

# **Experiences in Trade and Investment between LAC and Korea: Lessons Learned in Development**

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## **1. Trade and Investment as Drivers of Development in Korea**

Trade and investment were unarguably the main drivers of the outstanding Korean economic development. The heavy intervention by the government, together with private sectors' continuous efforts to innovate, led the momentum for the growth during the second half of the 20th century. Realizing the benefits of international trade, exports in particular, the Korean government aggressively pursued export promotion. Such measures included tax exemption/reduction targeting the exporting firms during the 1960s and the 1970s when Korea was the heaviest user of export subsidies.

Trade and investment are still very important components of the Korean economy in the age of globalization. Even though the kinds of policies pursued previously are no longer viable, public and private sectors are taking various measures to further promote trade and investment and sustain the fruits of the economic development. Since the 1980s, direct export subsidies decreased and have been replaced by indirect export promotion measures such as the utilization of the duty drawback scheme and export insurance scheme. In addition, strengthening the production capacity particularly in the technology intensive industry has been pursued by the government through active promotion of R&D activities since the early 1980s. Such export promotion and R&D promotion policies have led to the rapid increase of export values and the increasing export share of value-added technology-intensive products.

In the meantime, the fruits of economic growth were not distributed equally. The policy favoring LEs rather than SMEs was hugely successful in overall sense but also had its downsides. The SMEs which have always been important parts of Korean economy in terms of employment and output have been neglected in the process of economic development, causing serious imbalance between LEs and SMEs. But they have begun to realize these problems and are taking various measures to promote SMEs to achieve more equal growth.

## **2. Free Trade Agreements and Trade Facilitation between Korea and LAC**

Since the beginning of the 2000s, Korea-LAC economic relations in terms of trade and investment have developed quantitatively, but not qualitatively. As for trade relations, in the 2000s (2000-2013), Korea's trade growth with LAC averaged 11.9 percent, surpassing the 9.4 percent growth rate of Korea's total trade. In spite of the rapid increase in both sides' trade, trade relations have developed with unbalanced characteristics. LAC's trade deficit with Korea has been deepened. Inter-industry trade structure has been cemented. High dependency on some countries and items in terms of exports and imports has been consolidated. Investment relations between both sides have showed similar patterns as trade relations. While Korea's FDI flows to LAC have increased rapidly since 2004, LAC countries' investments in Korea are still minimal except for those of tax haven countries. By

country and by industry, Korea's investments are excessively concentrated in some countries such as Brazil, Mexico, and Peru, and in certain sectors including mining and manufacturing. Korean companies' participation in local supply chain in LAC is still incipient.

The Korea-Chile FTA, Korea's first FTA, has contributed to quantitatively and qualitatively upgrading trade relations between Korea and Chile. First, it is found that FTA with Chile led to not only trade expansion but also diversification of trading sectors and importing and exporting firms. Second, Korea-Chile FTA contributed especially to expanding exports of SMEs. LAC is a typical market that Korean SMEs avoid getting into owing to psychological barriers caused by the linguistic and cultural difference and long distance. In this circumstance, signing an FTA between two countries acts on closing the physical and psychological distance and it promotes the advancement of SMEs. Third, FTA between Korea and Chile showed a high rate of utilization. A high utilization rate indicates that firms in both countries are actively enjoying preferential tariffs. These rates surpassed the overall average utilization rate of Korea's preferential import and export tariffs.

However, in spite of these positive outcomes, there are several areas to improve in order to maximize the effect of FTAs. First, in case of the Korea-Chile FTA, despite its achievements, Korea's export base established after the Korea-Chile FTA has weakened in the Chilean market because of recent exhaustion of the first mover effect and intensifying competition with later FTA partner countries such as Japan and China. In order to maintain cooperative momentum fostered through the Korea-Chile FTA, it is necessary to diversify the cooperative scope from trade oriented economic cooperation to comprehensive cooperation including industry, investment, service, education, technology and so on. Second, while FTA between Korea and Chile shows a high rate of utilization, there are relatively wide variations between large firms and SMEs. Thus, it takes effort at the level of both nations to enhance the FTA utilization rate of SMEs to maximize the preferential effect of the FTA. Third, the Korea-Chile FTA greatly contributed to boosting trade between the two countries, but its effect on increasing mutual investment is slight so far. In 2004, when the Korea-Chile FTA went into effect, Chile was regarded as an important bridge for Korean companies to advance into the LAC market. However, there are almost no examples of Korean firms' entrance into the LAC market taking advantage of the agreement with Chile.

One of the serious obstacles that Korean exporting firms face in the LAC market is non-tariff barriers. Considering Korean experiences, trade facilitation measures such as Single Window and Authorized Economic Operator (AEO) are crucial for removing non-tariff barriers. And also trade facilitation is one of the more notable opportunities, or low-hanging fruit, to reduce trade costs between Korea and LAC. UNI-PASS has largely contributed to economic growth and improvement of business environment in developing countries including Latin America. Among LAC countries, Dominican Republic and Ecuador successfully adopted an e-clearance system based on UNI-PASS. Authorized economic operator (AEO), one of the main trade facilitation measures, has been playing crucial role as a facilitator of trade between both countries, as can be seen in the case of Korea and China. In spite of being a latecomer adopting the AEO program, Korea is regarded as a leading country thanks to its extensive range and swift enforcement. Korea has signed MRAs with 10 countries including Mexico.

To develop balanced and sustainable economic relations between Korea and LAC, the following must occur: First, Korea and LAC need to make active efforts to expand new FTAs and upgrade existing FTAs. Most of all, Korea should make a breakthrough in FTAs with Mexico and MERCOSUR by pursuing projects such as trade facilitation agreements and signing agreements in specific sectors. Also, Korea should initiate FTA negotiations with

Central American countries in which Korea's SMEs are operating. The FTA negotiations with the Central American countries where the least developed countries are concentrated especially demand a new negotiation strategy focusing on development and cooperation.

Second, both sides need to support LAC countries' insertion into the global supply chain by transferring Korea's economic development experiences and technologies. Policies and projects that support LAC components and materials industries' insertion into the global supply will simultaneously solve LAC's manufacturing sector challenges and create a friendly environment for Korean businesses seeking to enter the market.

Third, Korea and LAC need to foster interactive FDI. The Korean government should actively attract FDI from LAC, especially from Multilatinas, multinational firms originating in LAC. As for inducing the investment of Multilatinas in Korea, 'Latin America Desk' or "Multilatinas Desk" should be created within *the Invest Korea* for systematic promotion. Korea also needs to increase an awareness of Korea's positive business environment among Multilatinas. On the opposite side, LAC companies can devise strategies to enter Asian markets, for instance China, by using Korea's strength as a gateway to Asia on account of it being a logistics and FTA hub.

Lastly, Korea and LAC need to boost cooperation in trade facilitation to expand LAC countries electronic trade, Single Windows and AEO programs, and foster their respective mutual recognition agreements like Korea-Mexico. For this, Korea should increase exports of the UNI-PASS system to LAC countries, and initiate joint research for the AEO MRA including measuring the effectiveness of the program.