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The Investment Aspects from the FTA between Korea and China

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Abstract

Purpose – Purpose of this paper is to review and examine FTA of two countries, Korea and China, in terms of the investment aspects in bilateral FTA. Traditionally, there have been much mutual exchanges for international trade and investment between two countries for a long time. As the FTA has established between Korea and China in recent years, it can be expected that there will be more possibilities to take wide investment opportunities, which is mutual benefit to both countries in FTA era.

Research design, data, and methodology - The methodology to be taken is to look into, first general economic situations and a brief look at FTA from each countries, and then to examine investment aspects in present and future between Korea and China.

Results – The result examined in this research is that each country has been involved into mutual investment step by step, and it is also revealed that investment activities have been growing steadily as time goes by.

Conclusions – The FTA between Korea and China has new chance and hope for mutual co-operation in relation to investment aspects of the FTA at the level of economic exchanges, which can fully utilize national resources of each country.

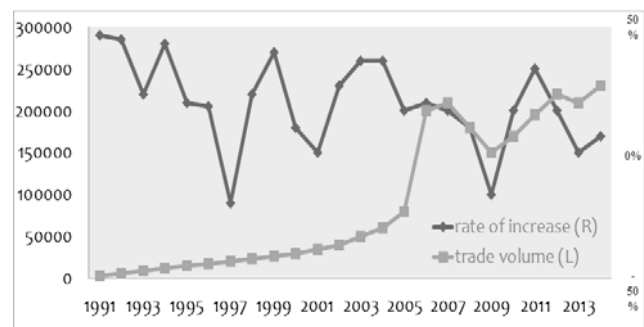
Keywords: Korea, China, FTA, Investment, Co-operation.

JEL Classifications: F02, G11, P33, P45, R42.

1. The Economic Exchanges between Korea and China

In 2000, the United States was Korea's top trading partner, followed by Japan and the European Union. Since then Korea's two-way trade has continued to expand modestly with these countries, but their share of Korean global trade has steadily declined, as a result of significant expansion of trade with China. From 2000 to 2014, as Korea's global trade tripled from \$333 billion to \$1.1 trillion, Korea-China trade rose eight-fold, from \$31.2 billion to \$235.4 billion. As a result, China's share of Korean merchandise trade rose from 9 to 21 percent, and China became both the top source of imports and the top export destination for Korean goods (Schott et al., 2015). Of all the FTAs concluded by Korea, the Korea-China FTA may be the

largest one in trade terms. It is, however, far from the best in terms of the depth of liberalization and the scope of obligations. At this time, it has been stabilized stage after take-off twice, which has formed diplomatic relationship as well as a membership joined to WTO (about 230billion) <Figure 1>.



Source: Lee (2015).

<Figure 1> Trade Volumes (mn \$) and Rate of Increase (%)

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2. The FTA between Korea and China

2.1. Preface

From the FTA between Korea and China, it is noticed that first, partnership has been emphasized in one or another way of expression, friendship, relationship and partnership between two countries for longstanding basements. Then importance or need for free trade in the world economic situations at the present time, therefore two countries should work together with various parts of economic co-operation and productive relationship. Both countries have confirmed this approach of free trade will produce mutual benefits as well as developing international trade. Therefore, establishing any rules as FTA would be advantageous and beneficial governing rules to both parties mutually.

By the FTA of two countries, it is possible to raise living standards, promote economic growth and stability, create new employment opportunities and improve the general welfare of the parties by expanding trade and investment between the parties (FTA between Korea and China, 2016). Then two countries have pursued to promote sustainable developments by economic partnership in terms of various developments, economically, socially and environmentally. Finally, this FTA has aimed to facilitate economic co-operation regionally.

2.2. Trade Volumes Exchanged in Two Countries

The free trade agreement (FTA) signed by Korea and China in 2015 governs almost \$300 billion in trade in goods and services. Of all the FTAs concluded by Korea with its major trading partners since the turn of the century, the Korea-China FTA may be the largest in trade terms. It is, however, far from the best in terms of the depth of liberalization and the scope of obligations on trade and investment policies. Korea and China agreed to liberalize a large share of bilateral trade within 20 years, but both sides incorporated extensive exceptions to basic tariff reforms and deferred important market access negotiations on services and investment for several years.

However, both countries have shared economic importance mutually, which has been linked with interdependence in terms of trade volumes of export and import situations. As far as a economic role of China to Korea is concerned, the portion of Korean export to China is nearly same as that of total of 7 countries, which has shown as 31 % that is added H.K and China (26%, compared to 11% US and 6% Japan). As for importance of Korea to China, Korea is the first country to import and third one to export in year of 2013 (Lee, 2015).

2.3. FTA in Korea

The Korea-China FTA is expected to provide economic and geo-political benefits. First of all, it will be beneficial for the substantial growth of Korean economy. According to KIEP, the Korea-China FTA is expected to increase Korea's real GDP by about 0.95-1.25 % in five years and 2.28-3.04 % in ten years (KIEP, 2012). According to KIEP, the service and investment liberalization will be no less important than the tariff reductions for a FTA feasibility study, which indicates that the potential dynamic effects will be possibly greater than the static effects of tariff reductions (Choi, 2012).

It is illustrated the reason Korea has pursued to FTA with China is First, chances to secure Chinese market as second domestic market, which has been rapidly developing economy, second, reflected into agricultural concern, third, institutional base for Korean company that entered Chinese market, fourth, Established global FTA network of three largest economic zone, and finally contributed to peace and stable development in region.

Korea's FTA with China is distinctively different from its other FTAs in that Korean negotiators focused on minimizing damage to the nation's agriculture, fisheries and livestock industries rather than maximizing profits through the removal of tariffs on major export items. According to the Ministry of Trade, Industry and Energy, the China-Korea FTA will remove \$5.44 billion in annual tariffs, nearly 6 times more than the \$930 million saved in the Korea-U.S. FTA and 4 times more than the \$1.38 billion lifted by the Korea-EU FTA (Huh, 2014).

2.4. Motives of China FTA

China has been looking for new strategy to expand its strategic and economic partnership with other countries in one way or another, and FTA is one of ways China has to seek in the new economic world. Especially, China has some motives to form free trade agreement beyond economic reasons in terms of political views, together with economic aspects. Since China has joined the WTO as official membership, their dream to open their market in free economic world has been realized, that is result of open door policy of economic terms from 20 years ago.

However, China FTA can be defined into sustainable economic efforts towards to world open economic situations, pursuing their national objectives in terms of political as well as economic sides. In that sense, it has summarized that first, to achieve political aim through economic approaches, second, to improve friendly relationship with other countries beside economic reason as resource acquisition and expansion of international trade, third, countries to form the FTA is from countries with small economic structure, to big ones, finally, especially active in multinational FTA with Asia and Pacific regions for establishing Chinese economic zone,

<Table 1> Motives of China FTA

Purpose	Countries
New Market and Overseas Expansion of National Companies	ASEAN, India, S.Africa, Brazil, Chile, Pakistan
Securing Energy	ASEAN, Australian, Chile, SCO, GCC, Pakistan, Iceland
Enhancing Regional Leadership	Korea, ASEAN, Pakistan
Channel to Connect Regions	ASEAN, SCO, India
Industrial Competitiveness	HK, Macao, Australia, NZ, Singapore, Iceland
Establishment of Chinese Economic Zone	HK, Macao, Taiwan
Grand Development of West Northeast Promotion	Korea, ASEAN, Pakistan
Network of Chinese emigrants	ASEAN
Recognition of Market Economy Position	Korea, Australia, NZ, Iceland

Source: Composed by Author.

promoting service sector, and expanding their influences in Asia region.

Followings are motives the China has utilized following each countries <Table 1>.

3. Investment in FTA between Korea and China

3.1. Composition of Agreement

It is the most comprehensive FTA of Chinese FTAs, and it has total 22 chapters composed, comparing with 24 chapters of US and 15 chapters of EU. From Chinese FTA, more chapters than NZ (18 chapters) and SU (16 chapters). It includes goods (goods, origin, clearance +trade facilitation, trade remedy, SPS, TBT) and service investment (svc, communication, finance, mobility, investment), standard. co-operation (property right, competition, transparency, environment, e-commerce, economic development) and general provision (first rule, transparency, exception, final rule, claim settlement). Major contents of this FTA are composed of product concession, non-tariff barrier, service and investment and rules and economic co-operation.

3.2. Investment Positions in General

The close relationships between trade and investment and competition policy have long been recognized. One of the intentions, when GATT was drafted in the late 1940s, was for rules on investment and competition policy to exist alongside those for trade in goods (WTO, 2016).

<Table 2> Investment Position in Korea.(2005–2014)

Year	Korean Outward FDI stock			Korean Inward FDI stock		
	A	China		A	China	
		B	C		B	D
2005	160	20	12.3	514	7	1.4
2006	228	26	11.3	622	11	1.8
2007	333	58	17.3	782	14	1.8
2008	336	46	13.6	607	6	1.0
2009	360	56	15.5	730	10	1.3
2010	406	64	15.8	828	18	2.1
2011	453	74	16.3	841	23	2.7
2012	534	80	14.9	955	29	3.1
2013	621	109	17.5	1,005	36	3.6
2014	717	132	18.5	998	44	4.4

A: World (billions of US dollars)

B: Billions of US dollars

C: Percent of total FDI abroad

D: Percent of total inward FDI

Source: Schott et al. (2015).

Investment will be a large component of bilateral expansion of service industries in both markets, but it still remains centered largely in manufacturing. The stock of foreign direct investment (FDI) in Korea doubled over the past decade, from \$514 billion in 2005 to \$998 billion in 2014, but China's share rose from only 1.4 to 4.4 percent <Table 2>.

3.3. Investment Provisions

Investment liberalization is a key priority for Korea given the sizable flows of FDI to China in recent years as well as the significant potential of the Chinese market for Korean service industries. As China experiences significant growth in investment and services, the quality of its FTA provisions has improved incrementally <Table 3>. As in services, the Korea-China investment negotiations on market access are scheduled to commence two years after the agreement enters into effect. This two-year delay effectively allowed the Korea-China pact to proceed expeditiously to conclusion.

Although the market access negotiations have yet to take place, the terms of investment protections have been established in the Korea-China FTA. In large measure the features of the investment chapter reflect the terms of the China-Japan-Korea trilateral investment treaty (Schott et al., 2015), but it also expands some areas. The investment chapter includes standard features, such as nondiscriminatory national and MFN treatment for post establishment investment; ensures that investments are afforded "fair and equitable treatment and full protection and security" consistent with the customary international law minimum standard of treatment; provides safeguards against

<Table 3> Investment Provisions between Two Countries

Article	Key Issue	Korea-China FTA
Scope and coverage	Includes services mode 3	o
National treatment	Covers pre-establishment phase	x
MFN treatment	Covers pre-establishment phase	o
Minimum standard of treatment (MSOT)	Protects investor property rights	o
Performance requirements	WTO TRIMs	o
Senior management and boards of directors	Nationality requirement	x
Nonconforming measures (NCM)	Positive or negative list approach	**
Investor-state dispute settlement	International arbitration	o

FTA = free trade agreement; TRIMs

= Agreement on Trade-Related Investment Measures

X = agreement does not include the provision O

= agreement includes the provision

* = MSOT article does not use customary international terms

** = NCM article does not include specific measures

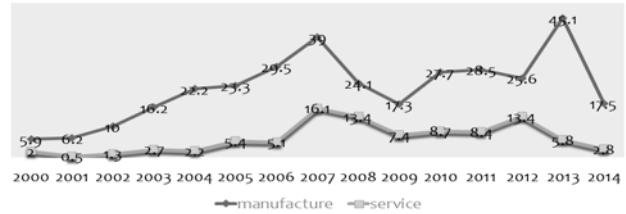
Sources: Jung(2012); MOTIE(2014).

expropriation and the provision of prompt and adequate compensation; and creates a functional investor-state dispute settlement mechanism.

3.4. Investment Trend of Korea to China

Investment patterns of Korea have been transformed to domestics market in China in recent years, however, it had utilized as indirect base for export as well as low-wage labour in pre-2007, but investment has switched to target internal market in China. As for companies in business in China, it is got involved in local procurement and sales in local market, which is 55% of 2007 to 71 % of 2013 in terms of rate of domestic market.

It is regarded that investment of Korea to China has entered matured stage, which means it has been from investment by processing trade of SMEs to that of domestic market of large company. It records 48 bn\$ (24,676 cases) in Sep. 2014 (investment standard). Investment to China was declined by 3 bn\$ yearly after the middle of 2000 year. It reduced again after increase by semiconductor and LCD investment (2013-14 year). It has been shown on out of China from labour intensive SMCs to mobile phone. However, it is still slight in service investment (20% of total Chinese investment) <Figure 2>.

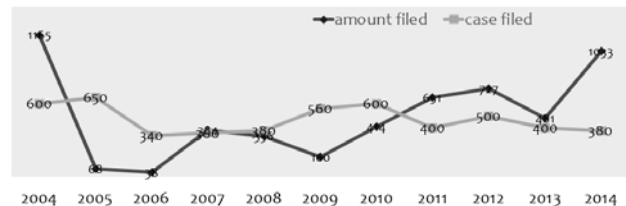


Source: Lee(2015).

<Figure 2> Mft. & Svc Investment by Korea to China

3.5. Investment Trend of China to Korea

China has pursued to policy of foreign investment at early of 2000 year, and this means internationalization by foreign investment. Investment by China to Korea has been still poor, but it is remarkably revealed that the investment of area in real estate and cultural contents has been increasing in recent times. Instead of decline in investment by manufacturing industry, it is shown that increase in service and trade sector is remarkable. FDI by China to Korea has sharply hiked 1.3 bn\$ during 1~9, 2014, which includes real estate development (Jeju tourist leisure, etc.), as well as cultural contents area (game) <Figure 3>.



Source: Lee(2015).

<Figure 3> FDI by China to Korea (case, m\$)

3.6. Current Status in Investment

Many countries took steps to further facilitate investment, with countries in Asia being particularly active. For instance, in the Republic of Korea the Ministry of Knowledge Economy (MKE) announced that it will provide a so-called "red carpet" service for foreign investors recommended by central government agencies, provincial governments and foreign embassies. Government services will include immigration, transportation, escorting, interpretation, related industry consultation and industrial field trip. The government will also step up efforts to attract investments from China with an aim to increase the amount more than 10-fold to \$2 billion in 2015 (UNCTAD, 2010).

China has surpassed the United States to become the largest FDI recipient in the world. FDI inflows to China reached \$129 billion in 2014, an increase of about 4 per cent. This was driven mainly by an increase in FDI to the services sector, particularly in retail, transport and finance, while FDI fell in manufacturing, especially in industries that are sensitive to rising labour costs. FDI inflows in services

surpassed the share of manufacturing for the first time in 2011. In 2014, the share of services climbed to 55 per cent, while that of manufacturing dropped to 33 per cent. Among major investing countries, the Republic of Korean investment in China rose by nearly 30 per cent in 2014, and the European Union (EU) experienced a slight increase. By contrast, FDI flows from Japan and the United States declined by 39 per cent and 21 per cent, respectively (UNCTAD, 2015)

Since FTA between Korea and China has formed and activated, two countries have closely made business into bilateral cooperation in terms of trade matters within FTA. One of areas is how to attract and support investment activities (KITA, 2016). By the countries' bilateral free trade agreement, in the first five months of the year, new Korean investment that arrived in China came to US\$2.2 billion, up 12.2 percent from the same period last year. The amount surpassed Japan's \$1.47 billion investment arriving in China over the cited period. Korean investment in China surpassed that of Japan for the first time in 2015.

It will be estimated that Korean investment in China will likely reach \$5.3 billion in 2016, spiking over 31 percent from \$4.04 billion in 2015. Chinese investment in Korea also has been on a steep rise, reaching a record high of \$1.98 billion in 2015. In the January-May period, Chinese investment that arrived here jumped 79.5 percent on-year to \$710 million in 2016 (ADB, 2016).

4. Implications from the FTA

4.1. Korean Sides

From two countries, each country has its own way of application through this FTA. In Korea, it is to expand access of domestic market in China, which has included structural change of export and investment to China, and this will have boosted an accessibility to domestic market in China. At the present economic situations between Korea and China, processing trade is largely main pattern of trade and Korea has relied much more upon Chinese labour force. However, by effects of FTA of two countries, tariff will be reduced as well as reliefs of non tariff barrier. Then, intermediate goods and raw materials can be imported from China and production and procurement could be in Korea. From this time on, export will be done to domestic market of China.

From Korean side of effect, it is clear that tariff could be reduced and NTB can be eased with products to export to Chinese domestic market. Especially, the effect has to be focused on semi- or final products that is distributed into Chinese domestic market. However, tariff will be demolished within 10 years for 26 of 100 products to export to China, and opportunity for consumer products is supposed to expand as well.

It is expected to pre-occupy service market and increase in export following to expansion of investment to enter domestic market in China. As for major export products to China, investment could be expanded in relation to sales activities as marketing, distribution and logistics. Also, additional opening will be done through subsequent negotiations for areas of service as well as improvement of investment environments in China. In summary, Korea will contribute to improving welfare of Chinese consumers, and industrial sophistication as well as qualifying changes of FDI in China.

4.2. Chinese Sides

In China, FTA will be a stepping stone towards world market, and it is good chances to utilize strength of Korea in order to improve competitiveness and to expand to enter and access world market. There are 3 stages to evaluate its FTA, first to utilize the merit of Korea, second qualitative developments and institutional advancements, third to going forwards to world market.

As far as utilization of the merit of Korea is concerned, it belongs to R&D, Brand, technology, outstanding individuals, design/planning and know-how to enter overseas market, etc.. Korea could be playing a role as test market, and China will obtain huge economic territory through FTA network. As for qualitative developments and institutional advancements, by improving productivity, it is possible for China to produce high-valued products and to materialize industrial sophistications. Also, it is expected to raise ability to adapt to international institutions.

For China, FTA is additional way of entering world market, getting along with Korea, making use of Korean FTA experiences and strength, which means China will have large opportunities to enter FTA countries like USA, EU, etc., with Korea. Mutual access to world market with Korea will be launching to explore win-win project. As far as the cost matters are concerned, political and economic cost will be reduced in comparison with forming the FTA with USA and Japan, etc.. From Korean point of view, it is expected to create employment and growth by attracting Chinese capital, and it will promote to enter value chain of small hidden champion.

4.3. Investment Aspect

One of advantageous aspects the FTA has is to share the mutual resources each country has sustained, and exchanged in the form of investment in FTA benefits. Korea and China has its own comparative advantage in every part of economic activities. As shown before, it is not much active for both countries to enter and invest what they have tried to, however it is evident phenomenon shown since the FTA between two countries has been formed that investment

between two countries has sharply increased in recent years. Therefore, it is worthwhile to expect more about investment in the future.

5. Conclusion

Historically, two countries have kept in touch each other in one way and another. Economically, FTA is big step for both countries to promote and cooperate into various part of sectors. Not one country, but both two countries have a lot of opportunities to develop potential possibility in either in economic sides or in cultural sides as well. Both countries have tied-up with economic sector very much and it is time to open and utilize bilateral market for each countries. Therefore, it is inevitable to form FTA of both countries at this time.

As far as application to FTA of both countries is concerned, each country has some chances to promote their

national economy by bilateral FTA, that is, Korea has widen existing Chinese market specially for domestic one, also, China has acquired of Korean market, and utilized the established FTA done by Korea to enter world markets. However, the FTA between two countries is new opportunity for both countries to enter more freely and smoothly for more investment activities, utilizing their own competitive resources. As shown previous chapter, move to other party will improve chance of investment and provide proper allocation of each country's resources.

Based on this research, it is well recognized that both countries using FTA should co-operate with each other, and apply some lesson and implications examined in this paper, especially investment aspects in level of pursuing bilateral win-win strategy. The conventional relationship of investment aspects has to be more developed into co-operation and mutual understanding, based on trust that has been established for long time.

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