

Korea-China FTA in Services: How Far Can We Go in the Follow-up Negotiations?



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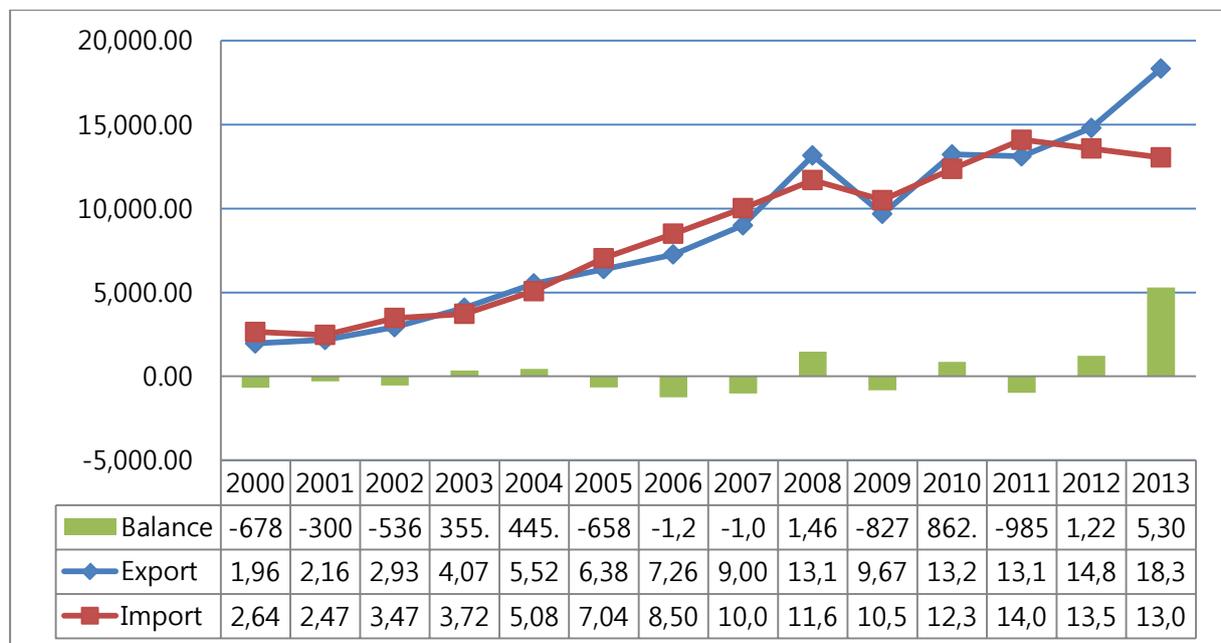
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After fourteen bilateral meetings lasting for about 30 months, South Korea and China finally settled on an FTA deal last November, 2014. Following the official procedural process, the agreement was initialed last February, 2015 and South Korea officially signed its bilateral Free Trade Agreement with China on June 1, 2015. As announced in the media, the Korean government plans to submit a ratification bill to the National Assembly before the end of the first half and seeks to have an FTA with China in force before the end of 2015. Notwithstanding all the administrative work being undertaken at this moment, this is not the end of the Korea-China FTA. Indeed, both countries agreed to resume a second-stage negotiation on services and investment liberalization in two years after the current first stage

agreement takes effect. Considering the growing importance of services and investment in FTAs, one may say that the Korea-China FTA is only halfway to its final destination.

Having underlined its importance, the services sector explains a large portion of the economy in both Korea and China. In Korea, the services sector accounts for some 60% of GDP and 70% of total employment. In China, the share of the services sector is relatively smaller; employment share is about 36% and GDP share about 46%, surpassing the share of the overall manufacturing sector in 2013. However, for the last five years China has experienced fast growth in the services sector at around 8% ~ 10%, which was above China's annual GDP growth rate. Accordingly, the services export from Korea to China expanded immensely, as shown in Graph 1.

Graph 1. Services Trade between Korea and China (mil US\$)



Source: Bank of Korea, ECOS. http://ecos.bok.or.kr/EIndex_en.jsp

Furthermore, with the global economic slowdown lasting longer than predicted, the Chinese government is looking for economic growth momentum inside the country, and hence the economic policies focusing more on service sector development. Under such circumstances, Korean firms have sought to adjust their strategies correspondingly with the aim of securing access to the Chinese domestic services market. In this regard, the Korea-China FTA is hoped to help and guide Korean firms adapting to drastic changes in the Chinese economic environment.

So, what to expect in the second-stage negotiations?

First of all, in the follow-up negotiations, both countries agreed to change the negotiating modality of liberalization in services and investment from the positive list approach to the negative list approach. In other words, in the second-stage negotiations, all services sectors are the subject of full liberalization unless otherwise stipulated; for instance, negotiating parties have to specify measures to be maintained and sectors that can adopt new measures in the agreement or reservation lists, and unbound limitation as in the positive list approach is not allowed. Due to its nature, the negative list approach is usually perceived as more comprehensively liberalizing than the positive list approach. It is known that the Korea-China FTA will be the first FTA in which China adopts the negative list approach. Another distinction of the Korea-China FTA from China's previous FTAs is that financial and telecommunication services are dealt with in separate chapters. Currently, both countries have left room for further liberalization in two important enabling sectors in the second stage. So far, the second stage negotiations seem to have great potential to enable more liberalization based on the negotiation framework built in the first stage.

Even with this promising built-in agenda, however, concerns regarding the overall level of liberalization in the second-stage FTA negotiations have yet to be cleared up.

Based on the outcomes of the first-stage negotiations, much guesswork could be done on how much farther both Korea and China were willing to go in the second stage. The level of liberalization in goods is about 90% in terms of the number of items, which is lower than the Korea-ASEAN or Korea-Vietnam FTAs. Moreover, notwithstanding Korea and China made some fair progress in the liberalization of the services sectors during first-stage negotiations, there has been reasonable doubt raised about whether this progress was adequate enough, especially compared to the offers submitted to the Doha Development Agenda negotiations. As Table 1 shows, overall market access liberalization has not improved much in the first stage; Korea has reduced limitations in twenty sub-sectors – out of 155 sub-sectors in total, while China did so in sixteen sub-sectors. At the same time, there are sectors where more limitations are imposed on compared to the DDA offers. Even after China opens the entertainment services market – which has not been opened to any other country - to Korea via the Korea-China FTA, there are only six sub-sectors that are fully liberalized; out of 155 services sectors under China's schedule of commitment, sixty five services sectors still maintain unbound limitations.

Table 1. China's Schedule of Commitment: DDA vs. Korea-China FTA

Level of liberalization	DDA	Korea-China FTA (changes from the DDA offers)		
Full liberalization	6	6		
Partial liberalization	83	84	Closed ▸ Partial	1
			Reduction in limitations	16
			Addition in limitations	8
			On par	59
Closed	66	65		
Total number of sectors	155	155		

Note: Author's calculation.

Table 2. Korea's Schedule of Commitment: DDA vs. Korea-China FTA

Level of liberalization	DDA	Korea-China FTA (changes from the DDA offers)		
Full liberalization	39	39		
Partial liberalization	67	67	Reduction in limitations	20
			Addition in limitations	6
			Changes in limitations	8
			On par	33
closed	49	49		
Total number of sectors	155	155		

Note: Author's calculation.

It may be too early to accurately predict the end outcome of the second-stage negotiations; however, these first-stage results leave an impression that two countries failed to harmonize the conflict of interests and sensitivities in services sectors and move one step forward. Then, I wonder how further liberalization can be achieved in the second stage.

Adopting the negative list approach seems a good starting point, with separate chapters for financial and telecommunication services. Despite its innate liberalizing nature, the negative list approach does not necessarily guarantee greater market access and further liberalization. There are ways to limit the potential of the negative list approach. It is indeed notable that Korea achieved a high-level free trade agreement with the European Union using the positive

list approach. Eventually, it is not the negotiating modality that leads FTAs to achieve high-level liberalization, but the willingness of the negotiating parties to do so. Of course, every country has a long list of sensitive items, which involves various, presumably conflicting, social and political objectives. Therefore, unless a government has a faith in the benefits an FTA can bring in and can persuade its domestic stakeholders about it, the level of ambition will eventually end up being compromised with no doubt. Furthermore, the global economy is still struggling with sluggish recovery from the financial crisis. Protective trade measures are enticing options to governments facing the current economic hardships and domestic political discontent. Considering the first-stage negotiation outcomes and the current global economic stagnation, the services and investment follow-up negotiations can only achieve a high level of liberalization if there is strong momentum for both countries to do so under a normalized economic environment. 