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A Comparative Study on Foreign Trade Barriers of China and Korea

韓中 對外 貿易 障壁에 관한 比較硏究

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Chapter 1

Introduction

1.1 The Background of the Study

The development of economic relations between Korea and China over the past decade has been dramatic. At the beginning of the 1990s, China was a relatively minor trade partner with Korea, yet China has become Korea's dominant partner in trade and investment. Economic relations between Korea and China have been expanding ever since China undertook the Four Modernization reforms in the late 1970s and the two countries established diplomatic relationship in 1987. The establishment in 1992 of formal diplomatic relations between Korea and China—relations between the two countries had ceased during the Cold War— has led to a surprisingly rapid growth of bilateral economic exchanges. In 2001, China became Korea's second-largest export destination, which implies Korea overtook Japan in terms of export volume. China was also the second-largest partner with Korea in foreign direct investment (FDI). Two years later, in 2003, China overtook the United States in Korean market.

Bilateral trade between the China and Korea has been growing steadily in both the volume and the variety of traded goods. Likewise capital flows between the two have been increasing although the flows have been mostly from Korea to China in the form of direct investment. Between 1989 and 2003, for instance, Korea's merchandise exports to China grew from $1.3 billion to $35.1 billion while China's merchandise exports to Korea grew from $472 million to $20.1 billion (UNCOMTRADE[1]). In fact, China has now emerged as Korea's largest trade partner. Also, by the end of 2004 Korea had invested $8.9 billion in China where prior to the late 1970s it had no investment at all, and during 2004 alone Korea invested $2.0 billion in China. These increases in both trade and investment are the

[1] UNCOMTRADE: United Nations commodity trade statistics database

signs of growing economic interdependence and integration of the two economies, which will lead to the removal of many trade barriers between two countries.

The global trend in recent years has been to eliminate as many trade barriers as possible. Organizations like the World Trade Organization (WTO) have been established for the sole purpose of limiting barriers and reconciling trade disputes among member nations. Free trade agreements among countries, such as the North American Free Trade Agreement (NAFTA), ASEAN in Asia, and the European Union Trade Agreements have reduced the number of barriers involved in regional trade. As the development of these regional trade agreements (RATs) has been witnessed to be worldwide proliferation, it continues to spread. In particular, with the two of major East Asian countries — China and Korea — have tended to bypass the prevalent trend of regionalism and instead have generally preferred multilateral trade liberalization approaches under the GATT and WTO regulations regarding RTAs.

1.2 The Purpose and Structure of the Study

In this paper, first of all I compare the main trade policies associated with trade barrier between China and Korea: the contents and process on the reduction of trade barriers of the two countries, such as lowering rate of tariff and taxes, releasing of tariff-rate quotas and banning of export subsides. Secondly, I seek to examine the possibility of establishing China-Korea RTA (Regional Trade Agreement).

Regional cooperation toward a freer trade environment has been spreading all over the world. In recent years, the tendency of globalization has promoted the regional economic cooperation. Korea and China are key players in East Asia and economy liberalization will lead to a more region-wide economic integration. It is expected that their deepening interdependence will lead, to a greater degree, to reduce trade barriers between them, establishing China-Korea RTA, which contributes to promote free trade process all over the world.

This paper is organized as followed:

Chapter 1 depicts the background and purpose of the study, and briefly introduces the trade relations between China and Korea, which will play an important role in explaining the significance of the reduction of trade barriers and establishment of free trade area between them.

Chapter 2 focuses on the literature review on the main contents of trade barriers and provides the implication of theory on trade barriers to show the deteriorate social welfare of trade partners by discouraging “gains from trade”.

Chapter 3 discusses the development and challenge of the China-Korea bilateral trade, and shows that with the reduction of trade barriers, the trade between China and Korea has increased rapidly than ever before, on the other hand, because Korea has kept a relatively persistent trade surplus form China for a long time, some argues such as “garlic war” and “kimchi war” took place, which might have worked as the obstacle for the development of bilateral trade, especially for the establishment of China-Korea FTA.

Chapter 4 dwells on the main trade policy of China and Korea, such as tariff rate or tax charges; tariff-rate quota policy; export subsidies; which will impede the multilateral trade around the world.

Chapter 5 is the reduction measurement of trade barriers, which will show the development and challenge faced by both countries in the processing of economic integration; and prove that the free trade agreement between the two countries has already become an unavoidable issue, despite that some challenges exist. Upon the deep cooperation of bilateral trade, the establishment of China-Korea FTA will come true in the near future.

Chapter 6 is the conclusion remarks, which will express the outlook for establishing FTA between China and Korea. A broader and deeper cooperation will enhance both the countries’ competitiveness in the world market and achieve a mutual prosperity and development.

Chapter 2

A Literature Review on Foreign Trade Barriers

2.1 The Theoretical Literature

When he wrote Wealth of Nations in 1776, Adam Smith referred to "a certain propensity in human nature ... to truck, barter, and exchange one thing for another."[2] Even children are known to be prone to swap such items as stamps, bubble-gum cards, marbles, and other items of mutual desire. But enjoyable and beneficial though trade may be, there is also a propensity to stifle it. Even the Reagan Administration, with a strong and outspoken penchant for free markets, has succumbed to pressures to curb imports of cars, steel, textiles, motorcycles, and other products from foreign lands.

About 50 years after Adam Smith wrote, John Stuart Mill in 1829 clearly explained and soundly denounced such restrictive policies in an admirable essay entitled "Of the Laws of Interchange between Nations." Mill was following in the footsteps of Smith, who openly opposed the mercantilistic policies whereby European nations had interfered with trade. As the basis for his arguments, Mill expounded the ideas of his more recent predecessor, David Ricardo, who had demonstrated that there is mutual benefit for countries which specialize and trade on the basis of "comparative advantage."

This simple and fundamental principle can be readily illustrated by the examples of the businessman who hires a secretary, the doctor who employs an accountant or the working mother who turns her child over to a baby sitter. The businessman may be a better typist, the doctor may have superior calculating abilities, and the mother may excel in providing affection and entertainment for her child. But by directing their time and energy to their professional duties, these three people will earn more

[2] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (New York: Modern Library, 1937), p. 13.

than enough to pay their employees. The businessman and doctor will have even more time for leisure, and the working mother will be better able to provide her child with needed food and clothing.

Yet, what we all implicitly accept and practice in our daily lives, we are pathetically apt to forget when we read or hear news about how some American industry is "hurt" by foreign competition. Nonetheless, the same principle applies. If the Japanese can produce cars and motorcycles more efficiently relative to other products such as beef, then we should buy our cars from them in exchange for our beef. If the Chinese can produce textiles by giving up less of other products than we must forgo here, then we should buy from them. Not only will we enable our consumers - especially the poorer ones - to improve their living standards; we will also provide jobs for our producers of wheat and soybeans, items in which we have a comparative advantage. If some people criticize the Chinese for "underselling" our producers, they should take note of Mill's words: "the world at large, buyers and sellers taken together, is always a gainer by underselling."[3]

Despite the common sense of the free-trade argument, we continue to erect barriers to impede trade. Just as Ricardo and Mill advocated free trade, they reviled restrictions. In 1817, Ricardo had written that "the sole effect of high duties on the importation either of manufactures or corn … is to divert a portion of capital to an employment which it would not naturally seek."[4] Mill similarly deplored barriers which have "the effect of encouraging some particular branch of domestic industry," for, he said, they are "purely mischievous."[5]

Who Was Hurt by Foreign Trade Barriers

Sometimes it is argued that since foreign governments impose barriers and provide subsidies of their own, they have rendered laissez faire unfair. Certainly, such policies abound and they surely hurt our exporters. Shouldn't we engage in "tit

[3] John Stuart Mill, *Essays on Some Unsettled Questions of Political Economy*
[4] David Ricardo, *The Principles of Political Economy and Taxation*
[5] John Stuart Mill, *Essays on Some Unsettled Questions of Political Economy*

for tat?" If we do, we are sure to suffer for it; as Mill put it, trade barriers are "chiefly injurious to the countries imposing them."

The loss to consumers when government restricts imports outweighs the gain to the protected industry. Trade barriers such as quotas and tariffs raise the price on all the protected products, whether their origin is domestic or foreign. That is the clear impact, for example, in the case of the agreement by Japan to limit the export of cars to the U.S. Both American and Japanese producers can hike their prices; both Chrysler and Toyota gain. The costs to our consumers exceed our producers' benefits.

Moreover, by setting up trade barriers, we abdicate the opportunity for setting a good example. As Mill wrote in his essay, "A country cannot be expected to renounce the power of taxing foreigners unless foreigners will in return practice towards itself the same forbearance." We should expect foreign countries to do as we do, not as we say. Until we renounce our own protectionist sins, how can we justify throwing stones?

Before yielding further to the temptation to plunge deeper into the web of trade restraints, it helps to remember that basic fact of all economics: the resources are scarce. We simply cannot produce all the goods and services people want and need. Thus we must bend all our efforts toward employing our resources to their utmost efficiency. Mill said it well: it is "the common interest of all nations that each of them should abstain from every measure by which the aggregate wealth of the commercial world would be diminished."[6]

2.2 Explanation of Foreign Trade Barriers

A broad range of obstacles that affect international trade, are commonly referred to as trade barriers. Essentially, a trade barrier is anything that makes trade difficult or even impossible. Examples of trade barriers range from government-instituted tariffs to cultural preferences. Trade barriers have a negative effect on exporters

[6] John Stuart Mill, *Essays on Some Unsettled Questions of Political Economy*

because they interfere with the normal supply and demand and make international trade more complicated. They also negatively impact importers and ultimately consumers since they interfere with competitive sourcing which can result in higher prices.

Trade barriers are as ancient as trade itself and there are many reasons countries institute trade barriers. Trade barriers initially arose in the form of tariffs levied to raise money. For many countries, tariffs are a major source of income and very important to the national economy. Tariffs, quotas and non-tariff barriers such as excessive regulations are now commonly used to protect domestic industry from foreign competition. Finally, countries often use barriers as tools of foreign policy. Very high or low tariffs can be used to reward or punish other nations in support of foreign policy initiatives. This is the premise of most free trade agreements and embargoes, boycotts and sanctions. For all of these reasons, trade barriers have become sensitive and controversial issues. However, as time goes on there will be less trade barriers with the development of the international trade and globalization.

2.3 Main Types of Foreign Trade Barriers

A number of trade barriers have been employed in order to protect industries, to raise revenue, and to counter the barriers erected by other foreign countries. These barriers create a distortion of relative prices across countries and, consequently, distort individual consumption patterns and lower individual welfare. A general discussion of these barriers and their consequences is provided below.

2.3.1 Tariff and Tax

Tariffs have been a means of protecting domestic industries and creating revenue for centuries. A tariff is really nothing more than a tax placed on goods by government as it enters or leaves a country. Tariffs add to the cost of imported

products and therefore tend to lower the quantity sold of the products levied with a tariff. In the early years, tariffs were the main source of revenue for the government and continued to be an important source of revenue. Today, the average tariff rates across goods and across countries are between 10 and 15 percent and are not a significant source of revenue for most countries. However, tariffs still present a significant barrier to trade among nations.

2.3.2 Quota

A quota, also referred to as a quantitative restriction, is a policy tool to restrict trade by placing a ceiling on the amount of a product that can be imported during a given period. As a result, the restriction will create artificially high prices on goods and reduce the amount of competition within that industry. A variation of the quota system is a voluntary export restriction (VER). Under VER, an exporting country is asked to restrict their exports under the threat of explicit restrictions and trade barriers.

In general, the goods that have quotas placed against them are goods that the country does not have a competitive advantage in and yet they produce them. Because the country does not have a competitive advantage in the goods, the cost of producing the goods will be higher than the cost of other countries, and therefore, the selling price will be higher than the world price of the goods. In the end, consumers are the ones who suffer the consequences by paying higher prices for the goods that have restrictions placed on it.

2.3.3 Subsidy

In economics, a subsidy is generally a monetary grant given by government to lower the price faced by producers or consumers of goods, generally because it is

considered to be in the public interest. Subsidies are also referred to as corporate welfare by those who oppose their use. The term subsidy may also refer to assistance granted by others, such as individuals or non-government institutions, although this is more usually described as charity. A subsidy normally exemplifies the opposite of a tax, but can also be given using a reduction of the tax burden. These kinds of subsidies are generally called tax expenditures or tax breaks.

Subsidies protect the consumer from paying the full price of the good consumed, however they also prevent the consumer from receiving the full value of the thing not consumed – in that sense, a subsidized society is a consumption society because it unfairly encourages consumption more than conservation. Under free-market conditions, consumers would make choices which optimize the value of their transactions; where it was less expensive to conserve, they would conserve. In a subsidized economy however, consumers are denied the benefit of conservation and as a result, subsidized goods have an artificially higher value than expenditures which do not consume. Subsidies are paid for by taxation which creates a deadweight loss for that activity which is taxed.

Subsidies come in the form of grants, concessionary loans, loan guarantees, and tax credits that are provided by a government to provide financial benefits on the production, manufacturing, and distribution of goods or services to foreign markets. Once again, these subsidies distort the relative price of goods and distort individual consumption patterns. Furthermore, it is an anticompetitive practice that restricts the ability of foreign producers to compete in a worldwide market. Subsidies have been widely used in the agriculture industry.

2.3.4 Other Trade Barriers

While there has been a decline in tariff rates across countries, a number of other barriers have often taken the place of the tariff. These barriers include exchange rate controls, dumping policy, fair trade practice, price brand, licensing requirements[7], government procurement practices[8], technical standards[9], and domestic-content rules[10]. In addition, a government can also make the custom system complex and burdensome to hinder imports. Like any other barrier, these requirements reduce the level of competition within a market and artificially create higher prices that reduce the welfare of the consumers.

[7] Often, a country can require a license, which is a property right to export to a country. The country will only issue so many licenses and they are then bought and sold among producers who want to export to the country.

[8] For government contracts, domestic producers are often given preferential treatment

[9] This could include pollution standards, safety standards, measurement standards, and health standards.

[10] A domestic content rule requires a certain portion of a product to be made domestically.

Chapter 3

China-Korea Bilateral Trade:

Development and Challenge

3.1 Trade Development between Korea and China

Before the establishment of official diplomatic relations, trade between Korea and China took the form of entrepot trade, carried out through Hong Kong, Singapore and other areas, and the bilateral trade volume between the two countries was not significant. It was only until the March 1988 that direct trade began to develop gradually. However, it was only non-government at that time. In 1991, China Association of International Trade established its first representative office in Seoul and the Korea Trade Promotion Association also established its representative office in Beijing. In 1992, the Agreement of China-Korea Non-government Trade and the Agreement on Non-government Investment Protection took effect in February and July respectively. On the August 24th of the same year, the diplomatic relation between two countries was finally established. Agreement on trade, investment protection and agreement about economic, trade and technological cooperation were signed by the government.

However, since official diplomatic relations were established, trade relations between the two countries have changed dramatically. Trade volumes have increased explosively, except for a temporary lag in 1998 when the Korean economy faced serious difficulties in the aftermath of the Asian financial crisis. Since then, the two countries have maintained relations of significant economic interdependence.

In 2003, a “comprehensive cooperative relation” was established between two countries and the economic cooperation began to develop rapidly and vigorously. Now, China has become not only the largest recipient of Korea’s foreign

investment but also the largest market for Korea's total export. At the same time, Korea has become the fourth largest trading country for China, the fourth largest market for China's export (excluding the Association of Southeast Asian Nations and the European Union), and the fourth largest country in terms of China's foreign direct investment. In short, economic cooperation between two countries has become a very important part of both countries' economies and such a relation will be strengthened further.[11]

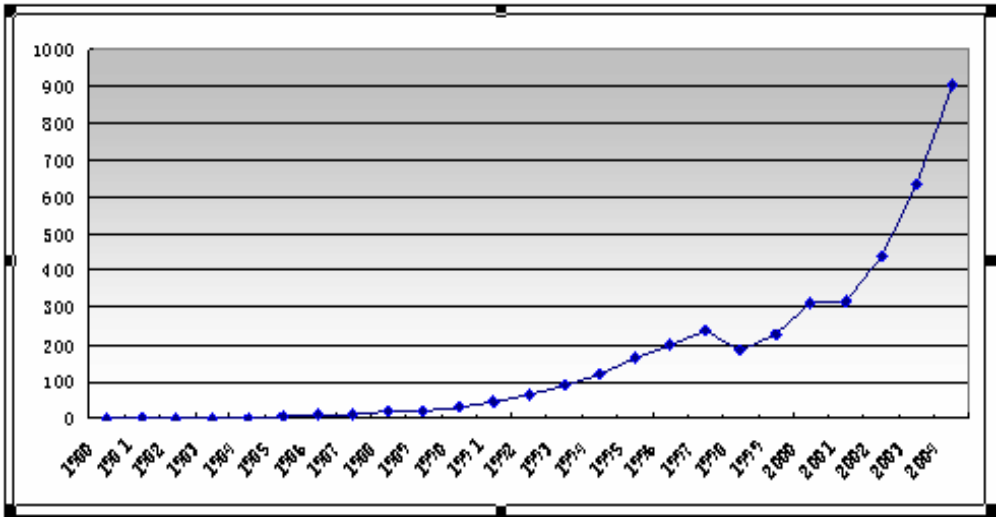
3.1.1 The Effect of Tariff on Bilateral Trade

Since the establishment of diplomatic relationship, the trade between two countries increased rapidly, especially in the recent 5 years (as shown in ***Finger 1***). According to the customs of China, the bilateral trade between two countries was only $5.03 billion in 1992. In 2003, it increased to $63.231 billion, with an annual growth rate of 11.7%. According to Korea's official estimation, in 2003, China has become the 2nd largest trading partner for Korea and its largest country for export. In 2004, the bilateral trade kept a rapid growth. According to the estimation from Chinese customs, the total value of import and export in 2004 has reached to $90.068 billion, which increased by 42.4% compared with 2003. If the European Union and the Association of Southeast Asian Nations are excluded, Korea is China's fourth largest trading partner, the fourth largest export country and the third largest country for import. [12]

[11] The Economic and Commercial Counselor's Office of the Embassy of the People's Republic of China in Korea: *A Brief Summary of the Economic and Commercial Cooperation between China and Korea*.
（http://kr.mofcom.gov.cn/aarticle/zxhz/hzjj/200410/20041000286652.html）

[12] The Economic and Commercial Counselor's Office of the Embassy of the People's Republic of China in Korea: *A Brief Summary of the Economic and Commercial Cooperation between China and Korea (2004).*

Figure 1: The bilateral trade between China and Korea (1980-2004)



Source: 1980-2000 Data come from Dingchang Shen, *Korea's Foreign Relations*, Hong Kong Social Science Publishing House
2001, 2003, 2004 data come from the Economic and Commercial Counselor's Office of the Embassy of the People's Republic of China in Korea
http://kr.mofcom.gov.cn/aarticle/zxhz/hzjj/200410/20041000286652.html ;
2002 data comes from the Department of Planning and Finance of the Ministry of Commerce of China
http://www.mofcom.gov.cn/article/200307/20030700109245_1.xml;
*2004 data are mainly the data for the first 10 months
*All the data are rounded to US$1 million.

The driving factors behind these trends are not difficult to understand. The tariff reductions planned by China in the context of its WTO accession are largely the continuation of a long-standing trend. This trend is reflected in the decreasing level and dispersion of tariffs and the continued reduction in NTBs[13], especially since the early 1990s (***Table 1***). In the early 1990s, tariffs still averaged above 40 percent (among the highest in the world at the time), with significant dispersion and a maximum rate above 200%. While the home market was highly protected, the penalizing effect of these tariffs on export production was neutralized through duty drawbacks and other incentives for export oriented investment projects. Currency markets were not unified until 1994. Foreign investors were straddled with

[13] NTBs: Non tariff barriers

requirements to form joint ventures, transfer technology to local partners, and source their inputs locally.

Table 1: China's Import Tariffs

	Unweighted Average[14]	Weighted average[15]	Dispersion (SD)	Max
1985	43.3	. . .	. . .	. . .
1988	43.7	. . .	. . .	. . .
1991	44.1	. . .	. . .	. . .
1992	42.9	40.6	. . .	220.0
1993	39.9	38.4	29.9	220.0
1994	36.3	35.5	27.9	. . .
1995	35.2	26.8	. . .	220.0
1996	23.6	22.6	17.4	121.6
1997	17.6	16.0	13.0	121.6
1998	17.5	15.7	13.0	121.6
2000	16.4	. . .	. . .	. . .
2001	15.3	9.1	12.1	121.6
2002	12.3	6.4	9.1	71.0
2003	11	5.5	. . .	. . .
2004	10.4	4.7	. . .	. . .

Sources: Chinese authorities; United Nations Conference on Trade and Development; World Bank; WTO; and IMF staff estimates

Under the terms of its WTO accession, China committed to substantial annual reductions in its tariff rates, with most of them taking place within five years of

[14] The unweighted average is based on a simple average of the statutory rates for the relevant year.
[15] The weighted average is based on the statutory rates weighted by the value of imports in each category.

China's WTO accession. The largest reductions took place in 2002, immediately after China acceded to the WTO, when the overall average tariff rate fell from over 15.3 percent in 2001 to 12.3 percent in 2002. Until 2004, the tariff rate has been reduced to 10.4, giving chances to the development of international trade.

Past reforms also introduced widespread import tariff exemptions, especially for processing trade and foreign investment and, therefore, a majority of China's imports were in effect not subject to any tariffs in 2000. Under its WTO commitments, China will further reduce its average tariff rate to 10 percent by 2006. Overall, under the WTO agreement, its trade regime will be increasingly tariff based and more transparent.

3.1.2 Korea's Trade Surplus with China

In the bilateral trade with Korea, China has always had some trade deficits, which has been growing every year. In 1993, only one year after normalization of relations, China had already become Korea's third-largest trading partner, behind the United States and Japan. In 2001, China became the number two destination of Korea's exports, second only to the United States. In 2003, China (excluding Hong Kong and Macao) finally surpassed the United States as Korea's top export market. The share of the China trade in Korea's total trade rose from 2.8 percent in 1990, to 6.4 percent in 1995, to 9.4 percent in 2000, and to 15.2 percent in 2003, even to 19.6 percent in 2004. Korean trade leaped from $6.4 billion in 1992 to $56 billion in 2003. After China's entrance into WTO, and with the removal of many trade barriers, trade between Korea and China has been increased from 10.8 in 2001 to 13.1 in 2002. (First year after China's entering WTO). Further more, it is convinced that the releasing of many trade barriers has given Korea the opportunity to reap huge surplus throughout 2002-2004. (As ***Table 2*** shows)[16] In 2004, there was a US$34.431 billion deficit for China, which increased 49.5% from 2003. Since the

[16] In 2004, China for the first time is likely to surpass the United States in its total trade volume with South Korea; this prediction is based on trade volume for January through August 2004.

establishment of diplomatic relationship and up to the end of 2004, China has a total deficit of US$69.4 billion.

Table 2: **Korea's Trade and Trade Surplus with China, 1985–2004**

Year	Korea's trade with China (percentage of Korea's total trade)	Korea's trade surplus with China (millions of U.S. dollars)
1990	2.8	–715
1995	6.4	1,740
2000	9.4	5,650
2001	10.8	4,890
2002	13.1	6,354
2003	15.2	17,201
2004	19.6	34,431

Source: KITA 2004

Overall Korea-China trade has averaged more than 20 percent growth year-on-year for the last decade, and most economists predict that with the establishment of China-Korea regional trade area (RTA), bilateral trade volume will more than double to over $100 billion annually by 2010 if not earlier.

Much of recent Korean economic growth has been driven by record levels of consumer spending, and Korean consumers are buying up the same low-costs goods imported from China and have become so addicted in recent years. On the other hand, China's rapid economic development and growing release of the trade barriers have been snapping up relatively less expensive and higher tech Korean products.

In the 1992–2004 periods, exports of Korean goods to China increased at an annual rate of 26.5 percent, while Korea's imports of Chinese goods increased at an annual rate of 17.5 percent. As ***Table 3*** indicates, the share of exports to China out

of Korea's total exports rose from 3.46 percent in 1992 to 10.71 percent by 2000 after the reestablishment of formal diplomatic relations; however, with the largest tariff reduction from 15 percent to 12 percent after china acceded to WTO, the share of exports rose from 12.09 percent in 2001 to 20.48 percent in 2004. And the share of imports from China rose from 4.56 percent of Korea's total imports to 7.98 percent in 2000; however, after quotas on most products were eliminated or scheduled to be phased out under the terms of China's WTO accession, the share has been rose from 9.43 percent in 2001 to 13.8 percent in 2004.

Table 3: Korea's Trade with China, 1992–2004

Year	Total exports ($,000)	Exports to China ($,000)	Share of exports (%)	Total imports ($,000)	Imports from China ($,000)	Share of import (%)
1992	76,631,515	2,653,639	3.46	81,775,257	3,724,941	4.56
1993	82,235,866	5,150,992	6.26	83,800,142	3,928,741	4.69
1994	96,013,237	6,202,986	6.46	102,348,175	5,462,849	5.34
1995	125,057,988	9,143,588	7.31	135,118,933	7,401,196	5.48
1996	129,715,137	11,377,068	8.77	150,339,100	8,538,568	5.68
1997	136,164,204	13,572,463	9.96	144,616,374	10,116,861	7.00
1998	132,313,143	11,943,990	9.02	93,281,754	6,483,958	6.95
1999	143,685,459	13,684,599	9.52	119,752,282	8,866,667	7.40
2000	172,267,510	18,454,540	10.71	160,481,018	12,798,728	7.98
2001	150,439,144	18,190,190	12.09	141,097,821	13,302,675	9.43
2002	162,470,528	23,753,586	14.62	152,126,153	17,399,779	11.44
2003	193,817,443	35,109,715	18.11	178,826,657	21,909,127	12.25
2004	225,483,772	46,862,563	20.48	203,434,549	28,032,645	13.8

Source: Korea International Trade Association, KOTIS database.[17]

[17] KOTIS: Korea Trade Information Service

3.1.3 Korea FDI and Export-Import Situation between China and Korea

In the bilateral trade between China and Korea, Chinese exports are mainly products from traditional labor-intensive industries, which includes commodities like garment and clothing accessories, textile fiber and products, iron and steel and related products, coal, corn, water, aquatic product, aluminum and related products, TV sets, radio, ancillaries of wireless communication appliances, component element of integrate circuit and microelectronics, tape recorders. The import commodities from Korea are mostly capital/technology-intensive products, like component element of integrate circuit and microelectronics, rolled steel, primarily processed plastic materials, wireless telephone, TV set, radio, accessories of wireless communication apparatus, telephony acid, chemical fiber yarn, automatic data processing machines and components, and component of automobiles.

Korea's imports from China are currently undergoing a structural transformation. China has been undergoing rapid industrialization, especially according to the subsidies on export of electrical machinery; it has begun to manufacture a rising volume of electronic and electrical components to be exported abroad. Thus, it is natural that Korea and China are entering an increasingly competitive environment with regard to certain commodities such as electrical machinery and optical instruments.

The structural change in Korea's imports from China can be seen in ***Table 4,*** which shows that the share of imports of raw materials decreased from 67.77 percent to 36.15 percent in the 1995–2004 period, the share of capital goods increased significantly from 8.05 percent to 35.79 percent, and the share of consumption goods increased slightly from 24.15 percent to 28.06 percent.

Table 4*:* Classification of Korea's Imports from China

Imported goods	1995		2001		2002		2003		2004	
Raw materials	($,000)	(%)	($,000)	(%)	($,000)	(%)	($,000)	(%)	($,000)	(%)
	5,015,830	67.77	5,837,474	40.61	6,778,856	38.96	8,184,340	37.36	10,058,238	36.15
Capital goods	596,035	8.05	3,682,384	28.77	5,199,808	29.88	7,320,748	33.41	9,453,282	35.79
Consumption goods	1,787,466	24.15	3,278,131	30.61	5,419,949	31.15	6,401,477	29.22	7,571,825	28.06
Others	1,865	0.03	775	0.01	1,166	0.01	2,562	0.01	3,853	0.01
Total	7,401,196	100.00	12,789,728	100.00	17,399,779	100.00	21,909,127	100.00	21,909,127	100.00

Source: Korea International Trade Association, KOTIS database, www.kita.org/.

The recent brisk exports from Korea to China are due, at least partially, to the fact that the Chinese economy is growing quite rapidly. While the bilateral trade is growing, Korea's direct investment in China also increases dramatically. In 1992, only 265 investment projects in China were proved by the Bank of Korea, with a total contracted value of $217 million and an actually utilized value of $140 million. According to the Ministry of Commerce of China, in 2004, Chinese government approved 5,625 FDI projects from Korea, with a total contract value of $13.911 billion and an actually utilized value of $6.248 billion (as shown in ***Table 5***). Especially, after china's entering into WTO in 2001, with the decrease of the trade barriers, Korean FDI in china has increased remarkable. The average annual growth rates of these three figures are as high as 20.22 %, 63.11% and 40.63%, respectively. In 2004, in terms of actually utilized FDI, Korea is the third largest source of investment for China, next only to Hong Kong and Virgin Islands. By the end of 2004, Chinese government has altogether approved 32,753 Korean investment projects, with a total contract value of $50.56 billion and a total utilized value of $25.933 billion (as shown in ***Figure 2*** and ***Table 5***).

Most of Korean FDI to China has been biased toward the manufacturing sector. As of November 2004, 87.3 percent of Korea's FDI in China was invested in the manufacturing sector. Within the manufacturing sector, the top two subsectors were electronics and telecommunications equipment; machinery and equipment. This trade pattern reflects the economically complementary structures of the two countries. During the 1998– 2003 period, as ***Table 6*** shows, parts and intermediate goods made up between 63.1 percent and 76.1 percent of Korea's exports of manufactured goods to China. With this trade pattern, during 2001-2004, the percentage of share of parts and intermediate goods in manufacturing goods exported to China has been decreased from 74.1 to 58.5.

Table 5: FDI from Korea (unit: 100million/project)

Year	Contracted Foreign Capital	Foreign Capital Actually Utilized	Number of Investment Projects Approved
1988	0.03	0.03	2
1989	0.09	0.06	12
1990	0.52	0.42	36
1991	0.81	0.42	111
1992	2.17	1.4	265
1993	5.97	2.62	616
1994	7.21	6.21	944
1995	10.65	8.04	758
1996	14.16	7.92	820
1997	13.91	6.59	1065
1998	8.33	6.15	316
1999	5.28	3.3	542
2000	23.7	15.1	2570
2001	34.87	21.52	2909
2002	52.8	27.2	4008
2003	91.8	44.9	4920
2004	139.11	62.48	5625

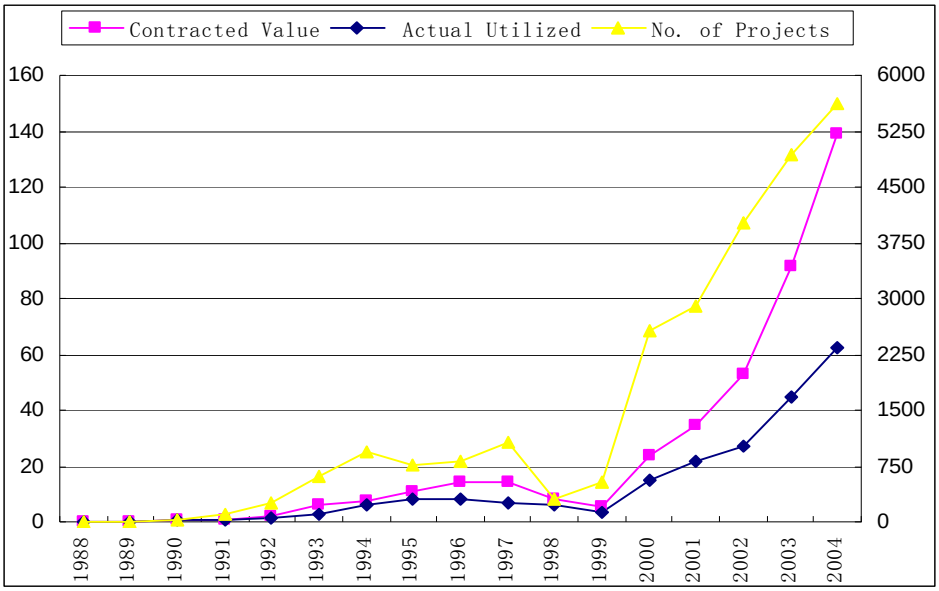
Source: 1988—1999 data come from the Korean Bank of Import and Export, excerpt from Dinchang Shen, Korea's Foreign Relations, Hong Kong Social Science Publishing House; 2000-2004 data come from statistics of the Ministry of Commerce of China

Table 6*:* Korea's Exports of Manufacturing Goods to China, 1997–2004, in millions of dollars

	1999	2000	2001	2002	2003	2004
Manufacturing goods exported to China (total)	12,203	16,360	16,314	22,304	28,765	36,608
Share of parts and intermediate goods	9,036	12,455	12,095	15,484	18,134	21,483
Percentage	74.0	76.1	74.1	69.4	63.1	58.5

Source: Trade Research Institute of the Korea International Trade Association

Figure 2: FDI from Korea (unit: 100million/project)



Source: 1988—1999 data come from the Korean Bank of Import and Export, excerpt from Dinchang Shen Korea's Foreign Relations, Hong Kong Social Science Publishing House; 2000-2004 data come from statistics of the Ministry of Commerce of China

Korea has recorded trade surpluses with China since 1993 (see ***Table 3***), and this trade imbalance between the two countries has been generally expanding, making the trade imbalance one of the tough bilateral trade issues. In 2002, Korea achieved a record trade surplus with China of about $6.4 billion. In 2003, Korea's trade

surplus with China increased further to $13.1 billion. In the same period, Korea's bilateral trade surplus with China accounted for about 88 percent of Korea's total trade surplus of $15.2 billion. On the other hand, China's competitiveness in fiber processing, textiles, and garments has been improving continuously, and in 2002 China began to enjoy a trade surplus with Korea in sectors such as garments, cotton textiles, silk products, and natural fiber products.

It has long been recognized that the existence of a bilateral trade surplus or a deficit can be a misleading indicator of microeconomic competitiveness and macroeconomic imbalance. Nonetheless, the bilateral trade imbalance has been one of the key issues in trade disputes all around the world. The widening trade imbalance could, therefore, escalate into a full-blown trade dispute between the countries involved. Thus, it is essential to prevent a potential trade dispute between Korea and China in order to sustain the expansionary trend of mutual economic exchanges in the future.

At various bilateral meetings, the Chinese government has continued to demand that its Korean counterpart redress the trade imbalance between the two countries. Meanwhile, the Korean government has insisted that maintaining the expansionary trade relations between the two countries should be given primary emphasis in the near future and that trade balance can be attained as the structural changes of trade relations between the two countries proceed.

In contrast with past meetings, China did not raise the issue of the bilateral trade imbalance between the two countries at the Korea-China summit in July 2003, which may reflect confidence on the part of China that this issue will be resolved in the near future with the releasing of the trade barriers and the forming of free trade area between two countries. At that meeting, the leaders of both countries agreed to an expansion and deepening of substantial cooperative relations in areas such as politics, economy, trade, culture and personal exchanges.

3.2 Challenges Faced by the Bilateral Trade

The expansion of Korea-China economic relations has been accompanied by and in many cases facilitated by the normalization and acceleration of Korea-Chinese political and diplomatic relations. Following the initial success of South Korea's Nordpolitik under President Roh Tae-Woo, successive South Korean administrations have made the improvement of bilateral relations with China a top priority. And there has already been a summit between President Roh Moo-Hyun and PRC President Hu Jintao in July of 2003.

This is not to say that the trend lines in Korea-China relations have been without friction. South Korea has run a relatively consistent trade surplus with China and this coupled with Korean concerns about a flood of inexpensive Chinese products has led to trade frictions on both sides that have spilled over into the broader public realm. Most memorable was the "garlic war" in 2002 and "kimchi war" in 2005.

"Garlic war" happened when a Korean attempt to stem the inflow of Chinese garlic led to Chinese retaliation on much higher tariff value Korean electronic imports and a rather hasty Korean retreat. While China's admission to the WTO has placed bilateral trade disputes in the context on international rules and norms, Korea has been the primary target of Chinese legal action on trade issues.

Kimchi means everything to Koreans; but they also place an increasing value on the nation's relationship with China, a country Korea fought against in the Korean War during the 1950s. The kimchi affair was not the first trade spat between the two sides, either: the "garlic trade war" in 2000 also involved Chinese food imports to Korea as above. On November 6th, 2004, during the Henan-ROK Friendship Week, the South Korean ambassador to China, Kim Ha-joong, said that the bilateral relationship between South Korea and China was far more important than the ongoing kimchi dispute. Chinese Foreign Minister Li Zhaoxing, who noted that kimchi was his favorite dish, also called for calm, saying the row should be resolved with some flexibility and creativity.

3.2.1 Garlic War

A trade dispute between China and Korea, concerning garlic, has cast a shadow over the two countries' trade relations in 2000. The Korea Finance and Economy Ministry declared to slap a tariff rate as high as 315 per cent on imported garlic. As a major garlic exporter to Korea, China regards itself as the target of unjustified trade protectionism. And the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) reacted quickly, declaring a ban on mobile phones and polyethylene imports from Korea.

China imported US$73.5 million worth mobile phones and US$340 million in polyethylene products from the Korea in 1999, while its garlic exports to South Korea were valued at US$15 million during the same period. The total volume of the three products involved in the trade dispute adds up to US$428.5 million, accounting for a mere 1.7 per cent of the two countries' aggregate trade volume in 1999. The volume of trade involved in the trade war becomes even less significant in light of the fact that Sino-Korea bilateral trade during the first four months of that year increased by 47.2 per cent.

Statistics from China's General Administration of Customs revealed that during the first four months of that year, two-way trade between China and Korea had rose to US$10.1 billion. China's exports to South Korea leaped by 60.3 per cent over a year earlier to US$3.3 billion and its imports grew by 41.5 per cent to US$6.8 billion.

According to China Economic Times, Korea had conducted anti-dumping investigations on Chinese bicycles and soda ash, a raw material used in manufacturing batteries and glass. An official from the Korea Embassy to China insisted that the garlic dispute should not to be associated with any other trade issue between China and South Korea. But analysts said no matter what South Korea's true intention were with the anti-dumping investigations, it had triggered an escalation of the trade war.

Before China retaliated, it had proposed to discuss the issue with Korea to find a

solution acceptable to both sides. But the talks broke off because of Korea's insistence on its own position of limiting garlic imports, which has seriously hampered bilateral trade and economic ties between the two countries.

The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) announced that China and South Korea signed a memorandum of understanding on April 21st, 2000, which put an end to the dispute over South Korea's hi-tariff measures against Chinese garlic.

The memorandum aims to solve the problems arising in the implementation of an agreement signed between the two countries in August 2000, under which South Korea was to import 32,000 tons, 33,728 tons and 35,448 tons of Chinese garlic per year at tariffs of 30% and 50% in 2001 to 2003. Shi Guangsheng, minister of the MOFTEC, urged the South Korean government to adopt effective measures to expand imports from China by removing tariffs and non-tariff barriers and creating favorable conditions for Chinese products to enter the Korea market, so as to ease China's huge deficits in bilateral trade.

The foreign trade between China and Korea totaled 34.5 billion in 2000, making Korea the sixth largest trade partner of the country. China's imports from Korea reached USD 23.21 billion, while its exports to Korea stood at USD 11.29 billion last year. China announced suspension of the import of Korean mobile telephones and polyethylene on June 7, 2000 after Korea decided to impose a high tariff of 315% on Chinese garlic beginning June 1. The MOFTEC then lifted the ban after it reached an agreement with Korea in August 2000. This agreement enables China to export up to 11,895 tons of garlic without any restrictions to Korea, as previously negotiated during the Uruguay Round. In addition, through the agreement China will be able to export 20,000 tons of frozen garlic with a tariff of 30 percent to Korea. Consequently, China will be able to export almost 32,000 tons of garlic to Korea each year without the burden of the 315 percent tariff.

In addition, MOFTE also told that it signed an agreement with its Korean counterpart, the Korean Ministry of Commerce, Industry and Energy to jointly set up a commission to promote mutual investment and economic cooperation. The

minister of the MOFTEC said that he believed the Sino-Korean investment promotion commission would play an important role in boosting mutual investment between two countries.

China reported USD 11.9 billion in trade deficit with Korea in 2000. It is suggested that Korea could buy more coal and corn from China, as these products are cheaper than those of other countries due to lower transportation costs. In the first 2 months of 2001, the foreign trade volume between China and Korea totaled USD 4.92 billion, an increase of 11.6% compared with the same period the year before.

3.2.2 Kimchi War

Kimchi, also known as gimchi or kimchee is a traditional Korean dish of fermented chile peppers and vegetables, usually based on cabbage. May 30, 2004—for the first time, Chinese-made kimchi has surpassed Korean exports of its national dish, increasing by 174% over the same period in 2003. Meanwhile, Korean kimchi exports fell by 23.3%. Local food companies explain the unexpected invasion of the kimchi market by the Chinese version as being a function of cheaper labor and ingredients. As a result, Chinese-made kimchi is sold at half the price of locally produced kimchi, even after adding transportation costs. In response, local producers have resorted to emphasizing the quality and authenticity of their kimchi.

A recently trade war between China and Korea over kimchi, a staple of the Korean diet has been started in September 2005. The Korea Food and Drug Administration announced that they had discovered parasite eggs in 9 brands of kimchi from China. The products accounted for almost five per cent of the kimchi market in Korea. Then, the Korea Food and Drug Administration ordered a ban on the Chinese kimchi and began an emergency recall on the 9 Chinese kimchi products already on the market. The Administration is also investigating the manufacturing procedures to identify the reason for the existence of the parasites in

the products. Therefore, restaurants in Korea are now stating they do not use kimchi from China. But others say they prefer the Chinese brands because they cost only one-quarter of the Korean brands. However, because of the Korea's import embargo on kimchi from china, the importation of kimchi has been sharply decreased until Jan. 2006.

The threat of a trade spat has now receded but this is not the first scare involving food originating from China. Earlier concerns range from the traces of lead found in Chinese-produced kimchi to the discovery of malachite green, a suspected carcinogen, in fishery products imported from the mainland.

But the ballooning volume of trade between China and Korea means the two neighbors cannot allow disputes over food imports to get out of hand. At stake is around $100 billion-worth of bilateral trade—which matters most to Korea since China is Korea's biggest export market. The two countries have now agreed to co-operate on improving monitoring and quarantine procedures for traded food. That means, in future, some of the fierier effects of kimchi may be avoided.

Chapter 4

Comparison of Foreign Trade Barriers of China and Korea

4.1 Import Regulation-Tariff

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports.

Tariffs are widely used to protect domestic producers' incomes from foreign competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import competing goods and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economies have sought to reduce tariffs on manufactured goods through several rounds of negotiations under the General Agreement on Tariffs Trade (GATT). Only in the most recent Uruguay Round of negotiations were trade and tariff restrictions in agriculture addressed. In the past, and even under GATT, tariffs levied on some agricultural commodities by some countries have been very large. When coupled with other barriers to trade, they have often constituted formidable barriers to market access from foreign producers. In fact, tariff that is set high enough can block all trade and act just like import bans.

4.1.1 China's Policy on Tariff and Other Import Charges

China has traditionally restricted imports through high tariffs and taxes, quotas and other non tariff measures, and restrictions on trading rights. In 2002, as part of its first year in the WTO, China significantly reduced tariff rates on many products and the number of goods subject to import quotas, expanded trading rights for Chinese enterprises, and increased the transparency of its licensing procedures. However, during 2003, China's second year of WTO membership, while China continued to reduce tariff rates on schedule and made other implementation progress, bureaucratic inertia and a desire to protect sensitive industries contributed to a significant loss of the momentum created in the first year of China's WTO membership. In 2004, China made progress by implementing required tariff reductions on schedule, including those related to China's continued participation in the Information Technology Agreement, and by fully implementing its trading rights commitments in July, nearly six months ahead of schedule.

In contrast with the continuity in tariff reductions, China's recent commitments on trade in services and other trade-related activities represent milestones[18]. Plans include the opening of key services sectors where foreign participation was previously nonexistent or marginal, notably telecommunications, financial services, and insurance. In those sectors, full access will eventually be guaranteed to foreign providers through transparent and automatic licensing procedures. China will also remove restrictions on trading and domestic distribution for most products. Apart from market access, China made major commitments on trade-related activities, such as national treatment and nondiscrimination principles, and with respect to Trade-Related Investment Measures (TRIMs) and Trade-Related Aspects of Intellectual Property Rights (TRIPs). Compliance with such commitments is likely to have far reaching implications domestically, including by encouraging greater internal integration of domestic markets (through the removal of inter-provincial barriers). Moreover, the commitment to comply with the principles and rules of the

[18] Indeed, some observers have argued that they represent the most radical services reform program negotiated in the WTO to date

international trading system will improve the transparency of the domestic policy environment.

China’s post-WTO accession tariff rates are “bound,” meaning that China cannot raise them above the bound rates without “compensating” WTO trading partners, i.e., re-balancing tariff concessions or, in accordance with WTO rules, being subject to withdrawal of substantially equivalent concessions by other WTO members. “Bound” rates give importers a more predictable environment. China may also apply tariff rates significantly lower than the WTO required rate, as in the case of goods that the government has identified as necessary to the development of a key industry.

4.1.2 Tariff and Taxes in Korea

While Korea has a relatively low average weighted tariff rate of 4.5 percent for industrial products, the weighted average of Korea's bound tariffs on all agricultural products is 64.1 percent, which poses a significant barrier to the trade of agricultural goods. Although Korea bound 91.7 percent of its tariff line items in the WTO Uruguay Round negotiations, tariffs on most forestry and fishery products are not bound. The United States continues to press Korea to reduce its applied tariffs on agricultural and food products.

As part of Uruguay Round WTO Agreement on Agriculture, Korea agreed to lower duties on more than 30 agricultural products including mixed feeds, feed corn, wheat, vegetable oils and meals, and fruits and nuts between 1995 and 2004, and has fully phased in those tariff reductions. However, duties remain very high on many high-value agricultural and fishery products. Korea imposes tariff rates of 30 percent or higher on most fruits and nuts, many fresh vegetables, starches, peanuts, peanut butter, various vegetable oils, juices, jams, beer, and some dairy products.

As part of its Uruguay Round commitments, Korea also established tariff-rate quotas (TRQs) that were intended to provide minimum access to previously closed

markets or to maintain pre- Uruguay Round access. (*See also "Quantitative Restrictions, TRQs and Import Licensing."*) Inquota tariff rates are zero or very low, but the over-quota tariff rates for some products are prohibitive. For example, natural and artificial honey are subject to an over-quota tariff rate of 243 percent; skim and whole milk powder, 176 percent; barley, 324 percent; malting barley, 513 percent; potatoes and potato preparations, more than 304 percent; and popcorn, 630 percent.

Through its Uruguay Round commitments, Korea has also reduced bound tariffs to zero on most or all products in the following sectors: paper, toys, steel, furniture, semiconductors, and farm equipment. Korea has harmonized its chemical tariffs to final rates of 0 percent, 5.5 percent, or 6.5 percent, depending on the product. In addition, tariffs on scientific equipment have been reduced 65 percent from pre-Uruguay Round levels. On textile and apparel products, Korea has harmonized and bound most of its tariffs at the following levels: 13 percent to 16 percent for man-made fibers and yarns, 30 percent for fabrics and made-up goods, and 35 percent for apparel.

4.2 Non-Tariff Barriers

A tariff-rate quota (TRQ) combines the idea of a tariff with that of a quota. The typical TRQ will set a low tariff for imports of a fixed quantity and a higher tariff for any imports that exceed that initial quantity. In a legal sense and at the WTO, countries are allowed to combine the use of two tariffs in the form of a TRQ, even when they have agreed not to use strict import quotas. In the United States, important TRQ schedules are set for beef, sugar, peanuts, and many dairy products. In each case, the initial tariff rate is quite low, but the over-quota tariff is prohibitive or close to prohibitive for most normal trade.

Explicit import quotas used to be quite common in agricultural trade. They allowed governments to strictly limit the amount of imports of a commodity and thus to plan on a particular import quantity in setting domestic commodity

programs. Another common non-tariff barrier (NTB) was the so-called “voluntary export restraint” (VER) under which exporting countries would agree to limit shipments of a commodity to the importing country, although often only under threat of some even more restrictive or onerous activity. In some cases, exporters were willing to comply with a VER because they were able to capture economic benefits through higher prices for their exports in the importing country’s market.

4.2.1. Tariff Rate Quota

4.2.1.1 Situation of Tariff Rate Quotas in China

In 1996, China claimed to have introduced a tariff-rate quota (TRQ) system for imports of wheat, corn, rice, soy oil, cotton, barley, and vegetable oils. The quota amounts were not publicly announced, application and allocation procedures were not transparent, and importation occurred through state trading enterprises. China later introduced a TRQ system for fertilizer imports. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low “in-quota” tariff rate; any imports over that quantity are charged a prohibitively high duty.

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of wheat, corn, rice, cotton, wool, sugar, vegetable oils, and fertilizer, with most inquota duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to be reserved for importation through non-state trading entities. China’s accession agreement sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quota to end-users that have an interest in importing.

However, China’s implementation of its TRQ systems has been problematic since it joined the WTO. Regulations for the administration of the TRQ systems were issued late, did not provide the required transparency and imposed burdensome licensing procedures. TRQ allocations in 2002 were also plagued by

delays. Chinese officials repeatedly argued that the agencies responsible for TRQ administration were unprepared for such a difficult task, resulting in onetime delays in allocations. China's performance improved in certain respects during 2002, and 2003 TRQs were issued close to the prescribed times. However, the most serious problems – lack of transparency, sub-divisions of the TRQ, small allocation sizes and burdensome licensing procedures – persisted in 2003.

4.2.1.2 Korea's Quantitative Restrictions - Tariff-Rate Quotas (TRQs)

Most imported non-food goods no longer require prior government import approval, but some products, mostly agricultural and fishery items, face import restrictions such as quotas or tariff rate quotas (TRQs) with prohibitive out-of-quota tariffs. Korea implements quantitative restrictions through its import licensing system, which is administered by domestic producer groups or government buying agencies such as the Agricultural Fishery Marketing Corporation (AFMC) and the Public Procurement Services (PPS). A government export-import notice lists restricted products. Korea also continues to restrict imports of value-added soybean and corn products. By aggregating raw and value-added products under the same quota, Korea restricts market access for value-added products such as corn grits, popcorn, and soy flakes. Domestic producer groups, which administer the quotas, invariably allocate the more favorable in-quota rate to their larger members, who use it to import raw ingredients.

Through the GATT Uruguay Round of multilateral negotiations, the government of the Republic of Korea opened most part of its agriculture and fisheries market on July 1, 1997. Because of domestic circumstances and the importance of these items, the Korean government still tries to restrict the import of beef and rice by non-tariff barriers such as quotas of quantity. As a result, some other countries, which are major agricultural exporters, demand that the Korean government remove non-tariff barriers on the commodities. Several significant problems are, however,

expected to occur if the Korean government immediately opens its rice market. The import of rice, first, creates substantial problems in Korea's domestic economy. Second, widely spread cultural focus on Korean is important.

4.2.2. Import Quota

4.2.2.1 Import Quotas in China

In the past, China often did not announce quota amounts or the process for allocating quotas. The government set quotas through negotiations between central and local government officials at the end of each year. Quotas on most products were eliminated or scheduled to be phased out under the terms of China’s WTO accession. On January 1, 2004, China eliminated import quotas on crude oil, refined oil, natural rubber and tires, in accordance with the schedule set forth in its WTO accession agreement. In prior years, China had eliminated import quotas on other products on schedule (such as air conditioners, sound and video recording apparatus, color TVs, cameras and watches) or ahead of schedule (crane lorries and chassis and motorcycles). When the auto quotas officially end on January 1, 2005, China will no longer have any import quotas in place.

4.2.2.2 Korea’s Import Quotas on Agriculture

As part of its commitments under the WTO Agreement on Agriculture, Korea agreed to reduce its domestic support (Aggregate Measurement of Support, or AMS) for agricultural products by 13 percent by 2004. At the end of the Uruguay Round in 1994, Korea earned a ten year period to prepare for the opening of its rice market. Ten years ago, it was negotiated that Korea would remove all non-tariff barriers, including import quotas, by Jan. 1, 2005. Under the import quota, no rice could be imported beyond a certain preset percentage or amount at any price or equivalently at any tariff rates. Tariffs are taxes importers pay at the border so that

the domestic price becomes more expensive. At the same time, Korea promised that minimum market access (MMA) would be changed from 4 percent to 8 percent. The market share of foreign rice would be 8 percent, at the minimum. In addition, 30 percent of imported rice should be able to directly reach customers in retail stores.

4.3 Export Regulation-Subsidies

4.3.1 Export Subsidies in China

China officially abolished subsidies in the form of direct budgetary outlays for exports of industrial goods on January 1, 1991. China agreed to eliminate all subsidies prohibited under Article 3 of the WTO Agreement on Subsidies and Countervailing Measures, including all forms of export subsidies on industrial and agricultural goods, upon its accession to the WTO in December 2001.

A general lack of transparency makes it difficult to identify and quantify possible export subsidies provided by the Chinese government. China's subsidy programs are often the result of internal administrative measures and are not publicized. Many of the subsidies take the form of income tax reductions or exemptions that are de jure or de facto contingent on export performance. They can also take a variety of other forms, including mechanisms such as credit allocations, low-interest loans, debt forgiveness and reduction of freight charges. It is alleged that subsidization is a key reason that Chinese exports are undercutting prices in Korea gaining market share and other countries. Of particular concern are China's practices in the textiles industry as well as in the steel, petrochemical, high technology, forestry and paper products, machinery and copper and other non-ferrous metals industries.

Many foreign subsidy experts are currently seeking more information about several Chinese programs and policies that may confer export subsidies. Their efforts have been frustrated in part because China has failed to make any of its

required subsidy notifications since becoming a member of the WTO three years ago. At a meeting of the WTO's Council for Trade in Goods in November 2004, China committed to submit its long-overdue subsidies notification in 2005.

Since shortly after China acceded to the WTO, Korea corn exporters have been concerned that China provides export subsidies on corn. In 2003 and 2004, it appeared that significant quantities of corn had been exported from China, including corn from Chinese government stocks, at prices that may have been 5 to 10 percent below domestic prices in China. As a result, Korea exporters were losing market share for corn in their traditional Asian markets, such as Japan, while China was exporting record amounts of corn. In 2005 however, trade analysts began to conclude that, because of several economic factors, including the improvement of subsidies, China is now trending toward becoming a net importer of corn.

4.3.2 Export Subsidies in Korea

Korea committed several years ago to phase out export subsidy programs that are not permitted under the WTO Agreement on Subsidies and Countervailing Measures. However, Korea continues to promote its economic development based on undue reliance on exports, particularly from its traditional export-oriented industries such as automobiles, semiconductors, shipbuilding, and steel. In addition, Korea is encouraging the development of export-oriented "next generation" industries, such as semiconductors and telecommunications.

Car industry in Korea has been referred to as a successful case of extensive state involvement in industry. It is hard to deny that the industry has achieved a remarkable level of performance compared to other newly industrializing countries (NICs) in Asia such as china. Car production has increased rapidly from more than 2 million in the mid-1990s to 3.5 million in 2004, and has constituted a large share of the country's exports. These achievements have been attributed to strong state intervention in the context of an initially weak manufacturing base and small

industrial elite. In other words, the state’s commitment to building a successful car industry appears to explain the private sector’s performance domestically and in the global market.

In February 2002, the Korean government revised the “Act for the Export-Import Bank of Korea” to enable the Export-Import Bank of Korea (KEXIM) to become more active in undertaking risks and extending credit lines to exporters. Under the new regulations, KEXIM is able to undertake risks that commercial banks are reluctant to assume. In addition, KEXIM's financing sources were expanded to include non-bank guarantee fees, thereby boosting exports from Korean companies.

Chapter 5

The Reduction Measurements of Trade Barriers

5.1 Preferential Trading Arrangements

The basic reason for regionalism is that it provides more and better market access for the countries through PTA (preferential trade arrangement). Compared with the multilateral approach, regional arrangement is much more flexible, wider and also faster since problems that would take years to solve in global negotiations can be dealt with much quicker. PTA, also known as the Close Economic Partnership (CEP) can cover the areas not yet covered or covered poorly by WTO arrangements, thus it plays a role as a WTO-plus movement.

There are various types of PTAs:

1. Free trade area (FTA): tariffs removed inside but members keep own external tariffs against nonmembers
2. Customs Union (CU): tariffs removed inside, and have common external tariff against nonmembers
3. Common Market: customs union + non-tariff barriers that restrict internal factor mobility are also removed.
4. Economic Union: common market + economic policies are coordinated (e.g. common monetary and fiscal policy, common currency)
5. Political Union: economic union + full economic and political integration; i.e. becomes one country.

In theory, within these several types of regional economic integration schemes, the simplest is a free trade area (FTA) that eliminates tariffs on goods among the member countries, while leaving national tariffs against nonmember countries unchanged. The early trade agreements among the Latin American countries were FTAs; however, even in the 1990s internal tariff barriers continue to exist.

5.2 Development of Free Trade Agreements in EARs[19]

Over the past decade, we have witnessed the worldwide proliferation of regional trade arrangements (RTAs). Even after the launch of the WTO multilateral trading system, RTAs have continued to spread. However, there have been marked variances across regions in terms of the degree to which regional trade integration has been carried out. The East Asian region is characterized by the dearth of RTAs. Regional integration moves have involved merely partial or loosely institutionalized groupings, i.e., AFTA (ASEAN Free Trade Area) and APEC (Asia Pacific Economic Cooperation).

China and Korea are both members of the Asia-Pacific Economic Cooperation (APEC) forum. One goal of APEC, as outlined in its 1994 declaration, is to establish a Free Trade Area among its member countries by the year 2020. Substantive principles which are encompassed in the APEC forum include investment liberalization, tariff reduction, deregulation, government procurement, and strengthening IPR protection.

In recent years, however, the region's support has shifted from multilateral trade arrangements to RTAs. A turning point was the outbreak of the East Asian financial crisis in 1997. Besides triggering massive economic unrest in East Asia, the crisis revitalized the demand for regional economic cooperation, which called for more cooperation and policy coordination among neighboring economies in the region. The interdependence among the East Asian economies through regional trade and financial linkages has increased[20]. In addition, slow progress of multilateral negotiations under WTO and APEC has emphasized their shifting preference to regionalism[21]. Recent developments in individual economies, such as China's miraculous export-driven growth performance and entry into WTO, Korea's regime change toward a more liberalized economic system are both counted as factors

[19] EAR: East Asian regions

[20] The intra-East Asian trade share in 2000 was 48.5 per cent, compared to 46.5 per cent for intra-NAFTA and 53.2 per cent for intra-EU.

[21] WTO's failure to launch the New Round in 1999 and APEC's failure to implement EVSL in 1998 are examples of the ineffectiveness of the multilateral liberalization approach.

behind the strategic change in the East Asian commercial policy for regionalism.

The rich potential for regional cooperation between the two Northeast Asian countries-Korea and China can be found in the dynamism of economic growth in this region. China has abundant natural resources and a huge labor force, but less developed technologies. Korea has relatively high-level technology and a wealth of experience in economic development, but few natural resources. If the two countries' attributes are efficiently combined to promote regional economic cooperation, Korea, and China could greatly benefit, and could then lead the other Asian countries.

5.3 Opportunity and Challenge Faced by China-Korea FTA

The international economy, though it implies economic activities transcending the scope of a nation, assumes the existence of "nations" as a prerequisite; and if there is no nation, there is no international matter. And the international economy should not be understood to mean that transcending the scope of a nation is to transcend a nation's interest. One nation's international economic activities are for promoting its national interest itself. The international economy is the economy of international scope but it is not for promoting international interest at all[22]. Therefore, Korea must seek after its national economic interest as a priority while promoting FTAs. As mentioned above, China's pursuit of a FTA with East Asia regions should be understood from a similar viewpoint, so that it has thoroughly calculated its interests.

It seems that the national interest Korea should pursue while pushing on FTAs would be in intensely seeking some trade strategies such as building up of a "trading power with global arrangement" (tentative proposition). In order for Korean economy to continue developing while overcoming limitations (such as lack of natural resources, geo-economic environmental issues, high degree of overseas dependency, and so on) under the mega-trend of globalization and

[22] Yang Si-Yuan (2004), *the logic on the relation between the international economy and nations*

regionalism, this kind of trade strategy should be adopted. Korea has already pursued a strategy called "Open Neo-Trading Nation" since the Kim Dae-Joong administration. Shim Young-sup (2001) defines this strategy as making Korea into a global business hub, making Korea into a business platform to provide its interiors to the world, and pushing forward with a unique competitive globalization model with Korean characteristics[23]. This concept is basically maintained by the "open trading strategy" in Roh Moo-Hyun administration, and is also rooted in the vision of "Northeast Asia economic hub." That is to say, the vision of Korean government, which pursues building up of a Northeast Asian economic community with peace and prosperity, is basically not aiming for an exclusive and discriminative regionalism but a globally arranged open regionalism.

The above principles should be applied in setting up the direction of trade and economic cooperation or FTA with China. That is to say, Korea needs to develop its trade and economic relations with China under the global-scoped development strategy, in which Korea should firmly establish its status in the world trade and economy system, and pursuing global arrangement, in order to enhance its own competitiveness (global management capability of Korean companies)[24]; furthermore, Korea should utilize China as a link into the global division of labor, and keeping itself from being over-dependent on Chinese economy or so-called "Chinization." What is apparent is that the continuous development of Korean economy in the future should be possible only if it positions itself appropriately in the global division of labor. Only then will the momentum of development be maintained. This applies to China as well. The Chinese economy having developed rapidly should be also seen as being incorporated into the global arrangement of industrial structures.

As economic interdependence between Korea and China grows significantly,

[23] For example, the Netherlands, Singapore, Ireland, and Belgium have successfully promoted some unique competitive globalization models respectively.

[24] For example, as the life cycle of high-tech products became shortened with price competition being intensified, companies should build up global management systems through global division of labor.

government officials and economists find it more and more necessary to form a free trade agreement to strengthen bilateral economic relations. According to Korea's Ministry of Foreign Affairs and Trade, Chinese Premier Wen Jiabao expressed interest in a free trade agreement between the two countries when he met with Prime Minister Lee Hae-chan in June, 2005. During the meeting in Beijing, Wen said, "Official intergovernmental talks on a Korea-China FTA should be initiated once research about its potential economic impact on the two countries reaches some progress."

The Korea Institute of International Economic Policy and China's Development Research Center of the State Council have been conducting joint research on the feasibility of a bilateral free trade pact since March, 2005. China overtook the United States as Korea's largest trading partner in 2004, accounting for more than 20 percent of the country's exports. Additionally, more than one-third of foreign direct investment by Korean companies has been going across the Yellow Sea to China since 2003.

5.3.1 The Concerns of Korea

While recognizing the necessity of a bilateral free trade agreement amid rapidly increasing economic interdependence between the two countries, both governments are still reluctant to launch an official government-level talk on the issue. Korea is concerned that a free trade agreement will cause massive inflows of cheap Chinese agricultural products, possibly hurting the nation's fragile agricultural industry. A free trade agreement will open the nation's market to the world's largest producer of agricultural goods, which has the world's biggest agricultural population of 800 million. This will have a huge negative impact on the Korea's farming industry. And the nation's agricultural output will decline about 12 percent if customs duties on Chinese goods are abolished as a result of a free trade agreement. In addition, this free trade agreement will also reduce the output of other labor-intensive industries including clothing and leather by 6 to 7 percent, which means that

thousands of jobs will be lost amid the influx of duty-free Chinese products in the domestic market.

Due to the geographic proximity of China and Korea, and the similarity of their climate and agricultural products, an FTA with China would have the most significant impact on Korea’s agricultural industry. If import duties are eliminated and the quality of Chinese agricultural products can be improved to a level that satisfies health and customs regulations, its impact on Korea’s agricultural industry could be much more far-reaching than generally anticipated. A comparison of China’s export prices with Korea's domestic prices reveals that, with the exception of onions and garlic, Korean prices are on average more than double the price levels of Chinese exports. In particular, the export prices of China’s chili peppers, sesame, rice, and beans are only about 20 percent that of Korea's domestic prices. Likewise, the prices of Chinese pears, peaches, corn, pork and garlic are about 30 percent of that in Korea, along with apples at 40 percent, grapes at 57 percent, chicken at 63 percent, and onions at 88 percent. Because of its proximity to the domestic market, they will probably dominate the nation’s market thanks to a FTA.

What’s more, for a country like Korea, in which its agricultural industry remains relatively underdeveloped, the potential impact of a proposed FTA on this sector should be considered as a critical factor in the process of selecting partners. The local agricultural industry, in particular, is expected to suffer the most damage from the opening up of Korea's domestic markets. Therefore, farmers are vehemently opposed to the signing of an FTA with China as well as efforts to move forward with FTA negotiations with other countries.

5.3.2 The Concerns of China

The trade structure between Korea and China is limited to a few selected commodities. Such a concentration on these limited items reflects the strong intra-industry trade structure between the two countries. At the same time, the export concentration on a few selected commodities has brought about frequent

trade conflicts (e.g. the trade dispute on garlic in June 2000). Korea has so often been confronted with fastidious NTBs in China, for example, anti-dumping or embargo for major exporting goods[25]. From 1997 to 2002, China brought 18 cases of anti-dumping issues before the courts. Korea was involved in 14 cases, and became the most frequently appealed country followed by Japan's nine cases and the U.S.'s seven cases. In addition, Korea's major export items to China had been concentrated on the less-competitive industrial sectors of China, including petrochemicals, iron and steel before 2001. These industrial sectors consist of Chinese national enterprises, which are, for the most part, less competitive in world markets. Therefore, the Chinese government tried to protect domestic companies by using various NTBs. We can expect that this Chinese policy will continue for a while in the near future.

With a China-Korea FTA, Korea has to open up its agricultural sector. In addition, China is rapidly closing its technology gap with Korea in the manufacturing sector. Korea should realize that a FTA with China will help the country greatly to maintain the technology gap while enjoying increasing exports in the manufacturing sector.

For the reason above, industrial/technological cooperation can yield more and better performances in their trade and investment, avoiding mutually harmful trade conflicts resulting from the fiercer competition. Moreover, Korea and China have attracted both an IT and automobile industry thanks to each government's energetic policy support and attraction of foreign capital. At the same time, immature industries and even high-tech industries are being transferred from Korea to China. Ever since the Chinese market opening was expanded through its accession to the WTO, Western firms, including U.S. players, have accelerated the transfer of their

[25] In analyzing the structural change in the Korean commodities exported to China, special attention should be paid to the following characteristic. The majority of Korean products exported to China has increased their dependence on the Chinese market, and have been designated as primary targets of Chinese import restrictions. In 2001, Korean export articles with high dependence on the Chinese market were organic chemical products (43.8 % of total export), leather and leather products (42 % of total export), pyrotechnic products (31.5 % of total export), shoes (31.3 % of total export), and plastics (29.2 % of total export). Among them, pyrotechnic products and organic chemical products are antidumping targets by China. For details, see Lim (2003b), op. cit.

industries and products through direct investments to China, regardless of its technological development stage. Consequently, China is quickly catching up with Korea.

However, several high-tech Chinese firms are expected to be threatened by Korean electronics products, which are already of better quality and will have greater price competitiveness once tariffs are removed. China's electronics industry, for example, is expected to shrink almost 3 percent due to more cost-efficient duty-free Korean electronics.

5.3.3 Prospects for China-Korea FTA

In 2003 Korean government designed a road map to pursue FTAs. According to Ahn Choong-Yong (2004), the government's FTA plan is divided into two main categories: a short-term plan and a mid- & long-term one targeting certain countries or regions. In the 1~2 years' short-term plan, the target countries are Japan and Singapore to which the joint FTA research was already done. The target countries in the next stage are ASEAN, Mexico, and the European Free Trade Association (EFTA), with relevant joint researches or negotiations yet to be conducted. The countries to be targeted in longer-term are the United States, China, the EU, etc.

According to this road map, China is a long-term target country. In contrast to the Korea-Japan FTA progress in which the joint research was completed in 2003 and official negotiation process already started, Korea-China FTA process has not yet begun even an official joint research. It seems that one of the main issues in Korea-China FTA negotiations in the future would be the agricultural issue, because it is difficult to deal with Korean agricultural issue that contains non-economic and some emotional factors. Korea is in need of time more than anything else to resolve the agricultural issue. Korea needs considerable time to restructure domestic agricultural sector; at the same time, Korean agriculture needs to gradually promote its adaptability or competitiveness through FTAs with some agricultural countries, whose agricultural competitiveness is suitable for Korea to

manage to adapt. Korea’s agriculture and agricultural products market can gradually enhance its adaptability while steadily raising the external impact by singing FTAs with some agricultural countries such as Chile, Mexico, Vietnam, India, Malaysia, Indonesia, and so on. If Korea without going through this process signs a FTA (encompassing agricultural sector) with China, then Korea's agriculture and agricultural products market will take a heavy blow out of China, which has great agricultural capacities.

Despite such challenges being posed to both countries, a free trade agreement between the two countries has already become an unavoidable issue. Considering the complementary industry structures of the two countries, both Seoul and Beijing unofficially find it very crucial for the two countries to be tied up to each other by a FTA. In contrast with Chinese government officials who are subject to less political pressure from interest groups, Korean officials will have to undergo harder times to get FTA talks on track due to likely severe opposition from farmers and civic groups. Despite anticipated conflicts of interests, both governments share the common objective of establishing a FTA in the future to augment bilateral economic relations. And economists note that a Korea-China FTA will most likely be realized in 5 to 10 years with the development of their bilateral trade.

Chapter 6

Conclusion

It is estimated that Chinese economy will maintain a relatively high economic growth for the next decade. The 2008 Olympic Games and the World Fair in China will provide further impetus for the Chinese economic development and will help to realize more of its development potential. Now, although the Korean economy has recovered from the IMF period[26], its domestic demand is still not strong enough to sustain a strong economic recovery and further development.

The huge market in China and its rapid economic growth can help the further recovery and development of Korean economy. At the same time, the further development of Chinese economy also needs the financial, technical and managerial support from Korea. The complementarities between the industrial structures of the two countries will surely push future economic co-operation into a broader and deeper stage, which will lead to the releasing of tariff, releasing of tariff-rate quotas and export subsides. With these persisting reductions of many trade barriers of both countries and development of regional trade integration, the common objective shared by both government of establishing a FTA will come true in the near future. And bilateral trade will enhance both the countries' competitiveness in the world market and achieve a mutual prosperity and development.

[26] Korean authorities and an IMF team concluded discussions on a strong economic program that provides for a decisive response to the country's present financial difficulties. The program comprises strengthened fiscal and monetary policies, far-reaching financial sector reforms, and further liberalization of trade and capital flows, as well as improvements in the structure and governance of Korean corporations.

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