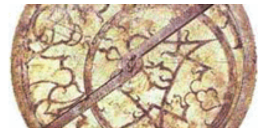
SciencesPo. GEM Groupe d'Économie Mondiale

Policy Brief
April 17, 2012



Korean Hallyu in trade policy

Patrick A. Messerlin [1]

In the last decade, Korean singers, dancers and actors have swamped East Asian stages and theaters. Most prominent among these is super-star Rain (Bi in Korean) who rapidly rose, with Confucian humility, from the poor streets of Seoul to the Time 100 most influential persons in the world. Astounded Chinese observers have given the name of "Korean Hallyu" (Korean wave) to this phenomenon.

There has also been a Korean Hallyu in trade policy in recent years. Two months after the official recognition of a "Comatose Doha" round of multilateral trade negotiations, Korea took two major trade initiatives that are likely to trigger new dynamics in the world trading system frozen by the Doha failure. In January, 2012 Korea proposed opening talks with China on a preferential trade agreement (PTA). And, in February, Korea offered to restart similar talks on a PTA with Turkey.

These Korean initiatives are not novel. They are the continuation by Seoul of a carefully designed policy implemented since the mid-2000s to sign PTAs with large, relatively open and well regulated economies. These initiatives have proven quite successful. By 2010, just 11 PTAs gave Korean firms free access to 57 percent of the world GDP. The two proposed PTAs with China and Turkey would add another 10 percent of the world GDP to that total, meaning that Korean firms will enjoy a level of market access close to what the Doha Round would have likely given them if it had been completed.

These initiatives reveal a worrisome "policy decoupling" between Korea (and a few other developed and emerging economies) and the US and the EU, which have been unable to take similar moves despite being in much worse economic shape than Korea. Seoul remains firm in seeking trade liberalization – be it via Doha or PTAs – as an indispensable engine for domestic

[1] I would like to thank Bruce Stokes, Lee Hye-Min and Cho Kyeong-Won for very helpful discussions. This brief is largely based on P. Messerlin, 2012. The EU preferential trade agreements: Defining priorities for a debt-ridden, growth starving EU. Groupe d'Economie Mondiale at Sciences Po. http://gem.sciences-po.fr.

growth. Brussels and Washington should be deeply concerned by such a policy decoupling because the Korean initiatives have the capacity to be game changers in Asia and Africa.

The Korea-China PTA

In both Europe and America, the Korea-China PTA is seen first and foremost as a political initiative. Seoul needs Beijing's support for stabilizing a dangerously volatile North Korea after the death of Kim Jong Il and his son's hasty succession. But, the economic consequences of this PTA are equally huge.

First, Korea's initiative opens a helpful door for China, which has been isolated in trade matters after the Doha failure. The US-sponsored Trans-Pacific Partnership (TPP) initiative leaves no room for China because Beijing will never be able to sign the anticipated TPP provisions on labor laws or state-owned enterprises. Moreover, the EU has still to make up its mind on what to do with China. Japan enjoys the luxury of two trade expanding alternatives—joining TPP and a PTA with the EU—rendering a trade initiative with China less urgent. Finally, no developing country is ready to sign a substantial PTA with China—the fear of the Chinese industrial powerhouse is simply too great. But clearly, a Korea-China PTA would be a game changer, forcing all these countries to reassess their current trade strategy vis-à-vis China.

Second, a China-Korea PTA is Korea's response to another key game changer in East Asia: the China-Taiwan Economic Cooperation Framework Agreement (ECFA) that gives to Taiwanese firms substantial preferences when entering Chinese markets. Korea hopes that the PTA with China will put its firms on par with those of its arch competitor Taiwan. How difficult and/or how shallow the Korea-China deal might be is a wide open question – as indeed, it is for the ECFA. But, moving (or moving first) may be a huge advantage when dealing with the mamoth Chinese economy and China's complex national and regional economic policy-decision processes.

The Korea-Turkey PTA

In 2010, Korea and Turkey started talks on a PTA, but Turkey wanted to focus only on tariff issues and lost interest. In sharp contrast with Korea's PTA-driven economic vision of the world, Turkey has seen PTAs as foreign policy instruments for (re)establishing its regional influence. If one excludes the customs union with the EU, Turkey has signed 18 PTAs, all of them with Middle-Eastern or Central Asian neighbors, often parts of the former Ottoman Empire.

Turkey's approach has encountered severe limitations. The markets opened by these PTAs to Turkish firms are small: the GDP of all Turkey's PTA partners represent less than 6 percent of world GDP – less than one-tenth Korea's result. Turkey's partners are economies that are highly protected and badly regulated, hence not promising in terms of growth prospects. Last but not least, the political benefits of these PTAs have been undermined by the Arab Spring revolutions that have overturned several of the regimes with which Turkey has signed PTAs.

Thus, a Korea-Turkey PTA would also be a game changer. Ankara has long been stymied by Brussels in its efforts to join the European Union. A trade deal with Seoul would demonstrate that Turkey has alternative economic partners in the global economy. Moreover, a Korea-Turkey PTA would help Turkey to shift from a trade policy driven by Ottoman nostalgia to a policy looking for the largest and fastest-growing markets in the world. For the Korean side, it is an additional opening to EU, Middle Eastern and Central Asian markets.

Lessons for the US and for the EU

Compared with Korea's PTAs, EU and US PTAs have produced limited market access. The EU's 32 PTAs have opened only 17 percent of the world GDP to EU firms. The US's 15 agreements have opened only 13 percent of the world GDP to American companies.

Why such paltry results? Most US PTAs have been driven by foreign policy concerns, as exemplified by the failed initiative to create a Free Trade Area of the Americas and then the successful, but economically irrelevant PTAs with Morocco, Oman and Bahrain in the wake of the 9-11 attacks in an effort to show that Washington could have strong relations with Muslim countries... Despite their names, these deals don't qualify as trade policy. In fact, the trade policy the most consistent with such PTAs would have been strong US support for a successful conclusion of the Doha Round. But, Washington had a hard time choosing between its international leadership in trade matters (which favored a compromise at the WTO) and its domestic trade hawks ready to kill the Doha Round if not "ambitious" enough.

Brussels' trade policy was ambiguous. It hoped to get both a successful conclusion of the Doha Round and extra benefits from PTAs. In the process it overestimated its true negotiating leverage with respect to its potential PTA partners. As a result, the EU chose the wrong PTA partners. Since 2006, the EU has tried to conclude PTAs with partners (Argentina, Brazil, India, Russia) that will become truly large economies only in the 2030s, that still have deep-rooted protectionist instincts and that are among the most regulated economies in the world. Such a choice was driven by the hope to get big preferences for EU firms in these future large markets. Such a hope can only lead to bitter disillusionment. As soon as the EU PTA partners realize the huge rents that EU firms will gain from the strong market access preferences these nations have granted to the EU, these nations will conclude PTAs with other countries, eroding EU preferences and leaving EU firms with severe adjustment problems.

Paradoxically, the current US and EU PTA policies have ended up with similar partners – too small and/or too badly regulated to have any chance of boosting European and American growth in the current economic crisis. As a result, top US and EU decision-makers (Presidents and Prime Ministers) are consequently not interested in supporting such PTAs, which then tend to be captured by narrow vested interests fighting for years before getting final ratification of modest deals.

Learning from the Korean Hallyu

The key Korean lesson for the EU and the US (and indeed for any country) is that Seoul conceives trade policy – be it Doha or PTAs – first and foremost as a component of a pro-growth domestic agenda, not as a quasi-autonomous policy with only rhetorical references to growth and jobs.

If PTAs are the only option left to the EU and the US for the time being, the Korean Hallyu suggests that they need to fulfill three conditions:

- Open big markets. The bigger the prospective trade partner's economy, the greater opportunity for American and European firms to expand the scale of their operations and the scope and variety of the products they can sell.
- Favor well-regulated partners. The better regulated the partner is, the more the country in question will be induced to improve its own regulations. Modern economies are regulated by norms in goods and by market regulations in services. The quality of these regulations decides whether a country has a thriving and successful economy or a sluggish and declining economy. Better regulations are powerful instruments to change the relative prices of goods and services, hence to increase the consumers' welfare, in modern economies where services represent 70 percent of the GDP.
- Look for timely results. Negotiating a PTA with a partner that may be a large economy in two decades is not suitable for the US and the EU, both debt-ridden regions with an urgent need of boosting growth today. Timing is key in choosing PTA partners.

Combining these three criteria suggests that the EU and the US should concentrate their negotiating efforts on concluding as soon as possible very few deals, in addition to the ones with Korea already done: a PTA with each other, EU bilateral deals with Japan and Taiwan, and a US deal with Japan through the Trans-Pacific Partnership.

Back to the WTO

By doing so, the EU and the US will inevitably amplify two costs of the emerging web of PTAs. First, such a web will inevitably generate discriminatory treatment among the economies linked by these PTAs simply because there is no negotiating process guaranteeing that concessions granted to one PTA partner will be granted to other PTA partners. These costs are likely to flourish in all the issues more complex than tariff matters.

Second, such a web of PTAs tends to leave aside many developing countries – those which are too small, too badly regulated and/or with growth perspectives too far away to be attractive. This perspective is certainly not a desirable one for world growth, development and peace.

This conclusion shifts attention back to the WTO forum, which remains the only and/or best place to solve these problems. In particular, the WTO emerges as by far the best forum for the small developing countries – a lesson they should remember.