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MODALITY OF KOREA-JAPAN FTA: FROM THE PERSPECTIVE OF KOREA

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I. Fundamental Principles for KJFTA

I.1 Comprehensive Coverage

The KJFTA should have a comprehensive coverage, encompassing all sectors of the economy in the liberalization process.¹ Instead of merely augmenting market access to each other, the KJFTA should seek broad economic cooperation including trade and investment promotion, mutual recognition, free movement of natural persons, competition, science and technology, transportation, broadcasting, environment, human resources development and financial cooperation. Since the trade between Korean and Japan would show a typical intra-industry pattern of industrial countries, simply eliminating tariffs and non-tariff barriers would no more than increase trade volumes and aggravate consequential trade (im-)balances. Considering gradual trade liberalization under the auspices of the WTO, such bilateral expedition of mere trade liberalization by the KJFTA would have no point of risking serious economic and political turmoil in both countries. The comprehensive economic cooperation between two countries can only guarantee mutually beneficial economic restructuring through economy wide structural adjustment. In particular, because economic cooperation can facilitate and complement trade liberalization, Korea and Japan should explore various ways to enhance a wide range of economic cooperation.

I.2 Substantial Liberalization

Trade between Korea and Japan under the KJFTA should be substantially liberalized not just because that was mandated by the WTO Agreement but also because it would otherwise readily undermine very fundamental aspects of trade liberalization due to convoluted domestic regulatory systems. Their unfortunate history and consequential political tensions between them may considerably compromise economic cooperation and legitimize divergent trade-restrictive measures. Thus, such vulnerability of economic cooperation between Korea and Japan despite importance and benefit of trade liberalization would be mitigated when both countries undertake substantial trade

¹ The comprehensiveness of FTA coverage is generally considered as a core element to avoid trade-diverting preferences. See generally James H. Mathis, *Regional Trade Agreements in the GATT/WTO*, 113-117 (2002).

liberalization.

I.3 Coherence with the WTO System

The KJFTA should complement the multilateral trading regime by complying with the WTO disciplines for regional trading arrangements and being flexible to accommodate non-party countries in the future.² There is a concern that the recent proliferation of FTAs may balkanize the world trading system by discriminatory application of preferential trading regimes.³ This problem can be aggravated by the lack of an effective checking mechanism under the WTO concerning the legitimacy of proposed or established FTAs.

For example, no FTA or customs union arrangement entered into force since the inception of the GATT has been formally disapproved by the pertinent committees. Moreover, major FTAs such as the North American Free Trade Agreement (NAFTA) notified to the WTO are still under review processes, i.e., consultations on draft report or factual examination. This particular weakness of multilateral disciplines on FTA establishment and management has led WTO Members to reconsider the current rules during the Doha Round negotiation.

The KJFTA should be negotiated to fully comply with the WTO obligations and enhance the WTO system. The KJFTA should be able to accommodate the current disciplines to the maximum extent possible. In the areas the WTO does not squarely address yet, the KJFTA should try to incorporate the fundamental purposes and objectives of the WTO system. Moreover, the KJFTA may try to improve and clarify the current WTO regime, particularly in the area of rules concerning the dispute settlement system and trade remedy mechanisms. These improvement and clarification should also be made to be consistent with the underlying mandates of the WTO.

II. Scope and Issues of the KJFTA

The scope of the KJFTA can be categorized into mainly three areas: 1) trade

² The importance of the “openness” of FTAs to encompass new members has been emphasized by many academics. See for example, Alan Deardorff and Robert Stern, “Multilateral Trade Negotiations and Preferential Trading Arrangements”, in *Analytical and Negotiating Issues in the Global Trading System* (eds. by Alan Deardorff and Robert Stern, 1994).

³ See, for example, Jagdish Bhawati, “Regionalism and Multilateralism: An Overview”, in *Trading Blocs* (Bhagwati, Krishna & Panagariya eds., 1999).

liberalization and market access through concessions for trade in goods and services, 2) enhanced cooperation for non-trade areas, and 3) institutional arrangements centered on a dispute settlement mechanism.

II.1 Trade Liberalization and Improving Market Access

There are too many areas to be discussed individually in the context of liberalization of trade and market access. The discussion below only deals with some selected issues that have notable importance between Korea and Japan.

Tariffs

Currently, the import-weighted average applied tariff rates for all sectors in Korea and Japan are 9.19% and 2.7%, respectively.⁴ The relatively higher tariff rates in most economic sectors of Korea imply that instant impacts of the KJFTA to trade between them would be more increase in imports from Japan and thereby bigger trade deficits of Korea against Japan. The bilateral trade deficit problem in the context of Korea-Japan trade has already become elevated to political issues due to the sheer size of the cumulative trade deficits of almost \$200 billion. It is true that this trade deficit itself has not yet been a serious cause for economic problems in Korea during the past decades. Despite such economic situations, the magnitude of a tremendous trade deficit at that level alone can be a major obstacle to hamper the progress of any bilateral trade negotiations that inevitably entail domestic political processes coordinating divergent sectoral interests. In that regard, asymmetrical transition periods may be considered to provide more time for Korea to completely eliminate the current tariffs. After all, a couple more years for gradual reduction of 2-3% tariffs would not matter economically as much as politically.

Non-Tariff Measures (NTMs)

Considering the fact that both countries' overall tariff levels are not in fact significant factors to affect bilateral trade except for certain limited sectors such as agriculture or fishery, NTMs are crucial issues to be addressed by the KJFTA for

⁴ Ministry of Foreign Affairs and Trade, *Korea-Japan Free Trade Agreement Joint Study Group Report* (Oct.2, 2003), 26.

meaningful and effective trade liberalization.⁵ Unlike tariff issues that can be dealt with relatively simple numerical formula, issues concerning NTMs demand careful scrutiny on several fundamental factors.

Firstly, the NTM issue needs better conceptualization because NTMs may encompass a wide range of different measures from governmental practices to private commercial conventions. It would be vital to specifically define the scope of NTMs that are to be addressed by the KJFTA. Often, different cultural and social practices cause commercially unreasonable barriers. In such cases, however, international treaties or governmental arrangements would have fundamental limitations in dealing with basically private practices. On the other hand, exempting divergent NTMs categorically as private practices that are outside the scope of governmental control may turn various systemically discriminatory measures of both countries into legitimized trade barriers.

Secondly, both countries may need to agree on how to resolve trade problems arising from NTMs in the context of the KJFTA. If they decide to resolve NTM problems with recourse to the treaty text, the FTA dispute settlement system needs to be augmented. Or in case they determine to address NTM problems with more consultative procedures, a special arbitration or consultation committee procedure may be required.

Trade in Services

The facilitation of trade in services has importance not only in improving services trade itself but also in promoting various economic performance and cooperation. Therefore, it would be crucial to establish the system and arrangement to spur trade in services between two countries. It is also implied that the endeavor to liberalize trade in services should cover as broad areas as possible.

In particular, as demonstrated by the experience under the WTO GATS, trade in services also embodies complicated issues concerning movement of natural persons and investment that often hinder further progress in trade liberalization under the multilateral trading system. The KJFTA would need to squarely address those areas and aim to agree on more liberalization schemes and commitments.

The commitment schedule of trade in services is inscribed either in positive

⁵ Currently, concerns on NTMs seem to be more intense in a Korean side. Although a broad category of “NTM” typically causes difficulty in rigorous academic research, certain sectoral practices, especially commercial practices relating to distribution services, have drawn much attention in this regard. See for example, Yang-Hee Kim and Byung-Taik Cho, “The Development of a Korea-Japan FTA and the Japanese Distribution Barriers: From the Competition Policy Perspective” (KIEP Policy Study 02-13, 2002; *in Korean*).

list formula as taken by GATS or in negative list formula as adopted by NAFTA. Since the KJFTA aims to go beyond the liberalization scope and level of GATS, the commitment schedule should adopt the negative list approach. As the economic structures of both countries tend to show more and more emphasis on services sectors, flexibility to accommodate broader services sectors under the negative list approach would be more efficient for the KJFTA.

Rules of Origin

“Rules of origin” systems typically play a pivotal role in implementing the FTA arrangement since companies nowadays actively utilize global sourcing and production systems and their products typically go through multiple processing over multiple countries.⁶ While rules of origin system for the KJFTA should be established to benefit bilateral trade between two countries, not merely trans-shipments of third country exporters to each country, it should not be excessively burdensome to adversely affect investment or trade with other countries. Normally, rules of origin system adopts “substantial transformation” criteria, which could be further specified as (i) criteria of change in tariff classification; (ii) specified process criteria; and (iii) value added criteria.⁷ Currently, two countries adopt a slightly different mechanism. For example, the Korean rules of origin system is based on the 6-digit Harmonized System (HS), whereas the Japanese rules of origin system is based on the 4-digit HS as methods for classification of the goods. If the KJFTA goes further than the WTO system in terms of the rules of origin, such difference may need to be harmonized for more consistent application of the system.

Trade Facilitation

Apart from market access commitments and elimination of various NTMs, trade facilitation measures can be important contributing factors to actually enhancing bilateral trade. Trade facilitation may be improved in a range of activities including customs procedures, preshipment inspection, paperless trading and the like. The reform

⁶ For detailed accounts on various legal aspects of rules of origin, see generally Edwin Vermulst, Paul Waer and Jacques Bourgeois (eds.), *Rules of Origin in International Trade: A Comparative Study* (1994).

⁷ A different way of specifying rules of origin – more specifically, price based definition and cost based definition – has been theoretically analyzed by Kala Krishna and Anne O. Krueger, “Implementing Free Trade Areas: Rules of Origin and Hidden Protection”, in *New Directions in Trade Theory* (eds. by Alan Deardorff and James Levinsohn and Robert Stern, 1995) 149-179.

or modification of the inefficient or unreasonable practices in the course of customs procedures often substantially improves bilateral trade. Accordingly, clear rules on these procedures to prevent arbitrary and discretionary discrimination are necessary to institute better infrastructure for bilateral trade.

Intellectual Property Protection

Infringement of intellectual property rights has not been a major problem in terms of Korea-Japan bilateral trade relationship, although their intellectual property regimes have often been target of trade policy measures of third countries, particularly the United States and the European Communities.⁸ Thus, at least in terms of intellectual property protection, the KJFTA may adopt the development under the WTO system. In other words, the intellectual property system of the KJFTA should be able to prevent breach of intellectual property obligations whereas it should not be overly restrictive to hamper free transfer of knowledge and innovation.

II.2 Enhancing Economic Cooperation for Non-Trade Areas

Although the legal and institutional frameworks for economic cooperation of Korea and Japan are established by FTA arrangements, various cooperative arrangements, *albeit* non-binding, to enhance cross border transaction would be crucial for effective economic integration. Such cooperative measures may be taken in various areas including, *inter alia*, investment, competition, science and technology, financial cooperation, environment and cultural cooperation. In fact, both countries have maintained various bilateral cooperative arrangements, especially at a governmental level. These channels should be continued and deepened by the KJFTA. Since those individual arrangements have not been properly coordinated, the KJFTA may construct an integrated and regularized forum to facilitate further discussion and cooperation.

For example, in investment areas, the bilateral investment treaty (BIT) between Korea and Japan entered into force on January 1, 2003. After 8 months of its application,

⁸ For example, Japan was challenged by the United States (DS28) and the EC (DS42) on protection of sound recording under the WTO dispute settlement system. The US complaint was in fact the very first case concerning the WTO TRIPS Agreement. These cases were resolved with mutually satisfiable solution. In November 1985, USTR initiated a section 301 investigation concerning Korea's lack of effective protection of US intellectual property rights (50 FR 45883). Both governments concluded an agreement to improve protection of intellectual property rights in Korea and the United States terminated the investigation on August 14, 1986 (51 FR 29445).

both countries have not scored many new investment deals. If the KJFTA would try to make further improvement on the current BIT, it should stipulate more incentive mechanisms to encourage bilateral investment, especially by small and medium size companies, or continue bilateral endeavor for promotion of investment by initiating divergent cooperative measures.

Competition areas would also be key areas to meaningfully address unreasonable trade practices of both countries. Technology progress would also be facilitated by enhanced frameworks for science and technology cooperation. In addition, overall economic cooperation would be facilitated by improved social infrastructure that entails environmental cooperation and cultural exchange.

II.3 Institutional Arrangement and Dispute Settlement Mechanism

A. Institutional Support

The broad scope of the KJFTA would require an institutional support to implement and monitor proper application of the trade liberalization. Since the KJFTA should be the initial arrangement for further economic integration between the two countries, it should establish formal organizational bodies to support continued endeavour. A ministerial level institution, such as FTA Commission, would be required to make important final determinations for managing and developing the KJFTA. Moreover, committees or councils to address individual issue areas such as, for example, NTM Committee, would be indispensable to sustain continued efforts for deepening economic cooperation. In addition, a standing dispute settlement body may be more efficient to deal with trade disputes since it would abate procedural procrastination inherent to *ad hoc* panel and assure higher expertise.

B. Trade Remedy System

Antidumping and Countervailing System

When both countries concluded their first FTAs with Chile and Singapore respectively, they adopted the same approach for antidumping and countervailing systems. They basically determined to use the WTO rules and the dispute settlement system thereof, instead of setting forth independent disciplines. The Korea-Chile FTA provides, in Chapter 7, that the parties maintain rights and obligations under the WTO

Antidumping and Subsidy Agreements and that antidumping or countervailing actions taken pursuant to them shall not be subject to the FTA dispute settlement system under Chapter 19. The Japan-Singapore EPA does not include specific provisions concerning antidumping and countervailing measures, implying that those matters would be addressed exclusively by the WTO Agreements.

Safeguard Mechanism

The Korea-Chile FTA also resorts to the WTO Agreements for its safeguard mechanism. Chapter 6 stipulates that both parties maintain WTO rights and obligations concerning safeguard matters. Safeguard actions would be dealt with exclusively by the WTO dispute settlement system.

Notwithstanding Chapter 6, Article 3.12 sets forth a special safeguard system for agricultural goods in case an import increase causes or threatens to cause serious injury or market disturbance.⁹ This special agricultural safeguard provision, however, substantially deviates from the special safeguard mechanism under the WTO Agriculture Agreement that employs, *inter alia*, automatic triggering system.

Unlike the Korea-Chile FTA that adopts a special sectoral safeguard system, the Japan-Singapore EPA has a customized transitional safeguard system that also substantially diverges from the WTO safeguard mechanism. The emergency measure system under Article 18 is to be applied only during the transition period. In other words, after transition arrangements are all completed, both parties will apply the WTO safeguard system without exception. In contrast to the WTO safeguard system that allows broader trade restrictive measures including quantity limitations as well as suspension of the obligation 'in whole or in part' or withdrawal or modification of the concession, Article 18 of the Japan-Singapore EPA permits only the suspension of the further reduction of customs duties or the increase of customs duties to a lesser MFN rate at the time when the measure is taken or the EPA entered into force. Transitional safeguard actions may be taken only after investigations are conducted in accordance with disciplines under the WTO Safeguard Agreement. The duration of a safeguard measure taken under Article 18 shall not exceed one year, and in very exceptional circumstances, may be extended to three years. Moreover, Article 18.7 mandates domestic judicial review systems. This transitional safeguard system includes several

⁹ Although 'material injury' and 'threat of material injury' are defined in line with the WTO Safeguard Agreement, the concept of 'market disturbance' is not specifically defined. The lack of clear definition on the latter element for safeguard actions may lead to serious controversy in actual application of the provisions.

elements to better serve the purpose of the safeguard mechanism, going beyond the current WTO system. The expiration of this safeguard mechanism after the transition period does not, therefore, seem to be necessarily a desirable progress.

C. Dispute Settlement Mechanism

Dispute settlement mechanisms typically play key roles in meaningfully maintaining and implementing trade agreements including FTAs. Based on their experience under the WTO dispute settlement system, Korea and Japan could develop their own dispute settlement mechanisms for their first FTA arrangements with Chile and Singapore, respectively. While these shared many common features in terms of procedural rules, they adopted starkly different approaches concerning exclusivity and scope of jurisdiction of FTA dispute settlement systems.