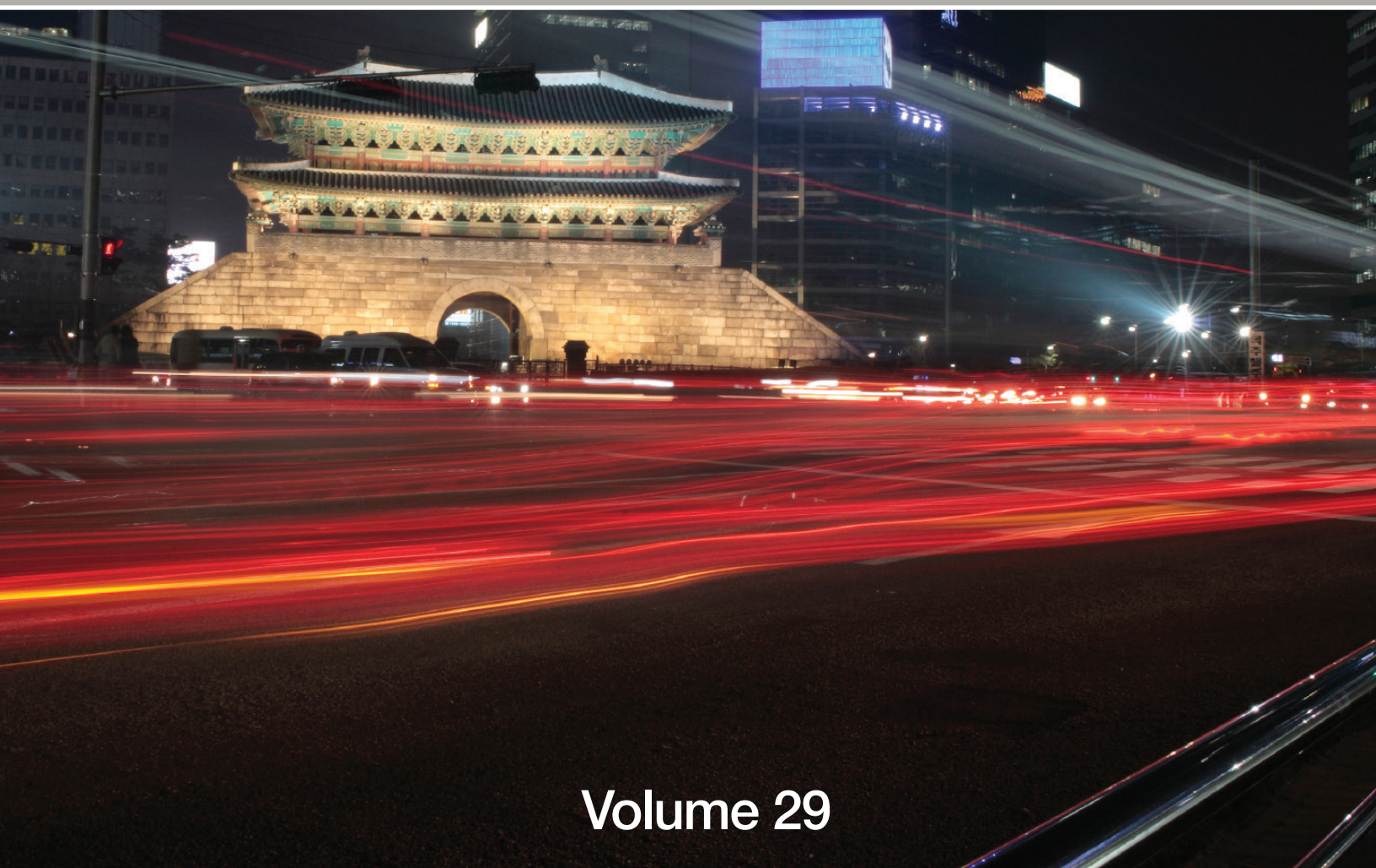




# KOREA'S ECONOMY

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# CONSIDERATIONS FOR KOREA AND THE TRANS-PACIFIC PARTNERSHIP

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## **Abstract**

The Trans-Pacific Partnership is designed to create what is often referred to as a 21st century trade agreement and serve as a potential stepping stone to a Free Trade Area of the Asia-Pacific. As Korea begins consultations on joining the Trans-Pacific Partnership, domestic and international trends are likely to weigh high on Korea's agenda. With economic growth slowing and Korea facing long-term structural challenges such as an aging population, President Park Geun-hye is seeking to increase innovation and spur job creation through the development of a creative economy. At the same time, Korea faces a changing international economic environment as international trade agreements shift from bilateral FTAs to larger regional trade agreements. This shift has the potential to provide Korea with a larger platform for the development of a creative economy; while Korea's extensive FTA network also places it in a position to serve as a linchpin to connect both the East Asian and the Asia-Pacific efforts to spur regional economic integration. As Korea consults with its potential partners, issues such as the future shape of regional rules and standards, the prospective economic benefits of increased regional trade, the potential to aid the shift to a creative economy, and the costs of joining the Trans-Pacific Partnership, along with foreign policy considerations, will likely play a significant role in Korea's final decision.

In East Asia, trade liberalization and regional economic integration are taking place along two tracks. The first track is the Trans-Pacific Partnership (TPP) that encompasses nations on both sides of the Pacific Ocean. The second, and more recent track, is an Asian track that centers on ASEAN and includes Korea, China, Japan, New Zealand, Australia, and India known as the Regional Economic Cooperative Partnership (RCEP).

While Korea has a free trade agreement (FTA) with the United States, upon which much of the TPP is expected to be based, and is in the process of negotiating bilateral FTAs with many of the current TPP participants, including Australia, New Zealand, and Canada, it had not previously expressed strong interest in joining the TPP prior to its announcement on November 29, 2013 that it would seek to begin the consultation process to join. However, a continued lack of participation could have significant implications for Korea despite its current participation in RCEP. The trading environment has evolved as states move towards larger, more regionally focused agreements. Of the two agreements, TPP is at a significantly more advanced stage and the most likely of the two agreements to impact the behind the boarder issues that have become the greatest obstacles to trade as tariffs have been cut over the years. If Korea chooses not to pursue TPP, it would face the prospect of finding itself in a similar situation to European states that are not part of the European Union – subject to rules and disciplines set by others but with little influence over the decisions.

This, however, is not consistent with Korea's broader free trade policy. Over the last decade, Korea has had one of the more substantial trade liberalization policies of any state in East Asia which was designed to both open markets for Korean exports and to introduce needed domestic reforms into the economy. In this tradition, the Park administration has expressed a desire for Korea to serve as a linchpin between the RCEP and the TPP. If Korea is able to serve as a common point between the two agreements, it could help to shape a broader agreement covering both East Asia and the Pacific states of the Americas. Serving as a linchpin for such an agreement, however, requires Korea's participation and influence in both camps.

Beyond the trade considerations, TPP has implications for Korea's domestic economic reforms. With provisions on intellectual property and the services sector, TPP could enhance Korea's ability to export new products from an increasingly innovative economy. With greater market access for intellectual property abroad, the TPP would expand the potential market for innovative Korean products and help to lay the groundwork for the environment necessary for the creative economy the Park Geun-hye administration hopes to develop to address Korea's long-term economic challenges.

## The Challenges Ahead for the Korean Economy

Despite having weathered the global financial crisis better than most OECD countries, the Korean economy faces a series of challenges in the years ahead. When the crisis hit in the fall of 2008, Korea was much better positioned to weather the storm than it was in 1997. Government debt was just below 30 percent of GDP, providing the fiscal space to implement one of the largest stimulus packages as a percent of GDP of any nation. At the height of the crisis in 2009, the economy grew, if only at an anemic 0.3 percent, and bounced back to grow at 6.3 percent in 2010 before tailing off more recently.

But if external shocks dominated the last two decades, the challenges that lay ahead may turn out to be domestic in nature. Despite the success of Samsung, Hyundai, and other Korean companies, the manufacturing heavy export model that has driven Korea's development will increasingly come under pressure from low cost producers in China and other emerging markets. While Korea currently maintains a large trade surplus with China that may change in the years ahead as Chinese firms rapidly catch up to Korean firms. This shift can already be seen in industries such as shipbuilding where Korea was once dominant. While Korea is still number one producer in terms of the total value of orders, China has surpassed Korea in terms of the total tonnage of orders. China may make more ships than Korea, but Korea's ships are more advanced.

At the same time that Korea faces an increasingly competitive external environment, its population is beginning to age and personal debt is reaching all time highs. Much like Japan, Korea has one of the world's lowest birthrates and the working age population is expected to begin declining during the term of the current administration.

Despite Korea's economic success it only recently put in place social welfare programs to support the elderly, one of two who lives in poverty according to the OECD. As Korea's population ages it may lose some of the budget flexibility that it maintained in the 2008 crisis to social welfare. One of Park Geun-hye's campaign pledges was to provide coverage to all retirees. The government has already enacted some reforms to the old age pensions and we should expect the costs to rise in the years ahead.

Efforts to shift Korea's economy towards greater domestic consumption are hindered by growing levels of household debt constraining increases in consumer consumption. Since 2003, household debt has risen from 72.9 percent of Korea's nominal GDP to 91.1 percent in 2012, while also rising from 126.5 percent to 163.8 percent as a share of disposable income during the same period.

To address these and other structural issues in the Korean economy, Park Geun-hye has proposed the development of a “creative economy” that spurs job creation and catalyzes a paradigm shift from an economy based in exports to one that fosters innovation. Park’s proposal has placed an emphasis on the convergence of IT and software technologies, scientific research, and integrating technology with cultural content. All are areas where Korea is perceived to have a competitive advantage.

Increasing competitiveness, creating jobs, and encouraging innovation means bridging the productivity gap between the services sector and the *chaebol*. While the *chaebol* are highly competitive internationally, many of the small and medium sized businesses that make up Korea’s services sector, which the OECD rates as one of the least efficient in the developed world, are inefficient but also the main source of jobs in Korea. In 2011, the ten largest *chaebol* accounted for nearly 80 percent of the economy, but less than 5 percent of employment. For this reason, the creative economy initiative is focused on improving productivity among SMEs and providing a competitive framework that will encourage entrepreneurship and innovation among Korea’s SMEs.

## Korea’s Trade Policy

Modern Korean trade policy begins in the aftermath of the Asian financial crisis when a shift from multilateral to bilateral trade agreements began. For much of its export driven development, Korea depended on multilateral trade negotiations, first through the General Agreement on Tariffs and Trade (GATT) and later the World Trade Organization (WTO), to open markets for the exports that drove its economic growth and development. For Korea, the crisis exposed imbalances within the economy and the need to undertake structural reform, some of which were mandated by the IMF as part of Korea’s rescue package during the crisis.

At the same time, broader shifts were taking place in the global trading system. The GATT/WTO process was coming under strain. Efforts to launch the current Doha round during the Seattle WTO meetings were unsuccessful and the round itself almost ground to a halt during the Cancun ministerial in 2003. Once the Doha round talks were up and running, they were primarily centered on addressing the needs of developing nations and eventually became deadlocked over issues related to agriculture.

Like many nations, agriculture was a sensitive issue for Korea despite its need to import a significant amount of food to feed its population. As with many Asian nations, rice is a highly sensitive commodity, and one of the obstacles to the eventual U.S.-Korea FTA (KORUS FTA) was a ban on U.S. beef in the aftermath of the discovery of BSE in the United States.

Beyond Korea’s own sensitivities and the Doha round’s focus on agriculture, the global talks were never able to address in any meaningful fashion the broader market access issues that would be necessary for an export driven economy such as Korea’s to benefit substantially from the round.<sup>1</sup> Meanwhile, there had been a growing proliferation of regional and bilateral FTAs that threatened to erode Korea’s competitive advantage and potentially spur trade diversion at Korea’s expense.

In response to these changes, Korea’s trade policy underwent a series of changes in the late 1990s and 2000s. Facing the prospect of trade diversion from the growing number of FTAs, Korea began exploring the possibility of engaging in its own bilateral FTAs under the Kim Dae-jung administration and launched its first FTA talks with Chile in 1999.

Until the conclusion of Korea’s FTA with Chile in 2003, it was one of two countries in the World Trade Organization (WTO) that had not concluded an FTA with another country despite its heavy dependence on international trade. Even today, exports and imports each represent more than 50 percent of Korea’s GDP. In contrast, the United States which is significantly less dependent upon trade concluded its first FTA with Israel in 1984 and the North American Free Trade Agreement in the early 1990s, more than a decade before Korea’s agreement with Chile.

Kim Dae-jung’s successor, Roh Moo-hyun, would lay out Korea’s first FTA Promotion Roadmap. Under the roadmap, Korea divided its potential FTA partners into two classifications. The first set included regional partners such as Singapore, ASEAN, and Japan that Korea would seek FTAs with in the short term, while Korea would seek FTAs with major economies such as the United States and the European Union in the medium-to-long term.<sup>2</sup>

However, midway through the Roh administration, the emphasis changed. Korea’s talks with Japan became stalled<sup>3</sup> over Japan’s reluctance to liberalize its agricultural sector and the decision was made to move up Korea’s plans to negotiate FTAs with the major economies. Negotiations with the United States began in 2006 and shortly after talks were concluded on the KORUS FTA, Korea began negotiations with the European Union. The emphasis in Korea’s trade policy also shifted from mostly regional, small economies to a pursuit of agreements with partners around the globe.

By the beginning of the Lee Myung-bak administration, Korea’s trade policy could be described as follows: (1) focused on reaching agreements with advanced economies and promising emerging markets; (2) pursuing high level, comprehensive agreements that contain a significant degree of liberalization and wide-ranging in terms of the areas covered; (3) a multi-track negotiating process; and (4)

greater outreach to the public and private sector to build a national consensus.

Trade policy also became a means to facilitate needed structural reforms. Despite Korea's success as a manufacturing exporter, the services sector is one of the least developed among OECD nations. The KORUS and EU FTAs were used as tools to liberalize services and inject international competition, something the Roh Moo-hyun administration was open about. In the case of the KORUS FTA, President Roh is said to have wryly noted that perhaps his negotiators did too good of a job on this count.

Despite being a latecomer to the drive for FTAs, Seoul has played a significant role in shaping the current environment in East Asia. After concluding the KORUS FTA, China signaled its desire to conclude an FTA with Korea, while Japan indicated that it would like to restart its negotiations with Korea. Though talks with Japan have continued to stall, negotiations with China are underway and the high standard of Korea's FTAs has likely helped spur China to agree to a more comprehensive agreement than would have been the case otherwise. Additionally, the Trans-Pacific Partnership (TPP) talks are largely modeled off of the KORUS FTA.

However, as the Park Geun-hye administration came into office in 2013, changes in the trading system and domestic needs necessitated a fresh look at Korea's trade policy. Emerging economies such as India and China were playing an increasingly more important role in international trade, while plurilateral and regional agreements began to take on a more prominent role as well. Efforts were underway to launch a plurilateral services agreement, as well as to update the Information Technology Agreement. The United States was pursuing both the TPP and the Trans-Atlantic Trade and Investment Partnership (TTIP), while China was pushing RCEP as an alternative to the TPP.

The updated trade policy roadmap put forward by the Park administration seeks to address the new challenges Korea faces while better integrating Korea's trade policy into its own shift towards a creative economy. Under the new policy Korea seeks to: (1) serve as a linchpin for regional economic integration; (2) be proactive towards the changing global trade order; (3) develop a trade model that is applicable to developed and developing countries; (4) promote policies that help to create jobs and greater integrate small and medium sized enterprises into trade agreements; (5) proactively take part in multilateral negotiations at the WTO; and (6) build the domestic political foundation for trade policies.

## The Trans-Pacific Partnership and Considerations for Korea

In Bogor, Indonesia in 1994, the member states of APEC agreed to work towards the goal of creating an area for free and open trade and investment in the Asia-Pacific in two stages. In the first, trade and investment would be liberalized among developed nations by 2010, while developing nations would join them by 2020. To help find a path to achieving that goal, the initial P4 members of New Zealand, Chile, Brunei, and Singapore sought to develop a path forward towards the Bogor goal. In doing so they established the framework for the current talks underway for the TPP which now also includes the United States, Canada, Mexico, Vietnam, Peru, Malaysia, Australia, and Japan.

As constructed, the TPP is designed to create what is often referred to as a 21st century trade agreement. In basic terms, this means that the goal of the TPP is to establish an agreement where tariff and non-tariff barriers are removed. Practically speaking, there are likely to still be some exceptions, such as rice, from any final agreement. However, if successful, the TPP would represent an important milestone whose ambition and scope could help to develop new rules and disciplines for a wide range of issues regionally and in future multilateral discussions.

One unique feature of the TPP is that it is expected to be a living agreement. New members would be able to join in the future and members could address new issues as they evolve.

In terms of its impact, potential income gains from TPP for Korea are substantial. In some of the more cited work done by Peter Petri and Michael Plummer,<sup>4</sup> Korea stands to see income gains from TPP of \$45.8 billion. This rises to \$50.2 billion if the Philippines, Indonesia, and Thailand were to move forward on their interest and join. Should Korea decide to remain outside of the TPP, it is expected to see a small income loss of \$2.8 billion. The expected gains from TPP, however, are smaller than the \$82.0 billion Petri and Plummer expect that Korea would gain from participation in the RCEP or the \$129.3 billion in income gains should a Free Trade Area of the Asia Pacific emerge.

However, as with any nation, the decision to join the TPP is not simply a matter of measuring the total income gains of each agreement and negotiating the one with the greatest income gain. The TPP is not merely a bilateral agreement, but a potential blueprint for the future shape of economic interaction across much of Asia and the Pacific. This means there are broader considerations such as Korea's vision for economic integration in the region, its own domestic economic interests and how they related to the international economic structure, and foreign policy considerations to name a few.

Given that the TPP is an ongoing negotiation, it is unclear if time remains for Korea to join and participate in the formation of rules. However, USTR Michael Froman suggested that any new partners to TPP would likely join after the negotiations are concluded. With this in mind, the following sections will look at some of these considerations for Korea joining the TPP in context of their impact on Korea and areas where it may have an interest in contributing to the development of rules in more detail.

### **Why Rules Matter**

Much of the debate over Korea's participation in the TPP has centered on the larger expected income gains from Korea's participation in RCEP. While understandable, as the income benefits of an agreement matter, they are not the whole picture.

Korea began engaging in bilateral trade agreements due to a concern that they would erode the benefits it gained from multilateral trade agreements. As tariffs become less of a barrier to the movement of goods than behind the border issues, the rules and the structure of the system take on increased significance. Of the two regional agreements, TPP is the most ambitious in terms of its coverage and its scope.

While the KORUS FTA is serving as a baseline for the TPP talks, the TPP is also expected to go beyond the provisions in the KORUS FTA. The TPP is expected to include new disciplines on state owned enterprises, labor, the environment, and competition policy, while also addressing cross-cutting issues such as development policies, the participation of SMEs in regional trade and investment, and regulatory coherence. While some of these provisions may ultimately be reflective of Korea's commitments under the KORUS FTA, their final shape may require some adjustment on Korea's part in areas such as regulatory coherence. However, for other issues, such as SME participation, Korea joining after TPP's conclusion may have minimal impact. To date, negotiators have focused on capacity building issues. This is an area where Korea could easily adopt any new measures unilaterally, most likely with minimal impact even if it decided not to move forward with the TPP after its initial consultations.

From the perspective of rules, there are three reasons it may be in Korea's interest to join the TPP in the first wave. First, while the KORUS FTA may be the current gold standard for an agreement, there are no assurances that TPP will not diverge from KORUS on some rules, especially on areas not covered by the KORUS FTA. For example, there is the issue of supply chains. If the final version of TPP included rules of origin or harmonized standards that help to facilitate trade through TPP members and make movement through Korea less appealing for regional supply chains, Korea may find itself in a situation analogous to non-EU member states in Europe. Not part of

the larger agreement, but having to meet regional standards to remain competitive.

Second, joining the TPP would help to set a standard of rules across the region under which Korean companies could operate. Because Korea's FTAs with partners other than the United States and the EU are not of the same scope and coverage, differing rules apply across agreements. The TPP would allow Korea to update those agreements and set common rules with new partners. While the *chaebol* have the capacity to deal with differing rules and tariff rates for differing agreements, TPP would help SMEs by providing them with one set of rules for whichever member state they wished to do business in.

Lastly, Korea's decision on TPP will signal its vision for the shape that regional integration should take. If Korea joins the TPP it will signal to Korea's other trade partners that Korea favors a high level of liberalization and the types of rules Korea hopes to see as regional integration moves forward. If Korea continues to demure over the long run, it may send a different signal and misconstrue Korea's intentions.

Why is all of this important? As a recent report by the Korea Institute for International Economic Policy<sup>5</sup> (KIEP) notes, tariffs in the United States and the EU on manufactured goods average 2.0 percent and 2.4 percent, respectively, while both are largely open economies. Despite this, both the United States and the EU are currently negotiating the TTIP. The KIEP report, however, goes on to note that in areas such as cosmetics, food and beverages, and automobiles the effect of the non-tariff barriers is 25.5-73.3 percent, while the costs from regulatory differences in general can reach the tariff equivalent of 10-20 percent.

However, the report also notes that in terms of global trade, "a U.S.-EU FTA can contribute to restructuring the global trading system around the U.S. and EU. For instance, if discussions on the FTA move ahead on a comprehensive level, covering trade in services, regulations, investment, intellectual property rights and government procurement markets, both sides can push the negotiations of results as global agendas, thus gaining a stronger foothold within a multilateral framework." Given the similar size and scope of the TPP it can have a similar impact.

### **Invigorating the Creative Economy**

The shift to a creative economy will require more than the creation of a domestic ecosystem that encourages investors and entrepreneurs to take risks and translate failure into success. It will require time, and cultural shifts that place risk taking above safe salaried jobs, things which no free trade agreement can provide. As Korea works to undertake this transition, trade policy can play a role in Korea's continued economic evolution with the TPP helping to create a broader regional environment more conducive to innovation and helping to spread the cost of research and development over a larger market.

For the last six decades, Korea's economy has in large part grown by learning to do the things others have already done better and cheaper. If Korea is instead to move to the production possibility frontier with other nations, such as the United States, innovation will take on a larger role in the economy. As it does, the value of production in Korea's economy will come to be based increasingly upon intellectual property (IP) and a greater portion of the economy dedicated to the services sector. Korean firms will increasingly compete with international rivals not on cost, but on innovation. This is already occurring in some industries, as was previously mentioned in the shipping industry.

Strong IP protections also play a role in encouraging exports. In foreign markets they provide assurances to investors and businesses that they will reap the gains from the new products and services they develop from their creativity, by protecting against intellectual theft and providing the safeguards needed to promote exports and the dissemination of technology. Weaker IP protections in neighboring countries would undermine Korea's potential competitive advantage as an innovative economy, while low wage countries would be able to utilize their cost advantages in combination with other countries IP. Having proper IP protections in place both domestically and internationally is important even with other advanced economies as the ongoing disputes between Samsung and Apple demonstrate.

Additionally, the TPP could help to open the services markets of many of the TPP member states. Members such as Chile and Brunei score poorly on metrics such as the GATS Commitments Restrictiveness Index. As Korea has learned through its own development, restricting the services sector produces lower rates of innovation and economic growth. A stronger commitment to service sector openings in the TPP would benefit emerging Korean service providers, who will likely be leaders in the creative economy, by providing them with new export opportunities and unlike tariff benefits, the benefits of expanded services access are something that do not often show up in estimates of the economic benefits of an agreement.<sup>6</sup>

In the case of SMEs, which the Park government is hoping to promote to enhance job creation, many of the most promising markets and opportunities may be in the services sectors of other countries. The inclusion of a more conducive environment for creative industries in TPP would also create a larger "domestic" market for entrepreneurial Koreans to develop and build new businesses.

As Korea becomes a more innovative economy, IP, services, and the needs of SMEs will continue to grow in prominence in the new Korean economy. By joining TPP Korea can continue to push for regional rules and services access that will benefit the creative economy in the long run.

## **The Cost of Entry<sup>7</sup>**

Now that Korea has expressed its interest in joining the TPP it will engage in a series of consultations with current TPP members. As part of the consultations, the existing members will seek commitments from Korea in regards to its ambition for the negotiations and potentially to resolve some existing trade irritants prior to Korea's accession. Since Korea will likely be joining after TPP is concluded, members would be seeking Korea's commitment to the full ambition of the TPP as it is negotiated.

This process is not dissimilar to Korea's talks with the United States over the U.S.-Korea FTA or Japan's and other countries' accessions to the TPP. In the case of the U.S.-Korea FTA, the United States asked Korea to address issues related to Korea's ban on U.S. beef and screen quota prior to entering into negotiations. Before Japan's entrance into the TPP, it engaged in the same process, where it agreed to engage the United States in parallel discussions on barriers related to the automotive industry, for example.

In the case of Korea and TPP, current participants could also seek advance commitments from Korea prior to granting it membership. Korea currently has restrictions on U.S. beef over the age of 30 months as part of a commercial agreement with U.S. industry and still has bans on the importation of beef from Canada. Requests for the immediate removal of these restrictions, or other issues, could make the cost of entry unattractive to Korea.

## **Outward Processing Zones**

In all of its FTAs, Korea has sought provisions to allow for the export of goods from outward processing zones to be included in its agreements and considered as Korean. This primarily means goods from the Kaesong Industrial Complex in North Korea, but in time could also include additional industrial complexes. While some TPP members currently have provisions on outward processing zones in their FTAs with Korea, not all TPP members do and not all of the provisions are comparable (see Table 1).

Despite the TPP being designed as a living agreement that would address new issues as they arose, the issue of outward processing zones might be the most difficult for Korea to raise in regards to TPP. While Korea should not seek to hold up the TPP talks over outward processing zones if it were to join the talks, there are clear steps it could take to ensure the issue is addressed.

First, Korea could request the inclusion in TPP of a provision to allow it to individually negotiate terms with each member for the inclusion of outward processing zones on the condition that this ad hoc access could not be utilized for the transshipment of goods from Kaesong. It could also be understood that talks

**Table 1****Provisions on Outward Processing Zones in South Korean FTAs**

| Free Trade Agreement                | Key Provisions  |
|-------------------------------------|---|
| <b>KORUS FTA</b>                    | <ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones 1 year after entry into force.</li> <li>• The committee's key criteria for consideration include: progress toward the denuclearization of the Korean Peninsula; the impact of the outward processing zones on intra-Korean relations; and the environmental standards, labor standards and practices, wage practices and business and management practices prevailing in the outward processing zone, with due reference to the situation prevailing elsewhere in the local economy and the relevant international norms.</li> <li>• The committee shall establish a maximum threshold for the total value of the originating good which may be added in the outward processing zone.</li> </ul> |
| <b>European Union FTA</b>           | <ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones.</li> <li>• The committee will establish what criteria must be met and will determine what total value of the final good may be added in the outward processing zone.</li> </ul>   |
| <b>European Free Trade Area FTA</b> | <ul style="list-style-type: none"> <li>• Provides for an exemption from the principal of territoriality.</li> <li>• Goods shall be determined to be South Korean goods if (1) the total value added does not exceed 10 percent; or (2) the total non-originating input does not exceed 40 percent of the final price claimed and the total value of the originating material is not less than 60 percent of the total value of the materials used in the re-imported material or product.</li> <li>• Allows for revisions to the exemption from the principal of territoriality after 3 years.</li> </ul>   |
| <b>Singapore FTA</b>                | <ul style="list-style-type: none"> <li>• Provides for the use of outward processing under the following conditions: (1) the value of the non-originating inputs do not exceed 40 percent of the customs value of the final good as claimed; (2) the value of the originating material is not less than 45 percent of the final customs value claimed; (3) the producer of the exported material and the final product are the same; and (4) the last process of production takes place in the originating country.</li> </ul>   |
| <b>India FTA</b>                    | <ul style="list-style-type: none"> <li>• Provides for an exemption from the principal of territoriality related to the Kaesong Industrial Complex.</li> <li>• Provides a list of eligible goods.</li> <li>• Goods shall be determined as originating in South Korea if the total value of the North Korean input does not exceed 40 percent and the value of the South Korean content is not less than 60 percent of the value of materials used in manufacturing the re-imported material or good.</li> <li>• Provides for the usage of safeguards on goods exported from Kaesong with a two month notice and the rescinding of the exemption from the principal of territoriality after 5 years.</li> </ul>   |
| <b>ASEAN FTA</b>                    | <ul style="list-style-type: none"> <li>• Provides for goods from either party to be considered originating from the party if processing is taken on materials exported from the originating party and re-exported to the party.</li> <li>• Provides for the list of eligible products and procedures to be determined at a later date.</li> </ul>   |
| <b>Turkey FTA</b>                   | <ul style="list-style-type: none"> <li>• Provides for the establishment of a committee to consider the inclusion of outward processing zones.</li> <li>• The committee will establish what criteria must be met and will determine what total value of the final good may be added in the outward processing zone.</li> </ul>   |

Source: South Korea's FTAs with the United States, the European Union, the European Free Trade Association, Singapore, India, Turkey and ASEAN.



on this issue need not be concluded with all members for the agreement to move forward. Second, it could seek the inclusion of similar language to Korea's FTAs with the U.S. and EU in the TPP as a whole to allow for further discussion of this issue to determine under what criteria inclusion would be appropriate. As part of that discussion there could be a provision that once criteria is met there would be discussion on harmonizing provisions related to outward processing zone access across TPP members.

### **Foreign Policy Considerations**

Free trade agreements also have political dimensions. In recent years, competition between China and the United States has increased in the region with each promoting their own respective regional agreement. In essence, Korea does not want to send the wrong signal to either its largest trading partner or most important security partner.

In recent years, China has expressed skepticism regarding the TPP and this is somewhat understandable. While the idea put forward by some that TPP was an effort to economically contain China was always overstated, China does stand to incur income losses from the TPP, which Petri and Plummer estimate to be \$46.8 billion. However, these would more than be made up for from a successful RCEP, which could bring China income gains of \$249.7 billion, or more importantly an FTAAP in which China would gain the most by far at \$678.1 billion.

Perhaps this, along with the appeal TPP may hold as a vehicle for domestic reforms in China, much as its WTO entry was, help to explain why China under Xi Jinping has begun to show signs that its thinking regarding TPP may be changing.

### **Domestic Constraints**

While late to join in the proliferation of FTAs, Korea has had one of the more robust FTA policies. However, in spite of Korea's dependence on trade there has been significant domestic opposition from interest groups such as farmers and at times the Democratic Party. As Korea considers whether to join the TPP talks these will need to be considered as well.

After experiencing harm from liberalizations under the Uruguay Round, domestic opposition from farmers to Korea's FTA with Chile delayed its passage until 2004. Since the passage of the Chile FTA, farmers in Korea have opposed the KORUS FTA and expressed opposition to the ongoing negotiations with China. As result, the National Assembly passed compensation packages, the FTA Special Law, for farmers damaged by trade.

Under Korea's initial FTA Special Law passed after the Chile FTA, farmers would receive income support if prices

fell below 80 percent of the base price and an indemnity for closing fruit orchards that competed with certain products imported from Chile from 2004-2008. However, the impact from the Chile FTA was less than expected, reducing the need for income support. Because the initial FTA Special Law had a high bar for income support, farmers received little income support. However, as the EU and KORUS FTAs came into effect the threshold for receiving income support has been raised from 80 percent of a base price to 90 percent, for which the government has set aside almost \$21 billion through 2017.

Opposition has also come from the Democratic Party, the successor party to the Uri Party which negotiated the KORUS FTA during the Roh administration. Once in opposition, the then Democratic United Party, sought to renegotiate certain provisions, such as those related to Investor-State Dispute Settlement, partially in response to the United States seeking additional negotiations on automobiles. However, once those negotiations were settled with adjustments on both sides, the Democratic United Party threatened to withdraw Korea from the agreement should they win the 2012 National Assembly elections if their demands were not met before implementation. While the Saenuri Party won the 2012 elections, the ruling party holds only a slim majority in the current National Assembly.

Lastly, relations with Japan will also be a consideration. Korea has a trade deficit with Japan and relations between the two countries have deteriorated since rows over history, Dokdo, comfort women, and the collapse of an intelligence sharing agreement in 2012. Polling by the Asan Institute for Policy Studies from September 2013 indicates that Korean views of Japan have fallen to on par with North Korea, while 80 percent of Koreans view relations between the two countries as being poor. However, the same polling also indicates that Korean views of intelligence sharing with Japan have significantly improved since the agreement's initial failure, with 60.4 percent of Koreans supporting the agreement. While domestic views of Japan will be a consideration in moving forward, the shift on intelligence sharing may indicate that significant policy steps with Japan are possible, though they may come with a political cost.

### **Concluding Thoughts**

In some ways there are two Korea's in the debate over whether to join TPP. The old Korea, which was a successful manufacturing powerhouse that would benefit from a higher quality FTA with ASEAN and its RCEP partners, and the new Korea that will increasingly rely on services and innovation for the creation of jobs and economic growth. Pursuing the

TPP should not preclude Korea from also taking part in RCEP, and would enhance key aspects of the current administration's trade policy, including efforts to make Korea the linchpin of regional economic integration, improve the access of SMEs to international trade, and integrate trade policy into efforts to make Korea into a creative economy. While achieving these goals would best be served through Korea's entry into the TPP before negotiations were concluded, the question for Korea is not so much if it will join the TPP, but when.

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<sup>1</sup> In fact, a study by the Peterson Institute for International Economic concluded that the Doha round had less value to the United States than the KORUS FTA. While the study did not provide the welfare benefits for Korea, it is likely that the same holds for it as well.

<sup>2</sup> Inkyo Cheong and Jungran Cho, "The Impact of Free Trade Agreements (FTAs) on Business in the Republic of Korea." Asia Development Bank Working Paper Series No. 156. October 2009.

<sup>3</sup> Talks with Japan stalled over the issue of agriculture in 2004. They essentially remained dormant under the Roh Moo-hyun administration. While the Lee Myung-bak administration has tried to revive the talks, they have not progressed beyond working level talks that were restarted in September of 2010. "FTAs Give Korea a Broad Trade Reach," *JoongAng Ilbo*, January 4, 2011. Jung Seung-hyun.

<sup>4</sup> Petri, Peter; Michael Plummer and Fan Zhai. *Asia Pacific Trade Website*. Accessed on October 12, 2013: <http://asiapacifictrade.org/>.

<sup>5</sup> Kim, Young-gui; Yoo-duk Kang, and Kyeong-ah Lee. "Prospects and Implications of a U.S.-EU FTA." KIEP World Economy Update, April 5, 2013. Vol. 3, No. 15.

<sup>6</sup> Ezell, Stephen. "Ensuring the Trans-Pacific Partnership Becomes a Gold-Standard Trade Agreement." Information Technology & Innovation Foundation, August 2012. Accessed on October 16, 2013: <http://www.itif.org/publications/ensuring-trans-pacific-partnership-becomes-gold-standard-trade-agreement>.

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