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Dimensions of Regional Processes in the Asia-Pacific Region

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Introduction

Asia and Pacific's growing importance to the rest of the world is widely acknowledged today. The dynamics of Asian economic development have tremendously impacted global trade relationships and regional cooperation. Thus, it is with great pleasure that we deliver another volume of Research Papers on Asia-Pacific economic issues.

This year we present 19 papers by various authors who examine the Asia-Pacific region from different perspectives. We decided to group them into 3 Chapters:

- Cooperation and trade
- Economy and policy
- Risks & challenges

Papers grouped in the First Chapter describe newly emerging regional trade architecture. You will find there a few analyses of general nature and regional scope (J. Dudziński, A. H. Jankowiak, E. Majchrowska) and some studies on specific trade agreements (A. Klimek writes about Shanghai Free Trade Zone, A. McCaleb and G. Heiduk try to find out what motivates China's cities to establish partner agreements with cities in Asia, B. Michalski analysing U.S.-Republic of Korea Free Trade Agreement, while M. Maciejewski and W. Zysk look for opportunities for Polish exports in the trade agreement between EU and Vietnam).

The Second Chapter is the most diverse one. It is devoted mostly to economic policy issues (including financial sector). S. Bobowski, L. Zyblikiewicz and K. Żukrowska look at the main threads in Asian regionalism. P. Pasierbiak and K. Łopacińska analyse the movements of Chinese capital. M. Dziembała and S. Mazurek deal with the subject of innovation supporting growth and development.

Articles in the Third Chapter are focused on extraordinary events influencing economies and development of the Asia-Pacific region. J. Pera prepared an assessment of risk of APEC countries, based on the country risk classification method and selected indexes of internal stability. A. Kukułka and B. Totleben analyse the impact of natural disasters on gross capital formation in Southeastern Asia. Finally, T. Serwach and M. Grabowski and S. Wyciślak deal with synchronization of business cycles and contagion of crises.

We sincerely hope that all the articles will be of great value to those who want to understand the role of Asia-Pacific economies in the global economy. Through various interests of authors, our volume provides a valuable insight into the problems of this region.

All the papers were submitted for the 8th international scientific conference "Dimensions of Regional Processes in the Asia-Pacific Region" which took place in

November 2015 at Wrocław University of Economics, under the patronage of Polish Ministry of Foreign Affairs, Ministry of Science and Higher Education and the Ministry of Economy.

We appreciate your time and consideration, and we look forward to the submission of your own good work. We also appreciate the time and effort of our peer reviewers. Thank you!

Bogusława Drelich-Skulska, Anna H. Jankowiak, Szymon Mazurek

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**ON THE WAY TOWARDS TIGHTER TRANS-PACIFIC
TRADE RELATIONS. THE CASE OF THE U.S.-REPUBLIC
OF KOREA FREE TRADE AGREEMENT (KORUS FTA)**

**NA DRODZE KU ZACIEŚNIANIU
TRANSPACYFICZNYCH RELACJI HANDLOWYCH.
STUDIUM PRZYPADKU UMOWY HANDLOWEJ
STANY ZJEDNOCZONE – REPUBLIKA KOREI
(KORUS FTA)**

DOI: 10.15611/pn.2015.413.06

JEL Classification: F02, F14, F15, F55

Summary: The paper addresses the issue of a new generation trade agreement between the United States and the Republic of Korea which entered into force in March 2012. The author takes a closer look at the strategic motives of this accord, as well as its first trade effects from the standpoint of the South Korean economy. Because of high competitiveness of both trading partners, particular emphasis is also put on the clusters of high-tech products and identification of the most important tendencies in this area. In order to provide a broader outlook, the author uses trade data of the International Trade Centre covering the period 2001–2014, which serves as a background for an identification of possible roots of contemporary phenomena.

Keywords: international trade, Republic of Korea, United States, free trade agreement, trade regionalism.

Streszczenie: Artykuł odnosi się do zagadnienia umowy handlowej nowej generacji zawartej między Stanami Zjednoczonymi a Republiką Korei, która weszła w życie w marcu 2012. Autor analizuje strategiczne motywy stojące za tym porozumieniem, jak również jego pierwsze efekty handlowe z punktu widzenia gospodarki południowokoreańskiej. Ponieważ obie strony umowy charakteryzują się wysokim poziomem konkurencyjności swoich gospodarek, szczególny akcent został położony na grupy towarów wysoko zaawansowanych technologicznie z zamiarem identyfikacji najważniejszych tendencji w tym obszarze. W celu poszerzenia całego obrazu Autor zdecydował się wykorzystać dane dotyczące strumieni handlowych dostępne w bazie Międzynarodowego Centrum Handlu za okres 2001–2014, co ma posłużyć jako tło do zidentyfikowania potencjalnych przyczyn współczesnych trendów.

Słowa kluczowe: handel międzynarodowy, Republika Korei, Stany Zjednoczone, umowa o wolnym handlu, regionalizm handlowy.

1. Introduction

The structure of the world economy in the 21st century was the subject of significant transformations. One of the main tendencies remains the proliferation of regional and cross-regional trade agreements (see more: [WTO 2011]). The most active countries, aware of the negotiation deadlock under the framework of the World Trade Organisation, seek new opportunities to sustain their openness and the role of the foreign trade as an engine of their economic growth and development. Thus an essential part of this strategic approach is to identify potentially attractive markets around the world and strive towards closing trade accords on the base of which comprehensive rules of bilateral economic relations are enforced.

It is also worth stressing in this context that most of the new generation trade agreements officially aiming at liberalising trade barriers are rather oriented at establishing the new trade-related provisions (e.g. competition policy, foreign direct investments, environmental aspects of trade, labour standards, protection of the intellectual property rights) essential for securing strategic interests of the largest multinational corporations. General political and economic rationales result basically from a constant fear that institutional competition between the regulatory systems and the level of their attractiveness for international business will sooner than later bring about an erosion of trade preferences and will contest the concessions negotiated multilaterally.

That is why competitive trade liberalisation [Bergsten 1996] can be identified as a new phenomenon, especially characteristic of the newly industrialised countries in the Asia-Pacific region (see more: [Dent 2006; Baldwin 2008; Solís, Katada (eds.) 2008; Ravenhill 2010; Skulska 2012; Oziewicz 2012]) for which relatively unhampered access to markets of highly developed economies stands as a crucial factor of their economic prosperity and development. However, contemporary research on the issue of the proliferation of free trade agreements (known also as a domino regionalism [Baldwin 1993; Baldwin 1997]) proves that not only economic reasons are usually taken into careful consideration as it comes to selection of potential new trading partners. Equally important are also various geopolitical interests¹ anchored in the priorities of domestic and foreign policies [Cattaneo 2009; Estevadeordal, Suominen 2009], e.g. the issue of international security in particular regions [Fijałkowski 2010; Grabowski 2012].

Against this background, the case of the trade agreement between the Republic of Korea (South Korea) and the United States (henceforth KORUS FTA) seems to be an interesting research issue in terms of exploring its main motives, as well as analysing its first mid-term trade effects with special regard paid to the goods classed as high-tech clusters. Deliberations covering the above mentioned aspects are generally aimed at achieving the defined research goals and addressing the validity of formulated hypotheses.

¹ See the case of Trans-Pacific Partnership signed in October 2015.

2. Methodological perspective and research goals

The main part of the provided analysis focuses on an identification of technologically highly developed product clusters (high-tech goods) which are the essential areas of international competitiveness of the South Korean economy and which benefited most from the preferential access to the U.S. market.

For the purpose of the research, the data of the International Trade Centre [*Trade Map* 2015] was used. It covers trade streams between the U.S and the Republic of Korea in the period 2001–2014 and is available on the 2-, 4- and 6-digit disaggregation level according to the framework of the Harmonised System (HS). In order to provide an in-depth analysis of technological intensity of the Korean exports and imports to and from the U.S., it was also necessary to convert the approach defined by UNCTAD [2012], which classes particular groups of traded goods according to their production factor intensity (resource-intensive, labour-intensive, low-tech, mid-tech, high-tech and unclassified), based on the Standard International Trade Classification (SITC) into the one coherent with the Harmonised System.

Another applied research method is the calculation of the Grubel-Lloyd index [Grubel, Lloyd 1971] which remains essential to identify the evolution of intra-industry trade (IIT) and its sub-categories (i.e. horizontal, vertical-high quality and vertical-low quality²) between the trading partners.

Taking into account the main set of motives of the KORUS FTA and drawing special attention to high-tech dimension of the bilateral trade, two following research hypotheses were defined:

- hypothesis no. 1 (H1): KORUS FTA was an essential step towards sustaining competitiveness of the South Korean high-tech exporters on the U.S. market³;
- hypothesis no. 2 (H2): Taking into account the nature of competitive trade liberalisation, growing pressures exerted by the second-tier Asian Tigers and high competitiveness of both parties, KORUS FTA serves as an efficient tool strengthening the intra-industry trade.

3. An overview of main rationales of the U.S.-Republic of Korea Free Trade Agreement

The agreement between the U.S. and the Republic of Korea was signed by the parties on the 30th of June 2007, but entered into force almost 5 years later on the 12th of March 2012, covering the trade in goods and services and providing a comprehensive

² The first one covers trade in goods of a similar quality based on the assumption that their prices do not differ from the average by more than +/-15%. The second type means that the economy exports more advanced goods in the same product cluster as it imports (assuming that higher prices mean higher quality), while in case of the third one, the situation is analogically reverse.

³ As Lee [2008, p. 61] puts it, Korea appeared to have comparative advantages in machinery (electrical, as well as precision) and transport-related equipment, and it showed fast growth in terms of RCA values.

liberalisation. This means not only the reduction of existing tariff barriers, but also harmonisation (standardisation) of trade-related provisions (e.g. competition, environment, intellectual property rights, government procurement, investment, labour⁴). However, in the most extreme scenario its full implementation will have not occurred until March 2031, which means 19-year long (*sic!*) transition period for the most sensitive agricultural goods, with several exclusions from the full liberalisation scheme [WTO 2014a, pp. 11–12; USITC 2007, pp. 1-8].

Both countries as WTO member states were also obliged to notify their trade accord in order to consider coherence of its legal framework with the rules of international trading regime under the article XXIV of the General Agreement on Tariffs and Trade (GATT) and the article V of the General Agreement on Trade in Services (GATS). However, in this context, it is worth noticing that a common practice is to present new trade deals with a *fait accompli*. In other words, first they are negotiated, formally fulfilling the obligation of so-called early announcement, and then after reaching the final version of agreement parties usually impede its notification until it enters into force. Factual presentation submitted by the WTO Secretariat was distributed more than 2 years later (in September 2014 [WTO 2014a]) and the consideration meeting within the Committee of Regional Trade Agreement was held on 10th of November 2014 [WTO 2014b].

Official declarations rationalising the agreement for the public would usually highlight the commitment of both parties to multilateral trading regime⁵, their openness to free trade and importance of their bilateral economic relations⁶. It has to be also emphasised that the Agreement was a key component of the United States' commitment to deepening commercial and economic engagement in the Asia-Pacific region [WTO 2014b, p. 2] expecting an increase the volume of trade and foreign investment⁷ [USITC 2007, p. xviii] as well as paving the way towards standards enhancing strong and effective intellectual property protection which stands as a crucial factor for economies whose economic growth and development is fuelled mainly by various types of innovations sustaining their high level of competitiveness.

Welfare gains according to the GTAP static model [Lee 2008, pp. 69–70; see also USITC 2007, pp. 2-6] are estimated at 0.32% of South Korea's GDP and 0.15% of the U.S. GDP. Dynamic analysis suggests even better results due to the gains achieved by more intense competition pressure, better allocation of resources and growth in productivity. From the South Korean standpoint, the automobile, electronics, and textile sectors were expected to benefit most, while farmers had to pay the highest

⁴ The text of the FTA is largely modelled on other recent U.S. FTAs, such as the U.S.-Central America-Dominican Republic and U.S.-Singapore FTAs [USITC 2007, pp. 1-3].

⁵ This does not mean that especially the Republic of Korea remains reluctant in negotiating and establishing free trade agreements with partners around the world [WTO 2015].

⁶ For a broader historical economic context of the KORUS FTA cf. Lee [2008, pp. 55–60]. More insights referring to security issues is offered by Heo [2008].

⁷ KORUS FTA was also perceived as a vehicle boosting growth of FDI as an effect of a comprehensive liberalisation and business-friendly regulation of trade-related issues.

price [Heo 2008, p. 374]. The tariff asymmetry between the United States and Korea suggested that the FTA was likely to result in a greater percentage increase in U.S. exports to Korea (because of the effect of lowering Korea's relatively higher trade barriers) than in U.S. imports from Korea (because the U.S. economy is relatively more open to Korea's imports) [USITC 2007, pp. 2-7].

4. General characteristics of bilateral trade flows

When analysing general trade data between the U.S. and the Republic of Korea one can easily identify a stable growth of the South Korean exports (with just one exception which was the crisis year 2009). However, trade relations with other partners were flourishing even more, which has an impact on the dropping shares of the U.S. market in the total value of the South Korean exports. Basically, a similar trend may be observed in the case of imports. Increasing values are accompanied by smaller and smaller shares of supplies from the U.S. As far as pure numbers are concerned, when the KORUS FTA entered into force (2012), it boosted South Korea's exports much more than its U.S.'s counterpart. This may be a result of different economic potentials of both partners, especially in terms of the size of their domestic markets. Smaller economies are generally much more open to foreign trade, which means that their leading companies tend to be much more determined to expand and sustain their competitive advantages, as it is vital for their future prospects.

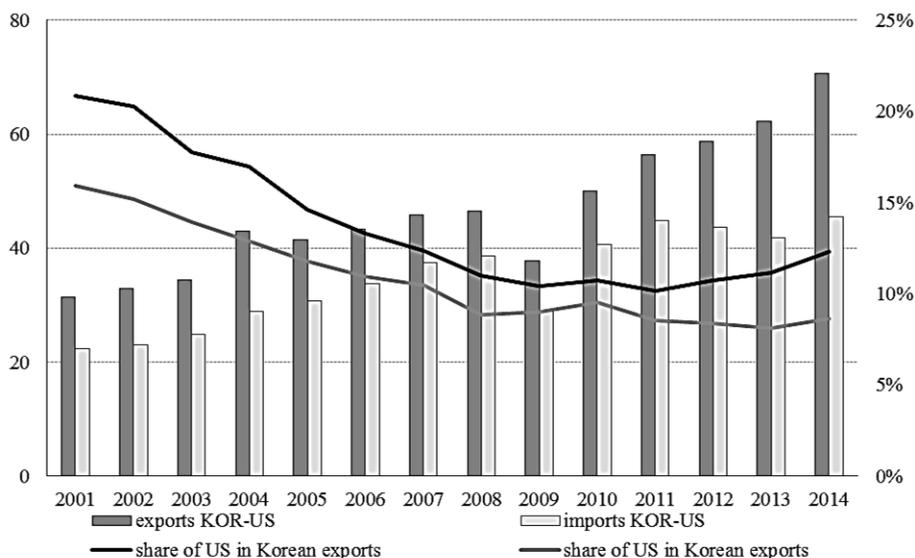


Fig. 1. South Korean exports and imports to and from the United States [USD bn] and the U.S. shares in the South Korean trade between 2001–2014

Source: Own study, based on *Trade Map* [2015]; UNCTAD [2012].

Focusing on the issue of technological intensity of South Korean exports and imports, in the case of the first one the analysis provides somewhat surprising observations. What is meant by this is the significant decline of shares of high-tech goods exported by South Korean producers (corporations) to the U.S (see Fig. 2).

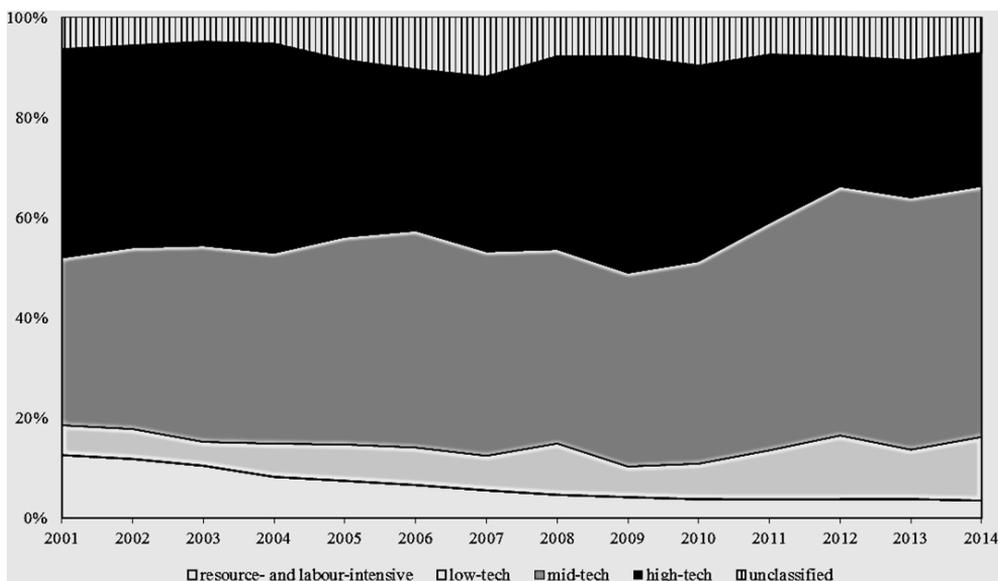


Fig. 2. Evolution of technological intensity of the South Korean exports to the U.S. between 2001–2014
Source: Own study, based on *Trade Map* [2015]; UNCTAD [2012].

This situation began in 2010, shortly after the first negative consequences of financial and economic crisis in the area of international trade were experienced. It may also suggest that U.S. producers were faced with the challenge to re-adjust and re-configure their supply chains according to new pressures resulting from greater price competition. So the strategic goal was to rationalise them by looking for cheaper, but more and more effective, partners operating in other countries of South-East Asia (second-tier Asian tigers). As far as the most important high-tech product clusters are concerned, this was the case of electric appliances for line telephony (HS 8517) which, having a share of 16.3% in total South Korean exports to the U.S. in 2011, experienced a drop in sales of 39.5% between 2011 and 2012.

A closer look into the U.S. trade data [*Trade Map* 2015] indicates two possible explanations. The first one is quite obvious: China; while the second may be related to the concept of nearshoring which benefited Mexican suppliers. If these interpretations are justified enough, it may be another evidence for more intense price competition in the times of crisis, negatively affecting producers which are better in terms of quality, but further in terms of geographical distance. What needs

to be kept in mind is also another potential source of cost instability resulting from price volatility in the energy sectors.

Thus referring to the hypothesis no. 1, the KORUS FTA itself does not seem to be an effective tool securing competitive advantages for the South Korean high-tech companies through preferential access to an attractive market. This remark remains valid also in the case of other high-tech clusters, such as data processing machines (HS 8471), their parts and accessories (HS 8473) and transmission appliances for radio-telephony (HS 8525). Only one exception are electronic integrated circuits and microassemblies (HS 8542); their sale to the U.S. market grew by 73.4% (2011–2014).

Against this background, it has to be emphasised that an important South Korean mid-tech sector which benefited from these new circumstances and increased their shares in the total exports to the U.S by 69.7% (2011–2014) was the automotive industry (HS 8703 and HS 8708). The sale of new cars rocketed from the level of 8.8 billion USD in 2011 to 14.9 billion USD in 2014.

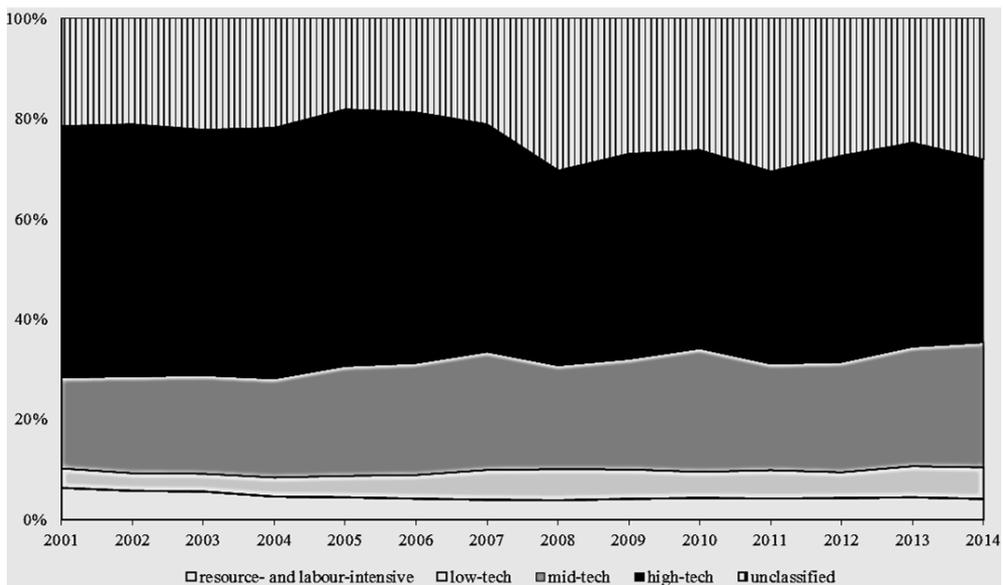


Fig. 3. Evolution of technological intensity of the South Korean imports from the U.S. between 2001–2014
Source: Own study based on *Trade Map* [2015]; UNCTAD [2012].

As far as the technological intensity of the South Korean imports from the U.S. is concerned, there are just minor transformations and the whole structure remains relatively stable (see Fig. 3).

5. Evolution of U.S.-South Korean intra-industry trade between 2001–2014 with a special regard to high-tech goods

Taking once again into account the fact that both parties of KORUS FTA have highly competitive economies and that their trade is saturated with mid-tech and high-tech product clusters, one can expect relatively significant level of intra-industry trade between them. What is more, KORUS FTA itself, treated as a tool of establishing more preferential mutual access to domestic markets, was believed to create opportunities to strengthen existing cooperation linkages and to establish new ones. The nature of the international division of labour suggests that developed economies usually have the capability to define and to support development of specific specialisation areas coherent with their both, comparative, as well competitive, advantage which is crucial for boosting their economic performance. Following analysis is aimed at verifying this assumption (see Fig. 4 and 5).

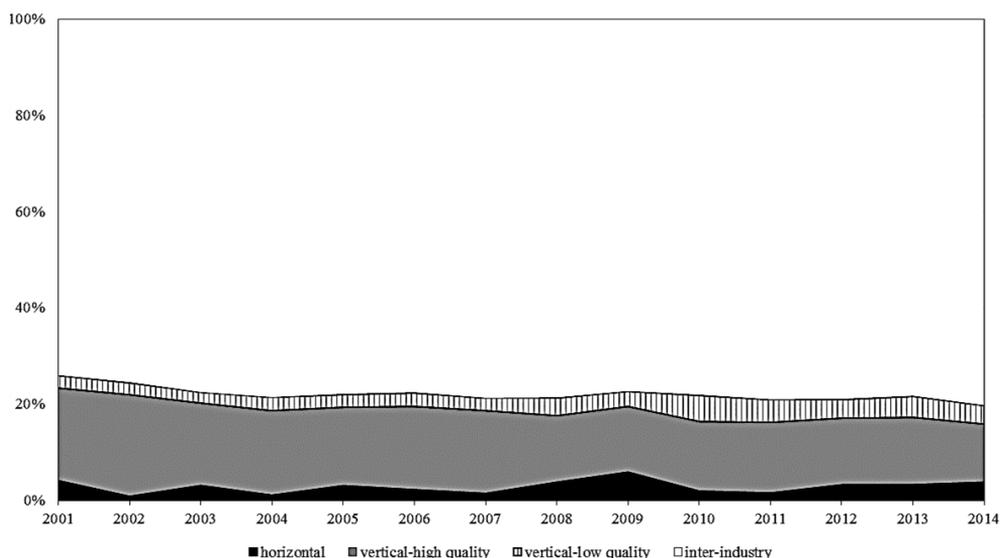


Fig. 4. Intensity of the U.S.-South Korean intra-industry trade (Grubel-Lloyd index) between 2001–2014

Source: Own study, based on *Trade Map* [2015].

A closer look at the data reveals rather unanticipated trends (see once again hypothesis no. 2). As far as the general trade flows are concerned, the intensity of intra-industry trade in the period covered by the research (2001–2014) turned out to have a slight tendency to decline (from 21–22 to 19.6%)⁸. Hence, neither the KORUS

⁸ These calculations substantially differ from the research provided by Lee [2008, p. 63] which for the period 1995–2004 were between 47–63%, but the difference may result from the fact that Lee used trade data at the 2-digit disaggregation level only, and this may have led to less exact results.

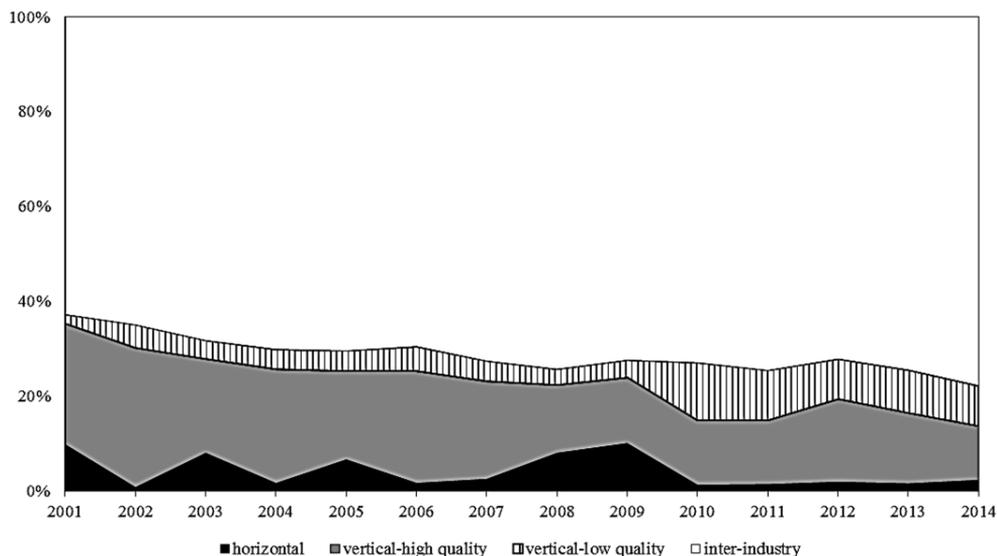


Fig. 5. Intensity of the U.S.-South Korean intra-industry trade (Grubel-Lloyd index) for high-tech goods between 2001–2014

Source: Own study, based on *Trade Map* [2015].

FTA entering into force in 2012, nor necessary corporate adjustments aimed at refining the effectiveness of their chains of added value, which resulted from the economic crisis, had enough power to reverse this course of action.

What is even more surprising, the same, yet even a bit stronger tendency was identified in the case of high-tech goods. It may be possibly explained by the magnitude of crisis consequences for U.S. companies whose priority was rather not oriented to strengthen the Trans-Pacific intra-industry trade relations, but quite the opposite. This would be the aforementioned reconfiguration of the production chains more towards the cheaper producers, forming contemporary Factory Asia or Mexican maquiladoras.

From the standpoint of South Korean producers, it was then necessary to look for trade possibilities on the new emerging markets. For instance, in the case of the most important product cluster HS 8517 (electric appliances for line telephony) these goods used to be traded in higher and higher amounts (and value) within Asia: China, Viet Nam, Hong Kong and India.

Against this background worth emphasising is also the fact that in the U.S.-South Korean intra-industry trade relations, the producers of the latter remained more competitive, which is represented by essentially higher shares of the vertical-high quality trade (both in a general analysis, as well as in the approach focused on high-tech goods only). That is why South Korean policymakers and high-tech corporations,

being aware of their competitive edge (in terms of advanced and inimitable technology protected satisfactorily by intellectual property rights), had to address the growing challenge of gradual drop in sales in the U.S. market and re-think the modes of entry and presence in emerging economies, looking at the same time for new potential locations of their businesses. This conclusion is in line with the results of the research carried out by Lee [2008, p. 58], who identifies a strong supply chain going from Korea to China, and then to the United States.

In effect, the hypothesis no. 2 has to be disproved, at least for the first years of operating under the framework of the KORUS FTA.

6. Conclusions

Based on the research results and identified observations, one can draw a generally justified conclusion that contemporary (cross-) regional trade agreements of new generation are not vehicles intended to liberalise trade and increase its volume. The emphasis is currently increasingly put on trade-related issues essential to establishing friendlier strategic political relations, especially in the context of rising China and attempts related to China's containment policy of the U.S.

As far as the KORUS FTA is concerned, trade effects projected before the deal entered into force have not been achieved so far. U.S. exports did not grow as expected, while the competitive position of South Korean high-tech producers tended to worsen slightly. These trends may be, to some extent, put down to the consequences of the global economic slowdown. It posed, however, new opportunities for less technologically advanced industries (e.g. automotive industry).

Summing up, a new extensive approach to the agreement covered in this paper in the area of trade and foreign direct investments needs to be carried in few years' time. This is because the mid-term and long-term effects will be much more comprehensive and tenable in the light of the further discoveries which might help evaluate their durability.

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