

A Review of the First Decade of the Korea-EU FTA

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I. Introduction

Last year marked the tenth anniversary of the Free Trade Agreement (FTA) between the European Union (EU) and Korea, which entered into force in 2011. The EU is the world's largest economy and Korea's third largest trade partner, only after China and the United States. Back when the FTA negotiations began in 2007, the EU was Korea's second largest export destination, from which Korea enjoyed the largest surplus. Also, more than 35 per cent of Korea's foreign direct investment came from the member states of the EU. Korea is also a major economy and a major trade partner of the EU, especially in Asia. The FTA with Korea was the first case of the EU's "next generation" FTAs, and is considered to have served as a benchmark for the EU's bilateral trade agreements thereafter (Kang 2016). As for Korea, it was the first FTA with a major economy, even before the US, its traditional ally, and China, its closest neighbor.

Because of its importance, the Korea-EU FTA has received attention from economics and trade policy. KIEP also took a look at the first decade of its implementation last year (Joe et al. 2021).

This Brief introduces some of the findings in Joe et al. (2021), focusing on the impact of the FTA on the bilateral economic relationship between the two sides.

II. Background of the Korea-EU FTA

The idea of a bilateral trade agreement between Korea and the EU began in the 2000s as a result of their mutual interests in increasing export markets (Lee 2011). Back then, the EU was, and still is, the largest single economic entity, accounting for about 30 per cent of the world economy and about 17 per cent of the world trade. The bloc was Korea's second largest trade partner, only after China, the country's closest neighbor. But Korea's share in the bloc's import market was a mere 3 per cent, and even this small share was being challenged by large emerging economies such as China, India and Turkey. Acquiring preferential access to the EU's market was desirable for Korean businesses. Also, an FTA with the EU was expected

to increase FDI inflows, thereby improving Korea's productivity and employment. For the EU, Korea was seen as an ideal partner in Asia, with fifty million population of (relatively) high income, to implement its next-generation FTA before the US gained preferential access to the region. Furthermore, the two economies' comparative advantages – the EU in services and Korea in manufacturing – made them complementary partners.

Also in the background was the weakening of the World Trade Organization (WTO)'s multilateral trading system and the resulting increase

of bilateralism or regionalism (MOFAT 2007). After the Fifth Ministerial Conference in Cancun in 2003 collapsed, the Korean government made an FTA Roadmap to set out the priorities of partners, first with smaller economies, such as Chile and Singapore, and then with major economies, including the EU and the US.

Against this background, the EU and Korea began preparations in 2006 and launched official negotiations in 2007, which resulted in an agreement in 2009 that was signed in 2010 and entered into force in 2011 provisionally and fully in 2015.

Table 1. Official Timeline of the Korea-EU FTA

Date	Event
May 15, 2006	Trade ministers of the EU and Korea agreed to begin preparation
2006	Preparation meetings
May 6, 2007	Official launch of negotiations
2007-2009	Negotiations
July 13, 2009	Announcement of agreement
October 15, 2009	Text agreed
October 6, 2010	Agreement signed
February 17, 2011	Ratification in the European Parliament
May 4, 2011	Ratification in the National Assembly of Korea
July 1, 2011	Provisional entry into force
December 13, 2015	Full entry into force

Source: Table 2-3, Joe et al. (2021).

III. Some Notable Features of the Korea-EU FTA

The Korea-EU FTA was the first case for both parties to include a whole chapter on Trade and Sustainable Development (TSD). Its Chapter 13 is dedicated to labor and environment. On labor, they committed to respect the interna-

tional core labor rights and standards, which include the International Labour Organization (ILO)'s core labor standards. Even though four of the eight ILO Fundamental Conventions had not been ratified in Korea by the time of its signing, the Korean government committed to take efforts to ratify them. On environment, they committed to implement multilateral

agreements and continue to cooperate at the international level to counter climate change. This feature is considered to have served as a benchmark for the EU's FTAs thereafter (Kang, 2020).

In terms of tariff liberalization, the FTA covers

all but a few sensitive agricultural products. Korea abolished import tariffs on about 82 per cent immediately and about 94 per cent in five years. Correspondingly, the EU abolished import tariffs on 94 per cent immediately and virtually all in five years.

Table 2. Schedule and Coverage of Tariff Liberalization of the Korea-EU FTA

	Korea				EU			
	N. products	Share	Value	Share	N. products	Share	Value	Share
Immediate	9,195	81.7	182.7	66.7	9,252	94.0	318.7	76.6
3 years	625	5.5	60.6	22.2	282	2.9	68.6	16.7
5 years	718	6.4	22.2	8.1	269	2.7	28.1	6.8
In 5 years	10,538	93.6	265.5	97.0	9,803	99.6	415.4	100.0
7 years	111	1.0	3.6	1.4	-	-	-	-
10 years	399	3.5	3.0	1.1	-	-	-	-
Further	169	1.5	1.3	0.5	-	-	-	-
Total	11,247	99.6	273.4	100.0	9,803	99.6	415.4	100.0
Excluded	44	0.4	0.0	0.0	39	0.4	0.0	0.0

Notes: Products are in HS 2006. Values are the annual average of 2004-2006 in billion USD. Shares are in percentage of total. Source: Table 2-4, Joe et al. (2021)

On services, it uses positive lists as in the General Agreement on Trade in Services (GATS) of the WTO, contrary to the negative lists used in the Korea-US FTA. Among the 155 categories of the WTO's classification, Korea allows access in 115, and the EU allows access in 139. The level of liberalization is similar to the Korea-US FTA in many important areas, including legal, accounting, tax, construction and financial services. Also, the two parties committed to Most-Favoured-Nation (MFN) treatments, prohibition of adoption or maintenance of measures to limit market access and national treatments.

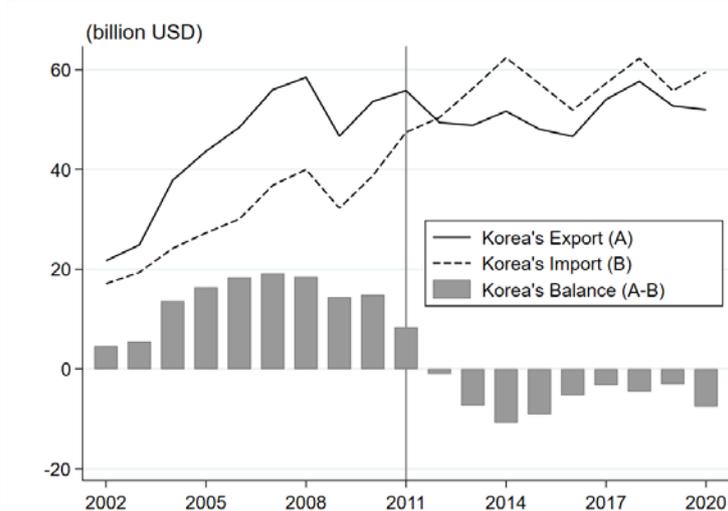
IV. Assessments

Despite high expectations, Korea's export to the EU stagnated right after the (provisional) entry into force of the FTA in 2011. This is considered to be partly due to the concurrent recession in the EU (Kang 2020). Also, other cyclical factors such as the downturn in the shipbuilding industry, which is Korea's major export area to the EU, and the weakening of Korean products' competitiveness in the EU due to the euro's weakening following the quantitative easing of the European Central Bank, are known to have contributed to the stagnation. On the other hand, Korea's import from the EU

rapidly increased during the same period, turn-

ing Korea's trade balance with the EU into deficit.

Figure 1. Aggregate Trade Flows between the EU and Korea



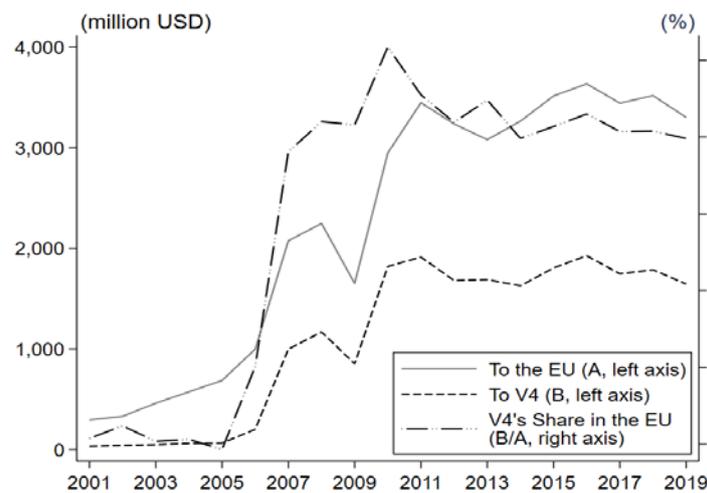
Source: Figure 3-1, Joe et al. (2021)

Contrary to the observed (unconditional) trend, careful econometric analyses reveal that the impact of the FTA was largely positive on the bilateral trade between the two economies compared to what it would have been without it. Lakatos and Nilsson (2017), for instance, show the FTA not only increased the value of exports (i.e., intensive margin), but also the probability of exporting (i.e., extensive margin), in both directions. Similarly, Grübler and Reiter (2021) find a positive effect on bilateral trade, focusing on the reduction of Non-Tariff Measures (NTMs).

Joe et al. (2021) offers another explanation for the stagnant Korean export to the EU. The production chain of major Korean car manufacturers' export to the EU moved forward into the

Central and European Countries (CEECs), such as Poland, Slovakia and Hungary, following those countries' accession to the bloc in the 2000s. Korea's export of car parts (HS8708) to the EU jumped in the mid-2000s following the CEECs' accession. Korea's export of car parts to the EU was less than 700 million USD until 2005, then jumped to nearly 1 billion in 2006, and again to more than 2 billion in 2007, reaching 3 billion by the end of the 2000s. Such a rapid increase was driven mainly by Korea's export to the Visegrád Group (V4). The share of the V4 in Korea's export of car parts to the EU remained around 10 per cent until 2005; then it jumped to more than 50 per cent by the late 2000s. This resulted in an increase of Korean car makers' market share in the EU.

Figure 2. Korea's Export of Car Parts (HS8708) to the EU and V4

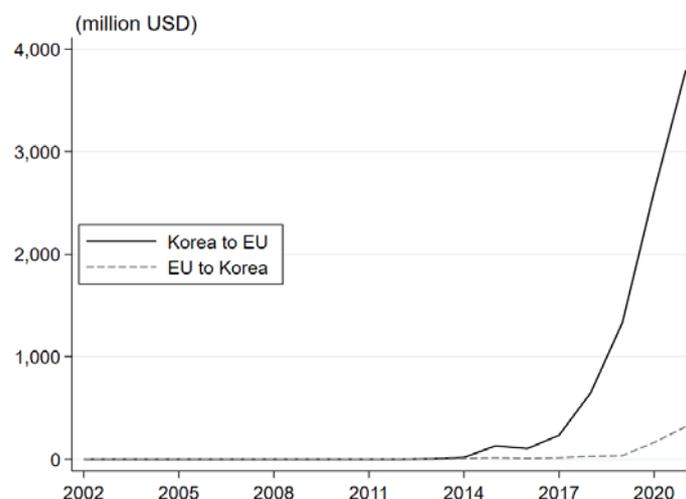


Source: Figure 4-4, Joe et al. (2021)

Joe et al. (2021) claims that such a story holds rather generally: that is, that the estimated effect of the EU-Korea FTA is positive for Korea's export to the CEECs in most industries, and even in those few industries where the effect is not significantly positive Korea's export to the member states other than the CEECs, it is positive for Korea's export to the CEECs. In short, the EU-Korea FTA has contributed to the

extension of Korean manufacturers' value chains into the EU, where Korea exports intermediate goods to the EU, which are then processed into final goods and sold in the EU. The high utilization rate of the EU-Korea FTA also supports this claim. In fact, the utilization rate of the EU-Korea FTA is substantially higher than the average and consistently among the highest of all Korea's FTAs in force.

Figure 3. Trade of Electric Cars (MTI741400) between the EU and Korea

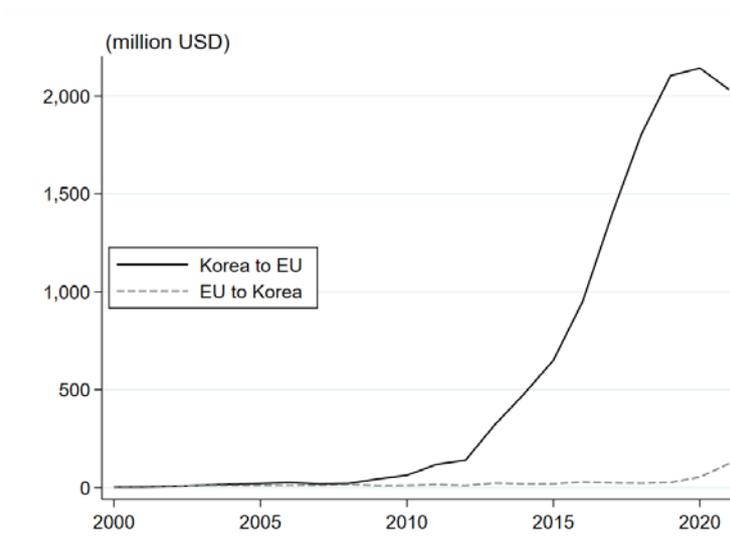


Source: Figure 4-6, Joe et al. (2021)

The rise in demand for electric cars, and hence for their batteries, is most rapid in the EU due to the public awareness and government policies on climate change. Joe et al. (2021) argues that Korean car makers responded to such increase in demand. Korea's export of electric cars (MTI741400) to the EU was virtually non

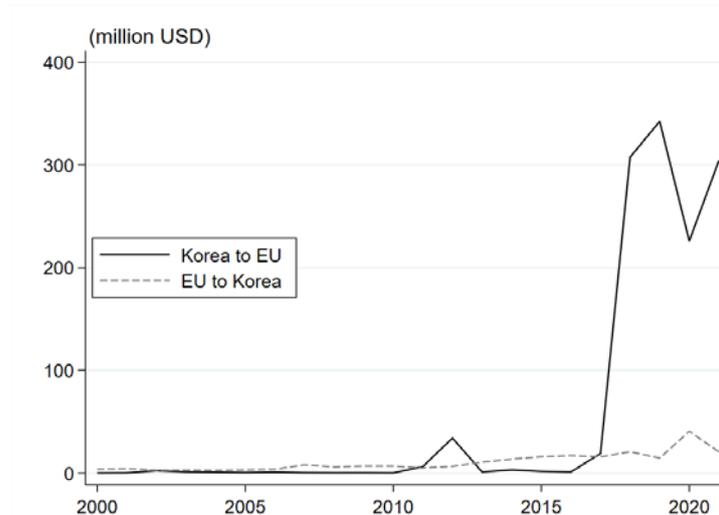
existent before the FTA. Then it started taking shape in the mid-2010s and grew exponentially, from less than 19 million USD in 2014 to 3.8 billion USD in 2021. Such a fast reaction by Korean car makers to the rising demand in the EU is contributing to the European Green Deal, by supplying efficient means to achieve it.

Figure 4. Trade of Batteries (MTI835220) between the EU and Korea



Source: Figure 4-14, Joe et al. (2021)

Figure 5. Trade of Battery Parts (HSK850790) between the EU and Korea



Source: Figure 4-14, Joe et al. (2021)

Batteries are essential parts of electric cars, taking up no less than 40 per cent of the whole value added. However, the production capacity of European batteries manufacturers cannot cover the large and rising demand in the EU. Korean manufacturers contribute to fill this gap, not only by exporting Korean batteries to the EU, but also by producing batteries in the EU. Korea's export of batteries (MTI835220) to the EU, for instance, started increasing mildly around 2010, then expanded since 2012, from 139 million USD in 2012 to more than 2 billion USD since the late 2010s.

The three largest Korean battery manufacturers, namely LG Chem, Samsung SDI and SK Innovation, invest heavily in the production capacity in the EU, particularly in the CEECs. For instance, LG Chem has produced batteries in Poland since 2018. In 2020, it had two factories and seven production lines, summing up to a production capacity of 40 GWh per year. It supplies batteries to major European car makers, including Audi, Porsche and Volkswagen. The other two, both producing batteries in Hungary, are making similar contributions to the EU's electric car value chain. As these companies increased production in the EU, Korea's export of batteries slowed down from the late 2010s.

Instead, Korea's export of battery parts (HSK850790) increased rapidly in the late 2010s, from a mere 1 million in 2016 to more than 300 million USD in the late 2010s.

V. Conclusion

Despite the high expectations and importance of the Korea-EU FTA, its first decade of entry into force coincided with stagnating Korean export to the EU and increasing Korean import from the EU. Adding on existing studies showing a positive impact of the FTA compared to what it would have been without it, Joe et al. (2021) presents evidences that its impact was positive for the economic relationship between the two sides, taking into account the structural changes of Korean manufacturers' value chains into the EU. This implies that their economic relationship has grown beyond the traditional trade and investment during the first decade of the Korea-EU FTA. **KIEP**

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