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Mercosur- South Korea: The feasibility of a Free Trade Agreement

by

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Abstract

Southern Common Market (MERCOSUR), created in 1991, is the most important regional integration initiative in Latin America in the post-bipolar order, among Argentina, Brazil, Paraguay, Uruguay and Venezuela. This group represents a potential market with more than 200 million inhabitants and it is considered to be among the four main economic regions of the world.

Another major economic actor to be considered in this paper is the Republic of Korea. This country has achieved an impressive economic growth which places it as the 11th largest economy in the world, according to information provided by the World Bank.

In addition, the ties between MERCOSUR and South Korea are steadily growing: From 1997 up to present, both economic actors have held different meetings to discuss the development of economic relations as well as bilateral cooperation in fields such as investment; education; culture, etc. Consequently, both parties agreed to conduct impact assessments on possible trade agreements between Korea and MERCOSUR in order to explore ways to enhance economic relations. For this reason, the Joint Study Group (JSG) was launched in 2005.

*According to the Korea-MERCOSUR Joint Study Report, both economies are highly **complementary** in terms of factor endowment, capabilities and specializations. However, while MERCOSUR countries charge higher tariffs on imported industrial goods, Korea applies them on agricultural imports. Hence, the main obstacle to tackle in this negotiation process seems to be the structure of trade and tariffs of both parties.*

The following paper will analyze the current scenario brought about the interest of MERCOSUR and Korea in studying the feasibility of a Free Trade Agreement (FTA). Furthermore, it will point out the problems that make this sort of commercial agreements difficult to achieve. Lastly, it will suggest another form of economic integration that could be considered more convenient and viable than an FTA in the current scenario: a Preferential Trade Agreement.

Key Words: *Korea - Mercosur - Free Trade Agreement - Preferential Trade Agreement - Tariffs - Agriculture*

Initial considerations

From MERCOSUR's perspective, South Korea (Korea) represents a new market for the block's exports. It took 50 years to become today in the economy number 11th according to the information provided by the World Bank³. Korea is located in a very crucial area; the northeast Asian sub region is one of the most dynamic in the world. The Korean economy is one of the four largest economies in Asia, based on GDP, and it is located between Japan and China, and 20per cent of the world's economy is produced in that region⁴.

The last two Korean administrations' policies had showed interest in developing ties with the Southern group. Signing an FTA with this Asian country, MERCOSUR could get gains, taking into account Chile's case. Korea is a very important economy, has the most well known brands over the world, the technology is one of the most advanced and the greatest resource; its people, their education and workforce.

1 THE WORLD BANK, Gross Domestic Product 2007, available at http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP_PPP.pdf [accessed May, 2009]

4 ASIA ECONOMIC INSTITUTE, South Korea poised to become the Northeast Asian financial hub?, http://www.asiaecon.org/index.php/special_articles/read_sp/11618 [accessed July, 2008]

Korea represents a market where the block members can export their commodities and semi-manufactured products, accomplishing one of the block's goals: diversification of export markets. MERCOSUR has the goods that Korea needs, and the block needs those high technologic and manufactured products that Korea offers.

The block, with an abundant base of production, exportation of commodities and competitive fields like air and space industry, atomic energy, software, biotechnology or technology applied to agricultural and livestock production appears as a commercial partner from a Korean point of view. It is important to emphasize that the opportunities are not uniquely in trade of goods but also in trade in services and investment.

The economies of Korea and MERCOSUR are highly complementary in terms of factor endowment, capabilities and specializations. The complementarities of the two economies can be harnessed for mutual benefit by the businesses and industries of both sides. Comparative advantage reflects a country's industrial and trade structure and traditional international trade theories claim that two countries will maximize gains of trade by specializing in production and exports of the products in which they have comparative advantage.

In this context, the Korean government agreed with MERCOSUR members to carry out impact assessment studies over a possible trade agreement between Korea and MERCOSUR during the visit of President Roh Moo-hyun to Argentina and Brazil in November 2004.⁵ Since then, both Parties have involved their respective private sectors to define their interests in the negotiations of a FTA.

This paper argues that the actors are not prepared to sign an FTA at this moment, because there are some issues that need to be solved first before reaching this sort of agreement, such as tariff concessions in the agricultural sector. In doing so, this paper will review the policy context of Korea's commercial relations with MERCOSUR as well as their respective policies on FTA. Then, it will focus on explaining the main topics that were included in the Joint Study Report (Report). Furthermore, two different agreements that involved Korea and the regional block will also be studied in order to explore possible scenarios of trade liberalization between them. The first one is the FTA between Chile and Korea, which was the first agreement of trade liberalization that involved the latter country, while the second is the Preferential Trade Agreement (PTA) between India and MERCOSUR that is the only PTA that the regional block has signed with a country at the present time. Lastly, some brief concluding remarks will be included in the last section.

⁵ CHOO, Jong-youn, *Agricultural investment opportunities in MERCOSUR member countries*, November 2006, available at Embassy of Korea in Buenos Aires, Argentina

BACKGROUND

1. An overview of MERCOSUR

MERCOSUR was created in 1991 under the Asuncion Treaty.⁶ This is the most important regional integration initiative in Latin America and its member States are Argentina, Brazil, Paraguay and Uruguay. Also, these countries represent a potential market with **more than 200 million** inhabitants and it is considered to be among the four main economic region of the world and the 10th largest economy as a block.⁷

Its purpose is to promote: 1) free trade 2) fluid movement of goods and people, 3) and the coordination of the external trade policies of its members. The primary aim is to increase the degree of efficiency and competitiveness of the involved economies extending the current dimensions of its markets and accelerating its economic development by an effective utilization of the available resources.

Further, in 1994 MERCOSUR member states signed the Ouro Preto's Protocol as an annex of the Asuncion Treaty, which established the institutional base of the block. The Protocol gives the block the capacity to negotiate and make concrete agreements with other countries and other international organizations, since the group has been recognized as an international juridical body.⁸

Subsequently, one of the most important steps was made on January 1st, 1995⁹ with the adoption of a common trade policy and a schedule of common external tariffs. This policy entails 11 tariff levels varying from 0 to 20 per cent and it applies to 85 per cent of the list of items; but with some very important exceptions for sensitive sectors such as automobiles, capital goods, computers, and other technological products. This common external tariff (CET) means that one has to pay for some products the same tariff if access is given to any of the block states¹⁰. It is this harmonization of tariffs that gives the block's countries their negotiation power as a result of common policy making in trade negotiations with third parties.

The common character of the CET implies abandoning the legal authority that every country had individually to fix the conditions of its trade policy, and this is one of the reasons that the utilization of CETs is not yet so frequent among countries. Another reason is the fear that the CET may have negative consequences for some of the countries.¹¹ So, this problem regarding individual interests sometimes emerges among the block countries.

The block's countries are experiencing a period of strong economic growth in the aftermath of a deep recession caused by financial crises in Brazil (1999) and Argentina (2001). They currently have competitive exchange rates, stable macroeconomic conditions, and improved terms of trade, which have

⁶ ORGANIZATION OF AMERICAN STATE'S FOREIGN TRADE INFORMATION SYSTEM, *Treaty Establishing a Common Market between the Argentine Republic, the Federal Republic of Brazil*, the Republic of Paraguay and the Eastern Republic of Uruguay, SICE-Foreign Trade Information System, available at http://www.sice.oas.org/trade/mrcsr/TreatyAsun_e.ASP, [accessed May, 2009]

⁷ MINISTER OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, November 2006, available at http://www2.mre.gov.br/dnc/dnc2/korea_mercosur_joint_study_report.pdf [accessed June, 2009]

⁸ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Política externa del MERCOSUR*, available at http://www.mre.gov.br/index.php?option=com_content&task=view&id=1587&Itemid=1316, [accessed May, 2009]

⁹ MERCOSUR SECRETARY, *Arancel Externo Común*, http://www.mercosur.int/msweb/Normas/normas_web/Decisiones/ES/CMC_DEC_1994-022_ES_Arancel%20Externo%20Comun.PDF [accessed June, 2009]

¹⁰ COMMISSION OF PERMANENT REPRESENTATIVES OF THE MERCOSUR, available at <http://www.mercosurpresidencia.org/index.php>, [accessed June, 2009]

¹¹ RED ACADEMICA URUGUAYA, *El Arancel Externo Común*, August 8, 1995, available at <http://www.rau.edu.uy/mercosur/faq/pre16.merco.htm>, [accessed April, 2009]

opened the door for significant export growth, spurred also by rising prices and demand for many of their products, particularly primary goods. Strong economic growth at home has also increased demand for imports. Brazil and Argentina are running sizable intra- MERCOSUR trade surpluses, with the smaller economies, Uruguay and Paraguay, maintaining small trade deficits.¹²

This group of countries has created an advantageous external strategy by identifying and defining which the common interests are, as well as looking for different alternatives, and taking those decisions that help to accomplish the group's goals.

The foreign policy of MERCOSUR has always been focused on the North Atlantic: USA and the EU. However there has been an increase in its commercial relations with Northeast Asian countries. It is said that the North Pacific region is going to become the world's new economic epicenter.¹³ Moreover, South Korea represents a paradigmatic case for being a country of recent industrialization and being located in that prosperous region with whom MERCOSUR is trying to build a more profound trade relation. Nowadays MERCOSUR's aim is to develop relations with those markets that are interested in the group's products. The Asian market is interested in the products offered by the members of the block.

2. The Relation between Korea and MERCOSUR

In 1996, South Korean President Kim Young-sam visited five Latin American countries: Guatemala, Chile, Argentina, Brazil and Peru. It was the first visit by a Korean head of state to Latin America. During President Kim's visit, various agreements were signed such as the investment protection and promotion agreement and fisheries agreement which provided an institutional framework for the expansion of exchanges and cooperation between Korea and Latin America. President Kim and his Latin American hosts agreed on the necessity to reinforce the cooperation. Latin-American leaders also expressed their strong desire to expand economic and trade relations with Korea.¹⁴

One year after that significant visit, the dialogues between MERCOSUR and Korea began. Although no agreement was signed, it is important to say that both actors made serious efforts to reach mutually beneficial goals.

The aims of these dialogues were: 1) to develop ties related to economic cooperation between both actors and to promote investment in our region, 2) to analyze the development of the integration process in MERCOSUR's international trade and in the Asia Pacific region, the multilateral negotiations and the situation in international trade.

The dialogue between the block and the Asian countries is very important, and until today we can note that it has been a slow advance. Eduardo Oviedo suggested that the word 'dialogue' is a very weak concept, since there are just diplomatic talks between both parts that tend to aim at the signature of an FTA.

Both regions suffered financial crises, bilateral economic relations were weakened in the second half of the 1990s and the beginning of the 2000s, but have been improved as the countries overcame these crises. This improvement can be seen clearly with regard to the bilateral trade.

In 2004, the visit of the former President Roh Moo-hyun to Argentina and Brazil can be considered an important trip to build confidence between the main members of MERCOSUR. The Korean government with its policy goal of building an *open trading country* is firmly committed to maintaining friendly trade relations with its trading partners, while also promoting strategic alliances in the form of FTAs.

¹² INTER-AMERICAN DEVELOPMENT BANK, *Integration and Regional Programs Department, MERCOSUR Report: 2004-2005*. No. 10, February 2006. ps. 21-24.

¹³ OVIEDO, Eduardo, *La política exterior argentina hacia el Asia oriental 1983-1999: consideraciones y aspectos principales*, November 2000, p.5, available at <http://www.iadb.org/intal/intalcdi/PE/2008/01660.pdf> [accessed May, 2009]

¹⁴ KWAK Jae-Sung, *Galvanizing Inter-Pacific Relations: Korea's Role in Asia-Latin America Cooperation*, East Asian Review, Vol16, N 4, Winter 2004, p. 66.

The visit of the present Korean President Lee Myung-bak, in November last year, to Brazil and Peru was an excellent opportunity to stimulate a better mutual knowledge and the political, economic and cultural relations between South Korea and Latin America. In addition to this, he reaffirmed the desire that once the phase of study has concluded, the negotiations must be open in order to reach an agreement of free trade between both units.¹⁵

Furthermore, the visit of Lee Myung-bak to Brazil last year showed that the interest of the Asian country in approaching Latin America is still active. This strategic policy is coherent with the diplomacy of "global" character and the economic and strengthening relations with regional powers on the basis of the need for commodities and energetic components of Lee Myung-bak's foreign policy.

3. Korea FTA policy

After the financial crisis in 1997, the Korean government started to overcome the crisis and to modernize its economic structure by taking overall reforms in every sector. Analyzing the benefits by removing trade barriers on a preferential basis, it began to consider and seriously undertake a new bilateral trade negotiation policy, and studied regional trade arrangements (RTAs). Regarding that, Korea has established a new 'open trade nation' paradigm with the specific objectives of becoming a market oriented, freer and fairer trading nation.

Korea has always preferred a multilateral framework to regional agreements and maintained its commitments to multilateral trade agreements because, due to its non-discriminatory and comprehensive coverage, it was considered the best way to achieve trade liberalization on a global level. As a result, of the world's major trading partners, only five economies- Korea, Japan, China, Taiwan and Hong- Kong- are currently not members of any regional economic arrangements. Nonetheless, the recent proliferation of regional trade arrangements and their successful performance have stimulated Korea to shift its trade policy toward FTAs.

The discussion about Korea's FTA policy is seen as an additional means to ensure further liberalization in its trade with its partners, the need for securing export markets and accelerated opening and restructuring of the Korean economy. Those partners and possible partners are large advanced economies or economic blocks and promising emerging markets. The initiative for a Korea-Chile Free Trade Agreement began in November 1998 with the decision of the Inter-Ministerial Committee on International Economic Coordination. The main objective was to overcome the structural weakness of the Korean economy sharpened after the financial crisis.¹⁶

It is safe to say that the Korea-Chile FTA will guarantee an extended presence of Korea in South America, even if modest in the short run. This will be highly significant for Korean South-American relations because the region's recent economic integration, financial fluctuations and economic recession, principally triggered by the Argentine crisis, have worked to reduce the interest of Korean businesses in the region, and to shrink trade and investment relations.¹⁷

In February 2009, South Korea's chief free trade negotiator Lee Hye-min said that "*due to many nations had turn to protectionism amid the global economic recession, the export-based South Korean*

¹⁵ INSTITUTO GALEGO DE ANALISE E DOCUMENTACION INTERNACIONAL (IGADI), *Corea Del Sur apuesta por América Latina*, December 8, 2008, available at www.igadi.org [accessed on March, 2009]

¹⁶ SOHN, Chan-Hyun, *Korea's FTA Developments: Experiences and Perspectives with Chile, Japan, and the U.S.*, Pacific Economic Cooperation Council, REGIONAL TRADING ARRANGEMENTS: Stocktake and Next Steps, Trade Policy Forum, Bangkok, June 12-13, 2001. p.22

¹⁷ KIM, Won-ho, De Gregorio Jose, *Implications for Korea's South America Policy*, Asian Development Bank Institute, September 29, 2003, available at <http://www.adbi.org/confseminarpapers/2003/09/29/312.korea.chile.fta/implications.for.koreas.south.america.policy> [accessed June, 2009]

economy needs to seek for FTA opportunities in a bid to strengthen economic alliance with its trade partners".¹⁸

A FTA eliminates tariffs and alleviates non-tariff barriers, stimulating trade for nations interested in it. This can be considered the second stage of economic integration. Indeed, economic integration is a term which describes how different issues between economies are integrated. The Hungarian Economist Béla Balassa explained the theory of economic integration in the 1960s. The degree of economic integration can be categorized into six stages:

1) preferential trading area, 2) free trade area, 3) customs union, 4) common market, 5) economic and monetary union and, 6) complete economic integration¹⁹

FTAs have become an important mechanism to compete in the global market, leading to a multi-track approach when negotiating FTAs, meaning that the negotiations can be carried out simultaneously with more than one country when necessary. The first step to arrive at a FTA is a preferential trade area (PTA), a trading block which gives preferential access to certain products from certain countries. This is done by reducing tariffs, but does not abolish them completely.²⁰

In the case of the South American block, Korea needs to deepen commercial and industrial cooperation and from a global view the need for an FTA agreement is essential in the current economic and financial slump that clearly affects South Korea, an economy dependent on the exporting sector.

Korea's growing interest in an FTA with MERCOSUR is attributed to the fact that MERCOSUR has been expanding its FTA partners²¹, including the signing of preferential trade agreements with India and SACU (South African Customs Union), actively participating in negotiations on FTAA, a pan-American FTA that includes the U.S., and launching FTA negotiations with the EU.

MERCOSUR countries have historically participated in the GATT/WTO multilateral trade system. Regionalism is presented as a trade policy tool complementary to the multilateral system. The Asuncion Treaty²² which established MERCOSUR, included a trade liberalization program, which constituted the first step to achieve the creation of a common market. Currently, MERCOSUR has already created a free trade area and has significantly advanced in the process of harmonizing trade policies with respect to third countries. However there are internal conflicts between the members since national interests sometimes are above those of the general needs of the block.

As noted at the beginning of this work, the block's harmonization of tariffs gives the negotiation power as a result of a common decision-making policy in trade negotiations with other parties. Regarding its capacity of negotiation with organizations and countries, the block has free trade agreements with Chile, Bolivia, Ecuador, Israel, India, Peru, Colombia, SACU and Venezuela. Besides the ongoing negotiations with the European Union, MERCOSUR is currently negotiating trade agreements with countries or groups of countries, such as ***Pakistan, Morocco and the Gulf Cooperation Council.***

¹⁸ CHINA VIEW, *S Korea finds economic breakthrough opportunities in FTAs*, February 20, 2009 ,available at http://news.xinhuanet.com/english/2009-02/20/content_10855949.htm [accessed May, 2009]

¹⁹ BALASSA, Béla, *The theory of economic integration*, London: Allen & Unwin, 1962, p.2

²⁰ MINISTRY OF FOREIGN AFFAIRS REPUBLIC OF KOREA, *Korea's FTA Policy*, available at <http://www.mofat.go.kr/english/econtrade/fta/issues/index.jsp>, [accessed May, 2009]

²¹ KIM Won-ho, *Evolution of Korean-Latin American relations, Korean Council on Latin America & the Caribbean*, March 6, 2008, available at http://www.latinamerica.or.kr/new_kclac/sub_01_06_view.asp?dbchoice=board_id4&idx=24&pageno=3 [accessed July, 2009]

²² ORGANIZATION OF AMERICAN STATE'S FOREIGN TRADE INFORMATION SYSTEM, *Treaty Establishing a Common Market between the Argentine Republic, the Federal Republic of Brazil, the Republic of Paraguay and the Eastern Republic of Uruguay*, available at http://www.sice.oas.org/trade/mrcsr/TreatyAsun_e.ASP [accessed June, 2009]

This policy of reaching and negotiating agreements with different regions is highly strategic, since the most important objective of the block is to diversify markets and to decrease the dependence on North American and European countries.

Table 1. MERCOSUR agreements with non Latin-American countries

	MERCOSUR PREFERENTIAL TRADE AGREEMENTS	FREE TRADE AGREEMENTS
INDIA	The Agreement grants preferential market access for certain product categories and contains provisions on trade measures such as trade remedies and technical barriers to trade (TBTs), generally referring them to the relevant WTO agreements. Signed in March 2005.	
SACU	It contains 1000 tariff lines on both sides for which preferences will be granted. Signed in April 2008.	
ISRAEL		It includes practically the whole tariff universe with immediate trade liberalization and a progressive tax relief. Signed in December 2007.

Sources: Foreign Trade Information System and official website of MERCOSUR.

The international context has put limits to MERCOSUR's trade ambitions. The reluctance of developed countries to advance in the liberalization of agricultural markets and the dismantling of subsidy structures while increasing pressure to include "new" issues (intellectual property rights, services, government procurement) in the WTO Doha Round has delayed progress in multilateral trade negotiations on which inter and intra-regional negotiations are dependent. Under these conditions, the expected gains from unilateral trade liberalization are relatively low for the MERCOSUR countries. The opening of these countries in the context of high protection barriers for agricultural goods would deteriorate their terms of trade, compensating for the positive effect of the increased efficiency stemming from trade liberalization.²³

In any event, MERCOSUR's external agenda has shown an extraordinary dynamism backed by a noteworthy negotiating and technical effort.²⁴

²³ RED MERCOSUR DE INVESTIGACIONES ECONÓMICAS, *The external agenda of the MERCOSUR: the impact of negotiations with FFTA, EU and WTO*, February 2006, p.12, available at http://www.redmercosur.org.uy/documentos/proyectos/Tinker_II/Final_Reports/CINVE-DECON-WELF-EN.pdf [accessed July, 2009]

²⁴ RED MERCOSUR DE INVESTIGACIONES ECONOMICAS, *MERCOSUR, A status report and prospects for Canada-MERCOSUR relations*, March 2005, available at [http://www.redmercosur.org.uy/files/FOCAL%20-%20Canada-Mercosur%20\(Final%20Report\).pdf](http://www.redmercosur.org.uy/files/FOCAL%20-%20Canada-Mercosur%20(Final%20Report).pdf) [accessed June, 2009]

ANALYSIS OF THE JOINT STUDY REPORT

4. *The Korea – Mercosur Joint Study Report*

During the visit of President Roh Moo-hyun to Argentina and Brazil in November 2004, President Roh agreed with his counterparts to conduct study on a trade agreement between Korea and Mercosur. Seizing this opportunity, they also signed a set of agreements for cooperation in economy, culture and energy and information technology.²⁵ With such agreements, Korea seeks to secure its foothold in strategic regions²⁶.

Six meetings were held in order to evaluate the implications of an FTA between Korea and MERCOSUR under the basis that the economies of the two sides would mutually supplement one another. It is important to note that both units worked together on this study and involved their private sectors in the talks to define their interests in the negotiations of a FTA. Finally, the document was completed in November 2006.

The content of the Report is divided in two main parts. Part I is an overview of the bilateral economic relations and Part II shows the aggregate impact of a MERCOSUR-Korea FTA, estimated using the Computable General Equilibrium (CGE)²⁷. Finally, Part III includes a summary of the impact assessment and ways to enhance the economic relations between MERCOSUR and Korea. Furthermore, the statistic data used in this study spans from 1990 to 2004.

4.a *Bilateral Economic Relations*

According to the Report, the commercial relations between Korea and MERCOSUR have not been well-developed in comparison to other partners. Indeed, bilateral trade between the parties was less than 1 per cent of Korea's total trade and 1.9 per cent of MERCOSUR's total trade in 2004.²⁸

Bilateral commercial exchange trade between Korea and MERCOSUR increased approximately four times in volume between 1990 and 1996. However, the financial crisis in East Asia and South America reduced the bilateral trade during the 90's²⁹. Nevertheless, by 2003 the region recovered the dynamism as a result of an improvement in the prices of commodities (**see Table 2**) and this encouraged Korea to build three new pillars in the bilateral relation: trade, development, cooperation and resources security.³⁰

²⁵ I KWAK, Jae-Sung, Op. Cit. p. 69

²⁶ JUNG Sung-ki, *Korea Seeks FTAs With S. American Nations*, Bilateral.org, November 18, 2009, available at http://www.bilaterals.org/article.php3?id_article=13777 [accessed June, 2009]

²⁷ A CGE model is a computer representation of a real economy that includes consumers, producers, primary factors of production, intermediate inputs, government, investment, etc. It is usually assumed that economic agents behave in accordance with the principles of the microeconomic optimization. The model makes possible the simulation of the effects of a tariff reduction on relevant indicators, such as GDP, welfare, exports, and imports. See MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.27

²⁸ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.11.

²⁹ Ibid., ps.11-12

³⁰ KIM, Won-ho, *Evolution of Korean-Latin American relations*, Korean Council on Latin America & the Caribbean, Op.Cit.

Table 2. Korea-MERCOSUR Trade (2002-2009)

(Figures in US\$ Million)

	2002	2003	2004	2005	2006	2007	2008	2009 (Jan-May-)
Export.	1,630	2,067	2,636	2,902	3,298	3,567	5,340	1,859
Import	1,354	1,370	2,101	2,828	3,516	4,112	6,697	1,589
Balance	276	697	535	74	-218	-545	-1357	270

Source: Kita

Table 2 shows a positive trend in the bilateral relation, especially in the trade exchange, where Korea increased its exports much faster than MERCOSUR in the last three years. It is important to take into consideration the model that Korea has been conducting since the 90's: *globalization strategy* as a new development model for an economic soft-landing³¹. The administration of Lee Myung-bak is interested in Latin-American countries not only as a safe source of abundant natural resources like food and energy, but also as an enormous market to expand information and establish technological and industrial markets that can provide support to local companies to cope with the worldwide economic slump³²

Another characteristic of the commercial bilateral relations between the Asian country and the South American block is the complementarity, which is negative for the latter. While Korean exports to MERCOSUR are manufactured goods such as electrical articles: e.g. wireless communication apparatus; electron tubes and computers, etc., the regional block exports primary products or low value-added primary processed goods such as minerals, soybean oil, flours derived from the extraction of soybean oil and cereals. Additionally, cheese, fish, leather, cotton, beef and pork are also exportable products to the Korean market.³³ For all this, the Report³⁴ supports that *the economies of Korea and MERCOSUR are highly complementary in terms of factor endowment, capabilities and specialization.*

The analysis of the bilateral commercial exchange by country reveals that Brazil is the most significant MERCOSUR member for Korea, followed by Argentina, Uruguay and Paraguay. Economic recession in Argentina and unfavorable economic conditions in the other two MERCOSUR partners made Brazil a crucial regional player for Korea. This situation can be illustrated with the first official visit of President Lee to Brazil in November 2008, after attending the G20 summit in Washington. At this summit, he suggested a closer cooperation and the development of synergies with South American countries. Also, President Lee explained that *"the flex-fuel vehicles, which are powered by Brazilian bio-ethanol, can be among the promising areas for bilateral cooperation, together with solar and wind power generation, light-emitting-diodes, hydrogen fuel cells and liquefied gas and coal"*.³⁵

³¹ KIM Won-ho, *Korean-Latin American Relations: Trends and Prospects*, Journal of Latin American Studies, Vol 11, Asian, 1998, p.15

³² KOREA HERALD, *S. Korea aims to expand into Latin America's IT, industrial plant markets*, Korea Herald, March 8, 2009, available at http://www.koreaherald.co.kr/archives/result_contents.asp [accessed June, 2009]

³³ Ibid.

³⁴ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p. 23

³⁵ KOREA TIMES, *Korea Seeks FTAs With S. American Nations*, November 18, 2008 available at http://www.koreatimes.co.kr/www/news/nation/2008/11/116_34629.html [accessed, January 2009]

Services: This sector plays an important role in the gross domestic product (GDP) of the parties. The data in the report shows that this sector represents 60 per cent of the GDP in Korea; in Argentina and Brazil 50 per cent; in Uruguay 62 per cent and in Paraguay 53 per cent. However, in 2004 the participation of MERCOSUR countries in Korea's total service trade was just 0.2per cent.³⁶

Despite the low volume exchanged in this sector, the report argues that services are a potential opportunity that should be developed in the future. A research supported by UNCTAD shows that MERCOSUR's members, especially Brazil, increased their exportations of *new and dynamic* services such as computing; business services; electric energy among others.³⁷

Furthermore, the South American block adopted a framework agreement on trade in services (the Protocol of Montevideo) that entered into force in December 2005. This legal instrument is a progress of the economic block in the services sector because it increased the number of commitments, especially in transparency and market access within the block. In part III of the agreement, the Liberalization Program was established as follows:

*In fulfillment of the objectives of this Protocol, the Member States shall maintain successive rounds of negotiations in order to complete in a maximum period of ten years, counting from the date of entry into force of this Protocol, a trade Liberalization Program for services within MERCOSUR*³⁸.

Investments. The Joint Study evidences active flows of overseas direct investment (ODI) from Korea's companies to MERCOSUR's members from 1968 to 2004. During this period the ODI amounted to US\$ 977 millions. In other words, these South American countries received 18.1per cent of Korea's total ODI and 1,25per cent of Korea's global ODI.³⁹

This positive attitude of Korea towards South America has started in the 90's, when the sub-region conducted market-oriented economic reforms and launched an economic block (MERCOSUR) in January 1995. Once South America recovered its dynamism, a large number of Korean enterprises decided to settle there, especially in Brazil due to its large population as well as the conditions offered to local investors, such as the raise of import tariffs on car production.⁴⁰

At the beginning of the new century, the scene was completely different. The Report points out the economic retraction of the sub-region caused by the international financial instability that hit its members' economies. For this reason, in the period 2002-2003 the annual average income of MERCOSUR was barely FDI US\$ 14.3 billion. Moreover, the FDI from MERCOSUR represents an insignificant portion in Korea's account.⁴¹

According to the latest statistics elaborated by the Economic Commission for Latin America and the Caribbean (ECLAC), in the period 2004-2008 Korea's ODI to Latin America and the Caribbean represented 7 per cent of Korea's global ODI. Brazil (569, 895 thousand dollars) and Argentina (8,380

³⁶ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.17

³⁷ QUIJANO, Jose, *El Comercio de Servicios en el MERCOSUR*, United Nations Conference on Trade and Development (UNCTAD), Geneva Marzo 2009, available at http://www.unctad.org/sections/wcmu/docs/c1mem3p25_sp.pdf [accessed June, 2009]

³⁸ SECURITIES AND EXCHANGE COMMISSION OF BRAZIL, *Montevideo Protocol on Trade in Services of MERCOSUR, Part III, Article XIX: Negotiation of specific commitment*, available at <http://www.cvm.gov.br/ingl/inter/mercosul/montv-e.asp> [accessed June, 2009]

³⁹ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. ps.21-22

⁴⁰ KIM Won-ho, *Korean-Latin American Relations:Trends and Prospects*, Op.Cit.

⁴¹ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.20

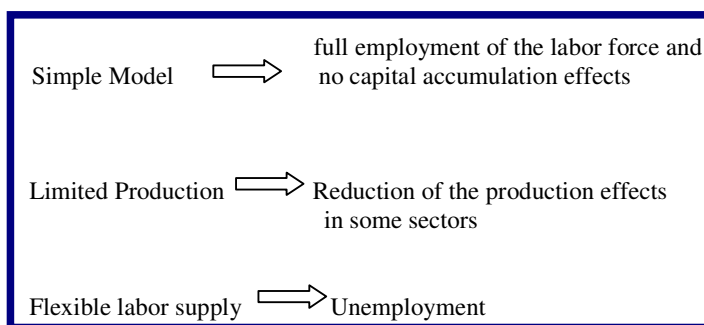
thousand dollars) have been favored destinations. In the former country, the investments were focused on the manufacturing sector (60%) as well as on natural resources (30%). Conversely, in Argentina most of the FDIs were in natural resources (90%) and only a small portion in the manufacturing sector (10%)⁴². Despite the fact that this sector has not been well-developed, the Joint Study supports that it has a high potential in the short term because of the large domestic markets of Korea and MERCOSUR.

4.b Impact of a MERCOSUR-Korea FTA

The second part of the Report focuses on analyzing the consequences of a hypothetical MERCOSUR-Korea FTA on each member party. For this reason, the CGE model is used to evaluate the macroeconomic impacts and a combination of trade indicators to evaluate the effects on every country involved in the process.

This Report aims to assess the impact of tariff reduction which is considered one of the most important elements in a FTA. Thus, three versions of the GTAP (Global Trade Analysis Project)⁴³ model were developed for the Report.

Table 3. Versions of the Global Trade Analysis Project



Source: Korea-Mercosur Joint Study

Furthermore, three potential scenarios have been established in every version of the model to explain the possible outcomes of implementing the FTA in the countries involved in this process⁴⁴:

a) 100per cent tariff elimination; b) 80per cent tariff reduction; c)50per cent tariff reduction.

Table 4. The Effects of the potential FTA on Regional Gross Domestic Product (unit: %)

Model	Simple			Limited Production			Flexible Labor Supply		
	50%	80%	100%	50%	80%	100%	50%	80%	100%
Scenario									
Korea	0.17	0.2	0.2	0.35	0.74	0.84	0.69	1.47	2
Mercosur	0.2	0.04	0.04	0.13	0.24	0.48	0.82	1.66	2.74

Source: Korea Mercosur Joint Study Report

⁴²ECONOMIC COMMISSION FOR LATIN AMERICAN AND THE CARIBBEAN (ECLAC), *Oportunidades de Comercio e Inversión entre América Latina y Asia Pacífico. El vínculo con el APEC*, November 2008, p. 62, available at www.eclac.org/publicaciones/xml/6/34516/LC.L.2971.APEC_esp_2008.pdf [accessed June, 2009]

⁴³ The most important features of this model are: the distinction between imports and exports according to their destinations, firms operate in perfectly competitive markets, different assumptions for capital accumulation. For further information, see MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p26.

⁴⁴ MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.46

Table 4 shows that the parties will obtain the highest economic profits if they eliminate all the tariffs from their bilateral commercial exchange. In contrast, the first variation of the model (Simple) simulates a FTA without those agricultural products considered sensitive for Korea such as wheat, corn, vegetables, fruits, soybeans. Actually, the outcomes of this version is the lowest among all the categories. This is the most important difficulty to overcome in the current process of negotiation and likewise it is the main reason for skepticism about the possibility of a FTA between Korea and MERCOSUR.

The data provided by the Report shows that most of the exports of MERCOSUR countries are basic products, mainly agricultural products, food, fish, fruits and different kinds of meat. In contrast, Korean exports to Latin America are mainly manufactured goods, among others, electronic goods including color TVs, electric goods, steel, and automobiles (See table 5).

Table 5. Opportunities for MERCOSUR countries in the Korean market.

Country/Opportunities	Agricultural Products	Food		Fish	Fruits	Meat	Leather/Wood products	Metallic products	Petroleum products and oils	Other
		Dairy products	Other							
<i>Argentina</i>	Soy-bean oil, Maize,	Milk Powder and Chocolates		Frozen fish	Citrus fruits	Bovine Meat	Leather and wood products			Tobacco
<i>Brazil</i>	Soybean	Cheese	Cake		frozen orange juice	Bovine meat, pork, poultry	Leather	Aluminum alloy, iron, ore	Crude petroleum oils	Ethanol, Tobacco, Heavy weight trucks
<i>Paraguay</i>			Fresh and Processed food*				Leather and wood products			
<i>Uruguay</i>		Cheese, butter*, cream*		Frozen fish		Bovine meat cuts fresh and frozen				Natural Honey

Source: Joint Study

For all what was mentioned before, the bilateral relation between Korea and MERCOSUR can be described as inter-industrial and complementary. Similarly, the responsible of the Korean Importers Association, Kim Wan-hee, stated that the technological edge of Korea and the natural resources of South America will be helpful to produce a powerful synergy effect.⁴⁵

In the order to evaluate the feasibility of a FTA, especially in the case of Korea and MERCOSUR, it is necessary to include an important factor in the analysis: **tariff concessions** and their role in the process of bilateral negotiations.

4.b.1 Obstacles that may provoke losing potential opportunities

Statistics in 2004 revealed that 86.7per cent of the Korean imports from MERCOSUR were agricultural, mining and steel products⁴⁶. Logically, it is correct to suggest that the regional trading block charges higher tariffs on imported manufacturing goods, while Korea charges higher tariffs on agricultural imports. Accordingly, this characteristic has become a serious obstacle because Korea applies a higher tariff (48%) on those economic sectors where South American countries have their best comparative advantages: *Agriculture*. In the following table the tariffs that each party applies on the main economy sectors can be seen.

⁴⁵ HAN, Jane, *Imports Group Goes to S..America*, Korea Times, November 23, 2008, available at <http://www.koreatimes.co.kr/www/news/include/print.asp?newsIdx=34932> [accessed May, 2009]

⁴⁶MINISTRY OF EXTERNAL RELATIONS OF BRAZIL, *Korea-MERCOSUR Joint Study*, Op. Cit. p.45

Table 6. Tariffs of MERCOSUR and Korea on different sectors

Parties	All products	Non-agricultural products	Agricultural products
MERCOSUR	10%	10.80%	10.10%
KOREA	12%	6.30%	48%

Source: Joint Study

The Report also remarks a second problem related to tariffs: the lack of coordination among MERCOSUR countries to apply common external tariffs (CET). Although the Protocol of Ouro Preto established a CET, general exceptions are allowed for capital assets and goods related to technology and telecommunications. Additionally, the members of the block can also modify the application of the CET on certain products which are enumerated in temporary exception lists.

Despite the initial goal of having a fully-functioning free-trade zone, MERCOSUR still remains an incomplete customs union without communitarian institutions that integrate and uniform the criteria to apply the policies in different fields⁴⁷. Therefore, this situation should be profited by the Korean government to obtain beneficial concessions.

The concern related to the protectionist barrier that Korea applies on the agricultural sector is, however is more complicated to solve due to the role that agriculture plays in its economic development. The former ambassador of Korean in Argentina shed some light on this issue⁴⁸:

Even though the agricultural sector of the Republic of Korea cannot supply us with enough agricultural products, we cannot import all that we need. Korea has some sensitive items, which are directly linked to the survival of Korean farming industries. If Korea opens up its agricultural market, under the present labor-oriented farming techniques -- and considering the majority of Korean farmers are more than 60 years old -- its agricultural sector will not be able to survive.

In the last trade policy review that the World Trade Organization (WTO) carried out on South Korea in 2008, the sensitiveness of the agricultural sector as well as the concerns of the government towards food security, especially for rice, were highlighted.⁴⁹ Similarly, during the WTO negotiations on agriculture, Korea promoted “non-trade” concerns, such as food security objectives. Despite the concessions under the Uruguay Round Agreement, Korea has simultaneously pursued food self-sufficiency and the implementation of agricultural policies domestic situation, *even if it influences production and trade*⁵⁰.

Furthermore, South Korea also supports the idea of a gradual liberalization in agriculture to take into account the sector’s “multifunctionality”. Consequently, the regular application of MFN tariff protection

⁴⁷ OPERTTI BADAN, Didier, *Reflexiones sobre el MERCOSUR*, in HUGENENEY FILHO, Clodoaldo and CARDIM, Carlos H. (eds.), *Grupo de Reflexion Prospectiva sobre el MERCOSUR*, Ed. Colecao Paisas E Regiones, Brasilia, 2003, p. 13.

⁴⁸ CHOO, Jong-youn, Op. Cit. p.1

⁴⁹ WORLD TRADE ORGANIZATION (WTO), *Trade policy review: South Korea*, October 2008, p.91, available at http://www.wto.org/english/tratop_e/tpr_e/s204-04_e.doc [accessed June, 2009]

⁵⁰ WTO, *Proposal for WTO negotiations on Agriculture: Republic of Korea*, January 9, 2001, p. 1-4, available at http://www.wto.org/english/tratop_e/agric_e/negs_bkgnd17_agri_e.htm [accessed June, 2009].

for agricultural goods, which is still more than eight times the average for non-agricultural goods, and the quantitative export restrictions for rice are some of the measures that the government has adopted in line with its principles and objectives.⁵¹

Based on the foregoing, it will be very difficult for MERCOSUR to obtain advantageous concessions from Korea in the agricultural sector. In this sense, the former ambassador Choo Jong-youn stated that his country is dealing with a dilemma. Even if they need foreign agricultural products, at the same time they are forced to defend and maintain food security for the next generations. Furthermore, he proposed the expansion of the cooperation between Korea and MERCOSUR beyond the traditional commercial exchange to solve this dilemma, The development of irrigation systems and more productive plague-resistant seeds are some alternatives to strengthen bilateral relations in this field.⁵²

4.c A broader cooperation:

The Report encourages the parties to strengthen their bilateral relationships with a broader cooperation in industrial, technological, social and cultural sectors. The following examples are meant to illustrate this point

- ***Trade facilitation:*** Korea and MERCOSUR should to make efforts to cooperate in areas such rules of origin, customs procedures, and technical regulations among others.
- ***Investment Cooperation:*** the parties should promote the foreign direct investment that is essential to maintain long term economic growth.
- ***IT, Science and Technology:*** Korea is considered one of the leading countries in IT industry and MERCOSUR should take advantage of this to develop this area.
- ***Education:*** it is crucial to improve human resources and to get a better understanding of each other.
- ***Energy, Tourism, Infrastructure and Transportation*** are others sectors that the Report suggests as important fields to be developed in the future by the parties.

5. Study Cases and a final recommendation

5.a Lessons from the FTA between Chile and Korea

In response to the rapid proliferation of regionalism throughout the world, Korea has been actively pursuing FTAs with major trading partners. As explained before, the financial crisis of 1997 forced Korea to start a deep restoration of the finance sector. Therefore the Korean government established a new “open trade nation” paradigm to turn Korea into a market oriented, freer and fairer trading nation.⁵³

In this context, South Korea chose Chile to negotiate the first FTA. At that moment, this South American country met all the requirements demanded by the Korean Inter-Ministerial Trade Policy Coordination Committee (ITPCC) such as: an accumulated experience in concluding FTAs; the high complementarity of its economy, especially in trade structure, as well as its geographic position on the continent that could be used as a bridge to extend exports to Latin American markets. Furthermore, the small size of the Chilean economy would minimize any possible risk or loss in the implementation of the agreement.

⁵¹ WTO, *Trade policy review: South Korea*, Op.Cit, p. 90.

⁵² CHOO, Jong-youn , Op. Cit. p.1-11

⁵³ SOHN, Chan-Hyun, *Korea's FTA Developments*, June 2001, Thailand, page 3, http://www.pecc.org/publications/papers/trade-papers/5_CP/7-chan.PDF

On the other hand, South Korea played a crucial role for the Chilean government as an *open door* towards the Asia-Pacific region. Furthermore, the latter country wanted to become a pioneer in reaching a FTA with a North Asian economy in order to expand its market toward the Eastern part of the world.⁵⁴

In September 1999, after two successful high level negotiation meetings, presidents Kim Dae-Jung and Ricardo Lagos met in Auckland on the occasion of the APEC Summit to declare the official launch of the Korea-Chile FTA negotiations. The FTA negotiations were completed in October 2002, and the agreement was signed in February 2003 after technical wording consultation on its text. Then, it went through parliamentary ratification to enter into force on April 1st 2004.

From the very beginning, both parties disagreed with the tariff concession schedules, especially in relation to their respective sensitive sectors. While the ITPCC protected the agriculture and fishery markets with a long grace period, Chile held a position of no exceptions, and demanded the abolishment of tariffs on all Chilean products, including agricultural goods, within 10 years of signing the FTA. The latter country argued that if that condition could not be guaranteed in the agreement, some sectors would be excluded from the negotiations such as manufacturing sectors; textiles; foot wear; washing machines and refrigerators, products that were very important within Korea's exports⁵⁵.

Article 3.4 of the Korean-Chilean FTA agreement explains that each party will eliminate its customs duties on goods in accordance with its Tariffs Elimination Schedule. It not only includes the possibility to remove the tariff immediately, but also within 13 and in some cases 16 years for those items that are sensitive for both economies. The following examples are meant to illustrate this point: Korea decided to retain the tariff on some Chilean products like fruit juice (grapes, strawberries), dried fruits, peach, pork, skate fish, sardines, yogurt, and cheese for 7 and 10 years. However, in the case of pears; strawberries and mixed fruit juices, the tariffs are to be phased out within 16 years⁵⁶.

In contrast, Chile will eliminate the tariffs on centrifuges within 7 years, as well as on tires for industrial use, car batteries, vacuum cleaners, and textiles. Also, apparel and steel products will get duty-free access within 10 years. Nevertheless, tires for passenger cars, bus and trucks use, textiles products like denim, fabric and filaments and garments and steel products will be liberated within 13 years.

Since this was the first time that Korea signed an FTA, the Chilean exporters received commercial exclusivity, especially in the field of tariffs. Indeed, this was the only agreement where Korea made generous concessions and important reductions in its commercial tariffs. For example the tariffs for some sensitive products like grape, kiwi, wine and pork will be eliminated by 2014 and in the case of garlic, onions, mandarins, dairy products, chicken meat and beef, their tariff elimination schedule will be negotiated after the end of the Doha Development Agenda negotiation of the World Trade Organization⁵⁷.

Throughout the bilateral negotiations, the agricultural concession tariff became a serious obstacle in Korea to ratifying the FTA. Actually, when it was finally endorsed, the Korean Farmers League, an agricultural umbrella organization, and pro-farm legislators forced the National Assembly to delay the vote three times. Simultaneously, a large number of violent demonstrations took place outside the Congress.⁵⁸ These organizations

⁵⁴ CHO, Myong-haing, *Korea-Chile FTA Three Years After: Its assessment and perspectives*, Online Power Point, May 14, 2007, available at http://www.sofofa.cl/BIBLIOTECA_Archivos/Eventos/2007/05/14_Cho_Myong-Haing.pdf [accessed June, 2009]

⁵⁵ SOHN, Chan-Hyun, Op. Cit. p. 8

⁵⁶ ORGANIZATION OF AMERICAN STATE'S FOREIGN TRADE INFORMATION SYSTEM, *Free Trade Agreement between the Republic of Korea and the Republic of Chile, Annexes: Tariff Elimination Schedules*, available at http://www.sice.oas.org/Trade/Chi-SKorea_e/Text_e.asp [accessed June, 2009]

⁵⁷ ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD), *Evaluation of Agricultural Policy. Reforms in Korea*, 2008, p. 41, available at <http://www.oecd.org/dataoecd/47/45/40383978.pdf> [access May 2009]

⁵⁸ KIM, Ji-hyun, *Korea's pursuit of FTAs still in murky waters*, Korea Herald, January 24, 2004, available at http://www.koreaherald.co.kr/archives/result_contents.asp [accessed June 2009]

argued that the cheaper products from Chile, especially grapes, kiwis and apples, would undermine the local agricultural sector, resulting in decreased sales and prices.

According to the report elaborated by the General Directorate for International Economic Affairs of Chile (DIRECON) on the 5th anniversary of the FTA with Korea, Chilean exports grew from US\$ 541 million in 2003 to US\$ 3.1 billion in 2007. In other words, Chilean exports to Korea rose by more than four times in four years. Furthermore, Chile's exports were focused on mineral ores and refined metals (copper, iron and steel), whereas agricultural and foodstuff products (grapes, kiwi, oranges, lemon, salmon and pork meat) represented a minimum quantity⁵⁹.

On the other hand, Korean exports grew by almost six times in the same period. Intermediate goods followed by consumer goods were the main products bought by Chile such as cars, small trucks, construction machinery, cellular phones, electric apparatuses and car tires⁶⁰.

Concerning investments, both Parties agreed at the Free Trade Commission that the numbers of projects that could be materialized are far from the potential. According to Korea's Eximbank, since the entry into force of the Korea-Chile FTA US\$ 42.3 million in investments have been materialized.

In conclusion, the FTA between Chile and Korea has been successfully implemented and the results have had positive impacts on both economies. Even if the commerce is more developed than the finance sector, the balance of the agreement has been satisfactory. Nowadays, fears and worries of farmers have disappeared due to the composition of Chile's exports: mineral ores and refined metals. Ultimately, the exclusive tariff concessions that Chile obtained from Korea being its first FTA partner made this agreement special and unique.

5.b The PTA between India-MERCOSUR

The development of relations between these two distant regions was an outcome of the South-South trade trend that had started to increase significantly in the 90s. Moreover, the integration process has moved beyond the regional level to reach an inter-regional, much more multifaceted and multi-sectoral level that includes political and economic objectives.⁶¹ The PTA between MERCOSUR and India is a good example of this interesting process.

Regarding the bilateral interaction between Latin America and India, different organizations and institutes such as the Focus-LAC programme, as well as financial credit institutions, Export Promotion Councils, the Chamber of Commerce and Industry and the Eximbank, have supported and enhanced this relation to start this process.

According to statistics provided by the Indian government, trade between the countries had been increasing in the last years. In comparison to the relation of MERCOSUR-Korea, it has been less developed and the volume of trade has not been very significant.

⁵⁹ GENERAL DIRECTORATE FOR INTERNATIONAL ECONOMIC AFFAIRES OF CHILE (DIRECON), *Fourth Anniversary of the Korea-Chile FTA: An Assessment of the results*, 2009, p.2-3, available at http://www.direcon.cl/documentos/corea/ANEXO_128_COMENTADO_2.pdf [accessed May 2009]

⁶⁰ Ibid., p. 3.

⁶¹ CERNAT, L. and LAIRD S. Laird, *North, South, East, West: What's best? Modern RTA's and their implications for the stability of trade policy*, CREDIT Working Paper No. 03/11, University of Nottingham, August 2003, p. 1-2, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=456941 [accessed June 2009]

Table 7. The Indo-MERCOSUR trade (1999-2002)

(In US\$ Million)

YEAR	EXPORTS	IMPORTS
1999-2000	317.60	732.85
2000-2001	476.52	603.11
2001-2002	626.49	765.74

Source: Ministry of Government and Industry of India

Table 7 shows a positive tendency in the bilateral relation. In the period 2001-2002 Indian exports to MERCOSUR countries picked up exponentially (49.3%). Except for the period 2000-2001, the commercial exchange was by far more beneficial for South American countries than it was for India.

The reports of COMTRADE (Commodity Trade Statistics Database of the United Nations) show that in 2002, the value of bilateral trade between India and MERCOSUR was between 1.3 billion dollars (data reported by India) and 1.8 billion dollars (data reported by MERCOSUR countries). Furthermore, in the same year, the share of India in MERCOSUR imports was 1.2 per cent. Although Argentina and Brazil amounted for 95 per cent of India's exports, Brazil has proved to be the most dominant trading partner among the four members of the block. Conversely, Uruguay and Paraguay have a negligible presence in Indian markets at the moment.⁶²

Moreover, the research carried out by UNCTAD about MERCOSUR and India⁶³, proved through two stactical methods⁶⁴ that there is a certain level of complementarity in the bilateral relation. In particular, the most important complementary products indicating potential for MERCOSUR exports to India are: petroleum oils, transmission apparatus for radio telephony, gold in semi-manufactured form, copper ores, soy bean oils, cotton and motor vehicle parts. Likewise, for India the complementary products are preparations of petroleum products, pharmaceuticals (both finished and bulk), antibiotics, motor vehicle parts, parts and accessories for data processing, and new pneumatic and rubber tires used for buses and lorries. These empirical methods had included items not traded between India and Mercosur in 2000-2002.

In this context, the India-MERCOSUR Framework Agreement was signed on 17th June 2003, in Asuncion, Paraguay. It was the starting point of a deep process of economic integration towards an FTA. At that time, the Ministry of Commerce and Industry of India released a statement to explain the intentions of the government about this issue:

The signing of the framework agreement will pave the way to enter into Preferential Trade Agreement as the first step and ultimately to negotiate a Free Trade Agreement in long-term interest (Ministry of Commerce and Industry of India, June 2003)

As a follow up to the said framework agreement, a PTA was signed on 25 January 2004, during the visit of Brazil's president Lula to New Delhi. One year later, five annexes to this agreement were signed,

⁶² UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT (UNCTAD), *Regionalism and South-South cooperation: The case of MERCOSUR and India*, June 12-13 2004, p. 4, available at http://www.unctad.org/en/docs/tdxibpd11_en.pdf [accessed June 2009]

⁶³ UNCTAD, Op Cit, p. 17-18

⁶⁴ One method is to compare Revealed Comparative Advantage (RCA), and the second one is a trade flow analysis to identify complementary products between countries. The latter was used by the International Trade Center, in 2003, to analyze the trade opportunities among MERCOSUR and Chile.

incorporated (19 March 2005), and finally, on June 1, 2009, the PTA came into effect. Moreover, it is expected that trade will double to \$10 billion from the present \$5 billion in the next 3 to 5 years.⁶⁵

The preamble of the agreement establishes two main objectives: the promotion and expansion of the existing relation by granting reciprocal fixed with the ultimate objective of creating a compatible free trade with the multilateral trading system.⁶⁶

As mentioned in the first part of this paper, a PTA contemplates the reduction of tariffs for an agreed list of specific products on a majority of tariff lines. In the PTA between India and MERCOSUR, they have agreed to give tariff concession to the other side on 450 and 452 tariff lines respectively. In the former case, meat and meat products, inorganic chemicals, organic chemicals, dyes and pigments, raw hides and skins, leather articles, wool, cotton yarn, glass and glassware, articles of iron and steel, machinery items, electrical machinery and equipments, optical, photographic and cinematographic apparatus are included. Most items obtain a duty concession of 10 per cent (93 items, like pork ham) and 20 per cent (336 items like machines for cleaning and freezers) and in few cases 100 percent (21 items, like printers)

In contrast, the trading regional block gave special tariff concessions on the following products: food preparations, organic chemicals, pharmaceuticals, essential oils, plastics, rubber and rubber products, tools and implements, machinery items, electrical machinery and equipments. The reduction of tariffs is as follow: 10 per cent on 393 tariff lines (apples, grains, milk and cream, vegetables), 20 per cent on 45 tariff lines (seeds of cumin, cyclic alcohols, and dried coconuts) and 100 per cent on 14 tariff lines (oil not crude, gasoline).

Since the India-MERCOSUR PTA is a very recent one, it is impossible to analyze any significant effect on the parties' commercial exchange. However, there are some indicators that hint towards possible outcomes of this agreement. On the one hand, MERCOSUR's offer list is concentrated on products that India exports to the region: organic chemicals. Nevertheless, the potential for India to gain market share is limited because 2 percent of CET is applied on the majority of the subcategories of organic chemicals.⁶⁷

On the other hand, India's offer list is not suitable for MERCOSUR, because it is more concentrated on machinery and mechanical appliances, as well as tanning or dyeing extracts than on grains. As a result, the South American trading block should profit from this opportunity and increase its market share in those products.⁶⁸ According to Annex II of the agreement, Paraguay is the only country that received a tariff concession (10%) on import soya-beans and crude oil. Similarly, this country is the only one among the members of the regional block that gave special tariffs reductions (20%) on Indian imports² of dried coconuts shells and seeds of cumin.⁶⁹

For all the reasons mentioned above, it is evident that the India-MERCOSUR PTA will not have a direct and significant impact on the bilateral relations. In particular, the PTA does not give it any concession for MERCOSUR, except for Paraguay, on the import of grains which is one of the more important products in the commerce of the regional block. Similarly, India has constraints in its exports, especially in organic chemicals, due to the application of the CTE on them.

⁶⁵ KATH HAZARIKA , Namrata, *Opportunities galore for Indian SMEs in Mercosur countries* , June 4, 2009, available at <http://smetimes.tradeindia.com/smetimes/news/top-stories/2009/Jun/04/opportunities-galore-for-indian-smes-in-mercocountries4832.html> [accessed June, 2009]

⁶⁶ MINISTRY OF COMMERCE AND INDUSTRY OF INDIA, India-MERCOSUR PTA, p.1, available at http://commerce.nic.in/trade/international_ta_indmer.asp [accessed June, 2009]

⁶⁷ BRAT, Michael, *India and Mercosur: Boosting Trade through Regionalism*, Center of International Trade, Economics and Environment, January 2005, p. 2, available at <http://www.cuts-citee.org/PDF/IBSA-1-India-Mercosur.pdf> [accessed May 2009]

⁶⁸ Ibid.

⁶⁹ MINISTRY OF COMMERCE AND INDUSTRY OF INDIA, Op.Cit. Annex II.

Moreover, the research conducted by Michel Brat⁷⁰ analyzes the possibility of a potential FTA between India and the regional trading block. After taking into consideration several factors, the author arrived at the conclusion that there are sensitive products, which are important for the parties' economies, but they will be very difficult to negotiate. While for MERCOSUR these products are tires and textiles; for India they are vegetable oil and some food products.

5.c Why a FTA is not suitable for MERCOSUR and Korea?

Despite the fact that PTAs or FTAs sometimes are easily confused in the economic literature, they are two different concepts. As mentioned in the first pages of this paper, the PTA is the first step towards a FTA.⁷¹ The scope of an FTA is to liberalize international trade within the limited number of countries. In other words, each country within the agreement establishes different rates to its counterparty.

The theory of international economics⁷² gives reasons why countries decide to form a FTA. This paper will briefly discuss the static or short-term effect, which develops two sub-categories: *trade creation and trade diversion*. The first one means that a free trade area creates trade that would not have existed otherwise. In all cases, the countries involved in the agreement will increase national welfare. Conversely, trade diversion analyzes losses incurred by forming a FTA. In this sense, it is common for economists to make the following statement, "*If the positive effects from trade creation are larger than the negative effects from trade diversion, then the FTA will improve national welfare*".⁷³

From our point of view, in the case that Korea and MERCOSUR decided to create a FTA, the results would be more characteristic of trade diversion effects than trade creation, because the FTA may be *welfare reducing* for the parties, especially for South American countries.

According to the Report, the economies of the parties are highly complementary in terms of factor endowment, capabilities and specialization. Nevertheless, the main problem in the bilateral relation is the tariff concessions, because Korea applies a higher tariff (48%) on the economy sectors where its counterparty has its best comparative advantages: *agriculture*. Moreover, the protection of agriculture is part of the Korean national interest that has historically been supported by different administrations. In this sense, the former ambassador Choo Jong-youn explained that his country is dealing with a dilemma between the need for foreign agricultural products and the defense of food security for the next generations.

In the case of Chile, tariff concessions also became an obstacle in the negotiation of a FTA with Korea, but the lack of experience of Korea in FTAs, forced it to give the South American country generous and exclusive tariff concessions and reductions. Moreover, the successful results gained by the parties after the implementation of this agreement are owing to the products that Chile exports to Korea. In comparison to MERCOSUR, Chile has concentrated its exports on mineral ores and refined metals rather than on agricultural and food goods.

Another problem in this negotiation process between the regional trading block and Korea is the lack of coordination among the MERCOSUR countries to apply common external tariffs (CET). As mentioned before, the Protocol of Ouro Preto established a CET, however, general exceptions are allowed for capital assets and goods related to technology and telecommunications. This is the outcome of the incomplete economic integration of MERCOSUR that still remains as a customs union without

⁷⁰ BRAT, Michael, Op. Cit. p.3

⁷¹ BALASSA, Béla, Op. Cit.

⁷² TSUJI, Tadahiro, *The Prospect of the Japan-Korea Free Trade Agreement*, Nihon University, 2005, available at http://caps.khu.ac.kr/pdf/12_01_02.pdf [accessed June, 2009]

⁷³ SURANOVIC, Steven, *International Trade. Theory and Policy. Chapter 110-2A: Trade Diversion and Trade Creation*, April 1998, available at <http://internationalecon.com/Trade/Tch110/T110-2A.php> [accessed May, 2009]

communitarian institutes.

Based on the foregoing, we believe that the creation of an FTA between MERCOSUR and Korea is not convenient in this context. Consequently, we propose a PTA as a viable alternative in this process of negotiation that can be used as an institutional vehicle for fostering cooperation, as well as a forum to harmonize regulatory issues in order to prepare the respective economies to liberalize those sensitive sectors in the next level.

As an example of the situation explained before, we can refer to our analysis of the PTA between India and MERCOSUR, where the parties dealt with the same issues than had appeared in the negotiations with Korea: agriculture. India only allows some agricultural imports from Paraguay, towards the other MERCOSUR members states the agricultural policy is not flexible. Consequently, the Indian offer list is concentrated on machinery and mechanical appliances, as well as tanning or dyeing extracts. On the other hand, MERCOSUR also constrains the possibilities of India to import some chemicals due to the application of CET. In spite of these difficulties, both economies decided to sign a satisfactory agreement for their interests, without forgetting that their final objective was to reach a FTA.

Concluding remarks

From the last decade, Korea and MERCOSUR have been strengthening their ties, especially after South American countries conducted market-oriented reforms in their economies. In this context, the decision of both actors to lead studies about the feasibility of a FTA was an outcome of this process of rapprochement and mutual interest in their comparative advantages.

Despite the report supporting the complementarity of both economies in terms of factor endowment, capabilities and specialization, there are some obstacles that they have to overcome in order to enhance their relation. Firstly, the issue related to tariffs. In the case of MERCOSUR, the main problem is the application of tariffs on imported goods, whereas in Korea is the application of tariffs on agricultural imports. It is important to remark that this problem does not seem to be solved in the short or mid-term because of the role that agriculture plays in the Korean economy. Secondly, the internal conflicts in the regional block as well as the status of its process of integration (incomplete customs union) can explain the lack of coordination at the moment of applying the CET.

The experience of Chile shows that it the possibility of a South American country to reach this kind of agreement with Korea was attributed to the exclusive concessions received from Korea in a particular situation, as well as its exports not being concentrated on agricultural products.

On the other hand, the PTA between India and MERCOSUR is an excellent example about what countries should do when there are obstacles in their mutual relation, especially in commerce, but at the same time, they take great efforts to be involved in an advanced level of integration. Although a PTA is the lowest level in a model of integration, it is a useful instrument to solve bilateral problems gradually and harmonize the policies in controversial fields.

For all the reasons mentioned before, a PTA has proved to be the best option for MERCOSUR and Korea in this current scenario. Based on the factors and tendencies that were analyzed in this paper, as well as on the conclusions of the Report, it is possible to state that in case of the parties continuing to insist on the negotiations of a FTA, the process might not move forward as fast as expected causing the parties to lose interest in the integration process.

“Now a partnership and co-operation agreement doesn’t sound exactly passionate, I know. But I also know that for passion to be lasting, we need to invest in the kind of mutual understanding and trust that develops over time (...)” **Pascal Lamy**

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