



A FREE TRADE AGREEMENT WITH KOREA: ECONOMIC BENEFITS

Overview

The purpose of Canada's trade policy agenda is to enhance its economic prosperity and provide a foundation for strong, sustainable economic growth, while reinforcing broader social policy goals. To remain internationally competitive, Canada must ensure that its exporters and investors have competitive terms of access to foreign markets. As such, the Government of Canada is pursuing an aggressive array of trade and investment initiatives.

As part of this re-invigorated trade policy agenda, Canada is pursuing a comprehensive free trade agreement (FTA) with Korea. Korea is Canada's seventh-largest trading partner and the world's 11th-largest economy. The FTA being negotiated will cover a wide range of areas including trade in goods and services, investment, government procurement, competition policy, as well as cooperation agreements on labour and environment. The aim is to provide greater market access opportunities for Canadians doing business in Korea, as well as to lower costs on products imported from Korea and to improve consumer choices.

An FTA would also provide greater clarity and certainty in our trade and investment relationship with Korea by addressing non-tariff barriers, improving regulatory transparency and enhancing rules governing investment and trade in services. An FTA could also create a safer and more predictable investment climate in Korea for Canadian businesses. As well, an FTA with Korea would strengthen Canada's commercial presence and open doors for Canadian businesses, not only in Korea, but also in other key markets in the wider Northeast Asian region, including China and Japan.

Building on Canada's Competitive Advantage

Canada is a trading nation, with exports comprising nearly 37.8% of GDP and one in five jobs supported by trade. Canada has prospered through liberalized and open, rules-based trade.

In 2005, Canada-Korea merchandise trade totalled nearly \$8.2 billion. Korea is Canada's seventh-largest export destination, and Canada's total exports to Korea reached \$2.8 billion in 2005. Canadians exported more to Korea last year than to India, Brazil and Russia combined. In 2004, Canada-Korea cross border trade in services totalled more than \$1 billion, with Canadians exporting more than \$700 million.



Market Access Benefits for Canadians

Although considerable market liberalization occurred after Korea's 1997 financial crisis, significant obstacles and rigidities remain a problem in some areas. An FTA could address significant issues such as: existing differences in tariff levels that are unfavourable to Canada, restrictive import licences, import procedures, non-tariff barriers and restrictions on cross-border trade in services and investment.

Trade in Goods

The Canadian market is already largely open to world imports, including Korea. Given that Korea's average applied tariff is significantly higher than Canada's, Canadian exporters can expect to take advantage of the significant market access improvements that would result from tariff elimination in an eventual FTA. Mutual tariff elimination would help level the playing field for Canadian exporters by making Canadian exports more price competitive with Korean domestic production. Canadian exporters would also gain a competitive edge over foreign competitors through preferential market access.

High tariffs are prohibitive to market entry. In the FTA talks, Canada will be seeking the elimination of tariffs on substantially all trade. Korea has high tariffs in key areas of export interest to Canada – an overall applied most-favoured nation (MFN) tariff rate of 12.8%, and an average applied industrial tariff of 6.3%, on fish products 17.6%, and on agricultural products 52.6%.

On the other hand, Canadian tariffs are comparatively low, averaging 6.7%. Moreover, Canada extends General Preferential Tariff (GPT)¹ status (at an average rate of 2.2%) to Korea (Korean automobiles are not eligible for GPT rates; Korean vehicles and automotive parts currently face a 6.1% and 8% tariff respectively). Canada's average applied tariff on industrial products is 3.9%, on fish products 1.4%, and on agricultural products 21%. Canada's average agricultural tariff decreases to 5.2% once tariffs on over-quota supply managed products, which are excluded from Canada's FTAs, are excluded from these calculations.

The largest potential export gains for Canada are likely to be in the agriculture, fish and forestry sectors. An FTA with Korea could provide significantly improved market opportunities for a number of products including, beef, pork, grains (wheat, barley, malt, flax), fruits (apples, honey), vegetables (potatoes, french fries), vegetable oils (canola, soybean) and oilseeds, as well as consumer-ready products. There is significant potential gain in the fish and seafood sector, given Korea's high tariffs and Canada's comparative advantage.

Industries where there may be enhanced market opportunities for Canada include building products, pre-fabricated housing, softwood lumber, aluminium, aircraft engines,

¹ The GPT program was instituted in the 1970's to help encourage economic growth through trade in developing countries.

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metals, certain chemical products, machinery and equipment (e.g. injection moulding equipment, and electrical and information technology equipment), electrical and power generating equipment, coal, fur products, and fertilizers. In some of these sectors, Korean tariffs range from 8-13%.

In the FTA negotiations, Canada also plans to address other Korean trade-related practices. For instance, Korea applies “adjustment tariffs” to a number of food and agricultural items, as well as certain fish and plywood products. Duties on most tariff lines subject to these tariffs are unbound and subject to a unilateral annual review by Korea, so they can vary significantly. Korean tariff escalation (higher tariffs for goods with a greater level of processing) is another concern in areas such as semi-processed foods, beverages and tobacco, all production stages of textiles and leather, basic metal products and non-metallic mineral products. Exports to Korea of some products with low tariffs may also be subject to tariff quota limits, some of which are administered by state enterprises or producer groups including wheat, malt and malt barley, feed peas and honey. Other market access concerns include import licensing requirements (e.g. sugar), different tariff treatment for like products (e.g. canola and soybean oil) and Korea’s tendering system for certain agricultural products.

Non-tariff barriers (NTBs)

Concerns have been expressed about Korean NTBs – particularly in the area of standards-related measures (SRM) – across a number of sectors, including the automotive sector. Canadian stakeholders have cited a lack of transparency in the regulatory process, including a lack of predictability and consistency in applying regulatory measures, and burdensome standards and certification requirements as serious problems. Other issues include complex permit and licensing requirements, differential taxation regime for imported products, and domestic policies that may discriminate against imported products.

Over the past few years, Canada has had a number of sanitary and phytosanitary (SPS) market access problems with Korea affecting our agri-food sector, including a ban on Canadian beef following the discovery of a cow infected with Bovine Spongiform Encephalopathy (BSE) in May 2003.

Through an FTA, Canada would seek to promote transparency and create mechanisms that allow for the early identification of issues and timely consultations to address specific issues, so as to minimize the risk of future trade barriers and promote joint cooperation. An FTA would maintain the ability of either country to use legitimate measures to ensure the protection of health, safety, and the environment, and would focus on improving procedures to help manage issues through better consultations and dialogue.

Cross-border trade in services and investment

In the context of the WTO General Agreement of Trade in Services (GATS), Canada is more liberal than Korea in respect of the scope and coverage of its market access commitments. Korea is relatively open in professional and other business services, but more closed in many sub-sectors in distribution services, environmental services, financial services and telecommunications services. For example, Korea remains closed for cross-border supply (mode 1) in several sub-sectors of interest to Canadian service suppliers, including: auditing, taxation, related scientific and technical consulting, environmental (sewage services, refuse disposal services), maritime auxiliary, financial services and parts of construction and distribution services.

With respect to financial services, Korea maintains restrictions on forms of establishment, on opening foreign branches for reinsurance, and on subsidiaries for non-life insurance. Despite continuing the deregulation and privatization of Korea's services sectors, the Korean government and the *chaebols* (Korean business conglomerates) continue to be involved in several activities which restrict foreign participation (e.g. telecommunications, railroads, and land development).²

A bilateral FTA could yield benefits, particularly for small and medium-sized enterprises, in sectors and areas of export interest to Canada, including financial services, information technology and communication services, environmental services and professional services. Canadian exporters would benefit from improvements in rules designed to increase transparency of regulations, broader access through temporary entry for business persons including a range of service providers and investors, as well as frameworks for the negotiation of mutual recognition agreements and provisions respecting professional licensing, and qualification requirements and procedures.

Korea is relatively open to foreign financial institutions, but concerns have been raised as to Korean regulatory transparency and about a number of operational barriers. A high quality financial services chapter similar to the one adopted in the NAFTA would be beneficial for Canadian financial institutions choosing to expand their operations in Korea. They would benefit from, among other things: increased certainty and predictability; increased market access; increased transparency; national treatment; and most favoured nation provisions.

Despite the extensive liberalization that has taken place with respect to the Korean investment regime and the favourable terms available to foreign investors in certain circumstances, foreign investors still perceive some aspects of the Korean investment environment as unattractive. Investment rules in an FTA based on Canada's model Foreign Investment and Protection and Promotion Agreement (FIPA) would provide Canadian investors with greater stability, transparency and protection for their investments. The transparency of non-discriminatory regulatory measures seen as barriers

² WTO Trade Policy Review, Republic of Korea, 2004.

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to investment could also be improved in the investment chapter of an FTA. Past investment agreements and FTAs signed by Korea suggest that Canada could expect to achieve a high-quality agreement, including commitments on non-discrimination, minimum standard of treatment, expropriation, performance requirements, transfer of capital and investor-state dispute settlement.

Other areas

Free trade agreements provide other potential benefits to Canadian exporters and consumers. This would include the establishment of rules of origin that ensure the benefits of the FTA flow only to goods qualifying as originating in the territory of either or both countries; the establishment of effective customs procedures to administer and enforce the FTA's rules of origin; and the reduction of administrative and transaction costs for businesses through trade facilitation measures. An FTA would ensure that each party maintains measures to proscribe anti-competitive business conduct and takes appropriate action, so that the benefits of trade and investment liberalization are not undermined. FTAs also contain procedures for the avoidance and settlement of disputes. In addition, an FTA also provides scope to explore new or improved approaches to trade policy in areas such as telecommunications, electronic commerce and intellectual property rights enforcement.

Protecting Culture and Supply Management

Canada's approach to the inclusion of health, public education, culture and environmental and social services is consistent with our current approach in both the multilateral and bilateral contexts: they are not on the negotiating table. Over-quota tariff protection on supply managed goods (i.e., dairy, poultry and eggs) will also be protected in any free trade agreement with Korea.