

Implications of the Republic of Korea's package for enhancing FTA utilization

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Summary

This policy brief reviews the Republic of Korea's experience in implementing Free Trade Agreements (FTAs) with a particular focus on measures taken to increase the utilization of preferences available under FTAs by Korean exporters. Key findings:

- The Republic of Korea was relatively late in negotiating FTAs with major trading partners. However, following a spate of activity in recent years it now has over 50 trade agreements with other countries.
- While FTAs provide exporters with preferential access to partners' markets, utilization of these preferences is often low for a variety of reasons including a lack of awareness amongst businesses as to how to take advantage of available preferences.
- The Republic of Korea has taken a number of steps to successfully raise the utilization rate of its FTAs between 2007 and 2013. Utilization rates are now between 40 and 90 per cent: higher than the regional average.
- Support for and consultation with businesses given by the FTA Promotion and Policy Adjustment Authority was crucial for improved utilization of FTAs by exporters. But more can still be done to provide support for SMEs which are less likely to use FTA preferences.

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Introduction: Issues in FTA utilization

The Republic of Korea was a late-comer to regionalism, having implemented its first free trade agreement (FTA) in April 2004 with Chile. The country now has free trade agreements with 50 countries including the United States of America, the European Union, ASEAN and India (see figure). The utilization ratios of these FTAs are fairly high, ranging from 40 per cent to 90 per cent as of December 2013 although the rates differ depending on the method of measurement.¹ Utilization rates are not identical across FTAs and some FTAs have recorded a poor performance in terms of utilization. Further, the utilization ratios of FTAs by companies in the Republic of Korea were previously quite low in 2008 and some suspicions regarding the benefits of FTAs were raised, despite the Government's active promotion.

Figure: Republic of Korea's network of FTAs (2014)



Today's high performance level has been achieved due to the strategic approach and diverse support mechanisms initiated by the Government of the Republic of Korea since 2010. This goes back to 2007-2009. When the ASEAN-Korea FTA was implemented on 1 June 2007, Korean companies expressed high levels of concern because of the geographical closeness of ASEAN, which is the Republic of Korea's fifth-largest trading partner. However, it was reported that only few companies were utilizing the FTA in exporting their products to ASEAN countries.

¹ The utilization rates can be defined in several ways (Plummer and others, 2010). One of those methods is:
 Utilization rate = $\frac{\sum_{h \in T} M_h^U}{\sum_{h \in T} M_h}$ where h is a detailed tariff line, M_h is the value of imports of tariff line h from a FTA partner country, M_h^U is the value of imports of tariff line h from an FTA partner country with preferential treatment under the FTA and T is the set of all tariff lines with preferential tariffs given in the FTA.

Despite the official announcement by the Government concerning the implementation of the ASEAN-Korea FTA on 1 June 2007, only five ASEAN members put the FTA into force as some countries were not ready to implement it.² Moreover, the tariff rates were only partially liberalized and the tariff schedules were fairly complex.³ It was difficult for Korean businessmen to understand the tariff schedules given in the FTA without in-depth knowledge of such agreements.

Steps taken to raise utilization rates in the Republic of Korea

Economic benefits from implementing FTAs are realized through the utilization of these agreements by private companies. Since concluding FTA negotiations is a difficult task, governmental authorities need to extend their roles to promoting FTA utilization through various activities, otherwise such agreements could remain just internationally-signed legal documents between member countries without delivering substantial benefits through increased trade. When the Republic of Korea faced a similar case during 2007-2009, it introduced a massive national policy package for enhancing FTA utilization ratios in its major FTAs. Subsequently, FTA utilization ratios reached more than 70 per cent (see table below), which is closer to those of advanced economies such as European Union and the United States.

The governmental package for enhancing FTA utilization was prepared by the FTA Promotion and Policy Adjustment Authority (FTAPPAA), which was established under the FTA Committee for Domestic Measures in June 2007. The FTAPPAA implemented various supporting programmes for business including: (a) educational courses for companies; (b) consultation; (c) workshops for explaining and providing information on FTAs; (d) building the portals for FTAs; and (e) organizing FTA expositions in foreign countries.

Officials and other staff of the FTAPPAA were improved in terms of numbers and FTA expertise in dealing with FTA business support issues. In addition, the FTAPPAA was given the authority to promote all FTA assistance tools and related resources in the comprehensive package, and the National FTA Utilization Centre (FTAUC) was established as part of the FTAPPAA and regional (local) FTA Assistance Centres. As such, the FTAPPAA plans major policies, goals and roadmaps on an annual basis and National FTAUC implements related details for achieving policy goals set by the FTAPPAA. Moreover, an FTA call centre was established at the Korea International Trade Association (KITA) in June 2014, which provides a daily consultation service for callers, including weekends.

² The five ASEAN countries are Indonesia, Malaysia, Myanmar, Singapore and Viet Nam. Customs authorities of Myanmar and Viet Nam could not process the application of preferential tariffs under the ASEAN-Korea for the first two years following its implementation. All ASEAN countries are now implementing this FTA and no technical problems have been found in handling the FTA tariff procedures.

³ Most FTAs adopt the categories of tariff liberalization for ease of understanding the tariff reduction schedule for a specific product. However, ASEAN FTAs tend to classify products into several groups. For example, the ASEAN-Korea FTA lists goods for Normal Track and Sensitive Track, and the Sensitive Track has the Sensitive List and the Highly Sensitive List.

Table: Republic of Korea's FTA utilization ratio

FTA partner	As of the end of 2012		As of November 2013	
	Exports	Imports	Exports	Imports
Chile	75.2	97.9	78.4	98.3
EFTA	79.8	61.9	80.5	42.0
ASEAN	37.7	73.8	38.5	80.1
India	36.2	52.7	43.0	62.3
European Union	81.4	66.8	80.9	67.6
Peru	78.0	92.0	92.0	98.4
United States	68.9	61.0	76.4	67.3
Simple average	65.31	72.30	69.96	73.71

Unit: Per cent. *Source:* Cheong, 2014

FTAs are promoted as enabling various policy goals to be achieved, with economic gains being the most important incentive. The Republic of Korea has been successful in concluding many FTAs in a short period (see figure) and in improving FTA utilization ratios. One of key factors has been the success in creating understanding among many businessmen (especially SMEs) of the importance of satisfying the rules of origin (RoO) as well as the provision of information about FTA tariffs and RoO. In addition, changing the perception of small and medium-sized enterprise (SMEs) CEOs concerning FTA utilization is a crucial aspect. Unlike large companies, SMEs do not have enough staff to deal with FTA business and they lack professional expertise in trade practices and business activities.

Policy implications

Several policy implications regarding FTA utilization can be identified from the Republic of Korea's FTA support experience. First, the FTA utilization ratios (see table) in exports by the Republic of Korea increased substantially during the past three-year period of FTA support policy, although they were lower than the ratios for imports. Utilizing FTAs in importing goods from FTA partners is relatively easy when compared to exporting, since exporting needs marketing to be undertaken among FTA partners.

Second, unlike those of large companies, FTA utilization ratios among SMEs in the Republic of Korea grow slowly and are lower. More active support for SMEs is therefore required. FTAs are widely utilized in most industrial sectors although progress has been slow in some sectors such as mining and agriculture. This is because exporters do not issue certificates for

RoO. The experience of the Republic of Korea clearly indicates that understanding RoO needs to be treated as one of most important elements in governmental programmes for supporting the business sectors.

Third, governmental authorities need to identify the barriers that prevent companies from utilizing FTAs. Based on the significance of those barriers and the possibility for improvement through governmental action, the Government of Korea formulated a roadmap for building infrastructure and assisting businesses in utilizing FTAs. Coordination among national agencies is critical in increasing the efficiency of that infrastructure and assistance.

Fourth, FTA policies also need to be improved. FTAs with large and advanced economies should be promoted, which will force economic reforms. In addition, trade and industry authorities need to understand the importance of the quality of FTAs. The more comprehensive such an agreement is, and the broader its market access, the higher will be the economic benefits. This point could be applied to Turkey. The European Union-Republic of Korea FTA offers more favourable treatment than the Republic of Korea-Turkey FTA. Businessmen will be inclined to use the FTA with the European Union, which will result in smaller gains for Turkey. Both the Republic of Korea and Turkey need to upgrade their existing market access under the FTA in addition to completing the negotiation for services and investment, in order to provide more incentives for FTA utilization by businesses and to ensure a more comprehensive FTA.

Finally, FTA member countries should be active in reducing non-tariff barriers. Meetings of the various levels of committees institutionalized in FTAs should be regularly held and non-tariff barriers should be discussed. FTA member countries also need to co-operate with each other in FTA implementation.

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