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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

Annual Report on the Implementation of the EU-Korea Free Trade Agreement

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1. INTRODUCTION

The Free Trade Agreement (FTA) between the EU and South Korea has been provisionally applied since July 2011[1]. It is the first of a new generation FTA, characterised by its far-reaching and comprehensive nature. It is also the EU's first trade deal with an Asian country.

After a little more than a year of its operation it is still too early to show the full impact of the FTA as the provisions on the tariff and non-tariff measures liberalisation, as well as the measures on services and investment, will come into force over a longer timeframe. However, major tariff dismantling has already taken place and the positive effects on the EU's exports are already being felt on the ground.

The purpose of this report is to comply with the obligations deriving from Regulation (EU) No 511/2011 of the European Parliament and of the Council of 11 May 2011 implementing the bilateral safeguard clause of the Free Trade Agreement between the European Union and its Member States and the Republic of Korea[2]. According to Article 13(1) of the said Regulation, the Commission shall make public an annual report on the application and implementation of the Agreement. Furthermore, Article 3(3) stipulates that the Commission shall present an annual monitoring report to the European Parliament and the Council on updated statistics on imports from Korea of products in the sensitive sectors.

2. OVERALL ASSESSMENT: EVOLUTION OF TRADE AND DUTY SAVINGS

The main conclusions, based on a comparison of data for the first year of implementation of the agreement (July 2011 – June 2012) compared to an average of the data from the past four twelve month periods (the 'reference period') are outlined below. This method of comparison over a longer period of time neutralises the impact of the crisis.

2.1. Evolution of trade

EU exports to Korea increased by 37% overall. Exports of products **fully liberalised** as from the date of provisional application of the agreement increased more than exports of other products. Exports of these products, representing 35% of EU exports to Korea, increased by **54%** (€4.4 billion) between July 2011 and June 2012, compared to the reference period. By comparison, exports of the same fully liberalised products to the world have increased by 27%.

This contrasts with products not subject to any preference, accounting for 18% of EU's exports, which increased by 20% over the period. For products **partially liberalised**, representing 43% of EU's exports, the increase in exports was **35%** or €3.9 billion.

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[1] The FTA is provisionally applied in the EU until all EU Member States have ratified it. The state of play of the ratification can be checked on the Council's Agreements website: http://www.consilium.europa.eu/policies/agreements/search-the-agreements-database?command=details&id=&lang=en&aid=2010036&doclang=EN

[2] OJ L 145, 31.5.2011, p. 19

Comparing the growth rate of fully liberalised products to Korea with the "normal" growth rate of the same products to the rest of the world, the growth differential translates into more than €2 billion extra exports.

At the same time, **EU imports from Korea have only marginally increased (1%).**

The current economic climate in the EU has clearly had a negative impact on the growth rate of Korean exports to the EU. Another reason for the fall in exports of goods from Korea to the EU is that Korean corporations continue to shift production to the EU and other countries, displacing direct exports from Korea. For instance, Korean carmakers have set up production plants in the Czech Republic and Slovakia and Korean electronics companies have production sites in several EU Member States, thus contributing to jobs and growth in the EU.

2.2. Duty savings

Duty savings were already sizeable even before the full implementation of the FTA. Under a conservative assumption, duties actually saved on EU's exports amounted to around €600 million over the first twelve months of the FTA.

The above figure is based on an estimated EU preference utilisation rate of about 50%, while the preference utilisation rate for Korean exports is 68%.

Although the EU preference utilisation rate has gradually improved in the second half of the first year of the FTA implementation, Korean exports still have a higher preference utilisation rate than EU exports. This can potentially be explained by a number of factors, including different conditions to apply the new administrative customs procedures and differences in the export profiles of companies since mainly large Korean companies export to the EU, while the EU exporters are rather fragmented. Finally, the "direct transport" provision which in some cases implies that goods that are shipped to Korea via logistic hubs, such as Singapore or Hong Kong, may lose the preferences can also partially explain this situation.

2.3. Automotive sector and other sectoral effects

EU car imports (HS8703) from Korea have increased by 20% (€ 663 million) in value and 12% (+45 000 vehicles) in volume during the first year of the FTA compared to the reference period. Despite the increase in car imports from Korea since the provisional application of the FTA, the level of car imports remains 37% below the level for the same twelve month period four years earlier.

The increase in Korean car imports has partly taken place at the expense of imports from other partners. Since the provisional application of the FTA, overall EU car imports from around the world have decreased by 15% in quantity and by €1.5 billion in value, compared to the reference period.

It is unlikely that a significant proportion of the increase in car imports from Korea to the EU can be attributed to the FTA liberalisation, since little liberalisation has actually taken place on the EU side; the EU's tariff was reduced by 3 percentage points for medium and large cars and by 1.7 percentage points for small cars, starting from an initial level of 10%, on the date of provisional application of the FTA and again one year later. This also has to be weighed against the depreciation of the euro by 7.2% during the first 12 months of the FTA, which offset the tariff reductions over this period.

According to Eurostat, EU car exports to Korea have increased by 69% (€840 million) in value and 70% (+33,000 units) in volume during the first twelve months of the FTA compared to the reference period. Cars have been partially liberalised; the Korean import duty has been reduced by 1.4 percentage points.

Regarding other sectors, EU exports of (fully liberalised) machinery and mechanical appliances representing more than a third of EU exports to Korea have increased by 25% since the provisional application of the FTA compared to the reference period. This may be partially linked to the immediate elimination of most of the 5% to 8% duties in these sectors, as well as the elimination of certain non-tariff barriers, such as the acceptance by Korea of self-certification for electromagnetic compatibility and electric safety for machines.

Other important sectors also show significant increases in EU exports of fully or partially liberalised products: transport equipment (51%), chemical products (23%), plastics and rubber (30%), textiles and clothing (25%) and base metals (20%). In terms of agricultural products, animals and animal products have increased by 84% and prepared foodstuffs by 35%.

Significant increases were recorded for both imports and exports of mineral fuels. However, there are indications that these increases are partially caused by external factors, in particular by the political tensions in the Middle East.

Post-FTA monthly data on services exports is not yet available. However, certain sectors, in particular telecommunications, financial services, environmental services and professional services, will benefit from the agreement due to legislative changes in Korea. However, many of the pre-FTA restrictions will only be lifted after the expiry of transitional periods, necessary for Korea to revise its regulatory framework. Therefore, depending on the sector, effects of the FTA will need time to materialise. In other sectors, such as maritime transport and construction services, the FTA bound the existing level of liberalisation. This provides legal certainty for the providers of these services against unilateral backtracking by Korea in the future.

Table 1: EU trade in passenger cars with Korea, July 2011-June 2012 compared to the average of the preceding four 12 month periods (change in € million and 1000 units).

	Imports				Exports			
HS6	**Value (€ mn.)**	**Change (%)**	**Units (1000)**	**Change (%)**	**Value (€ mn.)**	**Change (%)**	**Units (1000)**	**Change (%)**
870310	0	-28.3	0	128.0	0	-92.6	0	-76.9
870321	132	41.3	11	15.2	0	-61.2	0	-56.9
870322	172	33.9	17	18.2	5	172.4	0	169.7
870323	-47	-7.3	-17	-21.8	37	7.7	0	-2.2
870324	-17	-74.1	-1	-76.0	84	19.8	3	32.2
870331	172	357.9	22	313.1	2	1191.7	0	1118.2
870332	360	22.0	23	18.7	482	229.7	23	182.6
870333	-108	-69.2	-10	-75.8	231	225.1	7	228.3
870390	0	8.0	0	-32.0	0	-30.3	0	-43.8
Total	**663**	**19.9**	**45**	**11.7**	**840**	**68.6**	**33**	**69.5**

Source: COMEXT

Explanation to HS6 codes in Annex Table 1

870310		Motor cars and other motor vehicles specially designed for travelling on snow; golf cars and similar vehicles
870321	Petrol	Motor cars and other motor vehicles of a cylinder capacity not exceeding 1 000 cm3
870322		Motor cars and other motor vehicles of a cylinder capacity exceeding 1 000 cm3 but not exceeding 1 500 cm3
870323		Motor cars and other motor vehicles of a cylinder capacity exceeding 1 500 cm3 but not exceeding 3 000 cm3
870324		Motor cars and other motor vehicles of a cylinder capacity exceeding 3 000 cm3
870331	Diesel	Motor cars and other motor vehicles of a cylinder capacity not exceeding 1 500 cm3
870332		Motor cars and other motor vehicles of a cylinder capacity exceeding 1 500 cm 3 but not exceeding 2 500 cm 3 :
870333		Motor cars and other motor vehicles of a cylinder capacity exceeding 2 500 cm 3 :
870390		Other motor cars and other motor vehicles

3. ACTIVITIES OF THE VARIOUS IMPLEMENTATION BODIES ESTABLISHED UNDER THE FTA

The institutional provisions of the FTA envisaged the establishment of **seven Specialised Committees**, **seven Working Groups** and an **Intellectual Property (IP) Dialogue**. The EU-Korea FTA **Trade Committee** plays a supervisory role and is designed to ensure that the FTA operates properly. During the first year of implementation of the FTA the majority of the institutional bodies established by the FTA have met. When taking into account also those Committees and Working groups that met in the second half of 2012, there remain only three institutional bodies that did not yet meet: the **EU-Korea Committee on Cultural Cooperation**, the **EU-Korea FTA Working Group on Government Procurement** and the **EU-Korea FTA Working Group on Geographical Indications**.

It is noteworthy that as set out in the Protocol on Cultural Cooperation, the Trade Committee has no jurisdiction over the Protocol and the Committee on Cultural Cooperation thus exercises the functions of the Trade Committee as regards that protocol.

The first meeting of the **EU-Korea FTA Trade Committee**, which was co-chaired by Commissioner Karel De Gucht and Korea's, now former Trade Minister Kim Jong-hoon, took place on 12 October 2011 in Seoul. During the meeting, both sides endorsed the draft decisions on rules of procedure of the Trade Committee and the Dispute Settlement panel roster. They reviewed the implementation of the EU-Korea FTA in the area of Trade in Goods, Services, Rules and Trade and Sustainable Development. Discussion on ways to enhance cooperation to promote bilateral trade and on the economic outlook also took place.

On 14-15 December 2011 the **EU-Korea FTA Customs Committee** met in Seoul and discussed the Rules of Procedure and effective operation of the Committee. Both sides agreed to exchange data and information in relation to utilisation of the FTA. Various aspects of the implementation of the Agreement and efficiency of origin verification were discussed, including the issue of redrafting of the provision on direct transport. The Committee addressed also the transposition of list rules of Origin in HS2012, respective international affairs on Customs Policy Matters and the Mutual Administrative Assistance.

On 26-27 April 2012 the first meetings of the three **EU-Korea FTA Working Groups on Motor Vehicles and** Parts**, Pharmaceuticals and Medical Devices and Chemicals** were organised in Brussels.

The **Working Group on Motor Vehicles and Parts** discussed the implementation of the automotive aspects of the FTA, in particular regulatory aspects referring to product acceptance. Moreover, information on existing and new regulatory initiatives was exchanged.

The **Working Group on Pharmaceuticals and Medical Devices** discussed the Korean reform of the reimbursement price of pharmaceuticals, methodology for cutting the reimbursement prices of medical devices, change in the comment period for pharmaceutical reimbursement decisions, quality testing of pharmaceuticals and medical devices and the regulatory cooperation.

The **Working Group on Chemicals** exchanged views on cooperation with regard to the introduction and implementation of the Korean chemicals regulation and technical cooperation arrangements on chemicals, as well as a possible exchange of personnel between the Korean Ministry of Environment and the European Chemicals Agency (ECHA).

On 25 June 2012, the **EU-Korea FTA Committee on Sanitary and Phytosanitary Measures (SPS)** took place in Brussels. The Committee discussed issues of interest to both sides such as the rules of functioning of the Committee, transparency and exchange of

information, confidence-building activities, enhancing cooperation on animal welfare and problems arising from the application of SPS measures.

On 26 June 2012, the **EU-Korea FTA Committee on Trade and Sustainable Development** met for the first time in Brussels and was followed on 27 June 2012 by the **Civil Society Forum**, an advisory body consisting of the European and Korean Domestic Advisory Groups.

The meeting of the **Committee on Trade and Sustainable Development** provided a useful opportunity to exchange information on each side's initiatives in the area of trade and sustainable development, discuss the implementation of Chapter 13 of the FTA to date and agree on the next steps. The Committee adopted a decision on the rules of operation of the Civil Society Forum and the establishment of a list of experts in accordance with Article 13.15.3 of the FTA. Finally, the Committee made institutional, labour and environmental oriented operational conclusions.

The members of the **Civil Society Forum** were debriefed during their meeting on 27 June 2012 about the outcome of the Trade and Sustainable Development Committee's meeting. The Forum exchanged information on the implementation of Chapter 13 of the EU-Korea FTA and cooperation on specific economic, social and environmental issues. Paragraph 4 of this report describes in more detail the fulfilment and obligations under Chapter 13 of the Agreement and the activities of the Domestic Advisory Group and the Civil Society Forum.

On 25 September 2012, the **EU-Korea FTA Committee on Trade in Goods** met for the first time. The Committee addressed several FTA implementation issues as well as regulatory issues affecting bilateral trade flows in the sectors of aircraft parts, electrical and electronic products, food and agricultural products, cosmetics and thin-film solar panels. The Committee also discussed the likely impact on the EU-Korea FTA of Croatia's accession to the EU in July 2013.

On 26 September 2012 the first **EU-Korea FTA Committee on Outward Processing Zones on the Korean Peninsula** took place in Brussels. The Committee discussed the importance to Korea of this issue, which is legally and politically difficult for the EU. It was agreed that both parties would exchange data and have further discussions.

In addition, the **Dialogue on Intellectual Property** provided for in Chapter 10 of the FTA met for the first time on 26 September 2012. The Parties reaffirmed the primary importance they both attribute to intellectual property as an essential instrument to promote investment, creativity and employment. The meeting allowed the EU and Korea to exchange useful information on each side's recent legislative and policy developments in the field of intellectual property. The EU took the opportunity to inform Korea about a few IP enforcement issues that remain a matter of concern for European companies, including trademarks squatting, invalidation rates in the Korean patent system and the implementation of copyright provisions with regard to public performance rights in Korea

A discussion on ways to enhance the exchange of information and cooperation to support respective SMEs also took place. The Parties briefly exchanged views on current developments at multilateral level (WTO and WIPO) too.

On 27 September 2012 the **Committee on Trade in Services, Establishment and Electronic Commerce** as well as the **Working Group on Mutual Recognition Agreements on Services** met in Seoul. The Committee and the Working Group meetings provided a useful exchange of information between the Parties, on the implementation of both Parties' commitments resulting from the FTA in sectors including financial services, professional services, telecom, environmental services, postal and logistics services as well retail services.

On 16 October 2012 the second **EU-Korea FTA Trade Committee,** co-chaired by Commissioner Karel De Gucht and the Korean Trade Minister Bark Taeho, met in Brussels. The Committee reviewed the implementation of the EU-Korea FTA in light of the work carried out by the Specialised Committees and Working Groups and agreed that these bodies should advance the implementation of the FTA and be result oriented. The Committee addressed implementation issues related to the non-tariff annex on motor vehicles and parts, the non-tariff annex on pharmaceuticals, the direct transport clause, mutual recognition of Authorized Economic Operators, Outward Processing Zones on the Korean Peninsula, services, in particular financial services, postal and retail sectors. Other issues affecting bilateral trade between the EU and Korea were also discussed.

Before the end of the year 2012 two more institutional bodies met: **the second EU-Korea FTA Customs Committee** and the first **EU-Korea FTA Working Group on Trade Remedy Cooperation**.

With regard to the Committee on Cultural Cooperation in the context of the Protocol on Cultural Cooperation, first steps were undertaken with the Korean side towards its establishment and a Commission proposal for a Council Decision on the establishment of the Committee and its rules of procedure was presented at the Council for discussion on 23 August.

4. FULFILMENT OF OBLIGATIONS UNDER CHAPTER 13 OF THE AGREEMENT CONCERNING TRADE AND SUSTAINABLE DEVELOPMENT

Senior officials of the EU and Korea met on 26 June 2012 for the first meeting of the Trade and Sustainable Development Committee under the FTA. The meeting proved a useful opportunity to exchange information on each side's initiatives in the area of trade and sustainable development, discuss the implementation of the chapter to date, and agree on next steps. In addition, the Committee discussed some procedural issues.

Both sides stressed the importance of maintaining appropriate communication channels with the civil society bodies established under the Trade and Sustainable Development chapter. In this regard, the Committee agreed to exchange information on the outcome of the respective Domestic Advisory Groups' (DAGs) meetings and to meet regularly with the Civil Society Forum (CSF) – starting from the CSF's first meeting, which was held on the 27 June 2012.

The Committee agreed that the first meeting was both positive and productive. The important details of establishing the operation of the institutional mechanisms with regard to the Trade and Sustainable Development chapter have now been agreed. There was also a detailed discussion on substance concerning trade-related labour and environmental issues. On this we have a good basis on which to proceed and the Committee looks forward to the respective DAGs' as well as the CSF's engagement in this regard also.

5. IMPLEMENTATION OF REGULATION (EU) NO 511/2011

Regulation (EU) No 511/2011 is the EU's internal legislation to implement the bi-lateral safeguard clause of the EU-Korea FTA. The Regulation also includes the possibility to introduce prior surveillance and, pursuant to Article 3 of the Regulation, requires the Commission to monitor the evolution of import and export statistics in sensitive sectors, also potentially affected by the duty drawback.

5.1. Safeguard and prior surveillance measures

During the first year of implementation of the FTA, the Commission did not receive any request for the initiation of a safeguard investigation, and thus no measures were applied.

It should be noted, however, that on 4 August 2012, i.e. shortly after the first year of implementation of the FTA, France submitted to the Commission a request to introduce prior surveillance on imports of cars originating in Korea.

The French request was based on a legal provision requiring the existence of an increase of imports concentrated in one or several Member States (Article 6(2) of Regulation (EU) No 511/2011). This request was, however, based on statistics for a very limited time period, and more importantly, did not include any indication of a concentration of imports into one or several Member States as required by the legal provision invoked by France.

The Commission, nevertheless, carefully examined the development of imports from Korea into the EU and France over the last five years, and concluded that the legal conditions for such a measure were not fulfilled since no increase in imports concentrated in one or more Member State could be established. On this basis it was decided not to introduce prior surveillance measures.

5.2. Monitoring

As provided for by Articles 3 and 11 of Regulation (EU) No 511/2011, the Commission has been monitoring the evolution of imports and exports of Korean products in sensitive sectors, such as cars, textiles, and consumer electronics, potentially affected by duty drawback. Since the provisional application of the FTA the Commission has been sharing the results of its monitoring with the Member States, the European Parliament and the relevant stakeholders on a bi-monthly basis.

It should be noted that the scope of the monitoring has been extended to car parts, following a duly justified request received from the industry concerned.

a) Evolution of Korean imports into the EU in the sectors covered by the monitoring

The results of the monitoring during the first year of implementation of the FTA are summarised below. The corresponding graphs are enclosed to this report. It is noteworthy that for the purpose of the monitoring, the comparison of trade data has been made on year-to-year basis and thus some figures may differ from the general trade analysis in paragraph 2 above, where a different method of comparison was used to eliminate the impact of the crisis.

(i) Car sector

Imports of cars increased by 41% in the year following the provisional application of the agreement (July 2011-June 2012) compared to the previous year (July 2010-June 2011). It should be noted, however, that the absolute level of imports during the first year of implementation of the FTA is still far below the level of imports four years earlier. Indeed, imports in the period July 2011-June 2012 accounted for only 72% of imports in the period July 2007-June 2008. This confirms the analysis of import trends under paragraph 2.3.

The analysis based on quarterly figures shows that the increasing trend observed in the recent years already started before the provisional application of the FTA.

As regards car parts, imports increased by 47% in the year following the provisional application of the agreement (July 2011-June 2012) compared to the previous year (July 2010-June 2011). This increase is a continuation of the increasing trend which already began in the period July 2008-June 2009. The increase seems however to have intensified since the provisional application of the FTA. Looking at the figures on a quarterly basis, following a

slight decline in the end of 2011 the increasing trend continued in the first two quarters of 2012.

(ii) Textile sector

Imports of textiles decreased by 30% in the year following the provisional application of the FTA (July 2011-June 2012) compared to the previous year (July 2010-June 2011). This followed a significant increase during the two years preceding the provisional application of the agreement. It is difficult to establish a general trend on the basis of quarterly figures since imports fluctuated significantly. There was a significant increase of imports in the last quarter of 2011, but thereafter imports dropped to their initial level.

(iii) Electronics sector

Imports of electronics increased by 8% in the first year following the provisional application of the FTA (July 2011-June 2012) compared to the previous year (July 2010-June 2011). The absolute level of imports is however clearly below the pre-crisis level: imports in the period July 2011-June 2012 accounted for just 63% of imports in the period July 2007-June 2008. The analysis of imports based on quarterly figures shows that there was an increase in imports in the last quarter of 2011, which may be explained by seasonal effects.

b) Duty drawback

Specific monitoring was also carried out on the issue of duty drawback, as provided for by Article 11(1) of Regulation (EU) No 511/2011, in order to assess the foreign content in the Korean manufacturing process and thus in exports from Korea to the EU of final products.

The analysis focused on quantities of products subject to monitoring exchanged during the first 6 months of 2012, compared to the same period in 2011, when there was no agreement, as these are the most relevant figures available.

For the **electronics sector**, the increase in imports into the EU has mainly involved the following codes: 8519.81, 8526.92, 8527.12, 8527.21, 8527.92 and 8528.73. Imports into Korea of parts of these products have either decreased: for 8522, a decrease from China (-10%) and Japan (-23%) or, for 8529 an increase from China (+10%) but a decrease from Japan (-28%). In all cases, the increase of imports of inputs is not significant compared to the increase of imports of the final products.

For **textiles**, the only increase of imports from Korea to the EU involves products of code 5509 (+5%). For this product, the Rules of Origin would allow the importation of products of man-made staples fibres of 5503 and 5504. Nevertheless, imports of these inputs into Korea have significantly decreased in 2012 (except among others for imports in Korea from some Member States which seem to have benefited from the FTA).

For **cars** of code 8703, there has been a global increase of exports to the EU (+24% on average), even if this statement does not apply to all specific types of cars, depending of the engines involved. In the meantime, imports of inputs into Korea have also increased, either almost in the same proportion (+24% for China for car part of 8708, but -33% for Japan) or less (+8% for China for diesel engines, but -2% for Japan; +8% for China for bodies of car, but -12% for Japan; -35% for China for other engines and -17% for Japan).

From the different elements summarised above, so far, for the products subject to specific monitoring, the allowance of duty drawback did not seem to have any significant impact on the manufacturing pattern of Korea.

6. CONCLUSION

While it is still too early, after one year of operation, to draw conclusions on the long term impact of the EU-Korea FTA, the first signs are promising; there is clear evidence that even only one year into the FTA, the EU has benefited significantly and its exports to Korea are on the up. During the first year of implementation, EU exports to Korea increased by 37% overall compared to the reference period and exports of products fully liberalised as from the date of provisional application of the agreement increased more than exports of other products.

As regards Korean imports into the EU, the current economic climate in Europe has clearly had a negative impact on the growth rate of Korean exports. However, on both sides, exports of products fully liberalised as from provisional application of the agreement have increased.

Now the focus is being put on ensuring proper implementation of the FTA. This FTA establishes comprehensive monitoring based on a set of various Committees and Working Groups, the majority of which have met during the first year of implementation.

The prospects are bright and despite the fact that some external – not linked to the FTA - factors such as the Euro crisis create unexpected complications, the situation is likely to stabilise in the long term and allow bilateral trade to expand to its full potential.