconditions, the volume of Korea-Turkey economic trade is far from the expectations based on a 50-year friendship since the Korean War.

Synergy based on mutual complementarity between Korean companies' R&D know-how backed with capital and Turkey's ample labor force especially in high-skilled engineering area is expected to strengthen technology competitiveness and enlarge world market share for both countries. Thus, comprehensive cooperation differing in scope and context, such as strategic partnership and intergovernmental cooperative system should be fostered further.

It is imperative to bolster mutual economic partnership as far as possible, since the Turkish market provides an opportunity for trade deflection in the EU market and serves as a bridgehead to the Middle East market. On the other hand, Turkey could improve its national competitiveness through import of capital and advanced technology from Korea.

In conclusion, from a short-term perspective, technology venture on the corporation level is strongly recommended. In the middle and long-term perspective, support for the establishment of common production system for targeting trade deflection and Middle East market is required. Lastly, automobile, electronics, telecommunication, metallurgy, textile, chemical industry, construction, energy, defense industry, transportation, and agricultural products are the most prospective area of cooperation between the two nations.

05-02

The Current Status of Uzbekistan Economy and the Economic Cooperation between Korea and Uzbekistan

Jae-Young Lee, Hyeon-Joon Shin, and Sun-Young Kim (May 2005)

ISBN 89-322-6079-6/A5/84pp.

USD 5

The strategic importance of Central Asia has grown significantly since the collapse of the Soviet Union and the end of the Cold War. Central Asia is no longer a peripheral part of the international arena, but instead occupies a strategic core of the geopolitical system. Uzbekistan, situated in the very heart of Central Asia, not only serves as an important military or political partner but also as a potential export market and energy supplier. Therefore we should review the possibility of future cooperation with Uzbekistan.

Politically, under President Karimov's authoritarian regime democracy has not flourished, and censorship flourishes in many aspects of Uzbekistan society. However the president Karimov's firm rule means that civil revolutions in other former Soviet countries will not spread to Uzbekistan.

Different from other CIS countries, Uzbekistan's economic policy has been focusing on gradual transformation toward a market economy by means of centralized government policy. However, due to lagging economic reform and excessive government intervention, Uzbekistan does not have a stellar economic record. It is expected that Uzbekistan will implement more active principles of a market economy with less government intervention.

Recently, Korean enterprises have paid more attention to the possibility of entering CIS market, especially Uzbekistan as a bridgehead to Central Asian market.

Several measures should be considered to foster Korea–Uzbekistan economic cooperation.

First of all, the general environment between two countries should be improved to promote trade system and investment.

Investment by small and medium sized enterprise (SME) should be encouraged except for large scale energy and natural resources investment projects. To provide information for SMEs, who intend to invest in Uzbekistan, Korea could utilize bilingual Korean emigrants in establishing business information websites.

Since political interests play a more important role than market principles in Uzbekistan investment environment, Uzbekistan needs to be diligent in their investment environment. First, Korea can utilize intergovernmental policy coordination commission and joint economic commission to eliminate obstacles to investment. Korea can also support government projects in energy transportation, railroad, and highway construction since Korea should increase ODA to developing countries as a member country of OECD organization.

Finally, we need to emphasize the role of tripartite cooperation among government, industry and academia for fostering investment and future partnership between the two countries.

05-03

GCC · EU FTA: The Present and Its Prospect

Hee-Yeon Bae (Sep. 2005)

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USD 5

New movements in the Middle East region are adding to internal conflicts and natural resources (such as oil and natural gas), issues that often captures world's attention. One new big movement was made by Gulf Cooperation Council (GCC), a regional organization aimed at protecting political, military and economic interests of six nations in the Gulf region including Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and UAE. Recently, GCC is deepening internal integration by realizing a customs union and drafting framework for the introduction of a single currency. At the same time, GCC is advancing external integration by promoting trade agreements with the world's main traders. So far GCC has concluded a Free Trade Agreement (FTA) with Lebanon and some progress is being made on FTA negotiations with China (the GCC's biggest trade partner), India and Jordan.

Not until the early 21st century, did the integration of six GCC nations move forward. After the outbreak of the second Iraq War, governments of the GCC nations seriously recognized the strategic importance of regional economic integration and sought ways to build up a foundation for long-term economic growth along with plans to reduce high dependency on oil. And as a result, acceleration of GCC · EU FTA was adopted as one of the solutions.

EU was not known for its positive attitude concerning the GCC · EU FTA in the past. But as the EU grope for intra-regional multilateral cooperation system centered by the EU, the EU began to make efforts to improve their relationship and political ties with the Arab region where

the United States has had supreme influence. In addition, the EU, as the world's largest service exporter, is also expecting huge profits from entering the GCC's service market while securing oil and gas supply from the world's largest energy exporter. Since the GCC governments need to carry out reform in order to address chronic problems of the region such as high unemployment and low economic growth amid strong oil price, an FTA between the two blocs could serve as a good opportunity. Analysis of potential economic impact of GCC · EU FTA determined that the economic gain of GCC is similar to or larger than that of the EU, which is contrary to general expectations. And this outcome gives GCC strong incentive to push FTA negotiation ahead. For the GCC side, the petrochemical and aluminum industry which has comparative advantage, would have enhanced international competitiveness once GCC · EU FTA comes into effect.

However, FTA negotiations between the two blocs is developing more slowly than expected due to internal and external factors. Hence, despite both sides' announcement to complete negotiations by this year, it is difficult to estimate when they would actually reach an agreement. Currently, the United States' active involvement in FTA negotiations with the GCC countries is causing internal friction among the GCC countries on the matter of pursuing individual FTAs with the US. This problem is getting bigger having negative impact on the ongoing GCC · EU FTA negotiation. At the same time, the fact that the expectation from EU on the FTA agenda is too high (covering sensitive issues) is also increasing uncertainty. The EU has recently included human rights, immigration policy and other issues in the discussion agenda and is preparing a detailed code of execution on subjects such as cooperation against terrorism and non-proliferation of weapons of mass destruction. Nonetheless, considering the sensitiveness of those issues mentioned above, it is unlikely that tangible progress could be made in the early stage.

Meanwhile, GCC · EU FTA negotiation gives us some significant

implications that we need to consider when Korea starts FTA negotiation with the GCC. Since Korea's dependency of oil and gas on GCC is much higher than that of the EU, necessity of promoting FTA with the GCC is larger than that of the EU or China. Considering the keen competition going on in the world's energy market, especially between China and Japan, Korea needs to begin studying the feasibility of Korea · GCC FTA before it gets too late.

05-04

Understanding Contemporary German Politics & Economy and the Korea · Germany Economic Relations

Heungchong Kim, Kyuntae Kim, and Bernhard Seliger (Nov. 2005)

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USD 5

Germany has pursued a peace and coexistence policy with neighboring countries after the Second World War. Recovering from the ruins of the war, it stood as one of the exemplary economic powers in the world. After twenty years' effort of rapprochement and reconciliation toward East Germany, West Germany was successful in unifying the two countries by absorbing East Germany in 1990. Germany has established the key bilateral relation with France all through the European integration process, and it has led the big European issues of the formation of the single market, monetary integration of the EMU and the fifth EU enlargement.

Germany has suffered from economic recession since the second half of the 1990s. Characterized by the deteriorating fiscal deficit, higher unemployment rate, bi-polarization in the sectors of exports and domestic, and crises in the social security system, the German problem is evaluated to be from misguided unification policies including wrong currency conversion rates, aftermath of globalization and deepened European integration, failure in reforming the industrial structure, the loss of economic vitality from the highly regulated economy, and so on. Currently, the German government is making utmost efforts to solve the problems by conducting reform programs such as the Agenda 2010, the Hartz reforms, and so on.

Korea and Germany, sharing the common experience of national divide, has preserved a keen relationship since the 1950s. Germany is Korea's biggest trading partner among the European countries, and German investment together with the Netherlands recorded among the largest of those from the European countries. Korea's major trading items with Germany include machinery, electricity/electronics, and vehicles, and the trade volume totaled over US\$ 16 billion in 2004. From KIEP's analysis, bilateral trade record would increase by more than US\$ 1.1 billion if Korea establishes an FTA with the EU. Recently, both parties tightened its economic relations by enlarging the chances of cooperation in the areas of science and technology.

05-05

Recent Trend of M&A Market in Japan

Sung-Chun Jung (Nov. 2005)

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Recently, Japanese economy has become to show economic recovery from over 10 years recession. While Japan's economic recovery results from government's efforts to improve economic environment through reforming institutional arrangements, the most important factor that influenced economic activities is private firms' efforts to restructure their business activities. Of those private firms' efforts, we have to pay special attention to restructuring of corporate organization.

Japan's corporate organizations were restructured by merger and acquisitions (M&A). So we need to understand recent trend and characteristics in M&A markets of Japan to understand recent Japan's economic recovery. This paper reviews the trend and major characteristics of M&A markets in Japan and, at the same time, institutional reform with regards to M&A markets since the mid-1990s.

Japanese government has taken a different attitude on M&A policy from Korean government. Korean government actively opened the M&A markets and many foreign firms and funds invested in Korea, especially since Korean economic crisis. Now it is time to reconsider and assess the M&A policy in Korea and we can some implication from Japan's experiences. Thispaper will suggest some policy implication for Korean government's M&A policy.



Regional Study Series

05-01

Comparison of the Measures Implemented for Economic Reform and Actions Taken to Boost Economy in Korea and Japan

Chong-Yun Rhee (Feb. 2005)

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Although still unstable, many argue that the Japanese economy has overcome its 10-year long economic recession to slowly enter into the recovery phase. What lessons can Koreans learn from Japan?

The funneling of financial expenses into construction, civil engineering and other conventional infra-related areas that were sectors of over-production for a significantly long period of time, which required restructuring rather than more investment is garnering the most attention. As this resulted in a very minimal multiplying effect of the expenses found in the market,

As for the restructuring of banks and the handling of bad claims, Japan has taken a gradual approach. Therefore banks and companies were delayed from getting back on the right track as it held on tight to bad claims for quite long. However it did not generate the side effect of drastic restructuring. Contrary to Japanese action's, Korea's quick restructuring process led to a number of banks and main companies falling into the hands of foreign capital, massive unemployment and a quite unstable employment market where a number of former regular workers were re-employed as part-timers. In Japan, the production of foreign capital in listed Japanese companies is around 17~18%, which means that the leadership of the management is stably in the hand of the Japanese.

The Japanese government redefined its systems in a way that allows Japanese companies to reallocate its human and materialistic management resources in line with changes in the environment rather than delivering upper-handed instructions. This led companies to come up with a rational and efficient management system on their own.

In line with the emergence of shareholder capitalism and the low-growth era, Japan introduced an annual wage system and stock option while still maintaining its life-long employment structure as its backbone. In a nutshell, it has responded to the changes in the environment by enhancing the competition of individuals while maintaining the overall group-oriented system.

Regarding the bank's ability to offer efficient support to management activities by providing capital, there is little difference between Japan and Korea. However, in Japan there are general trading firms between banks and companies, in particular small and medium enterprises, which make up for the bank's low credit rating capacity. As a result, smooth and efficient capital flow to SMEs can be ensured.

So far I have reviewed the features found in Japan as it tried to overcome its long-term recession. Since Korea is about to face a long term recession, what lessons can it learn from the Japanese experience?

First, in order to put the Korea economy back on right track for stable growth, we must recover economic sovereignty by reducing share ownership ratio of foreigners to around 20%. In current situations where companies struggle to implement restructuring in an attempt to defend its management rights and shareholder's profit, they cannot afford to make investments for corporate development or come up with long-term development strategies. And it is hard to avoid confrontation between the management and labor in these situations.

Second, as seen in Japan's experience, there needs to be adequate financial expenditure to overcome the economic recession until the economy is put back on the right track. Here financial support should be funneled into areas that can raise the development potential of the

Korean economy not the traditional civil engineering and related fields.

Third, Japan upgraded its system to encourage investment while abolishing regulations that were obstructed investment. The investment environment in Korea is inferior to that of Japan so dramatic improvement of the investment environment is a prerequisite to overcoming the economic recession.

Fourth, though employers stress the flexibility of the labor market, an unstable employment is detrimental to the loyalty felt by the employees for their companies. Reflecting the development phase that the Korean economy is in, an introduction of a competitive environment based on guaranteed life-long employment, similar to that found in Japan, seems to be necessary.

Fifth, both in Korea and Japan, banks are in the process of being transformed from a public institution to more like a private company. Due to the lack of capability, banks in Korea and Japan have not fully performed the functions required to contribute to economic growth. It is against this backdrop that the government is required to come up with transitional measures to improve the public and economic functions of financial institutions, including banks.

05-02

A Study on Russia's Soviet-era Ruble-denominated Claims to Developing Countries and Their Treatments

Hyungssoo Zang and Yeo-Cheon Jeong (June 2005)

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This study deals with various issues related to the treatment of Russia's Soviet-era Ruble-denominated claims to developing countries. When the former Soviet Union broke up in 1992, Russian Federation succeeded with all external claims as well as external debts of the former Soviet Union. Russia's Soviet-era credits rendered to quite a few developing countries were largely military-related loans and mostly denominated in "Soviet" Ruble. The exchange rate between Soviet Ruble and US dollar used in original loan contracts committed before 1992 was unrealistically set high at 0.6 Soviet Ruble per US dollar, so the repayment burden of the Soviet-era Ruble denominated debts converted into US dollars using the exchange rate would be enormous and obviously unacceptable to developing poor debtor countries.

Besides the exchange rate issue, most of debtor countries are poor developing countries with heavy debt burden, sometimes unsustainable, and so many of those countries have actually approached the Paris Club for debt relief. According to the Memorandum of Understanding (MOU) between Russia and the Paris Club member countries signed at September 17, 1997, the new member to the Club, Russian Federation, has agreed to give upfront discount of 70 to 80 percent of its all Soviet-era Ruble-denominated claims to developing countries, including

interest arrears, before applying the standard terms of debt treatments in the context of Paris Club debt restructuring. Instead, Russia's claims would be converted into US dollar by using the contracted exchange rate of 0.6 Soviet Ruble per US dollar.

This study analyzed the cases of eighteen countries that have gone through bilateral debt negotiations with Russian Federation on the treatment of Soviet-era Ruble-denominated debts. Ten of these countries have been eligible for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative under the auspices of the International Monetary Fund and the World Bank. Under the Initiative, an HIPC country that has successfully undergone IMF-supported reform programs is expected to receive debt relief under Cologne terms of more than 90 percent cancellation in net present value terms of debts contracted before the country-specific cut-off date. Russian Federation, as a member of the Paris Club, is also required to provide comparable treatment in the process of reaching bilateral agreement with HIPC countries. These HIPC countries are, as of November 2004, Ethiopia, Mali, Mozambique, Nicaragua, Madagascar, Tanzania, Zambia, Guinea, Guinea-Bissau, and São Tomé and Príncipe.

On the other hand, the Soviet-era Ruble-denominated debts owed by non-HIPC countries, which have already approached the Paris Club at least once, may not be qualified for the Initiative's debt relief under Cologne terms. But the MOU on the Soviet-era Ruble-denominated debt treatment would be applied in default. The six non-HIPC countries covered in this study are Vietnam, Yemen, Cambodia, Iraq, Angola and Algeria.

The last group of countries that do not yet have experience in debt restructuring with the Paris Club would need to make bilateral negotiations with Russia on identifying the amount, maturities, and other terms of debts, the conversion rate of Soviet Ruble into US dollars, the cancellation rate applied, etc. This study reviewed the cases of Lao People's Democratic Republic and Mongolia.

Having reviewed various cases of bilateral debt negotiations between Russian Federation and developing countries on the treatment of Soviet-era Ruble-denominated debts, this study has cautiously touched the North Korean case. As South Korea currently has claims to Russia of about 1.6 billion dollars, Russia has continuously proposed that South Korean claims to Russia would be exchanged in an appropriate way with Russian claims to North Korea to end up with South Korean claims to North Korea. In order to assess the economics of the debt exchange scenario, one needs to solve potential problems associated with the intrinsic nature of Soviet-era Ruble-denominated debts.

According to the OECD, if the contracted exchange rate of 0.6 Soviet Ruble per US dollar were to be used, the Russian claims to North Korea at end-1993 would amount to about 6.2 billion dollars. The amount would likely to increase to a considerably higher number as of today since North Korea could not service most of principal and accumulating interest payments due to economic difficulties experienced by North Korea in the past dozen years. Should the terms and conditions concluded from the bilateral debt negotiations between Russian Federation and Lao People's Democratic Republic be applied to the North Korea case, as an explanatory example, about 75% of the 6.2 billion dollars in net present value terms would be forgiven. The forgiveness would increase to more than 90% in net present value terms if North Korea would be able to get comparable treatments under the enhanced HIPC debt initiative, which is however unlikely. This study would hopefully be able to give readers some insights on this issue of the treatments of Russia's Soviet-era Ruble-denominated Claims to North Korea.

05-03

A Study of the China's Technology Industrialization Model and Strategy

Seung-Chan Park (Oct, 2005)

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USD 5

China today is reformulating its technology industrialization strategy. The hard work, the benefits of latecomer status and effective industrial policy that brought our country to the level of a developed economy are no longer adequate for competition in the future. For the last 10 years, technology industrialization has become a key element of competitiveness like the quality of workforce and capital because it has been proved one of the most important determinants of nation's productivity and economic growth.

The technology environment changes such techno-hegemony, techno-regionalism and techno-protectionism, and techno-globalism has facilitated the necessity of strategic alliance among nation in the same region. As the result, the China has tried to develop the strong relationship with the nations in the far-east.

Among those nations, the Korea will obvious geographical and strategic reasons, be close ties with the China. However, it is obvious that the Korea will experience both the better and worse perspectives when it comes to the practical issues. On one hand, it has relatively easy access to the technological resources of China especially in basic science. Given this, the Korean government should develop the careful strategic plan, we will tackle the issue of the most effective directions for the technology alliance between Korea and China.

Let me suggest a few ways to find out some approach in sphere of

competition, supplementation and mutual cooperation between the two countries, compare korea with china in the field of technology type and relative power.

First, we need to have plural subject of the technology industrialization cooperation and make it more clear, korean government has to have information network stronger so that the mechanism of systematic support can be more effective and higher efficiency.

Second, we should strengthen the countermove for technology industrialization policy and investigate the technical cooperation demand of chinese government so that we can have a counterpower to policy change of chinese government. Also, we need to have several approach with plural pattern of technology industrialization cooperation.

Third, we need to strengthen the bargaining power in the field of technology industrialization cooperation, examining the strategy and policy change of chinese government so that we can prevent misunderstanding caused by inaccurate decision making on business level as well as government level.

05-04

An Analysis of the Economic Effects of Japan's Economic Sanctions Against North Korea

MIMURA, Mitsuhiro (Dec. 2005)

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USD 5

Discussions concerning the imposition of economic sanctions against the Democratic People's Republic of Korea (hereafter referred to as "North Korea") began after the Prime Minister Koizumi's first visit to Pyongyang on September 22, 2002. Chairman Kim Jong-il acknowledged that Japanese citizens had been abducted to North Korea and offered his apologies, stating that it was the work of persons affiliated with North Korea in the past. This turned what had previously been merely "suspected abductions" into real cases of abduction.

North Korea declared that eight of the thirteen abductees officially recognized by the Japanese government were dead, that four of the thirteen were alive, and that there was no record of the remaining one having entered North Korea. It also announced that another Japanese national who was not on the Japanese government's list was alive. The information on the abductees with which the North Korean government provided the Japanese government did not satisfy public opinions in Japan. In November 2004, the North Korean government sent to Japan what were ostensibly the cremated remains of Yokota Megumi, but DNA analysis revealed that they could not have come from Ms. Yokota.

Due to mutual distrust between the two countries, discussion of the imposition of economic sanctions against North Korea intensified. In

December 2004, the Japanese government, which had been hesitant about the issue, declared that it would consider economic sanctions against North Korea.

The economic sanctions imposed on North Korea by the Japanese government are divided into two parts: (a) the economic sanctions officially announced by the government; and (b) measures similar to economic sanctions. The former involves trade restrictions, restrictions on money transfers and a ban on the entry of ships related to North Korea into Japanese ports. The latter includes "catch-all controls", Port State Control, and tightening up ship insurance policy measures. These "catch-all controls" had a major impact on Japan's exports to North Korea. Port State Control and the tightening up of ship insurance policy measures shrank Japan's imports from North Korea. As a result, in 2003, trade between Japan and North Korea shrank by 29% compared with the previous year. Even during the early stages of the trade restrictions, trade between Japan and North Korea fell by 43.4%, bringing about a reduction of 12.8% in North Korea's exports.

Since trade between Japan and North Korea has already decreased to a considerable extent, the impact of economic sanctions against North Korea is declining as the years roll on. China and the Republic of Korea will be the alternative destinations for exports from North Korea. Thus, the impact of the economic sanctions is gradually weakening.

05-05

Korea-Japan FTA and Future Agenda for Korea's Large Conglomerates

Jang-Hee Yoo and Eun-Mee Kim (Dec. 2005)

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Multilateral trade negotiations have set the stage for world trade. However, we have also witnessed a sharp growth in bi-lateral trade negotiations even from countries engaged in multilateral trade negotiations. Nations enter into bi-lateral free trade agreements (FTAs) in order to benefit from increased competition, economies of scale, and better utilization of resources. The Republic of Korea signed its first FTA with Chile in 2004 and is actively pursuing FTAs with many other nations and regions. Among these, the FTA with Japan is one of the most important FTAs.

The Republic of Korea has consistently experienced trade deficits with Japan in the last 5 decades, which is attributed to large imports of machinery, materials and parts from Japan. In the manufacturing sector in particular South Korea has little comparative advantage in terms of accumulation of capital, technology or raw materials. Thus, many speculate that South Korean firms will be exposed to adverse effects when the FTA is signed. In fact South Korea's large business conglomerates are concerned that their products will not be competitive vs. Japanese products because their products' comparative advantages are largely derived from differences in tariff rates.

This paper discusses the price competitiveness of South Korean export products and the effects on market shares compared to those from Japan with a focus on the activities of South Korea's large business

conglomerates. An empirical analysis based on price elasticity of demand found that the sales volume of electronic products, textile and clothing, automobiles will decline as much as 2,700 billion won, 216,000 tons, or 226,000 units, respectively, when the tariff is eliminated. In spite of this pessimistic scenario, we also found from interviews with leading conglomerates that some South Korean firms believed that the textile and clothing industry will not be subject to negative effects, and that a few sectors with an advantage in developing new technology and products will even gain from the FTA. However, the paper critically argues that the lack of transparent management system and corporate governance could hinder South Korean conglomerates from fully benefitting from the Korea–Japan FTA.

The paper argues that Korea–Japan FTA can become a catalyst for the two nations in reorganizing world trade in terms of expanding the industrial structure or securing new markets. In order to maximize the positive effects while minimizing short-term negative effects, the South Korean government should prepare complementary measures such as the Trade Adjustment Assistance (TAA). As a country with high rate of trade dependency, South Korea should strategically move forward with the Korea–Japan FTA as a means to prepare for the new era of economic development.



M¹onograph

A Metaanalysis on Northeast Asian Economic Integration

Byeong-Hae Sohn and Heuongjong Kim eds, (Dec. 2005)

ISBN 89-322-0046-7/A5/158pp.

USD 7

This book is composed of five economic papers that address both methodological and analytical issues in measuring the effects of economic integration in Northeast Asia. First, we identify the stylized features of economic integration. Second, we apply them to different models for regional integration in Northeast Asia in order to explore the methodological robustness of those models and discuss the effects of economic regional integration.

The first paper by Cae One Kim (Seoul National University) discusses the merits of creating a common market in Northeast Asia. A common market tends to accrue more economic benefits to members than free trade agreements (FTAs). As China, Japan and Korea, share common cultural backgrounds, it is conceivable for Northeast Asia to create a Northeast Asian Economic Community. First, a common market will provide political fora for peace and political stability in the region. Second, transparent economic governance in a common market will reduce disputes stemming from information asymmetry among members. Furthermore, Northeast Asia will have more collective bargaining power that will deliver regional concerns in international economic relations. In the common market, leadership will be granted to a country that is devoted to market economy, sustaining economic restructuring and promoting a competitive edge in key industries through strenuous technological innovation. The author examines the potential role of Korea in substantiating a common market.

Byeong-Hae Sohn (Kyungbook National University) examines the evolution of a production network between China, Japan and Korea since the 1990s. As intra-industry trade brings about qualitative changes in trade structure, functional integration is already underway. In consequence, the three countries in Northeast Asia are increasingly enjoying interdependent linkages. Professor Sohn argues that the initiative towards economic integration in Northeast Asia should be congruent with and even strengthen a common production network. Subsequently, the 'production community' will lay the foundation for strategic alliances between China, Japan and Korea and also heighten competition. In that vein, Professor Sohn advocates industrial policies to support the competitive edge of part suppliers in Korea.

Heung-Chong Kim (KIEP) and Soon-Chan Park (Kong Ju National University) introduce various analyses on trends of intra- and inter-industry trade between China, Japan and Korea and discuss the feasibility of FTAs in Northeast Asia. A gravity model analysis shows that the current volume of trade is not high enough to confirm a natural trade partnership in Northeast Asia. The large proportion of bilateral trade involving China is still made up of inter-industry trade. Nevertheless, the ratio of intra-industry trade tends to rise and the regional production system is evolving in a way that enhances a vertical integration between the three countries. In view of that, FTAs between China, Japan and Korea will have pareto-improvement on industrial production.

Changkyu Choi (Myungji University) examines the role of foreign direct investment (FDI) in strengthening economic integration. The rapid economic growth of China and the proliferation of FTAs have transformed trade structure towards a vertically differentiated intra-industry trade. Empirical evidence supports that there is a positive correlation between intra-industry trade and FDI inflows in Northeast Asia. In turn, intra-industry trade will induce increased FDI inflows between China, Japan and Korea. The growth in FDI inflows may complicate industrial adjustment. As trade and investment liberalisation raise income inequality

and the incidence of poverty, members may invest in social safety nets.

Myung-Ho Park (Hankuk University of Foreign Studies) analyses European experiences in encouraging cultural cooperation and finds implications for Northeast Asia. European integration is composed of cultural dimensions as well as political and economic aspects. EU's policy towards cultural cooperation aims not only to promote awareness about cultural diversity but also to discover common European heritages. Europe's experience shows that it is not easy to set out the criteria of prioritising cultural policies. Another issue was the extent to which EU-level policy deteriorates indigenous culture. Based on European case studies, Professor Park raises a theoretical discussion regarding the justification of government's support in culture and arts and thereby suggests ways to promote cultural cooperation in Northeast Asia.

05-04

An Introduction of Korea-EFTA FTA

MOFAT and KIEP (Dec. 2005)

A5/pp. 79

Not for Sale

This book introduces major contents of the Korea-EFTA FTA, signed by the representatives of both governments in 15 December 2005. The FTA is expected to be one of the FTAs which can maximize the positive impacts of FTA with the developed countries. It is also anticipated to increase mutual benefits from complementary industrial structures of the partners. Korea would have more chances to provide its products to the markets of EFTA and Korea's industries will get balanced development through increased competitiveness in agriculture, services and so on.

This book gives precise and easy explanations on the Agreements on Korea-EFTA FTA including major contents of concession, introduction of the EFTA countries and economic relations between Korea and the EFTA countries.



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