

Korea's Strategy on Trade Agreements with Developing Countries in Africa and the Pacific Regions

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I. Introduction

As the US-China trade conflict intensifies, high dependence on US and China has been pointed out as a potential risk to the Korean economy. This calls for trade policies including diversification of trading partners and the establishment of a new model for trade agreements suitable to such diversified partners. Meanwhile, the necessity for such policies grows as protectionism spreads globally and trade order changes after the Covid-19 pandemic.

Africa and the Pacific (AP)¹ regions, the main areas of interest in this report, have been excluded from Korea's FTA network despite their high growth potential and strategic significance. Most countries in the AP regions are geographically distant from Korea and mostly underdeveloped, so we have approached the region only in terms of development cooperation. Currently, trade agreements and systems for trade

and investment with AP countries are insufficient, and the size of economic cooperation with these countries remains small. However, Africa has high market potential, owing to various factors such as its high population growth, middle-class growth, and transition to digital economy, while the Pacific island countries have abundant fisheries and marine resources, and wield voting power in international organizations. In this regard, it is necessary to build the foundation for cooperation with AP countries in the mid-to-long term.

Against this backdrop, this study seeks mid- to long-term strategies to promote trade cooperation with AP countries. First we consider introducing and expanding nonreciprocal arrangements for developing countries in the AP regions, as currently provided to United Nations-defined least developed countries. Then we consider introducing a reciprocal trade agree-

¹ Hereafter, this refers to the 49 sub-Saharan African countries and 15 Atlantic countries, excluding Aus-

tralia and New Zealand.

ment, for example, an FTA. As a result, we found that it is necessary to introduce an FTA model suitable for developing countries in the AP regions instead of introducing further non-reciprocal agreements. Based on the results of the study, this paper proposes strategic directions for trade cooperation with the AP regions, and furthermore, provides policy suggestions that should be included in the agreement with those countries.

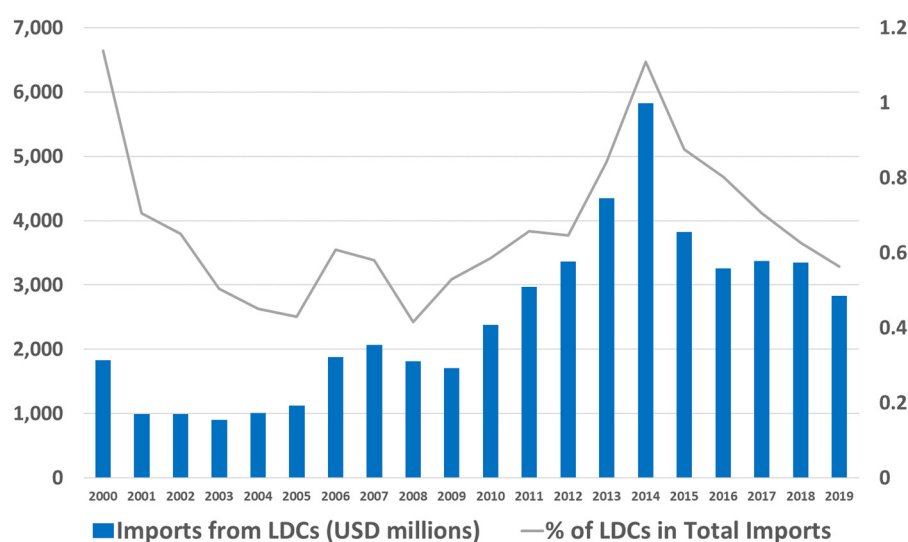
II. Korea's Nonreciprocal Arrangement

Korea prepared the legal basis for introducing the Generalized System of Preferences (GSP) in 1997, and had been exempting tariffs and quotas on imports from least developed countries (LDCs) since 2000. In 2001,

Korea provided duty-free quota-free (DFQF) access to only 80 products at the HS 6-digits. This grew to 3,790 products in 2008, expanding by 5 percentage points every year, and 4,802 products (about 95% of all products) were exempted from tariffs in 2012. In addition, Korea relaxed rules of origin (ROOs) requirements to allow products where non-originating materials do not exceed 60% of the FOB price of exports.

Korea has eliminated tariffs on about 95 percent of all product lines imported from LDCs since 2012, but the values of import from such countries account for less than 1 percent of Korea's total imports and the share is decreasing even further (Figure 1). Imports from the LDCs tend to be skewed towards some industries, and imports from ASEAN LDCs account for a significant proportion.

Figure 1. Trends in Korea's Imports from LDCs

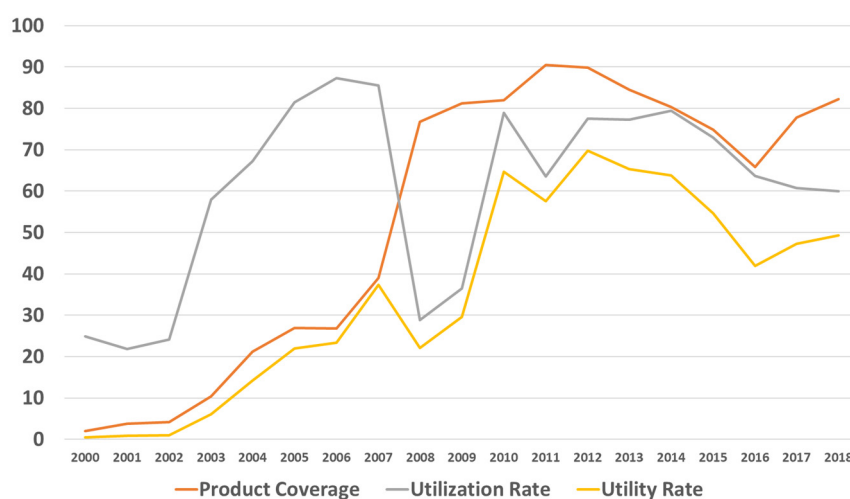


Source: Korea Trade Statistics Promotion Institute (KTSPi)

Figure 2 below shows the trend in product coverage, utilization rate, and utility rate of Korea's DFQF access over 20 years. The product coverage is defined as the proportion of imports covered by DFQF scheme relative to the dutiable imports. The utilization rate is defined as the percentage of imports that have actually received preferential tariff benefits out of the total imports eligible for DFQF access. Even if DFQF access is granted, it may

be difficult for the LDCs to benefit from the preferential treatment because of non-tariff barriers such as restrictive ROOs. Utilization rate provides information on how valuable DFQF status is for LDCs in market access. The utility rate is calculated by multiplying the product coverage by the utilization rate, and is defined as the ratio of the imports that received DFQF benefits out of the total dutiable imports.

Figure 2. Trends in Product Coverage, Utilization Rate, and Utility Rate of LDCs



Source: Korea Trade Statistics Promotion Institute (KTSPi)

The utilization rate, which represents the actual utilization of the DFQF system, fell to 30% in 2008 when the number of items covered by the DFQF system was significantly expanded to 75% of total products. Although the product coverage had expanded to 2012, utilization had fallen short of this, and has declined in recent years. Given the recent decline in utilization rate, the trade effects of the Korean DFQF seem to have weakened.

III. Korea's FTAs

In 2003, Korea adopted an FTA roadmap and had pursued multiple FTAs simultaneously with many countries. As the global trade environment changed rapidly, a new trade roadmap has replaced the past in 2013 to promote mutually beneficial FTAs with emerging countries, resulting in the finalization of the Korea-Vietnam FTA and upgrade of the Korea-ASEAN FTA. Among the developing countries, Korea has signed FTAs with ASEAN, China, Vietnam, Indonesia, India, Turkey, Chile, Peru, Colombia, Panama, Costa Rica, Honduras, El

Salvador and Nicaragua.

In this study, we analyze the impact of Korea's nonreciprocal and reciprocal trade agreements on trade using the gravity model. To examine the effectiveness of FTAs and DFQF treatment on Korea's imports, the following estimation equation is adopted.

$$M_{i,t} = \beta_0 + \beta_1 \ln Y_{i,t} + \beta_2 \ln Y_{KOR,t} + \beta_3 \ln Dist_{i,KOR} + \beta_4 FTA_{i,t} + \beta_5 DFQF_{i,t} + \delta_i + \tau_t + \epsilon_{i,t}$$

where i and t refer to exporter and time respectively.

The results of analyzing the effects of Korea's DFQF and FTA on imports are as shown in Table 1. Columns (1) and (2) are the results of estimation by OLS using a DFQF dummy start-

ing in 2008 and DFQF dummy starting in 2012, respectively. Columns (3) and (4) are the results of estimating the same model by PPML. According to Table 1, the effect of FTAs on imports is positive and statistically significant in all models.

The effect of preferential treatment of DFQF is different depending on the model. Only the PPML estimate of the DFQF dummy starting 2012 is significantly positive, while other estimates of DFQF are not statistically significant or even negative. Although not included in this paper, it is found that the effects of DFQF status are not statistically different from zero regardless of how the base year of DFQF is set. Table 2 shows the results of an industry-level data analysis, which is not much different from the previous country-level data analysis.

Table 1. Results for Gravity Model: Country-level Analysis

Variables	(1) OLS	(2) OLS	(3) PPML	(4) PPML
Distance (km, log)	-0.804*** (0.067)	-0.802*** (0.067)	-0.737*** (0.025)	-0.737*** (0.024)
Korea' GDP (\$, log)	0.328*** (0.125)	0.202* (0.125)	0.565*** (0.063)	0.564*** (0.063)
Exporter's GDP (\$, log)	1.278*** (0.0188)	1.294*** (0.0184)	0.521*** (0.038)	0.520*** (0.038)
FTA	0.659*** (0.082)	0.689*** (0.082)	0.100*** (0.029)	0.101*** (0.029)
DFQF1 (2008~)	-0.453*** (0.136)	-	0.058 (0.148)	-
DFQF2 (2012~)	-	-0.086 (0.162)	-	0.261* (0.135)
Country Dummy	0	0	0	0
Year Dummy	0	0	0	0
No. of Observations	3,733	3,733	3778	3778
Adjusted R^2	0.877	0.878	0.982	0.982

Notes: Robust standard errors are in parentheses. *, **, *** indicate statistical significance at the 10%, 5% and 1%.

Table 2. Results for Gravity Model: Industry-level Analysis

Variables	(1) OLS	(2) OLS	(3) PPML	(4) PPML
Distance (km, log)	-7.926*** (1.677)	-8.092*** (1.676)	-0.073 (0.174)	-0.075 (0.174)
Korea' GDP (\$, log)	0.522*** (0.126)	0.519*** (0.126)	0.487*** (0.182)	0.486*** (0.182)
Exporter's GDP (\$, log)	0.437*** (0.086)	0.407*** (0.086)	0.521*** (0.097)	0.520*** (0.097)
FTA	0.556*** (0.066)	0.565*** (0.067)	0.099* (0.058)	0.101* (0.059)
DFQF1 (2008~)	-0.438*** (0.129)	-	0.006 (0.190)	-
DFQF2 (2012~)	-	-0.167 (0.124)	-	0.236 (0.183)
Country Dummy	0	0	0	0
Industry Dummy	0	0	0	0
Year Dummy	0	0	0	0
No. of Observations	40,927	40,927	60,048	60,048
Adjusted R^2	0.741	0.741	0.465	0.465

Notes: Robust standard errors are in parentheses. *, **, *** indicate statistical significance at the 10%, 5% and 1%.

IV. Strategy on Trade Agreements with Developing Countries in Africa and the Pacific Regions

According to the previous analysis, the Korean DFQF scheme does not have much effect on expanding imports from LDCs. In addition, there are limitations such that DFQF only applies to the goods sector, and uncertainty in the continuation of benefits. On the other hand, an FTA will have a positive impact on imports, so it seems more appropriate for the recipient countries to pursue an FTA rather than nonreciprocal agreements. From the perspective of Korea, it is also desirable to pursue two-way

preferences to secure a potential market.

Meanwhile, it is worth considering a step-by-step strategy when starting FTA negotiations. The United States institutionalized a dialogue channel by signing a Trade and Investment Framework Agreement (TIFA) in the previous phase of discussing trade negotiations with underdeveloped countries. This could be a way to consider for trade cooperation with countries that have high development potential but have not reached the stage of discussing market opening. It is also necessary to push for a multilateral FTA with the African economic community,² while at the same time pursuing a higher level of bilateral FTAs with major countries in the community.

² This includes AMU, CEN-SAD, COMESA, EAC, ECCAS,

ECOWAS, IGAD, and SADC.

Considering the degree of development of AP countries, a new FTA model which includes ways to support the economic growth of partner countries should be sought. In the Korea-ASEAN FTA or the Korea-Vietnam FTA, various cooperation agendas are included in the “Economic Cooperation” chapter. In addition to including development cooperation provisions within FTAs, substantial efforts should be made to enhance the linkage between ODA and trade cooperation. It is necessary to encourage ODA agencies to participate in the process of reviewing the implementation of FTAs, facilitating implementation, and discussing future cooperation opportunities. It is

also worth considering using the Country Partnership Strategy (CPS) as a basic guideline for FTA negotiations with AP countries.

In addition, this paper proposed specific measures to promote trade and investment in the AP regions, as follows: support for trade and industrial infrastructure construction to promote trade cooperation; support for Korean companies, in conjunction with partner countries' infant industries; cooperation in enhancing the capacity of production and trade; assisting regional economic integrations in the AP regions; and establishment of a private-led consultative body. **KIEP**