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BRIEF

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Analysis of South Korea's Tariff System Under Trade Liberalization

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I Background

- Trade liberalization has progressed continuously around the world. In line with this global trend, the Korean government has implemented out policies related to tariff rates.
 - The Korean government has actively pursued free trade agreements (FTAs) with several partners simultaneously in response to tariff reductions resulting from multilateral tariff reduction negotiations and the expansion of regional trade agreements.
- So far, Korea has entered into FTAs with a total of 52 countries and regions, including mega FTAs with the United States, the European Union (EU), and, China.
- Therefore, we need to analyze how FTA preferential tariff rates impact Korea's tariff rate system.
 - This study utilizes data on total imports over the last decade and identifies tariff rates applied to imports from different nations and regions, and under different agreements, thus analyzing how FTAs to which Korea is a party affect Korea's overall tariff rate system.
 - This study also analyzes mega FTAs with the United States, the EU, and ASEAN states and all of Korea's FTAs so as to determine how FTA tariff rates have affected the percentage of imports to which preferential rates are applied by industry.

II Research and Analysis Results

1. Tariff Rate Changes in Korea and Other Major Economies

- Korea has continuously lowered its tariff rates since the 1980s, following the global trend of trade liberalization.
 - The Korean government carried out state-led economic development projects from the 1960s to 1970s. Therefore, the country's tariff rate policies were designed to protect or nurture specific domestic industries.
 - In 1984, there was a shift of focus from protecting industries to implementing market-oriented tariff rate policies.
 - In the early 1980s, the tariff rate applied to industrial products ranged from 40 to 80 percent. The rate dropped to 20 percent in the mid-1980s and plummeted again to eight percent in the mid-1990s.
- In line with the global trend of expanding regional trade agreements, Korea has signed FTAs with a number of countries. However, its overall tariff rate policies have not changed.
 - Since the mid-1990s, tariff rates applied to some items have been adjusted, but no changes have been made to the tariff rate system after the signing of FTAs.

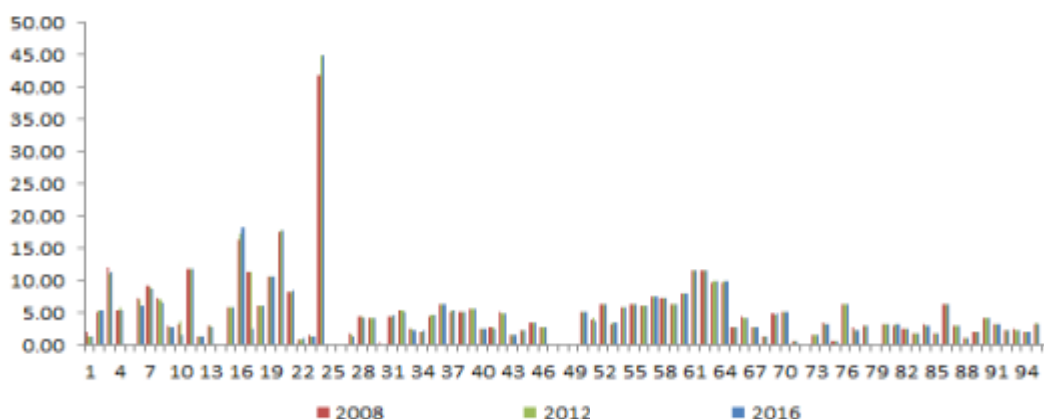
- This study looked at Korea and other countries that have signed a number of FTAs to find out whether any countries which have altered their tariff rate policies after entering into FTAs.
- The results of this investigation revealed that no country, among Korea, the United States, the EU, Japan, Chile, Canada, and China, has made any major changes to its tariff rate system.
 - Australia reduced the tariff rates applied to transport equipment and textiles that were subject to high tariff rates after the 1990s. However, such reduction seems to be unrelated to the establishment of FTAs.
 - Canada lowered the tariff rates applied to textiles.

[Figure 1] Average Tariff Rates for Chapter-Level HS Imports into the United States



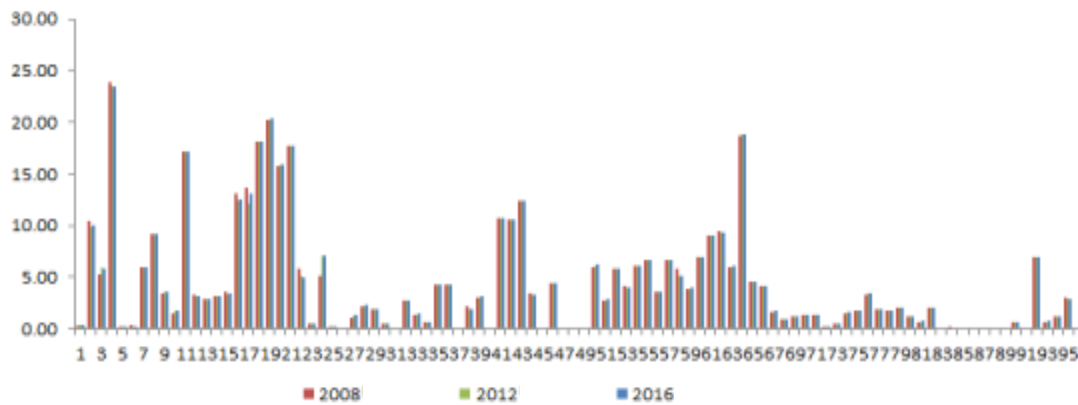
Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 2] Average Tariff Rates for Chapter-Level HS Imports into the EU



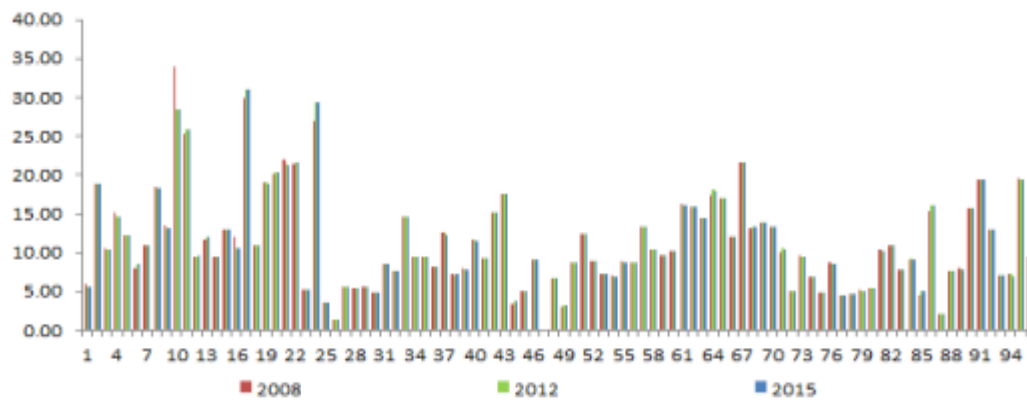
Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 3] Average Tariff Rates for Chapter-Level HS Imports into Japan



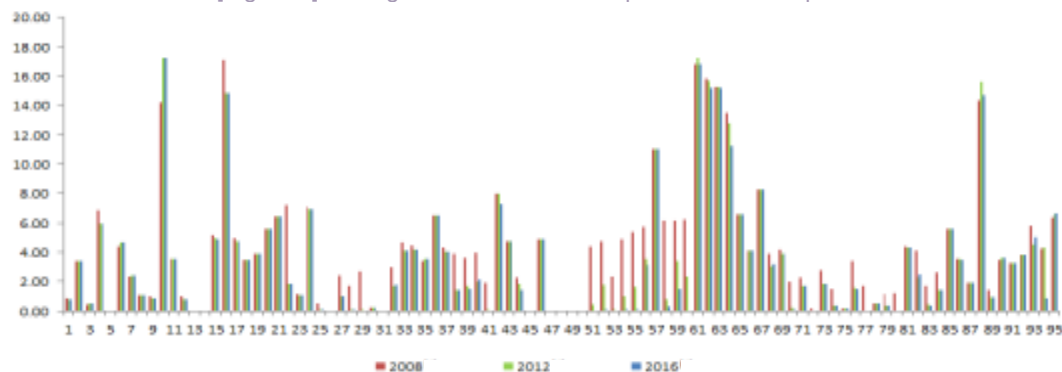
Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 4] Average Tariff Rates for Chapter-Level HS Imports into China



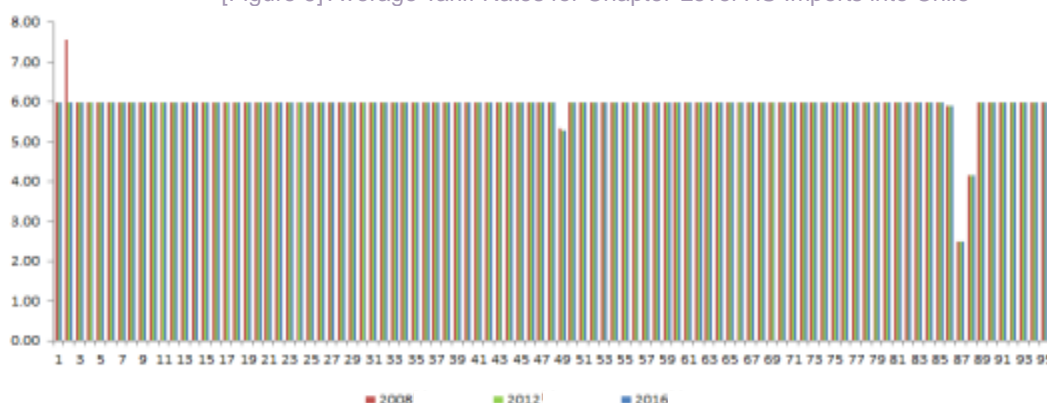
Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 5] Average Tariff Rates for Chapter-Level HS Imports into Canada



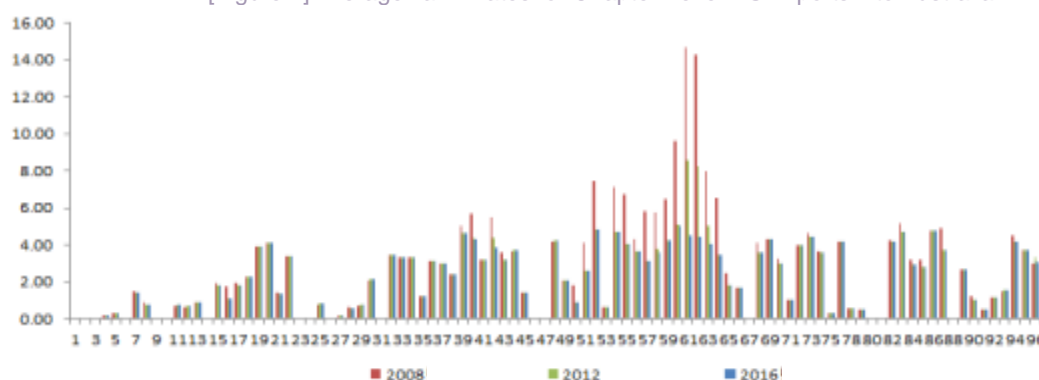
Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 6] Average Tariff Rates for Chapter-Level HS Imports into Chile



Source: <https://tao.wto.org> (accessed October 12, 2017).

[Figure 7] Average Tariff Rates for Chapter-Level HS Imports into Australia



Source: <https://tao.wto.org> (accessed October 12, 2017).

2. Tariff Rate Structure Changes Caused By the Expansion of FTA

- This study utilizes data on total imports over the last decade to analyze how the percentages of imports that are subject to FTA preferential tariff rates have changed.
- Korea has established FTAs with 52 countries. However, FTA preferential tariff rates are applied to only one-quarter of total imports.
 - In the case of Korea-United States FTA, Korea-EU FTA, and Korea-ASEAN FTA, which are regarded as large-scale FTAs, basic tariff rates were applied to about 60 to 70 percent of imports before the establishment of the FTAs. However, that proportion dropped to about 25 percent.
 - Most FTAs other than the FTAs mentioned above have lower percentages of imports subject to the FTA rates.
 - Aggregating the percentage of imports to which the FTA rates are applied in accordance with large-scale FTAs and other FTAs shows that one-quarter of Korea's imports are subject to the FTA preferential tariff rates.

A. Agricultural Imports

•• The most prominent characteristic is observed in agricultural imports. Before the FTAs came into force, most agricultural imports entered Korea under basic tariff rates. Now, however, such imports are subject to the FTA tariff rates.

- About 69.4 percent of agricultural imports from the United States, 72.8 percent of agricultural imports from ASEAN states, and 80.2 percent of agricultural imports from the EU came to Korea at the FTA tariff rates.

Table 1. Agricultural Imports into Korea by Tariff Rate

(Unit: %)

		FTA Tariff Rate	Basic Tariff Rate	WTO Concession Rate	Autonomous Tariff Rate	Others	Total
Korea-United States FTA	2013	71.6	9.4	0.0	12.1	6.9	100.0
	2014	63.6	8.0	0.0	23.1	5.3	100.0
	2015	70.4	8.8	0.0	15.2	5.5	100.0
	2016	69.4	9.7	0.0	16.2	4.7	100.0
Korea-EU FTA	2013	48.6	32.5	18.2	0.6	0.0	100.0
	2014	77.0	14.5	0.8	1.3	6.5	100.0
	2015	74.5	15.8	0.5	2.5	6.8	100.0
	2016	80.2	12.7	0.5	0.3	6.3	100.0
Korea-ASEAN FTA	2013	56.5	27.8	0.3	12.5	2.8	100.0
	2014	58.0	33.5	0.4	4.5	3.6	100.0
	2015	59.2	35.2	0.3	2.9	2.5	100.0
	2016	72.8	23.1	0.1	2.8	1.3	100.0

Note: "Others" includes provisional tariffs, adjustment tariffs, anti-dumping duties, concession rates among WTO developing countries, Asia Pacific Trade Agreement concession rates, and preferential tariff rate for the least-developed countries.

Source: MOSF internal data, modified by the authors.

B. Competitive Industries by FTA

•• By looking at industries for which high percentages of imports are subject to the FTA tariff rates, it can be seen that competitive industries are subject to the FTA tariff rates.

- Compared to the Korea-United States FTA, the Korea-EU and Korea-ASEAN FTAs have more industries importing more than half of all products at the FTA tariff rates. Moreover, competitive industries are subject to the FTA tariff rates.

Table 2. Industries Importing High Proportions of Products under the FTA Tariff Rates of Major FTAs (2016)
(Unit: %)

FTA	Industries that import more than half of their products under FTA tariff rates
Korea-United States FTA	Food and beverages (76.8), non-metallic minerals (65.6), chemical products(63.1), and other manufactured goods (61.6)
Korea-EU FTA	Non-metallic minerals (84.2), automobiles(83.4), food and beverages (83.0), mining products (68.9), chemical products (65.4), textiles and leather products (58.8), and agricultural and marine Products (53.9)
Korea-ASEAN FTA	Textiles and leather products(93.1), food and beverages (82.3), chemical products (75.3), non-metallic minerals (60.2), Wood and paper Products (56.2), other manufactured goods (58.8), and machinery products (51.1)

Source: Inter data of the Ministry of Strategy and Finance (MOSF), modified by the authors.

•• This study analyzed FTAs by industry and found that competitive industries vary by FTA

- In summary, the food and beverage industry and chemical product industry are competitive industries under the Korea-United States FTA, while the machinery and transport equipment industries are competitive under the Korea-EU FTA, and the textile and leather product industries are competitive under the Korea-ASEAN FTA.

C. Analysis of Major Industries

•• This study also analyzed individual industries in terms of what percentages of their imports are brought into Korea at the FTA tariff rates.

•• As of 2016, among industries that import products at the FTA tariff rates, the percentage of food and beverage imports that are subject to the FTA tariff rates was 62.9 percent which was the highest. More than 50 percent of textile products, leather products, and transport equipment were imported at the FTA tariff rates.

- Importantly, the electric and electronic device industry already enjoys an absence of tariffs in accordance with the WTO ITA, which has kept the proportion of electric and electronic device imports brought into the country at the FTA tariff rates at 10.4%, smaller than in other industries.

Table 3. Percentages of Imports Subject to FTA Tariff Rates by Industry

Top	Middle	Bottom
Food and beverages (62.9%), textiles and leather products (53.5%), and vehicles (51.9%)	Chemical products (41.3%), non-metallic minerals (39.0%), and agricultural and fishery products (33.0%)	Metal products (25.9%), machinery (25.6%), basic metal products (21.8%), and electric and electronic Devices (10.4%)

Source: Internal data of the MOSF, modified by the authors.

1) Food and Beverages

•• A large proportion of agricultural, fishery, food, and beverage products was imported at the FTA tariff rates. Particularly, the food and beverage industry showed the greatest dependency on FTAs for imports.

- The high basic tariff rates and WTO concession rates imposed on food and beverage imports seem to be protecting the domestic agricultural market. However, the FTAs seem to have minimized the effect of such high rates.

- The food and beverage industry imports 76.8 percent, 83.0 percent, and 82.3 percent of products at the FTA tariff rates under the Korea-United States FTA, Korea-EU FTA, and Korea-ASEAN FTA respectively.

- Most food and beverage imports from such large economies and economic communities are subject to the FTA tariff rates.

Table 4. Percentages of Food and Beverage Imports by Applicable Tariff Rate (2016)

(Unit: %)

	FTA tariff rate	Basic Tariff Rate	WTO Concession Rate	Autonomous Tariff Rate	Others	Total
Korea-United States FTA	76.8	20.2	0.1	0.3	2.5	100.0
Korea-EU FTA	83.0	10.0	0.6	0.2	6.1	100.0
Korea-ASEAN FTA	82.3	11.9	0.1	1.6	4.0	100.0

Source: Internal data of the MOSF, modified by the authors.

- The majority of food and beverage products imported at the FTA tariff rates come from the United States, the EU, Australia, and ASEAN states.

Table 5. Percentages of Imported Food and Beverages of Total Imports by FTA

(Unit: %)

	ASEAN	Australia	Chile	EFTA	EU	India	Peru	Singapore	Turkey	U.S.	Canada	China	Vietnam	New Zealand	Columbia
2013	9.3	-	2.0	0.5	9.8	1.2	0.4	0.0	0.1	14.9	-	-	-	-	-
2014	9.9	0.4	1.9	0.5	11.8	0.9	0.5	0.0	0.1	17.0	-	-	-	-	-
2015	8.9	9.6	2.1	0.6	12.5	0.8	0.6	0.0	0.1	17.0	1.5	0.0	0.0	0.1	-
2016	9.3	11.0	1.9	0.7	13.0	0.7	0.5	0.0	0.1	17.5	1.8	4.3	0.4	1.6	0.0

Source: Internal data of the MOSF, modified by the authors.

2) Textiles and Leather Products

- Along with agricultural products, textile and leather products are also subject to high tariff rates as an exception under Korea's central tariff rate system.

- Textile and leather products are subject to higher tariff rates than other imported items in many other countries as well.

- About 53.5 percent of total textile and leather imports was subject to the FTA tariff rates, showing that lower tariff rates than before are being applied to such imports.

- Since the FTAs have been expanded, textile and leather imports are coming largely from ASEAN states, China, and Vietnam as expected.

Table 6. Percentages of Imported Textile and Leather Products of Total Imports by FTA

(Unit: %)

	ASEAN	Australia	Chile	EFTA	EU	India	Peru	Singapore	Turkey	U.S.	Canada	China	Vietnam	New Zealand	Columbia
2013	23.6	-	0.0	0.1	7.0	1.1	0.0	0.0	0.1	1.0	-	-	-	-	-
2014	25.8	0.0	0.0	0.1	7.7	1.3	0.0	0.0	0.2	1.0	-	-	-	-	-
2015	26.2	0.0	0.0	0.1	8.2	1.7	0.1	0.0	0.2	0.9	0.1	0.1	0.0	0.0	-
2016	19.5	0.0	0.0	0.1	8.5	1.7	0.0	0.0	0.2	0.7	0.1	12.8	9.8	0.0	0.0

Source: Internal data of the MOSF, modified by the authors.

3) Transport Equipment

- The transport equipment industry was the only one that showed a huge dependency on one specific FTA for its imports.
 - As of 2016, about 75.5 percent of transport equipment imported at the FTA tariff rates is from the EU.
 - No other industry relied this much on a particular FTA.

Table 7. Percentages of Imported Transport Equipment of Total Imports by FTA

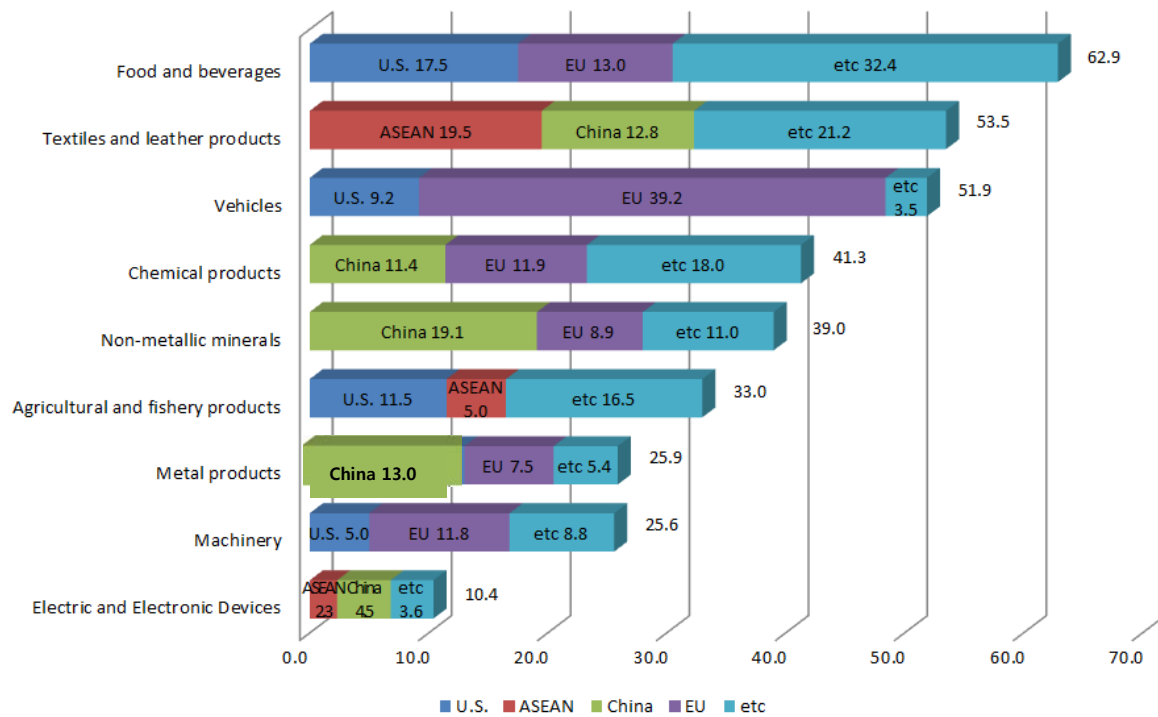
(Unit: %)

	ASEAN	Australia	Chile	EFTA	EU	India	Peru	Singapore	Turkey	U.S.	Canada	China	Vietnam	New Zealand	Columbia
2013	0.0	-	0.0	0.0	33.1	0.1	0.0	0.0	0.0	7.1	-	-	-	-	-
2014	0.1	0.0	0.0	0.0	40.9	0.1	0.0	0.0	0.0	6.5	-	-	-	-	-
2015	0.2	0.1	0.0	0.0	43.2	0.1	0.0	0.0	0.0	6.7	0.1	0.0	0.0	0.0	-
2016	0.1	0.1	0.0	0.0	39.2	0.2	0.0	0.0	0.1	9.2	0.2	2.6	0.2	0.0	0.0

Source: Internal data of the MOSF, modified by the authors.

- Other industries also showed a variety characteristics.
- In the aggregate, countries that apply a high proportion of FTA tariff rates have a competitive edge in some industries. In particular, the EU is competitive in six of the nine industries indicated below, while China is competitive in five industries, and the United States ranked first or second in terms of competitiveness in four industries.

Figure 8. Percentages of FTA Rate Application by Industry of Countries and Regions (2016)
(Unit: %)



III Policy Recommendations

(Recommendation 1) Changing the Flexible Tariff Policies on Agricultural Products

- Since Korea's establishment of multiple FTAs, the majority of agricultural products have been imported at the FTA tariff rates. What is notable is that a wide variety of agricultural imports that were used to be subject to autonomous tariff rates are now brought into Korea at the FTA tariff rates
- The fact that the majority of agricultural imports are now brought into Korea at the FTA tariff rates implies that the policies related to Korea's flexible tariff system will change.
- As much more agricultural products are imported at the FTA tariff rates than industrial products and the FTA tariff rates are going to be lowered gradually, it would be reasonable to apply the FTA tariff rates, rather than the flexible tariff rates, to agricultural imports.
 - However, if the prices of agricultural products in the domestic market soar as a result of a natural disaster, the flexible tariff rates would be applied temporarily.

(Recommendation 2) Basic Tariff Rates Applied to Agricultural Products and Textiles

- Agricultural imports are subject to relatively high tariff rates compared to other imported products. The purpose of such high tariff rates is to protect the domestic agricultural market.
- The high basic tariff rates and WTO concession rates imposed on imported agricultural products seem to protect the domestic agricultural market. However, the impact of such high rates has been lessened because of the large proportion of agricultural products that is imported at the FTA tariff rates.
- Therefore, the trade diversion effect in relation to agricultural products, and the difference between the FTA tariff rates and high basic tariff rates applied to agricultural imports should be considered when planning policies related to future tariff rates and improving the basic tariff rate system.
- Along with agricultural products, textile and leather products are also subject to high tariff rates as an exception under Korea's central tariff rate system.
 - Like other countries, Korea imposes a tariff rate of 13 percent, which is higher than the central tariff rate of eight percent applied to textile and leather products.
- Korea imports textile and leather products mainly from ASEAN states, China, and Vietnam. About 93.1 percent of the textile and leather imports from ASEAN states are brought into Korea at the FTA tariff rates. Furthermore, imports from China and Vietnam are expected to rise.

•• Textile and leather products are also subject to high basic tariff rates like agricultural imports. In this regard, the difference between the high basic tariff rates and FTA tariff rates, and the effect of trade diversion caused by such difference should be considered when attempting to improve the overall structure of the basic tariff rate system.

Reference

- Jaeho Cheung·Sunghoon Kang, 「Analysis of Korea's Tariff System Under the Expansion of Trade Liberalization 」, Korea Institute of Public Finance, 2017.