

TRADE SUSTAINABILITY IMPACT ASSESSMENT OF THE FREE TRADE AGREEMENT BETWEEN THE EU AND THE REPUBLIC OF KOREA

COMMISSION SERVICES POSITION PAPER

I. Introduction

This paper formulates the Commission services' response to the findings of the Trade Sustainability Impact Assessment (Trade SIA) of the Free Trade Agreement (FTA) between the EU and the Republic of Korea (hereinafter referred to as Korea) carried out by a consortium of independent consultants. It also gives the general context of the exercise, explains the structure of this particular Trade SIA and presents the main findings of the study. The present Commission services' position paper includes the Commission services' views on the findings and recommendations set out in the Final Report¹. The views expressed in the Report are those of the consultant.

The Trade SIA of the EU-Korea FTA was launched in October 2007 and finalised in October 2008 – well in advance of the completion of the negotiations. The consortium led by IBM Business Consulting in cooperation with DMI Associates, TAC Financial and TICON Development Consulting delivered a comprehensive analysis of the potential sustainability impacts of the FTA. The findings of the Trade SIA confirmed the outcomes of the previously conducted studies (Quantitative and Qualitative Analysis) about the possible impacts of the EU-Korea FTA. The Commission services remain convinced that the future EU-Korea FTA will not only liberalise trade, but also contribute to sustainable development in all its dimensions, economic, social and environmental.

The Trade SIA recommendations have been in most instances taken on board by the Commission's negotiators. The Commission services would like to underline that the Consultant's recommendations proved to be very useful in the negotiating process and were largely incorporated into the final outcome. Furthermore, a description of specific sectors and additional case studies included in the different phases of the Trade SIA proved valuable as they provided background and analysis that have been useful to the negotiators. However, the level of detail and the justification used to back some of the specific recommendations by the Consultant was not always sufficiently elaborated for the purpose of the negotiating efforts.

All reports and other accompanying documents produced as integrated part of the Trade SIA can be downloaded from the Commission's and the Consultant's websites:

<http://ec.europa.eu/trade/wider-agenda/development/sustainability-impact-assessments/>

<http://www.eu-korea-sia.org/pub/>

Background documents concerning EU-Korea trade relations, the FTA negotiations and relevant press releases can be consulted at:

<http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/korea/>

¹ This Trade SIA position paper is presented exceptionally after the negotiation of the FTA have been concluded. Therefore it focuses on explaining to which extend the Trade SIA recommendations have been taken into account in the EU-Korea FTA.

II. Overall context and objectives

The Commission is committed to pursuing a trade policy reconciling economic growth, social development and environmental protection, in line with Article 9 TFEU². This is why Trade SIAs have been carried out for all EU major trade negotiations since 1999. Trade SIAs are a process undertaken during a trade negotiation, which seeks to identify the potential economic, social and environmental impacts of a trade agreement. Trade SIAs reports have highlighted many ways in which trade agreements impact on people's lives, but also the complexity of cause-effect and the need for improved statistical databases, notably for analysing social and environmental impacts. They have helped to better understand the consequences of EU's trade policy choices. The Trade SIAs aim at informing the negotiators about possible consequences of a potential trade agreement and suggest concrete actions to be undertaken in order to enhance the benefits of trade liberalisation or to mitigate negative effects, where applicable. Additionally, they also put forward ideas for cooperation or proposed monitoring.

The Trade SIA of the EU-Korea FTA used different indicators to assess its potential impacts, covering the three pillars of sustainable development – economic, social and environmental. The results are mainly based on quantitative tools, but incorporate also input from stakeholders and experts to support the adequate analysis of the complex social and environmental impacts. The Commission ensured that the Trade SIA process engaged Civil Society and was built on open consultation, which was crucial for the quality and the credibility of the analysis. A workshop was held in Korea and several meetings with the Civil Society took place in the EU. The Consultant also benefited from valuable written input submitted by various stakeholders.

III. Rationale of the EU-Korea FTA

Korea has been designated a priority FTA partner in the Commission's *Global Europe* Communication of October 2006. At the core of this new trade strategy was a desire to negotiate a new generation of FTAs focusing on economies of high exporting potential for EU businesses. These FTAs should be ambitious in eliminating tariffs, as well as far reaching in the liberalisation of services and investment, and in finding novel ways of effectively tackling technical obstacles to trade (so-called "non-tariff barriers"; NTBs). Beyond focusing on securing substantial economic gains for the trading partners and enhancing overall economic relations, the FTAs aim also at addressing sustainable development issues.

The negotiations with Korea, the EU's fourth-largest trading partner outside Europe, have been launched in May 2007. The eighth and last official round of talks took place in March 2009. Since then, a number of meetings at Ministerial and chief negotiators level were organised and the final package emerged in July 2009. On 15 October 2009, after more than two years of talks, the FTA was initialled. Among the Asian FTAs the EU is negotiating, the talks with Korea moved the fastest.

Conclusion of the comprehensive agreement with Korea will liberalise trade between the parties in both, goods and services, introduce World Trade Organisation (WTO) -plus disciplines on, inter alia, industrial subsidies, intellectual property, geographical indications, as well as on NTBs affecting e.g. the car, electronics and pharmaceutical sector. The FTA will

² In defining and implementing its policies and activities, the Union shall take into account requirements linked to the promotion of a high level of employment, the guarantee of adequate social protection, the fight against social exclusion, and a high level of education, training and protection of human health.

also include strong sustainable development provisions. Additionally, the Agreement will give a timely signal, in a context of economic downturn, regarding global trade and investment promotion, and rejection of protectionism.

IV. Trade SIA of the EU-Korea FTA: overview of the study

A. Structure of the Study

The Trade SIA of the EU-Korea FTA provided detailed analyses of various trade liberalisation scenarios. The work carried out by the Consultant has been divided into three phases, which have been conducted consecutively, and were preceded by preparatory work incorporated into the "Inception Report". The three phases were:

- **Phase I** - "Global Analysis Report", which provided the general economic, social and environmental context for the EU-Korea trade and economic relations in order to explain better the possible impacts of the prospective FTA; the economic aspect of the analysis has been conducted based on the Computable General Equilibrium (CGE) modelling exercise and using the latest available version of the GTAP model and data base;
- **Phase II** - "Mid-term Report", which included a dedicated analysis in specific sectors and on horizontal issues to supplement the general qualitative and quantitative analysis of possible impacts conducted in the first phase. The sectors analysed were: automobiles, agriculture, financial services, environmental goods and services. The horizontal analysis focused on: rules of origin, technical regulations, standards and phytosanitary measures, intellectual property rights and investment. These specific descriptions were further complemented by case studies;
- **Phase III** - "Final Report", which summarised the outcomes of the previous phases of the exercise and made policy recommendations to enhance positive effects, mitigate potential negative impacts, or introduce complementary measures to enhance the sustainability of the proposed agreement.

Preparations of each phase of the process have involved consultations with various stakeholders. Their comments, suggestions or concrete actions' proposals have been taken into account in the reports by the Consultant. In addition to several meetings with Civil Society in Brussels, a special dedicated local workshop has been organised in Seoul in December 2007 in order to involve local stakeholders.

B. Economic impact

Most of the studies analysing the potential impact of the EU-Korea FTA conclude that the overall welfare gains are estimated to be significant, but not large, for Korea and modest for the EU relative to the size of the economy. Similarly, the Trade SIA came to the conclusion that the overall welfare effects identified (based on the modelling) are likely to be modest mainly due to the existing openness of both partners and high level of their integration into the global economy. It is worth noting that the more a country liberalises its pre-existing barriers, the greater the positive impact on welfare. Since Korea's trade regime is more restrictive than that of the EU, it is only logical that the FTA will have a greater impact on the Korean economy.

According to the Trade SIA, the most significant economic impact of the EU-Korea FTA is likely to be through fostering intra-industry specialisation, which in turn would increase productivity, efficiency, and technological innovation in a number of sectors. Since the implementation of the FTA will be done in over several years, the economic adjustment challenges are unlikely to be significant for either Korea or the EU even in the most sensitive sectors.

Moreover, the Consultant indicated in the Trade SIA, that some of the potential gains of the FTA are not easy to capture in the modelling exercise. This is particularly the case when it comes to quantification of gains arising from removing non-tariffs barriers, increasing investments flows or innovation.

If, however, the EU-Korea FTA is not implemented, the Trade SIA predicts that the bilateral trade and investment relations will be negatively affected notably as a result of preferential arrangements by the parties with other partners.

C. Social impact

According to the Trade SIA, the convergence in development levels and the broad similarity in the distribution of income between the EU and Korea tend to limit any significant social impacts, while noting that social and distributional impacts of the FTA will also depend on domestic policies, full implementation of labour standards and an effective social dialogue. The potential productivity and innovation effects of the EU-Korea FTA could be useful in addressing the social challenges confronting both Korea and the EU. In the medium to long term, both partners will have to increase productivity, participation in the labour market, promote decent work and address the challenges arising from an aging population. In this context, the FTA might prove to be useful by expanding employment opportunities and improving working conditions.

The Consultant concluded that the agreement is unlikely to have direct effect on poverty, as the FTA would focus on trade expansion in specialised sectors: manufacturing, services, and technology. The agreement might slightly improve the employment gender balance in both, the EU and Korea, in particular due to expansion of services industries.

The FTA is not expected to adversely affect employment overall. Some limited adjustments in employment at sectoral or regional level might be observed. However, in sectors such as automotive, adjustments could be attributed mainly, to external factors such as rising energy prices, increasing environmental standards or competitive challenges, rather than to the FTA.

D. Impact on environment

The Consultant concluded that the expansion of trade, production and investment that is expected once the FTA takes effect is unlikely to have significant adverse environmental effects since an adequate framework for environmental regulation and protection exists in both, Korea and the EU, already. As both partners face common global challenges in protecting the environment and especially in improving energy efficiency, the use of renewable energy sources and in addressing the challenges of climate change, the FTA could potentially contribute to easing access to clean technologies, environmental goods and services.

V. The Commission Services' views on the Trade SIA findings and policy recommendations

The key sustainable policy recommendations of the Trade SIA have been reproduced below. These are divided into two parts: A. "FTA related policy measures" and B. "Flanking and enhancement measures". The Commission services' position follows each recommendation and identifies points of agreement with the Consultant's views, provides complementary analysis, or flags lessons to be learnt.

A. FTA related policy measures:

1) Phasing of reductions in barriers

The Consultant recommended phasing in more slowly tariffs which might bring greater economic, social or environmental costs, and liberalising faster sectors that do not bring about such challenges. On the one hand, the Consultant suggested slower liberalisation in sectors, such as automotive in the EU or sensitive agri-food sector in Korea, as this would allow limiting the potential labour market adjustments. On the other hand, the Consultant proposed the reduction of barriers to trade in environmental goods and services, and swift elimination of tariffs for some agri food products, such as wines and spirits, and pharmaceuticals.

The Commission services took these recommendations into account in the negotiations and ensured that tariff liberalisation schedules corresponded to the sensitivity level of the given sector. While in the case of the automotive sector, the products that were identified as sensitive have been placed in the longer liberalisation category, the tariffs for wines and spirits will be eliminated promptly. In addition, 100% of EU tariffs on environmental goods are destined for early liberalisation (i.e. entry into force of the agreement). Similarly, Korea will eliminate 86% of tariff lines on environmental goods at entry into force of the FTA and by year three 97% of the environmental tariff lines will be duty free. The remaining 3% of tariffs lines will become duty free over a longer than three years transitional period.

In the context of the EU-Korea FTA, the Parties agreed also to the liberalisation of access to their respective environmental services markets. The commitments are far reaching and ambitious and go beyond the WTO General Agreement on Trade in Services (GATS) commitments in many instances. Exchanging the latest environmental technology and management will further help both, the Korean and European economy, to produce and grow in more sustainable ways.

2) Rules of Origin

For sectors with higher external most favoured nation (MFN) tariffs and greater dispersion in tariff structures (e.g. automobiles, textiles and apparel), the Trade SIA recommended that sufficiently high content requirements for Rules of Origin (RoO) be retained, at least to a significant degree, in these sectors. In the Consultant's view, maintaining strict RoO requirements would offset to some extent concerns about the possible impact of duty drawback. In addition, given the geographical location of Korea and its greater reliance on imported inputs, the Consultant considered that flexibility in RoO is appropriate for sectors with lower MFN duties and less dispersion in tariff structure. In addition, a cumulation of

content for the purposes of RoO between the EU and Korea is recommended in order to facilitate intra-industry trade within the FTA.

In the course of the EU-Korea FTA negotiations, RoO proved to be a difficult issue to settle. The RoO negotiated in the context of this FTA simplified and updated to some extent the existing EU RoO and the changes were made in close cooperation with the EU industry concerned. In this context, it can be noted that the Commission launched in 2005 a process to reform the rules of origin. This reform endeavours a “simplification” of the RoO. The changes introduced to the RoO included in the EU-Korea FTA go in the same direction to simplify the EU standard RoO, which is good for business and trade. At the same time, they secured as much as possible the standard EU rules in such sensitive sectors as textiles and apparel, allowing, however, for certain derogations within quantitative limits. In sensitive sectors (cars, some consumer electronics) the maximum foreign content allowed is 45%. The Commission's negotiators followed, as much as possible, the Trade SIA recommendations. As in every negotiation, the outcome reached in the EU-Korea FTA reflects a compromise, which seems acceptable to both parties.

3) Sanitary and Phytosanitary Measures and Technical Barriers

According to the Trade SIA, the FTA should make greater effort in utilising international standards for Sanitary and Phytosanitary (SPS) measures and technical regulations building on WTO rules under the SPS and Technical Barriers to Trade (TBT) agreement of the WTO. The utilisation of international standards for SPS and mandatory technical regulations in sectors, including automobiles, food products, electronics, and cosmetics, are important. The SPS and TBT related issues are significant for the market access for EU as well as for Korean businesses. The Trade SIA provided also a list of seven complementary recommendations focusing on transparency in developing technical regulations and allowing comments before their implementation, developing common approach for the listing of accredited suppliers under SPS measures, and developing SPS provisions allowing for regionalisation. Additionally, mutual recognition of conformity assessment and accreditation procedures should, according to the Consultant, be an objective. The Consultant called also for retaining recourse to the WTO Dispute Settlement for SPS and TBT issues, while securing access to a bilateral dispute resolution mechanism. Finally, in areas such as animal welfare and environmental eco-labels the Consultant suggested cooperation to develop standards.

The Commission services support the recommendations made by the Consultant and has tried, as much as possible, to reflect them in the negotiations' outcome. The FTA includes two separate chapters devoted to SPS and TBT aspects, respectively, with provisions reaffirming existing WTO commitments. In both cases, the recourse to the WTO Dispute Settlement will be secured. A bilateral dispute resolution mechanism would apply to the TBT chapter. In addition, a horizontal Transparency chapter has been negotiated. Moreover, dedicated sectoral annexes on i.a. electronics and automotive have been incorporated into the FTA. These annexes address existing technical standards in Korea, which are considered as creating unnecessary non-tariff barriers to trade.

The EU desired to reduce as far as possible the reliance on obligatory third party certification and to move, where possible, to convergence of standards and technical rules. The former approach of attempting to obtain mutual recognition of third party certificates of conformity with incompatible regulations had proved impractical when tried with other partners. The FTA includes measures that aim at facilitating trade between the EU and Korea in animals

and animal products, as well as plants and plant products while maintaining a high level of human, animal and plant health. It further provides for cooperation on animal welfare.

The issues concerning cosmetics have been successfully addressed outside the FTA. On the basis of the terms stipulated in an exchange of letters in July 2008, several amendments to Korean regulations which facilitate the marketing of imported cosmetics in Korea have been proposed and adopted. The Commission is closely monitoring the implementation of the terms of this understanding.

4) Intellectual Property Rights

In light of the level of development of Korea and the positive role that intellectual property protection can play in improving the investment climate and enhancing innovation and diffusion of technologies, notably with environmental technologies, the EU-Korea FTA should, according to the Trade SIA, go further in elaborating or clarifying substantive intellectual property rights and in creating standards for enforcement of intellectual property rights. Detailed recommendations submitted by the Consultant suggested: strengthening of protection and enforcement of the Geographical Indications (GIs), protection of copyrights including audio-visual and digital property, regulatory protection for patent applications, enhanced enforcement of intellectual property rights especially for audio visual and counterfeit goods, and improving enforcement procedures that would allow effective recourse to rights holders.

The approach adopted while negotiating the EU-Korea FTA was consistent with the Trade SIA recommendations. This ambitious agreement includes comprehensive provisions, going beyond WTO rules on intellectual property, with a particular focus on enforcement, including on border measures, which will reinforce effective action by right holders. Additionally, the FTA will offer, once in force, a high level of protection for EU GIs relevant for the Korean market, with the possibility of protecting additional GIs after entry into force of the agreement. Commission services share the view of the Consultant that better enforcement of intellectual property rights may significantly stimulate trade in various sectors, including environmental sector.

5) Investment

The FTA should encourage FDI in both directions between the EU and Korea. According to the Trade SIA, limits or controls on the level of equity participation by EU investors in Korean companies or of Korean investors in EU companies should be reduced and become more transparent. The Consultant suggested furthermore the utilisation of a negative list approach, instead of a positive list to enhance coverage, especially in the financial services, and incorporation of commitments not to use the relaxation of environmental regulations or labour standards as an investment incentive.

The recommendations made by the Consultant are supported by the Commission services. The EU-Korea FTA aims at addressing also investment related issues and the parties agreed on commitments, which would improve transparency and further liberalise access to each others' markets. The EU maintained the positive list approach in the negotiations with Korea. This is a general EU approach to services and investment negotiations, which is preferred by the EU Member States. The positive list approach clearly identifies the liberalised sectors and those sectors in which the parties to the agreement can still maintain limitations. Additionally,

the Sustainable Development chapter reaffirmed the parties' commitment to refraining from waiving environmental regulations or labour standards in a manner that affects trade or investment between the parties.

6) Sustainable Development

Based on the Council mandate for the FTA negotiations, the Commission has engaged actively in negotiating a Sustainable Development chapter with Korea, covering labour and environmental issues. It is highly ambitious in terms of substantive commitments and implementation and monitoring mechanisms.

While taking note of the EU's commitment to integrate a Sustainable Development chapter in its new generation of FTAs, the Trade SIA highlighted the convergence in development levels between Korea and the EU and the degree of links between economic, social and environmental issues. It recommended that such a chapter should include provisions on the implementation and monitoring of and cooperation on core labour standards and the decent work agenda, including in areas where ILO conventions are not yet ratified by either party. It should also incorporate and reaffirm common commitments to multilateral environmental conventions and international labour standards and related policy agendas.

The Commission services fully share the Consultant's views. Therefore, the Sustainable Development chapter of the EU-Korea FTA introduces a clear commitment by both sides to ILO core labour standards, decent work, and multilateral environmental agreements. It confirms the parties' right to regulate, while aiming at a high level of protection. It promotes also the ratification and effective implementation of ILO Conventions in cases in which this has not yet been achieved. It further establishes strong cooperation and monitoring mechanisms, building on public scrutiny through formal involvement of civil societies, including social partners. The operational details of the cooperation and monitoring mechanisms, including questions regarding the involvement of existing fora such as European social dialogue committees, remain to be worked out.

As interest of the wider society in matters of international trade increases, public scrutiny provides a strong incentive for and contribution to the implementation and monitoring of the FTA, and helps build a basis for public debate. The Commission services do not consider a sanctions-based enforcement system as an effective tool in the sustainable development area. Therefore, the agreement instead sets up mechanisms for settling differences through an independent panel of experts and further involvement of civil society.

B. Flanking and enhancement measures:

The Consultant focused on flanking and enhancing measures, which would complement the implementation of the FTA since relatively few mitigation challenges have been identified. The main flanking policy measures addressing economic impacts should be aimed at enhancing the positive effects of investment flows, supporting better awareness among SMEs. The main flanking policy measures to mitigate negative and enhance positive social FTA impacts relate to the improvement of employment, core labour standards and decent work principles, promoting employment participation, and promoting gender equality. Generally speaking, the involvement of social partners and civil society in the design and implementation of social policies is recommended. The Consultant also projected that potential benefits will derive from increased co-operation in environmental regulation and policy, and from the rapid liberalisation of environmental goods and services.

The Commission services fully support measures that would enhance the foreseen positive effects of investment flows in both directions and improve awareness about export opportunities among SMEs. Therefore, even ahead of the entry into force of the agreement, the Commission will use existing cooperation networks, including the newly extended to Korea, EU Gateway Programme, and distribute information about new opportunities arising from the FTA to inform various stakeholders, including SMEs. As explained earlier, the Sustainable Development chapter will address all issues linked to labour standards and related matters as raised by the Consultant.

Finally, the Commission services support rapid liberalisation of environmental goods and services. In the context of other ongoing FTAs, certain efforts would have to be made to further classify and standardise internationally the environmental goods and services in order to encourage trade facilitation. In the context of the EU-Korea FTA, the vast majority of environmental goods, as included in the EC Doha Development Agenda (DDA) offer, will be promptly liberalised.

The Commission services are also in favour of increasing co-operation on environmental regulation, which is currently being also promoted outside the scope of the FTA through bilateral workshops. Increasing awareness of the existing standards, especially for the small and medium enterprises (SMEs), will be crucial to expanding the full potential of existing or future possibilities.

VI. Conclusion

The findings of the Trade SIA confirmed the outcomes of the previously conducted studies and therefore provided a tangible reference point for the negotiators about the possible impacts of the EU-Korea FTA. As illustrated in the analysis above, the Trade SIA recommendations have been, in most instances, taken on board by the negotiators.

One should bear in mind that, in order to conduct an *ex ante* assessment of the possible outcomes of the trade negotiations, certain assumptions had to be made. These assumptions do not remain static, but change over time. However, the Trade SIA, despite its sometime unavoidable simplified assumptions and the lack of data for a more in-depth analysis of social and environmental impacts, remains one of very useful tools in assessing the impacts of EU's Trade policy.

The negotiators are convinced that the negotiated EU-Korea FTA will contribute to the sustainability of EU-Korea trade relations from the economic, social and environmental angle. It will be possible to assess fully the practical usefulness and effectiveness of certain recommendations included in the Trade SIA, in particular aiming at enhancing the possible gains from the FTA, monitoring progress towards implementing social and environmental commitments, and mitigating the potential negative impacts in the broader economic, social and environmental context, once the agreement enters into force and starts to be implemented.