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The Two Years after the Korea-EU FTA and Its Prospects

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Korea-EU FTA is the largest FTA that Korea has ever implemented with its trading partners. The EU is a very attractive market for Korean firms, with a GDP 14 times larger than that of Korea. When the negotiations were launched for the Korea-EU FTA in 2007, the EU was Korea's second largest trading partner and Korea's trade surplus amounted to 19.1 billion USD, which was the largest surplus with a single trading partner. From the EU's perspective, Korea represented its first FTA partner since it forwarded its proactive FTA strategy in 2006, known as 'Global Europe Initiative.' Given that Korea already signed the free trade deal with the US in 2007, Korea was a good trade partner in EU's 'pivoting to Asia' strategy. Several feasibility studies conducted both in Korea and the EU predicted that this

FTA would contribute to increasing trade between two sides, which would in turn create positive effect on economic growth. In implementing the FTA, Korea expected optimistic outcomes not only in terms of increased exports but also in investment growth and technological cooperation between the two sides.

However, since the FTA came into effect, Korea's export to the EU has been decreasing, while Korea's import from the EU has been increasing continuously. In 2012, Korea's export to the EU was 49.4 billion USD, while its import from the EU was reported to be 53.6 billion USD. As a result, Korea recorded trade deficit with the EU for the first time after 1997. This is an unprecedented outcome in that Korea's trade balance with one trading partner had deteriorated by more than 20 billion USD over a 5-year period. The most important reason for this disappointing outcome is the economic recession in Europe. At the time the FTA came into effect, the EU experienced a precipitous economic decline in the aftermath of the sovereign debt crisis in the Eurozone. EU's GDP contracted by 0.3% in 2012 and is expected to shrink further by 0.1% this year. This is the first time since the Second World War that European economies recorded two consecutive years of economic recession. Reasons for this recession are the simultaneous austerity measures of European countries and the deleveraging of private sectors in the Eurozone. While the deleveraging created very unfavorable economic environment for consumption and investment, the considerable budget cuts across Europe brought about a pro-cyclical effect which aggravated the economic crisis. In this context, it can be said that the first year of the Korea-EU FTA started amidst very unfavorable economic situation in Europe.

Korea's exports to the EU decreased by 12.3% for the first year and by 5.7% in the second year. Its imports from the EU, however, increased by 13.1% and 8.8%, respectively, for the first and second years. In order to evaluate this unequal result in export and import, it is important to note the following circumstances; first of all, Korea and the EU have recorded very different pattern of economic growth during the period of FTA implementation. Korea's GDP growth rate was 2% point higher than that of the EU. This means Korea's demand for imports should be higher than that of the EU. Second, Korea's export to the EU is concentrated into a few sectors such as ship (HS 89), automobile (HS 87) and electronics (HS 85). These three sectors represent almost 60 % of Korea's total exports to the EU, while other countries' exports are much more diversified. For instance, Korea's ship exports to the EU reached 13.6 billion USD (18%) in 2010, but it dropped to 7.9 billion USD in 2012. For the 1st quarter of 2013, ship exports to the EU declined almost by half compared to the same period in 2012. This shows a unique pattern of trade that Korea conducts with the EU. Ship exports of Japan and China to the EU only accounts for 1% and 2.7% respectively and a drop in new shipbuilding order in the EU had negligible impact on Japanese and Chinese exports to the EU. Third, it is often neglected that Korea started to import oil from the North Sea (Brent) in large amounts. Crude oil and oil-related products accounted for less than 1% of Korea's total imports from the EU before the FTA was implemented, but it increased by up to 13% in 2013. An increase in oil imports is nothing new, but it resulted in a trade diversion effect after the immediate removal of tariffs (3%) on oil imports. So the increase in oil imports from the EU did not cause Korea's overall trade deficit. All the more, one third of Korea's imports in crude oil are for re-export purpose after refinement. Fourth, weakening value of euro (since mid-2011) exerted positive influence on EU's export in that European products are becoming cheaper outside of Europe. The reasons for the weak euro can be explained by the decline of confidence and economic recession in the Eurozone and the lowest key interest rate since the introduction of the euro in 1999. As a consequence, the trade balance of crisis-affected European countries has been considerably improved and Germany recorded the largest trade surplus ever. It is expected that the euro will remain in weak value for a while considering the economic situation in Eurozone. This will create a favorable trade environment for Europe.

Korea's FTA policy has been focused on maximizing export potential to major trading partners. However, as long as the economic recession continues in Korea's trading partners, increasing exports through free trade talks has limitations. Besides, advanced countries are making efforts to expand the number of their FTA partners. It is highly probable that Korea's privileged status in European and American markets will erode rapidly. In this context, Korea FTA policy requires a change in orientation. On the one hand, policy support needs to shift from export increase in the short term to technological cooperation to increase productivity in the medium and long term. Technology cooperation is a follow-up measure for the revitalization of FTAs with advanced countries. Thus a network should be created to activate international technology transfer between Korea and the EU. On the other hand, it is necessary to use Korea's existing FTAs to improve Korea's regulation standard. As more and more trade is realized between Korea and the EU, regulatory dialogue will become more necessary. Considering the export-oriented character of Korea's trade activities, there is a limit to insistence on domestic regulations. In some areas (ex: environment), it will be inevitable for Korean firms to accept more advanced standards. It will be required to pay more attention to regulatory issues in balancing market access to foreign markets and policy sovereignty. KIEP