Korea-EU FTA Represents a Challenge for the United States

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Korea is a relative newcomer to the negotiation of bilateral FTAs, concluding its first agreement with Chile only in 2003. Prior to engaging in bilateral FTAs, Korea emphasized the multilateral trading system. However, as other nations aggressively pursued bilateral agreements to open up promising markets and multilateral trade negotiations stagnated, Korea responded to the changing international trade environment with a series of bilateral trade agreements. Korea's most recent agreement, with the European Union (EU), will only strengthen its claim to being the FTA hub of Asia and presents a challenge for the United States, whose own agreement with Korea is currently stalled.

Korea's FTA with the EU, which surpasses the KORUS FTA as the largest bilateral FTA, will immediately eliminate 82 percent of Korea's tariffs and 94 percent of the EU's tariffs. In five years it will eliminate 94 percent of Korea's tariffs and 99.6 percent of the EU's tariffs, with both the EU and Korea eliminating 98 percent or more of their tariffs in seven years. In contrast, the KORUS FTA would eliminate 94.5 percent of Korean tariffs in three years, with virtually all tariffs eliminated in ten years.

Once fully implemented, the Korea-EU FTA would potentially increase Korea's GDP by 2.4 percent and the EU's by less than one percent. European estimates have the agreement increasing exports to Korea by €19 billion (€1=$1.48), while the KORUS FTA is estimated to increase U.S. exports by up to $11 billion. Studies of the agreement's potential impact suggest that the greatest gains will come from the liberalization of services, with gains from financial and business services for both Korea and the EU. For Korea, the auto industry will likely benefit the most from the FTA, with electric goods, iron and steel, and textiles also expected to gain. For the EU, the biggest gains will come from increased services exports to Korea, but processed foods and manufacturing are also expected to benefit.

The EU is Korea's second largest trading partner after China, and its largest source of FDI, while Korea is the EU's fourth largest trading partner after the United States, Japan, and China. In 2008, the two conducted $98 billion in goods trade, with Korea importing nearly $40 billion worth of goods from the EU, while exporting $58.4 billion to the EU. The United States is Korea's fourth largest trading partner with two-way trade of $85 billion in 2008.

How the Korea-EU FTA Differs from the KORUS FTA

Much like the KORUS FTA, the Korea-EU FTA is a comprehensive agreement that excludes rice. However, the agreements do differ in some key areas, including the most controversial, trade in automobiles. In regards to autos trade, the EU and the United States took different approaches to address the non-tariff barriers the industry has faced in Korea, but there are also differences related to the elimination of tariffs. Under the Korea-EU FTA, Korea's automobile tariffs will be eliminated depending on engine size in three or five years. The KORUS FTA provides for the immediate elimination of Korea's automobile tariff.

In addressing the barriers posed by safety standards in Korea, the Korea-EU FTA commits Korea to recognizing the standards set by the United Nations Economic Commission for Europe (UN-ECE) as equivalent to Korean standards for core safety standards and to harmonize regulations pertaining to an additional 29 standards with UN-ECE regulations within five years. For all the standards not subject to harmonization or equivalence, Korea is committed to ensuring that they are not applied in a manner which limits market access. The agreement also provides that any new standards be based on UN-ECE standards, and that new features and technologies be allowed without difficulty.

In contrast to the EU's approach, the United States secured an exemption that allows each U.S. automaker to sell up to 6,500 vehicles per year in Korea built to U.S. safety standards. The KORUS FTA also contains provisions for Korea to reform many of the aspects of its tax structure pertaining to the sale of automobiles, which has been identified as one of the barriers to sales in Korea. While each agreement addresses issues in separate manners, any changes to Korea's regulatory or tax structure would apply to all WTO members on a most favored nation (MFN) basis.

The EU and the United States have also taken a different approach to handling dispute settlement related to automobiles. Both the EU and the United States have expedited dispute settlement mechanisms in their FTAs with Korea. The differences mainly reside in the how quickly each panel would reach a decision and the remedies that are open to the parties involved. Under the Korea-EU FTA, a final ruling would take no more than 75 days, while under the KORUS FTA a final report from the dispute settlement panel could take 141 days. However, while the Korea-EU FTA would produce a faster decision, the KORUS FTA has stronger remedy provisions. The Korea-EU FTA's remedy provisions are governed under the same rules as normal dispute settlement resolution under the FTA, while the KORUS FTA allows for the aggrieved party to restore, or "snap back," its tariff to MFN levels.

Both agreements include provisions on outward processing zones on the Korean peninsula, which would include the Kaesong Industrial Complex that is managed by South Korea but located in North Korea. Under each FTA, a committee on outward processing zones on the Korean peninsula is created to determine what geographic areas would qualify as outward processing zones and the criteria for the zones to be considered as part of the FTA. The KORUS FTA specifies that these criteria could include, but not be limited to, progress on denuclearization on the Korean peninsula, the impact of the zones on inter-Korea relations, environmental standards, wages, labor standards, management practices, and other criteria. The KORUS FTA would also require legislative approval by Korea and the United States of the committee's recommendations for goods from outward processing zones to be considered under the FTA. The Korea-EU FTA, however, does not specify what criteria would be considered for the inclusion of goods from outward processing zones and does not require additional legislative approval.

The two agreements also differ in how they handle the services sector, as well as labor and environmental issues. For the services sector the Korea-EU FTA uses a positive list, delineating Korea and the EU's commitments to liberalization. The KORUS FTA, in contrast, utilizes a negative list approach, which helps to ensure that new services are covered as innovation occurs.

On labor and the environment, the Korea-EU FTA calls for both parties to enforce their laws and to not weaken them to encourage trade and investment. However, unlike the KORUS FTA's provisions, these are not covered by the agreement's dispute settlement mechanism. The agreement also differs from the KORUS FTA in that it contains no investment chapter or investor-state dispute settlement provisions, as investment matters still remain the purview of EU's member states.

Passing the Korea-EU FTA

Now that the EU-Korea FTA has been initialed, the European Commission will present the agreement to member states after it has been translated into the EU's 23 official languages, most likely sometime in early 2010. After the EU Presidency and the Commission sign the agreement, the FTA will be presented to the European Parliament for approval. In Korea, consideration of the FTA will begin in the Foreign Affairs, Trade, and Unification committee before proceeding to the floor of the National Assembly for approval. The European automobile industry has opposed the Korea-EU FTA, much as the U.S. industry has opposed the KORUS FTA, but, unlike the situation in the United States, it is not expected to be able to stall the agreements approval in Europe.

Expectations are that the Korea-EU FTA will come into effect sometime in the middle or second half of next year. While USTR is continuing its efforts to find an acceptable solution for the concerns of the U.S. automobile industry, it seems unlikely that the KORUS FTA would come into force any time prior to mid-2011. The KORUS FTA's most significant obstacles have always been opposition to the agreement's auto provisions and the political calendar, neither of which has shown signs of changing. The current healthcare debate is likely to consume much of the administration's political capital and time for the remainder of the year, leaving only a small window early in 2010 for potential consideration by Congress before the mid-term elections begin to gear back up.

Korea's Other FTAs

Korea currently has FTAs with Chile, Singapore, ASEAN, and the European Free Trade Association and has concluded agreements with the United States and India, in addition to its agreement with the EU. It is currently negotiating FTAs with Canada, Mexico, Australia, New Zealand, the Gulf Cooperation Council, and Peru, while agreements with China, Russia, MERCOSUR, Turkey, Colombia, Israel, and the South African Customs Union are under consideration. Korea has also had preliminary discussions with Japan about restarting its previously stalled negotiations and has expressed support for a potential Korea-China-Japan FTA.

How the Korea-EU FTA Could Impact the United States

While it is still too early to make a definitive assessment of the impact the Korea-EU FTA will have on U.S. exports to Korea or the EU, there are two considerations that may shed light on the effect it is likely to have on the United States. The first is the likely effect the agreement will have on the United States as a whole, while the other is the effect the Korea-EU FTA may have on specific industries and products.

A study of the potential benefits of a Korea-EU FTA by Copenhagen Economics pointed out that, even in the absence of a Korea-EU FTA, the EU would not necessarily be worse off as Korea concluded FTAs with other large partners. The study noted that, while the EU would lose market share from import substitution, as Korea’s GDP grew from increased trade liberalization, it would also import more goods and the growth in the value of its import market would compensate for the EU's loss of market share.

While the United States may not as a whole suffer from the Korea-EU FTA, the same may not be the case for specific products or industries. A commodity like pork may be a good example. After the KORUS FTA was concluded, Iowa State University produced a study indicating that once the KORUS FTA was fully implemented U.S. pork exports would increase to 600,000 metric tons, more than is currently exported to Japan, the number one export destination for U.S. pork. However, the EU currently exports more pork to Korea by value, with U.S. exports totaling $284 million in 2008 and EU exports €240 million. Once the Korea-EU FTA is implemented, it is plausible that the EU would increase its market lead in Korea and cut into the predicted increase of U.S. pork exports to Korea. While U.S. pork exports would increase, they may not achieve the level they would have seen with European pork producers experiencing a first mover’s advantage.