

A Study on the Solution-Measures of Trade Frictions between China and Korea

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1. Introduction

China's emergence as a big player in world trade is a significant development in the global trade system. China introduced its trade reform policy at the end of the 1970s when China ranked 32nd among nations in global trade, due to China's Import Substitution strategy. Thirty years later, China became the world's largest exporter.

China's fast trade development is attributed to its implementation of a strategy and policy featuring –active absorption of foreign direct investments and encouragement of foreign trade development for the sake of coping with global economic integration and international industrial relocation. This strategy has accomplished immense results; however, it faces growing challenges. The swift expansion of China's economy has given rise to increasingly severe problems

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regarding resources, energy and the environment. Globally, the fast growth of China's trade volume has triggered an increasing number of trade frictions between China and other countries and caused relations between China and other countries to become more complicated.

The development of economic relations between Korea and China over the past decade has been dramatic. At the beginning of the 1990s, China was a relatively minor trade partner with Korea, yet China has become Korea's dominant partner in trade and investment. Economic relations between Korea and China have been expanding ever since China undertook the Four Modernization reforms in the late 1970s and the two countries established diplomatic relationship in 1987. The establishment in 1992 of formal diplomatic relations between Korea and China—relations between the two countries has ceased during the Cold War—has led to a surprisingly rapid growth of bilateral economic exchanges. In 2001, China became Korea's second-largest export destination, which implies Korea overtook Japan in terms of export volume. China was also the second-largest partner with Korea in foreign direct investment (FDI). Two years later, in 2003, China overtook the United States in Korean market.

Bilateral trade between the China and Korea has been growing steadily in both the volume and the variety of traded goods. Likewise capital flows between the two have been increasing although the flows have been mostly from Korea to China in the form of direct investment. Between 1989 and 2003, for instance, Korea's merchandise exports to China grew from \$1.3 billion to \$35.1 billion while China's merchandise exports to Korea grew from \$472 million to \$20.1 billion. In fact, China has now emerged as Korea's largest trade partner. Also, by the end of 2004 Korea had invested \$8.9 billion in China where prior to the late 1970s it had no investment at all, and during 2004 alone Korea invested \$2.0 billion in China. These increases in both trade and investment are the signs of growing economic interdependence and integration of the two economies, which will lead to the removal of many trade barriers between two countries.

The global trend in recent years has been to eliminate as many trade barriers as possible. Organizations like the World Trade Organization(WTO) have been

established for the sole purpose of limiting barriers and reconciling trade disputes among member nations. Free trade agreements among countries, such as the North American Free Trade Agreement(NAFTA), ASEAN in Asia and the European Union Trade Agreements has reduced the number of barriers involved in regional trade. As the development of these regional trade agreements(RATs) has been witnessed to be worldwide proliferation, it continues to spread. In particular, with the two of major East Asian countries—China and Korea—have tended to bypass the prevalent trend of regionalism and instead have generally preferred multilateral trade liberalization approaches under the GATT and WTO regulations regarding RTAs.

2. The trade strategies after China enters the WTO

In finance, a trading strategy (see also trading system) is a predefined set of rules for making trading decisions. Traders, investment firms and fund managers use a trading strategy to help make wiser investment decisions and help eliminate the emotional aspect of trading. A trading strategy is governed by a set of rules that do not deviate. Emotional bias is eliminated because the systems operate within the parameters known by the trader. The parameters can be trusted based on historical analysis and real world market studies (forward testing), so that the trader can have confidence in the strategy and its operating characteristics¹⁾

2.1 China's Trade Strategy

China's new trade strategy is simple. It appeals all cases that go against it at the WTO. China recently faced US tariffs on its tires. China quickly turned around and said that its export practices were fair, and that it would probably appeal the decision to the WTO for a reexamination.

China is also being forced to open up its premium content market so that

1) Booz-Allen &Hamilton, (2006), "Revitalizing the Korean Economy toward the 21ST century," Seoul.

imports are not funneled through a very small number of government controlled agencies before they make their way to consumers. China is also appealing that decision saying that “public morals” are at stake. That will delay Hollywood having access to one of the world’s largest consumer markets. China must feel that Western content is contaminated with too much sex and violence.

Of course, the Chinese effort to keep first-run movies from being broadly distributed around the country encourages the very large counterfeit market that is a significant part of the country’s underground economy. Knock-off DVDs are sold everywhere and in Beijing they are marketed within walking distance of Mao’s tomb. China has figured out that even if it loses WTO rulings, it can delay them for months, even years, buying time that helps it financially in the import/export markets.

2.2 China’s Strategy of Sustainable Foreign Trade

Faced with increasingly inadequate energy sources and resources, and also an increasingly heavy pressure upon the country’s natural environment, the Chinese government has become keenly aware of the necessity of transforming the mode of China’s economic development. In recent years, the Chinese government put forward a Scientific Concept of Development under which it is necessary to plan out the relations among economy, society, population, resources and environment as a whole; construct a resource-saving, environment-friendly and innovative country; and allow the country to develop in a well-coordinated, sustainable way. Under guidance by the Scientific Concept of Development, it is required to transform the growth mode of foreign trade and implement a strategy of sustainable foreign trade.

2.2.1 The Strategy of Sustainable Development of Foreign Trade

China’s economy and trade development have both embraced a new strategy. In the future, China has to adjust its economic development strategy according to its

Scientific Concept of Development. The key words of the new guidance for future development include: people first, innovation, balanced and sustainable development, and social harmony, among others. China will shift into an intensive development mode from its former extensive development mode²⁾.

Correspondingly, the trade strategy also needs to shift from export-oriented to a sustainable strategy. The strategy of sustainable foreign trade constitutes an important component of the strategy of well-coordinated and sustainable economic development, and also complements the latter. On the one hand, the implementation of the strategy of sustainable foreign trade helps realize sustainable economic development. On the other hand, the strategy of sustainable foreign trade relies on the transformation of the mode of economic development and also depends on the upgrading of China's industrial mix. The three pillars for sustainable trade strategy are economic sustainability, social sustainability and environmental sustainability.

As the tide of economic globalization sweeps over more parts of the Earth and with the formation of a production value chain in the world, different countries have taken different positions in the international –division of labor scene. As a developing country, China has, in the past three decades, succeeded in involving itself in the world's production network by means of attracting foreign investments and developing processing trade³⁾. But China has always remained on a low side in the world's production value chain. The key to implementing the strategy of sustainable foreign trade is to enhance China's position in the international – division of labor scene, from labor intensive activities to technology intensive and information intensive activities.

To reach the goal of economic sustain ability, China will:

- ① Increase export value added by means of innovation;
- ② Prolong the service value-added link of export products;

2) Jiang, Xiao, Dong, (2009), "The Research on the Dumping Law in China", China Law Press.

3) Seu, Kabseng, (2008), "The Trade Arrangement between China and Korea, Korea Business Association.

- ① Enhance international competitiveness of service sectors and develop trade in service;
- ① Increase China's own IPRs, world-class brands and international marketing networks by means of China's trans-national corporations; and
- ① Play an active role in multilateral and regional systems to create a better external environment.

2.3 Korea's Trade Strategy

Since adopting capitalism about 50 years ago, Korea has accomplished remarkable economic growth. Especially since the 1960s when the government implemented an aggressive economic development plan, Korea has achieved a substantial growth rate of 9 percent year on average. As a result, the nation's GDP recently reached \$10 000 per capita in 1995. One of the world's poorest countries after the Korean War, it is now about to rank among the advanced countries. The Korean economy has also undergone a sudden structural transformation. Although Korea's development strategy was based on unskilled labor at the early stages, the government has changed this strategy to transform Korea into a highly developed industrial nation whose economy is based on skilled labor, technology and competitive power through the support of an aggressive government economic policy⁴⁾.

Among the many factors that brought about economic growth and structural change in Korea, the most outstanding were an externally oriented policy associated with exports, the Korean people's continuous willingness to implement the systematic policy of the government, and prompt and adequate measures against external shocks. Particularly since the nation emerged from the Korean War with a lack of natural resources and a weak economic base, the export promotion policy and infant industry protection policy through import substitution

4) Cui, Yonen, (2008), "The Research on the dumping and semi-dumping system of China, 1997-2007's examples analysis.

played a critical role in economic growth and structural transformation. Prompt and appropriate government measures also enabled Korea to overcome the financial crisis in the late 1990s.

Over the last three decades of the 20th century, the global economy experienced a number of recessions and booms. Along with these, cyclical movements of the world economy, liberalism and protectionism have risen in the international trade environment. Such external changes inevitably prompted the Korean government to adopt an externally oriented economic model for national development. It has been that the achievement of national economic development in harmony with the global economy was possible because the Korean government succeeded in adapting the national economy to the changing external conditions and pushed forward an economic liberalization policy. Since globalization and the revolution in information technology are expected to greatly influence the global economy, the Korean government needs to carry on a development strategy in harmony with globalization the information technology revolution.

2.4 Korea's Strategy of Sustainable Foreign Trade

Moves in a number of key areas will help to position Korea so that it can respond successfully to the demanding challenges of globalization while developing further as an internationally competitive, market-oriented economy. Below we will consider four strategies that are particularly important for Korea's future economic well-being.

2.4.1 Preparedness for the New WTO Round

Using the Computable General Equilibrium model, researchers at KIEP evaluated how the New Round of WTO negotiations will affect the Korean economy. The result showed that in the event of a 1.0 percent improvement in productivity, real GDP and welfare would increase by 3.43 percent and 4.31 percent respectively.

Economic gain in accordance with this level of welfare improvement would reach around \$17 billion. This analysis hints that the New Round would lead to substantial benefits for the Korean economy⁵⁾. Because the negotiations may be concluded within three years, the Korean government must establish an economic restructuring program for domestic industries as well as a set of carefully considered negotiation strategies as early as possible.

3. The development of the trade frictions between China-Korea

3.1 Trade development between Korea and China

Before the establishment of official diplomatic relations, trade between China and Korea took the form of port trade, carried out through Hong Kong, Singapore and other areas, and the bilateral trade volume between the two countries was not significant. It was only until the March 1988 that direct trade began to develop gradually. However, it was only non-government at that time. In 1991, China Association of International Trade established its first representative office in Seoul and the Korea Trade Promotion Association also established its representative office in Beijing. In 1992, the Agreement of China-Korea Non-government Trade and the Agreement on Non-government Investment Protection took effect in February and July respectively. On the August 24th of the same year, the diplomatic relation between two countries was finally established. Agreement on trade, investment protection and agreement about economic, trade and technological cooperation were signed by the government⁶⁾.

5) Zhang, Tie, Lin, (2009) "The Strategy System and the Related System of WTO Major Members, the Economic and Science Press.

6) Lee, Chang-Kyu, (2008). "Economic Relations between China and Korea", Korea's Economic: Korea Economic Institute.

However, since official diplomatic relations were established, trade relations between two countries have changed dramatically. Trade volumes have increased explosively, except for a temporary lag in 1998 when the Korean economy faced serious difficulties in the aftermath of the Asian financial crisis. Since then, the two countries have maintained relations of significant economic interdependence.

In 2003, a “comprehensive cooperative relation” was established between two countries and the economic cooperation began to develop rapidly and vigorously. Now, china has become not only the largest recipient of Korea’s foreign investment but also the largest market for Korea’s total export. At the same time, Korea has also become the forth largest trading country for China, the fourth largest market for China’s export (excluding the Association of Southeast Asian Nations and the European Union), and the fourth largest country in terms of China’s foreign direct investment. In short, economic cooperation between two countries has become a very important part of both countries’ economies and such a relation will be strengthened further.

3.1.1 The effect of frictions on bilateral trade

Since the establishment of diplomatic relationship, the trade between two countries increased rapidly, especially in the recent 5 years. According to the customs of China, the bilateral trade between two countries was only \$5.03 billion in 1992. In 2003, it increased to \$63.231 billion, with an annual growth rate of 11.7%. According to Korea’ official estimation, in 2003, China has become the 2nd largest trading partner for Korea and its largest country for export. In 2004, the bilateral trade kept a rapid growth. According to the estimation from Chinese customs, the total value of import and export in 2004 has reached to \$90.068 billion, which increased by 42.4% compared with 2003. Unit 2010, If the European Union and the Association of Southeast Asian Nations are excluded, China is Korea’s first largest trading partner, the first largest export country and the first

largest country for import⁷⁾.

The driving factors behind these trends are not difficult to understand. The tariff reductions planned by China in the context of its WTO accession are largely the continuation of a long-standing trend. This trend is reflected in the decreasing level and dispersion of tariffs and the continued reduction in NTBs, especially since the early 1990s. In the early 1990s, tariffs still averaged above 40 percent (among the highest in the world at the time), with significant dispersion and a maximum rate above 200%.

While the home market was highly protected, the penalizing effect of these tariffs on export production was neutralized through duty drawbacks and other incentives for export oriented investment projects. Currency markets were not unified until 1994.

Foreign investors were straddled with requirement to form joint ventures, transfer technology to local partners, and source their inputs locally.

Under the terms of its WTO accession, China committed to substantial annual reductions in its tariff rates, with most of them taking place within five years of China's WTO accession. The largest reductions took place in 2002, immediately after China acceded to the WTO, when the overall average tariff rate fell from over 15.3 percent in 2001 to 12.3 percent in 2002. Until 2004, the tariff rate has been reduced to 10.4, giving chances to the development of international trade⁸⁾.

Past reforms also introduced widespread import tariff exemptions, especially for processing trade and foreign investment and, therefore, a majority of China's imports were in effect not subject to any tariffs in 2000. Under its WTO commitments, China will further reduce its average tariff rate to 10 percent by 2008. Overall, under the WTO agreement, its trade regime will be increasing tariff based and more transparent.

7) Li, Guang, Hui, (2007), "To Contribute the Development of Economic Between China and Korea by Corporation, the Press of the University for Foreign Affair.

8) Kim, Sangyom, (2008), "Trade Facilitation and A Northeast Asian Free Trade Arrangement", International Area Review.

3.2 The examples of trade frictions between China and Korea

3.2.1 Garlic War

A trade friction between China and Korea, concerning garlic, has cast a shadow over the two countries' trade relations in 2000. The Korea Finance and Economy Ministry declared to slap a tariff rate as high as 315 per cent on imported garlic. As a major garlic exporter to Korea, China regards itself as the target of unjustified trade protectionism. And the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) reacted quickly, declaring a ban on mobile phones and polyethylene imports from Korea.

China imported US \$73.5 million worth mobile phones and US \$340 million in polyethylene products from the Korea in 1999, while its garlic exports to South Korea were valued at US \$15 million during the same period. The total volume of the three products involved in the trade dispute adds up to US \$428.5 million, accounting for a mere 1.7 per cent of the two countries' aggregate trade volume in 1999. The volume of trade involved in the trade war becomes even less significant in light of the fact that Sino-Korea bilateral trade during the first four months of that year increased by 47.2 per cent⁹⁾.

Statistics from China's General Administration of Customs revealed that during the first four months of that year, two-way trade between China and Korea had rose to US \$10.1 billion. China's exports to South Korea leaped by 60.3 per cent over a year earlier to US \$3.3 billion and its imports grew by 41.5 per cent to US \$6.8 billion.

According to China Economic Times, Korea had conducted anti-dumping investigations on Chinese bicycles and soda ash, a raw material used in manufacturing batteries and glass. An official from the Korea Embassy to China insisted that the garlic dispute should not to be associated with any other trade

9) Wu, Wing, (2002). "Recent Claims of China' Exceptionalism: Reflections Inspired by WTO Accession", China Economic Review, 12, No, 2/3.

issue between China and South Korea. But analysts said no matter what South Korea's true intention were with the anti-dumping investigations, it had triggered an escalation of the trade war.

Before China retaliated, it had proposed to discuss the issue with Korea to find a solution acceptable to both sides. But the talks broke off because of Korea's insistence on its own position of limiting garlic imports, which has seriously hampered bilateral trade and economic ties between the two countries.

The Ministry of Foreign Trade and Economic Cooperation (MOFTEC) announced that China and South Korea signed a memorandum of understanding on April 21st, 2000, which put an end to the dispute over South Korea's hi-tariff measures against Chinese garlic.

The memorandum aims to solve the problems arising in the implementation of an agreement signed between the two countries in August 2000, under which South Korea was to import 32,000 tons, 33,728 tons and 35,448 tons of Chinese garlic per year at tariffs of 30% and 50% in 2001 to 2003. Shi Guangsheng, minister of the MOFTEC, urged the South Korean government to adopt effective measures to expand imports from China by removing tariffs and non-tariff barriers and creating favorable conditions for Chinese products to enter the Korea market, so as to ease China's huge deficits in bilateral trade.

The foreign trade between China and Korea totaled 34.5 billion in 2000, making Korea the sixth largest trade partner of the country. China's imports from Korea reached USD 23.21 billion, while its exports to Korea stood at USD 11.29 billion last year. China announced suspension of the import of Korean mobile telephones and polyethylene on June 7, 2000 after Korea decided to impose a high tariff of 315% on Chinese garlic beginning June 1. The MOFTEC then lifted the ban after it reached an agreement with Korea in August 2000. This agreement enables China to export up to 11,895 tons of garlic without any restrictions to Korea, as previously negotiated during the Uruguay Round. In addition, through the agreement China will be able to export 20,000 tons of frozen garlic with a tariff of 30 percent to Korea. Consequently, China will be able to export almost 32,000 tons of garlic to Korea each year without the

burden of the 315 percent tariff.

In addition, MOFTEC also told that it signed an agreement with its Korean counterpart, the Korean Ministry of Commerce, Industry and Energy to jointly set up a commission to promote mutual investment and economic cooperation. The minister of the MOFTEC said that he believed the Sino-Korean investment promotion commission would play an important role in boosting mutual investment between two countries.

China reported USD 11.9 billion in trade deficit with Korea in 2000. It is suggested that Korea could buy more coal and corn from China, as these products are cheaper than those of other countries due to lower transportation costs. In the first 2 months of 2001, the foreign trade volume between China and Korea totaled USD 4.92 billion, an increase of 11.6% compared with the same period the year before.

3.2.2 Kimchi War

Kimchi, also know as gimchi or kimchee is traditional Korean dish of fermented chile peppers and vegetables, usually based on cabbage. May 30, 2004—for the first time, Chinese-made kimchi has surpassed Korean exports of its national dish, increasing by 174% over the same period in 2003. meanwhile, Korean kimchi exports fell by 23.3%. Local food companies explain the unexpected invasion of the kimchi market by the Chinese version as being a function of cheaper labor and ingredients. As a result, Chinese-made kimchi is sold at half the price of locally produced kimchi, even after adding transportation costs. In response, local producer have resorted to emphasizing the quality and authenticity of their kimchi¹⁰).

A recently trade war between China and Korea over kimchi, a staple of the Korean diet has been started in September 2005. The Korea Food and Drug Administration announced that they had discovered parasite eggs in 9 brands of kimchi from China. The products accounted for almost five per cent of the kimchi market in Korea. Then, the Korea Food and Drug Administration ordered a ban on

10) Song, Shi, Fang, (2008), "The Analysis for the New Protectionism of Trade Strategy". Shandong Economic Press.

the Chinese kimchi and began an emergency recall on the 9 Chinese kimchi products already on the market. The Administration is also investigating the manufacturing procedures to identify the reason for the existence of the parasites in the products. Therefore, restaurants in Korea are now stating they do not use kimchi from China. But others say they prefer the Chinese brands because they cost only one-quarter of the Korean brands. However, because of the Korea's import embargo on kimchi from China, the importation of kimchi has been sharply decreased until Jan. 2006.

The threat of a trade spat has now receded but this is not the first scare involving food originating from China. Earlier concerns range from the traces of lead found in Chinese-produced kimchi to the discovery of malachite green, a suspected carcinogen, in fishery products imported from the mainland.

But the ballooning volume of trade between China and Korea means the two neighbors cannot allow disputes over food imports to get out of hand. At stake is around \$100 billion-worth of bilateral trade—which matters most to Korea since China is Korea's biggest export market. The two countries have now agreed to cooperate on improving monitoring and quarantine procedures for traded food. That means, in future, some of the fierier effects of kimchi may be avoided.

4. The problems of the trade frictions between China and Korea

4.1 Import Regulation-Tariff

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports.

Tariffs are widely used to protect domestic producers' incomes from foreign

competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import competing goods and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economic have sought to reduce tariffs on manufactured goods through several rounds of negotiations under the General Agreement on Tariff Trade (GATT). Only in the most recent Uruguay Round of negotiations were trade and tariff restrictions in agricultural commodities by some countries have been very large. When coupled with other barriers to trade. They have often constituted formidable barriers to market access from foreign producers. In fact, tariff that is set high enough can block all trade and act just like important bans¹¹⁾.

4.2 Tariff Rate Quota

4.2.1 Situation of Tariff Rate Quotas in China

In 1996, China claimed to have introduced a tariff-rate quota (TRQ) system for imports of wheat, corn, rice, soy oil, cotton, barley, and vegetable oils. The quota amounts were not publicly announced, application and allocation procedures were not transparent, and important occurred through state trading enterprises. China later introduced a TRQ system for fertilizer imports. Under these TRQ systems, China places quantitative restrictions on the amount of these commodities that can enter at a low "in-quota" tariff rate; any imports over that quantity are charged a prohibitively high duty.

As part of its WTO accession commitments, China was to establish large and increasing TRQs for imports of imports of wheat, corn, rice, cotton, wool, sugar, vegetable oils, and fertilizer, with most unquote duties ranging from 1 percent to 9 percent. Each year, a portion of each TRQ is to be reserved for important through

11) Jing, Le, Qing. (2008), "The Direct Investment Between China and Korea: Challenges and Strategies, the Economic Research Journal.

non-state trading entities. China's accession agreement sets forth specific rules for administration of the TRQs, including increased transparency and reallocation of unused quota to end-users that have an interest in importing.

However, China's implementation of its TRQ systems has been problematic since it joined the WTO. Regulations for the administration of the TRQ systems were issued late, did not provide the required transparency and imposed burdensome licensing procedures. TRQ allocation in 2002 was also plagued by delays. China officials repeatedly argued that the agencies responsible for TRQ administration were unprepared for such a difficult task, resulting in onetime delays in allocations. China's performance improved in certain respects during 2002, and 2003 TRQs were issued close to the prescribed times. However, the most serious problems—lack of transparency, sub-divisions of the TRQ, small allocation sizes and burdensome licensing procedures—persisted in 2003¹²⁾.

4.2.2 Korea's Quantitative Restrictions—Tariff-rate Quotas (TRQs)

Most imported non-food goods no longer require prior government import approval, but some products, mostly agricultural and fishery items, face import restrictions such as quotas or tariff rate quotas (TRQs) with prohibitive out-of-quota tariff. Korea implements quantitative restrictions through its important licensing system, which is administered by domestic producer groups or government buying agencies such as the Agricultural Fishery Marketing Corporation (AFMC) and the Public Procurement Services (PPS). A government export-import notice lists restricted products; Korea also continues to restrict imports of value-added soybean and corn products¹³⁾. By aggregating raw and value-added products under the same quota, Korea restricts market access for value-added products such as corn grits, popcorn, and soy flakes. Domestic producer

12) APEC Region, (2008), "A Report by the Asia Pacific Foundation of Canada (APEC) for the APEC Business Advisory Council (ABAC)", APFC.

13) Piao, Guang, Ji, (2009), "The trade development and the existed problem after the China and Korea establish diplomatic relations for 15 years". The Asian Economic Magazine.

groups, which administer the quotas, invariably allocate the more favorable in-quota rate to their larger members, who use it to import raw ingredients.

Through the GATT Uruguay Round of multilateral negotiation, the government of the Republic of Korea opened most part of its agriculture and fisheries market on July 1, 1997. Because of domestic circumstances and the important of these items, the Koreans government still ties to restrict the import of beef and rice by non-tariff barriers such as quotas of quantity. As a result, some other countries, which are major agricultural exporters, demand that the Korean government remove non-tariff barriers on the commodities. Several significant problems are, however, expected to occur if the Korean government immediately opens its rice market. The import of rice, first, creates substantial problems in Korea's domestic economy. Second, widely spread cultural focus on Korean is important.

5. The Reduction Measurements of Trade Frictions

5.1 Preferential Trading Arrangements

The basic reason for regionalism is that it provides more and better market access for the countries through PTA (preferential trade arrangement). Compared with the multilateral approach, regional arrangement is much more flexible, wider and also faster since problems that would take years to solve in global negotiations can be dealt with much quicker. PTA, also known as the Close Economic Partnership (CEP) can cover the areas not yet covered or covered poorly by WTO arrangements, thus it plays a role as a WTO-plus movement.

There are various types of PTAs¹⁴⁾:

1. Free trade area (FTA): tariffs removed inside but members keep own external tariffs against nonmembers

14) Institute for the International Economic, 2010, "the world trade organization".

2. Customs Union (CU): tariffs removed inside, and have common external tariff against nonmembers
3. Common Market: customs union + non-tariff frictions that restrict internal factor mobility are also removed
4. Economic Union: common market + economic policies are coordinated (e.g. common monetary and fiscal policy, common currency)
5. Political Union: economic union + full economic and political integration; i.e. becomes one country.

In theory, within these several types of regional economic integration schemes, the simplest is free trade area (FTA) that eliminates tariffs on goods among the member countries, while leaving national tariffs against nonmember countries unchanged. The early trade agreements among the Latin American countries were FTAs; however, even in the 1990s internal tariff frictions continue to exist.

5.2 Development of Free Trade Agreement in EARs

Over the past decade, we have witnessed the worldwide proliferation of regional trade arrangements (RTAs). Even after the launch of the WTO multilateral trading system, RTAs have continued to spread. However, there have been marked variances across regions in terms of the degree to which regional trade integration has been carried out. The East Asian region is characterized by the dearth of RTAs. Regional integration moves have involved merely partial or loosely institutionalized groupings, i.e., AFTA (ASEAN Free Trade Area) and APEC (Asia Pacific Economic Cooperation)¹⁵).

China and Korea are both members of the Asia-Pacific Economic Cooperation (APEC) forum. One goal of APEC, as outlined in its 1994 declaration, is to establish a Free Trade Area among its member countries by the year 2020. Substantive principles which are encompassed in the APEC forum include

15) Cheong, Inkyo (2006), "East Asian Economic Integration: Recent Development of FTAs and Policy Implications", KIEP Policy Analysis (Korean Institute for International Economic Policy).

investment liberalization, tariff reduction, deregulation, government procurement, and strengthening IPR protection.

In recent years, however, the region's support has shifted from multilateral trade arrangements to RTAs. A turning point was the outbreak of the East Asian financial crisis in 1997. Besides triggering massive economic unrest in East Asia, the crisis revitalized the demand for regional economic cooperation, which called for more cooperation and policy coordination among neighboring economies in the region.

The interdependence among the East Asian economies through regional trade and financial linkages has increased. In addition, slow progress of multilateral negotiations under WTO and APEC has emphasized their shifting preference to regionalism. Recent developments in individual economies, such as China's miraculous export-driven growth performance and entry into WTO, Korea's regime change toward a more liberalized economic system are both counted as factors behind the strategic change in the East Asian commercial policy for regionalism.

The rich potential for regional cooperation between the two Northeast Asian countries-Korea and China can be found in the dynamism of economic growth in this region. China has abundant natural resources and a huge labor force, but less developed technologies. Korea has relatively high-level technology and a wealth of experience in economic development, but few natural resources. If the two countries' attributes are efficiently combined to promote regional economic cooperation, Korea, and China could greatly benefit, and could then lead the other Asian countries.

5.3 Opportunity and Challenge Faced by China-Korea FTA

The international economy, though it implies economic activities transcending the scope of a nation, assumes the existence of "nations" as a prerequisite; and if there is no nation, there is no international matter. And the international economy should not be understood to mean that transcending the scope of a nation is to

transcend a nation's interest. One nation's international economic activities are for promoting its national interest. The international economy is the economy of international scope but it is not for promoting international interest at all. Therefore, Korea must seek after its national economic interest as a priority while promoting FTAs. As mentioned above, China's pursuit of a FTA with East Asia regions should be understood from a similar viewpoint, so that it has thoroughly calculated its interests¹⁶⁾.

It seems that the national interest Korea should pursue while pushing on FTAs would be in intensely seeking some trade strategies such as building up of a "trading power with global arrangement" (tentative proposition). In order for Korean economy to continue developing while overcoming limitations (such as lack of natural resources, geo-economic environmental issues, high degree of overseas dependency, and so on) under the mega-trend of globalization and regionalism, this kind of trade strategy should be adopted.

Korea has already pursued a strategy called "Open Neo-Trading Nation" since the Kim Dae-Joong administration. Shim Young-sup (2001) defines this strategy as making Korea into a global business hub, making Korea into a business platform to provide its interiors to the world, and pushing forward with a unique competitive globalization model with Korea characteristics.

This concept is basically maintained by the "open trading strategy" in Roh Moo-Hyun administration, and is also rooted in the vision of "Northeast Asia economic hub." That is to say, the vision of Korean government, which pursues building up of a Northeast Asian economic community with peace and prosperity, is basically not aiming for an exclusive and discriminative regionalism but a globally arranged open regionalism¹⁷⁾.

The above principles should be applied in setting up the direction of trade and economic cooperation or FTA with China. That is to say, Korea needs to

16) Jones, Ronald W, (2007), "Globalization and the Fragmentation of Production", Seoul Journal of Economics.

17) Vamvakidis, Athanasios. (2007). "Regional Trade Agreement or Broad Liberalization: Which Path Leads to Faster Growth?" in the IMF Staff Papers.

develop its trade and economic relations with China under the global-scoped development strategy, in which Korea should firmly establish its status in the world trade and economy system, and pursuing global arrangement, in order to enhance its own competitiveness (global management capability of Korean companies);

Furthermore, Korea should utilize China as a link into the global division of labor, and keep itself from being over-dependent on Chinese economy or so-called "Chinization." What is apparent is that the continuous development of Korean economy in the future should be possible only if it positions itself appropriately in the global division of labor. Only then will the momentum of development be maintained. This applies to China so well. The Chinese economy having developed rapidly should be also seen as being incorporated into the global arrangement of industrial structures.

As economic interdependence between Korea and China grows significantly, government officials and economists find it more and more necessary to form a free trade agreement to strengthen bilateral economic relations. According to the Korea's Ministry of Foreign Affairs and Trade, Chinese Premier Wen Jiabao expressed interest in a free trade agreement between the two countries when he met with Prime Minister Lee Hae-chan in June, 2005. During the meeting in Beijing, Wen said, "Official intergovernmental talks on a China-Korea FTA should be initiated once research about its potential economic impact on the two countries reaches some progress."

The Korea Institute of International Economic Policy and China's Development Research Center of the State Council have been conducting joint research on the feasibility of a bilateral free trade pact since March, 2005. China overtook the UK as Korea's largest trading partner in 2004, accounting for more than 20 percent of the country's exports. Additionally, more than one-third of foreign direct investment by Korean companies has been going across the Yellow Sea to China since 2003¹⁸⁾.

18) Li, Wongjun, (2009), "The analysis of Korea' export to China". The Industry Institute.

5.3.1 The Concerns of Korea

While recognizing the necessity of a bilateral free trade agreement amid rapidly increasing economic interdependence between the two countries, both governments are still reluctant to launch an official government-level talk on the issue. Korea is concerned that a free trade agreement will cause massive inflows of cheap Chinese agricultural products, possibly hurting the nation's fragile agricultural industry. A free trade agreement will open the nation's market to the world's largest producer of agricultural goods, which has the world's biggest agricultural population of 800 million.

This will have a huge negative impact on the Korea's farming industry. And the nation's agricultural output will decline about 12 percent if customs duties on Chinese goods are abolished as a result of a free trade agreement. In addition, this free trade agreement will also reduce the output of other labor-intensive industries including clothing and leather by 6 to 7 percent, which means that thousands of jobs will be lost amid the influx of duty-free Chinese products in the domestic market.

Due to the geographic proximity of China and Korea, and the similarity of their climate and agricultural products, an FTA with China would have the most significant impact on Korea's agricultural industry. If import duties are eliminated and the quality of Chinese agricultural products can be improved to a level that satisfies health and customs regulations, its impact on Korea's agricultural industry could be much more far-reaching than generally anticipated.

A comparison of China's export prices with Korea's domestic prices reveals that, with the exception of onions and garlic, Korean prices are on average more than double the price levels of Chinese exports. In particular, the export prices of China's chili peppers, sesame, rice, and beans are only about 20 percent that of Korea's domestic prices. Likewise, the prices of Chinese pears, peaches, corn, pork and garlic are about 30 percent of that in Korea, along with apples at 40 percent, grapes at 57 percent, chicken at 63 percent, and onions at 88 percent.

Because of its proximity to the domestic market, they will probably dominate the nation's market thanks to a FTA.

What's more, for a country like Korea, in which its agricultural industry remains relatively underdeveloped, the potential impact of a proposed FTA on this sector should be considered as a critical factor in the process of selecting partner. The local agricultural industry, in particular, is expected to suffer the most damage from the opening up of Korea's domestic markets. Therefore, farmers are vehemently opposed to the signing of an FTA with China as well as efforts to move forward with FTA negotiations with other countries.

5.3.2 The Concerns of China

The trade structure between Korea and China is limited to a few selected commodities. Such a concentration on these limited items reflects the strong intra-industry trade structure between the two countries. At the same time, the export concentration on a few selected commodities has brought about frequent trade conflicts (e.g.: the trade dispute on garlic in June 2000). Korea has so often been confronted with fastidious NTBs in China, for example, anti-dumping or embargo for major exporting goods. From 1997 to 2002, China brought 18 cases of anti-dumping issues before the courts.

Korea was involved in 14 cases, and became the most frequently appealed country followed by Japan's nine cases and the U.S.'s seven cases. In addition, Korea's major export items to China had been concentrated on the less-competitive industrial sectors of China, including petrochemicals, iron and steel before 2001. These industrial sectors consist of Chinese national enterprises, which are, for the most part, less competitive in world markets. Therefore, the Chinese government tried to protect domestic companies by using various NTBs. We can expect that this Chinese policy will continue for a while in the near future¹⁹⁾.

With a China-Korea FTA, Korea has to open up its agricultural sector. In

19) Kim, Bucan,(2008), "The Research on the Forming of Asia Economic Zone and the Relationship Between China and Korea.

addition, China is rapidly closing its technology gap with Korea in the manufacturing sector. Korea should realize that a FTA with China will help the country greatly to maintain the technology gap while enjoying increasing exports in the manufacturing sector.

For the reason above, industrial technological cooperation can yield more and better performances in their trade and investment, avoiding mutually harmful trade conflicts resulting from the fiercer competition. Moreover, Korea and China have attracted both an IT and automobile industry thanks to each government's energetic policy support and attraction of foreign capital. At the same time, immature industries and even high-tech industries are being transferred from Korea to China.

Ever since the Chinese market opening was expanded through its accession to the WTO, Western firms, including U.S. players, have accelerated the transfer of their industries and products through direct investments to China, regardless of its technological development stage. Consequently, China is quickly catching up with Korea.

However, several high-tech Chinese firms are expected to be threatened by Korean electronics products, which are already of better quality and will have greater price competitiveness once tariffs are removed. China's electronics industry, for example, is expected to shrink almost 3 percent due to more cost-efficient duty-free Korean electronics.

5.3.3 Prospects for China-Korea FTA

In 2003 Korean government designed a road map to pursue FTAs. According to Ahn Choong-Yong (2004), the government's FTA plan is divided into two main categories: a short-term plan and a mid-& long-term one targeting certain countries or regions. In the 1~2 years' short-term plan, the target countries are Japan and Singapore to which the joint FTA research was already done. The target countries in the next stage are ASEAN, Mexico, and the European Free Trade Association

(EFTA), with relevant joint researches or negotiations yet to be conducted. The countries to be targeted in long-term are the United States, China, the EU, etc.

According to this road map, China is a long-term target country. In contrast to the Korea-Japan FTA progress in which the joint research was completed in 2003 and official negotiation process already started, Korea-China FTA process has not yet begun even an official joint research. It seems that one of the main issues in Korea-China FTA negotiations in the future would be the agricultural issue, because it is difficult to deal with Korean agricultural issue that contains non-economic and some emotional factors. Korea is in need of time more than anything else to resolve the agricultural issue.

Korea needs considerable time to restructure domestic agricultural sector, at the same time, Korean agriculture needs to gradually promote its adaptability or competitiveness through FTAs with some agricultural countries, whose agricultural competitiveness is suitable for Korea to manage to adapt. Korea's agriculture and agricultural products market can gradually enhance its adaptability while steadily raising the external impact by signing FTAs with some agricultural countries such as Chile, Mexico, Vietnam, India, Malaysia, Indonesia, and so on. If Korea without going through this process signs a FTA (encompassing agricultural sector) with China, then Korea's agriculture and agricultural products market will take a heavy blow out of China, which has great agricultural capacities.

Despite such challenges being posed to both countries, a free trade agreement between the two countries has already become an unavoidable issue. Considering the complementary industry structures of the two countries, both Seoul and Beijing unofficially find it very crucial for the two countries to be tied up to each other by a FTA. In contrast with Chinese government officials who are subject to less political pressure from interest groups, Korean officials will have to undergo harder times to get FTA talks on track due to likely severe opposition from farmers and civic groups. Despite anticipated conflicts of interests, both governments share the common objective of establishing a FTA in the future to augment bilateral economic relations. And economists note that a Korea-China FTA will most likely be realized in 5 to 10 years with the development of their bilateral trade.

6. Conclusion

It is estimated that Chinese economy will maintain a relatively high economic growth for the next decade. The 2008 Olympic Games and the World Fair in China will provide further impetus for the Chinese economic development and will help to realize more of its development potential. Now, although the Korean economy has recovered from the IMF period, its domestic demand is still not strong enough to sustain a strong economic recovery and further development.

The huge market in China and its rapid economic growth can help the further recovery and development of Korean economy. At the same time, the further development of Chinese economy also needs the financial, technical and managerial support from Korea. The complementarities between the industrial structures of the two countries will surely push future economic co-operation into a broader and deeper stage, which will lead to the releasing of tariff, releasing of tariff-rate quotas and export subsidies. With these persisting reductions of many trade frictions of both countries and development of regional trade integration, the common objective shared by both government of establishing a FTA will come true in the near future. And bilateral trade will enhance both the countries' competitiveness in the world market and achieve a mutual prosperity and development.

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