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**Impact of the EU-South Korea Free Trade Agreement on Swedish
Manufacturing Firms**

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Abstract

A Free Trade Agreement (FTA) between the EU and South Korea entered into force on July 1, 2011. The agreement is the most ambitious FTA between EU and a country in Asia so far. While South Korea has become a major world economy, its relative share of trade with the EU has declined since the 1980s. In contrast, intra-regional trade has become more important for South Korea, especially with China. The FTA is estimated to significantly increase Sweden's export to South Korea but could also increase competition in respective markets. It is still early to measure the agreement's full effect on trade statistics; however, there is a need to examine attitudes and reactions of Swedish firms to provisions in the agreement. Interviews with officials from twelve international Swedish firms together with trade and investment statistics, and a theoretical background, aim to give a full overview of the topic. The main objective of this paper is to investigate the short-term impact the FTA have had on Swedish manufacturing firms' strategies, operations, trading pattern, competitiveness, and future prospects of the agreement.

Keywords: Free Trade Agreement, Global Production Networks, Preferential Trade, Trade Policy

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List of Abbreviations and Concepts

ACEA - European Automobile Manufacturer's Association

AFTA - ASEAN Free Trade Area

ASEAN - Association of East Asian Nations

ASEAN+3 - ASEAN plus Japan, China, and South Korea

Chaebol - Korean business groups

CNY - Chinese yuan (renmimbi)

DOTS - Direction of Trade Statistics

EFTA - European Free Trade Association

EU or EU-27 - European Union

Eurostat - European Commission Statistics

FDI - Foreign Direct Investment

FTA - Free Trade Agreement

GATS - General Agreement on Trade in Services

GATT - General Agreement on Tariffs and Trade

GPN - Global Production Network

GVC - Global Value Chain

IMF - International Monetary Fund

IPRs - Intellectual Property Rights

JPY - Japanese yen

KITA - Korean International Trade Association

KORUS - US-South Korea Free Trade Agreement

KRW - Korean won

MFN - Most Favored Nation

NAFTA - North American Free Trade Agreement

NTB - Non-Tariff Barrier

OECD - Organisation for Economic Co-operation and Development

PTA - Preferential Trade Agreement

SCB - Statistics Sweden

SEK - Swedish krona

SITC - Standard International Trade Classification

Spaghetti Bowl - Complexity of preferential trade agreements

TNC - Transnational Corporation

TPP - Trans-Pacific Partnership

UN - United Nations

UN Comtrade – United Nations Commodity Trade Statistics Database

USD - US dollar

WTO - World Trade Organization

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1. Introduction

A Free Trade Agreement (FTA) between the European Union (EU) and the Republic of Korea (hereafter referred as South Korea) has been under negotiation for several years. Discussions started in 2007, and after eight rounds of negotiations the agreement was signed on October 6, 2010 and entered into force on July 1, 2011. It is the most ambitious FTA between the EU and an Asian country and is a part of a broader 'Global Europe' initiative introduced in 2007. The agreement covers a wide range of areas (e.g. trade in goods, trade in services, investment provisions, customs measures, and cultural exchange) and strives to increase mutual market access for European and Korean companies in respective countries.

While South Korea has become a major world economy, its relative share of trade with the EU has diminished since the 1980s. In contrast, intra-regional trade has become more important for South Korea, especially after China emerged as an important economic power. In an attempt to increase its importance for Asia, the EU is negotiating a number of Preferential Trade Agreements (PTAs) with fast-growing Asian countries to improve its trade relations. Even though China, Japan and the US are more important for South Korea than the EU as trading partners, the country does not want to be solely dependent on them, therefore seeing the EU as an alternative.

Many of the areas covered in the agreement had stagnated in the multilateral discussions pursued by the World Trade Organization (WTO). The stalled negotiations of the Doha-round have led to a surge in PTAs. This recent increase further complicates progress on a multilateral level, although it might be the only way forward. Bilateral discussions, despite being discriminatory, might pave the way for multilateral breakthroughs. Free trade is in itself a controversial issue. In spite of making goods cheaper for consumers and increasing overall wealth, the forces free trade unlocks will inevitably hurt industries that are not competitive enough.

1.1 Problem and Purpose of the Study

The FTA between the EU and South Korea will inevitably affect companies in Sweden, especially because Sweden is a country with small domestic market, and its firms heavily depend on exports and foreign production. The agreement's impact has been estimated to increase Sweden's export to South Korea by 80 percent. Some Swedish companies will also experience tougher competition, while consumers are likely to benefit from this agreement (Swedish Trade Council, 2011).

It is still too early to measure the full effect from the FTA on trade statistics. However, there is a need to examine attitudes and reactions of Swedish firms toward provisions in the agreement. Among important questions the agreement brings are how it has affected Swedish firms with presence in South Korea; has it altered their strategies and activities; how will it affect these companies in the future? Companies care less about the academic nature of global trade negotiations, but rather actual impact on them. Stability and predictability are higher priorities for companies since corporate decisions are based on current regulation and conditions. The perceived value of the EU-South Korea FTA depends, of course, on what company is examined, in what industry it is present, and what activities it has in South Korea. Therefore, the impact from the FTA might vary from negative to very significant.

The main objective of this paper is to investigate the rather short-term impact of the EU-South Korea FTA on Swedish manufacturing firms' strategies, operations, trading pattern, and competitiveness.

1.2 Research Questions

The attitude of companies to the agreement is an interesting area of research since it can reveal the impact of PTAs, and actual effect of trade policy on business. As a result, the following question and sub-questions were formulated:

In what ways have Swedish manufacturing firms been affected by the agreement?

- *How did Swedish firms prepare strategically to the agreement?*
- *What impact has the agreement had on Swedish firms' global production networks?*
- *What does the agreement imply for Swedish firms' operations in the long-term perspective?*

1.3 Structure of the Study

This study consists of seven chapters. Chapter one introduces the problem and purpose of the study and defines the area of research. It also provides a brief background and outlines the methodology of this study.

The second chapter contains the theoretical background and a summary of earlier findings within areas of research relevant to the study. This involves international trade theory, as well as theories on preferential trade and global production networks.

The aim of the third chapter is to describe Korean trade policy in general, and attitude towards PTAs in particular (agreements under discussion and recently concluded ones). This chapter also includes a brief summary of the EU-South Korea FTA.

An overview of trade statistics between the EU, Sweden, and South Korea together with a historical development of exchange rates over the last decade, form the fourth chapter. Qualitative data on trade complements the section.

Chapter five includes historical data on European and Swedish investment in South Korea, its character and structure. It also provides an overview of Swedish firms in the Korean market, their sector classification and time of entry.

Chapter six presents empirical findings obtained from conducted interviews and analysis of the collected data on the short-term impact the FTA had on Swedish manufacturing firms' strategies, operations, trading pattern, and competitiveness, and gives a comprehensive discussion on the impact of the agreement

The final chapter summarizes findings of this study and answers the research questions raised in chapter one. It also suggests further areas of research related to this topic.

1.4 Methodology

1.4.1 Quantitative Data

This study is based on analysis of contemporary theories on trade and localization processes, free trade agreements as well as global production networks. The theories are complemented by merchandise trade statistics analysis and description of recent patterns in trade and investment with a focus on Sweden and South Korea. Subsequently, companies selected to participate in this study are based on a list of Swedish firms currently present in South Korea (activities ranging from sales or representative offices to production facilities). The total number of such firms in early 2012 was 78 (Embassy of Sweden, 2012).

1.4.2 Qualitative Data

The qualitative data of this study serves as a liaison between the theoretical background and conclusions of this study. Twelve firms were interviewed between April 2 and May 7, 2012 in order to investigate actual impact of the EU-South Korea FTA. Interviews were either in the form of personal meetings, telephone interviews, or written replies, all based on standardized questions. Interviewees were officials from sales, logistics, or corporate governance departments. Depending on situational factors, additional questions were asked. All obtained data was compiled into a database presented in chapter six. The questionnaire can be found in appendix B.

1.4.3 Data Reliability

Statistics on trade was provided by several international sources, such as Direction of Trade Statistics database of the International Monetary Fund (DOTS IMF), UN Commodity Trade Statistics Database (UN Comtrade) and European Commission statistics (Eurostat). In spite of being internationally recognized for trustworthy statistics, the original data is retrieved from national statistical departments, which leaves a room for interpretations. This results in discrepancies in numbers, mostly due to different reporting systems. As both South Korea and Sweden are considered advanced economies, they are likely to present reliable data. Two national sources of statistics were used in order to compare patterns of trade between South Korea and Sweden: Korea International Trade Association (KITA) and Statistics Sweden (SCB).

Merchandise trade statistics includes all goods that are added or deducted from national material resources through imports and exports. Goods in transit or temporarily admitted goods are excluded from trade statistics. Both South Korea and Sweden use the general trade system and their trade statistics is based on customs data. It is important to note that the EU has expanded from twelve to 27 members during the discussed period. Thus, individual members' statistics is included in the combined EU statistics the same year they are included in the union.

Data on Foreign Direct Investment (FDI) flows was obtained from the Organisation for Economic Co-operation and Development (OECD) (although originally reported by respective countries) and complemented by national department data. FDI is calculated as net inflows at the end of each month and combined for annual figures. It is composed of three categories: equity capital, reinvested earnings and intra-company loans. Korean data excluded

reinvested earnings until the end of 2007, which might distort statistics. 2007 was also the year when OECD began to register statistics for the combined EU-27. Korean data on disbursed inward investment is only available until 2010, while there are notification figures for 2011. Data on FDI notifications could indicate how companies prepare strategically for the future. However, disbursed investment was considered most relevant as it was the actual capital invested. Sector classification of investment is based on investor application, i.e. companies themselves classify the nature of their investment. Alternative ways of measuring FDI by national statistical agencies make data from multiple sources rather different. Statistics in certain industries might be considered classified information and not reported.

A full list of Swedish companies in South Korea was provided by the Embassy of Sweden. The largest companies were contacted since they, if affected, will have the most impact on the Swedish economy. Smaller companies might be more heavily affected by the agreement but this impact is less significant in real terms. It should be noted that interviews to a certain extent are influenced by individual managers' opinions. Answers alter depending on type of firm, industry classification and personal background of respondent. However, it is believed that as all interviewees occupy high managerial positions, they possess necessary expertise to interpret the impact of the agreement.

1.5 Limitations of the Study

The primary object of this study is Swedish manufacturing firms. A firm is considered to be Swedish if it is owned by more than ten percent by a Swedish source, or if the firm has strong connections to Sweden. Although this study does not include firms from other European countries, some general assumptions can be drawn from the Swedish experience.

The firms involved in this study are not strictly of a manufacturing nature. Despite manufactured goods are their main products, these are often complemented by such services as customer support. Embedded services performed by manufacturing firms themselves are not part of trade statistics presented in this paper; nonetheless they have been briefly discussed during interviews as they are an important competitive advantage of Swedish manufacturing firms. In addition, one firm active in trading with manufactured goods and one retailing firm were also taken into account in order to obtain a more general overview of the agreement.

2. Theoretical Background

A theoretical framework consisting of an introduction to international trade theory, a historical background of PTAs, and the emergence of Global Production Networks (GPNs), will be the foundation for the following parts of this paper. An understanding of these areas is vital for full comprehension of the agreement and its impact on firms.

2.1 International Trade Theory

Theories regarding the benefits and disadvantages of trade have been discussed for centuries. International trade theory evolved from early mercantilist views, in which nations were believed to compete in a zero-sum game with winners and losers, to the theories of absolute (Adam Smith) and comparative advantage (David Ricardo). The latter view stated that even though some countries were more competitive than others, countries could still complement each other in an international division of labor (due to each nation's factor endowments) that enabled a higher world output, and in theory larger wealth (Krugman & Obstfeld, 2008).

While early theories could explain trade between countries with different characteristics, they were of less help in explaining trade between similar countries. Such models could not explain why countries of similar economic characteristics traded goods that both countries produced. Krugman presented a '*new trade theory*', stating that choice between similar products also matters to consumers. Countries can export and import goods of the same classification because consumers want to have a choice. '*Economies of scale*' is another central feature in Krugman's model. Industries with less economies of scale have a more local/regional fragmented production, while industries with large economies of scale can produce for a global market. The model presents arguments against constant return on economies of scale, which could provide rationale for the '*infant industry*' argument. Protection can sometimes contribute to the appearance of world leading firms. Hence, the model does not always support free trade (ibid.).

Ability to trade must be seen together with ambition to trade, i.e. trade policy. Throughout the 20th century, international trade was held back by certain barriers. Since its signing in 1947, the General Agreement on Tariffs and Trade (GATT, predecessor of the WTO) has been successful in reducing tariffs, although it has proven to be more difficult to tackle non-tariff barriers to trade (especially multilaterally) (Van den Bossche, 2008). Individual countries with homogenous exports might be strongly affected by tariff rates but in general, non-tariff

barriers are key obstacles to trade. According to the World Trade Report, half of the world trade is already subject to no tariffs (WTO, 2011).

2.1.1 Advantages and Disadvantages of Free Trade

Arguing for free trade might be easy in theory, but it is complicated in reality. Trade negotiations are more influenced by politics than economic theory. One of the most intricate issues of free trade is that even though it brings benefits to the world as a whole, it will inevitably hurt some people/industries/companies in certain regions/countries (Stiglitz, 2002). In turn, government in regions negatively affected by free trade might try to offset the negative impact by raising tariffs or imposing other barriers to trade. Populist measures are often seen positively by the local population but can in the worst case scenario lead to escalating barriers to trade and increased protectionism. The victims of free trade are more visible (and more loud, often with support from lobby organizations) than the combined benefits of trade to consumers. Ewa Björling, the Swedish Minister for Trade and advocate of free trade, stressed the impact of the recent EU-South Korea FTA on Swedish consumers. She stated that many consumer goods will become more affordable (Björling, 2011).

Joseph Stiglitz (2002) points out the negative aspects of free trade, and that it is not the only option for countries. European automotive manufacturers lobbied aggressively against the EU-South Korea FTA, unwilling to face increased competition in an industry already injured by overcapacity (ACEA, 2009). Stephen Odell, head of the European division of Ford Motors, claims that he is neither opposing South Korea nor free trade but the agreement has created trade imbalances and that non-tariff barriers still exist for foreign firms in South Korea (Financial Times, 2012).

In contrast, the negative impact of protectionist measures to the competitiveness of companies is often neglected. When discussing factors as outsourcing, one often ignores the impact of insourcing by foreign companies enabled by openness to trade and investment. Countries might need to protect industries at a certain stage of economic development (i.e. infant industry protection). But in general, if an industry cannot remain competitive facing international competition, the forces working against its rationale are often too strong, and life support to an ailing industry puts a lot of pressure on taxpayers (Bhagwati, 2012).

As a safety measure, the agreement allows a re-introduction of tariffs if one part claims that there is a lack of compliance in the implementation of the FTA (European Commission, 2011a).

2.2 Theories on Preferential Trade Agreements

In addition to the debate on positive and negative impact of free trade, the recent surge in PTAs and its significance for multilateral trade negotiations have been widely discussed. Preferential trade is trade with favorable treatment of goods or services originating in member countries, thus discriminating non-members. This is allowed by the WTO because unilateral trade policies and protectionism restrict trade volumes of many countries. A PTA can offset the negative effects of such policies, however its general impact must be considered together with political circumstances. Preference margins are generally small and are not the main reason for negotiating a PTA. Half of the world trade today is subject to no tariffs. Additionally, commodities with high tariffs often maintain this level even after a PTA is concluded, as some categories might be regarded as sensitive. Non-tariff barriers and technical barriers to trade are seen by trade policy makers as important reasons for signing preferential agreements (WTO, 2011).

The number of PTAs has increased significantly from approximately 70 in 1990 to 300 in 2010. All WTO members, except Mongolia, participate in at least one PTA. Preferential trade theory suggests that PTAs increase trade between member countries and divert trade with non-members. Intra-PTA trade accounted for 35 percent of total merchandise trade in 2008, with half of it covered by bilateral and half by plurilateral agreements (ibid.).

The stalled negotiations of the Doha-round together with a changed economic geography and transnational production networks have been the main drivers for PTAs. A changed economic geography has also resulted in a broader and more groundbreaking agenda of trade negotiations, including investment measures, competition rules, standards, rules of origin etc. The WTO has expressed concerns over preference-based trade agreements' discrimination of partners not included in these agreements (Kawai & Wignaraja, 2011).

Bhagwati (2008) argues that the proliferation of bilateral PTAs has a negative impact as it undermines trade negotiations at a multilateral level. The '*spaghetti bowl*' of trade agreements also complicates regulation for companies. Others (e.g. Mansfield, 1998; Mavroidis, 2011) argue that pursuing bilateral agreements is a more pragmatic approach to trade and is the only way forward, i.e. bilateral PTAs are better than no agreement at all. PTAs enable governments to avoid disruptions in trade and to ensure market access and competitiveness for domestic companies in foreign markets (Mansfield, 1998).

An increasing number of trade agreements is complicating an understanding of trade policy for companies. Conflicts between different trade regimes have existed for long. Regional PTAs could potentially transform into a breakthrough in multilateral talks and provide a framework for deeper economic integration. In the World Trade Report (2011), the WTO notes that reforms done in a preferential agreement might eventually be applied non-discriminatory. Bilateral agreements can evolve into a plurilateral agreement. However, it is an ambiguous role for the WTO to allow preferential agreements while trying to pursue a multilateral agenda (Lindberg & Alvstam, 2012).

2.3 Localization Strategies

Transaction cost theory argues that a firm should outsource processes that are less value adding and are not competitive advantages of the firm. These processes can be sourced externally at lower cost at required quality. Production networks consist of both internal and external functions. Thus, components and services that can be bought at a lower cost should not be internalized within the firm (Anderson & Gatignon, 1986).

Dunning's eclectic paradigm (1988) is a successor of the transaction cost theory and is a common model for explaining investment, localization, and internationalization decisions of a firm. A firm either seeks ownership-, location-, or internalization advantages when venturing into foreign markets. The motivation of a internationalization process decides if firms export, license out production or engage in FDI. Firms' foreign investment is often of a market-seeking nature. Companies can also be resource-seeking and therefore locate operations where wanted material or labor is redundant, easy accessible, cheap or of high quality. Other firms seek efficiency through high productivity, beneficial tax regulations or in any other way advantageous business climate of that location (Dunning, 1988).

Firms' localization decisions also depend on what position they have in a value chain (Porter, 1985). Up-stream firms close to the source of natural resources are restricted to a place where the material can be extracted or a location where it can be inexpensively processed with unlimited energy supply (e.g. cement factories are fragmented due to its heavy weight and low cost per unit, which creates a need to be close to demand). In other industries with high value per unit, such as specialized steel, a rationale for exporting worldwide from one location might exist. On-stream companies have a different focus: they refine and combine raw materials and components into processed products. The production processes is crucial to these firms that often are linked in production networks. Labor, location and other costs

become important factors. Down-stream firms are producers of finished goods or involved in the marketing and distribution of goods. Such firms focus on market size and structure, and try to match their production chain in accordance with these factors (Porter, 1985).

2.3.1 Global Production Networks and PTAs

There are many questions a firm has to consider in relation to whether locate production in a specific market/region, simply export from home-market production facilities, or to export from a third country. Other alternatives to consider are usage of export hubs, amount of outsourcing, and in-house production, etc. A firm can outsource certain parts of its value chain that add less value or are not a firm-specific advantage. Outsourcing could either be up-stream (raw materials, components etc.), on-stream (processing of products/components), or down-stream (final assembly, distribution etc.) in the production process. Localization decisions of business units are often based on the integration type a company has, market or efficiency seeking, and the purpose of each business unit (Dunning, 1988).

Diminishing distance and time to trade has enabled TNCs to procure components wherever they can be produced at lowest cost and highest quality. These production networks have no clear-cut area of research. Many of the concepts involved have interdisciplinary origins and several theoretical definitions overlap. Nevertheless, they originate in the notion of the value chain, brought up by Porter in 1985, which outlines a business unit's primary activities (how inputs are processed into components/services), supporting activities (functions such as HRM, IT), and how all these contribute by adding value to the final output (Porter, 1985). However, GPNs are more complex than that. In reality, value chains are spread over several countries with internal and external functions linked. International trade has switched from trade in finished goods to trade in tasks performed in several countries (Grossman & Rossi-Hansberg, 2008). GPNs can be defined as '*the globally organized nexus of interconnected functions and operations of firms and non-firm institutions through which goods and services are produced, distributed, and consumed*' (Coe, 2009, p. 557). Coe explains further that GPNs distinguish themselves through clear extra-firm networks, are multi-scalar (cover many different perspective, from local to global), move beyond the notion of a chain (vertical horizontal mesh), complex to govern, and finally that the networks have to be considered in relation to their environment and to the isomorphic impact that exist between the firm and its surrounding (Coe, 2009).

Transnational corporations' (TNCs) production networks were not only made possible by diminishing barriers to trade, but they are also the *de facto* drivers of international trade,

especially in intermediate goods (Feenstra, 1998). The latter goods make up an increasing share of international trade, as much as 50-80 percent today depending on trading partners (Miroudot, Lanz, & Ragoussis, 2009). The scale of trade in parts and components within different PTAs vary significantly. Regional PTAs in areas with integrated production networks are likely to boost intermediate trade, up to 35 percent in some cases (WTO, 2011). Conversely, if there is extensive intermediate trade within a region, signed preferential agreements are likely to have more depth. A regional clustering of tasks has enabled emerging countries in East Asia to join production networks at their stage of economic development: networks of individual suppliers specializing in specific services or phases of production (Baldwin, 2008). Non-equity modes of production, such as flexible arrangements with local firms, offer a lower threshold for including a specific country into a production network (WTO, 2011). For South Korea, intermediate goods made up 54 percent of exports and 70 percent of imports (non-fuel value) in 2009 (WTO & IDE-JETRO, 2011). Investment chapters in PTAs are also important for efficient production networks (ibid.).

Country of origin is an important definition since it is the basis, on which free trade can be granted, and it is often a complicated matter when two or more countries have been involved in the production process (WTO & IDE-JETRO, 2011). Members have to prove that the manufactured goods give them right to preferential treatment. A PTA might also change the feasibility of all components of a product, and countries might possibly switch to trading partners within existing preferential treaty: existing strict rules of origin are likely to motivate firms to switch to suppliers covered by the agreement (WTO, 2011). Country in which final assembly is done is often appointed as country of origin, which can skew statistical figures and attitudes towards trade policy and trade negotiations. Trade surpluses do not often show an accurate picture of world trade. Final assembly boosts trade statistics in a misleading way. For instance, only a small fraction of an iPod's value is added in China although the final product is recorded in statistics as Chinese (Linden, Kraemer, & Dedrick, 2009). Sturgeon and Gereffi (2009) state that '*even the best trade statistics ... can only hint what is happening in GVCs*' (Global Value Chains) (Sturgeon & Gereffi, 2009, p. 5). This makes it more appropriate to talk in terms of added value, or tasks, rather than finished goods. However, no such statistical measure exists yet (trade in services is in fact a measure of value added, but statistics on trade in services is less detailed than trade in goods and is more difficult to classify) (Grossman & Rossi-Hansberg, 2008).

The emergence of GPNs has a more practical implication for firms: they have to decide how to organize their supply activities to meet global demand and to minimize production cost while maximizing utilization of global competencies and adapting to local, regional and global institutional forces (Kawai & Wignaraja, 2011). Surveys by the Asian Development Bank and the Inter-American Development Bank reveal that approximately one quarter of firms did make use of PTA preferences. Small firms have difficulties exploiting benefits while firms with more resources are likely to make use of PTA preferences (WTO, 2011).

2.4 Theoretical Summary

A review of the three main areas of research relevant to this study (i.e. trade theory, preferential trade agreements, and global production networks) has been provided to form a suitable setting for the following study. Not all theories covered are directly applied when presenting the findings of this study, although they are needed for a wider perspective.

General trade theory explains why do nations trade and what benefits can be derived from trading, and is less applicable on firm level. The subsequent discussion on positive and negative effects of free trade policy is necessary since different views and attitudes exist on free trade and PTAs. They are complementary to multilateral trade negotiations and do not have the same agendas. Research within preferential trade can help to explain firms' attitudes towards PTAs, especially as these are likely to be an important part of trade liberalization during the coming decades.

The last section presents theories on global production networks. Diminishing transport costs and removal of barriers to trade have enabled TNCs to build capabilities through global supply chains. TNCs are not only a product of diminishing barriers to trade but also one of its causes, boosting and changing the pattern of international trade. Cross-border production networks, especially of regional nature, promote freer trade and non-discrimination. Theories regarding localization decision and production networks are used in the analysis of Swedish firms' activities in South Korea.

3. Korean Trade Policy

This chapter gives an overview of South Korea's attitudes towards trade in general, its reflection on tariffs on goods, and also describes attempts for regional and international integration in form of PTAs the country has signed or are currently negotiating.

The country has a low rank in the World Bank's MFN (Most Favored Nation) Trade Tariff Restrictiveness Index, occupying the 83rd place out of 125 countries. MFN applied tariff was 12.1 percent (simple average) during the period of 2005-2008, although a trade weighted average was only 7.3 percent during the same period. Applied tariff on agricultural products were 90.2 percent in 2005-2008 while non-agricultural products on average had 3.7 percent in tariffs (World Bank, 2010). The Korean government traditionally has had high tariffs on agricultural products. As it is a geographically small country with scarce resources it seeks to decrease dependency on other countries in energy and food sectors.

In addition to the introduced trade agreement with the EU, South Korea is currently discussing or has recently concluded PTAs with several other trading partners. Most significant is a FTA with the US and potential future agreements with China, India and Japan. South Korea also has PTAs with ASEAN (Association of South East Asian Nations) members and EFTA (European Free Trade Association). For most countries preferential agreements have been more viable than pursuing trade liberalization in the multilateral arena (Kawai & Wignaraja, 2011).

So far, Asia has had little success in attempts of deeper economic integration. Most PTAs in Asia are rather weak and not especially revolutionary (Ahnlid, 2011). South Korea, located between the economic giants of China and Japan, has little bargaining power in comparison to them. Achieving a regional FTA including all major Asian economies would be highly influential, but is currently unlikely to materialize. There is an ongoing discussion about a China-Japan-South Korea trilateral FTA, although there are many controversies that have proven difficult to overcome even at a bilateral level (The Economist, 2012). First of all, due to underlying disputes between the regional powers (e.g. India-China, China-Japan, Japan-South Korea). For instance, war crimes are still a barrier to political unification between South Korea and Japan. Second, disagreement exists due to excised regional competition between two different formats of trade liberalization. ASEAN+3 (ASEAN members plus Japan, China, and South Korea) and a Trans-Pacific Partnership (TPP) with the US, Australia, Vietnam, Malaysia, and Chile as important partners (Japan and Singapore joined discussions

recently), are two different arenas for regional and inter-regional trade liberalization, and in part conflictive against each other and with other bilateral negotiations. Countries are reluctant to grant foreign companies access to their home market but unwilling to fall behind competing countries with similar agreements in place or under discussion (Ahnliid, 2011).

South Korea, as already mentioned, has been able to sign FTAs with ASEAN members. Despite being a regional association, individual agreements had to be negotiated with each member. Hence, there are differences between these agreements and how far-reaching they are in character. Each agreement has its own list of sensitive products excluded from the agreement and regulating to what degree foreign companies are granted access. The same is valid for ASEAN's regional trade agreement, the AFTA. It is in fact a number of bilateral agreements signed bilaterally between all partners (Baldwin, 2008).

3.1 Overview of the EU-South Korea Free Trade Agreement

The EU-South Korea FTA covers a wide range of areas with trade in goods, services, and investment measures being the most important provisions. European companies are to experience better market access in South Korea and vice versa. The parties shall remove both custom duties and non-tariff barriers (NTBs). Almost all custom duties on industrial goods are to be fully removed over a transitional period of five years, eliminating 98.7 percent of duties between the parties (or an estimated 1.6 billion euro in value). Four annexes outline the elimination of duties in the important industries of consumer electronics, motor vehicles, pharmaceutical products and medical devices, and chemicals (European Commission, 2011a).

The full impact of the agreement is yet to be seen, but statistics show increasing trade between the EU and South Korea in the second half of 2011. Export of cars from South Korea to the EU increased by 84 percent in July 2011 compared to July 2010; petrochemicals increased by 81 percent and metal/machinery by 241 percent. Export of aircraft and its components from the EU to South Korea increased by a staggering 1,693 percent. It occurred due to a large order of aircraft by a Korean carrier. Export of European cars and machinery grew by 96 and 55 percent respectively during the same period (Embassy of Sweden, 2011). However, it is difficult to estimate how much of this increase can be attributed to a recovery in the world economy after the crisis of 2008 and how much to effects of the agreement.

The agreement has the largest impact on machinery and appliances sector due to its size. The FTA is estimated to remove 450 million euro in tariffs within this sector annually. The chemical sector is projected to benefit from duty savings of 175 million euro. Some smaller industries show remarkable improvement in trade conditions. Footwear and textiles are industries where a significant share of duties has been removed (95 and 93 percent correspondingly). Iron and steel also see a 93 percent removal of tariffs. Agricultural and other sensitive sectors remain, at least partially, protected (European Commission, 2011a).

The central aspect to examine when classifying country of origin is the substantial transformation that is giving the product its characteristics (WTO & IDE-JETRO, 2011). A product originates in the EU or South Korea if it has been wholly manufactured, or sufficiently processed there. To be perceived as sufficiently processed, goods require a physical transformation of goods resulting in change of tariff heading, a certain local percentage of value added, specific operations of significant importance, or a combination of the factors stated above. The situation is further complicated when European producers can use Korean inputs, and still claim the product is originating in the EU. The process also has to go beyond minimal operations to originate in one of them and be transported directly from one to another (transshipping and warehousing is allowed but must be accompanied by a separate bill of lading indicating point of destination). Goods must be accompanied by an origin declaration to receive preferential treatment (European Commission, 2011a).

The agreement on services is an interesting part of this agreement. It goes beyond the General Agreement on Trade in Services (GATS) of the WTO and is the most far-reaching FTA in services signed by the EU. It liberalizes investment regulation, foreign ownership requirements, and market access in most service sectors (ibid.).

The Dispute Settlement mechanism is similar to that of the WTO but has a strong focus on reaching quick solutions through mediation. Six specialized committees have been created to overlook the FTA, and seven working groups continue to discuss important issues. Appendix A provides more detailed information on the agreement (European Commission, 2011a).

In order to increase awareness of the agreement, the European Commission held a number of conferences for different stakeholders. The aim was to present the agreement in its implementation process (European Commission, 2011b).

3.2 South Korean FTAs with the US and EFTA

A FTA between the US and South Korea (KORUS) has been ready for several years, but stalled by political opposition in the US. It has also faced much criticism in South Korea, sometimes resulting in strikes. The agreement entered into force on March 15, 2012. It has been long since the US concluded such a groundbreaking trade agreement (the North American Free Trade Agreement (NAFTA) is the only agreement greater in size and scope) and it is the most influential FTA for the US with an Asian country. Almost 80 percent of duties on American consumer and industrial goods to South Korea will be instantly removed, while 95 percent of tariffs on all bilateral trade shall be removed after five years (Congressional Research Service, 2011). Interesting is that tariffs on sensitive products, such as agricultural products, will also be eliminated over a certain period of time. The agreement also infers significant commitment to increase market access in the services sector, opening up virtually all sectors for cross-border investments. South Korea already has strong ties to the US, and this agreement will cement this partnership. The US currently has a trade deficit with South Korea in goods and a surplus in services. The agreement is estimated to increase American merchandise export to the country by ten billion US dollar and by the same amount for Korean exports to the US (ibid.).

A FTA between South Korea and EFTA was launched in 2006. It covers trade in goods, services, government procurement and intellectual property issues. This was the first FTA between South Korea and any European country. It has similar features to the Korean agreement with the EU but is different regarding the agricultural sector. South Korea and the members of EFTA (i.e. Iceland, Norway, Liechtenstein, and Switzerland) have similar views on agricultural protection and reaching an agreement has thus been easier. Tariffs on agricultural goods are to a large extent excluded from the agreement. South Korea has become an important trading partner of the EFTA countries. Trade in services and bilateral investment have also been enhanced. Bilateral trade in goods numbered three billion US dollar in 2005 and it has since substantially expanded to 5.7 billion US dollar in 2009 (EFTA, 2012).

4. Trade between South Korea and the EU

The following chapter provides a general description of South Korea's trade with the EU and Sweden in focus. A detailed description is given on merchandise trade using the Standard International Trade Classification (SITC).

4.1 General Overview of Trade

In 2011, world total trade grew by 6.6 percent (down from 14 percent in 2010). Merchandize trade grew by 19 percent (compared to 22 percent in 2010). The decline occurred mostly due to weak economic situation of developed countries (e.g. European sovereign debt). The Asian region led the development and its exports grew by 30 percent and returned to a pre-crisis level of exports. Europe, although showing eleven percent export growth, did not reach this level yet. In general, developing countries show better economic performance than developed economies during 2010-2011 and this trend is likely to continue even in 2012-2013, when estimated world trade growth will be five percent (UN, 2012).

An important shift in trade patterns occurred in recent years: due to flexibility of developing economies under the crisis and rapid industrial development, South-South trade grew by 14 percent in 1995-2011 compared to the world average eight percent under the same period. Under these circumstances, free trade agreements with Asian countries are becoming more important (ibid.)

4.2 South Korean Trade

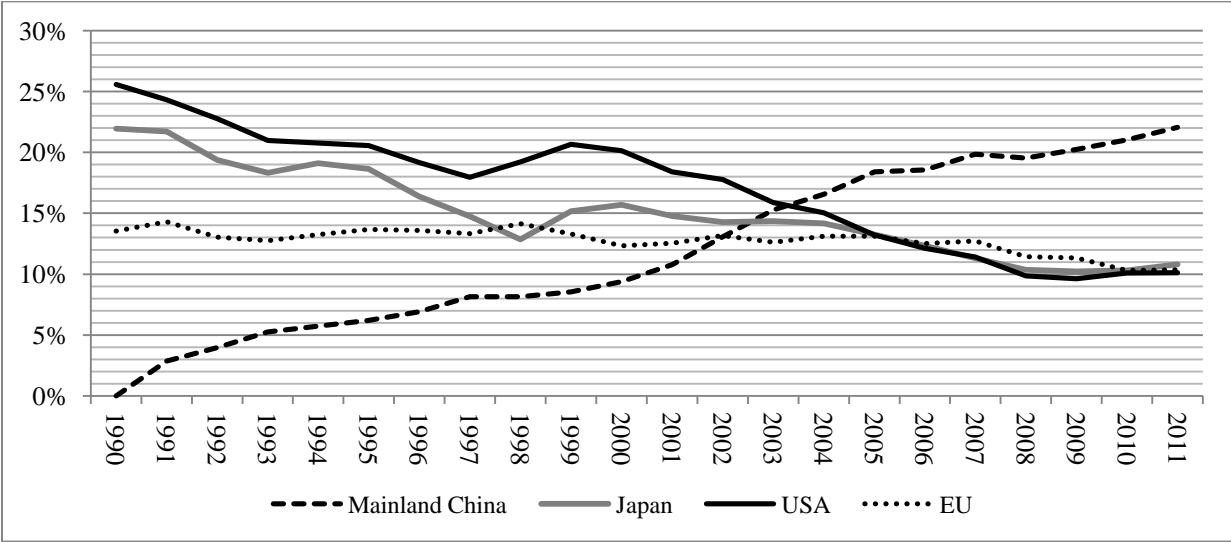
In 2009, Korean exports decreased by 14 percent and imports by almost 26 percent. During 2010-2011, the country experienced a considerable growth in both exports and imports, reaching 555 and 524 billion of US dollar in 2011 respectively (KITA, 2012). South Korea plays an important role in world trade and was the seventh largest exporter and ninth largest importer of merchandize goods in 2011, accounting for 2.3 and 2 percent of the total exports and imports respectively (WTO, 2012b).

South Korea's main export destinations were China, the EU, the US, Japan, Hong Kong and Singapore in 2011. The first four countries and Saudi Arabia are also the main sources of imports to South Korea. In general, Korean trade is well diversified: 18 trading partners made up 80 percent of total imports and 24 accounted for 80 percent of exports (KITA, 2012).

Figure 1 presents selected partners' share of total Korean trade. It can be clearly seen that the major trading partners of South Korea (e.g. Japan and the US) have been replaced by growing

importance of mainland China: in 2011 its share was 22 percent in comparison to almost zero in 1990. It should be noticed that although mainland China officially maintained a zero level of trade before the 1990s, it traded indirectly through Hong Kong. The share of the European Union remains rather stable until 2005, but has since slightly declined, and contributed to ten percent of total Korean trade in 2011 (IMF DOTS, 2012).

Figure 1
South Korean total trade per selected partners in 1990-2011 (percent)



Source: IMF DOTS, 2012

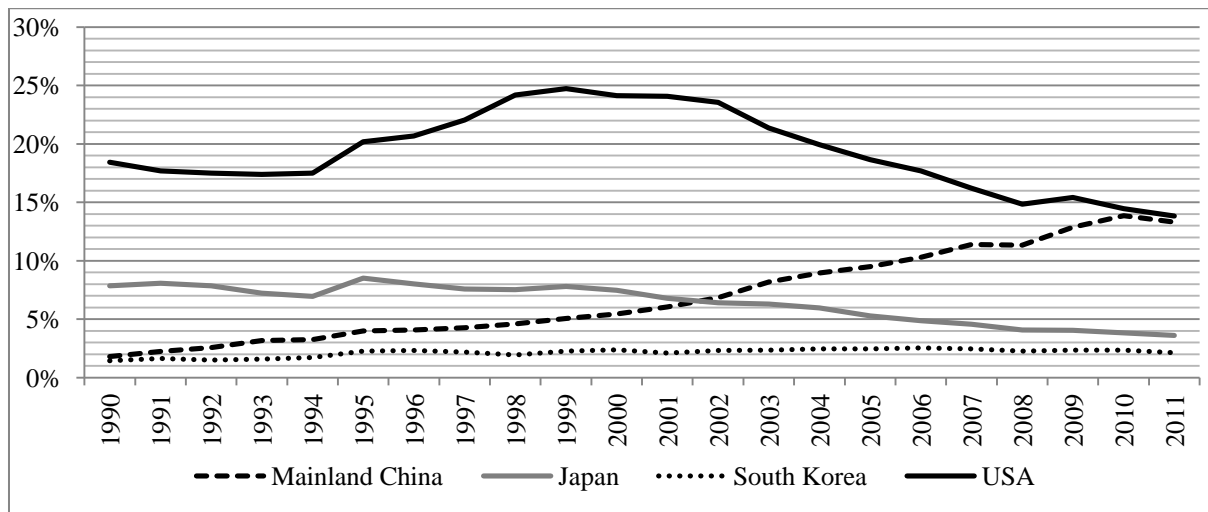
4.2.1 Trade between South Korea and the EU

South Korea is an important trading partner of the European Union: in 2011 the country was its tenth largest export and eleventh largest import partner (2.1 of both total exports and imports). At the same time, the EU is one of the major trading partners of South Korea: almost twelve percent of the country’s exports go to the EU, which makes the union the second largest export destination for South Korea. Regarding imports, the EU occupies the fourth place and contributes 9.4 percent of the total imports of the country (Eurostat, 2012).

The following figure shows the EU’s total trade per selected trade partners. In general, the main trends follow the same path as in South Korea: mainland China’s share of trade is rapidly growing, while the US and Japan are losing their positions as leading trading partners (Eurostat, 2012). Being the largest exporter in the world, China has overtaken a share of Korean trade with Europe (WTO, 2011). Nevertheless, South Korea has been able to maintain its trade share with the EU during the last two decades without drastic changes (figure 2).

Figure 2

EU's total trade per selected partners in 1990-2011 (percent)



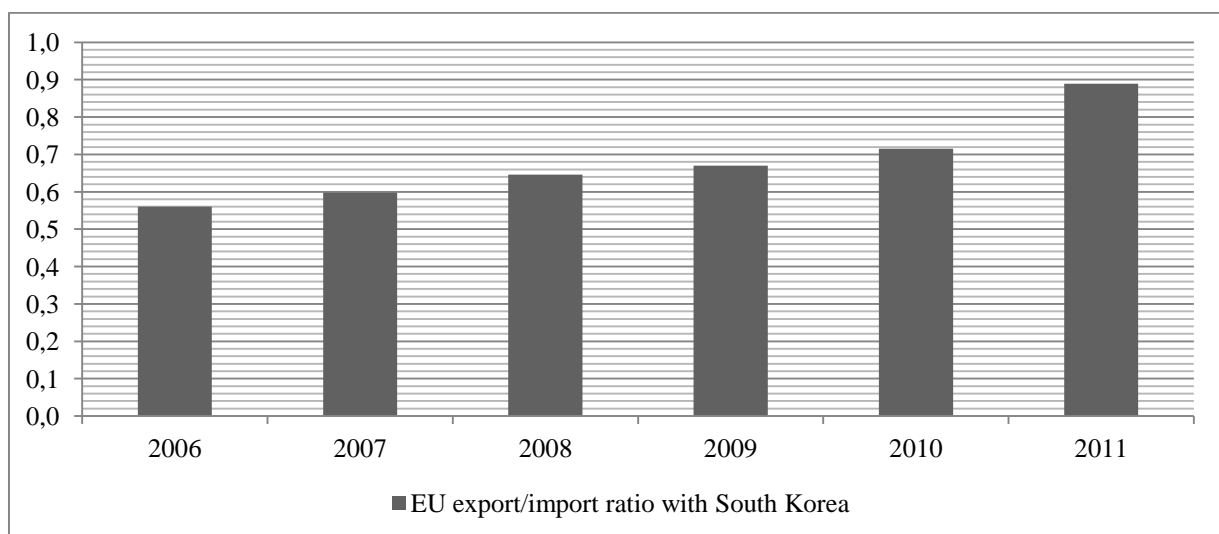
Source: Eurostat, 2012

It is important to note that intra-European trade accounts for a larger part of both imports and exports of the EU than external trade (e.g. 79 percent of agricultural goods were traded within Europe in 2010) (WTO, 2012a).

Figure 3 shows the EU export/import ratio with South Korea. It can be clearly seen that although there is a considerable trade surplus in favor of South Korea (approximately five billion US dollar in 2011), the surplus is gradually decreasing. It occurred mostly due to a major increase in European exports to South Korea.

Figure 3

EU's export/import ratio with South Korea in 2006-2011



Source: IMF, 2011; Eurostat, 2012

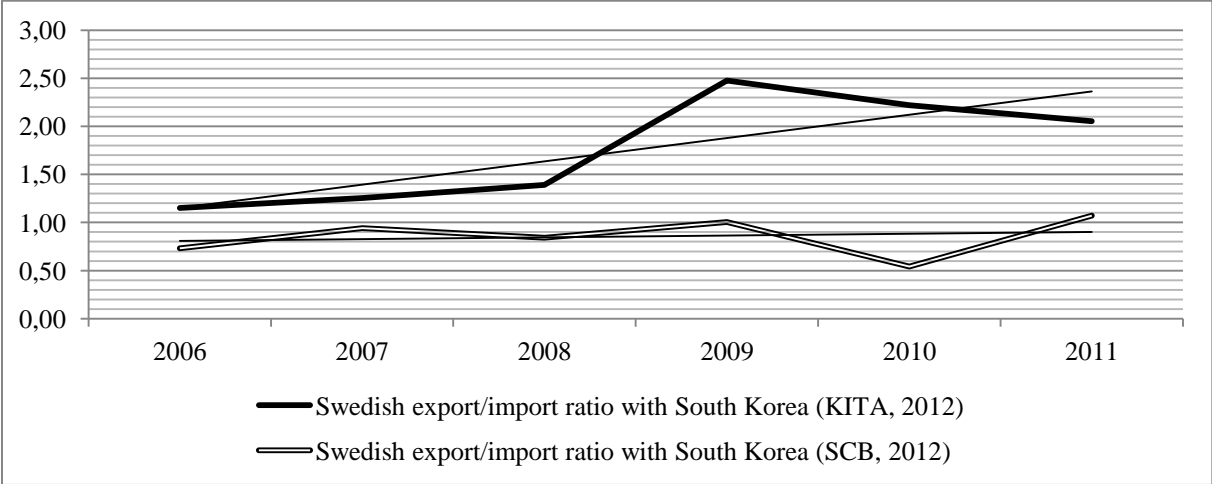
In 2011, European exports to South Korea reached approximately 42 billion US dollar (comparing to 28 billion in 2006) and imports made up 48 billion US dollar (51 billion in 2006) (Eurostat, 2012). This fact cannot be solely attributed to the FTA’s entry into force in 2011. A recovery from the economic crisis of 2008 should not be neglected.

4.2.2 Trade between South Korea and Sweden

Following the same trend as the European Union, Sweden experienced a constant growth in trade until 2009, when the amount of exports decreased by almost 29 percent (down to 131 billion US dollar). However, in 2011 Swedish exports increased to approximately 180 billion and imports to 170 billion US dollar. The country’s trade surplus has decreased but nonetheless reached ten billion US dollar (SCB, 2012).

Sweden’s imports in 2011 were less diversified than exports: only 14 countries accounted for 80 percent of the total imports, while 22 countries contributed to the same percentage of total exports. The main export destinations outside the EU were Norway, the US, China, Russia and Australia, however most of the top partners were inside the EU: Germany, the UK, the Netherlands and France. Most imports came also from Europe: Germany, Norway, Denmark, the Netherlands, the UK, Finland and Russia (ibid.).

Figure 4
Sweden’s export/import ratio with South Korea in 2006-2011



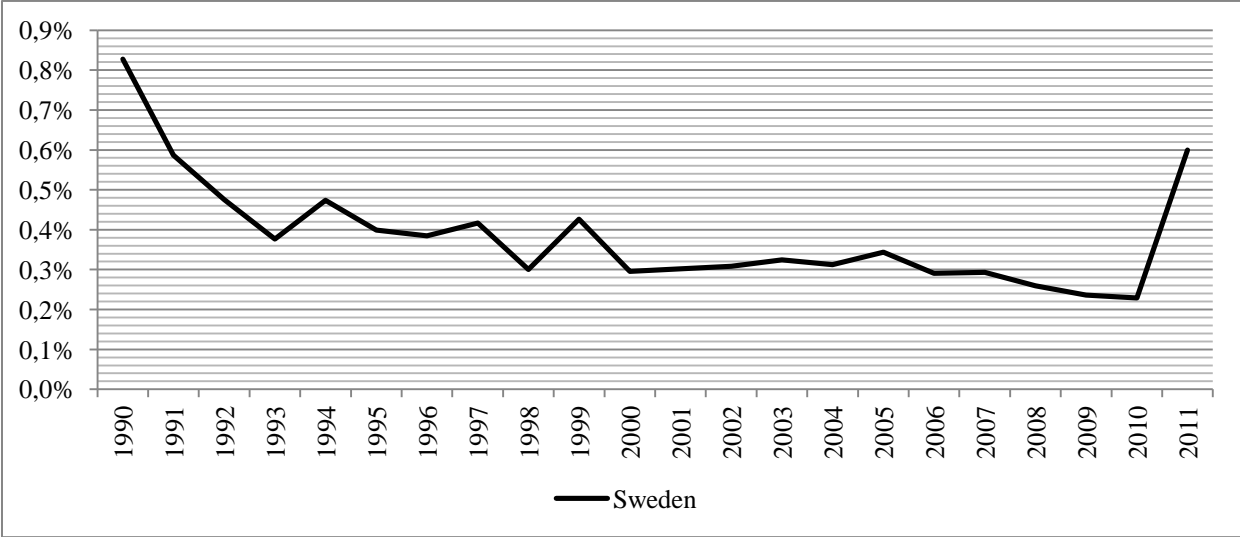
Source: KITA, 2012; SCB, 2012

Figure 4 shows export/import ratio of Swedish trade with South Korea in 2006-2011. It is characterized by a surplus in favor of Sweden, which was rapidly growing until 2011 and increased by as much as 40 percent in 2011, accounting for more than one billion US dollar (KITA, 2012). Although national sources differ in numbers, the overall trend is rather similar: the Swedish export/import ratio with South Korea is increasing.

As mentioned in chapter 1.4.3, the discrepancies in statistics are likely to originate in differences in reporting systems (e.g. strategic industries such as defense are not mirrored in statistics, time lags, and currency fluctuations). The low rank of Sweden in the trading partner list of South Korea as well as major discrepancies in statistics from the national sources (figure 4) can also be explained by the fact that a considerable amount of exports from South Korea to Sweden go through large and more convenient cargo ports in Europe (e.g. Rotterdam, Hamburg, Antwerp). Korean goods with Sweden as final destination are often recorded as ones destined for instance to the Netherlands, Germany, etc. Sweden might record such goods as products imported from the EU. On the other hand, Swedish goods designated to South Korea are often re-exported to this country through hubs in China and therefore might be recorded as Chinese (WTO, 2011).

The volume of trade between the countries has increased significantly, reaching approximately two billion US dollar in Swedish exports to South Korea and one billion US dollar in Korean exports to Sweden in 2011. South Korea was the 14th largest importer to Sweden and the 26th largest export destination. Sweden is less important for South Korea, which is illustrated in figure 5. Sweden was only the 68th in the list of the most important destinations for Korean exports and the 35th of the largest importers in 2011 (KITA, 2012).

Figure 5
Share of Sweden in total trade of South Korea in 1990-2011 (in percent)



Source: IMF DOTS, 2012

Comparing trade statistics from official sources of Sweden and South Korea, a considerable difference was found in 2010 data. While Korean statistics showed a progressive increase in trade surplus in favor of Sweden during the last years, Statistics Sweden showed a large

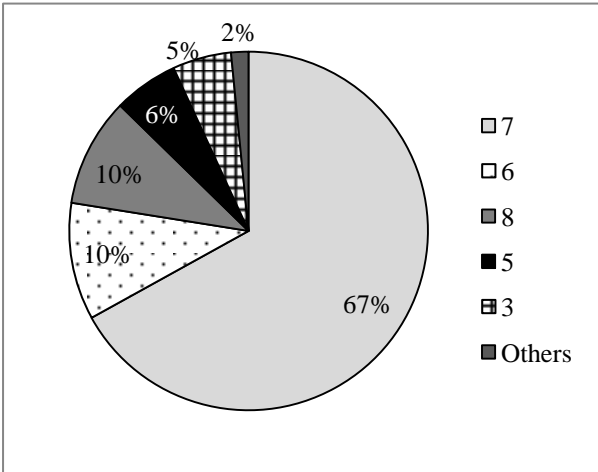
(almost one billion US dollar) negative balance in its trade with South Korea (SCB, 2012). Looking at a more detailed level, it was noticed that machinery and transport equipment (SITC-7) in Swedish data of 2010 had a significant increase in value (more than 2.5 times) compared to other years. Following the data down to 5-digit SITC level, it was found that electronic integrated circuits and microassemblies (SITC-77649) experienced almost ten-fold growth in 2010. On the contrary, Korean statistics showed a sudden increase in this subgroup in 2009 (KITA, 2012). Nevertheless, this increase cannot explain such differences in data as its value was considerably lower than the one in Swedish statistics (225 thousand and almost 1 billion US dollars respectively). It is possible that this transaction was reported by Sweden in 2010, while South Korea recorded it in 2011, when SITC-776 group increased by 77 percent (no data is available for 5-digit level in 2011) (KITA, 2012; SCB, 2012).

4.3 Trade by Main Commodity Group

4.3.1 South Korea - the EU

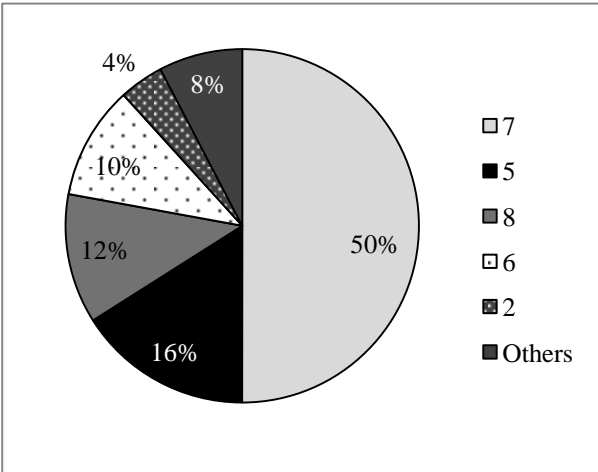
Figure 6 shows Korean exports to the EU by main commodity groups in 2011. It was dominated by machinery and transport equipment (67 percent of the total imports from South Korea). Main exported items of this group were ships, motor cars, valves, automatic data processing machines and telecommunication equipment. Other major groups of exports in 2011 were miscellaneous manufactured goods (optical instruments) and manufactured goods classified by material (products of iron steel, rubber tyres, etc.), each accounted for ten percent of total exports (KITA, 2012).

Figure 6
Korean exports to the EU by main commodity group in 2011 (in percent)



Source: KITA, 2012

Figure 7
Korean imports from the EU by main commodity group in 2011 (in percent)



In 2011, half of Korean imports from the EU was machinery and transport equipment (group 7 according to SITC classification) (figure 7). The main single items of this group were telecommunication equipment, engines motor vehicles for goods and mechanical handling equipment. Other large groups of imports were chemicals and miscellaneous manufactured articles (16 and 12 percent respectively). Together these groups made up almost 80 percent of the total Korean imports from the EU (KITA, 2012).

4.3.2 South Korea - Sweden

Almost 37 percent of Swedish exports to the world in 2011 were machinery and transport equipment, followed by manufactured goods and chemicals (18.6 and eleven percent respectively). The main import commodities were petroleum oils, other than crude, telecommunication equipment and medicaments (SCB, 2012).

Figures 8 and 9 show a breakdown of Korean exports and imports to and from Sweden in 2011 by SITC commodity groups. Machinery and transport equipment (SITC 7) accounted for 78 percent of the total Korean exports to Sweden, followed by manufactured goods, classified by material (14 percent) and chemicals (four percent). Main exported items were ships, motor cars, household electrical equipment, and products of iron steel (KITA, 2012).

As of Korean imports from Sweden, their structure is rather similar to exports: 67 percent of exported goods belong to machinery and transport equipment, 18 percent to manufactured goods and eight percent to chemicals (ibid.).

Figure 8
Korean exports to Sweden in 2011 (in percent)

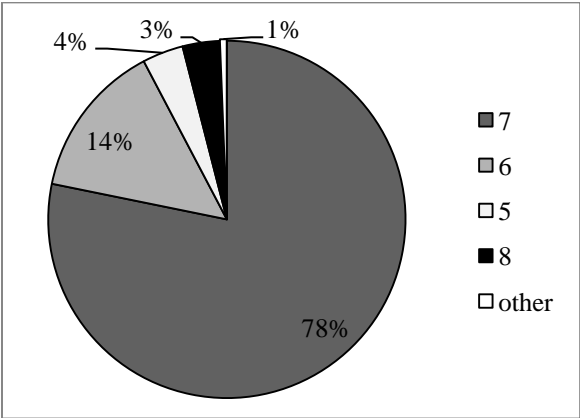
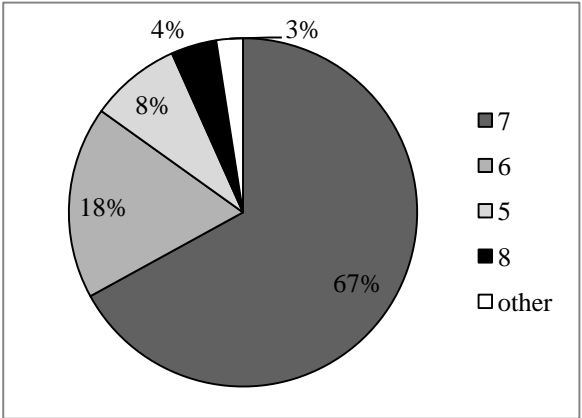


Figure 9
Korean imports from Sweden in 2011 (in percent)



Source: KITA, 2012

Trade between South Korea and Sweden during recent years has been dominated by SITC groups 7 and 6 (machinery and transport equipment, and manufactured goods, classified by materials) in both exports and imports.

The following table lists the top ten goods that were exported from Sweden to South Korea in 2009-2011. In 2011, these goods together accounted for 60 percent of total imports from Sweden. It can be easily noticed that telecommunication equipment (SITC 764) dominates imports and accounts for 30 percent of total imports from Sweden. Main items of this group were radar apparatus, radio navigational aid apparatus and radio remote control apparatus (KITA, 2012).

Table 1

Ten major items exported from Sweden to South Korea in 2009-2011 by SITC classification

SITC	Name	Value in 2011 (thousand USD)	Share of Korean imports from Sweden (2011)	Share of Korean imports from Sweden (2010)	Share of Korean imports from Sweden (2009)
764	Telecommunications equipment, n.e.s.	649288	30%	2%	4%
713	Internal combustion piston engines, and parts thereof	116352	5%	5%	3%
675	Flat-rolled products of alloy steel	99931	5%	5%	5%
782	Motor vehicles for the transport of goods and special-purpose motor vehicles	87476	4%	6%	3%
542	Medicaments (including veterinary medicaments)	67990	3%	4%	4%
744	Mechanical handling equipment, and parts thereof, n.e.s.	62292	3%	3%	2%
671	Pig-iron, spiegeleisen, sponge iron, iron or steel powders	56627	3%	3%	3%
728	Other machinery and equipment specialized for particular industries; parts thereof, n.e.s.	54373	3%	8%	5%
874	Measuring, checking, analyzing and controlling instruments and apparatus, n.e.s.	50116	2%	3%	5%
741	Heating and cooling equipment, and parts thereof, n.e.s.	46374	2%	4%	6%
	Total	1290819	60%	43%	40%

Source: KITA, 2012

Analyzing Korean imports from Sweden in 2009-2011, one can notice that imports tend to become less diversified: top ten imported products made up only 40 percent of the total imports from Sweden in 2009.

Swedish imports from South Korea are less diversified than exports (table 2). The top ten products made up 78 percent of the total imports from South Korea in 2011. Most of the items in top ten belonged to SITC group 77 “*Electrical machinery, apparatus and appliances*”. Two largest imported items were valves and tubes, and ships and boats (SCB, 2012).

Table 2

Ten major items imported from South Korea to Sweden in 2009-2011 by SITC classification

SITC	Name	Value in 2011 (thousand USD)	Share of imports from South Korea (2011)	Share of imports from South Korea (2010)	Share of imports from South Korea (2009)
776	Thermionic, cold cathode or photo-cathode valves and tubes	248522	21%	70%	34%
793	Ships, boats (including hovercraft) and floating structures	225778	19%	0%	0%
764	Telecommunications equipment, n.e.s., and parts, n.e.s., and accessories of apparatus falling within division 76	120118	10%	5%	14%
781	Motor cars and other motor vehicles principally designed for the transport of persons	117458	10%	3%	7%
674	Flat-rolled products of iron or non-alloy steel, clad, plated or coated	60076	5%	2%	6%
778	Electrical machinery and apparatus, n.e.s.	46768	4%	2%	3%
625	Rubber tyres, interchangeable tyre treads, tyre flaps and inner tubes for wheels of all kinds	43972	4%	2%	5%
775	Household-type electrical and non-electrical equipment, n.e.s.	32024	3%	2%	3%
784	Parts and accessories of the motor vehicles of groups 722, 781, 782 and 783	21415	2%	1%	2%
772	Electrical apparatus for switching or protecting electrical circuits	19069	2%	1%	1%
	Total	935199	78%	88%	75%

Source: SCB, 2012

In general, the countries' bilaterally traded items belong to the same SITC groups of sophisticated manufactured goods (i.e. high-tech industrial goods) differing only in last two digits.

4.4 Terms of Trade of South Korea

South Korea's terms of trade shows a decreasing trend (Ministry of Knowledge Economy, 2012). Since 2005 (index 100) the country's terms of trade (net barter index) has fallen to 79 in 2011. The figure was 175.3 in 1995. It shows decreasing terms of trade for Korean exports. However, it also indicates rising commodity prices (mainly food and oil) until the financial crisis in 2008 and decreased demand for Korean goods after it (World Bank, 2010). The fact that much of Korean companies' production has shifted to other countries makes the concept of terms of trade quite obsolete.

A country's terms of trade reflect the prices of exports compared to imports, i.e. what prices a country has to pay for imports and in turn how much does it receive for exports. It illuminates the products that are most beneficial to for production and trade. An appreciation of a nation's currency would make imports cheaper, and hence improve terms of trade, but it might also hinder exports since they have become more expensive for other countries. Terms of trade might also skew the statistical figure (e.g. an increase in world commodity prices will increase the value of exported goods even if the volume might in fact be the same) (WTO, 2011).

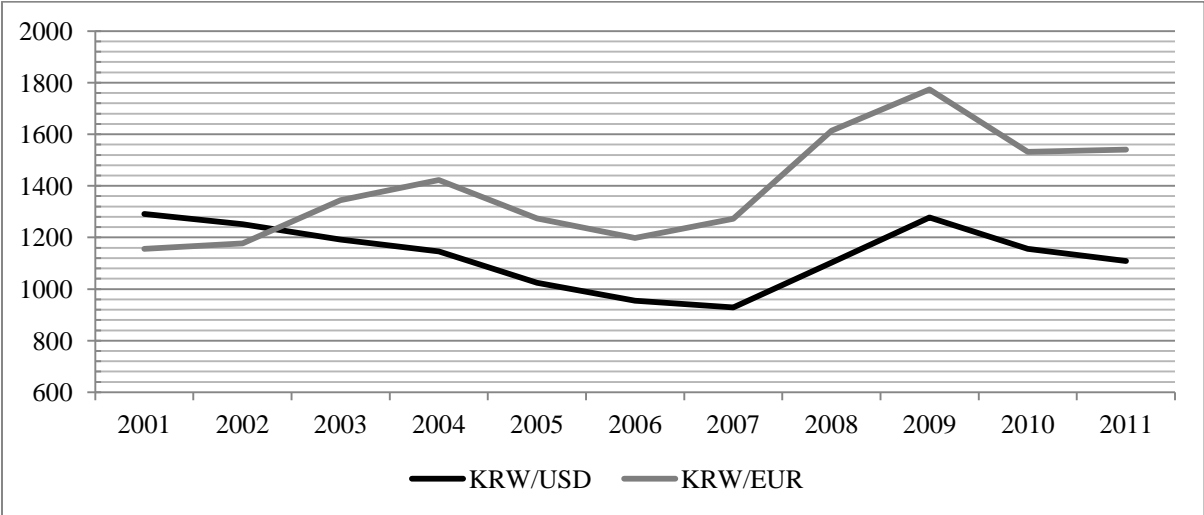
4.4.1 Exchange Rate Effect on Trade and Investment

Exchange rate fluctuations are important to follow for TNCs as their competitiveness depends on the price of their products in foreign markets. An appreciating of the domestic currency could offset, at least partially, the positive effects of a PTA. Predictability for trade and investment is vital in order to create a stable business environment. Most large companies deal with exchange rate fluctuations by hedging future revenue and costs in certain currencies. Currency fluctuations are likely to severely impact small exporting companies without advanced financial risk management systems. Currency fluctuations also alter and distort FDI statistics. An actual increase in FDI might be reflected as a decrease due to changes in exchange rate (UNCTAD, 2011).

The Korean won (KRW) was tied to the US dollar until the Asian financial crisis in 1997, when it was allowed to float more freely. Still, the won fluctuate less against the US dollar than other currencies. During 2004-2006 the won appreciated against the US dollar (USD) and the euro (EUR) (Figure 10). The Korean won was overvalued until 2007 followed by a rapid depreciation until 2009, where it was believed to be 30 percent undervalued. Over the last decade, the won has lost value against the euro but gained against the US dollar. During recent years, Korean exporting companies have benefitted from a depreciating currency that

made Korean exports more competitive in the global market, while the depreciation had adverse effect on the terms of trade of South Korea (Ogawa, 2010).

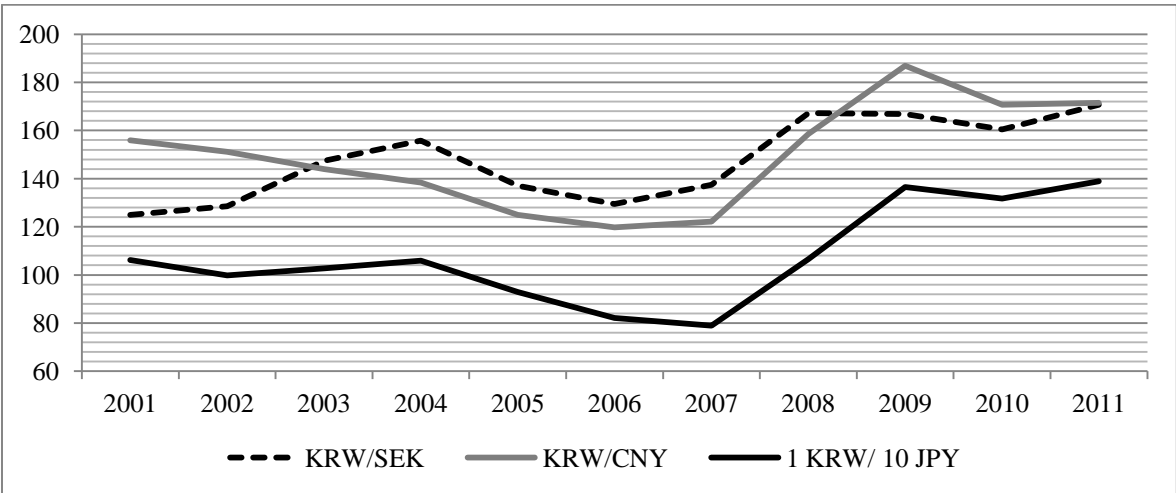
Figure 10
Exchange Rate of Korean won against US dollar and euro in 2001-2011



Source: IMF, 2012

In general, the development of the Korean won against the Swedish krona (SEK) resembles the one of the euro (cf. figures 10 and 11). The won has depreciated from 125 to 160 won per krona during the last decade. It might have put Swedish firms in South Korea at a disadvantage compared to Chinese, American, and European competitors with lower valued currencies.

Figure 11
Exchange Rate of Korean won against Swedish krona, Japanese yen and Chinese yuan in 2001-2011



Source: IMF, 2012a

The development pattern is rather similar when comparing the won against other Asian currencies (figure 11). The Japanese yen (JPY) is considered to be undervalued since 2008 (at about 10 percent) despite appreciation the last few years. Speculation in cheap loans in Japanese yen invested in currencies with higher interest rates (e.g. the Korean won) contributed to yen appreciation. In contrast to Korean companies, Japanese companies have suffered export decreases due to an appreciating currency. The Chinese yuan (CNY) along with the Korean won has been tied to the US dollar. It has continued to follow the development of the dollar even though it has no longer a fixed exchange rate. As China is an export-oriented economy, the Chinese government artificially holds back yuan appreciation in order not to injure its exports. These actions have provoked negative reactions in other economies whose exports potentially suffer from unfair Chinese competition (Ogawa, 2010).

As mentioned in the theoretical background, Asia has become a base for production networks in which value is added in a number of countries. Currency fluctuations complicate the predictability and planning of investment and trade. There is an ongoing discussion between ASEAN+3 to find a common currency unit (Asian Currency Unit) similar to the predecessor of the euro (European Currency Unit) (Ogawa, 2010).

5. Foreign Direct Investment in South Korea

This section begins with an overview of Korean FDI policy followed by statistics on European and Swedish FDI in South Korea in order to visualize the importance of European FDI for the country. The chapter also describes Swedish investment in South Korea during the last five years.

Foreign direct investment (FDI) can be defined as investment in which a firm acquires substantial controlling interest in a foreign firm. A substantial controlling interest is often referred to as a stake above ten percent. FDI comes in many forms: from acquisition of a foreign firm, setup of a regional sales office/subsidiary, joint venture with a local firm, to Greenfield host-market production, etc. (Chen, 2000). Companies can also venture into non-equity modes of investment (e.g. strategic partnerships, licensing, contract manufacturing), providing an alternative to trade and FDI, especially in developing countries (UNCTAD, 2011). Trade and investment do not have to be a substitution for each other. They can in fact be complementary. Liberalization of trade and investment policies has indicated mutually beneficial results (WTO & IDE-JETRO, 2011).

Production networks' activities (e.g. intra-firm trade, FDI, franchising, and services outsourcing) complicate policy-making for governments. Before the proliferation of GPNs, firms used to establish host-market production. Today, markets are more integrated and TNCs are organized in alternative ways (chapter 2.3.1). The relation between trade, investment and non-equity FDI must be understood before one can fully comprehend and predict the direct impact of a FTA on countries included in the agreement and indirect effect on third parties (UNCTAD, 2011).

5.1 Inward FDI Policy

South Korea has experienced extraordinary economic development since WWII. Successful economic planning, with *chaebol* (i.e. Korean business groups) being one of its main tools, helped to transform the country from a war-torn nation to a technologically advanced economy in just a few decades. South Korea's wealth was built on exports and the country acquired competencies in industries such as electronics, appliances, and personal vehicles. The Asian financial crisis struck in 1997 when South Korea was at an economic peak. *Chaebol* business groups were not only accredited as part of the Korean economic development but also were blamed for the crisis as received state support distorted

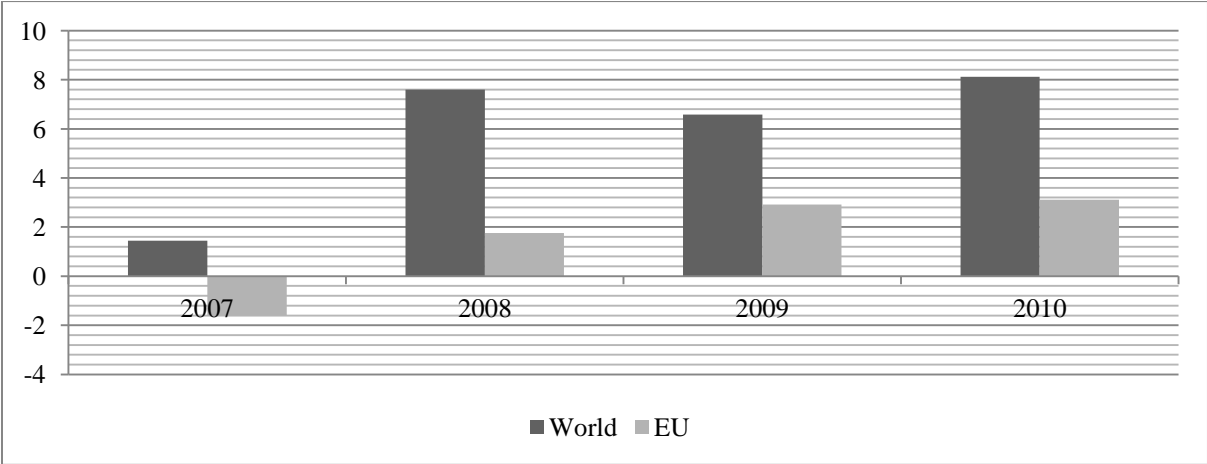
competition. *Chaebol* used the state as lender of last resort and did not give proper attention to market uncertainties and necessary economic restructuring (Ha & Lee, 2007).

After the crisis, South Korea liberalized its economy as part of an IMF rescue program (Sohn, 2002). Today the country plays an important role in Asian production networks, yet it lags behind in terms of attracting FDI as foreign investments make up a small share of FDI in relation to size of its economy. The country’s outward investment was almost three times larger than its inward investment in 2010 implying that South Korea has to improve its inward investment policy (OECD, 2012). Strong labor unions, unclear investment regulation, and a business environment dominated by the *chaebol* business groups are other factor that might have deterred investment from South Korea (Financial Times, 2010). The EU-South Korea FTA tries to address several of these issues.

5.2 European FDI in South Korea

The EU has been the largest investor in South Korea over the last few years, contributing to approximately 40 percent of total inward investment in 2010 (figure 12). Total inward FDI to South Korea was approximately eight billion US dollar with three billion from the EU.

Figure 12
EU and total inward FDI to South Korea 2007-2010 (in billion USD)



Source: OECD, 2012

Largest single investors during the last years were the Netherlands (28.1 percent) and the UK (25.6 percent). Swedish investment accounted for 2.9 percent of total European FDI in South Korea. Looking at the manufacturing sector the Netherlands was the largest investor (28 percent) followed by Germany (25 percent), the UK (9.5 percent), and Sweden (6.3 percent). Sweden accounted for a large share of European FDI in South Korea in manufacturing but not in services. Most European investment in the Korean manufacturing sector in 2005-2009 went to electrical and electronic equipment, transportation machinery, and chemicals. These sectors

together made up almost 75 percent of FDI within manufacturing (32, 22, and 20 percent respectively) (Delegation of the European Union to the Republic of Korea, 2010).

5.3 Swedish FDI in South Korea

Swedish FDI makes up a small share of European investment flows to South Korea in nominal terms, but higher in relation to the size of the Swedish economy. Swedish investment in the country reached 54 million US dollar in 2011 (table 3). In 2010, Swedish FDI accounted for less than two percent of European FDI in Korea while it accounted for almost ten percent in 2008 (OECD, 2012). Statistics Sweden shows a different picture than the one provided by OECD due to different measurement of FDI. Unlike OECD, Swedish national statistics shows negative net investment in 2007, 2009, and 2010. Korean data for inward disbursed investment in 2011 was not available during the writing of this paper.

Table 3
EU and Swedish FDI in South Korea 2007-2010 (in million USD)

	2007	2008	2009	2010	2011
EU (OECD)	-1612	1753	2911	3113	n/a
Sweden (OECD)	85	173	27	74	n/a
Sweden (SCB)	-24	34	-132	-507	54

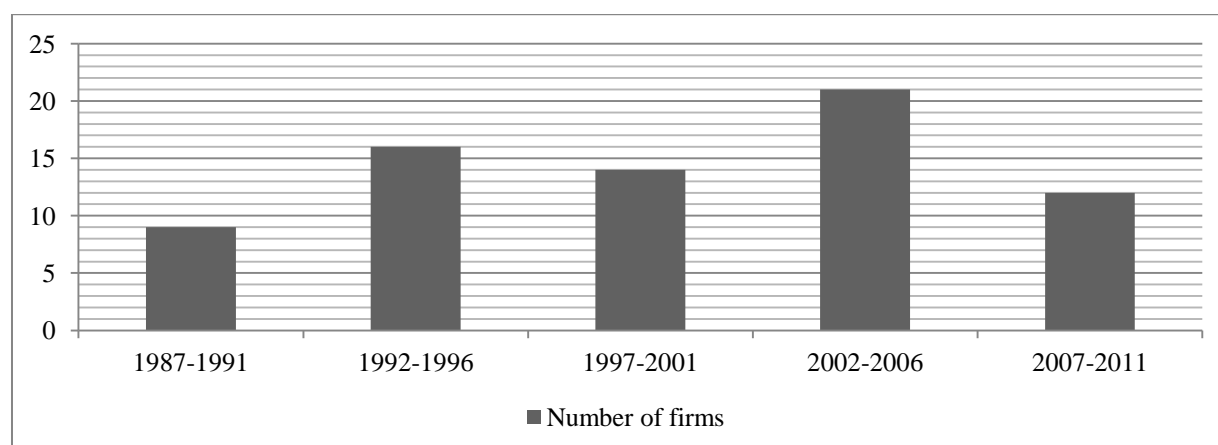
Source: OECD, 2012; SCB, 2012

5.3.1 Number of Swedish Firms in South Korea

The Swedish Trade Council estimated that approximately 337 Swedish companies had activities in South Korea in 2010, including local subsidiaries, branch offices, distributors and manufacturing. Some of these are integrated in the local economy, while others sell directly to consumers (Swedish Trade Council, 2010). The number of Swedish companies that have offices or subsidiaries in South Korea is 78, 75 percent of which are registered in Seoul. Almost all Swedish companies (95 percent) are located in the greater Seoul area (including Gyeonggi region and city of Incheon). It is, however, only the registered location while companies might be present in many regions (Embassy of Sweden, 2012).

The number of newly registered Swedish firms in South Korea remained approximately at the same level over the last two decades at an annual average of three new companies (Figure 13). Around 15 new companies established operations in South Korea each five-year period. It should be noted that figure 9 shows firms that were still present in South Korea by early 2012. Companies that have left the country before 2012 are excluded from the figure.

Figure 13
Number of Swedish firms entering South Korea the period of 1987-2011



Source: Embassy of Sweden, 2012

The manufacturing sector stands out when considering Swedish firms in South Korea (table 4). 19 out of 78 firms can be classified in the industrial equipment industry. Second and third largest groups are consumer goods and health care/life science followed by IT and telecom and automotive industry.

Table 4
Swedish firms in South Korea by industry (by early 2012)

Industry	Number of firms
Industrial equipment	19
Consumer goods	8
Health Care & Life Science	8
IT & Telecom	7
Automotive	6
Civil security & Defence	5
Transport & logistics	5
Chemicals	4
Metals	4
Other	12
Total	78

Source: Embassy of Sweden, 2012

Since sectors are often interconnected and many companies operate within multiple industries, this classification could be arbitrary. Several firms are directly linked to other sectors as suppliers (e.g. manufacturing is often accompanied by engineering services). It is difficult to distinguish between a manufacturing and service company as they are often interrelated. Noteworthy is that this list and industry categorization is based only on number of firms. Categorization can also be done according to revenue, number of employees etc. In real terms, sector distribution might be different as one large firm can generate more revenue than several small ones.

6. Impact of the EU-South Korea FTA on Swedish Manufacturing Firms

The following chapter presents data obtained from interviews with Swedish manufacturing firm officials. The interviews were based on a standardized questionnaire regarding firms' awareness of the agreement, preparations before its installment and its impact on firms.

6.1 Empirical Findings

6.1.1 Scope of Companies

This section examines the scope of firms that participated in this study. Twelve companies originating in Sweden with various activities in South Korea were interviewed. Many of them have only sales offices in South Korea, therefore relying on exports from Sweden or other countries in both Europe and Asia. However, a majority of them have service facilities or assembly in South Korea. Two companies have established larger production in the country. Machinery and industrial equipment (SITC 7) is the largest group of exports from Sweden to South Korea. It is also reflected in this study: a majority (nine firms) of participating firms belongs to this sector. Two firms produce goods that belong to SITC 6 (manufacturing goods classified by material). One firm belongs to SITC 2 (crude materials).

The list of companies participating in this study is shown in table 5. Four companies are producers of finished goods, one is a supplier of raw materials, and the remaining companies manufacture parts and components. A majority of the latter group is suppliers to firms with final assembly in South Korea. One company can be considered both as on-stream and down-stream due to the nature of its business. An important aspect of Swedish business in South Korea is embedded services that accompany manufactured goods (e.g. aftersales services, customer support, etc.). Swedish firms see them as an important competitive advantage and part of their trademark, and one reason for local presence in South Korea. It is highly valued in the country, providing long-term relationship between supplier and customer.

Table 5

Participating firms in South Korea listed by position in a value chain

Firm Category	Name
Up-stream	Höganäs
On-stream	ABB, Alfa Laval, CEJN, Ericsson, Haldex, SKF
Down-stream	H&M, Scania, Volvo Cars, Volvo Trucks
Other	Cellmark

Source: Compiled by authors, 2012

Revenue from the Korean market in these companies currently range from marginal to seven percent. Most of the firms admit that South Korea is losing its importance as a focus market and source of revenue. This fact can be explained by the growing importance of China as a trading partner of the EU (figure 2, chapter 4.2.1).

6.1.2 Perceived Value of the EU-South Korea FTA

An overwhelming majority of interviewed companies became aware of the FTA at early stages of its negotiations. It is interesting to notice that those who were unaware of the agreement belonged to firms that import goods to South Korea and have rather small sales offices in the country. Paradoxically, these firms are the most affected by the agreement as they heavily depend on imports. Companies with greater local presence were better informed about the agreement. Those firms that were actively interested in the FTA found it difficult to understand the whole scope of the agreement. The low level of awareness of Swedish firms with small presence in South Korea can be attributed to poorly functioning information channels within the EU. It might also be explained by a low priority of South Korea as a target market for exports.

Most of the firms showed little interest in the process of negotiation the agreement. Only firms that are large in terms of revenue and worldwide presence actively followed the agreement and were involved in direct or indirect lobbying of their interests. These firms belong to industries that are impacted the most by the FTA (e.g. car industry, machinery and equipment, and retail industry). A Swedish car manufacturer as a member of the European automobile manufacturers' association raised concerns that the FTA will enable Korean manufacturers to compensate rising costs of domestic production at the expense of European manufacturers. Although having limited involvement in the negotiation process, an overwhelming majority of the firms made necessary preparations for the FTA coming into effect. These preparations were mostly of bureaucratic character, involving adjustment of sale and export documentation, contacting customs and other local authorities, etc.

Along with the EU-South Korea FTA, there are a number of other bilateral and multilateral agreements that are of great interest for Swedish firms. In general, the wider presence a firm has, the more eager it is to follow FTAs around the world. Consequently, a majority of the firms follows negotiations of other agreements. This mainly involves regions with firms' production facilities or focus markets. At the same time, showing an interest in bilateral or regional agreements, the firms have little concern of the WTO negotiations (the Doha round). The fact that most of the manufacturing tariffs already are low can explain this lack of

interest. It was mentioned earlier (chapter 2.1) that NTBs are hard to eliminate multilaterally: the WTO includes all major economies who apply approximately the same tariffs everywhere (with the exception of developing countries). Bilateral and regional agreements therefore, become more interesting as they can eliminate non-tariff barriers.

The following part speculates on possible effects of the FTA on Swedish industries that were not highlighted in this study. Health care and life science industry is an important area where Swedish firms have considerable presence in South Korea (table 4). The main obstacles to trade within this industry are such NTBs as reimbursement rules, pricing, certification, etc. In addition, South Korea lacks transparency in price setting governed by local authorities. The FTA addresses these issues by strengthening rules of pricing, unification of standards and by enhancing mutual cooperation in the industry. Despite potential positive outcomes, it will be difficult to overcome established the stale price setting system in South Korea. The case of health care and life science is rather similar to that of the car industry, where producers are concerned about whether they will obtain full access to the Korea market. The FTA also provided unification of standards and certification processes and enabled monitoring of results by specially created authorities. Nevertheless, European car manufacturers do not see the benefits of the FTA as they claim South Korea has not granted them equal access to the domestic market compared to local manufacturers. Although the Korean health care industry is not as competitive as its car industry, South Korea might adopt a similar approach in order to protect domestic industry under this FTA.

The machinery and appliances commodity group is the sector with largest savings from tariff elimination. Swedish firms, however, were not substantially influenced by this elimination as a major part of manufactured had already low tariffs. On the basis of this fact, firms in the chemical industry may face the same effect as, according to the European Commission, the chemical sector is the second largest beneficiary from the agreement. Hence, eliminating the tariffs cannot significantly influence Swedish firms' financial results: as in the case of the health care industry, the main barriers to trade are nowadays of non-tariff nature. Elimination of such barriers is always constrained by bureaucracy and unwillingness to cooperate. In order to eradicate NTBs, South Korea has to adopt a new decision-making process and develop mechanisms able to overcome the problems stated above.

6.1.3 Tariffs and Trade Facilitation

The FTA between EU and South Korea has lowered or removed tariffs on raw materials, components, and finished goods. Although most companies have benefitted from lowered

tariffs in general, the impact was marginal, taking into account the relative significance of South Korea as a market in relation to global revenue. In most cases tariffs of approximately five-ten percent will be brought down to zero-two percent during the coming years, resulting in better margins for firms. Nevertheless, savings on tariffs will be distributed between manufacturers and their customers, depending on bargaining power. Tariff levels did not seem to lead to increased trade volume: many components were already previously under low or no tariff rates. Although in some product categories tariff decreases were significant (chapter 3.1), the impact of this reduction affected only a minority of Swedish firms. Trade facilitation appears to be more important part of this agreement than tariff provisions. Several firms in this study claimed that barriers other than tariffs (i.e. NTBs) are the most interesting part of this agreement. It coincides with the previous findings, explaining why firms are more interested in PTAs than a multilateral agreement.

A majority of participating Swedish firms experienced no additional problems regarding standards and regulations in South Korea. Others, present in industries without coherence in regulation over national boundaries (e.g. automotive, telecom, etc.), are facing problems regarding standards and certificates, and express concern over the compliance of Korean authorities with the agreement. Interviewed firms have raised doubts over enforcement of country of origin requirement (e.g. duty drawback issue, where imported inputs from countries outside of the agreement are granted duty-free entrance to the EU or South Korea if re-exported), certificates and testing (type approval), and market access. Technical barriers to trade and other grey area measures are perceived as obstacles for some Swedish firms in South Korea. One interviewee expressed disappointment about the EU-South Korea FTA's possibility of solving some of the technical barriers to trade the firm faced. Another manager hoped that products originating in the EU, stored in a third location, and designated to South Korea, should be granted preferential treatment as European goods. None of these problems have been solved so far. On the other hand, one respondent replied that his company had received better access to government procurement.

6.1.4 Strategies, Trading Pattern and Competitiveness of Swedish Firms

It is exceptional that the agreement has had little impact on the companies' localization strategies and their trading pattern. Few of the respondents thought the agreement would affect their internationalization process. Some firms agreed that components produced in multiple locations might now be more viable to source from Europe. These components are usually sophisticated equipment, constituting a minor part of trade.

Despite several companies think of South Korea as an interesting market, it is usually perceived as too small, especially in comparison to China. Many firms focus on establishing and building capacity in China, which in turn reduces the importance of South Korea. Even though the country has advantages from being close to emerging China (e.g. by stimulating the regional economy) Swedish firms are not using South Korea as a gate to Asia. There are a number of factors explaining this phenomenon. One senior manager claimed that strong labor unions are one aspect that deters investment from South Korea. Further, despite being positive for the attractiveness of South Korea, this FTA came too late. It might have had larger impact five-ten years ago. Currently, several other Asian countries are more economically attractive for Swedish firms (e.g. countries of ASEAN).

Several companies participating in this study noticed that the introduction of the EU-South Korea FTA has enhanced their competitiveness, albeit marginally, especially against local competitors in South Korea. It can be explained by a less global nature of Korean companies and, therefore, less ability to compete with large international firms. Some of them also experienced increased ability to compete with Japanese and Chinese counterparts that do not have similar agreements with South Korea. Despite an increased competitiveness, a majority of Swedish firms' rivals comes from Europe and is equally global in nature, which creates similar market conditions.

6.1.5 Currency Fluctuations of the Korean Won

Currency fluctuation is problematic for most international companies. Firms in South Korea face this problem as the Korean won has been quite volatile during the previous decade (chapter 4.4.1). Interviewed firms deal with these fluctuations either by selling in a global currency (e.g. euro or US dollar) or in Korean won with a central currency risk-management department that compensates currency fluctuations. A department like this is rather resource consuming, requiring the company to be of considerable size.

Several interviewed firms were anxious about customer dissatisfaction arising from usage of foreign currency in the country, as prices will fluctuate more of no apparent reason. In general, the development of the Korean won has followed the US dollar, therefore making it more reasonable for Swedish firms to sell in American currency to avoid higher volatility. The Korean won has fluctuated more heavily against the euro and krona, which has possibly put Swedish exporters at a disadvantage against Chinese and American competitors. Similarly, Japanese firms in South Korea have to a certain degree lost competitiveness due to its rising currency.

6.1.6 The FTA and its Future Prospects

On state level, losses from a free trade agreement have to be compensated by higher benefits to continue the implementation of trade liberalization. On firm level, a FTA will ultimately benefit certain industries more than others. For instance, producers of cars in Europe are likely to face increased competition within the coming decade as Korean firms are more cost competitive. Similarly, Korean manufacturers of trucks will face increased European competition in South Korea for the same reason. One interviewee raised concerns over compliance with the agreement by the Korean government. A manager of one automotive company says that as of today, there is unfair competition and not sufficient access to the Korean market. A lawyer of another company concurs that there is a lack of compliance to the agreement by Korean authorities. Insufficient transparency decreases mutual trust and interferes with the implementation of provisions. Furthermore, he feared this FTA might be used as a template for other agreements, which could significantly hurt the company by granting foreign competitors similar market access. The implementation and compliance of the agreement will affect both European and Korean attitudes towards it, and their willingness to comply with PTAs in general.

During the negotiation process Swedish firms perceived that South Korea was in a better bargaining position than the EU (even though most of these firms were not negatively affected by the FTA). Nevertheless, the EU market is significantly larger than the Korean and European companies might experience unequal market gains. It is mostly the European car manufacturers that explicitly are against the agreement; all other companies that participated in this study notice no adverse effects on their business. Moreover, several firms see the agreement as a necessary competitive advantage against the recent US-South Korea agreement and future PTAs with other countries

6.2 Discussion Based on Findings of the Study

The following chapter presents application of the theoretical framework as well as discussion based on the most significant empirical findings of the study. In addition, the paper assesses the long-term prospects of the EU-South Korea FTA from a Swedish firm perspective.

In general, one should not overestimate the impact of FTAs on Swedish firms, especially in the short-term perspective. The Swedish Trade Council's estimation of 80 percent increase of Swedish exports to South Korea due to the EU-South Korea agreement seems somewhat overrated. Most companies admitted that the FTA brought gains in the form of decreased tariffs, even though a few percent drop in tariffs does not radically change the market structure, especially for products with inelastic demand. Moreover, international firms have made significant investments in global production networks and logistics systems that cannot be changed overnight. Gains from tariff eliminations seem not to exceed losses from adjusting logistic systems (e.g. switching from local production to imports). Swedish firms do not see the FTA between the EU and South Korea as motivation for further market development, as they prioritize other markets in Asia over South Korea. Despite positive impact, the agreement is not able to offset underlying forces of national competitiveness and capabilities gained from established production networks.

6.2.1 A Supply Chain Perspective on the Agreement

Table 5 visualizes positions of participating Swedish firms in their respective production chains. According to Porter's value chain theory, firms were divided into up-stream, on-stream and down-stream companies. Up-stream firms engage in refining process of raw materials (production of metal powder in this study). On-stream firms are situated in the middle of value chain, using processed raw materials and components to produce parts and semi-finished goods (firms involved in this study produce industrial, automotive, and telecommunication equipment). Down-stream firms produce finished goods using parts and components as input (retail and automotive industries). One firm is difficult to classify as it supplies different stages of production (paper and pulp industry).

Analyzing the up-stream level, there were no significant indications of shifts in production network. As raw materials are characterized by rather inelastic demand, the demand was not significantly changed by the tariff reductions. As no other factor important for an up-stream firm's localization was changed by the agreement, it is easy to understand the absence of the FTAs impact at up-stream level of global production networks.

A few percentages drop in tariffs does not change the market balance between suppliers and customers for up-stream and on-stream firms, as the marginal gains are often shared between them. At these levels, factors others than cost competition, are more important (quality, embedded services, inter-firm cooperation, etc.). On-stream companies are situated in the center of global production networks and function as a link between up-stream and down-stream firms.

On the other hand, for both Swedish and Korean down-stream firms that produce finished goods, the marginal decrease in tariffs has resulted in a visible drop in consumer good prices. At this level, price is more important as a decrease in tariffs will often lead to an equal decrease in the market price, i.e. down-stream firms use the tariff reduction as a competition tool. As mentioned earlier, up-stream and on-stream firms use cost competition to a lesser extent. Some Korean consumer products (e.g. cars and consumer electronics) have already become significantly less expensive, while price reduction is less visible in parts and components sector as many of these products were under low tariffs prior to the agreement. The effect of tariff reduction is not equally important for Swedish manufacturing firms in South Korea. It can be explained by a small share of the Korean market owned by these firms and strong presence of competitors from China, the US and even other European countries.

Trade flows between the EU and South Korea are shaped by the FTA and firms' internal decisions. An overwhelming majority of fundamental localization decisions of Swedish firms were made internally apart from the FTA's influence. Based on Dunning eclectic paradigm, it is possible to examine motives behind firms' established trade and investment patterns. He defined three types of benefits a firm consider in its internationalization process: ownership, location, and internalization advantages. According to this study, all of Swedish firms possess an ownership advantage in form of unique technologies, trademarks and embedded services. Firms' localization decisions are often based on resource-, market- or efficiency-seeking. In general, South Korea is not favorable location for production. Although labor productivity is high, relatively high wages and strong labor unions deter firms who seek efficiency from investing in the country. A scarcity of natural resources stops resource-seeking firms. The most obvious reason for investing into the country is market-seeking. The relatively large domestic market and favorable economic conditions are localization advantages in South Korea. Moreover, local content requirement force firms to establish production in the country. According to the empirical findings of this study, Swedish firms engage in trade, investment or a combination of both (licensing is seldom considered as it requires sharing of core

competencies, which is the base for Swedish competitiveness). A larger part of Swedish firms chose to export to the Korean market. It can be explained by relatively low trade tariffs and absence of location and internalization advantages in South Korea. Low trade tariffs are perceived as one of the main reasons for choosing trade over investment. Therefore, the free trade agreement between the EU and South Korea supposed to be crucial for them. Since tariff barriers were already low the FTA did not change the rationale for the entry mode. Swedish firms' low awareness of the agreement can be attributed to that.

Swedish firms that chose to establish operations in South Korea are motivated by location advantages. As mentioned earlier, efficiency and resources are not likely the reasons for the establishment; market is the main location advantage that attracts Swedish firms' production networks. Sophisticated demand, domestic market size and legislation (e.g. local content requirement) shape Swedish firms' decision to invest in South Korea. In addition, it is crucial to be close customers for firms who perceive South Korea their focus market. Due to local business culture, customers expect additional services. Local presence is important to ensure a high level of customer satisfaction.

There are additional factors that can be considered when explaining firms' localization decisions outside the Dunning theoretical framework. Thus, the geographical proximity of South Korea to other markets could potentially attract Swedish firms. However, none of the interviewed firms saw South Korea as a potential gateway to Asia or China. Surprisingly, despite geographical closeness of the country to China, none of the respondents was interested in using this proximity. Motivation behind it was rather simple: benefits that could be obtained from local presence in China exceed the loss from higher tariff barriers. Due to the Korean geographical location away from ASEAN countries, the firms were also not interested in using South Korea as a possible export hub to them.

For Swedish firms, the EU-South Korea FTA can become a stepping-stone to Asian production networks. Most of the Swedish industrial equipment and machinery exports to South Korea are used as inputs for production and further exports for instance to China. These exports can in turn be additionally processed and exported to other countries, thus becoming a part of Asian global production networks. It is important for Swedish firms to become an integrated part of these networks as the Asian region drives global trade growth (chapter 4.1). In a longer perspective, participation in Asian production can interlink Swedish and Asian production networks, creating shifts at an on-stream level. The accumulated impact of the EU-

South Korea FTA and other possible future agreements with Asian countries can further strengthen Swedish manufacturing firms' position in Asia and worldwide.

6.2.2 Timing of the Agreement

Many empirical evidences of this paper are pointing out that South Korea is losing its importance as a trading partner in Asia for the EU. The country has not regained its pre-crisis share of trade with European Union and is not likely to reach it in the nearest future. The reason behind is that emerging China overtook a certain share of trade from its Asian neighbors (both South Korea and Japan). Due to the enormous market size, geographical location and economic potential, China is seen more attractive in terms of trade and investment by many international firms. Under these circumstances, South Korea is slowly being shadowed by its larger neighbor. Many on-stream companies that are situated in the midst of global production networks noticed a decreasing profitability of the Korean market and ceased demand for certain types of goods. Moreover, the firms predict that unless drastic changes in the region occur (e.g. new trade agreements, political changes in China, etc.), the economic situation in the Korean market will slowly deteriorate in the future. Therefore, firms did not show much interest in following the EU-South Korea negotiations and most of them were not involved in lobbying of their interests. It does not imply that Swedish firms have a low interest in politics and trade negotiations as they are keen to follow other trade agreements (chapter 6.1.2). They rather have low interest in the agreement itself. Many stated that the FTA came out late and it could be of more interest five years ago (before the economic crisis in 2008), when the Korean market generated more revenue for the firms. Another explanation of why the FTA came too late lies in the field of free trade. As already mentioned before, applied tariffs on manufactured goods were already low in comparison to those of other important Asian markets (e.g. China or India). Therefore, actively participating in an FTA would be more interesting in markets with higher tariffs.

From a Korean perspective a trilateral agreement with China and Japan is more important than the one with the EU. An agreement between the most important economies in East Asia would be highly significant for each member. Thus, it is not very surprising that there is a lack of interest in implementing the agreement from Korean authorities (or at least delayed enforcement) while awaiting future agreements, even though a PTA with China and Japan would likely be a shallow and less binding agreement than the EU-South Korea FTA. Although South Korea shows positive economic development, its share of trade with the European Union is decreasing. In contrast, trade with China is becoming more important,

implying that the country absorbs a certain part of European trade previously done with other Asian countries.

6.2.3 Non-Tariff Barriers Remain a Concern

Non-tariff barriers remain an obstacle for Swedish firms in South Korea. This was one of the aspects the agreement tried to address by unification of standards, simplifying certification procedure, etc. As brought up in the theoretical background on trade, the multilateral trading system has managed to reduce tariffs barriers but non-tariff obstacles remained a problem as they are difficult to tackle multilaterally. Inability of the WTO to solve this problem has led to the surge in PTAs, under which elimination of non-tariff barriers could be negotiated more easily. NTBs are often present in the so called sensitive industries (e.g. industries that are of strategic importance for the national economy). The EU-South Korea FTA has been more far-reaching in elimination of non-tariff obstacles than multilateral trade negotiation; however such issues as warehousing, duty drawbacks, labeling, technical barriers to trade, and type approval remain a problem for Swedish firms in South Korea. One interviewee in this study mentioned that when one obstacle is removed another arises. As long as NTBs are not removed according to the FTA, it is difficult to judge the outcome of the agreement. Only when its full implementation is reached, the agreement's total impact can be assessed.

Firms from sensitive industries share a common opinion that unless non-tariff and technical barriers will be fully eliminated, the agreement brings rather negative impact on firms' competitiveness in Europe, opening their domestic market to cheaper Korean goods. Swedish manufacturing firms from other industries admit overall positive effect of the agreement, though companies do not perceive it as something that might significantly influence their operations in South Korea.

If the agreement would bring the immediate removal of NTBs, Swedish firms would consider deeper strategic adaptation to the agreement. In addition, Swedish firms with less presence in South Korea may have neglected the agreement due to a lack of information about its scope and implications. This suggests a need to improve communication between European trade policy-makers, industry organizations, and individual firms.

6.2.4 Long-term Effects of the EU-South Korea FTA

Almost all firms involved in this study say that regardless of how important the PTA is, it has somehow been beneficial through decreased tariffs, improved market access, and increased cooperation. The FTA's impact might be invisible in a short-term perspective while it might be more influential within a longer timeframe. Since not too much time has passed after the agreement was installed, its provisions have not been fully implemented. Tariff barriers have not been fully levied and non-tariff barriers (e.g. unification of standards and certificates) have not been removed. Committees continuously work with compliance and transparency issues. Additionally, absence of the agreement between the EU and South Korea would most likely put Swedish firms in an unfavorable position in South Korea, especially since foreign competitors have preferential access to the Korean market (or will receive it in the future).

As mentioned earlier, nowadays non-tariff barriers are the main obstacles to world trade. Due to continuous efforts by the WTO toward tariff reduction, many manufactured goods are currently under low duties. Eliminating them would not bring significant changes to the world trade picture. NTBs are difficult to eliminate over a short period of time as it involves a huge amount of bureaucratic work and often collides with well-established local business culture. Therefore, the impact of NTB removal should be studied in the long run. It is likely that such impact would be of great significance as many Swedish firms claimed that non-tariff barriers divert trade with South Korea.

Successful implantation of the EU-South Korea FTA might lead to its application as a template for other European agreements. It is important to have agreement with emerging markets, as developing economies are likely economic growth in the nearest future it is important for the EU to sign agreements with them. Under these circumstances it is important for the union and individual firms to obtain necessary experience in the field of FTAs and their implementation. This FTA taken together with other PTAs can multiply the benefit of each agreement on its own. Competition in signing preferential trade agreements with fast growing countries has driven trade liberalization as countries sign agreements proactively to remain competitiveness. In spite of unclear outcome of this competition in multilateral negotiations, PTAs are addressing important issues within trade liberalization. It is crucial to have public support in order to pursue continuous trade liberalization. Negative effects from FTAs might be perceived as unfair competition in public opinion, making further progress difficult.

7. Conclusion and Topics for Further Research

Throughout the paper the important issues of the EU-South Korea free trade agreement have been discussed. The answers to research questions formulated in chapter 1.2 summarize findings and refer back to theoretical and empirical data of this study.

In what ways have Swedish manufacturing firms been affected by the agreement?

- *How did Swedish firms prepare strategically to the agreement?*

The short answer is that Swedish firms did not adapt strategically to this agreement. Strategic adaptation in this case refers to decisions that affect firms' organizational structures, production networks and inter-firm cooperation. For Swedish firms in general, adapting to the agreement meant mere bureaucratic compliance with its provisions (export documentation, contact with local authorities, etc.). The firms did not make any strategic decisions based on the agreement before it entered into force.

The absence of strategic preparations can be explained by a decreasing importance of tariff barriers to trade. Average applied tariffs on manufactured goods were generally low even before the agreement. A significant boost in trade caused by elimination of tariffs will occur only in a limited number of industries. On the other hand, non-tariff barriers remain important for a majority of Swedish firms. Thus, the passive behavior of Swedish firms before the agreement can also be explained by delayed elimination of non-tariff barriers. Another reason of limited adaptation to the agreement is rather low interest of Swedish manufacturing firms in South Korea, as the country is partly losing its significance. This coincides with increasing interest in other Asian markets (mainly China).

- *What impact has the agreement had on Swedish firms' global production networks?*

Swedish firms had a limited interest of this agreement. This is reflected in the inability of the agreement to impact firms' localization decisions. Well-established production and logistics systems make Swedish manufacturing firms inert in their localization decision process. From a firm perspective, size of market, timing of agreement and general economic conditions are ultimately more important than benefits the EU-South Korea FTA brought. As already mentioned, non-tariff barriers are today the main obstacles to trade. It is still unclear if the FTA can tackle NTBs adequately as such barriers remain in South Korea even after the FTA came into effect. What is clear is that little has changed in the structure of Swedish firms' global production networks.

At up-stream level no signs of localization changes were found. Indeed, raw materials exported from the EU have rather inelastic demand and was not significantly influenced by the tariff reductions. As no other factor important for an up-stream firm's localization was changed by the agreement, it is easy to understand the absence of the FTAs impact at up-stream level of global production networks. However, at on-stream level, certain shifts in firms' supply chains can be attributed to the FTA. Some firms switched from external suppliers (i.e. not covered by the agreement) to European suppliers, as it became cheaper to export from Europe to South Korea. PTAs can change the feasibility to source components produced in multiple locations of a TNC's production network. Diverted trade with third countries is a horizontal shift within global production networks at on-stream level. As Europe is not a favorable location for mass-production, due to high costs, the diverted goods are mainly sophisticated components and equipment.

Down-stream firms are the most affected by the agreement in a supply chain perspective as cost competition is especially important for producers of finished goods. For instance, Swedish truck manufacturers estimate that decreased duties will enable them to compete with local producers more effectively and increase their market share in South Korea. As another advantage, Swedish firms have well-established global production networks, while Korean rivals are not as global in their nature. Swedish down-stream manufacturers do not only compete with local producers in the Korean market: American and Japanese companies also have a strong presence there. The fact that the EU-South Korea FTA entered into force earlier than KORUS and absence of a corresponding FTA with Japan and China gave a significant (although short-term) advantage for Swedish firms in South Korea. However, it is still an open question how European competitiveness will be challenged in the future.

- *What does the agreement imply for Swedish firms' operations in the long-term perspective?*

In spite of marginal short-term impact on Swedish manufacturing firms, the full effect of the EU-South Korea FTA must be analyzed in a longer perspective. As multilateral trade negotiations have been stalled and taking into account the growing importance of Asia for the world economy, the European Union pursues similar agreements with other Asian countries (e.g. India, ASEAN members, Japan). The EU-South Korea FTA can be used as a template for such negotiations. The combined impact of multiple agreements will be significant as these countries are important to the world economy. Agreements in constellations excluding the EU will negatively impact the EU's attempt to promote trade with Asia. A possible

trilateral FTA between China, Japan, and South Korea, a regional Asian agreement pursued by ASEAN-3, and the Trans-Pacific-Partnership negotiations led by the US (including Japan and Singapore) could pose serious threat to the EU's ambitions in Asia. In order to balance these efforts, the EU introduced a number of free trade negotiations with Asian countries. If successful, the EU-South Korea FTA can speed up the negotiation process of other agreements, creating a competitive advantage for Europe over its rivals in the region. A free trade agreement visualizes the lack of benefits to non-members of a preferential tariff area, which in turn is likely to push trade liberalization in general. In the long run both Sweden and South Korea will benefit from the agreement, but its impact is likely to be unequal. Since the European market is much larger, Korean firms are more dependent on trade with Europe than European firms in South Korea. Therefore, increased market access in Europe will benefit Korean industry to a larger extent. However, the impact of the agreement will not be significant for either party as the importance of other economies is much greater.

At a firm level, Swedish firms in industries with international competitiveness will be positively affected by the FTA, while industries sensitive to exports are less likely to receive any net benefits from the agreement. Still, this agreement is seen as necessary for both the EU and South Korea: the EU need it to compete against KORUS and coming PTAs while South Korea uses it as a balancing tool against the dominant position of China and Japan in Asia. Under these circumstances, the EU-South Korea FTA can become a bridge to Asian production networks for Swedish firms. Most of their exports to South Korea belong to industrial equipment and machinery and used as inputs for further production and exports (e.g. to China) thus, becoming a part of Asian global production networks. Being integrated into these networks, Swedish manufacturing firms can more easily benefit from regional economic growth in Asia as this integration can even bring changes to Swedish firms' own production networks, creating shifts at an on-stream level.

Further areas of research include assessing long-term effects on trade volumes, long-term effect on Swedish firms' competitiveness, other FTAs' impact on Swedish firms, and whether the EU-South Korea FTA will be used as template for other agreements in Asia. This study can also be used in analogous research conducted in other EU members. A similar paper focusing on a single industry or on all Swedish firms present in South Korea could have been made. Nevertheless, it is believed that a single industry research would be of less importance to a wider audience, while a survey of all Swedish firms would be too time consuming given the time frame of this project.

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Appendix A Overview of the EU-South Korea Free Trade Agreement

The agreement consists of 15 chapters, three protocols, four understandings, and in addition several annexes and appendixes. The first chapter covers the main objectives and definitions of the agreement. The second chapter addresses national treatment and market access for goods. This is an important section, stating that the parties shall remove both custom duties and non-tariff barriers to trade. Almost all custom duties on industrial goods are to be fully removed over a transitional period of five years, eliminating 98.7 percent of duties between the parties (or an estimated 1.6 billion euros in value). The removal of barriers is also expected to promote trade. Machinery and appliances is the sector that account for most gains in value due to its size, while other smaller industries (e.g. textiles and footwear) will experience higher relative gains. Agricultural goods are exempted from these provisions. Additionally, four annexes outline the elimination of duties in the important industries of consumer electronics, motor vehicles, pharmaceutical products and medical devices, and chemicals.

The third chapter describes trade remedies, which are similar to the law of the WTO. A country can impose safeguard duties if illegal dumping or subsidies occur. Technical Barriers to Trade discussed in the fourth chapter are another important aspect, as NTBs have become greater obstacles to trade than tariff barriers. Technical barriers include technical regulation, standards, marking and labeling for example. This chapter states that the parties shall cooperate on standards and regulatory issues, and promote transparency in regulation. The fifth chapter regulates Sanitary and Phytosanitary Measures. In order to facilitate trade in animal, animal products, and plants, the parties shall promote transparency and human/animal health. Chapter six discusses customs and trade facilitation, and highlights the need to cooperate in customs and customs-related issues. The seventh chapter on trade in services, establishment and e-commerce goes beyond the General Agreement on Trade in Services (GATS) of WTO, making the agreement the most far-reaching PTA in services signed by the EU. This section liberalizes investment regulation, foreign ownership requirements, and market access in most service sectors.

Chapter eight covers payments and capital movements, and is a prerequisite for other clauses. Chapter nine aims to increase transparency in government procurement. Chapter ten states how intellectual property can be protected. It includes copyright, design, and geographical indications. Intellectual Property Rights (IPRs) protection is prioritized by European companies, especially since IPRs are neglected in other parts of Asia. With transnational

production networks spanning over several countries, it is crucial that IPRs will be respected. Issues regarding competition are covered in chapter eleven, stating that anti-competitive practices (e.g. cartels, monopolies, anti-competitive mergers) shall not be tolerated. Subsidies are an interesting sub-section as the Korean *chaebol* business groups were built with the help of state support. Also, the EU has significant subsidies within the agricultural sector, but they shall not be discussed until three years after the agreement comes into force.

The twelfth chapter states that transparency is central in the whole agreement and is the basis for building mutual trust. It also has a separate section that discusses efficient and predictable regulatory environment. Chapter 13 introduces provision regarding trade and sustainable development, including labor and environmental standards. Mechanisms for the monitoring progress are also mentioned. Chapter 14 introduces the dispute settlement mechanism of this PTA. It is similar to the WTO although it incorporates a faster judicial process. Settlement begins with consultations and if an agreement cannot be found, the case is brought to an arbitration panel. The panel publishes a ruling within 120 days from its installment. The ruling is followed by a period of compliance and possible sanctions by the affected party. The mediation mechanism, although without binding ruling, can be used for quick solutions to simpler matters. Chapter 15 it outlines institutional, general and final provisions, i.e. how the agreement is going to be implemented. The agreement will be monitored by annual meetings of a Trade Committee. The committee is co-chaired by a member of European Commission and the Minister for Trade of South Korea. Six specialized committees have been created to overlook the agreement, while seven working groups continue to discuss important issues.

Rules of origin are covered by the first protocol of the agreement. The focus lies on the substantial transformation that is giving the product its characteristics. A product originates in the EU or South Korea if it has been wholly obtained, or sufficiently processed there. Being sufficiently processed refers to change of tariff heading, percentage of value added inputs into a product, specific operations of significant importance, or a combination of the reasons stated above. However, EU producers can use Korean inputs, and vice versa, and still claim the product is originating in the EU. The process also has to go beyond “*minimal operations*” and transported directly from one to the other (transshipping and warehousing is allowed but must in that case be accompanied by a separate bill of lading indicating point of destination). In order to receive preferential treatment, goods must be accompanied by an origin declaration. Authorized exporters can issue origin declarations themselves, thus minimizing bureaucratic administration.

Appendix B Questionnaire

1. What activities does your company have in South Korea?
 - a. number of employees
 - b. revenue and South Korea's percentage of total revenue
 - c. suppliers and customers
 - d. trade or production
2. When did you become aware of the EU-South Korea FTA?
 - a. if so, was the agreement easy and unambiguous to understand?
3. Did you follow the process of negotiating the agreement?
 - a. if so, did you actively try to impact the agreement through lobbying organization or other way?
4. Did you prepare in any way for the agreement coming into effect?
5. Do you follow the process of other FTAs and the WTO Doha Development Agenda?
6. How has the agreement affected you in practice?
 - a. tariff levels
 - b. trade facilitation (non-tariff barriers and technical barriers to trade)
7. Once the agreement was in place, would you say it has changed your:
 - a. localization strategies
 - b. procurement
 - c. trading pattern
 - d. attitude to South Korea as a gate to Asia
8. How would you describe the agreement has impacted your:
 - a. overall strategy
 - b. financial situation
 - c. competitiveness
9. How do you deal with currency fluctuations? Is it a problem?
10. Are you worried the agreement might have adverse effects?
11. How do you continue to work with the agreement?