ECONOMIC DEVELOPMENT STRATEGIES OF CHANGING EAST-ASIAN COUNTRIES AFTER 2009

Edited by Csaba Moldicz

BUDAPEST BUSINESS SCHOOL
UNIVERSITY OF APPLIED SCIENCES
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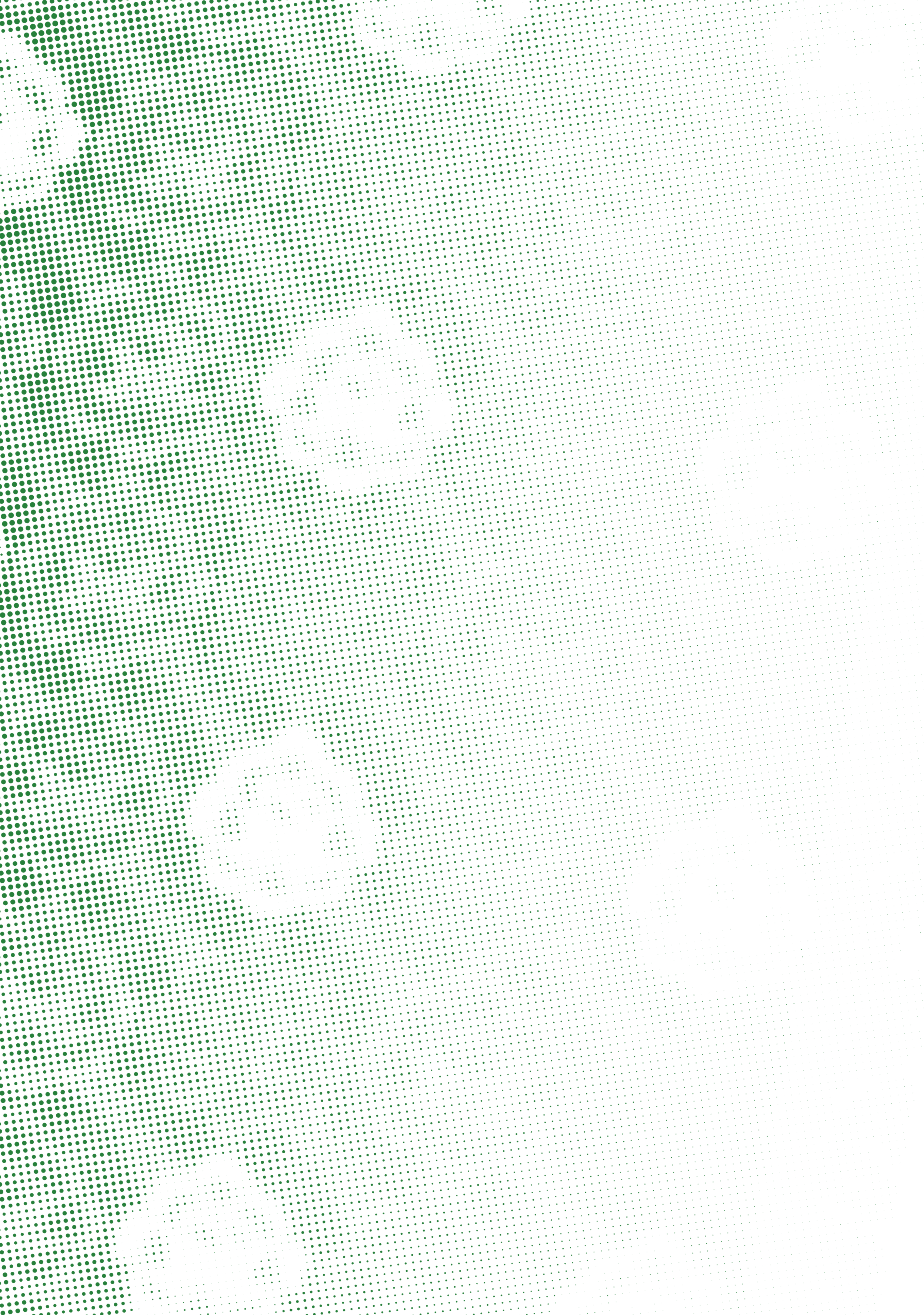


Preface

The Oriental Business and Innovation Center (OBIC) was set up by the Budapest Business School, University of Applied Sciences and the Central Bank of Hungary in 2016. One of the main goals of the initiative was to contribute to a better understanding of Asian cultures, economies, and languages in Hungary. OBIC's activities aim to improve the students' language skills, enhance academic mobility towards Asia, and support Asia-related researches. This collection book is the fourth in the OBIC Book Series and the first one solely dedicated to economic development policy questions and international trade issues.

The collection book contains six studies of fives Hungarian scholars and experts. The starting point of all papers was the basic question: how the Great Recession (2008-2009) changed the economic and political environment in the East-Asian region, and what policy reactions have been evoked by the crisis on multilateral and bilateral level.

Őrlös' paper focuses on the multilateral aspects of development policy. His study reflects mainly on the changing landscape of the multilateral development banks in East-Asia, putting a strong emphasis on the Asian Infrastructure Investment Bank and the New Development Bank. In her paper, Tősér analyses the changing trade policies of the region from the perspective of the European Union. Since trade policies of the member states are carried out in a European framework within the Single Market, this European trade policy perspective is relevant for the reader.

Majoros' paper emphasizes the changing attitude of Japan regarding the importance of trade integrations, as he highlights Japan was reluctant to get involved in regional economic integration forms until 2000. He puts: "This paper examines what happened in Japan, which had had no bilateral free trade agreement with any country (or group of countries) until the turn of the millennium." How and why this change in attitude could take place, his paper tries to find answers to.

Vándor's study shows the changing trade policies of the island Taiwan by focusing on small and medium enterprises. When concluding his paper, he summarizes: "The developments demonstrate that, at present and in the foreseeable future, the economic and trade (as well as political and social) situation of Taiwan will not depend on the—basically uninterrupted, slightly modified—policies adopted in Taipei, but on the fluctuating cross-Strait situation." highlighting the growing importance of the Cross-Strait relations.

Neszmélyi covers two papers in the book, both focusing on the Republic of Korea. The first paper analyzes the historic development of the Korean development banking landscape, putting emphasis on economic developments after 2008-2009 and policy reactions afterwards. The second study investigates the effects of the EU-South Korea free trade agreement.

The Oriental Business and Innovation prepared this book with the goal of giving an overview of new trends in development policies and international trade policies in the region. We hope the papers provide the reader with valuable insights as to the economic development strategies in the changing East-Asian Region.

We are thankful for the financial assistance of the Central Bank of Hungary, and the leadership of the Budapest Business School and all the people who supported our efforts in the making of this collection book.

Csaba Moldicz
Editor of the book

Minilateralism, Statecraft and Emerging Multilateral Development Banks in Asia

László Örlős[1]

Changing world order and shifting geopolitical balances are reflected in a moving landscape of the multilateral development banks (MDBs). Based on their short track record in functioning and operations as well as the huge financing needs in their regions, the Chinese-led Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB or the BRICS Bank) established by Brazil, Russia, India, China, and South Africa are expected to be complementary to existing traditional MDBs.

Asia as a whole is expected to experience an improvement in growth. Many economies are projected to see faster growth as China's economy slows to a more sustainable growth rate. Improving perceptions and accelerated growth, with still relatively low interest rates, provide an important opportunity to boost infrastructure investment to make up for shortfalls in the past, improve longer term supply side capacity, and to meet challenges relating to growing population and climate change. Asia will continue to face a high demand for infrastructure in the coming decades.

1. Introduction

Driver for infrastructure demand in Asia is its rapidly growing population and that the region is experiencing an unprecedented pace of urbanization. 42 million people are added to Asia's population every year. Furthermore, Asia has the largest rural population among the continents totaling almost 2 billion. An additional billion Asian urban population by the middle of the century is projected, thus making sustainable urbanization a priority. As regards climate change, it has added greater urgency for sustainable infrastructure investment in the coming years, both to mitigate risks associated with climate change and to bolster countries' resilience. This will place a burden on Asia's economies, especially on lower income and emerging economies. At

1 Views of the author, as expressed in this paper, do not necessarily reflect the official position of the Ministry of Finance of Hungary.

the same time, it also provides an opportunity for countries to develop on a sustainable path from the outset.

Traditional and newly established MDBs active in Asia help member countries sustain the level of infrastructure investment necessary to support their growing populations and economies. Emerging MDBs such as the AIIB and the NDB, as the focus of our research, are about to develop new approaches:

- in business models maximizing development impact originated from fresh official and additional private financial resources as well as

- thematic priorities around Sustainable Infrastructure, Cross Border Connectivity, and Mobilizing Private Capital to guide their investment prioritization.

Furthermore, this paper examines the root causes and implications of a new financial multilateralism in Asia as dominated by China given the recognition that the country's empowered foreign policy is reflected in its leading role and new type of engagements in the newly established MDBs.

2. The Concept of Regional Development Banks

The reason and need of the existence and operation of MDBs established by sovereign nations is the subject of constant disputes, but in the meantime, since the market is not a substitute for their functions, they operate as a depository of economic stability, long-term development and prosperity. MDBs as supranational financial intermediaries are established by a group of countries with the aim of providing long-term financing borrowed from capital markets, official sources, or providing policy advice, technical assistance through its expertise base in order to reach development goals, economic integration and social cohesion.

Traditionally, shareholders of MDBs comprise of both developed donor, as well as emerging, and developing recipient countries. As one of their mandates, MDBs facilitate market creation conducive to a development friendly business environment, while their project financing activity is conducted through:

- providing long-term financing to middle income countries or even to higher income countries in the form of loans, equity and guarantee in case of no access to private markets in the given sector; and/or

- providing financial resources at favorable terms or in non-reimbursable forms (concessional financing) to low income countries (Griffith – Jones, 2008).

Market failures, such as the lack of long-term financing due to increasing perceived risk over time or changing, unstable regulatory frameworks, are often times specifically linked to infrastructure, again in the center of MDBs' activities. As the relevant literature points out, MDBs are created to correct market imperfections and help to overcome limitations of private finance through:

- providing counter-cyclical finance in case of private finance drying up; and

- facilitating the creation of risk-sharing and other innovative market instruments bringing together emerging and developing country actors, creditors and private investors.

Originally, the creation of MDBs in the decades following World War II was intended to serve the purpose of hard infrastructure reconstruction and development. In the 1980s, however, these institutions began moving their focus towards a broader view of economic development and started to place greater emphasis on creating robust investment climates (Weiss, 2017). This process then turned to exercising a broad range of policy conditionality as backed by the Washington Consensus (see Williamson, 2000). Western-dominated MDBs were about to advance economic policy-related conditionality as well as environmental and social safeguards fostering best practices in the field of procurement and anti-corruption.

This paper focuses on the newly established MDBs pursuing development goals and active in Asia like the AIIB and NDB. Operations of traditional MDBs, including the World Bank Group, the Asian Development Bank, the European Investment Bank or the European Bank for Reconstruction and Development operating in Asia for decades, fall outside of the scope of the survey.

Development goals pursued by MDBs aim at the assistance of developing countries as well as the promotion of regional, economic and social integration of certain geographical units. Therefore, the notion of a multilateral development bank, by definition, does not rule out the possibility of financing developed countries when it comes to the objective of closing up financing gaps and strengthening economic and social cohesion.

3. Geopolitical Movements Affecting Asia and New Motivations in the Multilateral Arena

3.1. Advancing China's Interests on the Global Stage

The fall of 2013 was a remarkable season for the Chinese diplomacy, and in terms of its implications, for the multilateral world, as well. Some months after Chinese President Xi Jinping assumed office, a major initiative, namely the establishment of a new China-led MDB, aimed at positioning China as a leading actor in the multilateral arena on its own right, was unveiled. By that time, as a joint and equal arrangement among the BRICS countries, i.e. Brazil, Russia, India, China, and South Africa, the NDB[2] was already in the making along with an ambitious development program to build an economic belt along the historic Silk Road titled as the One Belt, One Road (OBOR).

Several authors argue that the AIIB, along other financial means like the Silk Road Fund[3] and the NDB, are merely vehicles to finance OBOR a signature economic policy action plan worth USD 1.4 trillion[4] with a westward overland route ('the Silk Road Economic Belt'), and a maritime route ('the 21st Century Maritime Silk Road') across the Indian Ocean to Africa and Europe. These structures link 65 countries in Asia, North Africa and Europe with a population of almost 4.4 billion through developing a network of fast railroads, highways, airports, and power transmission lines.

Notwithstanding the merits of these explanations, our review of the relevant literature indicated that recent changes in the landscape of MDBs active in Asia are true reflections of shifting geopolitical balances impacting international finance in which China, along with other emerging regional powers, are constantly challenging the world order established after World War II. Already some start-up phase decisions of these newly established institutions as regards governance, operating and management principles (see more details in chapter 5) showcase that the evolution of the MDBs is not a one-way street anymore and that a dual system of how MDBs can operate, as dominated by emerging powers as new "designers" including China, might emerge in the longer run.

2 Eichengreen (2014) and Chen (2014) point out that the idea of establishing the BRICS Bank was initiated by Beijing that met with strong interest from the remaining BRICS participants.
3 China announced to contribute USD 40 billion to establish the Silk Road Fund aiming at strengthening connectivity along the Belt and Road Initiative (Wu, 2017).
4 An amount 12 times bigger than the post-World War II Marshall Plan (South China Morning Post, 2016). Analyst often emphasize that the Marshall Plan was a focused and institutionalized arrangement engineered by the United States in favor of the reconstruction of Europe, the OBOR lacks an institutionalized nature and can be considered rather as an action plan with ad-hoc individual arrangements.

This approach of considering AIIB as a new multilateral actor with creative features is based on the notion that OBOR's basic objectives are domestic ones, even though this bank marginally serves foreign policy functions thus partially supporting geopolitical ambitions of extending China's influence on multiple regions. These domestic goals revolve around consuming massive excess capacities and overproduction from China, improving security for China's energy imports as well as making attempts to rebalance prosperity within the country through benefiting interior provinces to be converged to the richer coastal regions. At the same time, AIIB and the BRICS Bank are meant to promote global public goods benefiting the entire world. This, however, does not exclude that these banks directly or indirectly promote Chinese political and economic interests. As several commentators pointed out at the time of the announcement to establish AIIB, Chinese companies are likely to gain a large portion of the contracted work from infrastructure projects financed by the AIIB and the NDB (Wang, 2014), thus benefiting the Chinese economy.

Given the fact, however, that China's export-import bank and its development bank, that directly promote Chinese economic interests abroad, reached the World Bank's level in terms of lending to developing countries in the late 2000s, one can argue that economic benefits are now outweighed by political considerations.

3.2. Fostering Financial Public Goods on the Regional and Global Level

Given their mandates, capitalization and financial and advisory instruments, regional development banks are well placed to provide public goods, that is to unlock and coordinate cross-country solutions for complex infrastructure development with the involvement of governments and the private sector. Due to their complex nature, public goods are often underserved, thus creating room for MDBs to act.

In the run up to the NDB's formal establishment, reputable economists argued with the robust infrastructure requirements in emerging market economies and low-income countries to achieve long-term poverty reduction and inclusive growth. They also recognized that the private sector can meet these needs only in part and the funding gap is beyond what existing MDBs and bilateral donors can meet. They concluded that a new development bank anchored in emerging markets and developing countries could help to address the financing gap and simultaneously become a "powerful catalyst for change" (Stern et al, 2013). According to their estimates, infrastructure spending will have to rise from about USD 800 billion to at least USD 2 trillion a year in the coming decades. Others estimated the financing need for economic infrastructure even higher, almost USD 4 trillion per year and pointed out that this need could increase further by up to USD 1 trillion annually in order to meet the United Nations' 17 Sustainable Development Goals of the 2030 Agenda for Sustainable Development (Woetzel et al., 2017). The newly established multilateral development banks could serve as innovative institutions to fill this gap.

Demand for infrastructure is growing in line with the speed of economic development and the pace of the population movements from rural to urban areas in developing countries. Infrastructure development funding gap is estimated at USD 26 trillion in Asia through 2030 (ADB, 2017; Woetzel et al, 2016). To give a perspective on the dynamics of infrastructure development needs, the world's infrastructure stock was about USD 15 trillion in 2003 (Griffith – Jones et al., 2008).

While infrastructure supports long-term economic perspectives, the magnitude of infrastructure projects and the associated slow financial returns are not attractive to private investors. Parallel to the chief negotiators' meeting to establish the AIIB, a creative thinking among MDBs led by the World Bank and its private sector arm, the IFC has evolved in 2013 and 2014. The idea of creating a new asset class by separate financial platforms of MDBs was meant to attract savings in pension and sovereign wealth funds' resources and channel them into long-term risky infrastructure financing to the benefit of emerging and developing economies.

In order to turn infrastructure assets in developing countries into a recognized asset class, the following challenges had to be addressed: (i) Build a pipeline of well prepared and commercially viable projects; and (ii) Structure projects in a way to address the regulatory, political and reputational risks associated with investments in emerging economies. Any MDBs that aim to be successful in infrastructure financing has to support to Public-private partnerships (PPP), and should have the following features: (i) Leveraging the private sector; (ii) Addressing public goods; (iii) Partnering for solutions; and (iv) Promoting sustainability and protecting investors and partners from reputational and other risks.

MDB and public-private investments currently amount to an annual USD 180 to 200 billion and USD 40 to 60 billion, respectively. On the other hand, estimates of long-term assets held by the largest institutional investors are in the tens of trillions of dollars, and only a tiny part of their increasing resources (circa 1 percent of assets) is invested in infrastructure finance (Croce – Yermo, 2013).

Given the agreed framework for the sustainable development agenda (Sachs, 2015), several internationally confirmed principles including the "From Billions to Trillions", the "Hamburg Principles", and the "Financing for Development", are paving the way of how constrained and scarce public and MDB funding should be used to pursue private sector solutions to achieve sustainable development goals by 2030. Some of the countries in Asia including China have accumulated sufficient savings to finance infrastructure development while many other countries are positioned differently and remain on the recipient side. In addition, there had been concerted efforts by bilateral donors and MDBs toward poverty reduction to meet the Millennium Development Goals by 2015, thus investments in infrastructure have been quite limited, therefore creating room for the newly established MDBs (Wang, 2014).

3.3. Reforms in Global Economic and Financial Governance: New Multilateralism in Asia

China's step on the stage of multilateral finances is considered by many stakeholders as a threat to the existing liberal international economic order. Due to a perceived lack of cohesion among their members, the NDB and the Contingent Reserve Arrangement of the BRICS (CRA) are not seen as strong enough to challenge the Bretton Woods system.

When it comes to identifying motivations of emerging powers for creating new MDBs, one has to realize that the risk in the contemporary global economy had been long existing that the established powers will stick to their old institutions, and while doing so, the world will lose the option of collective action and a deeper form of global cooperation (Woods, 2008). Reality proved the prediction. Though, there had been an emerging trend toward global governance frameworks, like the G20 consisting of the largest industrialized countries, these settings remained an informal coordination platform by nature, consequently decisions were subject to slow national legislations and processes.

A large group of emerging market economies, however, expected proportional representation, and thereby more inclusion in the decision-making processes in the Bretton Woods institutions based on their weights in the global economy. Slow responses from these institutions as well as long-standing inaction by the United States with the largest voting power diminished the strength of the global financial architecture, hence emerging economies have been pushed toward choosing regional or bilateral ways of representing and pursuing their political and economic interests.

While China, along with other developing nations, criticized the Western-dominated international financial architecture as being unfair to the Global South in terms of voice and representation, the IMF quota and governance reform to increase, among others, China's voting power in the IMF as put together and approved by members in 2010, was not implemented due to the lack of legislative action by the United States until 2015. As the world economy continues to change, the same dynamic that delayed these past reforms, is likely to delay or prevent further reforms in the future (Weisbrot – Jake, 2016) against a backdrop of a continued economic growth in China and a moderate one in Europe since the economic and financial crisis of 2008. The prolonged inaction vis-à-vis democratization and legitimacy reportedly had been a cause of frustration among developing countries and emerging economies, and slowness in the reform process of the Bretton Woods institutions is cited among the reasons for the creation of the AIIB and NDB. To sum up, the balance of power has been shifting from the global multilateral and development institutions to regional levels.

Similar to the case of AIIB, an even more dominant factor for the establishment of the NDB might have been the general dissatisfaction of BRICS countries with the pace of the voice reform at the Bretton Woods institutions, which they consider to be outdated as those arrangements do not reflect the current global economic power distribution.

The concept of multilateralism is an evolving one globally and especially in Asia. A series of events such as the Asian financial crisis of the 1990s and the global financial crisis in the late 2000s proved that global multilateralism of the post-World War II era is not the most effective way of responding and stabilizing crisis situations in international finances (Brummer, 2014). In addition, a prolonged accommodation of ambitious dynamic emerging and developing countries, located especially in Asia, to better reflect their increasing role in the global economy contributed to develop alternative solutions.

Therefore, while being more active in foreign economic policy, China has accelerated its engagements in minilateralism, the latter defined as the gathering of a sub-group of countries within or outside a multilateral institution focusing on solving a problem while the multilateral institution is unable to reach agreements among its members (Wang, 2014). This paper argues that, by its intentions to establish AIIB, China wished to strengthen its leading role in minilateral initiatives such as the NDB or the CRA, but at the same time, decided to move beyond them and aimed to form an institution focusing on regional problem solving with a global perspective in terms of its membership. It is worth noting that before China entered the multilateral stage, some of its bilateral agencies (e.g. the China Development Bank or the China Exim Bank) pursued larger infrastructure investment projects than the World Bank. Furthermore, China as a new donor built up a development finance budget of USD 130 billion in 2016, larger than that of the six major Western-dominated MDBs like the World Bank, the Asian Development Bank, the Inter-American Development Bank, the European Investment Bank, the European Bank for Reconstruction and Development, and the African Development Bank combined (Gallagher et al., 2016).

Table 1

BRICS Selected Economic Indicators (2016)

Country	Brazil	Russia	India	China	South Africa
GDP (current USD billion)	1,796	1,283	2,264	11,199	296
GDP per capita (current USD)	8,840	9,720	1,670	8,250	5,480
Annual GDP growth (%)	-3.6	-0.2	7.1	6.7	0.3
Total Reserves (current USD billion)	365.0	377.1	361.7	3,098	47.2
Population (million)	207.6	144.3	1,324	1,379	55.9

Source: The World Bank

Given their start-up phase in their life cycles, sizes, basic governance arrangements and shareholder base in case of the AIIB, it would be hard to argue that China's recent intention is to use these institutions to undermine the Western-dominated financial system. There is certainly a learning curve that they have to go through. Broadly, it is safe to say that if China's position as a rising power and ambition for fair representation and further reform are recognized by the US-led international system, China will rather strive to follow rules and procedures of the traditional multilateral institutions and China-dominated institutions will generally go for complementarity in their activities. This does not exclude the possibility of alternative solutions in governance or operational mechanisms. However, if confidence erodes and suspicion deepens between the main stakeholders, as recently evidenced by the new National Security Strategy of the United States[5], chances will grow that China would opt for a hard liner approach when pursuing its foreign policy, also resulting in attitude changes toward the new MDBs.

While the United States quietly confirmed China's aspiration for recognition as a financial power as demonstrated in the latest years of the Obama administration[6],

5 The National Security Strategy of the United States of December 2017 refers to China as a competitor, challenger and a revisionist power along with Russia (The White House, 2107).

6 Chinese sources indicate that an agreement was reached at the Obama-Xi Summit meeting in September 2015, acknowledging China's status as a major power while working to ensure that the rising power process would be a peaceful one. Shortly after this meeting, the US Congress authorized the 2010 quota and governance reforms at the IMF in December 2015 (Gu, 2016).

we are currently witnessing, a more explicit suspicion, coupled with stepping back from international commitments by the Trump administration[7], leaving more space for Chinese dominance in the world. Moreover, recent developments with regard to a potential trade war do not strengthen directions towards mutual trust, thus undermine chances and potential of multilateral cooperation globally. We project that the multilateral financial arena will be an important segment of a strengthened activism in China's foreign policy in the medium and long-term.

4. Changing Landscape of Multilateral Development Banks

2013 and 2014 saw an active engagement in the multilateral financial area by China and other major emerging powers. In July 2014, the BRICS countries established the NDB. In terms of financial fire power, a subscribed capital of USD 50 billion and an authorized capital of USD 100 billion have been set aside by the founding members. Shareholders aimed to mobilize financial resources to invest in infrastructure and sustainable development in member countries but also other developing economies. In addition to an arm investing in the real economy, the BRICS countries created their own monetary fund, called the Contingent Reserve Arrangement of USD 100 billion to deal with balance of payment pressures and support financial stability in member states.

Moreover, after five consultation rounds taking exactly one year, a memorandum of understanding on the establishment of the AIIB was signed by 21 Asian countries in October 2014. In the meantime, the United States led a campaign to convince interested countries not to join the new, China-led bank. This, however, was without success since several US allies, including the United Kingdom, decided to join the new initiative. Following five chief negotiators' meeting, 53 countries out of the 57 prospective founding members, including 20 non-regional and 14 advanced economies of the G20 had signed the Articles of Agreement by October 2015. With its commencing of business in January 2016, AIIB became operational within a bit more than two years after its official announcement, almost tripling its membership base in the meanwhile which showcases the effectiveness and attractiveness of the Chinese diplomacy. China's dominant role in the AIIB is expressed through its veto right in the governance of the institution, a similar feature that the US enjoys in the IMF and the World Bank.

7 The United States' withdrawal from multilateral initiatives such as the Trans-Pacific Partnership agreement and the Paris Agreement on climate change (COP21), or the cut in funding for MDBs including the World Bank.

4.1. The Asian Infrastructure Investment Bank

4.1.1. Membership and Governance Arrangements

With its diversified global shareholder base (currently 84 approved members, of which 62 are full members, membership has practically no geographical restrictions and is not limited to sovereigns[8]) and USD 100 billion capital stock with 20 percent assigned to paid-in capital, AIIB, headquartered in Beijing, ranks among the medium-sized MDBs, i.e. it is smaller than both the World Bank and the ADB and slightly larger than the African and Islamic development banks. According to its Articles of Agreement, as a regional bank AIIB has to preserve its regional character, therefore its regional members hold the majority of the capital stock, a minimum of 75 percent of the subscribed capital.

Table 2

Geographical Distribution of Membership at the AIIB as of March 2018

Regional Members (40)		Afghanistan, Australia, Azerbaijan, Bangladesh, Brunei Darussalam, Cambodia, China, Fiji, Georgia, Hong Kong, India, Indonesia, Iran, Israel, Jordan, Kazakhstan, South Korea, Kyrgyz Republic, Lao PDR, Malaysia, Maldives, Mongolia, Myanmar, Nepal, New Zealand, Oman, Pakistan, Philippines, Qatar, Russia, Saudi Arabia, Singapore, Sri Lanka, Tajikistan, Thailand, Timor Leste, Turkey, UAE, Uzbekistan, Vietnam
Regional Prospective Members (8)		Armenia, Bahrain, Cook Islands, Cyprus, Kuwait*, Samoa, Tonga, Vanuatu
Non-regional Members (22)	Africa	Egypt, Ethiopia
	Europe	Austria, Denmark, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, United Kingdom
	North America	Canada
Non-regional Prospective Members (14)	Africa	Madagascar, South Africa*, Sudan,
	Europe	Belarus, Belgium, Greece, Romania,
	Latin America	Argentina, Bolivia, Brazil*, Chile, Ecuador, Peru, Venezuela

Source: AIIB
Notes: * Prospective founding member: a member whose membership has been approved by the Board of Governors but has not yet met the requirements of membership

As defined by its Articles of Agreement, AIIB performs global best practice, i.e. transparency, independence and accountability in terms of its governance structure and arrangements. All powers of the AIIB are vested in its Board of Governors whose

8 AIIB's Articles of Agreement, Chapter I, Article 3. See also membership of Hong Kong, China in the AIIB.

members are appointed by the member countries. It is a differentiating feature that founding members differ from new accession countries by having been granted an additional 600 votes. Strict principles, embedded in internal procedures and governance ensuring best practices in the environmental, social, labor and procurement areas are exercised by the management, and scrutinized by a non-resident Board of Directors. This latter is composed of twelve Directors, of which nine are elected by regional members, while three others are appointed by non-regional members. Members of the Board of Directors are elected for a two-year term and may be re-elected. This body is in charge of the direction of general operations, approval of the strategy, annual business plan and budget, establishment of policies and an oversight mechanism, and general supervision of management and operation.

The management team of the bank consists of the President, a national of a regional member country and elected by the Board of Governors to serve up to two 5-year terms, and Vice Presidents. Vice Presidents are appointed by the Board of Directors upon recommendation of the President.

Table 3

Representation of Membership at the AIIB as of March 2018 (%)

Director	Countries represented	Voting power
China	China, Hong Kong, China	27.6
Russia	Iran, Kazakhstan, Russia, Tajikistan	8.8
India	India	7.7
South Korea	Fiji, Israel, Korea, Mongolia, Samoa, Usbekistan	5.6
Australia	Australia, New Zealand, Singapore, Vietnam	5.5
Saudi Arabia	Jordan, Kuwait*, Oman, Qatar, Saudi Arabia, United Arab Emirates	5.5
Turkey	Azerbaijan, Brunei, Georgia, Kyrgyz Republic, Pakistan, Turkey	5.2
Indonesia	Cambodia, Indonesia, Laos, Myanmar, Sri Lanka	4.8
Thailand	Bangladesh, Malaysia, Maldives, Nepal, Philippines, Thailand	4.3
Total Regional		75.3**
Germany	Austria, Finland, France, Germany, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Spain	15.3
United Kingdom	Denmark, Hungary, Iceland, Norway, Poland, Sweden, Switzerland, United Kingdom	7.6
Egypt	Brazil*, Canada, Egypt, South Africa*	1.8
Total Non-Regional		24.7

Source: AIIB, own calculations
Notes: *Prospective Founding Members; **Includes Afghanistan, Timor-Leste and Vanuatu, countries not listed under any Directors.

EU and OECD members, including five G7 economies, have now been contributing and directly influencing institutional building, strategies and policies as well as procedure and standard setting exercises of the AIIB at its start-up phase (Liu, 2017) to ensure that AIIB adheres to global best practices and standards. Furthermore, advanced economies' membership was key to China's ambition to make this bank truly international instead of regional. Though regional members control the bank with their super majority weight[9], non-regional developed countries have significant voting shares. Furthermore, the management structure is such that the President was nominated by China. India, as the economically most powerful state in South Asia, and the second largest shareholder of the AIIB, has a Vice President position, and the additional three Vice Presidents out of the senior management team of five are from non-regional nations (UK, Germany and France[10]). Beyond the assumption that EU and OECD countries' memberships benefit the AIIB in its initial phase through their involvement in shaping strategies and internal processes, joining AIIB was also in the best political and economic interests of these developed countries, so that they were able to demonstrate towards China that they are willing to support its signature initiative in the multilateral stage.

The AIIB is supposed to support operations in regional member states, however, a recently approved strategy for financing in non-regional members opened up the bank resources to countries outside the geography of Asia. Out of the region projects must fall in one of the following categories: (i) Investments supporting connectivity with Asia; (ii) Investments in global public goods, specifically renewable energy; and (iii) Investments with geographical proximity at the discretion of the Board of Directors (AIIB, 2018a). It cannot be established at this time whether this strategy is a "lex-Egypt", the only explicit reference in the strategy as a non-regional member meeting the above principles, or the bank will more broadly widen the scope of operations to geographies outside of Asia in due course.

While most US allies have joined the AIIB, including Canada this March, the US and Japan still keep their distance from it, and they are not expected to join in the short run due to geopolitical considerations.

9 A super majority vote of the Board of Governors shall require an affirmative vote of two-thirds of the total number of Governors, representing no less than three-fourths of the total voting power of the members.

10 The UK was the first European country to apply for membership in the AIIB, and Germany is the biggest European shareholder of the bank.

Major decisions as defined by the Articles of Agreement require a super majority vote of the Board of Governors, meaning that key decisions require the support of non-borrower countries, in the following areas: (i) increase in the authorized capital stock; (ii) changes to the regional capital stock ownership share; (iii) election, suspension or removal of the President; (iv) amendments to the Articles of Agreement; (v) revise the composition of the Board of Directors; (vi) allocation of net income to purposes other than retained earnings; and (vii) increase a member's capital subscription at its request.

4.1.2. Operational Highlights

AIIB is drawing lessons from track records and experiences of other MDBs to improve efficiency and value propositions. To demonstrate its ambition to be complementary to existing MDBs, cooperation agreements have been concluded with dominant global and regional players in multilateral finances.

Table 4

Cooperation agreements between the AIIB and major MDBs

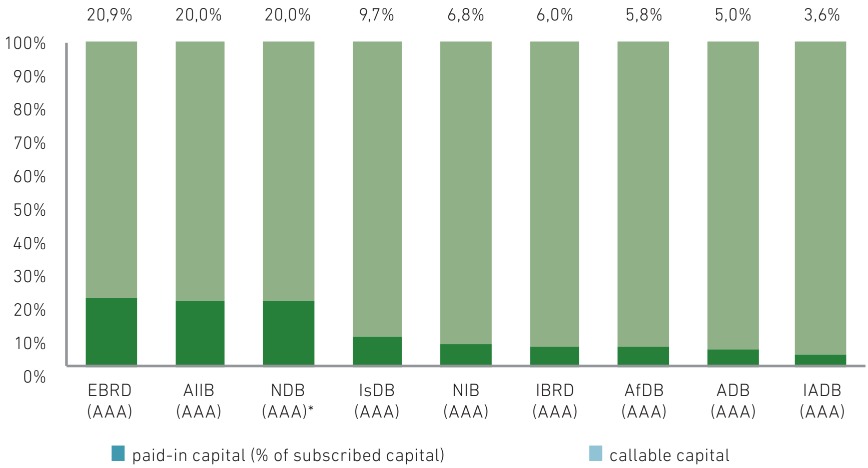
MDBs	Cooperation agreements	Amount of co-financing, Total project cost, December 2017
World Bank	Co-financing framework, April 13, 2016	USD 13.3 billion
IFC	Hedging and currency risks agreement, February 9, 2017	USD 1.0 billion
ADB	Memorandum of Understanding, May 2, 2016	USD 10.3 billion
EBRD	Memorandum of Understanding, May 11, 2016	USD 8.7 billion
EIB	Framework agreement seeking joint strategic projects, May 30, 2016	USD 1.8 billion

Source: AIIB

In terms of credit rating, due to its conservative capital structure, AIIB belongs to the best rated global development banks such as the European Bank for Reconstruction and Development, the Islamic Development Bank, the International Bank for Reconstruction and Development and a few others as confirmed by the major global credit rating firms (S&P, 2017). This ranking confirms not only the bank's capital position but also shows that the bank's membership base and governance framework is appreciated by the rating agencies.

Diagram 1

Capital structures and credit ratings* of MDBs



Source: MDB's web pages
Note: * Ratings by S&P, Moody's and Fitch, except for the NDB whose rating was assigned by the leading Chinese rating agencies.

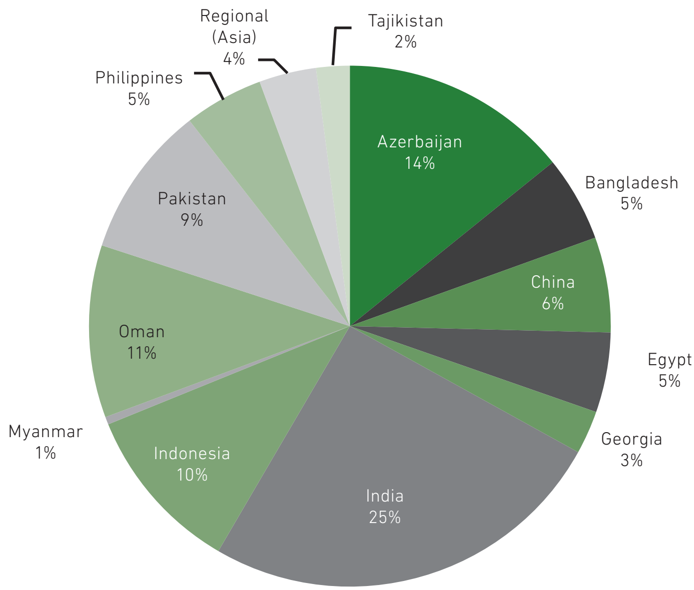
AIIB focuses on supporting the long-term, competitive financing of the infrastructure development funding gap in Asia estimated at USD 26 trillion through 2030. AIIB's mission is to improve economic and social development through a focus on sustainable solutions, cross-border connectivity and private capital mobilization. Its modus operandi is known to be lean, with a small and efficient management team and highly skilled staff, clean, an organization with zero tolerance for corruption, and green, meaning the highest respect for the environment.

At the outset, AIIB divided the next decade of its operations into two parts. In its start-up phase (2016-2020), it is basically focusing on building institutional capacities, providing primarily sovereign lending, and building partnerships with other MDBs through co-financing as well as establishing AIIB's brand in the capital markets through initial borrowings. In the growth phase (2021-2027), AIIB's balance sheet is expected to grow rapidly along with an expanding loan disbursement trend. Borrowings from the market to meet liquidity needs will potentially ramp up to the excess of USD 10 billion a year by the mid-2020s.

The AIIB has put in place strong policies on governance, finance, procurement as well as environmental and social frameworks. Investment operations in terms of approved loans till the end of 2017 totaled to USD 4.2 billion that catalyzed a more than five times total project cost of USD 21.5 billion.

Diagram 2

Geographical distribution of loans approved at the AIIB (end-2017)

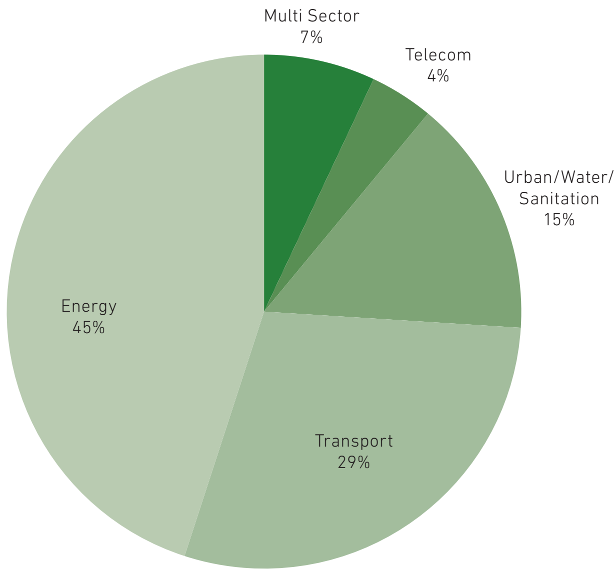


Source: AIIB

AIIB's financing is spread over 12 countries and several sectors with the largest exposure to India and Azerbaijan in the energy and transport sectors. The current portfolio shows that AIIB's efforts are focused on complementing existing activities of other MDBs through energy, transport (road, rail and water), urban, water and sanitation, and telecommunications projects (see more details at Diagram 2 and 3). A quarter of its current portfolio is a standalone one, while the rest is co-financed by other MDBs. Cooperation with other MDBs certainly supports the process of being able to create projects and markets on a standalone basis in the medium to longer run. Based on its capital strengths, the potential of yearly commitments might increase to at least USD 10 billion in the medium and long-term.

Diagram 3

Approved projects by sector at the AIIB (end-2017)



Source: AIIB

The AIIB is offering four main instruments to its clients: sovereign loans, non-sovereign backed financing, equity investments, and guarantees.

4.2. The New Development Bank

The NDB was established within the context of the BRICS inter-governmental mechanism by its five founding members, Brazil, Russia, India, China and South Africa at the fifth BRICS Summit in Fortaleza, Brazil in July 2014, by signing the Agreement on the New Development Bank (NDB, 2017). According to its Articles of Agreement, the main mandate of the bank is to mobilize resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries, complementing the existing efforts of multilateral and regional financial institutions for global growth and development.

The NDB was established exclusively by the BRICS countries with the unambiguous intention to emphasize the increasing demand of emerging market countries for an acceleration of a paradigm shift in development cooperation. At the collective level, it can also be seen as a consequence of the increasing institutionalization of the BRICS grouping (Chenoy et al., 2016). As laid down in its general strategy, the bank regards its own creation as an expression of the growing role of BRICS and other emerging markets and developing countries in the world economy, and their greater willingness to act independently in matters of international economic governance and development (NDB, 2017).

4.2.1. Lean Governance and Decision-Making

The NDB was established with an initial authorized capital of USD 100 billion and an initial subscribed capital of USD 50 billion. The subscribed capital stock is divided into paid-in capital, with an aggregate value of USD 10 billion, and callable capital with an aggregate value of USD 40 billion.

The Bank's main governing bodies are the Board of Governors and the Board of Directors. Each of the five founding members may appoint members and alternate members of those bodies. The Board of Governors approves the general strategy of the bank every five years. It may also admit any new member to the Bank by determining the conditions of their admission and may decide on any increase in authorized and subscribed capital stock of the Bank.[11] The Board of Directors is responsible for the conduct of the general operations of the Bank, including decisions concerning the Bank's budget, business strategies, loans, guarantees, investments and borrowings. The Board of Directors' non-resident character reduces administrative costs and, according to the expectations, helps the Board focus on high-level policy issues and particularly complex projects rather than routine day-to-day operations.

A unique characteristic of NDB's governance structure is that each founding member holds an equal number of shares and equal voting rights. Most of the decisions are taken by simple majority and no single shareholder has a veto right over any matter. As a consequence, and in sharp contrast to all other MDBs including the AIIB, it prevents any one country from dominating the decision-making processes or controlling the functioning of the Bank.

Although no advanced countries were allowed to participate in the founding of the BRICS bank, its membership is principally open to members of the United Nations, in accordance with the terms, conditions and procedures determined by a special

11 Article 11 of NDB's Articles of Agreement.

majority[12] at the Board of Governors. Since 2017, the NDB is officially open to accept new membership applications. However, the Bank follows a rather reluctant expansion approach as the admission of any new member might take place only if it does not overly strain its operational capacity and decision-making processes. The geographical diversity and the reasonable mix of advanced, middle-income and lower-income countries should also be ensured (NDB, 2017). Advanced countries are restricted to a maximum of 20 percent of voting power and can only join the NDB as non-borrowing members ensuring that the bank is run by the BRICS countries. Furthermore, President Putin made it clear on the margin of the G20 Summit in Hamburg that it would not support the acceptance of any countries that are currently imposing economic sanctions against Russia (Stuenkel, 2017). Notwithstanding the above, the NDB forecasts that by 2021 its membership will reflect its vision to become a truly global financial institution with extended membership.

In the context of the political agreement on the establishment of NDB, it was agreed that the bank's headquarters will be based in Shanghai, China, and its first regional office will be located in Johannesburg, South Africa as explicitly laid down in the Articles of Agreement.[13] The first president of the Bank was nominated by India and each of the other founding members nominated one Vice President. The Agreement on the NDB ensures that the president will always be elected from one of the founding members on a rotational basis and each of the other founding members will always be entitled to have at least one Vice President position.[14]

4.2.2. Innovative Operational Focus

As reflected in its name, the NDB intends to be "new" and innovative in many aspects of its operation which intention has evidently been demonstrated in considerable parts of the General Strategy. The document emphasizes that the Bank intends to implement the "principle of equality, mutual respect and trust" towards their members and borrowers in different aspects of its operation which is a unique differentiation compared to other MDBs (Cooper, 2017). In this context, it can be pointed out that these principles are traditionally seen as substantive characteristics of a South-South co-operation as well, apparently differentiating from the existing considerable inequalities in North-South economic relations (Zhu, 2015).

12 A special majority means an affirmative vote of four of the founding members concurrent with an affirmative vote of two third of the total voting power of the members.
13 Article 4 of NDB's Articles of Agreement.
14 Article 3 of NDB's Articles of Agreement.

Referring to the paramount importance of national sovereignty, the Bank intends to apply national laws and procedures on project implementation issues, whenever possible, without compromising quality and without infringing the Bank's reputation and institutional integrity. It will support the implementation of projects that fulfil the need of the member countries concerned, respecting their development priorities and strategies. Additionally, the Bank regards its members and borrowers as equal partners and, therefore, will initiate dialogues with borrowers on how to address the particular challenges of their socio-economic environment (NDB, 2017). This kind of operational model can also be interpreted as a specific manifestation of the division of labor between the shareholders, borrowers and the management of the Bank.

During the implementation of its financing operational program, the Bank intends to support the development agenda of BRICS and other member countries, in coordination with ongoing government programs and the activities of other development partners. Within the spectrum of infrastructure and sustainable development, the Bank's key areas of operation will mainly include the following (NDB, 2017): (i) Clean energy; (ii) Transport infrastructure; (iii) Irrigation, water resource management and sanitation; (iv) Sustainable urban development; and (v) Economic cooperation and integration.

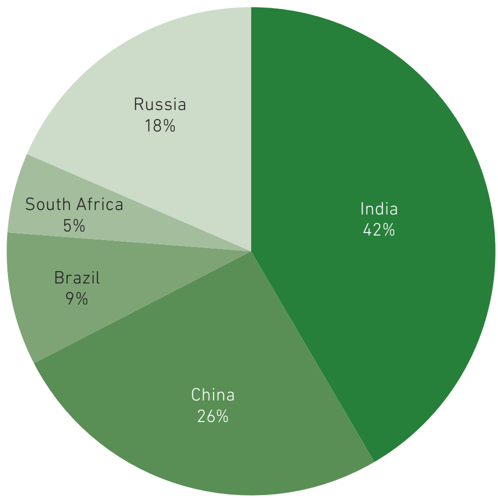
As a justification for the choice for these focus areas, the Bank envisaged a number of advantages to its borrowers and shareholders. These are centered around quick and effective responses, specialized expertise and financing sources targeting institutional investors that seek sustainability-friendly assets. The sustainability-requirement also implies that the bank will have to pay rigorous attention to the environmental and social impacts of the individual projects and the Bank's entire operation as well.

The NDB aims to structure, appraise, negotiate and approve loans within a period of 6 months without compromising risk assessment standards and credit quality. According to the expectations, a lean and flat organizational structure will result in lower administrative costs in a medium term, which will also allow lower lending costs.

The core mandate of the NDB is to mobilize resources for infrastructure and sustainable development in BRICS countries. The portfolio of outstanding loans is the most important tool and a "visible indicator" for achieving this purpose (NDB, 2017). Thus far, the Bank has committed USD 3.4 billion in loans to its member countries with a strong emphasis on renewable energy (see more details at Diagram 4 and 5). The lending is currently mainly focused on sovereign and sovereign-related operations. According to the projections of the Bank, the amount of loan approvals will gradually increase and will reach the yearly amount of USD 10 billion to 15 billion by 2021 (NDB, 2017).

Diagram 4

Geographical distribution of loans approved at the NDB (end-2017)

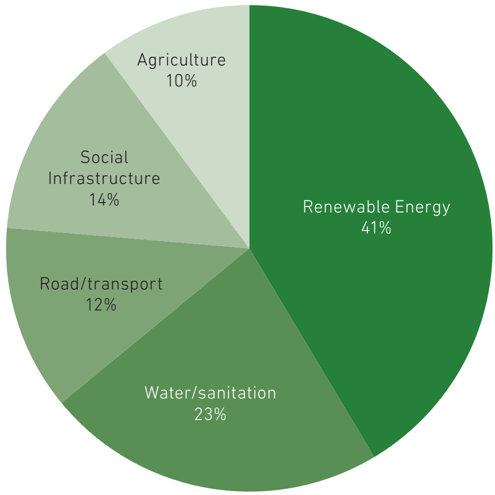


Source: NDB

NDB will utilize a full range of financial instruments, as envisioned in its Articles of Agreement. In the period between 2017-2021, the Bank primarily plans to provide traditional long-term loans, but as its capacity and financial strength grow, it intends to offer loan guarantees as they are still “underutilized” by most existing competitors of the Bank, as well as direct equity investments when appropriate to project needs and risk profile. Other innovative instruments such as project bonds, asset securitization, derivative arrangements to hedge risk and reinsurance schemes will be explored at a later stage (NDB, 2017).

Diagram 5

Approved projects by sector at the NDB (end-2017)



Source: NDB

During a relatively short period, the NDB made its best efforts to create partnerships with all key MDBs and regional financial institutions, national development banks, commercial banks and other organizations through concluding memoranda of understanding and cooperation agreements. The purpose of these agreements is to underscore the bank's strong efforts to build on joint capacities for preparation, implementation and assessments of projects to a more significant scale. Thus far, however, there is no information available as to any concrete co-financing arrangement with financial actors.

5. Distinguishing Features: A Comparative Analysis of Multilateral Development Banks

5.1. Procurement, Social and Environmental, and Fiduciary Policies, Governance

In the run up to their creation, concerns had been defined as regards capacities and willingness of the new MDBs to adopt internationally accepted principles, practices and procedures for governance, environmental and social safeguards as well as procurement. In the meantime, the AIIB established its own principles and standards, however, it may agree to the use of country or other MDBs' systems in case consistency can be ensured, whereas the NDB is relying on existing country systems not only in procurement but in the environmental, social and fiduciary fields rather than bypass them with external standards. An important difference between the AIIB and NDB procurement policies is that the latter ties it to membership. While established MDBs usually make their loans and other operations conditional on international invitations, neither the AIIB nor the NDB is applying this feature.

Regarding governance arrangements, the most notable difference is that the NDB and the AIIB do not have resident boards of directors unlike in the case of most MDBs[15], meaning that the board has regular meetings, but this is not a day-to-day exercise. Operational efficiency in these governance frameworks can be ensured if the necessary level of trust between shareholders' representatives and the management is built up and maintained, and a healthy division of labor, with certain demarcation lines, is drawn between the two bodies. To ensure fiduciary responsibilities, a clear accountability framework is to be set up at both institutions that can be expected to happen by the end of their start-up phase. However, it also has to be noted that in November 2016, the European Parliament raised its concern that "so far the AIIB's governance structures do not foresee adequate involvement of shareholders in project financing decisions, and that the publicly available project documentation lacks any detail on the fulfillment of the environmental and social measures that the AIIB requires from its lenders" (European Parliament, 2016).

5.2. Financial and Human Capacities

Both the AIIB and the NDB differ in size of their capital base and human resources. In terms of financial fire power, both emerging MDBs are smaller than the World Bank, the Asian Development Bank or the European Investment Bank, equivalent to about 40 percent, two-thirds and one-thirds, respectively. They are, however significantly larger than some of the regional development banks (e.g. three-times of the size of the European Bank for Reconstruction and Development). Given the lean philosophy of the new banks, their human resources capacities will not converge to the ones of the old MDBs but expected to remain in the range of 250 to 500 in the longer run. This

15 European Investment Bank has no resident Board, too, however, one can argue that the EIB's room for maneuvering in terms of policy directions are crystal clearly defined by the respective EU policies and mandates, hence a non-resident Board might be deemed as warranted.

means that their capacities will be limited to exercise their own independent sector expertise and in depth advisory services, consequently they will rely on partner institutions in this respect. Both banks' financial capacities support the scenario of annual loan approvals going up to around USD 10-15 billion by the 2020s.

Table 5
A comparative table of major MDBs

Multilateral Development Banks	Number of Members	Number of Employees	Subscribed Capital, USD billion	Loan Disbursements, USD billion (2014)
African Development Bank	80	2,000	90	4.6
Asian Development Bank	67	3,000+	153	22.3
European Investment Bank	28	3,200	275	95.0
European Bank for Reconstruction and Development	64	2,000	34	4.2
International Bank for Reconstruction and Development	188	10,000+	253	32.0
Islamic Development Bank	56	930	77	5.2
Asian Infrastructure Investment Bank	64	127	100	4.2*
New Development Bank	5	100+	50	3.4*

Source: Overseas Development Institute (2015); Callaghan – Hubbard (2016); MDBs' web pages
Note: *Loan Approvals

The newly established MDBs have just started to build up their business and financial profile, consequently, though AIIB has already gained the best credit rating[16] despite the lack of track record, they are not yet tested in the international capital markets in terms of the conditions of fund raising.

5.3. International Backing and Special Membership Features

MDBs in operation for several decades have been backed by the United States, while this support or interest to join does not exist in the case of the AIIB and NDB. Given, however, track records of established MDBs, experience and lessons learned can be followed by the new institutions.

16 All the three major global credit rating agencies, Moody's, Fitch, and S&P assigned its top notch rating to the AIIB in 2017. In 2016, NDB obtained domestic "AAA" credit rating with stable outlook in China from two of the leading domestic rating agencies China Cheng Xin International Credit Rating Co. Ltd and Lianhe Credit Rating Co. Ltd.

It is possible at the AIIB that non-sovereign entities apply for membership in case their home country is a member (see the membership of Hong Kong, a special administrative region of China). In addition, it is worth noting that dominant Western European countries were not seeking membership for the European Commission nor the European Investment Bank in the AIIB when applying for their own membership. This has been criticized by the European Commission by claiming that the individual EU members' signing up for the AIIB occurred not in a coordinated manner and without ensuring representation for the European institutions.

5.4. Differences in Mandates

While Western-dominated MDBs with majority shareholding from developed, well established donor countries focus on poverty reduction, and their development finance activities are often tailored with concessional elements, the AIIB and the NDB, created by borrowing countries of established MDBs to finance developing countries' needs, aim at sustainable infrastructure investments through commercially viable solutions. This means that these new banks are not supposed to set aside part of their net income for the purposes of concessional financing to the extent the World Bank Group does. To clarify, though it might not seem obvious, development outcomes, such as poverty reduction, environmental and social performance, are not contradictory to good financial performance, they are actually highly correlated with each other (IFC, 2007).

Another important, distinguishing characteristic compared to traditional MDBs is the institutions' concentrated operational approach centered around infrastructure and sustainability. The emerging MDBs' focus on sustainable infrastructure solutions is a response to the demand for basic energy, water and transport services in a way that safeguards the environment, while stimulating economic growth in the affected regions.

5.5. Game Changers in Private Capital Mobilization

Mobilization of private capital for infrastructure financing solutions is a key function of the MDBs. According to the cited calculations, new infrastructure demand in Asia over 2015-2030 could amount to USD 26 trillion. Based on historical information, USD 16 trillion of the forecasted new demand are to be financed from identifiable sources. This means that roughly an annual supply of USD 0.7 trillion financing gap will exist.

Though statistics and projects might differ in the exact magnitudes, it is clear that demand for Asian infrastructure investment far exceeds supply. Private capital and commercial sources from various stakeholders, especially form institutional investors are essential to finance Asia's infrastructure investment needs and MDBs can play a catalytic role to unlock those resources.

The AIIB's recently approved strategy for private sector mobilization as well as the NDB's general approach towards PPPs puts emphasis on leveraging resources of the private sector thus facilitating their participation in infrastructure investments also in the context of the 2030 Sustainability Agenda (AIIB, 2018b). In order to fulfill the huge funding gap for infrastructure in Asia, both institutions have to work on solutions whereby the available financial potential of the region, along with savings of global institutional investors and sovereign wealth funds, can be turned to real investments. This catalytic role, the ability to identify and select bankable projects can make both institutions "game changers" (Callaghan – Hubbard, 2016). Both institutions are uniquely positioned vis-à-vis the public sector in terms of coordination of national policy contexts and business environment key to achieving acceptable risk-return profiles for private investors, an honest broker type of role that the private sector is unable to play. However, their relatively small human capacities do not support the fulfillment of this role. It is still premature to answer whether relying on external consultant capacities will be sufficient for systematic engagements with the private sector in a region of diverse challenges.

6. Conclusion

It is hard to deny the fact that China has already made significant steps toward restructuring the post-World War II international economic order by shifting balances from the US to China through multiple initiatives and supportive institutions. The US, however, does not show many signs of active counterbalancing in the direction of this movement. Furthermore, the US is stepping back from global arrangements and thereby giving more space to China to exercise its foreign economic policy ambitions. At the same time, advanced economies other than the US and Japan, have been actively partnering with Beijing and other emerging economies in adding value to the multilateral financial architecture. This new partnership as well as ambitions of leading emerging powers to reform the global financial governance had been institutionalized through the China-led AIIB and the NDB of the BRICS countries. This process contributes to establishing high governance and operational standards, thus providing quality to underserved geographies including Asia.

Given the ambitious development programs backed by China and other major emerging powers, and the sizeable funding gap in infrastructure in Asia, estimated at USD 20 to USD 30 trillion through 2030, there had been an immense need for new multilateral arrangements that could be complementary to its well-established peers, and could also find new ways to unlock private sector resources for the purposes of infrastructure projects.

In conclusion, this paper found that while the new institutions will help address the huge financing needs in emerging and developing countries through mobilizing resources from inside and outside of Asia, they are to serve multiple political objectives in parallel, namely:

- promoting China's foreign and economic policy agenda striving for the emergence of a multipolar world order;
- providing financial public goods through engaging with regional peers, and
- increasing representation of emerging markets in the global economy, thus stimulating reforms of global financial institutions.

This paper argues that policies and measures implemented by the AIIB and the NDB right after their establishment are important steps toward the potential of playing a global role by delivering on sustainable infrastructure and connectivity. Innovative new approaches in business models and operational arrangements, and a new-type of accountability mechanism that redefines the roles and responsibilities of shareholders and management can create new ways of institutional arrangements for the MDBs in the 21st century, making them more effective through healthy competition.

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Japan in the Web of Integrations

Pál Majoros

Spring 2018 was an important time in the history of international free trade. Japanese Prime Minister Abe Shinzo and the President of the European Commission Jean-Claude Juncker signed a free trade agreement, which will enter into force in autumn 2019 following the ratification processes. On 8 March 2018, the leaders of eleven countries (Japan, Canada, Mexico, Singapore, Malaysia, Brunei, Vietnam, Chile, Peru, Australia and New Zealand) signed the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership) in Chile. Japan is holding negotiations with South Korea and China on free trade concurrently with other free trade negotiations.

This paper examines what happened in Japan, which had had no bilateral free trade agreement with any country (or group of countries) until the turn of the millennium. What are those motivational factors, which spurred Japan (and, for that matter, the entire Far East) to arise from their apathy for integration? Are there any common cultural and civilizational causes that explain the strong tendencies of integration in the region in the beginning of the 21st century? Or, alternatively, are there instead hard and fast economic factors in the background?

The willingness to cooperate has strengthened in East Asia and we have seen the strengthening of regional integration over the past 20 years. To better understand the process, we need to overview the major historical, cultural and civilization characteristics of Japan and its region.

1. Japan's Economic Development Policy after World War II

The losers of World War 2, including Japan, were not involved in the setting up of the new world order, and after a while neither the Soviet Union, nor the East-European countries participated in the establishment of the new international institutions (IMF, IBRD, GATT, NATO). The new world order therefore served the interests of the US and Western Europe, that is of the so-called West, and represented the interests and values of a western type of civilization. However, after a few years of stagnation

(1945-49), a remarkable egress presented itself. Communists seized power in China, which triggered the modification of the US's Far Eastern security policy strategy. The several times humiliated Japan was offered a strategic partnership, which is understandable, since there was no other state in the region, that could combat the Asian communism (Soviet Union and China), and that could be advantageous geographically, too. The introversion of the Japanese and their economic problems lent themselves to the American initiative. Japan embarked on a new (third) period of modernization, in which the US served as the model, supporting the country financially in return for which they created military bases on the island. The Japanese miracle dates from 1955. It was literally a miracle, which meant fast export-driven economic growth (with an annual average beyond 10 percent between 1955-1973, and slightly below 10 percent between 1974-1988), full employment, structural transformation, and transition from labor-intensive production to capital-intensive and knowledge-based production (Bassa, 2011). In this period, Japan barred itself from foreign capital inflow (the small amount coming from the U.S.).

Due to the environmental disasters at the end of the 1960s, Japan's economic strategy had to be modified. The energy- and raw material-intensive production was outsourced to neighboring states, and Japan became an exporter of capital, while favoring technology-based production. Due to their geographical proximity, the first wave of capital investments was in the so-called Tiger countries (South Korea, Taiwan, Hong Kong, Singapore). These changes took place in good time, since though they came unexpected, the crude oil price boom of 1973 did not take Japan fully by surprise. The outsourcing of energy-intensive production had begun, and efforts were made to develop the production of nuclear power, and to diversify the sources of the acquisition of fossil fuels. Although the crisis shaking the world brought a minor recoil, the urge for modernization and the export-driven growth path brought an increase significantly surpassing the global average rate.

Japanese capital outflow included not only money, but technology, know-how and a new model of development for the Tiger countries, since they too followed an export-driven growth path. The main difference, however, was that the target of their export was mostly Japan. They managed production until the point of assembling spare parts and units, but the assemblage of the final product took place in Japan. With the inflow of Japanese capital, in these countries we find the appearance of specific micro (corporate) integrations, of supply chains (predecessors of the global chains), and also, no less importantly, the fusion of ownership. These are the first signs of Japan's integration aspirations.

From the mid-80s, there were new bursts of capital outflow, this time to the so-called small Tigers (Thailand, Malaysia, Indonesia, The Philippines), and, at the same time, to the increasingly modernized China. Then in the 90s, the countries of Indochina became the targets of capital export (Vietnam, Cambodia, Laos, Myanmar), although it was obvious from the 80s that the whole globalized world served as Japan's target. Still, geographical proximity is a crucial factor. Japan's capital investments can best be modelled by the so-called flying goose model. According to this model, the geese flying in V shape are led by Japan the leader. In our case this means that it exports technology to the cooperative countries, and simultaneously, creates market for its products. The leader country is capable of continuous technological modernization, the results of which are granted to firms in partner countries. With this method, both the leader country and its followers can attain faster economic growth, and thereby become the models of export-oriented economy (Kasahara, 2013). Needless to say, the dominant model is Japan: Japanese private capital is expanding in the region thanks to government incentives which satisfy the country's aspirations for economic dominance. There was a similar process 60-80 years before, with recourse to weapons. However, there are great players in the region apart from Japan, namely the US, due to its capital and merchandise exports, and military presence, and China, which—becoming a market economy—has been strengthening since the 90s.

In 1991, there was another important change in the global scene: the world economy was significantly affected by the disintegration of the Soviet Union and the turn of the regime in East-European socialist countries. The previously secluded socialist countries became exposed to globalization. The international capital flows increased, and multinational companies found new targets in the socialist world. In an economic sense, the world extended horizontally. In the field of security and military policy, the disintegration of the common enemy, the Soviet Union created a new situation in economic relations. The previously cooperating countries began to consider each other as rivals (and not as enemies). Japan had to face a number of challenges. First, the economic growth and expansion of China was an important factor, despite the fact that Japan had had a positive trade balance with the country. Second, as a consequence of the more or less severe South Asian crises in the 90s, the pace of economic growth started to stagnate and, from 1998, to turn negative temporarily. In the „flight of wild geese" model, the leader Japan has lost its place, and confused its followers, the major and the little Tiger countries. Corporate micro integrational relations loosened, and countries that had developed due to Japan's support started to establish their own development strategy and international relations thereby becoming rivals (mainly South Korea, Taiwan and Singapore). Third, we must not forget the controversial relations between Japan and the US. From the end of the 70s, Japan has accumulated a significant trade surplus with the US. By steadfastly purchasing US government securities and investing in the US, Japan precipitated the disapproval of the US, which sought to hinder its expansion in various ways. After the end of the cold war, the otherwise peaceful US-Japan relations were not only tried by economic tensions, but also by political controversies such as the question of the presence of American military bases in Japan (when it was revealed that nuclear weapons had been stationed on the bases despite the agreement), and Japan's standpoint regarding the diffusion of American and Western human rights principles in Southeast Asia. In this regard Japan resorts to its roots of civilization, having been disillusioned in the western economic-cultural model, and considers its success the product of its own culture (Huntington, 2002).

2. After the Turn of the Millennium

The turn of the millennium found Japan in a difficult situation. It suffered an economic recession, and its previous partners opened up to others. Moreover, the micro integrational relations loosened, and the disputes between China (which entered the WTO) and the US became more bitter. The aging and decreasing population became a social issue, since on the one hand, the working-age population decreased, leading to shortage of labor, and, on the other hand, the growing volume of pension expenses squeezed the budget. Further problems in the increasing well-being have been the young generation's alienation from the national traditions including the Confucian, and the low level and decreasing tendency of social reproduction. This is the time when it dawned upon the educated Japanese that China, which had been looked down on for 150 years, is after all at the roots of Japanese culture. These were shocks without effective redress.

Japan interpreted globalization as the opening up of the world providing opportunities for the country. However, Japan hardly opened up, and did not allow the inflow of foreign capital, while it imposed the highest tariffs (e.g. on rice and foodstuffs) in the developed world. Japan had difficulties in adapting to the changed international environment, e.g. it could not appear in the region of East and Central Europe opened up by globalization. It was an important change, that the previously contemned China overtook Japan first in the field of export, then in production.

Japan's response is telling: it is characterized by an increasing seclusion in terms of culture and civilization. Japan emphasizes its cultural identity, its individuality and difference from western and other Asian cultures. (Indeed, Confucianism is an important bond between Asian civilizations). Japan considers its previous economic success as the product of their own civilization, which is both economically and culturally superior to the declining Western civilization (Huntington, 2002). Japan distanced itself from western (US) thinking and turned to Asia. It strived to preserve the superiority of Asia and its own leading position in the economic sphere, in a way to guarantee that South Asia become the growth pole in the 21st century. For this reason, Japan opened up economically, which was a move made partly under constraint, the consequence of the 1997/98 crisis. It had to allow the inflow of foreign capital and change its economic ideology. As part of this change of attitude, Japan, which previously disapproved of all kinds of integration, finally opened up: it allowed foreign direct investment, and launched an integration strategy. All in all, it is the combination of civilizational and economic constraints that gave birth to the first signs of integration.

The period after the turn of the millennium is the beginning of integration: measures were taken to rescue the Japanese corporations affected by the crises of 1997-98 and 2007-2008, and the inflow of foreign direct investment was allowed. However, the amount of capital inflow was still considerably lower than the outflow. In 2016, FDI in Japan constituted hardly more than 4 percent of the GDP, which is an outstandingly low level compared to the developed and less developed countries of the world. Yet in recent years the capital outflow was USD 120-150 bn, making Japan the fourth greatest exporter. The 2008 global financial crisis brought about the diminution of world trade, as well as a significant setback in demand in developed countries, which resulted also in the further loosening of micro integrational relations in the region.

3. Abenomics

An important measure taken in recent years was the unveiling of a policy package advocated by Japanese Prime Minister Abe Shinzo, the so-called Abenomics, according to which the economy was the most important priority. The package comprises three directions:

- monetary easing (increasing the economy's money supply, and thereby securing a low rate, controllable inflation).

- fiscal expansion, boosting government spending (mainly in the area of infrastructure). It is the result of the increasing budgetary spending that Japan's gross national debt has exceeded 220 percent of the GDP, which is the highest in the developed world.[1]

- structural reforms in all areas of the economy and striving to become one of the leaders of the fourth industrial revolution (digitalization and robotization, development of artificial intelligence). One of the reforms is the more powerful development of integrational relations. Easing labor shortage by bringing more women into the workforce (Womenomics).

Abenomics has jolted changes in Japan's foreign trade policies, too. The previous multilateral approach has been replaced by a bilateral thinking: a new foreign trade strategy was elaborated along with the failure of the WTO Doha Round, the rivalry between China and Japan for primacy in Asia, and to become the gravitational center of Asian trade. The change in strategic thinking was influenced by the American President, Barack Obama's integration strategy: the commencing negotiations between the U S and the EU on TTIP (Transatlantic Trade and Investment Partnership), and on TPP. Yet on the Asia-Europe summits (ASEM), the main topic is the extending of trade relations, which means that the EU also intends to extend its foreign trade relations with the Southeast Asian states. For Japan, the enhancement of trade with the EU is no doubt a positive sign, although the more dominant appearance of the latter in the region jeopardizes Japan's interests. Therefore, it has become of utmost importance for Japan to elevate the basically micro-integrational, corporate relations to a national and international (interstate) level. It needs to be said that according to the GATT/WTO regulations, duty exemption within the free trade zone need not be extended to the other WTO member states. This prompted almost all countries and integrations of the world (EU, US) to resort to these means in trying to improve their market positions. It is beyond the scope of this study to analyze the effects of this process on the WTO,[2] but needless to say, it will weaken the multilateral relations.

In order to preserve and improve trade positions, Japan signed comprehensive cooperation agreements with several countries of the region. These agreements are not homogeneous due to the pragmatic approach of Japan's economic diplomacy. The contents, force and scope of the contracts are diverse. Trade in goods and services, protective rules of origin, protection of intellectual property rights and investment, clauses excluding double taxation were all included in the agreements (this is why

1 However, this is not an uncontrollable issue, since the Japanese government has become indebted to its own population, not to foreign countries.
2 In her essay, Kruppa (2016) explores this question in detail.

in secondary literature we increasingly find the terms like RTA/Regional Trade Agreement or EPA/Economic Partnership Agreement, which slightly differ from the earlier FTA/Free Trade Agreements. This study does not aim to fully elaborate the individual agreements, the texts are available on the website of the Japanese Ministry of Foreign Affairs. I would like to emphasize but one point: the learning process is recognizable. The initial agreements were plainly industrial free trade agreements, which were extended and modified in the domain of the economy, while the latest ones included questions of civilization and society (e.g. protection of the environment).

According to Hilpert (2014), bilateral and regional cooperation forms cannot be considered the alternatives to the multilateral trade system (WTO), but rather their complement. I cannot wholly agree with this view, since the global changes show that almost all actors of the world trade have turned to bilateralism. The WTO as a general system does operate, but the operators take advantage of the loopholes in order to improve their own situation. Through these bilateral agreements the countries can extend their trade in goods and services, maintain their competitive advantage in the geographically close countries, ensure their imports of raw material and energy carriers.

Japan is doing the same: beside its economic role in the Asian cooperation, the other factor is the strengthening of its political presence and the improvement of the cooperation with neighboring countries based on mutual confidence. Furthermore, Japan would like to improve its position in the competition with China for economic supremacy in the region, and to broaden its economic scope with new bilateral or multilateral agreements.

It is well worth mentioning that currently, Japan ensures preferential benefits to 138 countries and 5 regions. For many years China has been the greatest beneficiary, within the framework of the GSP system it provides two-thirds of the preferential imports (Komura).

4. Japan's Free Trade Agreements

By the beginning of 2018, Japan has signed 17 regional trade agreements that are still existing. Two of these, namely the one signed with the EU, the other with the TPP have not yet entered into force and are currently under ratification. Japan's free trade agreements are as follows: agreement with ASEAN as a multilateral organization and a separate agreement with its seven member states (Brunei Darussalam, Indonesia, Malaysia, The Philippines, Singapore, Thailand and Vietnam); agreements with developed countries (OECD) such as Australia, Chile, Mexico, Switzerland, and with developing countries such as India, Mongolia and Peru; and finally, agreement with the EU and the CPTPP, or the Trans-Pacific Partnership Agreement.

Table 1

Japan's regional trade agreements (2017)

Partner	Date of signature	Date of entering into force
Singapore	January 2002	November 2002
Mexico	September 2004	April 2005
Malaysia	December 2005	July 2006
The Philippines	September 2006	December 2008
Chile	March 2007	September 2007
Thailand	April 2007	November 2007
Brunei-Darussalam	June 2007	July 2008
Indonesia	August 2007	July 2008
ASEAN	April 2008	December 2008
Vietnam	December 2008	October 2009
Switzerland	February 2009	September 2009
India	February 2011	August 2011
Peru	May 2011	March 2012
Australia	July 2014	January 2015
Mongolia	February 2015	June 2016
TPP	January 2018	Not in force
EU	January 2018	Not in force

Source: [online] Available form: http://rtais.wto.org/UI/PublicSearchByMemberResult.aspx?MemberCode=392&lang=1&redirect=1

FTA drafts under negotiation are the following:

- Multilateral drafts:
    - RCEP-Regional Comprehensive Economic Partnership, ASEAN + 6
    - China-Japan-South Korea FTA
    - Japan-GCC (The Gulf Cooperation Council)

- Developed countries:
    - Japan-Canada FTA
    - Japan-South Korea EPA

- Developing countries:
  - Japan-Colombia FTA
  - Japan-Turkey FTA

- Preferential agreement:
  - APEC (Asian Pacific Economic Cooperation)

4.1. Japan's Agreements in the Region – ASEAN[3] and Its Member States

Over the past 15 years, Japan placed emphasis on the development of foreign relations in the region. The crises in the world economy affected the countries of the region similarly, and the destabilization of the network of relationships, described above as the wild geese model, spurred Japan to build its regional free trade relations. Initially it held bilateral negotiations with certain countries (Singapore, Malaysia, The Philippines, Thailand, Brunei, Indonesia and, later, Vietnam), then with ASEAN, the intergovernmental organization.

From a broader point of view, the region includes Mongolia and Australia, too. Therefore, from the 17 agreements 10 concerns the region, and this clearly shows the importance of cooperation between countries in the region. Japan's agreements made with the countries of the region, including ASEAN, serve long term purposes. It is through these steps that Japan intends to increase its influence in the region, and to keep up with the rival China, which has similar aspirations. Initially it established free trade agreements with the member states, and an Economic Partnership Agreement (EPA) with the integration. However, it is worth mentioning that although China overtook them when signing a Comprehensive Economic Cooperation Agreement in 2002, the EPA signed with Japan (2008) is of a higher level. (A similar agreement between ASEAN and China dates from 2010).

3 The Association of Southeast Asian Nations (ASEAN) was established on 8 August 1967 in Bangkok, Thailand. The Founding Fathers were Indonesia, Malaysia, The Philippines, Singapore and Thailand. Later the organization's membership expanded to include Brunei Darussalam on 7 January 1984, Vietnam on 28 July 1995, Laos and Mianmar on 23 July 1997 and Cambodia on 30 April 1999. Thus today, these ten states are the members of ASEAN. In the beginning, the primary objectives of the cooperation were the protection of political stability and security due to the Chinese political threat, and Japan's increasing economic influence in the region. It was only from 1977 that the member states exchanged trade preferences, then in 1992, they established the ASEAN Free Trade Area (AFTA). The principal aims of ASEAN include the acceleration of economic growth, the promotion of regional stability, peace and mutual assistance. (Cf. [online] Available form: http://asean.org)

The contract that entered into force in December 2008 contained measures toward the liberalization of trade between Japan and the ASEAN member states. Deregulation and the opening of the market was a long process entailing the following steps:

- the reduction of customs tariffs and the gradual lifting of nontariff barriers.
- the gradual removal of hindrances to the services trade.
- the liberalization of capital movements.
- special, tailormade treatment of less developed ASEAN countries (Cambodia, Laos, Myanmar).

In recent years, the main area of the regional expansion of Japanese capital has been the ASEAN, and primarily the Indo-China region, that is the less developed countries. Beyond the geographical proximity, this is also due to Japan's growing unemployment, and the income differences between the countries. Consequently, they started to offshore labor-intensive production to countries of low income (Vietnam, Laos, Cambodia and Myanmar). Japan is/was the second biggest source of FDI for the ASEAN countries.

The trade in goods between ASEAN and Japan has stagnated in recent years with and ASEAN export surplus. Japan has a 10 percent share in ASEAN's total trade in goods, and thus is the second greatest partner of ASEAN (ASIEN Economic Integration Monitor). The bilateral agreements concluded with the individual countries and the multilateral agreement complement each other.

After the agreements with China and Japan, ASEAN concluded a similar agreement with South Korea, what is more, also with Australia, New Zealand and India. Indeed, ASEAN participates in such trade cooperation form which encompass almost half of the world's population. This shows that the motor of integration in Southeast Asia is ASEAN.

4.2. Bilateral Agreements with Developed Countries – OECD Members

Japan concluded an agreement with Mexico, as the first OECD member state in 2004, and with Chile in 2007. Both agreements apply to trade in goods and services, and also include regulations on capital movements. It is a common denominator of the two countries that both of them lie on the coast of the Pacific and are members of the APEC cooperation.

The free trade agreement with Australia was signed only in 2014 (virtually simultaneously with China). These agreements apply not only to trade in goods and services, but also to the free movement of capital. The agreement emphasizes the trade in agricultural and fishery products. (Australia is also an APEC member state).

In 2009, Switzerland was the first European state to sign an agreement with Japan, which applied to goods, services, the regulations of product origin, intellectual property rights and capital movement. (In this they overtook China, which concluded a similar agreement only in 2013). It is a matter of interest that Switzerland is one of the few European countries which has a trade surplus with Japan (due to the export of Swiss luxury products).

4.3. Bilateral Agreements with Developing Countries

Japan has concluded free trade agreements with three developing countries: with India, Peru and Mongolia. The significance of the agreement with India lies in the fact that the country has the second greatest population in the world, and, regarding its purchasing power, the third largest producer, which includes a significant middle-class whose consumption creates a sizable market for Japanese products. The widely available cheap labor force may help Japan redress these problems. It needs to be emphasized at the same time, that China has no free trade agreement with India.

Japan concluded a free trade agreement with Peru in 2011, which aimed at the free movement of industrial products and the gradual reduction of customs (the agreement between China and Peru dates from 2009). Negotiations are currently continued on the services trade and free capital movement (Peru is also an APEC member state).

In the case of Mongolia, the free trade agreement was motivated by the abundance of raw materials (2015), and at this point they overtook China, since the latter has no similar agreement with Mongolia.

4.4. Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) was preceded by the TPP. The TPP was signed by 12 countries in 2016 including the US, but in January 2017, President Trump signed away the agreement. After the US quit the TPP, 11 member countries remained (before the signing of the new agreement, it was also called TPP-11 in literature).

Following the US withdrawal, Japan—with a few months' hesitation—decided to resume negotiations. The Chinese-initiated RCEP negotiations played an important role in this decision, promoting China's aspirations for dominance (this is, of course, also a win-win situation, from which China was to benefit the most). Japan could not remain an outsider this time either, moreover, in the TPP-11 the country assumed the leading role, taking it over from the US.

The CPTPP can briefly defined as the clustering of 11 countries lying on the two coasts of the Pacific Ocean into one huge market on the basis of mutually accepted regulations which bear on the phenomena of the digital era. This market in the case of the CPTPP contains 510 million people. This is the first comprehensive, high-level integrational agreement, which is the result of a series of negotiations held by geographically distant countries with rather diverse levels of economic development, and a readiness for compromises (Cf. Japan's USD 38 000 GDP per capita, and Vietnam's USD 2164).

In 2016, the CPTPP member states generated 13 percent of the global GDP, and 15-15 percent (export and import) of the international trade in goods and represent a considerably smaller economic power than the TPP-12 would have been with the inclusion of the US (38 percent of global production).

As a new free trade agreement, the CPTPP synthetically contains all the characteristics of the mentioned FTAs, TRAs and EPAs. First, it is an industrial free trade agreement (member states lift customs and other barriers on trade according to different timetables, due to the diverse levels of development, that is the developed countries remove the barriers as the agreement enters into force, while the less developed states do the same a few years later, quite asymmetrically). Second, it is an agricultural preferential agreement, although the trade in several product groups is free, including the majority of foodstuffs. The agreement includes the free movement of services and of capital (although not the free movement of labor-force). A separate chapter deals with public procurement and investments, and the competition rules. The TPP emphasizes the protection of intellectual property rights, food security and the trading of medicinal products. It also deals with the regulation of environmental protection (in connection with international trade). This new generation of trade agreement „with respect to its contents, can become the golden standard of free trade agreements, and serve as a model contract for other transregional international integrations" (Kruppa, 2017). The Philippines, Indonesia, Thailand (ASEAN countries) as well as South Korea and Taiwan are all interested in the TPP-11.

Previously, Japan had had bilateral free trade agreements with eight countries (Australia, Mexico, Chile, Peru, Singapore, Malaysia, Vietnam, Brunei). Similar agreements are currently negotiated with Canada, too, leaving out only New Zealand. Since a number of countries have had bilateral agreements, it seems that the TPP is the multilateral extension of the many bilateral agreements.

4.5. Japan – European Union Free Trade Agreement

The free trade agreement concluded with the EU (JEFTA – Japan-EU Free Trade Agreement) is for Japan as important as the TPP agreement. The five-year long free trade negotiations have been successfully concluded by December 2017, the partners signed the documents, and the ratification process began. After ratification the agreement can enter into force in early Autumn 2019. Regarding their content, logic and structure, the TPP and the JEFTA agreements are rather similar, except for one major difference. The TPP agreement is multilateral, while JEFTA is a bilateral contract. Despite the fact that a number of countries participate in JEFTA, due to the EU'S common trade policy, the Community participated in the negotiations as one negotiator.

There are around 640 million people or potential consumers in Japan and the 28 EU member states. They generate 30 percent of the global production and 39 percent of the world trade (this date does not include the internal turnover of the EU). For the EU Japan is the sixth most important export and import market, whereas the EU is the third for Japan. These facts highlight the significance and practical importance of the contract. Both the EU and Japan entertain great expectations of the agreement.

The free trade extends to industrial products, services and to a significant number of agricultural and food products. The agreement includes questions of environmental protection (in accordance with the Paris Agreement), consumer protection, competition policy and the protection of intellectual property rights, and also contains the protection of designation of origin (e.g. Tokaj Aszú).

4.6. FTA Drafts under Negotiation

The importance of the gulf countries (Bahrain, Kuwait, Qatar, Saudi Arabia, United Arab Emirates) derives from the fact that they are significant crude oil exporters, and Japan's indispensable suppliers. The trade balance is negative with most of these countries, therefore Japan is opening up and expects the same from them.

China-Japan-South Korea FTA: between the three economically most important East-Asian countries multilateral negotiations have been commenced, which—beyond economic and trade issues—covered also political questions. Questions concerning the China-South Korea relationship seem to be more or less settled, just as the issues between Japan and South Korea. However, occasionally severe conflicts flare up between China and Japan, such as historical disputes which have not been completely settled since World War II, island disputes (the Spratly Islands and the Sen-kaku Islands), the building of artificial islands on the South China Sea. Moreover, it is well worth mentioning that Japan has long had a significant trade surplus with China. In recent years the negotiations have concentrated more on political questions, because Japan has been concluding free trade agreements with other regions. The free trade negotiations with the EU and TPP—to which Japan had fully dedicated itself—had a negative impact on the economic dimension of the trilateral negotiations. Japan signed both agreements (including the CPTPP without the US). Currently, all countries concerned are trying to establish which solution would be best for them both economically and politically: bilateral agreements with the US, or the RCEP / Regional Comprehensive Economic Partnership, the ASEAN + 6 integration (10 ASEAN countries plus China, Japan, South Korea, India, Australia and New Zealand). This cooperation is promoted by China, since it played no part in the TPP, and expects to increase its economic and political dominance in the region. The ASEAN states already have bilateral agreements with the other countries. Apart from the mentioned 10, China has bilateral agreements with Australia, New Zealand and South Korea (moreover, it continues negotiations with Japan and prepares to commence negotiations with India). Beyond the ASEAN, Japan has free trade agreements with Australia and India, and is holding negotiations with South Korea and China. Interestingly, Japan has concluded no agreements with New Zealand (although it will in the CPTPP 11).

From the developed (OECD) countries Japan is holding negotiations with Canada, which is a NAFTA member state and party to the CPTPP agreement. This means that there is an agreement with Mexico through NAFTA, and while there are ongoing negotiations with Canada, Japan does not intend to conclude such an agreement with the US.

Japan is holding also bilateral negotiations with South Korea. Beyond trading in goods and services, the negotiations cover the capital movements, too, and concentrate on the questions of intellectual property rights.

From developing countries Japan is holding trade negotiations with Turkey and Colombia. Turkey entered the picture because it has a Customs Union Agreement with the EU, therefore the contract with Turkey has to be similar to the Japan-EU free trade agreement. In the case of Colombia, the geographical location is decisive: there are agreements already with Chile and Peru from the countries of the South American coastline of the Pacific.

4.7. Preferential Agreement: APEC

The APEC was formed in 1989 by the cooperation of 12 countries. Today it contains 21 member states: the US, Canada and Mexico from NAFTA; Chile and Peru from South America; Australia and New Zealand from the Australian continent; Japan, South Korea and Russia from Asia; 7 member states from ASEAN (Brunei, Indonesia, Malaysia, The Philippines, Singapore, Thailand and Vietnam); and Papua New Guinea from Oceania. The Greater China (The People's Republic of China, The Republic of China (Taiwan) and Hong Kong) joined the loose union in 1991, which can be considered rather as a preferential trading area, a loose consultation forum. In 1994, they set the long-term objective of the free movement of goods and capital, which they confirmed in 2014. This integration is the typical example of new regionalism: its almost 30 years' history is characterized by the intercontinental economic cooperation between developed and developing countries (they are not concerned with political and human rights issues). It is of key importance for this study that there are several functioning regional integrations within APEC (including NAFTA, AFTA, the bilateral agreements of ESEAN, the free trade agreement between Australia and New Zealand). The extension of already existing bilateral and multilateral agreements to a mega-regional or plurilateral level would accelerate the transformation into a free trade area. However, we must not forget that Russia and Papua New Guinea do not participate in regional cooperation.

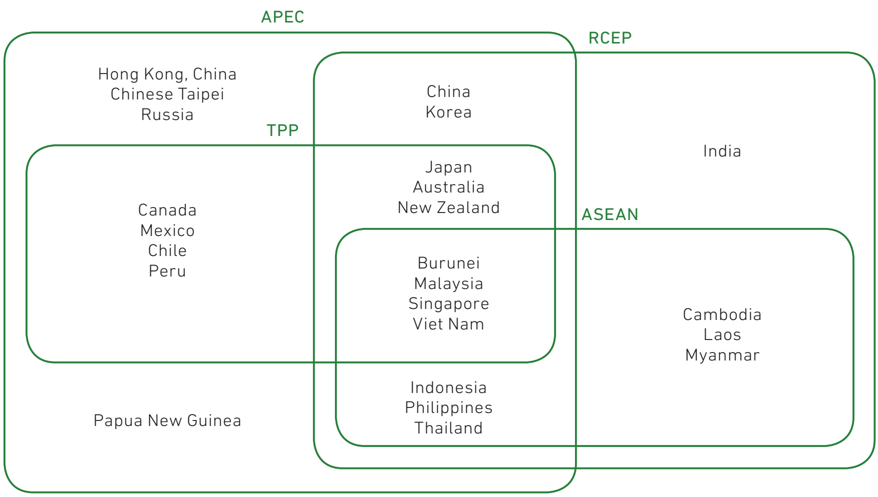
Concentrating on Japan, we find that it has free trade agreements with 11 out of 20 APEC member states (7 ASEAN members, Australia, Chile, Mexico and Peru), and is holding similar negotiations with South Korea, China and Canada. There are no such agreements with the US, Taiwan, Hong Kong, New Zealand, Russia and Papua New Guinea. (APEC, 2016)

5. Motivations for Building Free Trade Relations in Asia

In the Southeast Asian region, we find a complex system of integrations. The majority of free trade agreements between the countries of the region was concluded in the 21st century, while in Europe similar agreements date from the 1950s. After the turn of the millennium, the number of free trade agreements soared including the bilateral free trade agreements and the multilateral ones encompassing part of the region or the whole. This is why secondary literature considers Asian integrations as late comers. The hardly intelligible web of agreements is likened to a bowl of spaghetti in literature. The following diagram shows the mega integrations together with their overlapping.

Diagram 1

Integrations in the Asian region



Source: Kawasaki (2014)

One may conclude from the diagram that the motor of Southeast integration is ASEAN. Its member states (the least developed ones) participate in two or three mega integrations, not to mention the web of the numerous bilateral agreements. It is worthwhile to bear in mind that not all countries joined the integration process actively. In the case of Taiwan, the reasons are presumably political, that is the socialist China hinders its aspirations adhering to the 'one-China principle'. Due to the 'one country two systems principle', Hong Kong represents a special case: it is part of China on the one hand but has maintained its sovereignty in several areas as well as its international legal identity on the other. In the global trade issues, it follows in the footsteps of China, the motherland.

Russia and Papua New Guinea have little to do with the region and its integrations. In the case of Russia, this has political reasons: no peace agreement has been signed with Japan after World War II, and Russia's annexation of the Kuril Islands is still a matter of dispute between the two countries. The transitional Russia is viewed with apprehension. Indeed, the annexation of Crimea from Ukraine is unacceptable for the majority of countries. Papua New Guinea is signatory to the APEC and is the least developed member state. Even though it gained independence in 1975, the country lacks the appropriate endowments and opportunities which could accelerate its economic growth and establish its break out.

India is one of the greatest countries in South Asia, however, it is not an organic part of the Far East. After 1991, India radically revamped its economic policy, introduced liberal reforms and has been developing ever since. The country has started to tread the path of integrations over the past years. It joined the RCEP negotiations, although the more or less severe disputes with China hinder a more intensive integration.

The US is connected to the region through APEC, however, its withdrawal from the TPP and the non-participation in RCEP shows that it is withdrawing from the regional multilateral agreements. Nevertheless, from a geopolitical point of view, the presence of the US is evident (military bases, US naval force on the waters of the region, US multinational corporations in the region). The United States proposes bilateral agreements to individual countries, but we have to bear in mind that Trump's 'America above all' principle is based on the economic dominance of the US, and the countries of the region tend to lack motivation for such a cooperation.

Let us briefly summarize the strengths (advantages), weaknesses (disadvantages), opportunities and threats (dangers) of the process of Asian integration on the basis of Oehler-Sincai's insights (2014).

The strengths include:
- geographical location (South Asia is the motor of global development)
- outstanding pace of economic growth
- firm economic foundations
- size of internal market
- abundance of energy resources
- high purchasing power of a rising middleclass
- cooperation organized in a network

The weaknesses include:
- problems of human resources, shortage of highly qualified labor force
- shortcomings of the institution system and the infrastructure
- slow decision-making (at ASEAN level)
- lack of a common solidarity fund

The opportunities include:
- historical, inter-civilization, and cultural relations (which are, alas, occasionally destabilizing factors)
- sizable markets like China, India, Japan, ASEAN + 6 that facilitate the establishment of the optimal size of production, and economies of scale.

Finally, the major threats are:
- the flaring up of regional conflicts on the South China Sea
- the double focused integration process, the rivalry between China and Japan, which is influenced by the ASEAN relations.

5.1. Japan's Motivations for Integration

After the turn of the millennium, Japan also joined the initiatives promoting integration. In the beginning, the agreements were characterized by being concluded only with the relatively small countries of the region. These negotiations constituted a learning process: apart from the concrete problems of trade, issues addressed during the negotiations multiplied to include questions concerning the regulations of origin, services trade and capital movement (FTA>RTA>EPA). Japan has shown great concern for its partners' interests, despite its greater strength, and the fact that they lacked bargaining power. Japan has not applied standardized agreement drafts or templates but strived to find mutually advantageous solutions (win-win strategy). As a result of the pragmatic approach, the contents, force and scope of the contracts differ. It was as a result of this learning process that they concluded contracts with developed countries.

Traditional forms of integration (Viner, Balassa – free trade zone, customs union) do not meet the requirements of the 21st century, since the role of integrations has changed. In the new environment of a globalized world economy, geographical distances have become less significant, and immediate access to information has changed the relevance of the time factor. Therefore, in the new agreements, parties go beyond traditional economic and trade issues (not merely industrial free trade), and include sections on investment protection, taxation, logistics and the protection of intellectual property rights. What is more, agreements tend to cover questions of environmental protection, joint action against environmental disasters and the war on terrorism. In this period of the development of integrations, the latter are necessary but not sufficient conditions of the community of economic interests. However, the role of integrations as communities of value is on the increase. Currently, we see only the initial steps, but this is no doubt the future of development. Integrations within a regionalism that keeps up with globalization: this is the future. The latest agreements are characterized by the combination of economic interests and values of civilization. The basis of the institutionalist theory of integration is to ensure that sound economic and trade relations are accompanied by fair political relations.

From the perspective of the export-driven Japanese economic strategy, the positive world economic environment—which welcomed Japan's economic opening up without returning it—is of outstanding significance. At the same time, in the past two decades the multilateral regulations (WTO) of international trade have not changed, and the boom in bilateral free trade agreements has curbed Japan's opportunities in the global market. Needless to say, this process has two sides: in the emergence of bilateralism an important role was played by the restrictions on multinational corporations as well as by the bilateral aspirations of the EU and the US which served as a model. Due to the consequences of the effect-countereffect dialectic, Japan faces the following economic dilemma: it has to respond to the tendencies of increasing regionalism in the world and participate in the development of bilateral relations. The result is spectacular: according to the WTO, there are 300 existing free trade agreements in the world economy, 5 percent of which with Japan's participation. 90 percent of these bilateral (previously multilateral) agreements are of the free trade zone type, while 10 percent are customs union (Kruppa, 2016).

The Asian financial crisis of 1997-98 compelled the countries of the region to face a common challenge in order to sustain their high level economic growth rates. First, the establishment of AFTA (ASEAN Free Trade Area), and later China's aspirations for integration compelled the countries of the region including Japan, to join this process (fear of exclusion) (Kawai – Wignaraj, 2011).

Further economic motivations:

- Through these agreements, Japan can diversify its import of raw material and energy carriers. The free trade agreements promote this objective.

- The agreements facilitate the freedom of capital movement and provide new investment opportunities for Japanese capital. They can outsource production into countries with low income and participate in the extraction of raw material and energy carriers.

- In Asia, cooperation forms in production will provide the framework of regionalism. Japanese capital movement follows the 'flying wild geese' model, which means that multilayered relations of supply and cooperation have been established (with frequent multiple ownership). This model is similar to the global value chains established by the multinational corporations of developed countries.

Free trade agreements between China and Japan are also the instruments of rivalry. This economic and political competition between the two great economic superpowers contributes to the enlargement of the South Asian integrations, but at the same time, slackens the development of institutions encompassing the region (Völgyi, 2011, p. 5).

The geopolitical interests of China and Japan are also of utmost importance. Both powers aspire for a dominant (though not monopolistic) role in their own region. This explains why they concluded their first free trade agreements with the countries of the region. China slightly overtook its regional rival, Japan in time, but by 2018 their competition in the sphere of integration has become balanced.

6. By Way of Conclusion, or Japan on the Road to Integration

China and Japan play a leading role in the regional processes of integration. However, during the past 15 years, the balance of power between the two countries has shifted. China has overtaken Japan first in import (2003), then in export, and has become the world's greatest exporter since 2010. It also overtook Japan in GDP (2008) and working capital export (2016). Yet as regards per capita indicators, Japan is in a better position. In a rather short time, China became one of the leading economic players of the world, although the US is yet ahead of the former in production. Nevertheless, according to experts, China will overtake the US in 15 years (China officially set this objective for 2049).

The struggle for the leading role in the region—between Japan, China and the US—had started earlier, and these ambitions had been underlined by their respective participations in different integrations. Nowadays Japan is taking over the role of the US in the CPTPP, but in the Asian region China's expansion seems to be uncontrollable.

The US withdrawal from TPP-12 significantly eroded its role in the region and will also slacken its competitiveness in the longer run. The withdrawal is bound to trigger the country's lagging behind the region and a limited influence in the regional economic processes, although this region will be the center for growth in the 21st century. Trump's move goes against the development of free trade and the strengthening of globalization (similar to BREXIT).

These integration agreements make one believe that although China is the greatest trading power in the region, it does not intend to take advantage of its asymmetric economic power and negotiating strength. China appears as the 'benevolent' neighbor, which indicates that the trading giant should not be feared (Hilpert, 2014). China's aim is to improve the political stability of the region and to maintain the peaceful relations between the neighbors. Japan's goals are similar.

Japan and China are partners and rivals at the same time, initiators and leaders of the regional integration processes. Japan is the leading economic power of the CPTPP agreement, which is a comprehensive, high level cooperation affecting most of the economic spheres, like the RCEP initiated by China and representing its interests.

The two Asian giants stand face to face. Japan can be the leader of CPTPP but cannot regain its earlier leading role in the region. For Japan the main question is whether to remain a global economic power or become a regional power. To keep its position, it is of utmost importance for Japan to participate in the integration process.

Both countries are building their own network of integrations with occasional overlapping, due to the geographical proximity. Smaller economies strive to establish good relations with both powers. The micro integrational system of corporate relations initiated by Japan seems to be more powerful for the time being, and the building of integrational relations is important also for the future China. Their rivalry extends to integration efforts in the region and to the more remote parts of the Pacific region (especially with APEC countries).

They set out on diverse paths: Japan started with capital allocation, with a network of corporate integrations in the 1970s (called micro integration or de facto integration), and after the turn of the millennium, it began to build its network of integrations on a macro level (de jure integrations). China followed a different path: taking advantage of the significant working capital inflow after 1990, they integrated the multinational companies in their own corporate system (their global value chain). The aim of the macro integration initiatives after the turn of the millennium was to guarantee long-term market opportunities for Chinese production (this is promoted by the One Belt One Road initiative, too).

The rivalry between Japan and China is visible in other areas, too. They seek to increase their influence in the region by their aid policy, and their increasing working capital export serves similar purposes. The multilateral investment banks they established (the Japanese-led Asian Development Bank (ADB) and the Asian Infrastructure Investment Bank founded by China (AIIB)) are not really rivals, but this may change (Goreczky, 2018).

China or Japan, or rather China and Japan? Opposition, competition or cooperation. If they choose opposition, this will lead to protectionism and setback in the region in the long run and may also cause more severe problems. Japan cannot be a winner in such a situation. Therefore, a mutual cultural cooperation based on the roots of civilization seems to be more favorable, that is a real partnership and the strengthening of regional cooperation forms. The economic endowments and opportunities of the two countries complement each other. Japan is pioneering the scientific-technological development, while China boasts a staggering abundance of labor force, and a decent raw material supply. The big and ever increasing Chinese market is important for Japan (regarding both the means of production and the consumption of the growing Chinese middle-class). The synergetic effects of these complementary endowments are incalculable in the area of trade and investment.

After World War II, Japan turned towards the US and restructured its economy following the American model. This gave momentum to its economy for 30 years. However, as half a century passed, it turned out that for Japan this is not the only path to tread. It turned to its values of civilization once more, strengthened its cultural identity emphasizing its individuality and difference from western and other Asian cultures (Huntington, 2002). Thus, Japan is moving away from western civilization (while retaining a number of its values) and is turning towards Asia. This is most conspicuous in the strengthening of regional economic cooperation. Although Asian civilizations show diverse characteristics, they have common cultural roots and civilization, in which an important role is played by Confucianism that prioritizes group interests (e.g. family and company) over individual. In East Asia, democracy and human rights are interpreted differently than in western cultures. Besides adhering to its roots of civilization, Japan also has to return to the common Asian fundaments. This can provide the basis of an efficient cooperation in the long run, which will no doubt be difficult, due to the mentioned rivalries and the recent historical disputes.

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East Side Stories: The Evolution of EU Trade and Investment Policy towards South Korea, Japan, China and Taiwan

Júlia Tősér[1]

Since the creation of the common commercial policy in the Treaty of Rome 51 years ago, the EU and its economic environment has changed dramatically in many ways. Internally it concentrated periodically on enlargements and on tightening the integration through treaty reforms and through the expansion of its competences. Externally, in the past two decades the rise of emerging economies has profoundly changed the global economic landscape. The stalemate of multilateral trade negotiations in the World Trade Organization (WTO) (Civic Consulting, 2016) have led to a major shift in EU trade policy in the mid-2000's, turning the focus primarily on bilateral arrangements. Asia as the world's largest and most populous continent, and a region of great geostrategic importance became key in the pursuit of partners who are ready and able to offer mutually beneficial new market access opportunities for businesses, contributing to boosting jobs and growth in the EU as a whole. The EU has three strategic partners in East Asia: the People's Republic of China, Japan and South Korea. Responding to changes in the global economic landscape and the expansion of global supply chains, the EU recognized the economic potential of Asian partners and committed itself to the intensification of trade relations with the region. As a result of its new strategic orientation in the last decade, the EU has concluded a free trade agreement with South Korea, then negotiations of a similarly comprehensive and ambitious deal have been concluded with Japan, and negotiations for an investment agreement with China has been launched in 2013 with the objective of improving conditions for market access and protection of EU investments. In line with the 'one-China' policy, the EU does not have diplomatic or formal political relations with Taiwan, nevertheless cooperation in international fora on issues of common interest and structured dialogues on economic and trade matters provide a solid ground for the intensification of economic relations.

The objective of this paper is to provide an overview of the evolution of EU trade and investment policy vis-à-vis these four East Asian partners and to analyze the merits

1 The views expressed herein are those of the author and do not necessarily reflect an official position of the European Commission.

of policy options for the intensification of trade relations between the EU and East Asia. In the first chapter you find an introduction to inter-institutional procedures behind the making of EU trade policy. The second chapter provides a historical overview of multilateral negotiations in the WTO and explains the reasons of the current stalemate, which inspired the EU to pursue bilateral trade negotiations for enhanced market access opportunities. While the analysis of factors leading to profound changes in the world economy are outside the scope of this paper, the third chapter summarizes those developments in the world economy, which mainly explain the EU's growing interest in trading with East Asia. The fourth chapter assesses the evolution of EU trade policy since 2006, when strategic grounds for so-called new generation trade agreements were laid. The fifth chapter of the study overviews the development of EU trade policy with South Korea, Japan, China and Taiwan, followed by an analysis of long-term economic trends, to provide a background to the tailor-made policy choices for each of the four partners.

1. Interinstitutional Procedures behind the Making of EU Trade Policy

The decision-making regime for the negotiation and conclusion of free trade agreements on behalf of the EU has been established in the Treaty of Rome and has provided the model for the conclusion of all international agreements under the Treaty on the Functioning of the European Union (TFEU)[2].

In this regime the strategic policy orientation is determined by the European Commission. By its exclusive right of initiative, the Commission requests authorization to start negotiations with third countries on the basis of negotiating directives, which form part of the mandate and set out broad expectations regarding the outcome of negotiations. The proposed mandate is discussed with Member States in the Trade Policy Committee[3] and adopted by ministers at the meeting of the trade configuration of the Foreign Affairs Council (FAC/Trade) or, if agreement on the content has been reached earlier and the adoption does not require further discussions, at any meeting of the Council[4]. Negotiations are conducted on behalf of the EU and its

2 The provisions are included in Article 218 of TFEU.

3 The Committee is one of the four Council Committees set up by the Treaty itself. The respective treaty articles serving as a basis for the Committee are the following: Art. 111 – Treaty of Rome, Art. 113 – Treaty of Maastricht, Art. 133 – Treaty of Amsterdam, Art. 207 – TFEU.

4 Considering that FAC/Trade meets twice a year, it became usual practice to adopt mandates at other Council meetings. While the visibility is certainly higher if trade ministers adopt a mandate, the EU often opts for the earlier start of the negotiations instead of delaying the adoption until the next FAC/Trade meeting.

Member States by the European Commission and in regular consultations with the Trade Policy Committee. Negotiations are organized in rounds where experts of both sides try to make progress, ideally in all areas. It is almost impossible to estimate the duration of negotiating an FTA, but as a general rule, it takes at least two years if there is political willingness on both sides to find compromises in all areas, including sensitive issues. If major economic sensitivities are at stake or the political interest to conclude an FTA is diminishing, negotiations can be prolonged for years, or even decades.

The tabling of textual proposals or the indication of flexibilities do not require additional authorization from Member States, however, the Commission has to keep in mind that the outcome of negotiations requires approval by the Council either by simple majority or by unanimity, depending on whether the scope of commitments is limited to areas conferred to EU competence, or the agreement includes commitments that are exercised jointly by the EU and its Member States. When negotiators reach agreement on the provisions of the future agreement, the Commission and the partner initial the agreement, which is a technical step in order to provide a basis for the signature and conclusion of the deal. Once the initialed copy is available, parties can start the legal scrubbing, which is a joint exercise aiming to clean the text from any legal ambiguities or possible misunderstandings. In this phase the substance of commitments is no longer negotiated, nevertheless the reviewing of the hundreds and thousands of pages of articles require almost half a year[5]. Following this process, the EU can start the translation of the outcome to all of its official languages. Assuming that the legally scrubbed version is available in English, it takes another 4-5 months to produce the official texts in the other 23 languages.

Once the agreement is available in all EU languages, the Commission can make a proposal to the Council for the signature of the deal. In this phase, the Council (mostly at the meetings of Trade Policy Committee) checks if the outcome is compatible with internal EU rules and the balance of possible gains and losses is acceptable for the EU and its Member States. If the assessment is positive, the Council may proceed to the authorization of signature and, if the agreement goes beyond EU exclusive competences, the provisional application of certain selected commitments. This decision should not be understood as the conclusion of the agreement, which is the final step of the procedure, and it is subject to the consent of the European Parliament to the agreement and the completion of national ratification procedures. Parties prefer to

5 Since an FTA covers extensive market access commitments in the area of goods and services, the total length of an agreement with all the annexes and protocols can reach 1500-2000 pages.

agree on the provisional application of trade agreements to speed up the implementation of market access commitments (most importantly: tariff dismantling), which is the exclusive competence of the EU while waiting for the legal confirmation of the deal, which can take additional years[6]. While legally speaking provisional application means less certainty for businesses as the agreement can still be rejected by any of the parliaments, for the time being there has been no precedence for such action in the history of EU trade policy. In case provisions of an FTA do not go beyond commitments falling under EU exclusive competence, the Council can authorize the signature with qualified majority support,[7] and the EU can conclude the agreement following the consent of the European Parliament, without the need for national ratification.

It is important to note that while trade policy, which governs trade between EU and non-EU countries, has always been a core competence of the European Union, its scope has expanded considerably over time as a result of treaty reforms and rulings of the European Court of Justice. The Treaty of Rome covered only trade in goods, which reflects the fact that the Community's economy and external trade were geared mainly to production and trade in industrial products. When the services sector became the main source of jobs within the European Union and accounted for a substantial proportion of its international trade, partly due to the competition with newly industrialized countries in traditional sectors and partly to the economic changes brought about by the new information and communication technologies, it was necessary to expand the scope of common commercial policy to these areas in order to be able to develop common responses and to maintain the EU's leading role in world trade. The changing nature of trade was reflected in the outcome of the Uruguay Round negotiations under the GATT, which embraced a three-fold structure: trade negotiations on products (GATT), services (GATS) and intellectual property (TRIPS). In 1994, the Court ruled[8] that the EU did not have exclusive competence over the entire scope of the GATS and TRIPS. In order to clarify the situation, the treaty revisions in Amsterdam (1997) and Nice (2000) broadened the scope of the common commercial policy, but only the TFEU conferred full powers to the EU in the field of services and intellectual property, together with foreign direct investment (FDI). While earlier FTA negotiations already included a market access agenda on investments (as part of

6 The EU-Korea FTA, which had to be ratified by all EU Member States was signed on 6 October 2010. Its application started on 1 July 2011 but the agreement has not entered into force until 13 December 2015.

7 55 percent of member states—in practice this means 16 out of 28—representing at least 65% of the EU population, vote in favor.

8 Opinion of the Court of 15 November 1994. Competence of the Community to conclude international agreements concerning services and the protection of intellectual property - Article 228 (6) of the EC Treaty. Opinion 1/94.

the third mode of supply of services covered by GATS, which refers to the supplying of services through commercial presence), only the TFEU has established an exclusive competence in FDI as part of the common commercial policy, enabling the EU to negotiate agreements covering provisions on investment protection.

2. The Changing Scenery of Trade Liberalization: Transition from Multilateral Rounds to Bilateral Negotiations

In the second half of the 20th century, the primary forum for economic liberalization was the General Agreement on Tariffs and Trade (GATT) and its successor, the WTO. Negotiations were conducted in rounds, where every party offered concessions on the basis of the most favored nation principle, which means that if a country offers a lower customs duty rate for a product, or a commitment to base its national trade rules on certain principles, it has to be provided for all other WTO members. In the early years, the GATT trade rounds concentrated on further reducing tariffs. Then, the Kennedy Round in the mid-sixties brought about a GATT Anti-Dumping Agreement and a section on development. The Tokyo Round during the seventies was the first major attempt to tackle trade barriers that do not take the form of tariffs, and to improve the system. The eighth, the Uruguay Round of 1986-94, was the last and most extensive of all. It led to the creation of the WTO and a new set of agreements. In this period, the European Communities played an active role in the rounds, and together with the US and Japan it shaped the agenda and very largely the outcome of trade negotiations. Europe's traditionally defensive position towards trade liberalization have changed with the paradigm shift within the European Communities, which has created political momentum for the establishment of the Single European Market (SEM) and in parallel, a more proactive position on international trade (Young – Peterson, 2006) The SEM and associated introduction of qualified majority voting with the Single European Act (SEA) resulted in the ability to act at EC level in almost all the issues under discussion in the GATT Uruguay Round between 1986 and 1994, enabling to pursue offensive interests—mainly in the area of industrial goods - while defending agricultural sensitivities.

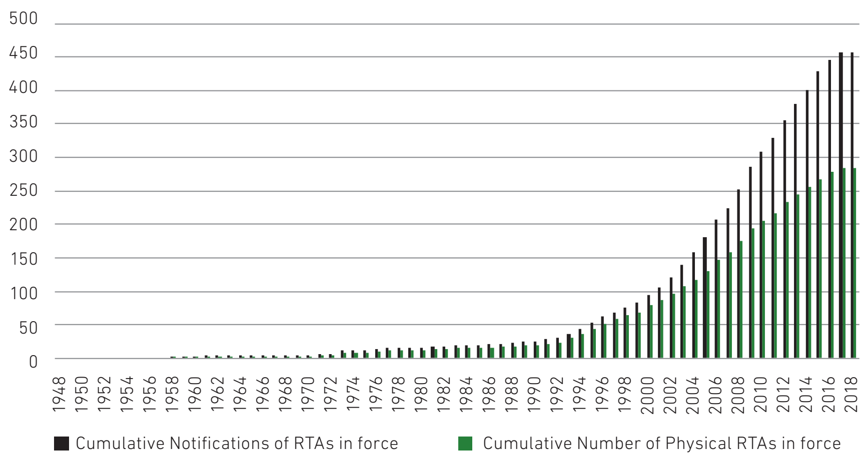
From the mid-1990s, the EU became the main proponent of a new multilateral round of trade negotiations. With the US reluctance to engage in further multilateral liberalization due to domestic opposition, and developing countries also being against a comprehensive round, the EU assumed a kind of leadership role. The European Commission considered that a comprehensive multilateral round would bring more benefits for the EU than preferential agreements with some of its trading partners.

However, shortly after the start of a new multilateral round called Doha Development Agenda (DDA) 2001, profound changes in the internal and external conditions forced the EU to develop new approaches and to find new export markets to support jobs and growth at home.

While the DDA is formally still ongoing, certain developing economies have prevented to adjust its negotiating modalities to global economic realities, notably the major shift in the relative economic power of key emerging partners. Already tangible when the DDA was launched, the imbalance between the contribution that large emerging economies are willing to make to the system and the benefits they would derive from it, this imbalance has grown significantly since and is expected to continue in the future. Recognizing that without rebalancing the relative contribution of developed countries and emerging economies to the system, the negotiating function of the WTO is likely to remain in a deadlock, and a large number of WTO members, including the EU, have decided to pursue bilateral FTAs to improve their access to new markets. As mentioned earlier, non-discrimination among trading partners is one of the core principles of the WTO; however, FTAs ('regional trade agreements' or RTAs in the terminology of WTO) constitute one of the exemptions and are authorized under the WTO, subject to a set of rules. As the graph below illustrates, the proliferation of FTAs has been unprecedented in the past decade as the modus operandi for trade liberalization.

Diagram 1

Proliferation of regional trade agreements (RTAs)



Source: WTO, Regional Trade Agreements Information System (RTA-IS).

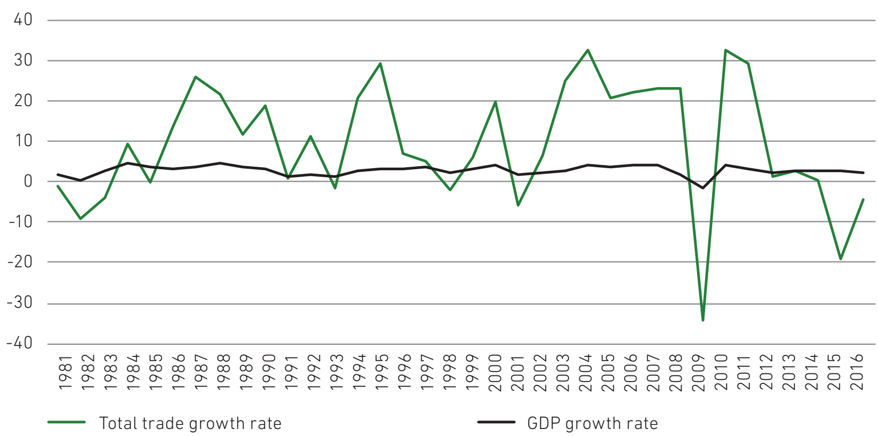
3. Changing Global Landscape

For a proper assessment of the EU's trade policy with East Asia, one has to understand the global economic context in which various policy initiatives take place. Since the study focuses quite extensively on strategic objectives set out by the EU and on their implementation with four East Asian economies, the contextual analysis is necessarily a bit sketchy, nevertheless it is useful to overview some significant changes in the world economy prior to the EU's first standalone trade strategy of 2006.

A great expansion in global trade flows took place in the period before 2006, at an average rate of 17 percent between 2000 and 2006, which explains the drive behind the negotiation of new FTAs envisaged by Global Europe. Until the years of economic and financial crisis, the average growth rate of global trade steadily surpassed the average of global GDP growth. Following a sharp upturn in 2010, global trade growth has slowed since 2012, relative both to its strong historical performance and to overall economic growth.

Diagram 2

Expansion of global trade



Source: UNCTAD statistical database

Recent literature (World Bank, 2015) reveals that this is due to a combination of cyclical and structural factors. The cyclical factor refers to the fact that the negative effect of a crisis on trade performance is not limited to the crisis period but persists through the medium term. GDP levels in developed economies remain below levels that would be suggested by historical average growth rates and the implication of lower demand in high-income countries is reflected in the weakness of their import volumes. With high-income economies accounting for the majority of world trade, their lingering weakness inevitably impacts the recovery in global trade. It is unlikely, however, that weak demand alone explains the slow growth of global trade and empirical evidence suggests that global trade is growing more slowly not only because world income growth is lower, but also because trade has become less responsive to income growth. The decreasing elasticity of trade—1 percent increase in world GDP is associated with a lower increase in the volume of world trade—can be explained by a number of structural factors. First, countries heavily involved in global value chains aim at higher proportion of the value of final goods being added domestically, meaning less border crossing for intermediate goods. Second, although not necessarily independent from the role of weak demand, impaired credit channels could be another important driver of trade performance, given that trade finance became costlier and less available during financial crises and their aftermath. Third, the majority of trade restrictive measures introduced in 2009 as temporary ones remained in place and were followed by new measures: of 1 185 recorded measures since October 2008, only 251 of these had been removed by May 2014. Trade-restrictive measures include the introduction of new import or export tariffs, increases in existing import or export tariffs, the introduction of import bans or quantitative restrictions, the establishment of more complex customs regulations or procedures and local content requirements. On the other hand, over the past four years members implemented more trade-facilitating than trade-restrictive measures and the estimated trade coverage of import facilitating measures is more than two times larger than that of import restricting measures. However, according to the WTO, the net increase in import restrictive measures since October 2008 is estimated to affect only about 4.1 percent of world merchandise imports, so it is unlikely that increased protection has been the cause of weaker trade performance and the decline in the elasticity of trade. But the slower pace of liberalization in the 2000s, compared to the 1990s, may have contributed to the lower growth in trade and, hence, dampened trade elasticity.

One factor behind the expansion of world trade in the 2000's was the accelerated fragmentation of production of both goods and services and the associated development of foreign outsourcing and offshoring. Agricultural and industrial production is increasingly taking place through global value chains, and as a result, two thirds of world imports concern intermediate inputs (WTO, 2013). As a result of radical reductions in communications costs, services trade is also expanding dramatically. Whole sectors that were once non-traded (and thus impervious to foreign competition)—such as banking or retail—are rapidly transforming through e-banking or e-commerce into some of the most globally tradable sectors. Meanwhile, world trade has been growing even more rapidly than world production—by 9 percent per year between 1981 and 2000, whereas the world GDP grew by 3 percent over the same period (UNCTAD statistical database)—underscoring the powerful forces continuing to drive global economic integration. A central feature of this trend is the rise of multinational corporations and the explosion of foreign direct investment (FDI). With some notable exceptions, such as the major oil companies, firms that engaged in FDI—that is, the ownership and management of assets in more than one country for the purposes of production of goods and services—were relative rarities before 1945. In the post-1945 period, however, FDI has surged, growing more rapidly than either production or international trade—even though the growth rate has been volatile, with dramatic falls as well as rises over this period.

Table 1

Foreign direct investment: Inward and outward flows and stock, annual, 1970-2016 (USD at current prices in millions)

		1980-1989	1990-1999	2000-2009	2010-2016
Flow	Inward	92 934	397 568	1 095 206	1 505 631
	Outward	93 353	413 840	1 099 687	1 435 711
Stock	Inward	1 074 809	3 825 892	12 017 862	22 989 066
	Outward	1 011 034	4 074 124	12 377 306	23 673 186

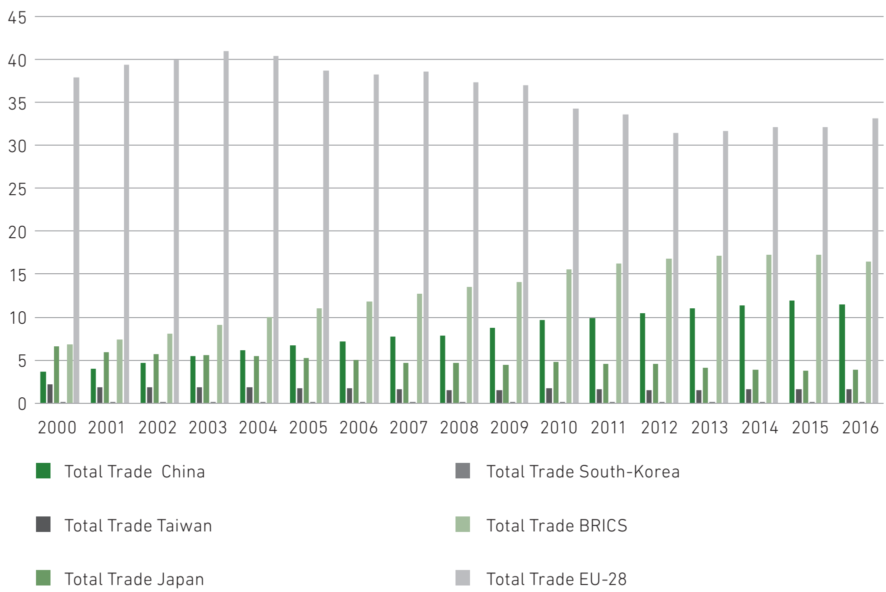
Source: UNCTAD statistical database

As a result of the expansion of foreign affiliates and supply chains in the global economy, the exports of foreign affiliates increased from USD 1.5 billion to USD 7.5 billion while their employment increased from 21.5 million to 71.7 million jobs between 1990 and 2012 (UNCTAD, 2013).

The rise of the emerging economies—such as Brazil, Russia, India, China, and South Africa (BRICS) - as both economic and political actors, is having significant and far-reaching impact on the world economy. Thanks to their economic growth and size, these countries have emerged as important powers, at a regional as well as global level, therefore it is necessary to develop appropriate policy responses to the opportunities and challenges presented by them, including by China, who, together with India, integrated itself into global value chains, whereas Brazil, Russia and South Africa rather take advantage of globalization by selling their raw materials or natural resources. Developed economies, such as the EU, South Korea and Japan are keen to find appropriate policy responses to these changes, and one of them is the intensification of cooperation with each other. The rise of BRICS can be illustrated with their rising share in global merchandise trade, which more than doubled between 2000 (7%) and 2016 (16%). The performance of China is outstanding within the group: in 2000 it already accounted for 53 percent of total BRICS trade, which further increased to 70 percent by 2016. While the share of BRICS in world trade (16%) is still below the EU (36%), long-term trends call for appropriate policy responses.

Diagram 3

Share in global merchandise trade (% of total)



Source: UNCTAD statistical database

4. The Evolution of EU Trade Policy since 2006 in View of Its Strategic Documents

This chapter aims to provide an overview of EU trade policy by explaining the policy challenges and economic context of its strategic documents since 2006 and their endeavors with the four East Asian partners that are in the focus of this study. The main findings are summarized in the table below.

Table 2

Strategic challenges and initiatives of EU trade policy since 2006

	Global Europe – Competing in the World (2006)	Trade, Growth and World Affairs - Trade Policy as a core component of the EU's 2020 strategy (2010)	Trade for All – Towards a more responsible trade and investment policy (2015)
Policy challenges	Provide businesses with new opportunities abroad while the multilateral negotiations are in a stalemate.	Emerging economies are on the rise while the EU has not yet recovered fully from the economic crisis.	Trade is a key source for jobs and growth in the EU but there is severe public distrust due to fears that FTAs will compromise EU values and key standards.
Policy responses	Negotiation of bilateral FTAs with selected partners based on economic criteria.	Complete ongoing FTA negotiations while working towards the reduction of tariff and non-tariff barriers also with non-FTA partners.	Continuation of the ambitious trade agenda while confirming that this cannot be done at the price of compromising on core principles.
Role of trade policy	Improve competitiveness in foreign markets.	Contribute to the Europe 2020 agenda (triple objective of smart, inclusive and sustainable growth), and to the EU's external policies as a whole.	Deliver economic results while protecting and promoting EU values.
Views on multilateral negotiations (WTO Doha Development Agenda)	Concluding the DDA is the first priority.	Concluding the DDA remains a top priority, however, bilateral deals are not against a multilateral deal.	Multilateral trading system is the cornerstone of EU trade policy, however, the conclusion of the DDA is no longer realistic.
Specific initiative for South Korea	Launch of FTA negotiations (2007)	Signature (2010) and implementation (2011 onwards) of the FTA	Review the FTA with a view to improve its functioning and to cover investment protection (negotiations have not yet started).
Specific initiative for Japan	No specific initiative	Launch of FTA negotiations (2013)	Prioritizing the conclusion of FTA negotiations (2017).
Specific initiative for China	No specific initiative but underlining the importance of enforcing intellectual property rights, tackle market access issues and seize investment opportunities	Launch of negotiations for a comprehensive investment agreement (2013)	Prioritizing the conclusion of investment negotiations (negotiations are ongoing).
Specific initiative for Taiwan	-	-	Exploring the idea of negotiations for an investment agreement (reflection is ongoing).

Source: own compilation

4.1. Global Europe – Competing in the World (2006)

Seeing the stalemate of multilateral trade liberalization in negotiations of the Doha Development Agenda, businesses started to lobby in the European Commission to negotiate bilateral FTAs to preserve their competitive advantage vis-à-vis emerging economies and to secure better conditions for the operation of their transnational supply chains. The appointment of Peter Mendelssohn as trade commissioner in 2004 brought a new approach to the EU's trade strategy with a focus on bilateral FTAs. He argued that ambitious and well-calibrated FTAs with carefully chosen partners could create new trade opportunities and improve the competitiveness of EU companies in key foreign markets experiencing high growth (Kang, 2017). Incorporating new objectives in trade policy, the European Commission announced a new strategy in October 2006 with the title 'Global Europe: Competing in the World' (European Commission, 2006). The strategy emphasizes the role of EU trade policy as an important element of competitiveness in foreign markets. While the Commission committed itself to working to the restart of multilateral negotiations, it also recognized that the EU needs to adapt its tools of trade policy to new challenges and engage with new partners to ensure the opening of new markets. To this end, the Commission decided to negotiate comprehensive FTAs with selected countries which share the EU's ambition. The design of these new FTAs represents a significant point of departure of the EU's earlier FTAs: new generation FTAs are very wide in scope of trade and investment areas, covering all relevant areas of a regulatory nature that can unnecessarily raise the cost of market access. Provisions are accompanied with firm legal commitments and enforcement options that are credible to market players, as well as with joint monitoring, options for appeal. In contrast, earlier FTAs focused mainly on tariffs and rules of origin, possibly services not going beyond the parties' GATS commitments and sometimes other chapters of a regulatory nature but solely with 'best endeavors' and mere cooperative intentions beyond the obligations already undertaken in the WTO.

Global Europe declared that the choice of the so-called new generation FTAs is based solely on economic motivations, contrary to earlier agreements, which were part of broader association agreements. The two economic criteria introduced by Global Europe to identify the EU's new FTA partners meant a radical departure from earlier practice since solely the market potential (market size multiplied by growth rate) and the level of protection of their market (both tariff and non-tariff barriers) were taken into account. On this basis, the strategy gave priority to three partners: ASEAN, South Korea and Mercosur (with whom negotiations were launched in 1999 but the process stalled). The strategy pointed out that 'China also meets many of these criteria but requires special attention because of the opportunities and risks it presents'. In addition, in the analytical document accompanying Global Europe, the Commission declared that new competitiveness-driven FTAs would need to be comprehensive and ambitious in coverage, aiming at the highest possible degree of trade liberalization including not only commitments to reduce tariffs and non-tariff barriers but far-reaching liberalization of trade in services covering all modes of supply, thus covering market access for FDI.

Envisaged by Global Europe, negotiations for a free trade agreement with South Korea were launched in 2007. Regarding China, the strategy notes that the country meets many of the criteria set out for FTA partners, nevertheless it requires special attention because of the opportunities and risks it presents. The strategy does not mention specific initiatives with Japan and Taiwan.

4.2. Trade, Growth and World Affairs – Trade Policy as a Core Component of the EU's 2020 Strategy (2010)

The EU's next trade strategy was released four years later, in 2010 by the trade commissioner of the Barroso Commission Karel de Gucht, who defined trade policy as a core component of the EU's 2020 strategy (European Commission, 2010). This Communication was a crucial element of the external dimension of the Europe 2020 strategy by setting out how trade and investment policy could contribute to the triple objective of smart, inclusive and sustainable growth, and to the EU's external policies as a whole. At that time, the EU had not yet been able to fully recover from the economic crisis and while people felt Europe was well placed, there were worries about whether Europe could compete in the future with the fastest growing economies. While public opinion recognized the value of trade and open markets to deliver lower prices and greater consumer choice, they placed job creation at the very top of their priorities for the EU's trade policy, which was reflected in the strategy. By 2010, the world economy and world trade underwent profound changes and it was projected that by 2015, 90 percent of world growth would be generated outside Europe, with a third from China alone. The expansion of global value chains necessitated recognizing that European companies need inputs, services and highly qualified workforce and their intellectual property needs to be protected. While tariffs on industrial and agricultural goods remained important, market access for services and investment, opening of public procurement markets, better protection and enforcement of intellectual property rights and regulations based on international standards were also treated as priority areas.

Despite the slow progress, the strategy kept the conclusion of the Doha Development Agenda as a top priority for the EU. On the other hand, it introduced a doctrine that has remained a core element of EU trade policy since then: bilateral agreements are not the enemy of a multilateral deal because 'liberalization fuels liberalization'[9] and bilateral FTAs can respond to certain newer questions that global trade rules ought to take care of. At the same time, with the stalemate of the Doha Round this is unlikely to happen in the foreseeable future.

Since the implementation of the Global Europe agenda—negotiating an ambitious new generation of bilateral trade agreements with important trading partners—was not yet completed—in fact, only the negotiations with South Korea were concluded—the new strategy confirmed that a large part of the Commission's negotiating capacity would be spent on delivering balanced free trade agreements put forward as priorities of the previous strategy. Prior to the publication of the new strategy, the European Council identified enhancing trade with the EU's strategic partners as a crucial objective, while recalling that these partnerships must be 'two-way streets based on mutual interests and benefits and on the recognition that all actors have rights as well as duties' (European Council, 2010). On the basis of this call, the strategy recognized that China was the EU's second largest trading partner, although bilateral trade remained well below the potential. Important market access barriers persisted —in standards and regulations, services, investment and public procurement, as well as insufficient enforcement of IPRs, an opaque standardization system, burdensome certification procedures and industrial policy measures aimed at import substitution, forced transfers of technology and granting local producers preferential access to raw materials. Another chapter of the strategy revealed that the Commission was 'also considering whether stand-alone investment agreements with other countries, such as China, would be worthwhile.' This idea has evolved to the launch of negotiations for a comprehensive investment agreement with China in 2013. As regards Japan, the strategy noted that it was eagerly seeking economic integration with its main trading partners, including the EU, however, while tariffs in Japan were generally low, regulatory barriers on trade in goods, services, investment and public procurement remained high and were perceived as being as insurmountable as ever. Japan's capacity to demonstrate that these barriers can be removed was the key condition for the launch of FTA negotiations between the EU and Japan, which was examined by the High-Level Group set up at the EU-Japan summit in 2009. Negotiations with Japan were launched in March 2013 and concluded in December 2017.

9 The principle assumes that if Country A and Country B provide preferential access to each other's market by means of an FTA, other countries will also endeavor to negotiate FTAs with these partners to reinstate level playing field for their economic operators.

4.3. Trade for All – Towards a More Responsible Trade and Investment Policy (2015)

Five years later the new Commissioner, Cecilia Malmström published her strategic visions in a communication entitled Trade for All – Towards a more responsible trade and investment policy (European Commission, 2015). The strategy reflected the intense debate about trade across the EU, mostly fueled by the launch of the EU's most ambitious endeavor to date, the Transatlantic Trade and Economic Partnership (TTIP) in 2014. Before the start of TTIP negotiations, which was meant to deliver an FTA with the U.S., trade policy was an issue of marginal interest for the public opinion in the EU. Launching FTA negotiations with the biggest developed partner of the EU radically changed the context and perception of free trade among European citizens fueled by the fear from compromising European values and standards. However, the return of the value-influenced agenda shall not be seen as a return to the pre-Global Europe era. Prior to declaring the primacy of economic considerations in 2006, the EU already pursued an offensive trade agenda, but at that times trade concessions were treated as an instrument to maintain close political relations with former colonies in the African, Caribbean and Pacific region, in North Africa and in Latin America. Global Europe confirmed this offensive stance but eliminated the supremacy of foreign policy considerations. In the pre-TTIP era it was taken for granted that partners would not try to water down traditional European approaches, such as the precautionary principle, which are often perceived by third countries as non-tariff barriers for market access. The launch of TTIP negotiations and the requests presented by the U.S. in the negotiations was the first time that European citizens questioned the Commission's ability or readiness to preserve basic principles while striving to improve market access conditions for EU businesses in a foreign country. While the Commission continuously assured citizens that TTIP will safeguard European standards that protect the people and the environment as well as governments' right in the future to set them as high as they wish, many European NGOs and a growing number of citizens continued to follow these negotiations from a defensive point of view, as opposed to the offensive standpoint of previous negotiations. Against this background, the Commission had to take advantage of every opportunity to assure citizens that though EU laws aimed to protect human life and health, animal health and welfare, or the environment and consumers will not be changed because of any negotiation. To reinforce these messages, the strategy confirmed that while Europeans wanted trade to deliver real economic results for consumers, workers and small companies, this cannot be done at the price of compromising core principles like human rights, sustainable development around the world or high-quality safety and environmental regulation and public services at home. While the TTIP negotiations have been de facto on hold since the Trump administration took office (no round has been held since October 2016), it has not been terminated by the U.S. as the Trans-Pacific Partnership negotiations were.

Four years after starting the application of the EU-South Korea FTA, it remained to be the most ambitious trade deal ever implemented by the EU, which clearly contributed to the credibility of the EU's commitment to engage with Asia while opening up a fast-growing East Asian market for EU exports. The strategy mentioned the idea of revising the FTA with a view to improve its functioning and to cover investment protection[10], which remains to be initiated. The conclusion of the EU-Japan FTA was highlighted as a strategic priority, which was then achieved in December 2017. As regards China, the strategy called the ongoing negotiation of a bilateral investment agreement the top priority towards the deepening and rebalancing the EU's relationship with China. The strategy did not change the EU position on the Chinese suggestion for further deepening the relationship through an FTA: it reiterated that the EU will only be ready to engage in such a process once the right conditions are met, in line with the jointly adopted EU–China 2020 strategic agenda for cooperation. For the first time, the strategy mentioned Taiwan in the context of exploring the launch of negotiations on investment, building on the investment provisions under negotiation with China.

Regarding the future of multilateral negotiations, the strategy pointed out that in order to re-establish itself as the driver of global trade liberalization and the pre-eminent forum for trade negotiations, the WTO needs first to turn the page on the DDA, and this would require a strong sense of responsibility from all its members. In the past years the crisis has deepened further, as the Trump administration is not only reluctant to make any concessions multilaterally, but it also heavily criticizes the entire rulebook for its inability to address the challenges presented by China.

In September 2017 the Commission issued a report overviewing the implementation of the Trade for All strategy, confirming that the fundamentals of the strategy continue to guide the EU's approach: openness combined with a level playing field, while promoting high standards of labor, environmental, consumer and social protection. By the time the report was published, an 'agreement in principle' had been reached at the FTA negotiations with Japan and the first five years of the EU-South Korea FTA saw European exports increase by 55 percent , proving that well-designed FTAs are the right policy instruments to provide additional opportunities for EU businesses.

10 The EU gained competence in the area of foreign direct investments (FDI) with the entry into force of the TFEU, which took place after the conclusion of negotiations.

As regards the relationship with China, the report mentioned the ongoing investment negotiations, the victory of the EU in a WTO dispute settlement case against Chinese measures to restrict the exports of certain raw materials, and the problem of overcapacity, which is most pertinent in China's economy. In the bilateral relationship, the EU confirmed to use all available actions to address Chinese policies undermining the level playing field for producers and traders, including unfair subsidization and extensive export support. In relation with Taiwan, the report confirmed that the EU was preparing for the launch of bilateral investment negotiations.

The next chapter provides detailed case studies to give a better understanding of the evolution of the EU's trade relations with South Korea, Japan, China and Taiwan against the objectives set out in the three strategic documents. The selected East Asian economies are all key trading partners of the EU, however, their economic policies, macroeconomic forecasts, market size, production structure, level of openness and international status are different, which allows to showcase a variety of arrangements governing bilateral trade. Two of these countries, notably South Korea and Japan are current and future FTA partners while the cooperation with China and Taiwan is based on tailor-made sectoral initiatives without a preferential market access component.

5. The Evolution of EU Trade Policy vis-à-vis South Korea, Japan, and China

5.1. South Korea: The First Partner for a New Generation FTA

Formal diplomatic relations between the EU and South Korea began in 1963, and in spite of wide cultural differences and geographic distance they share the same commitment to democracy, human rights, the rule of law and market economy. South Korea's rapid growth throughout the second half of the 20th century increased its appeal as an economic and political partner for Europe, which increasingly sought to engage South Korea in trade. Since the upgrading of relations between the EU and South Korea to a Strategic Partnership in 2010, qualifying the country to one out of the ten strategic partners of the EU, the level of commitment from both sides has been very high which made possible the further intensification of bilateral cooperation.

Before turning to the details of the EU-South Korea FTA, let us take a look at its context in view of the trade policy of South Korea. Beginning in the 1950s and for several decades thereafter, South Korean trade policy was heavily export-driven and characterized by government support to key industries, such as the petrochemical, steel, semiconductor, shipping and shipbuilding industries. South Korea began to liberalize its economy in the 1980s with the introduction of the Comprehensive Liberalization Policy and continued to deregulate throughout the 1990s. For a time, South Korean trade policy focused exclusively on multilateral negotiations in the framework of the WTO. However, the country turned its focus toward liberalization with the 2001 launch of the Doha round in an effort to increase its national competitiveness, secure overseas markets for its export-driven economy, and obtain steady sources of energy and raw materials. This also provided a greater impetus for South Korea to push through important structural reforms, away from government-led policy towards market openness and deregulation (Civic Consulting, 2016). Negotiating an FTA with the EU was included in South Korea's FTA roadmap announced in September 2003. This roadmap identified potential FTA partners on the basis of economic criteria, such as economic feasibility and being large and advanced economies, similarly to the EU's Global Europe strategy (Kang, 2017). Official negotiations were launched in May 2007 after a series of preparatory meetings held in the previous year. It took over two years, eight rounds of negotiations and many intersessional meetings to finalize the agreement in October 2009. By this time, South Korea had already finished FTA negotiations with the USA and had signed the South Korea–US FTA (KORUS) in June 2007, which was a major incentive for the EU to conclude the deal as soon as possible to avoid ending up in a less favorable position in the South Korean market compared to U.S. businesses. Since the Congressional approval of KORUS was delayed and the implementation of the agreement started only in March 2012, for almost a year EU operators enjoyed a better position in the South Korean market than their U.S. competitors. The EU-South Korea FTA was signed in October 2010 during the partner's presidential visit to Brussels for the 8th Asia-Europe Meeting summit. Following the consent of the European Parliament in February 2011 and the ratification by the National Assembly of South Korea, the provisional application of most parts started on 1 July 2011. The agreement formally entered into force on 13 December 2015, following the ratification of the agreement in all EU Member States.

The EU-South Korea FTA was the first FTA negotiated by the EU with an Asian country, and its 15 chapters and related annexes went further than any previous agreement in lifting trade barriers. Certain components of this FTA reflect the classic elements of free trade agreements, such as provisions on tariff reduction, which in this case eliminated customs duties on most agricultural and industrial goods by the 5th year of the tariff elimination schedule and provided longer transition periods for the elimination of duties for some highly sensitive agricultural and fishery products. Other aspects of the EU-South Korea FTA broke new grounds. The chapter on services, establishment (including market access for FDI) and e-commerce has broad coverage in terms of sectors and market access commitments. Specific annexes on electronic goods, motor vehicles and parts, pharmaceutical products and medical devices and chemicals that present detailed sector specific provisions with the objective to reduce regulatory barriers represent a novel approach for FTAs. The FTA provides for a comprehensive institutional framework to oversee the implementation of the agreement with several committees and working groups, which meet on a regular basis, providing both parties with the means to discuss and cooperate on issues related to the FTA, as well as develop solutions for any problems that arise (Civic Consulting, 2016).

Before the implementation of the FTA, South Korea had substantially higher import tariffs for European products than the EU for South Korean products and the FTA has corrected this imbalance. Applied trade-weighted average tariffs on EU exports to South Korea have come down from more than 8 percent before the FTA to 2 percent in the first three years and have fallen further since then, increasing the competitiveness of European products in South Korea, such as cars, chemicals, and apparel. As of early 2017, applied trade-weighted average tariffs on South Korean exports to the EU have been reduced to zero in nearly all relevant industries, reducing the prices of products imported from South Korea to the EU, such as cars and electronics. Since 2011, preference utilization rates have continuously increased for South Korean exports reaching 87 percent in 2016, signaling that South Korean firms indeed make use of the tariff preferences under the FTA. Preference utilization rates for EU exports increased as well, but remained at a lower level, at 71 percent in 2016 (European Commission, 2017a). At Member State level, there is a wide range of preference utilization rates, fluctuating from 20.8 percent (Malta) to 86.8 percent (Belgium). The countries with the highest rates, above 80 percent, are Belgium, Slovakia, Cyprus, Austria and Hungary. Member States with the lowest rates, below 60 percent, are Croatia, Ireland, the Netherlands, Estonia, Finland and Malta. As regards the evolution of trade in goods, the exports of goods from the EU to South Korea increased by 59 percent from 2010 to 2016. The average increase of EU exports to South Korea was 8.1 percent, while the average growth of EU imports from South Korea 0.8 percent per year.

Since the application of the FTA, the conventional bilateral EU trade deficit in goods with South Korea has turned into a surplus from 2013. Total EU exports to South Korea have increased both because exporters sell higher quantities and because they sell at higher prices, indicating an upgrading of quality. A similar phenomenon can be observed for South Korean exports to the EU, suggesting gains in product availability in both the EU and South Korea (Civic Consulting, 2016). EU exports of services to South Korea increased by 59 percent, compared to 40 percent for EU imports from South Korea from 2011 to 2016. Over the same period, EU inward FDI stocks (Korean investments in the EU) increased by 78 percent, and EU outward FDI stocks (EU investments in South Korea) increased by 38 percent (Eurostat).

On 18 May 2017 the European Parliament adopted a resolution (European Parliament, 2017) to take stock of the first five years of implementation of the FTA between the EU and Korea. The Parliament acknowledged the very positive economic results of the agreement for the EU, while also expressing concerns on some outstanding points and in particular as regards labor rights in Korea.

The first six years of application show that the EU-South Korea FTA has worked well, however, there is still room for improvement in order to bring the expected benefits to both sides. The specialized committees and working groups established will continue to discuss and seek solutions to the implementation and market access issues, for instance the authorization of beef exports from the EU to South Korea, the acceptance of the principle of regionalization for animal diseases by South Korea and the resolution of certain outstanding issues in the area of intellectual properties. According to the assessment of the European Commission, improvements in the areas of customs procedures could contribute to increase the preference utilization rate, and further facilitate the participation of small and medium sized enterprises. Apart from improving the implementation, technological changes in the past year, for instance in the area of electronics, require adaptations of the FTA. To this end, the European Commission and South Korea are pursuing exploratory discussions on a package of amendments to the FTA or its protocols (European Commission, 2017a). Before the start of formal negotiations, the Council needs to authorize the Commission to engage in the modernization on the basis of proposed negotiating guidelines, which have not yet been presented by the Commission.

5.2. Japan: A Solid Partner in a Turbulent Era

The conclusion of negotiations and the start of provisional implementation of the EU-South Korea FTA in 2011, gave a renewed impetus to the idea of an FTA between the EU and Japan, due to the fact that negotiations in the DDA remained in a deadlock and with the bilateral FTA, one of Japan's main competitors in the market of non-luxury cars became entitled to preferential access to the EU[11].

11 The EU committed to eliminate duties for car parts (tariff level: 4.5%) immediately. Tariffs for mid and large cars (tariff level: 10%) were eliminated after 3 years whereas tariffs for smaller cars (more

The EU-Japan Summit in 2010 established a Joint High-Level Group (JHLG) to identify 'options for strengthening all the aspects of the Japan-EU relationship'. The JHLG reported to the Summit held next year with a full analysis of the current working arrangements and the options open to the parties to enhance and improve their relationship. The joint statement issued at this Summit concluded that leaders agreed to start the process for parallel negotiations for a deep and comprehensive FTA and after one year of intensive preparatory talks ('scoping exercise'), in May 2012, the Commission agreed with Japan on a very ambitious agenda for the future negotiations covering all EU market access priorities. On 18 July 2012, the European Commission asked the EU Member States for their agreement on opening negotiations for an FTA with Japan. On 29 November 2012, the Council decided to give the Commission the green light to start these negotiations. In the context of the scoping exercise both parties demonstrated their willingness and capacity to commit themselves to an ambitious trade liberalization agenda. The Commission also agreed with Japan on specific 'roadmaps' for the removal, in the context of the negotiations, of non-tariff barriers as well as on the opening up of public procurement for Japan's railways and urban transport market. Given the importance of the elimination of non-tariff barriers for achieving a level playing field for European businesses on the Japanese market, the negotiating directives adopted by the Council foresaw a parallelism between the elimination of EU duties and of non-tariff barriers in Japan. Negotiations were officially launched on 25 March 2013, and the first round was held in April 2013.

The launch of negotiations was an important signal to the world because two major developed economies endeavored to tackle complex regulatory barriers in a mutually satisfactory manner, without compromising their high-level standards. When negotiations were launched, Japan was the world's 4th largest national economy, the EU's second biggest trading partner in Asia after China, and the 7th largest trading partner of the EU in the world. The EU was the 3rd largest trading partner of Japan. Japan is one of the EU's strategic partners and together the two sides account for about a quarter of the world's GDP. According to the European Commission's estimations, a deep and comprehensive FTA between the two economic giants may be able to boost Europe's economy by 0.6 to 0.8 percent of its GDP and could result in growth and the creation of 400 000 jobs. The impact assessment presented by the European Commission before the launch of negotiations expected that EU exports to Japan could increase by 32.7 percent, while Japanese exports to the EU could increase by 23.5 percent.

than 10%) were fully phased out after 5 years following the start of provisional application. Products originating in non-FTA partners of the EU, such as Japan and the U.S. are subject to these duties.

While the first three years of negotiations mostly focused on understanding each other's approaches and difficulties, negotiations in key areas were progressing relatively slowly. The biggest challenge for EU negotiators was the fact that in the case of Japan, regulatory and other behind the border issues such as rules, restrictions on competition and technical barriers to market access have long been more important than tariffs or other border measures. The existence of non-tariff measures affecting trade or limiting competition was important in key sectors, such as financial services, distribution, railway equipment as well as other key EU exporting sectors such as automobiles, machinery, pharmaceuticals and foodstuffs. Horizontal commitments for intellectual property protection, government procurement, competition and investment protection complemented, where necessary, with sector-specific commitments were important elements in this context. The U.S. withdrawal from the ambitious Trans-Pacific Partnership agreement in January 2017 allowed Japan to divert all its negotiating capitals, both at technical and political level, to the conclusion of the FTA with the EU after Prime Minister Shinzo Abe has said a TPP without the US—and its market of 250 million consumers—would be 'meaningless' (BBC, 2017). Following an intense phase of negotiations, on 6 July 2017 the parties announced agreement on key elements, which was followed by the announcement of finishing the overall negotiating process on 8 December 2017. Following the legal-linguistic review of the texts and their translation to all official languages of the EU, the European Commission proposed the signature and conclusion of the agreement in April 2018, aiming for its application and entry into force before the end of the current mandate of the Commission in 2019 (European Commission, 2017b).

According to calculations by the European Commission (European Commission, 2017b), the FTA will remove the vast majority of the €1 billion of duties paid annually by EU companies exporting to Japan, as well as a number of long-standing regulatory barriers. It will also open up the Japanese market of 127 million consumers to key EU agricultural exports and will increase EU export opportunities in a range of other sectors. The agreement also opens up services markets, in particular financial services, e-commerce, telecommunications and transport. It also guarantees EU companies access to the large procurement markets of Japan in 48 large cities and removes obstacles to procurement in the economically important railway sector at national level and addresses specific sensitivities in the EU, for instance in the automotive sector, with transition periods before markets are opened. The deal also includes a comprehensive chapter on trade and sustainable development; sets the highest standards of labor, safety, environmental and consumer protection; strengthens EU and Japan's actions on sustainable development and climate change and fully safeguards public services. At the same time, negotiations continue on investment protection standards and investment protection dispute resolution. The firm commitment on both sides is to reach convergence in the investment protection negotiations as soon as possible, in light of their shared commitment to a stable and secure investment environment in Europe and Japan.

This joint endeavor proved that the EU and Japan are ready to occupy the vacuum left by the U.S. protectionist orientation under the Trump administration. If and when Japan and the U.S. do eventually negotiate an FTA, the U.S. will have to compete with the concepts of the EU-Japan FTA, and until this materializes, U.S. companies will be behind the Europeans in their expansion into the Japanese market. For the EU, even the conclusion of negotiations is helpful to portray itself as a dynamic bloc, capable of engaging globally, despite the public concerns against other recent free trade initiatives such as the TTIP and CETA.

5.3. China: An Evolving Relationship with an Emerging Power

In the four decades since China and the European Economic Community established bilateral relations in 1975, both have changed enormously, and China is now the EU's second-biggest trading partner behind the United States and the EU is China's biggest trading partner. Unlike South Korea and Japan, the EU does not negotiate an FTA with China and the dynamics of negotiations for a comprehensive investment agreement do not give a full picture of the relationship. It is more relevant to look at how challenges posed by the difference in economic systems are handled.

Currently, the EU's China policy is defined by the 'Elements for a new EU Strategy on China' (European External Action Service, 2016) which, together with the Council Conclusions 'EU Strategy on China' (Council of the European Union, 2016), form the EU's strategy towards China. The strategy directs the EU to find practical ways to engage China in its reform process so as to achieve mutual benefits in political, economic, trade and investment, social, environmental, and other relations. Reciprocity, level playing field and fair competition across all areas of cooperation should be strengthened, especially as the EU and China work towards the completion of a comprehensive agreement on investment, in order to create new market opportunities.

However, elevating the EU–China economic relationship into the genuine strategic partnership envisaged by EU and Chinese leaders requires more effort from both sides. On the one hand, many EU business leaders perceive Chinese companies as sources of unfair competition, in both the EU and Chinese markets. State ownership remains a salient feature of the Chinese economy, which creates concerns for the EU about market access (European Union Chamber of Commerce in China, 2017). On the other hand, Chinese companies perceive being targeted by certain EU policy measures, such as anti-dumping and countervailing duties, arguing that most cases were launched against imports originating in China (European Commission, 2017c). China is in the midst of a complex economic transition. Structural changes under way in its economy and slower rates of growth are creating new challenges for European and Chinese businesses operating there, and the impact of new technologies and innovation is likely to force further changes to existing business models. In these circumstances, differences over the role of the state in their respective economies mean that the European and Chinese economic models are unlikely to converge in the near future. (García-Herrero, et al., 2017). For the settlement of these differences, the EU and China use a wide range of instruments of the trade policy toolbox overviewed below.

5.3.1. Resolution of Trade Disputes through High-Level Informal Dialogues

In the beginning of the decade, the solar panel dispute was by far the biggest trade controversy between the EU and China with imports from China valued at more than €20 billion in 2011. Under the Climate and Energy Package 2020 the EU became the largest market for solar panel products, reflecting growing demand for renewable energy consumption. China, meanwhile, has surpassed the EU as the largest solar panel manufacturer in the world, and the lower prices of Chinese solar panels have encouraged the installation of solar systems in EU Member States. A group of European manufacturers who felt marginalized by the pricing of Chinese exporters submitted a complaint to the European Commission against alleged unfair competition. After an investigation, the EU imposed tariffs on solar panels imported from China, prompting the latter to immediately launch an anti-dumping investigation on European wine (Chen, 2015). Since both parties understood the scale of consequences of an eventual trade war, they decided to settle the dispute through negotiations. The agreement reached in July 2013, endorsed by about 90 percent of Chinese solar manufacturers, set up a minimum price for panels until the end of 2015 and a limitation of the export volume. Chinese companies were also allowed to export to the EU up to 7 gigawatts per year of solar products without paying duties. The amicable solution of the solar panel case facilitated settlement in the wine case: in March 2014, the Chinese industry committed to withdraw its anti-subsidy and antidumping complaint against EU wine imports, in return of technical assistance and cooperation activities provided by the European side in areas such as winegrowing, winemaking and quality controls, marketing approaches, wine tastings, and the system for the protection of geographical indications. The Chinese wine industry undertook to assist the EU industry to organize EU wine tastings in China, to improve the wine knowledge among the Chinese consumers, and promote the appreciation of wines and its culture. Both parties agreed to set up permanent information and communication exchanges, monitor the implementation of their cooperation, and collaborate at international level on advocacy activities aimed at improving market access conditions in third countries (European Commission, 2014a).

Before the settlement of the above two cases, in 2012 the European Commission suspected that Chinese producers, notably Huawei, the second largest player in the Chinese market and its smaller rival ZTE are hurting European telecom equipment suppliers through artificially low prices, which are at least in part funded by the massive credit lines from the Chinese government. In 2011 China exported telecommunication network equipment to the EU market with a value of approximately just over €1 billion per year. In 2012 Trade Commissioner Karel De Gucht announced the Commission was considering launching a trade defense investigation on its own initiative, without the need for an industry complaint and despite the lack of the support of a number of EU Member States[12]. On 15 May 2013, the College of Commissioners decided in principle to open an ex officio antidumping and an anti-subsidy investigation concerning imports of mobile telecommunications networks and their essential elements from China. Following a series of confidential discussions, in October 2014 the EU and China agreed on a framework for Beijing to address EU concerns by limiting export credits to the two companies. As a result, the European Commission decided to reverse its earlier decision in principle and refrained from pursuing the investigation into mobile telecommunications networks from China (European Commission, 2014b).

5.3.2. Trade Defense Cases Coupled with Multilateral Consultations on the Core of the Problem

Currently, a key concern for the EU, shared by other key players of global trade, is China's industrial overcapacity in a number of sectors, for example in the steel sector. Overcapacity is a deep-seated problem in the Chinese economy and was already pointed out by the National Development and Reform Commission in 2003

12 Trade defense instruments address unfair practices occurring in international trade. Anti-dumping is the most frequently used form of trade defense. According to the WTO, all its members, including the EU, have the right in some well-defined situations to impose additional duties on imported products to prevent damage to their domestic industry. The European Commission investigates any allegations and, if justified, proposes antidumping or anti-subsidy measures.

(Zhengzheng, 2004) and now it is being perceived as a global problem, calling for multilateral efforts. The reason why the issue has gathered steam in 2015-2016 is arguably due to the Chinese interpretation of its 2001 WTO accession protocol, which, according to China's claims, automatically grants the right to be treated as a market economy from the end of 2016. Being treated as a market economy is more than a political recognition: it has far-reaching economic consequences in the WTO. If China is recognized as a market economy for the purpose of trade defense investigations, it shields the country from being subject to assessments based on the prices in third-party country (which are usually higher) and instead use domestic prices as a benchmark. As a consequence, the possibility for trading partners to launch trade defense investigations against Chinese imports would be significantly limited, as it would be more difficult to prove the distortion of prices if the bases for comparison is limited to Chinese producers. While the U.S. openly opposes China's claim for market economy status (Lawder, 2017), the EU introduced a new way of calculating the dumping margin in anti-dumping investigations on imports from all WTO Members whose prices and costs are distorted because of state intervention. The changes apply to all WTO members; thus, the applicability of the new methodology is not limited to China, and the European Commission has never confirmed that the recent changes were proposed in response to the WTO dispute settlement procedure initiated by China against the EU (case number: DS516). To shield the EU's steel industry from the effects of unfair trade, the EU has acted among others through trade defense, imposing anti-dumping and anti-subsidy duties on Chinese imports. However, trade defense can only address the effects of global overcapacity on trade and not its root causes. To that effect, the EU participated in the creation of the Global Forum on Steel Excess Capacity in December 2016. Bringing together 33 economies—all G20 members plus some other interested OECD countries—its membership covers all the world's major producers, including China. The Forum reports annually to the G20 ministers. In the first year, participating economies have exchanged data on steel capacity, subsidies and other support measures. This increase in transparency has enabled the Forum members to focus on the underlying causes of the problem of overcapacity in steel and agree on concrete steps to address them by enhancing the role of the market and changing the structure of the industry (European Commission, 2017d). In addition to this plurilateral Forum, the EU stands ready to work with China bilaterally in the context of a joint bilateral platform on steel, which was set up by the EU-China Summit in 2016 (European Commission, 2017e).

5.3.3. Dispute Settlement Cases in the WTO

On top of negotiated solutions, the EU and China an active users of the WTO's dispute settlement mechanism to seek judgement whether the law or practice of one party, which the other party considers unfair, is violating an agreement or a legal commitment under the WTO. Since China's accession to the WTO in 2001, 13 cases were launched between the EU and China. The EU was complainant in 8 cases and respondent in 5 cases (World Trade Organization, 2018). Cases have been launched in various sectors of economic interest or systemic value. As the point of WTO dispute settlement proceedings is not to pass moral or political judgement but to settle the disputes preferably through consultations and to ensure that the defendant brings its policy into line with the ruling or recommendations of the Dispute Settlement Body, we can conclude that the EU and China equally benefit from the WTO's dispute settlement system, since all closed cases ended with the amendment of the contested measure, without triggering the ultimate weapon, the imposition of additional tariffs by the complainant on products originating from the respondent.

5.3.4. Negotiating a Preferential Agreement for Improving Market Access Conditions

As part of the EU's objective of deepening and rebalancing its relationship with China, an immediate priority is the conclusion of a comprehensive investment agreement, negotiations on which have been ongoing since 2013. The agreement to launch these negotiations was reached at the 15th EU-China Summit in February 2012, and in October 2013 the Council adopted a negotiating mandate for the Commission. The launch of negotiations was announced at the 16th EU-China Summit in November 2013, and the first round of talks was held in January 2014. The EU's general objective is to replace the bilateral investment treaties all EU Member States except Ireland have concluded with China by a single EU-China agreement, which creates a more level playing field for business, opens new market opportunities for both sides and, provided China advances its economic reforms and gives the market a more decisive role, could pave the way for broader trade ambitions when the conditions are right (European Commission, 2017e). As regards the state of play of these negotiations, 17 rounds were held between 2013 and the first half of 2018, the latest one between 22 and 24 May 2018. On the basis of publicly available information (European Commission, 2018), it is difficult to estimate the timeframe for concluding these negotiations because exchanges on certain key elements require further technical work before political decisions can be made.

The European Commission estimates that in an ambitious liberalization scenario, leading to a 10 percent reduction in the cost of estimated market access barriers, EU FDI stocks in China would increase by 1.9 percent. Due to the openness of the EU market, the impact on Chinese FDI stocks would be rather limited, even in case of an ambitious scenario (0.9 percent). The improved legal framework for EU companies in China would allow them to expand their operations locally, increasing their turnover and labor force, and an increase in FDI activity can trigger an increase in trade flows as well (European Commission, 2013). Available literature suggests that trade and FDI are complementary, meaning that an increase in FDI activity can trigger an increase in trade flows. The study concludes that the exports stimulated by FDI as a result of intra-firm or inter-firm trade is more important that the substitution of some exports by the additional FDI (Copenhagen Economics, 2012).

In early 2014, China proposed to "work jointly to create conditions for launching a feasibility study of a China-EU free-trade agreement". The initiative was a point of departure from China's FTA strategy, primarily focusing on other Asian countries, which have been integrated into the Chinese production process mainly as a supplier of components, or developing economies in Africa and Latin America, which are important resources of raw materials and energy for China's industrial sector. The idea of an FTA between China and the EU has likely been triggered by the Trans-Pacific Partnership (TPP) and TTIP negotiations—major initiatives without the participation of China. However, this initiative has never entered to an operative phase as it was put on hold with the understanding that parties should prioritize the conclusion of the investment agreement before embarking upon a comprehensive, therefore more difficult and controversial trade agreement.

5.4. Taiwan: A Potential Partner for a State of the Art Investment Treaty

Considered by China a 'renegade' province, and in the absence of UN membership, Taiwan is not recognized as a sovereign state by its main trading partners, including the EU[13]. However, the EU recognizes Taiwan as an economic and commercial entity and supported its accession to the WTO in 2002 as Chinese Taipei. The European Commission opened a European Economic and Trade Office in Taipei in 2003 and it has a structured dialogue on trade issues of common interest, organized in four

13 The EU has no diplomatic or formal political relations with Taiwan, in line with its 'one China' policy (recognition of the government of the People's Republic of China as the sole legal government of China).

working groups meeting twice a year. These meetings allow to discuss issues related to sanitary and phytosanitary rules (including food safety), technical barriers to trade (including automotive and organic products, standards, certification and testing requirements), intellectual property rights, pharmaceuticals, cosmetics and medical devices. On top of this, in the annual consultations, all trade policy issues are addressed, including WTO obligations and issues of bilateral concern.

As Taiwanese products often have to compete with their South Korean and Japanese counterparts globally, some local businesses are putting pressure on the government to advocate for an EU-Taiwan FTA to reinstate the level playing field with their main competitors in the EU market (Focus Taiwan, 2017). Following the start of application of the EU-Korea FTA, the Taiwanese government advocated for an FTA with the EU (Taiwan Today, 2011), which was not reciprocated by the European Commission for years referring to limited resources due to ongoing negotiations with other Asian countries (European Parliament, 2013a) and an underlying understanding that any agreement has to be concluded first with Beijing before advancing with Taiwan. Following the launch of EU-China negotiations for a comprehensive investment agreement, the Taiwanese government shifted its focus and proposed to start negotiations for a similar investment agreement, which, as they see it, would also help pave the way for a comprehensive bilateral economic cooperation agreement in the future. Among EU institutions, the European Parliament has been by far the most open to the idea of signing an agreement with Taiwan. On the Annual report on the main aspects and basic choices of the Common Foreign and Security Policy (CFSP) in 2009 it stated that 'given that the expansion of cross-strait economic relations is in the interest of both sides and of the EU, [the European Parliament] strongly supports the enhancement of EU-Taiwan economic ties and the signing of an EU-Taiwan economic cooperation agreement' (European Parliament, 2011a). In its report to the annual report from the Council on the EU's Common Foreign and Security Policy (CFSP) of May 11, 2011, the EP stated that it 'strongly supports the enhancement of EU-Taiwan economic ties and the signing of an EU-Taiwan economic cooperation agreement' (European Parliament, 2011b). On the Annual report on the Common Foreign and Security Policy in 2012, it urged 'the Commission and the Council, in accordance with Parliament's CFSP resolution of May 2011, to take concrete steps to further enhance EU-Taiwan economic relations, and to facilitate the negotiation of an EU-Taiwan economic cooperation agreement' (European Parliament, 2012). During its plenary session on October 9, 2013, the EP adopted a resolution on EU-Taiwan trade relations, calling the European Commission 'to begin talks with Taiwan over an agreement on investment protection and market access so as to deepen economic and trade relations for the benefit of both sides' (European Parliament, 2013b).

Many scholars across Europe support the view that an EU-Taiwan FTA or investment agreement could help stimulate economic growth and employment on both sides. Messerlin (2012) argued that EU-Taiwan negotiations would help the EU to prepare for bilateral EU-China negotiations. It was also observed that the quality of Taiwan's regulatory environment, growth potential and market size (especially given the scale of Taiwanese investment in China) meant that Taiwan would have offered the EU a better opportunity than many of the countries with which the EU was negotiating trade agreements (Messerlin, 2012). In 2012, the European Chamber of Commerce in Taipei (ECCT) released a study by Copenhagen Economics on trade enhancement measures between the EU and Taiwan (Copenhagen Economics, 2012). The study was an update of the 2008 study on the same topic (Copenhagen Economics, 2008), and it confirmed the potential economic gains for both Taiwan and the EU from a bilateral FTA. It concluded that the potential benefits from a trade agreement were even bigger than in 2008 when a GDP gain of €2 billion and an increase in EU annual exports of €12 billion had been estimated for the EU as a result of an FTA with Taiwan. The authors considered this comparable to the relative contribution of the EU-South Korea trade liberalization (€5 billion per year) as Taiwan's economy makes up 40 percent of South Korea's economy. This conclusion was confirmed by other studies, suggesting that potential benefits to the EU of an agreement with Taipei are comparable to those offered by other FTAs being negotiated (Dreyer et al., 2010).

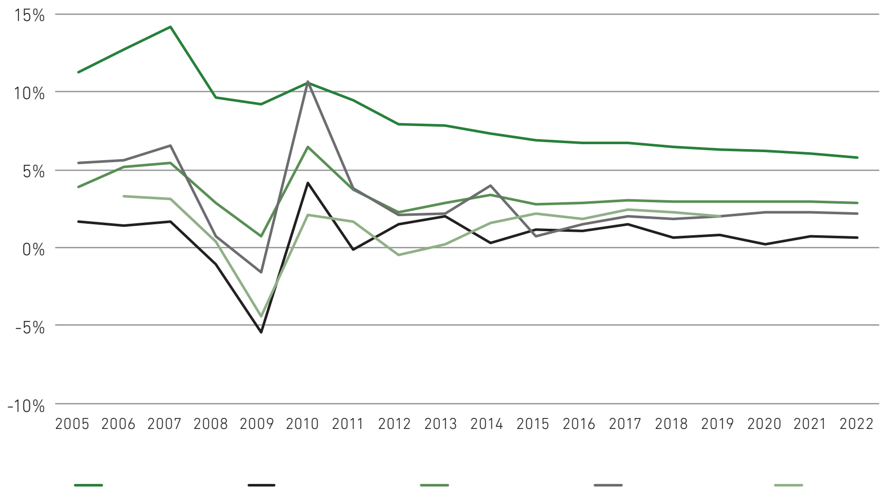
In light of the Commission's reluctance to offer a perspective for the deepening of economic relationship in the previous years, the inclusion of Taiwan in the 2015 trade strategy, the reference to the possibility of negotiating a bilateral investment agreement, was a major step forward. In the follow-up of this prospect, it was agreed to establish an expert level EU-Taiwan working group on investment, which held a number of meetings in 2017 focusing on technical issues, without prejudice to any decision on the launch of negotiations. Despite the almost unanimous advocacy by scholars for the launch of negotiations, the Commission has not yet requested a formal authorization from the Council to launch negotiations. Considering that such initiatives are usually preceded by a public consultation and a comprehensive impact assessment, which has not yet taken place for an EU-Taiwan Investment Agreement, at this point in time it seems unlikely to start any negotiations under the current Commission, which leaves office in the second half of 2019.

6. Economic Trends Triggering Policy Choices

Economic forecasts suggest that China, Japan, South Korea and Taiwan will remain important partners for the EU in the long term. With the exception of Japan, growth rates are estimated to surpass the EU-28[14] average, and forecasts suggest a positive trend in the expansion of their exports and imports, although at a slower pace than in the years following the economic crisis, which is most notable in the case of China.

Diagram 4

Economic growth - facts and forecasts



Source: International Monetary Fund, World Economic Outlook Database, October 2017; Eurostat. Estimates start after 2016 with the exception of Taiwan (2015). Source of estimates for EU-28: Economic forecasts presented by the European Commission.

While China's growth rate continues to surpass global average, it has fallen since the beginning of this decade. Official statistics indicate that growth was 9.5 percent in 2011, 7.8 percent in 2012, 7.7 percent in 2013, 6.9 percent in 2015 and 6.7 percent in 2016 and while sources disagree on the extent of the slowdown, its existence is not disputed by international forecasts. The slowdown has been attributed to a number of factors, such as excess capacity as a result of a growth model too focused on investment; the accumulation of excessive leverage in several sectors of the economy;

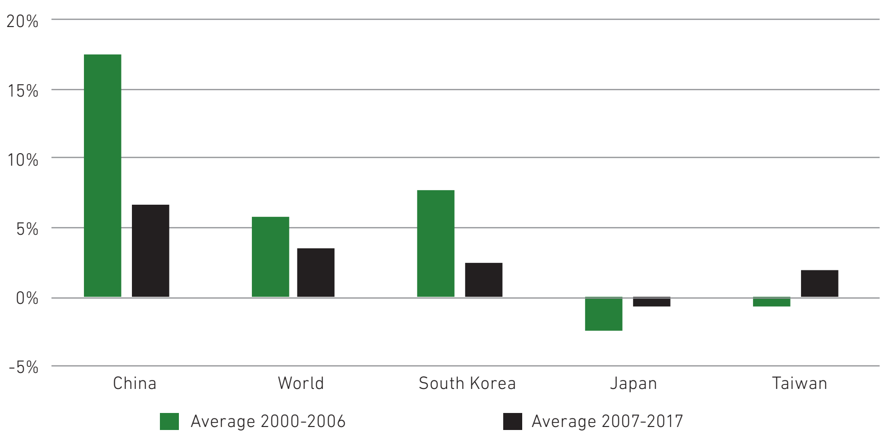
14 To neutralize the effect of EU enlargements on trade, the study refers to EU-28 aggregated data calculated by Eurostat for the entire reference period.

and the exhaustion of the engine of growth represented by rural-urban migration as rural-urban income differentials have narrowed and cities have become increasingly congested. Some of these factors point to a deeper slowdown, while others imply that the growth rate should now stabilize or, if properly managed, even revert to higher levels (Armstrong et al., 2015). During the last few decades, China has integrated strongly with the rest of the world and simulations suggest that the Chinese economic slowdown will have an adverse effect on global economic growth, the extent of which will depend on the intensity of the slowdown and on the specific trade links between economies. The impact on advanced countries is likely to be smaller than that on emerging countries and the slowdown may be softened by a decrease in world commodity prices as a result of decreasing Chinese demand, which would represent a favorable supply-side shock for commodity importers (CNBC, 2016).

Despite decreasing GDP growth, the average growth of EU exports to the four partners matched or surpassed the global average, both in the pre-Global Europe era (2000-2006) and thereafter (2007-2017) with the exception of exports to Japan.

Diagram 5

Average growth of EU imports

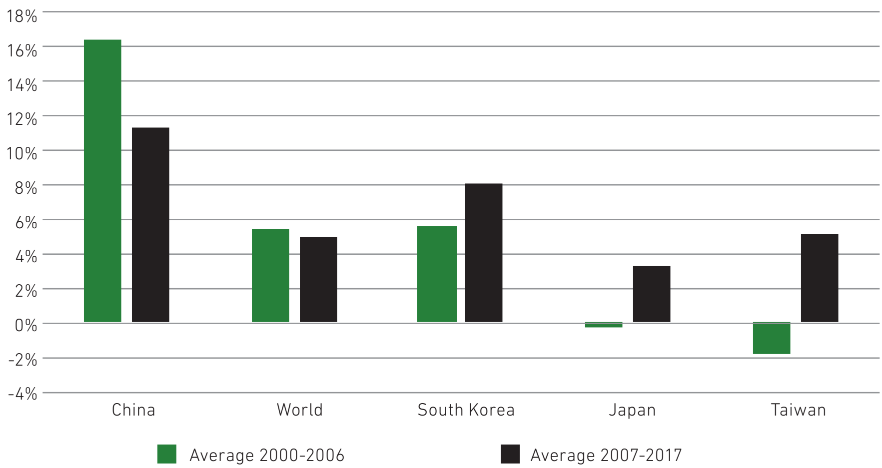


Source: Eurostat COMEXT

As regards import trends, the decreasing growth rate of Chinese imports is remarkable (from 18 percent to 7 percent). This can be explained with the structural changes of the Chinese exports to more elaborate products, which are based on extensively high value foreign intermediates, and also with the economic slowdown in China. The picture behind the lower average growth rate of South Korean imports shows a fluctuating trend in the period between 2007-2017: imports dropped dramatically in the years of the financial crisis (-4.64% in 2008 and -18.29% in 2009), followed by a hectic recovery in the 2010s (+21.75%), 2011 (-8.15%) and 2012 (4.69%). Since 2014, average growth rates of South Korean imports to the EU are again well above the average growth rates of EU imports worldwide (3%).

Diagram 6

Average growth of EU exports



Source: Eurostat COMEXT

Decreasing growth rates of exports seem to be coupled with diminishing openness to trade, with the exception of the EU, whose international commitments in WTO and bilateral agreements provide limited policy space for restrictive measures. This trend calls on the EU to look at ways to enhance trade relations, particularly when global competition for taking a slice of the shrinking cake of imports is accelerating.

Economic openness is commonly measured as an average of exports and imports as percentage of nominal GDP. The table below not only reveals that despite the differences in their economic systems, Japan and China are at a comparable level of openness (well below the world average), it also highlights the importance of effectively implementing FTAs with South Korea and Japan, as the provisions of these agreements can shield EU exporters from certain measures threatening with the potential effect of closing the partners' markets.

Table 2

Trade openness indicators (average of exports and imports of goods and services as a percentage of nominal GDP)

Partner	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
South Korea	40	52	46	48	56	56	52	48	42	39
Japan	17	17	13	15	15	16	17	19	18	16
Taiwan	66	68	56	68	70	82	78	75	66	61
China	31	29	22	26	25	24	23	22	19	18
EU-28	38	39	34	38	41	42	42	42	42	42
World	29	31	26	28	30	30	30	30	28	27

Source: UNCTAD statistical database

Against this background, the steady increase in EU exports to the four partners is notable, as well as their increasing share in the EU's total exports.

The same trend can be observed in the services domain, where the EU was able to increase its exports and improve its balance over the past ten years.

With this, by 2016 the four partners accounted for 10 percent of the EU exports and 22 percent of its surplus in its total trade in services. While there is no EU-level arrangement in force for the protection of investments, and preferential market access commitments to FDI are applicable only with South Korea, the continuous growth of FDI stocks suggest an intensification of cross-border ties, calling for appropriate measures to enhance business confidence and to facilitate the operations of global value chains.

Table 3

Year	South Korea		Japan		China		Taiwan	
	Million Euro							
	Stocks		Stocks		Stocks		Stocks	
	Inward	Outward	Inward	Outward	Inward	Outward	Inward	Outward
2010	13.140	37.480	133.370	98.053	6.111	80.978	720	10.618
2011	10.782	36.306	147.642	100.933	20.362	104.323	819	10.521
2012	16.866	35.206	166.531	96.130	27.428	120.725	2.990	11.011
2013	15.517	32.097	151.458	81.631	22.226	128.000	1.081	9.522
2014	17.928	42.936	163.974	73.154	23.389	145.812	1.201	10.940
2015	18.666	44.853	172.282	88.875	38.006	168.039	1.579	12.693
2016	19.232	50.339	205.689	82.816	45.080	177.673	1.841	17.156

Source: Eurostat (bop_fdi_main (<-2012); bop_fdi6_geo (2013->)) Break in series in 2013. Data until 2012 calculated according to BPM5, data from 2013 calculated according to BPM6

6. Conclusions

While South Korea, Japan, China and Taiwan are among the EU's top trading partners, the sustainability of trade expansion depends on many factors, the entirety of which cannot be captured by a single analytical toolbox. Empirical evidence, namely the case of the EU-Korea FTA strongly suggests that an FTA can have sizeable positive effects on trade flows between the parties, who can then become relatively more important to each other as trade partners despite the declining trend prior to the implementation of the agreement. While it is very suggestive that the intensification of trade and investment relations between the EU and South-Korea is mainly due to the FTA in force, it must be acknowledged that other factors such as macroeconomic trends and unilateral policy choices also have an important effect on bilateral trade. Trade and investment trends between the EU and Taiwan suggest that an FTA is not a precondition to increasing imports and exports, provided that the openness of both parties is sufficiently high.

In the coming years it is essential to ensure that provisions of the EU-South Korea FTA remain able to respond to economic and technological changes amidst the partners' decreasing openness to international trade. With Japan it is to be seen to what extent the FTA will be able to stimulate bilateral trade and turn the EU's traditional deficit to a surplus at a time when forecasts indicate a slowdown in economic growth on both sides. The most challenging question in the past decade, which points well beyond the region, has been to find appropriate means to rebalance the relationship with China, as it has decided to slow down economic reforms, which are indispensable to greater openness.

Public opinion in the EU—nearly three quarters of respondents—consider free trade as positive (Eurobarometer, 2017), which provides solid support for the continuation of seeking new market access opportunities in third countries. Assuming the continuation of the European Commission's practice, the publication of a new trade strategy with new political and policy orientations is expected in 2020, after the new Commission takes office. The new strategy will provide an opportunity to reflect on, inter alia, the need for new initiatives with East Asia and on means and ways to better enforce existing commitments and to tackle unfair trade practices, while improving economic, social and environmental conditions in and outside the EU.

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Development Policy Instruments in the Republic of Korea – The Role of Development Banks in Korea

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This study aims to provide a comprehensive overview of the incentive policy and instruments being implemented in the Republic of Korea (South Korea, hereinafter Korea). Korea has been famous for its impressive economic development since the 1960s and one of the major factors behind the economic success was the guiding role of the state (government). In Korea the government has developed a sophisticated and efficient incentive system that enabled the Korean companies, especially the Korean "giants" (chaebols) to be the locomotives of the export-oriented development. Korea used to be a typical follower of the Japanese model in this respect: the main preference was given to selected sectors contrary to other models, like in many European countries where—instead of sectors—the main focus was on horizontal goals, like the improvement of employment, environmental policy, regional development, etc. Financial institutions, first and foremost the central bank (Bank of Korea, BOK) and other development-oriented institutes (like Korea Development Bank, KDB) contributed to development of the Korean economy through various periods and stages of growth, until the present. Through its proactive monetary and credit policies, the Bank of Korea has repeatedly striven to bring the Korean economy quickly on a stable growth in the aftermath of the catastrophe of the Korean War, which broke out soon after its establishment, and the economic setback including the twin oil shocks of the currency crises of the 1970s and the late 1990s, as well as the recent global financial crisis.

1. Introduction

The peculiar way of development of the Republic of Korea is of interest for a variety of reasons. Noland (2011) underlined that rapid growth coincided with extensive state interventions in the economy, and considerable controversy exists as to how much this performance should be credited to the country's state-led development strategy and to what extent the lessons from that experience might be portable or applied elsewhere. He added that the salience of this issue has grown as Korea has become a more important provider of development assistance and advice. Currently, the country faces challenges in maintaining its superior economic performance in the face of an aging population domestically and a taxing external environment (Noland, 2011).

The main field of research of the present study is how and why development policy—with its sets of instruments—changed during the recent decades in order to maintain and improve the economic competitiveness of the Republic of Korea. The author aims to find answers to questions as follows:

- What are the main features and focal points of the Korean development policy?
- Which are the main goals and elements of the corporate development system?
- Which are the preferences of the FDI policy?
- What kind of economic policy instruments did the Korean government apply in the past and applies at present, and what were/are the roles the financial sector took on in order to contribute to the development of the Korean economy?

Principally, the study is based on secondary research, the backbone of which will be a comprehensive bibliographic overview focusing on the aforementioned questions. Bibliographic sources from Hungarian and Korean HEIs, like Seoul National University (SNU), Korea Development Institute (KDI), banks like Korea Development Bank (KDB), Bank of Korea (BOK), available and reliable information from internet. Statistical data were obtained from international and Korean databases, like KOSTAT, Korean Customs service, etc.

Mention has to be made about the fact that the author used to live and work in the Republic of Korea (2000-2004) so his first-hand experiences, moreover his previously published papers, especially Neszmélyi (2004; 2017) could also serve as starting points in the course of elaboration of the present study.

2. The Roots: The Japanese Model – Developmental State

In the bibliography, the notion and first definition of „developmental state" can be attached to Chalmers Johnson (1982), applied principally to the case of Japan, but it was also extended to other countries. From among the latter, first and foremost the first wave of newly industrialized Asian economies: South-Korea, Taiwan, Hong

Kong and Singapore can be singled out as classic developmental states, but the main characteristics of the extended version of the classic developmental state model can also be valid (with some limitations, of course) for the second generation of the newly industrializing countries in Southeast-Asia (Ricz, 2016).
Ricz underlines that Johnson's definition (1982) is still valid and by this the major attributes of the developmental state are: "a capitalist, plan-rational model, with a long-term commitment to the development-oriented approach, and active state interventionism in order to achieve main socio-economic objectives. It is also tenable that for building or maintaining a developmental state some kind of social consensus is needed regarding the central role of state in development, as well as on the content of the main socio-economic objectives" (Ricz, 2016, pp. 5-6).

On the basis of C. Johnson's "classic school", Ritz (2016) and Csáki (2016) both gave thorough analyses of the peculiar characteristics of the developmental state. Within this explanation they underlined that the Japanese leadership wanted to make a clear distinction between their approach and model and both the American model and the Soviet-type planned economy. While in Japan (and later on in Korea as well) economic planning had a very important role in the economic development, the approach of the Japanese model was "plan rational" while the approach in the socialist bloc was of the former Soviet Union's "plan ideological" (Csáki, 2016; Ricz, 2016). According to Meredith Woo-Cumings (1999, p. 1) the developmental state "is a shorthand for the seamless web of political, bureaucratic and moneyed influences, that structures economic life in capitalist Northeast-Asia".

Levi-Faur (1998) in his comparative analysis on the development policies of Israel, Taiwan and Korea underlined that trade policies of economies in the world can be distinguished by their preferences with respect to the import and export of goods and services. The trade policy that characterizes developmental states is aimed at a maximization of export and a minimization of import (see Table 1). This trade strategy can be called mercantilist, neo-mercantilist, or governed trade, and its basic guidelines follow the policy recommendations of Alexander Hamilton and Friedrich List. 'Export as much as you can and import as little as you have to' is an old mercantilist policy that, although attracting severe theoretical criticism, has managed to survive and even thrive in many countries. It is the scope and depth of the implementation of this principle that helps identify a developmental state and distinguish it from the American regulatory state on the one hand and the Scandinavian welfare state on the other (Levi-Faur, 1998).

Table 1
The Main Types of Trade Policies

Policy	Minimization of imports	Maximization of imports
Minimization of exports	Self-sufficiency (Fichte)	-
Maximization of exports	Governed trade (Hamilton, List)	Laissez-faire (Smith, Ricardo)

Source: own compilation on the basis of Levi-Faur (1998, p. 75)

Nester (1990) emphasized that during the post WWII period Japan concentrated on developing her national economy, and to reach dominant position in East Asia and, later on, in the world economy. In order to achieve these goals, the Japanese government systematically managed the economy through inter-related industrial, trade and financial policies. These neo-mercantilist policies became successful, and by the 1990s Japan became the world's second largest economy. Today it is still one of the biggest economies, with one of the highest per capita incomes, and Japanese corporations and banks are powerful forces in all important global markets.

Regarding the industrial policy, during the post-war period Japanese government attempted to develop the economy's powerhouse in the direction of higher value and technology-based industries. At the beginning the emphasis was on textiles, in the 1950s on heavy industries like steel, petrochemicals and shipbuilding, while the 1960s and 1970s the focus was shifted towards motor vehicles, consumer electronics and microelectronics. Later on, in the 1980s frontier technologies like biogenetics, aerospace, robotics, and the fifth-generation computers came into the forefront. Nester also explained that in Japan the economy could grow rapidly, as the market was protected from imports and foreign investments. Therefore, this growth provided benefits entirely to domestic producers, it allowed them to rapidly diminish their costs to world levels and without foreign intervention. After fierce domestic competition, a few winners emerged in a solid and strong position and became a domestic basis, a "virtual fortress" that later could enter the world market. Nester also referred to Johnson, who claimed that Japanese industrial policy implementation tools comprised a number of instruments of protection like discriminatory tariffs, preferential commodity taxes on national products, import restrictions based on foreign currency allocations, and foreign currency controls, while on the development side they included the supply of low interest funds to targeted industries through governmental financial organs (Nester 1990, pp. 165-166).

Ritz (2015) pointed out that financing development used to be a neuralgic point in classic developmental state literature. As long as in the case of the classic, Northeast-Asian developmental state a very specific and unique context (in the form of financial development aid from the US and Japan, traditionally high domestic saving rates, relatively closed economic systems, and repressed domestic financial markets) contributed to the financial viability of a national development model. However, at the current stage of financial globalization and of most recent experiences of global financial (and economic) crises, it can be underlined the developmental state in the 21st century have a much narrower room for maneuver to finance their (much broader) economic growth (development) agenda, as did their classic antecedents in the middle of the last century (Ricz, 2015, p. 23).

According to Kim (2014) Korea could be characterized as a developmental state that placed a strong emphasis on industrial policy. After the post-war recovery and reconstruction and having reached a fundamental level of economic development, Korea concentrated on the development of its industrial sectors and, later on, shifted its focus from industrial policy towards innovation and competition policy in the early 1980s. However, the tradition of developmental state survived in various ways, and public procurement for innovation (PPfI) is evident in this context, which is actively implemented particularly in the green industry and shows the manner in which industrial policy and innovation policy are interconnected. The "New Technology Products Program" was actively implemented in Korea (Dae-In, 2014).

Hundt (2014) claimed the Korean government has continued to play a dominant role in the economy. The state guided the industrial and financial restructuring after the Asian economic crisis (1997-98) and intervened to stimulate the economy during the 2008 global financial crisis. He pointed out that state elites have displayed a distinctive form of economic leadership during this process. This is largely consistent with the developmental state, rather than just focusing on performance-related indicators like the annual rates of economic growth. Korean state elites have retained their influential position as economic managers by, for instance, practicing a revised form of industrial policy. According to Hundt (2015), the neoliberal reform had significant social implications. Rather than neoliberalism acting as a democratizing force that shrinks the power of the state, he underlined that the Korean state used the reform agenda to justify an expansion of its powers. The state presented itself as an agent capable of resolving long-standing economic problems, and of defending law and order. By doing so, the state reduced the political space available to non-state actors (Hundt, 2014; 2015).

3. The Formation and Evolution of the Korean Development Policy

Among political and economic analysts there has been a long debate about the role of the state in the economic development of the Republic of Korea, as the features of a developmental state, a neoliberal state and/or a welfare state have appeared simultaneously in the various governments' policies since the 1990s. Suh and Kwon (2014) argue that although the nature, degree and extent of government intervention have varied from administration to administration, the basic stance of a developmental state has been retained, while neoliberal and welfare policies have been used concurrently to further economic and social development. This coexistence of contradictory approaches reflecting alternative market economic systems was the product of a combination of government policies that has for the past 20 years provided the Korean government with the ability to deploy flexible policy mixes in response to changes in the political and economic environment and to maximize the outcomes of developmental policies (Suh – Kwon, 2014).

The economy of the Republic of Korea is arguably one of the most spectacular success stories of development in the recent half century. However, at the start of that period—after the Second World War and the Korean War, till the early 1960s, Korea was a poor country and its prospects for recovery and development were considered gloomy. Its per capita income was lower than that of Mozambique or Bolivia, which is really difficult to understand now, when it is wealthier than Spain or New Zealand, and was the first Asian and first non-G7 country to host a summit of the G20, the unofficial steering committee of the world economy (Noland, 2011).

Mention has to be made of foreign aids as well which very significantly helped Korea's survival in the post-war period. Then and from the early 1960s, it merely contributed to the successful take-off of the Korean economy. In his article Tran (2011) refers to the fact that the US offered about 60 billion USD in grants and loans to Korea between 1946 and 1978. In the same period, the total amount of aid provided by the US to the entire African continent was 68.9 billion USD. Even that time, during the Cold War, the US considered Korea an important ally, and the Korean economy could utilize the aid well (Tran, 2011). According to Noland (2011), the goal was to maximize the value of the American aid which facilitated politicized rent distribution, financed most of the capital accumulation and at its peak in the late 1950s, roughly 80 percent of imports.

Korea is a well-known case of successful catching up achieved through an effective government-led export-oriented strategy. The country is one of the few ones in the world that has managed to radically transform its domestic economy from one based on agriculture to that of a leading world industrial power, with a constant increase in income per capita and a high growth pattern. Industrialization and the shift from light to heavy and chemical industries boosted the rising growth pattern and favored a virtuous integration into foreign markets. Key policy tools have been the Five Year Economic Development Plans. From 1962 to 1992, the Korean government developed seven plans which set clear targets, identified lines of actions and assigned resources to achieve them. A distinctive characteristic of the multi-annual plans has been the gradual upgrading of targets as objectives were achieved. Actions in key policy fields were sequenced and made coherent with each other. Industrial policy prioritized industries with increasing knowledge content, trade policies selectively managed import restrictions and export incentives, and exchange rates were managed to favor the exports of national products (OECD, 2012).

The Republic of Korea is a well-known example of a late-industrializing country in which development finance played an extremely important role in the country's industrialization process. A key characteristic of this process was the speed with which economic transformation took place. In a context of fast output growth, three rapid changes were witnessed in the sectors and industries driving the growth process. In 1953-1960, the share of manufacturing in gross value added was 12 percent, reached 23 percent in 1971-1980 and 27 percent in 2001-2009. Within the manufacturing sector, light industries were predominant in the 1950s, responsible for nearly 80 percent of all value added in the sector. However, after that date, the sector started to progressively lose ground to the heavy and chemical industries, which grew rapidly, especially from the early 1970s onwards. The value added of the latter in total manufacturing was 64 percent in the 1980s, 75 percent in the 1990s and 83 percent in the 2000s (UNCTAD, 2017).

By gradually promoting the creation of domestic, scientific and technological capabilities and by supporting learning, the Korean government supported the modernization and technological upgrading of domestic industries. In the first stages, the government focused on reverse engineering and learning from foreign best practices. Since the 1970s it has invested in the establishment of government research institutes to support the development of domestic capabilities. Since the 1980s, the government gave incentives to the private sector for investing in research and development (hereinafter R&D). By the 1990s, the chaebols were highly committed to R&D and the government broadened the policy mix for R&D to include support to venture business in parallel with the rising demand from the private sector (OECD, 2012).

Technological parks played a key role in mobilizing regional innovation. They have been introduced in Korea since the mid-1990s on the basis of the successful experience of other countries. In 1997, the government invested 25 billion Korean Wong (hereinafter KRW) over five years in the creation of each of the six-pilot techno-parks. In the light of the success of them the government supported the establishment of additional parks. Techno parks have played a key role in mobilizing the development and innovation of production at the regional level and provide additional services such as business coaching, management and marketing advice, infrastructure provision and R&D support (OECD, 2012).

Comparing the peculiar ways and experiences of development of Korea and Taiwan, many scholars found a number of similarities. The most prominent ones are as follows: relatively small land, with significant population, scarcity of natural resources, especially energy carriers, colonial past, underdeveloped economy after the colonial period which was further devastated by the war(s) (WWII, and in case of Korea, the Korean War as well), strong (dictatorial) political leadership until the late 1980s, export-oriented economic development policy, American economic assistance helped the recovery and the take-off, following Japanese and American patterns, conflicts and continuous tensions in the direct geographic neighborhood, high savings ratio, especially during the take-off period (1970s), democratization process from the late 1980s. At the same time, mention has to be made of significant differences as well, like the role of state (government) in guiding the economic development was strong in both cases while in Korea the government monopolized the credit allocations giving preference to the selected big export-oriented companies (which became the chaebols). In contrast, in Taiwan the interfering role of state was not that strong, mostly family-owned small and medium enterprises (hereinafter SMEs) led the economic development. In addition, Korea followed the chaebol-model, while Taiwan the successful SME model. However, it is an even more important difference, that in Korea the success of the selected companies was pre-decided by the government, while in Taiwan self-made companies became successful (Neszmélyi, 2017).

Finally, mention has to be made of the system of SME-financing in Korea where the government plays a key role through a number of channels. It provides loans through public financial institutions, such as the Korea Finance Corporation (KFC) and the Small and Medium Business Corporation (SMBC). Loans can be provided directly to SMEs or through "on-lending" in which the KFC provides 40 percent of the loan for financial institutions, which are responsible for the remainder. On-lending is more efficient as it utilizes the knowledge and experience of financial institutions. Total SME lending during 2011 by the KFC and the SMBC amounted to 11.8 trillion KRW, equivalent to 85 percent of the increase in the stock of loans to SMEs that year. Reaching one of the highest shares in the OECD, SMEs accounted for 78 percent of the banks' corporate lending in 2012, as a result of structural changes in the financial market and public support (Jones – Kim, 2014).

The most widely used instrument of public support is credit guarantees, which promote loans to SMEs by reducing the lenders' risks. In the period of 2007-2011, public support in the form of credit guarantees amounted to 100 trillion KRW (8 percent of 2011 GDP) compared to 42 trillion KRW of direct lending. After the financial-economic crisis of 2008, the limit on individual credit guarantees was raised from 3 billion KRW to 10 billion KRW (9.6 million USD) and the ceiling on the coverage of guarantees from 85 percent of the loan amount to 100 percent. The Bank of Korea also encourages SME-lending through its Bank-Intermediated Lending Support Facility, which provides funds to banks at preferential rates. To receive the full amount of funds available under this scheme, nationwide banks must allocate more than 45 percent of their new loans to SMEs (more than 60 percent in the case of local banks). The government promotes SME financing through moral suasion on financial institutions. For example, in the wake of the 2008 financial crisis, it asked banks to roll over SME loans automatically to prevent the default of sound SMEs (Jones – Kim, 2014).

4. The Korean Financial Sector and Economic Development

In the Republic of Korea, the developmental state model meant a comprehensive guiding role of the government, but besides the narrowly interpreted "government"—the cabinet—other state-run organizations played an important role in the formation and implementation of the development policy. The financial sector, first and foremost the bank of issue had various roles through its monetary policy instruments and sometimes through direct operations. Besides the central bank (Bank of Korea) several other banks played an important role in the development policy, far more than other financial institutions do in general. From among the latter—first and foremost—the establishment and role of the Korea Development Bank (KDB) needs to be mentioned.

In addition to KDB, other development finance institutions were established in the Republic of Korea. To finance the agricultural sector, in the early 1960s, the agricultural cooperatives and the Agricultural Bank were consolidated into the National Agricultural Cooperatives Federation (NACF) (UNCTAD, 2017). It was done in due time as it was visible already that as a result of the politically-motivated land reform, miniature, family-based farms were created which faced serious difficulties of productivity and efficiency. I would like to underline that agriculture was a peculiar field, a "white spot" in terms of the Korean development policy. The spectacular economic success of the Korean national economy can be considered as a result of the export-oriented industrial development, while the food and the agricultural sector were out of focus. The small and fragmented farms could be viable from the point of economy only by being integrated into an efficient and two-level co-operative system. Therefore, from its establishment up to now the NACF has had a substantial role. As Korean farmers could hardly be competitive on their own, they joined co-operatives, and since the late 1950s the two-level co-operative system headed by NACF has given a comprehensive framework for the Korean agricultural production. NACF and its affiliated organizations provide financial assets, production inputs and extension services and they are also directly involved in the various stages of the supply chain (See more here: Neszmélyi, 2004 and 2017).

In the same period, as a further financial institution, the Industrial Bank of Korea was created, with the aim of providing for small and medium-sized industrial units. In 1967, the Korea Development Finance Corporation was created, with a mandate to support the development of private enterprises through the provision of medium-term and long-term financing and equity participation, as well as technical and managerial consulting services. In 1976, the Export–Import Bank of Korea (Korea Eximbank, KEXIM) was established. The institutions were created to support industrial development, and all provided long-term credit drawing on funds mobilized through borrowing from the Government, or international financial institutions and foreign banks, and by issuing securities. They were not normally permitted to accept deposits from the public, especially in the form of demand deposits, a feature that distinguished them from conventional banks. The development finance system of the Republic of Korea was therefore well coordinated, with the Bank of Korea working closely with commercial and development banks and specialized financial institutions to support an agreed development strategy. Policy-based loans accounted for about 50 percent of total credit available in the economy during the 1970s, and for 30 percent in the 1980s, thus demonstrating that the entire financial system was development-oriented. (UNCTAD, 2016).

A summary which was issued in 2010 on the 60th anniversary of the establishment of the Bank of Korea (BOK) describes facts and the history of the BOK in details. The modern central banking system was introduced to Korea when the former Bank of Korea was established in November 1909. It was just at the eve of the Japanese annexation (1910), so for the following 45 years Korea became a colonial part of Japan.

4.1. The Deliberation of Korea and the Korean War

Noland (2011) recalled the circumstances of „ground zero" in Korea after the Second World War. He considered this starting point considerably unfavorably, as agricultural and industrial production were well below pre-war levels and much of the physical plant and equipment barely functioning. Inflation hit triple digits. The ranks of the unemployed were swelled by the return of 500 thousand refugees from other parts of the Japanese empire. Crime and gang activity surged. Levels of human capital and per capita income were higher in North Korea, which predominated in industry, mining, and power generation, compared to the South which was largely agricultural (Noland, 2011).

After the end of the Second World War, from the point of economic self-reliance and development, one of the most urging issue was to re-establish the independence of the bank of issue, cutting the links off from all that resembled the Japanese supremacy. On the 8th September, 1945, the American forces which stationed in Seoul dismissed the Japanese Governor of the Bank of Chosun and closed all of its branches in Japan once and for all. In November of that same year, the U.S. military discharged all Japanese executive officers from the bank and appointed Koreans in their places. The bank's functions changed in some respects. At the time of liberation, Japanese and Taiwanese banknotes, Japanese military notes and the like circulated as currencies, in addition to Bank of Chosun banknotes. Six months after the deliberation of Korea, the Bank of Chosun emerged as the sole issuer of legal tender south of the 38th parallel. In addition, the Chosun Foreign Exchange Bank, which the United States Army Military Government in Korea (USAMGIK) had set up on June 16, 1947 for the purpose of promoting foreign trade and facilitating foreign exchange control, was transferred to the government of the Republic of Korea. In February 1949, the President of the country instructed that the Governor and executive officers of the Bank of Chosun serve concurrently as governor and executive officers of the Chosun Foreign Exchange Bank. As a result, the Bank of Chosun became in practice the only foreign exchange bank in the country (Bank of Korea, 2010).

The Korean War broke out only 13 days after the start of the operation of the Bank of Korea. With the war's outbreak, the Bank immediately changed to a war footing. As the battle front shifted, the Head Office was temporarily relocated to the south, to Daejon, then to Daegu, and finally to Busan. Martial monetary and financial policies were introduced in such a way as to directly regulate financial institutions' deposits, credits, and fund operations in response to the economic situation, and to deregulate or relax regulations when conditions improved. After the cease-fire in 1953, the government switched from a war-time to a peacetime footing and concentrated on raising the country from the devastation of war and resurrecting the national economy. The Bank of Korea also turned back its financial system management to peacetime mode and strived to press the inflation down. The Republic of Korea was still one of the poorest countries in the world. In 1955, when it joined the International Monetary Fund and the International Bank for Reconstruction and Development, its per capita GNI was about 65 USD. At the beginning of 1954, aid for post-war restoration and economic reconstruction started to arrive from other countries, first and foremost from the United States. Its amount was 710 million USD in total between 1954 and 1956, which was equal to approximately one-sixth of the Korean GDP in that time. A significant part of the foreign aid that was received after the armistice was sold to the public through the Bank of Korea, and the counterpart funds generated by these sales were deposited with the Bank and managed by it (Bank of Korea, 2010).

4.2. Post-War Recovery – Selective Financial Assistance and the Establishment of the Korea Development Bank

Mention has to be made of a new element of the legislation that time, namely the General Banking Act. It was promulgated together with the Bank of Korea Act on May 5, 1950, as the Korean War broke out only a couple of weeks after it (on 25th June of 1950), and it took effect only from August 15, 1954. After the General Banking Act had gone into effect, financial institutions were to maintain reserves against deposits as prescribed by the Monetary Policy Committee, and to receive supervision and inspection by the Office of Bank Supervision. In accordance with the General Banking Act, financial institutions were allowed to handle both long and short-term financing, while the Monetary Policy Committee was enabled to determine the upper limit of long-term loans. The Act also set forth provisions to ensure the public benefit of fund management by financial institutions, by restraining their investment in real estate and prohibiting their establishment of speculative funds and credit extension on terms unduly favorable to one party or the other. Along with the rapid increase in demand for financial instruments for the rehabilitation and economic restoration after the Korean war, the government established a new financial institution, the Korea Development Bank (KDB), as a specialized bank, on April 1, 1954, with the view of strengthening the economic development towards stability and facilitate the reconstruction and improvement of the industrial sectors, infrastructure, financial and corporate system in long run (Bank of Korea, 2010).

KDB was in the epicenter of the development finance system which supported government policy and transformative growth. It was built on the assets and facilities of the Industrial Bank, which in the late 1940s virtually used to be the only provider of long-term credit in the economy. The main roles assigned to KDB were to provide medium-term and long-term loans to the industrial sector and to help develop the national economy (KDB Act, Law No. 302, promulgated on 30 December 1953) (UNCTAD, 2016).

The KDB has been acting as the biggest supporter of public finances and corporations. It was continuously widening its business scope and gained wide and rich expertise in the fields of development finance, corporate banking and corporate structure development (KDB Seoul). Mention has to be made of the fact that originally the Bank of Korea opposed establishment of the KDB. The Monetary Policy Committee argued that the establishment of the KDB, which was intended to be independently run under the Minister of Finance, was contrary to the principles of the legislation of the Bank of Korea Act and the General Banking Act, which was based on the idea of centralized financial control. Consequently, BOK considered the KDB's simultaneous existence and operation of both long and short-term financing incompatible with the principles of sound bank management. In March 1954 the Korean government issued the first Industrial Rehabilitation Bonds, in value of five billion hwan[1], to raise the capital for KDB establishment and operation (Bank of Korea, 2010).

During its first years, KDB was tasked with funding the restoration of industrial facilities and the reconstruction of basic infrastructure. In performing this task, its prominent role in the financial system of the Republic of Korea was soon established. By 1955, the bank accounted for over 40 percent of total bank loans and, at one point, for 70 percent of the equipment loans and 10 percent of the working capital loans made by all financial institutions. In the 1950s, 50 percent of KDB funds came from the Government's fiscal loans programme and another 37 percent was raised by issuing bonds (UNCTAD, 2016).

The main goal of the economic policy in the post-war period was to assist and accelerate the post-war recovery and curb the vicious cycle of inflation. In the early stage of the recovery, public projects and the production of basic necessities got priority at the allocation of financial assistance funds with the view of focusing on the quick restoration of production facilities to satisfy basic needs. In 1955 and later on, the limit

1 The hwan was the currency of the Republic of Korea between 15th February 1953 and 9th June, 1962.

on funds available to the private sector was gradually raised, and the management of funds by financial institutions was appropriately adjusted to ensure a balanced supply of working capital. After the mid-1950s the post-war recovery projects were completed, as the American foreign aid policy changed from grants to soft loans, while the Korea – U.S. Joint Economic Committee pushed forward strong economic stabilization policies. This came about in the form of the Fiscal and Monetary Stabilization Plan in 1957, which was the first comprehensive plan aiming to diminish the inflation by monetary instruments (using the money supply as a control index) and tighten both fiscal and monetary policies. In the first year of the plan, the fiscal efforts focused on the reduction of the monetary supply by limiting increases in national defense spending, fiscal investments and loans. One year later, in 1958 the government increased tax revenues through the introduction of new types of taxes like the education tax, and also by the adjustment of tax rates. In the field of monetary instruments, the tight approach was reinforced by preventing total credits from increasing faster than savings deposits. In 1958, the Bank of Korea (hereinafter BOK) revised the Regulations on Fund Management of Financial Institutions, and, in March 1959, allowed these institutions to increase their lending in proportion to the increases in their savings deposits. Besides, the BOK simplified the interest rate scheme twice: first in July then in November 1959. Furthermore, BOK narrowed the gap between its rediscount rate and the loan interest rate of commercial banks in order to reduce the dependence of the financial institutions on the rediscount window and to restore the effectiveness of its interest rate policy (Bank of Korea, 2010).

4.3. The 1960s: The Establishment of the Fundamentals of the Korean Economic Development

The early 1960s was a time of political and social shocks in Korea. The country was shaken by the April 19 Revolution in 1960 and the May 16 Military Coup in 1961. The impressive growth began only after the May 1961 military coup and was a direct consequence of the new military regime's policies. Two major political and organizational changes accounted for the subsequent rapid development of the Korean textile industry. The first was the appointment of two economic secretaries to the President. This enabled Park Chung-hee to monitor economic issues on a daily basis. The second was the establishment of an Economic Planning Board in June 1961; this board was to be the heart and brain of the Korean economic miracle (Levi-Faur, 1998).

The situation was further complicated by the cuts in American aids. The military government—among such circumstances—drafted and implemented its first 5-year

Economic Development Plan in 1962 with the view of elevating the people from poverty and to establishing the fundamentals of a self-reliant economy. The Bank of Korea assisted the government with the elaboration of the draft plan in 1960. The government took direct control over commercial banks in June 1961 in order to ensure the effective implementation of the Economic Development Plan. Moreover, in May 1962 the independence of the central bank was also curbed significantly. The aim was to establish a government-controlled financial system and to maximize the economic growth (Bank of Korea, 2010).

The switch from import substitution in the 1950s to export-orientation from the early 1960s onwards brought about the first adaptation of the role of KDB to new policy priorities. The constitutive act of KDB was amended for the first time to raise its capital and allow it to develop a set of policy instruments that was the core of the export credit programme. The provision of payment guarantees for foreign borrowing (see above) was one of the key policy instruments of the export promotion strategy, as it allowed export-oriented firms to access foreign capital at considerably lower interest rates (Cho – Kim, 1995). In order to fund its activities, KDB started to issue industrial finance bonds (KDB bonds) (UNCTAD, 2016).

In June 1962, the government imposed monetary reforms as part of the emergency monetary measure to direct floating capital into industrialization efforts and tie down excess liquidity. The significant increase in liquidity brought about by this process served to increase inflation, while the reduction in aid and rise in imports jeopardized the foreign currency reserves. The government re-adjusted the Fiscal Stabilization Plan in 1963 to steer economic policy toward stable growth by means of fiscal and monetary tightening and tougher price controls. In the meantime, the government and the Bank of Korea adjusted the foreign exchange rates in 1964 and the interest rates in 1965 to more realistic levels respectively, so as to enhance their price adjustment mechanisms, while rationalizing its foreign exchange policy and monetary and financial policy. After the accomplishment of the first 5-year plan, the Second Economic Development Plan started in 1967 till 1971, and it led to noticeable development in industrialization. Mention has to be made of the fact that Korea benefitted from the economic boom in developed economies, as well as from the Vietnam War and from other positive external conditions. In 1962 the government enacted the Foreign Capital Inducement Act in order to attract foreign capital, and after this Act was legislated in 1966, the amount of foreign capital inflow started to increase sharply. As at that time the domestic savings base was still modest, foreign capital became inevitable in the expansion of investment and the improvement in foreign currency liquidity. However, it also generated problems like high inflation, and some companies made wrong investments by excessive borrowing. The government made significant efforts to improve its relations with international financial organizations, and as a part of that, Korea joined the International Financial Corporation (IFC) in March 1964 and the Asia Development Bank (ADB) in August 1966. During the second half of the 1960s, the annual growth rate of the Korean economy remained at a high rate of about 10 percent, and as the prices soared and the current account deficit widened, signs of an overheated economy became visible (Bank of Kore, 2010).

The development finance system that was established to provide financial resources for rapid economic development was not limited to such development and specialized banks. In the early 1960s, commercial banks also supported development. They did so both directly, by providing policy loans, and indirectly, by providing resources for development and specialized banks for on-lending operations. As part of the overall financing architecture, the Bank of Korea came under the control of the Government, which served as a mainstay of the whole system in its critical role as provider of liquidity and guarantees (UNCTAD, 2016).

4.4. The 1970s: The Decade of the Economic Take-Off for the Republic of Korea

In the 1970s, the development strategy of the Korean government was shifted towards the heavy and chemical industries, as noted above. To support this new strategy, it established training centers to help form a skilled workforce and research institutes to generate research and development activities. On the financing front, it enhanced the role of development and specialized financial institutions as vehicles that provided long-term credit at low interest rates. KDB, in particular, refocused its role to finance new industries in addition to the energy sector and export-oriented industries (UNCTAD, 2016).

Between late 1969 and early 1971, the government cooled down the economy by implementing Comprehensive Stabilization Measures in every economic sector. Similarly, the Bank of Korea tightened the stance of its monetary policy. In 1972, the Korean government enacted three legislations with the view of shifting the grey market to the organized financial sector: the Short-Term Financing and Banking Act, the Mutual Savings and Finance Company Act, and the Credit Union Act. Moreover, in December 1972, it also passed the Act on Promoting the Development of Heavy and Chemical Industries and Diversification of Financial Structure (Bank of Korea, 2010).

To strengthen the lending capacity of the development and specialized banks, the Government created a National Investment Fund in 1974, and the deposit-taking banks and insurance companies were required to lend a certain portion to this fund. The fund then transferred these resources to development and specialized financial institutions in the form of long-term loans at low interest rates. Between 1974–1991, 80 percent of its lending was allocated to such institutions. Between 1974–1981, when the larger heavy industries were being established, 62 percent of the fund's total lending was allocated to KDB. As an additional funding source, KDB issued foreign currency bonds (UNCTAD, 2017).

The Bank of Korea strived a lot to improve the structure of banks in order to serve as the backbone of the financial sector. The Bank of Korea strengthened the foundation for banks' self-sustaining management by tackling their difficulties with non-performing loans and institutionalizing their accountability in management. In 1973, after the privatization of the Commercial Bank of Korea, the BOK encouraged banks to expand in size. In late 1973, the first oil crisis had a negative impact on the Korean economy which was characterized by slowdown, surging inflation and an increasing current account deficit. In response to the new situation the government announced a programme called "Presidential Emergency Measure to Stabilize the National Economy" in January 1974. Still in 1973, the government started to develop the heavy and chemical industries, and for the financing it established the National Investment Fund in 1974 and the Export-Import Bank of Korea in 1976. Moreover, the Bank of Korea worked out a system for preferential finance to channel funds into these industries. The second oil crisis in 1979 generated a price boom in the international markets not only for crude oil, but other raw materials, and slowed down the advanced economies in the world (Bank of Korea, 2010).

4.5. After the Two Oil Crises: the 1980s

In the 1980s, the successful establishment of the heavy and chemical industries allowed for the support of new industries further up the value chain, such as the automobile and electronics industries. Once more, KDB reoriented its funding, towards these industries. In the same decade, KDB began to prioritize lending to SMEs and to support industrial restructuring (UNCTAD, 2017).

In 1982, the Korean government launched economic stimulus packages to revive the economy without risking its economic stability. Among the measures mention has to be made of lowering the money supply growth target to 20-22 percent, a significant reduction of its rediscount rates and the lending and deposit rates of financial institutions. As a part of stimulus measures the government cut house acquisition and registration taxes by 30 percent to facilitate the development of the housing market. In the early 1980s, a number of structural problems deriving from the government-oriented economic development appeared on the surface, like chronic inflation and growing imbalances in development among various economic sectors. The government, therefore, decided to make a shift towards a private sector-led economic development, with special focus on the restoration of the market mechanism, economic openness, and financial deregulation. In 1981, the government amended the Regulation of Tax Reduction and Exemption Act. This Act served as an instrument to assist certain industries, to significantly shrink the scope of the industries eligible for tax reductions and exemptions. Moreover, a system of tax credits for technology and human resource development were created, hence the method of industrial support could be changed from a direct approach targeting specific industries to an indirect support approach valuing the functions of industries. For three years after 1986, the Korean economy showed a spectacular growth again, exceeding 10 percent annually. Moreover, in the course of this period, Korea finally left behind its chronical current account deficit: during the mentioned period it reached a current account surplus of 30 billion dollars. Korea, ultimately benefited from the so-called "three lows": the weak USD (Japanese Yen), the (relatively) low oil prices, and the low international interest rates. After 1986, the sustained current account surplus started to curb the excess demand for funds, and left market rates to fall. In December 1988, the Korean government and the BOK took decisive measures in order to liberalize the interest rates. Lending rates of all financial institutions were liberalized, with the exceptions of those on loans backed by funds for specific policy purposes, and those on loans for the agricultural, fishery and livestock sectors. By the 1980s, the government encouraged private companies to expand their investments in technological development through tax discounts, financial support and by the government purchase system. In 1981, the government granted the companies a 10 percent tax deduction on their technology and human resources development costs. In order to increase the corporate research and development efforts and make more seed capital available for company start-ups, the government supported the establishment of more venture capital institutions such as the Korea Technology Development Corporation. In the first part of the 1980s, the Korean leadership concentrated on assisting SMEs to enable them to play a complementary role to large firms, while in the second half of the decade it strived to make SMEs more competitive. In 1982, certain business areas were declared to be open only for SMEs and, in 1983, comprehensive measures were taken to identify and support SMEs having high growth potential and to improve their product quality. Besides the government, the Bank of Korea significantly enlarged its financial support scheme for SMEs, moreover, it also encouraged financial institutions to increase their financial support to rural and fishery areas. The Republic of Korea joined the Organization of Economic Cooperation and Development (OECD) in 1996, with the view of establishing the fundamentals for speeding up the domestic economic system. The Bank of Korea participated in the establishment of the Executives' Meeting of East Asia and Pacific Central Banks (EMEAP) in 1991, and then joined the Bank for International Settlements (BIS) in 1997, strengthening its exchanges and cooperation with the central banks of major countries (Bank of Korea, 2010).

4.6. The 1990s and the Impacts of the Asian Financial Crisis (1997-98) on the Korean Economy

In the 1990s, KDB was the main supplier of funds to high-technology industries and began to expand its international and investment banking business in order to become a globally competitive investment bank. The aim was to support companies of the Republic of Korea operating abroad, underwrite corporate bonds and support merger and acquisition projects (UNCTAD, 2017). In 1997, a large and persistent current account deficit emerged in the Korean economy that slowed down the foreign capital inflows and thus seriously exploited the foreign exchange reserves exercising a squeezing effect to the KRW. By the second half of 1997, the confidence of foreign investors eroded in the Korean economy. The reason for this was the currency crisis in Southeast Asia that spread over to Korea rapidly causing insolvency of Kia Motors, one of the biggest motor vehicle producers. In early November, foreign exchange conditions deteriorated rapidly, and the KRW went into a freefall against the USD. The Bank of Korea had to provide support for the settlement of foreign claims. Foreign exchange reserves of Korea rapidly fell, and on 3rd December the Korean Government finally compelled to sign a Standby Arrangement for 21 billion USD with the International Monetary Fund (IMF). The International Bank for Reconstruction and Development (IBRD) and the Asia Development Bank (ADB) were also ready to provide an additional 10 billion USD and 4 billion USD. Furthermore, another 23.35 billion USD was offered by a number of advanced countries, like the United State and Japan. In April 1998, the government restructured 21.7 billion USD in short-term foreign liabilities as fresh debts with one to three-year maturities under government credit guarantees in order to stabilize the liquidity of foreign currency. It issued Foreign Exchange Stabilization Fund Bonds denominated in foreign currency during that year in the value of 4.1 billion USD. The bond market was opened at the end of 1997 to attract foreign investments, and later on, in 1998, the full stock and money markets were opened. Foreigners were also allowed to engage in mergers with and hostile takeovers of domestic companies. The foreign investment environment noticeably improved by opening more industries to foreign direct investment and allowing foreign investors to purchase domestic real estates in Korea. To mitigate the structural vulnerability of the Korean economy, the government pushed forward with the restructuring of financial institutions and other businesses. In the frames of this endeavor, the Bank of Korea facilitated the restructuring of the financial institutions and supported the smooth recovery of the real economy, and at the same time made all efforts to preserve the stability of prices and the financial markets (Bank of Korea, 2010).

The Asian financial crisis in 1997 called for a renewed role for KDB, moving beyond its strategic role of picking winners with the capacity to add value throughout an export chain to encompass a countercyclical role in order to help the country overcome the credit crunch. In addition, it was involved in the process of the comprehensive corporate restructuring in Korea following the crisis. During the global financial crisis in 2008, KDB played a substantial, countercyclical role again (UNCTAD, 2016).

In accordance with the IMF-agreement, the BOK raised interest rates to ensure foreign currency liquidity and stabilize the exchange rates. The foreign exchange market regained stability by the second quarter of 1998, and interest rates were steadily cut to avoid the deepening of the recession in the real economy. The BOK acquired Deposit Insurance Fund Bonds and Non-Performing Loans Resolution Fund Bonds in order to support the restructuring of financial institutions, while extending special liquidity loans to sustain financial stability. These policies and measures contributed to the fact that the domestic financial and foreign exchange markets regained stability in 1998, and later on, the real economy started to grow again even faster than it was expected and regained its vitality. The current account reverted to a substantial surplus, which improved Korea's possibilities to pay off external debts. Korea fully repaid its IMF borrowings before maturity, on August 23, 2001 (Bank of Korea, 2010).

The Korean government, therefore, implemented a corporate restructuring programme from January 1998 after agreeing with the business sector on five principles for restructuring: the enhancement of transparency in corporate management, the elimination of cross-payment guarantees, radical improvement of financial structures, selection of core businesses and greater responsibility of the majority of shareholders and management. As a result, 64 affiliated companies signed the Financial Structure Improvement Agreements with their main creditor banks between February and April. The mentioned companies' total borrowings from financial institutions ranged over 250 billion KRW. In May 1998, all the banks were asked to form a committee in order to determine corporate insolvencies and evaluate the levels of insolvency of a total of 313 companies that showed signs of financial imbalances. As a result of the corporate restructuring initiatives, the top five chaebols (with the exception of Daewoo) met most of the requirements stipulated in the agreement on the financial structure improvement: the debt ratio target of 200 percent, the elimination of cross-payment guarantees, the attraction of foreign capital, and the dissolution or spin-off of affiliates. Besides the top five, other large corporations were also successful in meeting most of the requirements specified in the agreement. Thus, their debt ratio shrank by half compared to its level at the end of 1998 (Bank of Korea, 2010).

4.7. The Present Age: The Financial-Economic Crisis (2008-2009) and the Post-Crisis Period

By the 2000s, the volume of international capital inflow significantly increased. Foreign investors had continuous interest in acquiring ownership of Korean equities which reached 43.9 percent in Korean domestic stocks by the end of July 2004. Foreign net purchasing of domestic bonds such as Treasury Bonds and Monetary Stabilization Bonds increased to over 32 trillion won in 2007. In 2008, after the American Lehman Brothers' bankruptcy, the impact spilled all around the world, plunging the global financial system into a severe shock. The Korean economy was not an exception, it was heavily hit as well. The Korea Composite Stock Price Index, which was around 1,400 before the Lehman Brothers' crisis, shrank to 939 on October 24, 2008. Volatility in the financial market increased, and the real economy contracted sharply in parallel with falling stock prices and the value of the Korean won which resulted in the drop of the Korean GDP. The main direction of the government was focused on fiscal spending. Moreover, the Bank of Korea also took decisive steps to mitigate the effects of the crisis: it lowered its policy rate from 5.25 percent to 2 percent and pumped liquidity into the sectors suffering from the credit crunch. In response, the Bank of Korea made six cuts in its base rate between October 2008 and February 2009 to slash it from 5.25 percent to 2.0 percent. Moreover, it injected a big volume of liquidity, in anticipation of the overall deteriorating financial health, in all economic sectors. It purchased back the Monetary Stabilization Bonds in the value of 700 billion KRW on October 23, 2008 and purchased 1 trillion KRW in government bonds from financial institutions on November 19. It pumped about 8.3 trillion KRW into securities companies to solve their problems of liquidity, and about 5 trillion KRW under repurchase agreements into the market for credit bonds such as CDs and bank debentures from October 2008. The open market operations of BOK previously comprised only transactions in government bonds, government-guaranteed bonds, and Monetary Stabilization Bonds, but in November and December 2008 this list of eligible collateral was expanded to include bank bonds, some special bonds, and mortgage-backed securities (MBS) of the Korea Housing Finance Corporation. In addition, starting from December 2008, twelve securities companies were temporarily permitted to engage in repurchase (RP) transactions, together with counterparties that were previously eligible: the nineteen banks, one securities company and the Korea Securities Finance Corporation. In order to assist small and medium-sized enterprises in improving their balance sheets, the Bank of Korea raised its aggregate credit ceiling from 6.5 trillion won to 9 trillion won in November 2008 and increased it again to 10 trillion won on March 23, 2009. The BOK not only increased the liquidity supply but also established more channels and means of providing liquidity. The government and the Bank of Korea also strived for increasing financial institutions' capacities to extend credit. The government made new investments totaling about 8.7 trillion KRW in the Korea Development Bank, the Industrial Bank of Korea and the Export-Import Bank of Korea, on November 13, 2008 and March 23, 2009, to finance export and import companies as well as SMEs. The Bank of Korea paid a total of 500.2 billion won in interest on reserves on December 11, 2008. What is more, the Bank of Korea concluded currency swap agreements with the central banks of major countries in order to stabilize the foreign exchange market and poured foreign currency liquidity into the market to prevent the instability of the foreign exchange market from spilling over into other areas. All these resulted in a positive GDP growth already in the first quarter of 2009 (after -4.5 percent growth in the last quarter of 2008). The stock prices returned rebounded to pre-crisis levels in 10 ten months, and moreover, the foreign exchange reserves increased to a never experienced high level of 273.7 billion USD by the end of January 2010. This means that the Republic of Korea found its way very rapidly out of the global financial-economic crisis (Bank of Korea, 2010).

By its financing activities the KDB has been playing a key role in the advancement of the phenomenal economic growth of the Korean economy, through supplying it with resources and financial knowledge (even today within the globally leading industries and multinational conglomerates). Today, KDB Bank is a representative corporate bank that acts as market leader and stabilizer. The core business areas are corporate banking and restructuring, investment banking, venture capital, technology finance and consulting, overseas financing business, pension and trust, research and credit review. Being a global player, the expanding global KDB network operates in 21 countries, made up of 9 overseas branches, 5 subsidiaries and 8 representative offices. In Europe, KDB has a branch in London, 2 subsidiaries in Hungary and Ireland and a representative office in Germany, Frankfurt.

Both the rapidly changing macro-economic environment of the last decade and the recent financial crisis have highlighted the necessity of the rapid responsiveness of the banks to the external environmental changes (Kalmár – Zéman – Lukács, 2015). Thus, in recent years, plans have been designed to redirect KDB towards the future economy and to facilitate to complete this task, in 2013 and 2014, KDB started with several initiatives to support SMEs that promote a creative economy and entrepreneurs and companies which develop new technologies. These initiatives comprised a financing scheme for a creative economy. The goal was to provide investments and loans for SMEs that promoted a creative economy, a Techno Banking fund which concentrated on intellectual property, a pioneer programme to provide support to future-oriented start-ups and SMEs and a growth accelerating programme to provide venture companies and start-ups not only with funding but also with networking opportunities and mentoring support. The biggest recipients of new investments in start-ups were industries of cultural content, information technology, biotechnology and manufacturing. The push towards a creative economy and technology aims to reduce the dependency of the economy of the Republic of Korea on the manufacturing sector. However, this reorientation, with the support of KDB, does not preclude the historical role of KDB of supporting massive infrastructure projects, which it maintains. In 2014, KDB, with other partners, committed nearly 2.2 billion USD to the Power Energy Fund III of the Korea Infrastructure Investments Asset Management Company, the largest infrastructure fund in the country's history (UNCTAD, 2016).

During the 2000s, there were various ideas and plans to privatize KDB. The arguments in favor of privatization were that KDB was inhibiting the development of the financial system of the Republic of Korea, and that privatization was an expected endpoint for a bank that was expanding by incorporating new banking activities (e.g. investment and insurance) and becoming progressively internationalized, with subsidiaries and branches in different parts of the world, as part of a strategy to transform it into a global investment bank. However, such plans have recently been reversed, and privatization is no longer on the government agenda. The latest plans are to streamline KDB activities and to reassert its role as the country's key provider of finance for development (UNCTAD, 2016)

Connel, in his study (2014) mentions that in her inaugural address on 25 February 2013, (former) President Park Geun-hye, daughter of late General and President Park Chung Hee announced her vision to create a "Second Miracle on the Han River" by a new policy focus on developing a so-called "creative economy". However, the exact meaning of "creative economy" from a policy perspective remained partially unclear and it is still a topic of discussion. The former president defined it as the idea of creating new engines of growth and employment through "the convergence of science and technology with industry, the fusion of culture and industry, and the blossoming of creativity in the very borders that were once permeated by barriers." This focus on the new forms of the convergence of information and communications technologies (ICT) with traditional industries, as well as culture and content, has been a recurring theme in her statements on the creative economy agenda. The creative economy agenda represents a substantial and necessary effort of the Korean government to set the foundation for sustained growth and prosperity in the future. Furthermore, it means new approaches and opportunities to tackle pressing social and demographic challenges. Moving forward, it is important that the Korean government should not lose focus of its goal of ensuring the best potential ecosystem in Korea for innovation, entrepreneurship and fostering creative new industries. Tackling regulatory, structural, and cultural barriers requires a long-term approach and commitment, and may not yield short-term results (Connel, 2014).

Despite the recovery of the global economy, the country's economic growth has been progressing at a slower rate than it had been before the crisis, due to increased vigilance as to credit risk on the part of financial institutions, and more stringent financial regulation on the part of governments around the globe. The full-scale movement towards correcting the global imbalances is expected to strongly rely on the nation's exports. In the medium- and long term, the basic demographic changes, deriving from the low birth rates and the ageing of the population, will reduce the labor supply, and this may to undermine the long-term growth potential. These problems point to the necessity of finding and developing new drivers of sustainable economic growth. This should be the highest priority in the economic policy during the forthcoming years (Bank of Korea, 2010).

5. Conclusion

In the wake of the recent global financial crisis, the world economy is now seeking a new paradigm, and Korea must cope with these circumstances in a proactive manner. It should play a leading role in coordinating the opinions of industrialized nations and emerging market countries and forging a consensus within the framework of international cooperation.

The division of the Korean peninsula, the heritage of the Japanese colonial system, the devastation of the Korean war and the geo-political and economic context of the bipolar world order, all had substantial implications on the Korean economy, including the applied development model and instruments. Political and economic analysts agree about the fact that Korea in its economic development policy followed a specific way that we can call the Japanese model based on the theory of the developmental state. However, due to historical, cultural, political, societal and other reasons, the country has not fully copied but rather adapted this model to its needs and endowments. The government and the central financial institutions have been playing a traditionally strong role in the mechanism of the formation and implementation of the economic development policy.

The model Korea implemented focused substantially on the consciously selected and nurtured industrial companies that rapidly grew into big conglomerates (chaebols) which acted as locomotives and flagships of the Korean export-oriented industrial growth. However, nowadays the government pays more attention to the development of SMEs and to their better integration into the national economy. Therefore, there are special schemes and instruments for SME-financing as well.

In order to fulfil the changing role as a provider of subsidies, long-term loans and other financial instruments for the development of the national economy, Korean financial institutions, like BOK, KDB and other institutions have gone through successive transformations, adapting their functions and repositioning themselves in response to changing circumstances and the different stages of development that the Republic of Korea experienced over time.

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On the Side Lines of the Changing East-Asian Region – The Case of Taiwan[1]

János Vándor

1. Preface

There is a significant dichotomy concerning the international (economic) position of Taiwan: though it is organically integrated into the mainstream of global and Asian continental economic cooperation, and especially trade, at the same time it is drifting to the sidelines and it must fight to preserve at least part of its earlier central position. When Taiwan commenced its economic development, it had rather favorable conditions in comparison to other political entities. However, during the last 2-3 decades these conditions have changed for the worse. Though the economic policy and strategy of the consecutive Taiwanese governments aimed at realistic goals, the economic position of the island has been weakened by both internal and external factors. Certain elements that contributed to the rapid industrialization, and especially to its rise as a technologically vanguard economy, lost their relevance, and some social and economic elements of the home economy made it more difficult for the local administration to keep pace with the development of Taiwan's 'natural competitors'. The most crucial element in the transformation of the set of conditions was the (re) establishment of economic ties with the Mainland. This event and the consequences seem to be blessings and curses and had serious impact on the general economic position of the island. The present tug-of-war with China further complicates these bilateral relations and exerts negative impact over the global and Asian cooperation of the island, and as its consequence, Taiwan's economic security is jeopardized.

1 Research that enabled the author to compile this study was supported by scholarships granted by the Taiwanese government (2014) and Oriental Business and Innovation Center of Budapest Business School, University of Applied Sciences (2017). He is very grateful for both scholarships just as he feels obliged to express his appreciation to the academic institutions that received him and treated him with extreme hospitality, namely Universitas Gadjah Mada (Yogyakarta, Indonesia) and National Formosa University (Huwei, Taiwan). In the course of his research, the author succeeded in making interviews with people who can be considered experts in the public and the private spheres of the economy and politics. These interviews contributed to the understanding the Taiwanese situation, but their number cannot be considered here as scientifically satisfactory. This explains the relatively wide use of secondary resources. As for the content of this paper, the views expressed here are solely those of the author.

The paper makes an attempt to explore and clarify some of the basic factors related to the island's development, present problems and economic survival.

There is nothing permanent but change. This daft commonplace cannot be considered scholarly at all, but this does not contradict the fact that sometimes it points at reality. During the last decades, enormous transformation has taken place on the global scene in general, and in the eastern part of Asia in particular. What seemed to be constant one day, could be turned upside down by the next. Half a century ago observers proclaimed the 21st century to belong to Japan, and very few cared about a sleeping giant that was expected to remain quiet at least for another century. But the giant has awakened and became the epicenter of all the major (social, political, economic, but also cultural) tectonic moves of the last quarter of a century. This giant, the People's Republic of China, dictates the trends of the global, and especially the Asian scene.

And in this endurance of change, one can find one example for permanence and that is the inseparability of China and Taiwan.[2] Due to many elements, this is a 'Catch 22' situation. Regardless of their contingent intention these two parties cannot neglect each other. There is no power equilibrium between them and definitely the weaker party, namely the island is a subordinate actor. Nevertheless, an actor can be bigger and stronger than others but it does not mean that it is free to do simply what it wants.[3] While many questions related to these strong bonds have been studied and dealt with by great many scholarly and other works, in this study attention is focused on the exploration of what can be the impact of the radical transformation going on in the local commercial arena, and what the impact of China's economic emergence is on the trade and commercial situation of Taiwan.

2. The Economy and the Economic Policy in the 'Early' Decades – Some Characteristics

By many major indicators, Taiwan belongs to the top class of economic entities. The present status of the island has been achieved, however, by covering a rather unique

2 This paper is not about the legal and political status of Taiwan. In order to preserve objectivity, the author of this paper will refer to Taiwan either by this name or as 'the island', or in general, as 'the political entity'. Not even the name officially used by the island (Republic of China) will be used here unless it is connected to a source among the references and/or in the bibliography or mentioned by a third party in a quotation.

3 In simple terms, though China surpasses Taiwan practically in every respect, politically, economically, militarily, etc. Still, it is refrained in its actions by many motives that can be related to much wider international considerations.

and complex road of development. It is correct to state that Taiwan was relatively underdeveloped when it started to climb the economic ladder, but if it is compared to other former dependent territories either in Asia or on the global scene, then we can say that the island was much better off than either the colonial territories or the newly independent countries, including the Asian ones. It suffered comparatively less than most of the neighboring states (Korea, the Philippines, the other Southeast Asian entities) and it enjoyed rather peaceful and propitious conditions during the Japanese colonization. Naturally, the defeat of Japan and the island's return to the Mainland caused dramatic changes, and it would be correct to say that—at least economically and for a shorter run—not for the better.[4] However, the events of the 1950s and the 1960s set the development of Taiwan on new tracks. While the economic policy followed by the Government of the island could not be separated from the conscious contribution of the KMT (and Chiang Kai-shek), it must be realized that within this initial period the set of conditions has been determined more by external events and actors. The military shield held over Taiwan by the USA, the American political commitment and economic-financial assistance were accompanied by some political pressure to modify at least the economic policy of the KMT, and that provided the proper background for the internal adjustment of the local economy.[5]

Still, during the politically most turbulent years of the 1940-1970s, the development of the economy (GDP) was exceptionally high, fluctuating between 7-10 percent annually between 1952 and 1990, and even between 1991-1996 the average growth rate was 6.3 percent. The gross domestic savings grew from ca. 15 percent above 25 percent, sometimes surpassing the 30 percent ratio. The unemployment rate had remained very low all through the first half-century, and the role of foreign trade in the creation of GDP increased exponentially (from 22 percent in the 1950s to 75-80 percent by the end of the century) (Tsai, 1999). Structural changes were also very remarkable as the weight of agriculture decreased from about 28-30 percent to 3.6 percent in the composition of the GDP, and the value of industrial output increased twofold (from 23.9 percent to 38-45 percent). Perhaps the most significant change was reflected by the composition of Taiwanese exports: the share of agricultural products dropped from 19.0 percent (1952-1960) of unprocessed and 65.8 percent of processed agricultural

4 Politically it might be a sensitive statement and scientifically it is difficult to verify, but the author claims that the arrival and the first years of the KMT rule caused more harm to the economy of the island than what a 'hostile occupation' could have done.

5 Analyzing the early phases of Taiwanese development, economists are inclined to forget about the decisive impact of political and military factors. However, if these are lost out of sight, then the level (the quality and quantity) of American (and Japanese, West-European, etc.) contribution to the fast East Asian transformation, the facilitation of rapid industrialization, including the adjustment of the industrial and trade policies of Taiwan cannot be properly understood.

products to 0.5 percent and 3.6 percent, respectively, between 1991 and 1996, while the ratio of industrial products rose from 15.2 percent to 95.9 percent for the same period. (Ibid.) Naturally, these developments could not be achieved in the absence of supporting economic and (foreign) trade policies. These data clearly show that the character of the Taiwanese economy was radically changed, and this once agricultural island has been turned into a (newly) industrialized economy where industrializations—after a relatively short phase of import substitution—have been started by hosting some flung away (light) industries of the leading industrial countries (USA, Japan), and relatively soon the production of technologically advanced products and goods was also started.

It must be pointed out that it was not historically unavoidable that Taiwan had followed the path covered, however, it must be also added that at a historically favorable juncture (in a politically and economically favorable situation, thanks to the radical—progressive—transformation of industry and science in these last decades of the 20th century, the constructive social, educational, labor, etc. conditions of the local society, etc.) the island's governments adopted more or less the correct economic policies. The island became increasingly open to the outside world, but all these were mostly the consequences of the elements mentioned and not of a spontaneous selection of one of the paths available.[6] The 'state' promoted rural development, tried to avoid large-scale deficit situations. Furthermore, it increased budgetary surpluses, on the one hand, and created proper credit facilities for local firms in order to back up export and general liberalization, etc., thus paving the way for an international market-oriented, flexible and viable economy (Tsa, 1999; Ranis, 2007; Li, 2002). The areas where the government's role proved to be decisive were education and the scientific and technological fields. Preceding many competitors, Taiwan started to invest heavily in education at a very early stage, thus creating a labor force that was not simply cheap, but also trained. With its 'Chinese' background Taiwan was in a more favorable position than many other political entities as education has always been a central

6 With this—admittedly—simplified statement the paper does not wish to disregard the political and economic hardship the Taiwanese society had to endure. The paper 'only' wants to emphasize that—especially in comparison to many other political entities—Taiwan got the early chance to depart on a development path, and it could embrace the opportunities. One commentator (Ranis, 2007) states that besides the favorable conditions mentioned, secularism, egalitarianism and nationalism all contributed to the development of the island (Ranis, 2007, p. 38). However, the author questions the remark related to nationalism. Naturally, KMT considered itself a 'nationalist' party, the sole representative of the Chinese people, but in Taiwan the 'Great China' chauvinism could not gain ground during the KMT times, as the local people turned against the 'intruding mainlanders' relatively soon and disassociated themselves from them. Second, especially after the death of Chiang Kai-shek, the Taiwanese governments disengaged themselves from China in accelerated pace and tried to follow an independent, realistic, definitely pro-Taiwan, but never totally and openly non-Chinese line.

point in Chinese social life. At the same time, credit must be given to the local governments for encouraging the extension of public education and vocational training rather early (Vándor, 2017). In addition to education, and very strongly connected to it, Taiwanese governments and enterprises turned to technology-intensive productions and prepared the ground for high tech industries. Though it was not totally without precedent, and it was not very frequent either, that the government started to invest very heavily in research and development (R&D) and initiated the establishment of the scientific infrastructure, that has been serving the private and public technological activities ever since.

Through their prudent financial policies, the governments managed to achieve the sound international financial position of the island and, simultaneously, they also strongly supported local actors. The continuous trade surplus, the relatively high rate of domestic savings and not least the rather low level of foreign direct investments helped Taiwan to avoid the worst effects of the 1997-1998 Asian financial crisis.[7] In spite of the fact that serious political changes occurred both by the end and also in the very early years of the new century,[8] the economic attitude of the Taiwanese governments remained basically unchanged: the consecutive administrations tried to make adjustments to the changing global and Asian trends and, combining public and private efforts, they facilitated the strengthening of the Taiwanese firms that turned to external markets and especially to modern (technologically most advanced) industrial activities.

Approaching the end of the previous millennium, the Taiwanese economy did not change radically. The island had to face difficulties like all the other political entities of the global economy, but the economy could withstand the external pressures and

7 In the latter part of the 1990s, Taiwan's foreign exchange reserves stood at USD 86 billion, while South Korea stood at USD17 billion. The island's foreign debt was only USD 100 million (!) while that of South Korea reached USD 230 billion (!) (Ranis, 2007, p. 47). Taiwan has always belonged to the political entities having the highest level of reserves both in relative terms and in real figures. The sound financial position contributed to the mitigating of the effects of the crisis. The financial situation of the island is still very strong but—as it will be indicated in the main text—the present problems differ very much from those of the late 1990s.

8 The last one and a half decades of the last century saw the democratization of the political system and the 'Taiwanization' of the political and economic scene. After fifty-five years the KMT—in peaceful and democratic elections—lost the power. Naturally, this event should not be considered as a 'simple replacement' of one political force by another, but the developmental state character of the administration did not change drastically. In reality, the transformation that occurred in those years could be attributed more to the consequences of the changes of the global and East Asian political and economic scene, and first and foremost to the radical reconsideration of Chinese (PRC) policies and strategies.

relatively easily fended them off.[9] Nevertheless, as new developments occurred in the 1990s, both at home and in the external environment, the governments had to make adjustments. The changes originating from these adjustments were rooted in both the political and the economic areas. The process of democratization weakened the role and weight of the (earlier more autocratic) central executive power holder: the introduction of liberal political ideas and practices also contributed to the decrease of the government's ability to determine all or most of the factors of the economic life of Taiwan.[10] This does not mean that the 'developmental state' character of Taiwan disappeared overnight, but the state's role and influence in the economy diminished. While on the island the role of the 'state' (the government) became internally more complex, the securing of a favorable environment for the functioning and the development of the economic players had to be implemented amongst worsening external conditions.

Considering the basic elements of Taiwanese economic policy in connection with economic growth and development, the export-oriented industrialization, with special emphasis on technological advancement remained the cornerstone of the economic policy of every Taiwanese government. Earlier elements of such endeavor (e.g. reduction of trade barriers in order to facilitate export, prudent fiscal policies, flexible labor regulations, etc.) were preserved. In a natural way, there were sporadic tensions that accompanied significant Taiwanese social and economic changes, however, by the turn of the century, the economy was in a relatively good shape, and the island's economic structure and social and political fabric were not endangered by serious upheavals. In the earlier decades, most of the Taiwanese could enjoy some of the fruits of development. Simultaneously with rapid growth, the living standard improved and private consumption also increased fast (Li, 2010, p. 30). Relative social tranquility could be to a great extent attributed to the peaceful transformation of the rural scene. In the previous decades, industrialization did not occur at the full expense of the countryside. On the contrary, the gradual and balanced modernization of the rural economy did prevent the emergence of social and political tensions and also annulled the negative effects of rural-urban migration (Booth, 2007, p. 80). These positive achievements did not contradict the trends whereby the agricultural sector is

9 Here reference is made to the Asian financial crisis of the late 1990s and to the more global economic crisis of the first decade of the century.

10 It is well-known that (liberal) democracy is 'not a cheap exercise', and the society has to pay its price. Liberal democrats claim that the positive elements compensate for and outweigh the negative impacts. Illiberal democrats, on the other side, consider their political system more efficient and competitive. This debate has indirect relevance in our case, as up till now no one could question the (liberal) democratic nature of the Taiwanese political system.

being replaced by the industry, which, is more sensitive to international competition. On the one hand, this competition increased class-consciousness so to speak, and on the other hand, it demanded the government to improve the local business environment for the export-oriented and high tech-based industries and to create conditions under which both the local and foreign economic players could satisfy their interests. (This was not a kind of 'altruistic' action on behalf of the Taiwanese leadership, but the consequence of the understanding that there was a fierce competition between the leading local actors /the NICs/ for luring external developed partners to cooperate with them.) The attempts to generate a 'win-win' situation between the different actors, including the government itself, could be clearly seen by the facilitation of the business climate on the home front that has resulted in making Taiwan one of the most business-friendly entities not only in Asia, but on the global scale as well.[11]

Nevertheless, the restructuring of the economy and the more relaxed political climate encouraged the airing of social and political grievances on the part of both the emerging industrial labor force and the more vulnerable entrepreneurial strata. (One may recall that due to the increase of industrial production and the strengthening of the service sector, the composition of the labor force has changed significantly.[12] Still, labor strains would not be worth mentioning, if these did not concern cross-Strait relations, in concrete terms, the 'exodus' of the Taiwanese to the PRC since the late 1990s. This will be explored in a latter part of this paper.)

In this period of the turn-of-the-century, as far as the general economic policy of the Taiwanese governments was concerned, no drastic changes occurred in the long-term targets. Export promotion and technological development were still high on the agenda and led to the rapid expansion of foreign trade (and also to the fast increase in

11 According to the rankings of the World Bank, Taiwan scores among the best in providing favorable conditions for business activities (See: Vándor, 2017; and World Bank, 2017). It must be emphasized that this—and any similar—remark should not be understood as if there were no shortcomings or problems in the island's economic policy. The comment simply means that in international comparison, Taiwan offers better conditions for business activity than many of its partners or competitors. On the other hand, it must be also emphasized that—according to the relevant reports, in many respects the most important competitors, namely Singapore and Hong Kong are ahead of Taiwan.

12 The ratio of agricultural employees has been reduced to a small segment of the total work-force. What can be considered important from the processes that had taken place is not only the increase in the employment in industry and services, but that unemployment has never been a real issue since the 1970s, and that employment was not only secured, but the work-force proved to be one of the best in East Asia. The average unemployment rate in Taiwan was 3.04 percent between 1978 and 2018, the highest level being 6.02 percent in 2009, and the lowest was reached in 1979. At present, the unemployment rate is at 3.8 percent (See: Trading Economics, [online] Available form: https://tradingeconomics.com/tai wan/unemployment-rate).

outward-bound FDI). The regularly surpluses on the foreign trade balance were characterized by relatively high import content. In a sense, it was a natural consequence of the island's objective conditions (small size, limited resources, etc.), but it had long-term effects, too. While it was profitable for Taiwan to be involved in the newest and most sophisticated form of international cooperation, namely the 'infiltration' into global and regional production and supply networks (generally known as Global Value Chains, /GVCs/), at the same time, this process resulted in the high-level dependence on external partners. This penetration into GVCs proved favorable for Taiwan in the last two decades, however, the recent international (and mainly PRC-related) changes raise questions concerning the attainability of the positive elements of this situation.

The other decisive factor that determined the external and internal position of Taiwan, namely its technological development, secured its economic strength and international acceptance for some 2.5-3 decades and facilitated its penetration into the GVCs.[13] This pillar of the local economy, however, has also been weakened recently, and this process must be connected to the cross-Strait relations, as well. It was a simplification and exaggeration to remark that Taiwan has been relegated to a second-class industrial and technological power, but its further development is curtailed by the rapid rise of China in these areas and also the political means applied by the PRC in order to limit the international trade movements of Taipei. In a certain way, the island has become the 'prisoner' of its own ambitions—as can be observed through the development of the PRC-Taiwan ties, presented in the next part.

The general assessment of the achievements and shortcomings of the first 4-5 decades of Taiwan depends very much on the position and approaches of an observer. In a short paper it is impossible to provide a concise, objective depiction. This paper takes into consideration not only the 'local past' but also the position of other actors and the global situation in general. In this respect it concludes that Taiwan—not independent of the conditions created by external forces—has achieved more than most of political entities having been in similar position at the beginning of their independent development. In spite of the significant shortcomings, the island has proved to be capable of turning into a first class, sound economy that under rather harsh conditions became modern and competitive, managed to become one of the technologically most developed economic (production) entity, and, thanks to these developments, secured its place among the leading economies of the world.

13 On the general technological issue, including the R&D situation of the island see Vandor 2018.

3. The Small Versus Large Enterprise Dilemma

Because of the economic and social history of East Asia, the role of the family-based—using today's term small- and medium-sized—enterprises (SMEs) have always been playing a unique role.[14] Their (negative) contribution to the prevention of revolutionary economic transformation in the earlier centuries and their (more positive) unique position in the economic governance of much of East Asia (and particularly Southeast Asia), the characteristics of such firms constitute questions that are explored in many works. The paper in this section intends to shed some light on their present position in Taiwan.

Some observers correctly consider Taiwan as a formerly SME-based economy, although the state lately has been providing ever strengthened role to the big ('national') companies. The small vs. large enterprise dilemma has its root in the old KMT economic policy. After consolidating its power on the island, the KMT promoted the creation of large public enterprises and commenced their privatization at a later stage. However, in the course of this privatization, mainly small and medium-sized enterprises were supported, and such smaller sized, generally family-owned and very numerous firms became the leading economic players on the island. In other words, during the early phases of the accelerated Taiwanese economic development the SMEs constituted the backbone of economic transformation, including industrialization.[15] Larger private companies came into existence only in the later decades of the last century. This meant that many of the SMEs owed their existence to the government, and that also resulted in the relatively strong dependence on the assistance (sometimes also the political and economic 'goodwill') of the administration. When these SMEs managed to stand on their own feet, they still needed and kept governmental ties. The government was also interested in preserving relationship with private enterprises in order to direct these companies toward the fulfillment of 'national' objectives and also to exert certain control over them. (It should not be forgotten that Chiang Kai-shek /and KMT/ considered himself the depositary of the Chinese nationhood and traditions and tried to preserve Chinese culture and values as much as possible.) In addition to the maintenance of traditional Chinese characteristics of family enterprises (ethnic and linguistic closeness, cultural similarities,

14 To be more precise, the role of these kinds of economic actors has been radically different from that of the European and North-American players.

15 It is known that while in South Korea the big—frequently family owned—conglomerates (*chaebol*s) took the lead in development, in Taiwan family-owned, though in terms of their size, much smaller enterprises became the harbingers of economic progress. It requires deeper economic and social analysis to determine the pros and cons of chaebols v. SME conditions.

kinship relations, etc.), it seemed easier for the administration to help and also to control smaller companies.

By the end of the century, it became clear that the SMEs, in spite of the governments' support, could not keep pace with international competition. Some of the key Taiwanese players became aware of this situation and attempted to enforce 'internal growth', and some of them finally succeeded in growing into internationally recognized (global) enterprises. They still required the support of their home government but became capable to survive without basic government assistance and could also avoid being controlled by the administration. After a while, the dichotomy between SMEs and large firms created tension for the government, as the administration had to increase its preference for fast expanding large companies and for those who found their interest in direct external trade. It had to accept the continuation of opening up, the incorporation of the island into global production and trading networks but could not efficiently handle the repercussions on the more local-oriented SMEs, and the social tensions caused by deepening globalization.

Considering the characteristic features of Taiwanese SMEs, it is known that one of the strongest components of the traditional (family-connected) enterprises was their ethnic nature although—due to the internationalization of 'national' economies and to all its consequences—this characteristic has been fading. Hsiao, Kung and Wang (Hsiao et al., 2010) and many others argue that though ethnic affiliations are still prevalent in Taiwanese and Southeast Asian (Chinese) ties (and in this respect one might come to the conclusion that traditional—including kinship and family—features still prevail), they also emphasize that this 'taishang' relationship does not rest on the old ethnic foundation but responds to the new conditions of international cooperation. They dwell on the phenomenon of 'taishang', while others emphasize the relative importance of 'guanxi'[16] (social relationship) that should not be totally separated and should not be equated with the ethnic and family relationship, either. The aim of these references is to point out that 'taishang' gradually replaces or overrides 'guanxi'. This is the consequence of many facts, including the one that the traditional family-led companies—though they could flexibly adjust to new, local conditions, and partially to lacking the required experiences—could not always make the necessary flexible

16 Both terms cover special types of relationship that cannot be simply explained. Nevertheless, they can be interpreted as follows. Taishang is unique in the sense that it relates to the group of Taiwanese doing business in China. Though not only SMEs, but big firms and also individuals can be covered by this term, the majority of the players concerned belong to the group of SMEs. Guanxi is a much more widely used term, and it can be understood as a complex system of social and private relationships that facilitates informal and formal business cooperation.

adaptation to international economic conditions. They are compelled to learn new rules of a new game, and in this respect 'guanxi' cannot serve their interest as it used to do. In addition, the rules are usually set by China and for this reason 'taishang' is the dominant feature of our time (Hsiao et al., 2010).

Another feature of the SMEs-large enterprises issue—and this can be again connected to the general changes in the internal and the external economic environment—is the trend of the rapid weakening position of SMEs. This is clearly reflected by the fact that while in the first decades of development, SMEs accounted for a significant part of GDP, lately their ratio was radically reduced.[17] They did not disappear from the island and still constitute a significant economic and political force, but their position has been undermined by local economic processes triggered by global changes. In general, such a transformation could be considered as an internal issue, although in East and Southeast Asia it has deeper impacts. As a spill-over effect, the 'redefined' role of the ethnically identifiable SMSs introduced new elements in the wider regional cooperation. While traditional (ethnicity-based) factors can be still experienced in East- and Southeast Asia (mainly but not exclusively in the form of Chinese[18] business relations), globalization and technological development have significantly disrupted their application and utility through their economic consequences. In fact, the traditional SME-system has already been at least partially shattered.[19]

The above facts must be supplemented by the claim that SMEs have not only been losing ground to big companies at home but have also become more dependent on 'international subcontracting networks' (Li, 2002, p. 20). Because of the need for capital accumulation and concentration, as well as the growth in size to increase competitiveness, (Taiwanese) SMEs usually cannot meet this requirement. The reverse

17 Lin Thung-hong states that since the 1990s the Taiwanese SMEs' share within the export of industrial goods went down from 76 percent to 18 percent. At the same time, the large enterprises' ratio rose to 82 percent. He also adds that the contribution of one single mega-company (Hon-Hai Group, that is Foxconn) to the GDP was 21 percent in 2013 (Lin, 2017).

18 While it would be a mistake to equate the Chinese and the Indian economic and business presence in Southeast Asia, as far as the ethnic (and cultural, religious, political etc.) factors of these two communities are concerned, they can be compared, and many similar characteristics can be found.

19 In spite of the weakening of the SMEs, they are still a force to be reckoned with, both socially and politically. That is the explanation why the government of President Tsai declared that it wants to strengthen their position within the framework of the New Southbound Policy (NSP), and it attaches great importance to their role in the implementation of NSP. In spite of this, scholars have pointed out that during the last decades—and not only years—the international business models made the reliance on family/ethnic ties and management less and less attainable. The author fully agrees with this observation despite the fact that most of the large Taiwanese enterprises are still managed by the founding families or founders.

situation, namely the fading of SMEs' position and the appearance and significant expansion of large, internationally considerable companies creates—up till now relatively unknown—social and political contradictions. Nevertheless, while it is clearly visible that the power relations between the large and small companies and the administration have somewhat, and mainly the big firms have acquired the upper hand in the open and liberalized international market, the SMEs are still present and can put heavy pressure on any Taiwanese government.

This is nowhere more visible than in the role of the SMEs and the private sector in general, in handling cross-Strait relations. Having received the chance to move to the Mainland, a rather familiar and supposedly easy and profitable territory, the Taiwanese SMEs pressurize the government to represent their interests, in other words, to open the borders, ease restrictions and facilitate—for them—an intra-Chinese collaboration. Thus, the SMEs played a decisive role on cross-Strait relations. (They were followed by the bigger companies, which later on took over the lead.)

4. The Watershed: Entering China

After four decades of close to total separation in the early 1990s, China and Taiwan met each other again—at least in the sphere of economic cooperation. Nevertheless, in spite of this separation, since 1949 the parties could never 'forget' about the other side, and the drift between the PRC and Taiwan has been always on the agenda. In the first decades the island (and Chiang Kai-shek) enjoyed American support. Still, after the USA-PRC rapprochement—and in spite of the diplomatic and political isolation—Taiwan could preserve, furthermore, strengthen its economic and scientific-technical cooperation with the major powers of the world. Nevertheless, when Beijing introduced its reforms, Taiwan was one of the very first to rush to make use of this opening. The implementation of Taiwanese interests and the consequences of the newly born cooperation cannot be neglected in the course of assessing of the island's present position and future.

Before exploring these ties, some remarks must be made. It must be repeated that Taiwan—not independent of the conditions created by external forces—has achieved more than most of political entities having been in similar position at the beginning of their independent development. In spite of the significant shortcomings, the island went through—the otherwise unavoidable—Western-type of capitalization, including the new stratification of economic actors, the rise of huge, 'global-size' enterprises and the weakening of traditional family-based SMEs. Thanks to heavy investments and supportive plans concerning leading technologies, Taiwan has risen to a very high level. On the other hand, it could not become a real trailblazer in new technologies. It is capable of accommodating first class—in their narrow fields—globally recognized companies, but these enterprises are not in the frontline of general innovations. They are excellent and keep the pace with others within their limited technological realm, in segments of high tech productions, but it is an unanswerable question whether they can ensure the maintenance of the island's technological position, or due to the 'ageing' of their products they will gradually lose their position. In addition, in general economic terms, the rise of some giants created new demands, and most of these cannot be satisfied in Taiwan, but only on the global scene. These factors compelled these enterprises—and also many SMEs—to turn their attention to the global market, and first of all to China.

Though the Taiwanese leaders could feel and calculated with the challenges of the China-factor, they proved incapable of preventing the emergence of the one-sided dependence on the PRC that determines the present and the future fate of the island. It is a closely related question whether Taiwan or any other political entity in Asia including the global scene, could have followed a different line and whether they could have avoided this dependence on the Mainland.

By the turn of the century, Taiwan became a model for many high tech aspirant political entities. Though there were observers who warned the leaders of the islands of the shortcomings in development, the successes eclipsed the problems, the achievements were recognized and applauded and very few doubted the straightforward progress of Taiwan. Below the surface, however, processes had been set into motion that—gradually—undermined the economic, social, and not least the political position of the island. Though these trends materialized within a complex set of factors, it is clear that the basic and major original elements of these trends can be traced back not to the island but to the other side of the Taiwan Straits: to the PRC. Since the late 1980s, the fate and international standing of 'Formosa' has been determined by China unconsciously, and in Taipei through the China/PRC-policy of the Taiwanese governments.

Had China remained a self-excluded and inward-looking political entity, the island most probably could have maintained the position previously attained and could have remained the unquestionable and self-reliant vanguard technological power that it had been earlier. Awakening China, however, within the framework of cross-Strait ties, first managed to bring the profit-hungry and survival-conscious Taiwanese—public and private—actors into its own orbit, then made the ties and relationship indispensable, and finally created the situation from where Taiwan cannot escape the direct and indirect heavy weight of the Mainland.

Exploring this question from Taiwan's perspectives, it is clear that from the start there was a Taiwanese eagerness to enter China from the private sector's side. The governments showed high level of vigilance. In spite of this, there was a very fast and successful penetration of the island into the Mainland, which can be explained by many factors. Besides the 'natural' closeness of the two parties (in cultural, linguistic, etc. terms), the relative 'hospitality' of the Mainland towards the profit-interest of the 'islanders', or the Taiwanese was also decisive. Similarly, it seems to be unquestionable that Taiwan's unique international standing also played a role in the thinking of Taipei.[20] At first, the island managed to follow its independent (let us call it PRC-free) economic and social policy and then succeeded in riding on the initial waves of the Mainland's rising economy. Its companies—and through them Taiwan in general—made huge profits exploiting the opening up of China and the incomparable qualitative differences between the development levels of the two economies. This was the period when—seemingly—Beijing needed Taiwan more than the island needed the Mainland. In reality this was not the case, but it could not be seen clearly at that time. In the maintenance of the development edge of Taiwan, the penetration into the PRC market (both as a seller and as production partner) constituted not only a decisive, but a necessary factor. The economic, financial gains earned in China very

20 As mentioned, by the time of the Chinese reforms, by the late 1980s, Taiwan had already been excluded from all the major international organizations, and this expulsion was not only politically painful but also brought some negative economic side-effects. True, the island could find its economic partners, but with the reforms in the PRC, the situation significantly changed—and not in a positive way for the island. Here one additional factor must be kept in mind: the importance of regional cooperation. International economic cooperation has never been as important and decisive as it is today. Regionalism has become one of the most determining factors of our time, and those who are left out of such schemes must face worsening conditions. Thus, the isolation for Taiwan became a very great challenge. Depending on the perception of Taiwanese behavior, the PRC tightens or loosens the ties. This is proved by the Chinese attitude towards Taiwan's FTA and other economic cooperation attempts with third parties. During the somewhat more PRC-friendly administration of President Ma Ying-jeou, China did not prevent Taiwan and Singapore to conclude an FTA. (It is also revealing that the title of this agreement was as follows: 'Agreement between Singapore and the separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu on Economic Partnership /ASTEP/.) China also closed its eyes to the Taiwan-New Zealand FTA-type cooperation. Since the coming into power of President Tsai, no such flexibility could be observed on China's side. The latest example for the impact of China's importance in the exclusion of Taiwan from international economic cooperation is indicative again. Though Washington withdrew from the Trans-Pacific Partnership (TPP) negotiations, the idea has been revived and pushed forward by 11 states. In the absence of China—and also the USA, but in this respect that is a secondary issue—Taipei could have made efforts to talk about its membership in the TPP, but the partners did not invite Taiwan to join. Probably they thought it wiser to keep Taiwan away instead of creating an imminent or future problem for themselves.

significantly contributed to the attainment of Taiwan's international position and internal—economic and social—solidness. At the turn of the century, however, the situation radically changed. Nevertheless, for some time it could be regarded as a win-win state of affairs. Gradually, however, it turned out that Taiwan is not a match for China and the PRC can—well, not easily swallow but on an ever-increasing scale—disregard and substitute the island. In the second decade of this century, it was already evident that Taiwan fell into the trap where it became a partner heavily dependent on the Mainland. The consecutive governments of the island have been making attempts to loosen this dependence, but now it is rather difficult to predict a positive outcome.

Looking back to the (now) origin of Cross-Strait ties, it can be considered a total coincidence that the Chinese reform-era and the Taiwanese democratization period, as well as its miraculous rise took place so close to each other.[21] What seemingly served as a decisive element was the fact that, despite the shortcomings of the KMT's earlier economic policies, the island had at least some 25-35 years advantage over the Mainland. By the time of the Mainland's opening, Taiwan was already an open, export-led economy, a global player with a highly developed industrial sector, possessing strong economic and technological advantages over China. When Beijing started its catching-up, China was an impoverished, huge but underdeveloped country. Looking back to the past[22] it seemed to be a great adventure to accept the invitation of the Chinese government to join its modernization program, and the Taiwanese companies were happy to start knocking on the door of China.

21 Chiang Kai-shek died in 1975, while Mao in 1976. Chiang was succeeded by his son, Chiang Ching-kuo, who followed his father's autocratic rule, but paid serious attention to economic development and significantly contributed to the transformation of Taiwan's economy. In the political sphere he incorporated more Taiwan-born politicians and experts into leadership position, and by the end of his rule he tolerated the introduction of democratic elements in the island's political life. He died in 1988. Deng managed to eliminate the remnants of the followers of (Mao's) Cultural Revolution and opened the road to 'socialist market economy' in the early 1980s. Though the Deng-reforms required certain easing in the political sphere, the crushing of the Tiananmen Square protests showed that he did not consider the relinquishment of the Party's rule and the strong control over the society acceptable. Performing a light comparison, it can be said that from the late 1970s till the mid-1990s in China, Deng Xiaoping directed the opening of the economic area, but stuck to the rigidity of the political system, while on the island Chiang Ching-kuo followed the liberalization of the economy and facilitated political democratization. Though the two parties closely followed each other's move, these trends and actions could hardly be connected, as during this period contacts between the two sides of the Strait were rendered more difficult or still forbidden. (It should not be forgotten that certain level of communication and personal contacts could be preserved and handled through informal contacts and overseas Chinese intermediators.)

22 It is well-known that after the proclamation of the PRC (still in the early 1950s), its leaders first encouraged the business companies to remain and help stabilize the economy, but after a while the leadership decided to eliminate the local 'bourgeoisie'.

In addition to the economic and business interests on the part of the island's politicians—just as in other parts of the world—there was the expectation that economic transformation will be also supplemented with political changes in the PRC. The Deng-reforms seemed to be pragmatic and forward-looking and, on the one hand, led to serious confusion in interpreting the situation, while on the other they deserved encouragement. From the perspective of this study, not the philosophical and ideological ideas and contradictions are important, but the simple fact that though China still used old 'socialist' terms in its political propaganda, it also introduced market-compatible practices (e.g. market conditions, competition, profitability and profit-making, wealth accumulation, private ownership, etc.) and encouraged foreign, including Taiwanese companies to come to the aid of the PRC. These newcomers helped it to get into the center of global economy and attain not simply a leading, but a determining position with old, ideologically sound and power-securing factors like state control, central regulations, etc.

Responding to this transformation of China, the Taiwanese were among the first who arrived at China and probably with the greatest vigor—and the biggest amount of investments. That was a seemingly good start after decades of separation and official prohibition on both sides. Looking back on these last decades, no unequivocal answer can be given to the question, who gave and who gained, profited more from this bilateral relationship. Today it would be difficult to reject the notion that though at the beginning it was more a win-win situation, at present there is no doubt that China seems to be the 'winner'. From the perspective of our study what deserves attention here is the fact that after a short while the external economic relations of Taiwan became dependent less on the 'classic trade policy' of the island's government and more decisively on the situation of the cross-Strait ties. While the Taiwanese administration's mildly shifting foci always followed the 'tested' liberal policies, the fate of Taiwanese prosperity has started to be strongly interlinked with these bilateral relations. It would be a simplification and exaggeration to claim that the island has become totally dependent on the Mainland but looking at the relatively static economic and trade policies of the successive governments, it is clear that the basic differences in strategies reflect nothing but the administrations' perception of China, of cross-Strait relations, and not least the political motives and targets behind these strategies.

In view of this dependence the question arises whether the Taiwanese governments can be held responsible for the creation of this situation and the rise of China. There are opinions that represent the views that for some time, external partners—among whom the Taiwanese—'dominated China's economy …' but actually '… have brought little actual technology and knowledge to China' (Fuller, 2008, p. 240[23]). Refuting such position, Fuller himself rejects this notion and instead states that 'Taiwan has in fact played a critical role in boosting China's technological development ...' (Ibid). The previous position should be rejected outright. All through its history, the PRC was never dominated by external powers.[24] (Fuller's) second claim cannot be approved of, either. For the PRC the appearance of external investors, especially at the very beginning of the reform period was extremely important for many reasons, and the catching up with the developed countries in the area of industrial and technological achievements was one of the goals pursued. At the same time, Taiwan, just as all the other knowledge-holders, had no intention to share whatever technological knowledge it acquired. As a general characteristic of international networking (including GVCs, outsourcing and other types of cooperation) and science (knowledge, pattern, etc.), owners are ready to share their scientific assets as their interest dictates. Naturally, the arrival and the sharing of a higher level of knowledge, expertise and practices will facilitate the development of the 'beneficiaries', yet the impact of this kind of transfer of capabilities also depends on many other factors. As the general trends have determined the processes, Taiwanese companies (not the political entity itself, but its enterprises) also introduced 'modern technologies' on the Mainland only at the level and in the form that seemed literally profitable and necessary.

On the other hand, it was natural that the Chinese governments always attempted to improve the technological level and competitiveness of their own companies and increase the value-added content of local products (Chan, 2015). In this respect, the Taiwanese companies were not different from the others. What made them special, was their 'Chineseness'[25], their relatively high number and economic presence.[26]

23 Fuller refers to Yasheng Huang (2003).

24 This remark could be refuted by the reference to the Stalin-Mao period, although it should not be forgotten that that was a rather voluntary self-submission of Mao to the 'genius' of Stalin, and it did not survive the death of the Soviet ruler.

25 It is natural that in areas where linguistic and cultural understanding still play an important role, this kind of sameness matters a lot. Furthermore, we can calculate with the strength of the traditional Chinese family and social relations (e.g. guanxi) that promoted ties but brought about also negative consequences. Through personal interviews, the author learnt from Taiwanese businessmen that Chinese authorities not only 'exploited' the political weakness of Taiwanese entrepreneurs (as they could not turn to anybody for real defense), but frequently used them as scapegoats whenever the 'need' arose. They frequently carried out actions against this group of companies in a manner that they did not dare to show in case of other external partners.

26 Ever since the Chinese reforms, there have been a permanent influx of foreign investment into China and—especially in the early years—overseas Chinese capital took significant part of this FDI. In those years most of the capital arrived from or via Hong Kong—and Taiwan was following the city state. It can be assumed that already before the authorization of direct contacts between the PRC and the island, Taiwanese capital could be channeled to the PRC either through Hong Kong or the overseas

Though the Taiwanese entered the Chinese production and consumption markets relatively early, disregarding the non-official channels of contacts, they had to start from square One. At the start, they were welcomed by both the central and the provincial administrations, just as all the other FDI-providers, and managed to expand their activity and presence. Thus, within a relatively short time, the number of Taiwanese companies and the ratio of their investments increased significantly. At that stage, they proved to be useful and valuable for the PRC and profitable for themselves and the island, in general.

Already from a rather early period of the renewal of cross-Strait ties, the Taiwanese administration kept an eye on the cooperation and tried to use methods, mainly in the form of qualitative and quantitative restrictions or prohibition, to create a political and security wall around the island.[27] The Taiwanese were allowed to visit the Mainland from 1987, and the first trade permits were issued in 1989. At this time, all transactions over USD 1 million and involving technologically advanced products had to get a permit from the Ministry of Economic Affairs (MoEA), but later on such limits and the general conditions were 'liberalized'. In spite of some negative 'side-effects', no government could really stem the escalation of cross-channel cooperation.[28]

Restrictions have been kept ever since, but the conditions changed (limits were raised, and conditions loosened), while the ever more liberal economic policy—which responded to the demand of the Taiwanese enterprises and also to the international market conditions—facilitated more than prevented the increase in cross-Strait economic and business relations. In order to make some order in cross-Strait relations, the two parties set up their 'informal' bodies that were entrusted to channel their communication into orderly manner. Taipei established (still under Chiang Ching-kuo) the Straits Exchange Foundation (SEF) attached to the Mainland Affairs Council,

Chinese of Southeast Asia. Data indicate that though in this period most of the enterprises in China were owned by local entrepreneurs, the technologically more advanced ones belonged to foreigners among whom the overseas Chinese, including Taiwanese, were represented by a high number (Anita Chan, 2015).

27 In 1992, the 'Act Governing Relationships between Peoples of the Taiwan Area and the Mainland' entered into force and has been valid ever since. It underwent several amendments mainly due to the demands of the business circles of the island. In general, the purpose and the direction of the provisions have remained the same as in the original text. [online] Available form: https://www.mac.gov.tw/en/News_Content. aspx?n=4F2E0C155DF44564&sms=2C46F5E37DC2E1D2&s=1A530DDE8A245DC0

28 Chin mentions that since the 1990s Taiwan's inward FDI (as a percentage of the GDP) increased from 5.8 percent (1980) to 12.7 percent (2007), while its outward FDI increased from 0.2 percent to 41.3 percent channeling funds mainly to the PRC. Furthermore, in spite of the administration's efforts, the companies managed to forward capital to the PRC either using offshore subsidiaries or holding companies (Chin, 2013, p. 7).

while Beijing created the Association for Relation Across the Taiwan Straits (ARATS), belonging to the Taiwan Affairs Office of the State Council of the PRC. Though the two institutions have been dealing mainly with general political issues, their coming into being had positive impact on the approach of private and commercial actors.

The formulation of the so-called 1992 Consensus made relations more tranquil, but the consequences, namely the rapid widening of relations and the great interest of the Taiwanese in the China-business, sent alarming signals to Taipei. Perceiving the danger stemming from the direct bilateral contacts, the then President of the island (Lee Tung-hui) proclaimed the 'no haste, be patient' policy (NHBP, 1996), which had to be replaced soon by different approaches (Chin, 2013). President Lee was the first top leader of the island who toyed relatively openly with the idea of Taiwanese independence. His successor's, Chen Shui-bian's attitude was the same, but for us what needs to be recalled is the fact that though President Chen was an ardent opponent of the Taiwan-China ties, he could not prevent the fast increase of Taiwanese attachment to the China market and to China itself, but on the contrary, had to accept it. Ma Ying-jeou followed a different line of policy. In the spirit of the 1992 Consensus, he preferred a lower tone Taiwan-policy and a higher level of economic cooperation. While his approach proved to be successful in improving economic ties and also guaranteed a kind of political rapprochement, he could not withstand the high and fast rise of the dependence-creating penetration of the Taiwanese into China.

All in all, ever since the opening up of bilateral contacts, it has been one of the most difficult and also sensitive issues in Taiwan's cross-channel policy how to balance between the economic and security considerations. The enterprises and companies always demanded the opening up and the reduction of the restrictions, while the public showed an ever-increasing intention to keep a distance from Beijing. This had to be done simultaneously with increased economic stability and rising living standards. In spite of the statistical data, that reflected the correlation between the development of the PRC-Taiwan economic collaboration, politicians usually refrained from explaining the essential elements of these relations, the strong and further strengthening connection between Beijing-Taipei cooperation and the one-sided inter-dependence. Very few references have been made to the fact that external conditions compelled the governments to get ever closer to the PRC.

5. Short Summary of Questions Related to the External Trade Position of Taiwan

Looking back to the trade policy history of Taiwan, it is clear that after the Chiang Kai-shek area, the last 40-45 years have been characterized by a liberal and export-oriented external economic policy. Different governments applied different tools, trying to adapt to specific conditions, but, in general, the economic and commercial targets have remained similar, and the economic political strategies also showed a high level of analogy. Naturally, Taipei also had to take into consideration its global and/or regional (power) position and was compelled to adjust its strategies and tactics to others, but it could do that on its own. In other words, it could afford to look around in the global market first and then consider the endeavors of the partners. However, since the turn of the century, it has had one permanent direction-indicator, the PRC. Whatever Taipei wants to do or achieve now, first it must consider the negative (or positive) implications vis-à-vis China, and then it can deal with the additional elements of its external economic relations.

Interpreting the international trade position of Taiwan there is no doubt that earlier this used to be rather strong. As indicated in the first part of this paper, in spite of its size Taiwan was one of the most important merchandise trading entities on a global scale (both on the export and the import side). There was a continuously increasing external demand for Taiwanese goods, including high tech products, although since the beginning of this decade, the trends—both on the export and import side—indicate decreasing values.[29] The composition of the foreign trade was very positive all through the last decades, and it still seems to be very promising as manufactures take the biggest share in export (89%) but also in import (65.9%). On the other hand, however, the trade in electronic and other high-quality products has been stagnating. On the import side (concerning these merchandise groups again) also a declining trend can be experienced. Declining import sometimes can be considered a positive development but bearing in mind that in Taiwan the purchase and delivery of technologically advanced goods serve the basis of processing and re-export, this decline cannot be considered as an unequivocally favorable trend.

Approaching this issue form another angle, it is known that Taiwan has been a net exporter, and the permanent foreign trade surplus does not only refer to the relative

29 The data mentioned originate from the World Bank Database ([online] Available form: http://stat.wto.org/CountryProfiles/TW_E.htm) unless otherwise indicated. According to the latest statistics found at WTO merchandise export—the most important area of Taiwanese export—decreased by 2 percent from 2015 to 2016, while the same figure for imports was 3 percent.

economic stability of the island, but also shows the ability to utilize the surplus capital to further its economic goals, including the extension of trade but also the facilitation of production cooperation abroad. The huge surplus capital allowed the island to become a major FDI-provider. All figures confirm that Taiwan is not simply a net FDI-player, but the outflow of FDI is close to three times higher than the inward-bound investments (WTO, 2014). With the approval and support of the governments, the island's companies––invested heavily in most of the countries of East Asia, however, China is still the most important destination. At the same time, FDI is again a double-edged sword. It really facilitates the expansion of political entities' and companies' activities abroad, and it can deepen their cooperation with third parties, introduce market products and through this process contribute to the acquirement of enough income and expertise to strengthen their overall competitiveness. On the other hand, FDI binds the investor to these third markets in a way that—among given circumstances—the FDI-provider might become more vulnerable than the recipient itself. If a recipient is relatively weak and there is no other potential investor to replace a dominant one, then this weak partner cannot do too much against the FDI-partner, and this foreign investor can negotiate with the recipient from the position of strength. If this is not the case, then either the situation is more balanced, and none of the parties can dictate the other one (that can be labeled as a more or less win-win situation), or the FDI-provider might become the hostage of its own investments. This latter situation occurs in the Taiwan-China case. While the heavy Taiwanese FDI in China had been very useful for many reasons during the 1990s and the very early 21st century for both parties, later on FDI became such a forceful connecting element, that it may complicate the isolation from the Mainland. Taiwan needs reliable markets so much that through concentrating FDI in China, the island weakens itself instead of strengthening its own position as an FDI-provider. This is taking place even though the spreading of Taiwanese capital over ever larger economic areas is no doubt a precondition for the island's independent economic and commercial survival. Though—theoretically—the internal investments (namely, keeping the capital at home) might produce several positive results economically and financially (and also technology-wise and socially in the labor market), the organic penetration of Taiwan into third countries' markets can be one of the best ways to overcome the island's international exclusion from the international trading blocs and to tackle any trade limitation originating from Taiwan's political-diplomatic subordination.

With the Taiwanese FDI in China worth between USD 150-200 billion, the island cannot escape dependence. Not only because the government itself cannot do too much against this situation, but due to the enterprises' intransigence to enjoy the benefits of the huge Chinese market. These companies are not ready to sacrifice their profits as long as the government cannot come forward with viable alternatives. (The New Southbound Policy propagates the entrepreneurs to 'turn South', but the southern states cannot offer the same advantages as China.)

FDI is still one of the most important tools and one of the most efficient ways of breaking through the barriers of isolation. Nevertheless, it can balance the negative impact of being excluded from the community of states, at least partially. For the export-oriented Taiwan, the only way to secure its prosperity, its industrial (and technological) development—and not least the decrease of its dependence on China—is the expansion of its external economic relations. Its scope of action, however, is relatively limited. Concerning its bilateral economic contacts, in spite of its diplomatic seclusion,[30] Taipei succeeded in establishing trade cooperation with some 50 countries, including the most important economic and trading actors of the global market, such as the USA, Japan or the European Union. There are more than 60 Taiwanese trade representations acting as facilitators of bilateral economic cooperation.[31] These trade offices efficiently handle the economic issues, but as most of the business and commercial activities of the island's companies are carried out go through direct channels their role is more supplementary than substantial. At the same time, the single most important partner and bilateral contact is, again, the PRC. In this case, the management of bilateral issues is handled not via such representations, but through 'informal' and officially controlled institutions.[32]

The question of presence and absence in an international organization has been already mentioned here. It is clear that in the age of regional integrations (regionalism), 'simple' bilateral relations and individual ('national') actions cannot substitute the role played by multinational institutions. And here the position of the island is

30 It is well-known that the island is recognized as an independent political entity (state) or as the representative of the Chinese people by about 20, mainly very small, internationally rather insignificant, economically 'valueless' countries. Economically and financially, probably, these partners cost Taiwan more than it can 'earn', but for political reasons the island cannot afford to break these ties.
31 These representations also act as quasi-diplomatic missions. These systems of trade representation clearly show a tacit understanding by Beijing and Taipei that the PRC acknowledges that its major political and economic partners are reluctant to easily sacrifice their interests and cut their ties with Taiwan, while the governments of the island note that these parties consider China the more important player and in this respect, again, the island's scope of action is relatively limited.
32 On the Taiwanese side, the Straits Exchange Foundation (SEF), while in Beijing the Association for Relations Across the Taiwan Straits (ARATS) are entrusted to handle the issues. As one can find the executive power-holders of both parties behind them, every move they make can be considered officially approved. SEF and ARATS are deeply involved in formulating bilateral ties, and in this respect, they are the decision-makers (actually the governments behind them), who set the framework for economic and trade collaboration, but the actual economic cooperation is realized through 'independent' public and private enterprises.

extremely weak,[33] as third parties' economic interests and political considerations overwrite their readiness to accept that Taiwan cannot make use of its economic and technological advantages, and yet the formerly close allies prefer to work with China rather than with the island. In practical terms, this means that Beijing prevents the entry of Taiwan into all the major economic (regional) blocks and thus deprives it of all the positive effects such blocks could offer to their members. There are very few international organizations where Taiwan managed to secure some kind of presence, mainly observer status. One of the otherwise very significant exceptions is the WTO. Taiwan entered the Organization on 1 January 2002.[34] In the WTO it has full membership and bears the same rights and obligations as all the other members, but it is clear that still within this body—in given cases—cannot rely on the support of others against the PRC, unless in the subjects concerned, the interests of others meet the interest of Taiwan. Its attachment to APEC and OECD are politically also a very significant element, which helps the island to preserve certain fragments of its earlier international position. But even this presence does not constitute full membership. In the OECD, Taiwan is only an observer, and China can easily step up against Taiwan's presence at meetings and debates.[35] These are the forums where it can appear on its own right and have its voice heard, but none of these—otherwise decisive—organizations are in the position to show Taiwan the way out of the very painful and expensive international exclusion.

33 As indicated earlier, the international activities of Taiwan are heavily restricted by the PRC. This concerns both the political and also the economic movements of the island. It is clear that the island could enter or secure (different kind of) presence in a very small number of international organizations. Similarly, it managed to formalize its economic and trade cooperation with very few partners. Besides Singapore and New Zealand, Taipei signed an FTA with Panama, drafted one with Nicaragua and concluded a Close Strategic Economic Partnership (CSEP) framework with Paraguay. (MOEA) Apart from them El Salvador, Honduras, Guatemala are the other major collaborators. (The case of Panama is uncertain because of the termination of diplomatic ties and the withdrawal of the recognition of the 'Republic of China' by Panama.)
34 China entered WTO on 11 December 2001, three weeks earlier than Taiwan. Naturally, the accession talks went on separately, and it is clear that China had to swallow a bitter pill with the acceptance of the island. A major victory for Beijing was the denomination of the island as 'The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu', which is always referred to as 'Chinese Taipei'. Practically, that is the only leading international economic organization where Taiwan could obtain full status. In all other cases, it was invited as observer with more limited rights.
35 As one of the latest examples for annoying Taiwan, in 2016 China prevented the Taiwanese delegation to join an OECD steel talks because it was angered by the island. (See Associated Press Report: Taiwan protests ejection from OECD steel talks, blames China. April 19, 2016. [online] Available form: https://www.seattletimes.com/business/taiwan-protests-ejection-from-oecd-steel-talks-blames-china/). Though later on the delegation could participate in the meeting in the status of an observer, nevertheless, the case clearly shows how easily the PRC can 'punish' the island if it wants to.

It would be a mistake not to see that the PRC pulls the strings with relative ease and at its own discretion. When it feels that the government of the island remains within certain political limits and disregards the question of sovereignty, the PRC shows higher level of inclination to give Taiwan some leeway for strengthening its international cooperation. If cross-Strait relations get sour, China will harden its position and directly or indirectly prevent Taipei from joining universal or regional organizations.[36]

6. Conclusions

Though in this research the focus is on Taiwan, in order to understand the conditions of the island, the observer must start and must also finish with the exploration of the China-Taiwan ties. For roughly four decades, Taiwan could relatively easily follow its own line of development, but since the 'grand opening' its fate has been inseparably bound with the Mainland. For some time, the Taiwanese could believe that they can keep the distance and preserve their individual scope of action, but that proved to be simple rainbow chasing. Today Taiwan still represents a significant power. It has enough military strength to withstand a violent assault, though only for a very few days. It has a strong economy with more and more weaknesses. It can determine its internal (democratic) policy and its own external economic and trade policy within shrinking frames. It can strive for preserving or further developing its own trade routes, partnership—but sailing between Scylla and Charybdis, between heavy subordination and gradual but unavoidable decline is not a comforting situation.

On the other side of the strait, China has become a kind of co-leader of the world. It succeeded in increasing its political leadership role, its economic weight, and simultaneously—and this can be considered the most dangerous and delicate issue for Taiwan—it successfully launched its rapid technological and industrial development and excellence. Technological and industrial development constituted the only areas where the island could be a match for the Mainland. These were the only spheres where the island could not only utilize its decade-long edges but could also rely on the direct assistance of its allies. Because of the very fast and extensive Chinese development in technological revolution, the island faces very tough competition and the odds are not the best. This tough competition can be felt in many areas, and it is more than indicative that China has also started to accelerate the development of

36 During the Ma-administration, in 2010, Taiwan and China signed the Economic Cooperation Framework Agreement (ECFA) that was expected to boost bilateral trade. Later, in 2013, the two parties concluded the famous Cross-Strait Service Trade Agreement, that could not be ratified due to the protest not only of the opposition, but also as a consequence of the Sunflower Movement.

its semiconductor industry (one of the major areas of Taiwanese high-tech production capacity) and has also broadened the scope of its brain-drain, offering excellent job opportunities for Taiwanese specialists working in cutting-edge industries (Neszmélyi, 2017). Therefore, the preservation of the island's position is more and more complicated. It is not defenseless in this respect either, but it must find the best policy and the best means for achieving its targets.

Looking back on the political and economic history of the island, the last 7-7.5 decades can be classified in different manners. From the specific viewpoint of this study, the Author divides this period into two parts. In the first 4.5-5 decades, the internal and external conditions for the development of the island proved to be rather good, even favorable. Taiwan became prosperous, rich, advanced, and, at the same time, democratic. In this period, Taiwan could be considered a strong international actor who, in spite of its diplomatic expulsion, could not be subordinated.

The second phase, interestingly enough, started with the introduction of the Deng Xiaoping reforms in the PRC, with the emergence of the pro-Taiwan political forces on the island, the acceleration of technological development, and not least the transformation of the international economic and production cooperation. In this second phase, the international conditions have changed to the detriment of the island. The relative power balance and the balanced mutual interests, that had characterized the 1980s and the 1990s, gradually disappeared or were modified and replaced by the domination of Beijing. The internal political changes, including the strengthening of Taiwanese identity and the political line followed by DPP, made relationship with China tenser and less cooperative. These elements further complicated bilateral relations and contributed to the isolation of the island and the limitation of its international actions.[37] At the beginning, technological development proved to be decisive for the island, as its organic presence and mature penetration into global technological collaboration contributed to the reinforcement of Taiwan's global and Asian eminence and production capabilities. Taiwanese firms became not only significant contributors (suppliers or outsource centers) to the most innovative and leading high tech companies of the global market, but some Taiwanese companies have become lead firms on their own right.[38] This process, in general, could be considered positive, but in case of Taiwanese companies, the unfavorable political and economic conditions (seclusion

37 This can be seen in the withdrawal of diplomatic recognition by Panama and the restrictive steps taken by Beijing concerning the presence of Taiwan in the international organizations.
38 Such enterprises as Quanta, TSMC (Taiwan Semiconductor Manufacturing Co.) Hon Hai Precision Industry (Foxconn), Mediatek and others are among the top firms of high tech industries and some of them appear on the Forbes 500 lists.

from the international community, expulsion from regional trade integrations and all the economic and trade consequences that can be linked to such a situation) might compel these enterprises to leave their home base behind and move to third areas. These trends can be accompanied by more negative consequences, in a way at the will of China.

Since the late 1980s all the Taiwanese governments have been aware of the delicate nature of the PRC-Taiwan relationship. All of them attempted to handle the question but according to their own perception of the situation. Nevertheless, in spite of the differences in approaches, one trend can be easily observed: each of the island's administrations originally planned to extend the distance between Beijing and Taipei, but in the course of their governance all of them—without exception—became more closely bound to the Mainland than at the time they had started their governance. The Chen Shui-bian administration increased restrictions adopted by the Lee Teng-hui government, and by 2008 the presence of the PRC in Taiwanese economy redoubled. Ma Ying-jeou made an attempt to keep the ties at 'normal' political level hoping that this situation would create a modus vivendi whereby the PRC will refrain from taking harsh measures to speed up the (re)unification process. Though relations improved during this period, the dependence of the island further increased. Tsai Ing-wen's administration declared that it wanted to reduce the island's dependence 'on one single country' and—just like Chen Shui-bian—propagated the 'turn South' policy (New Southbound Policy). The achievements of the first ca. two years are rather meager. The developments demonstrate that, at present and in the foreseeable future, the economic and trade (as well as political and social) situation of Taiwan will not depend on the— basically uninterrupted, slightly modified—policies adopted in Taipei, but on the fluctuating cross-Strait situation. Governments in Taipei might ease tension or demonstrate their strength to Beijing, but the frameworks are set on the other side of the Straits.

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An Overview of the Trade Relations between the Republic of Korea and the European Union in the Light of the KOREU Free Trade Agreement

György Iván Neszmélyi

As a result of the stalemate of Doha-round, and of the financial and economic crisis in 2008-2009, a new trend seems to emerge in the field of trade liberalization in the world: instead of striving for a comprehensive, multilateral framework, a growing number of "new generation" free trade agreements have been emerging that are concluded on bilateral level or among a few countries.

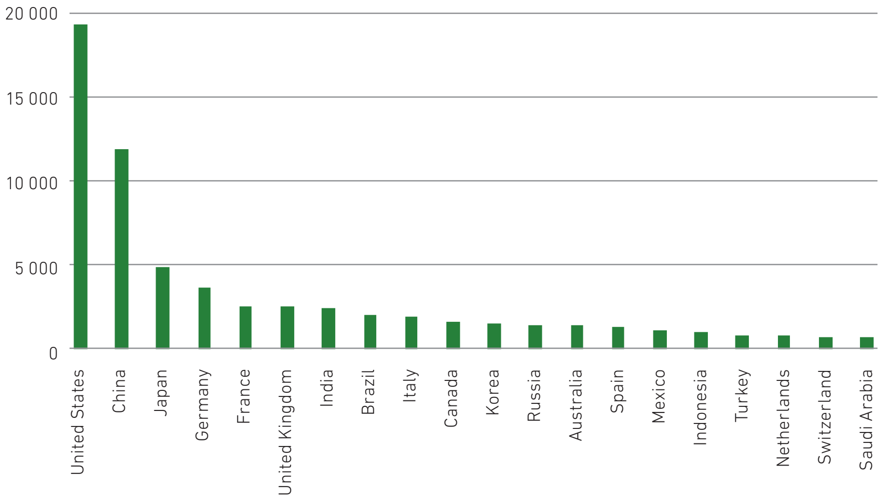
The Republic of Korea joined this trend in 2008. Since then it has concluded a number of FTAs with Asian, American, European and other partners including the USA and the European Union, and it still has a number of draft agreements under negotiation. The EU-Korea FTA (KOREU) entered into force on 1 July 2011, marking a new era in the EU-Korea trade relations. It is the most comprehensive free trade agreement ever concluded by the EU, and the first with a partner country in Asia. Since it came into force, import duties have been eliminated on nearly all products (98.7 percent of duties within five years), which resulted in a far-reaching trade liberalization in services as well. Since 2011 the European Union's export to Korea has been growing, and the former trade deficit in the EU-Korea relations has shifted to European surplus in the balance of trade. This can be seen as an advantage for the EU, but it also reflects the vulnerability of the Korean economy's competitiveness.

1. Introduction

The division of the Korean peninsula in 1945, the heritage of the Japanese colonial system and the devastation brought about by the Korean war all had serious implications on the South Korean economy. Already in the early 1960s the Republic of Korea was one of the poorest countries in the world. The main features—or endowments—of the country can be characterized as follows: relatively small land with a significant population, scarcity of natural resources, especially energy carriers, colonial past, underdeveloped economy after the colonial period which was further devastated by wars (The WWII, and the Korean War 1950-53) as well, strong (dictatorial) political leadership until 1988, export-oriented economic development policy. The American financial and economic assistance—until the early 1970s—gave an additional impetus to the economic recovery and take-off as well as following Japanese and American models too. The high savings and investment ratio, especially during the take-off period (1970s) and the political democratization process from the late 1980s has to be mentioned too. Nowadays South Korea is one of the world's wealthiest nations, its economy ranked 11th in the world in terms of GDP (current prices) (see Figure 1).

Figure 1

The 20 countries with the largest gross domestic product (GDP) in 2017 (in billion USD)



Source: author's own compilation from Statista (2018a) based on IMF data

Li et al. (2016) claim that in general, scholars focused merely on the implementation of the social responsibility of corporations (CSR), rather than the interrelationship between the social responsibility and the economic development. In case of Korea, the economic development was coupled by tremendous sacrifices from the part of society. Korean workers paid high price for the impressive economic growth. During the 1970s and 1980s—still in the course of the military regime—through series of demonstrations, Korean workers demanded better working conditions and higher wages, and these protests were often brutally suppressed by the police forces. Nowadays productivity of Korean labor became one of the lowest among the OECD members. Employers expect the solution from loosening the Code of Labor, even though labor unions protest against it. Since 2016 workers of Hyundai have been demanding salary increases, and strikes continued even in January 2018 (Song, 2018).

2. The Development of the Trade Policy of South Korea

As a consequence of the above, foreign trade is of vital importance for the Republic of Korea, a country which has not much natural resources, not to mention energy carriers, and until the 1970s and-80s the domestic purchasing power was modest and limited. From the early 1960s the main cornerstone of South Korea's economic development policy was the export-orientation which was implemented with the strong guidance of the government, while the main actors of the economic development were—and still are—the big Korean corporations called chaebols. The Republic of Korea strived for the liberalization of the international trade hoping liberalization would be favorable for the Korean export-expansion. This policy worked well by contributing to the spectacular economic success of the Republic of Korea during the 1980s.

2.1. Shifting towards Export-orientation

During the post-war period till the early 1960s, the key policies for the Korean economy were import substitution industrialization. It helped to protect the domestic import substitution industries, but also impeded exports. Kwak (1994) in his study focused on the changes and characteristics of Korea's trade policies and pointed out that on the premise of the industrial promotion for leaving behind the colonial economic structure, from the establishment of the Republic of Korea in 1948 until 1961 trade policy basically focused on export promotion and import restraint, but exports did not expand to any great extent (Kwak, 1994).

The major shift from import substitution to the export oriented economic development policy took place in the early 1960s in the Republic of Korea and can be attributed to General Park Chung-hee, who seized power in 1961 in a military coup and served as President of the Republic of Korea between 1963-1979. The period between the beginning of industrialization in 1962 and South Korea's membership in GATT in 1967 can be considered as a period of perfect import substitution, in which the government maintained high tariff rates and a positive list system for import controls. Then from 1968, the average tariff rate steadily fell, but since the tariff level remained comparatively high until 1977 and drops in the tariff rate were offset by increases in the percentage of controlled imports, the ten years between 1967 and 1977 should really be considered as a period in which the import substitution strategy was fundamentally maintained even though the concept of raising efficiency by promoting competition had yet to take root. However, the expansion of exports and membership in GATT, which occurred during this period, did pave the way for import liberalization. In its move toward import liberalization from 1977, Korea, on the surface, declared it would promote competition by liberalizing imports, partly because of external pressure to open its markets. This period should therefore be characterized as a stage of "passive" import liberalization. The Five-Year Import Liberalization Plan announced in 1983 can be regarded as constituting a full-scale liberalization policy, both qualitatively and quantitatively. Import liberalization trends in Korea until 1983 could be characterized as market opening in return for export expansion. In 1981 the Korean government drew up a comprehensive plan for liberalization throughout the following five years until 1988. Announcing tariff reductions in advance and items that would be removed from the import control list, the government pressed domestic industry to search for and take its own steps to compete against increasing imports. Tariff rate revisions during this period focused on overall tariff reduction and a levelling off of tariffs among import items. The revised tariff rates were generally 5-10 percent for raw materials, 20-30 percent for intermediate and capital goods, and 40-50 percent for consumer goods. By 1988 these rates had been lowered to 5-10 percent, 20 percent, and 20-30 percent, respectively. The high tariff rates for agricultural products, however, remained virtually the same. In 1985 the Korean government implemented minor revisions in the import liberalization plan by pushing forward the deadline for reaching import liberalization in the initial plan and reducing the number of controlled items under special laws. That was because the United States urged Seoul to allow bigger access to Korea's markets. Under these revisions, the ratio of manufactured goods subject to import controls dropped below 1 percent in 1988. By 1991 the import liberalization rate for manufactured goods practically reached 100 percent. Furthermore, in 1991 the simple average tariff rate for manufactured goods dropped to 9.7 percent. It also has to be added that Korea's enthusiasm about the trade liberalization did not extend to the import-policy, even if there were plans and spectacular measures as it had been described before (Kwak, 1994).

Lee (2012) adds that comparing to the trade structure in 1971, in 2011 Korea traded much less with advanced economies and much more with emerging and developing countries. During the past four decades, Korea's trade share with emerging economies rose from 17.5 percent to 67 percent. Since the 2008 global financial crisis, advanced economies have continued to face major brakes on growth while emerging economies appear to maintain solid growth momentum. Similarly, from 1986 to 2011 by region, Korea traded much more with Asia (37.0 percent to 50.8 percent) and the Middle East (7.2 percent to 14.1 percent), and much less with North America (33.8 percent to 10.4 percent).

Armstrong (2012) emphasized that the export oriented, but heavily protected Korean economy really took off as it implemented a unilateral opening in the 1980s. Unilateral liberalization was underpinned by commitment to the multilateral trading system and supported through liberalization through APEC. The concerted unilateral liberalization within the framework of GATT negotiations helped Korea and other East Asian economies to open up and this led to an increase in trade shares and in the pace of economic modernization.

Kwak (1994) adds that the Korean import liberalization process could be divided into pre- and post-1983 era. Although before 1983 government policies in general showed an attitude of preferring liberalization, but those policies were just purely hypocritic and after all led to the necessary mitigation of the impacts of the liberalization of the domestic economy. Kwak added that the government's promotion of genuine import liberalization began only after 1983 (Kwak, 1994). Looking back on Kwak's study after 25 years, and on the developments in Korean import-liberalization before the Millennium, one may conclude that in spite of the government's steps and other evidences, Korea had to experience two severe economic crises until liberalization reached such a critical level that foreign consumers' goods (and retail and wholesale stores) are more visibly present in Korea's domestic market.

While from the late 1980s Korean companies invested a lot abroad (from the early 1990s affiliates of Korean chaebols and banks appeared from 1986 to 2011), those foreign companies who wished to invest in Korea had very limited possibilities. The Republic of Korea applied a two-tier policy towards foreign investors: they were welcomed to those areas and sectors in which they could bring brand new technologies, know-hows which did not exist before in Korea, or it would have cost too much, or it would have taken too long to develop them with domestic resources only. On the other hand, in many other sectors, especially in the wholesale and retail trade, foreign companies were not allowed or if they were, only under strict conditions. The situation in case of inbound investments has changed since 1997-98, due to the Asian financial-economic crisis.

2.2 The Implications of the Asian Financial Economic Crisis of 1997-98

Korea overcame the crisis relatively quickly, but with a 55 million USD bailout package from IMF. Pollack (1997) points out that in return for this amount, Seoul had to cut public spending, and open its market more to foreign goods and investors and curb the ability of the conglomerates to expand.

Cho (1998) underlines that as a part of the IMF-Korea deal, a structural adjustment programme was agreed upon which focuses on the following four areas:

- trade liberalization,
- capital market opening and liberalization of foreign exchange control,
- corporate restructuring, and
- financial sector restructuring

In terms of trade liberalization, a timetable was set in line with the WTO commitment to eliminate trade-related subsidies, restrictive import licensing, and the import diversification programme. Steps were planned to be taken to streamline and improve the transparency of import certification procedures. Further to measure in trade, the programme comprised capital account liberalization steps as well, e.g. foreign financial institutions were to be allowed to participate in mergers and acquisitions of domestic financial institutions in a friendly manner and on equal footing. By mid-1998, foreign financial institutions were allowed to establish bank subsidiaries and brokerage houses. Legislation was to be assigned to the first special session of the National Assembly to harmonize the regime on equity purchases with OECD practice. The ceiling on the aggregate foreign ownership of listed Korean shares was to be increased from 26 to 50 percent by the end of1997 and to 55 percent by end of 1998. The ceiling on individual foreign ownership was to be increased from 7 to 50 percent by the end of 1997. By the end of February 1998, other capital account transactions were to be liberalized by easing foreigners' access to domestic money market instruments and the corporate bond market and simplifying the approval procedure for foreign direct investment. A timetable was to be set by the end of February 1998 to eliminate restrictions on foreign borrowing by corporations (Cho, 1998).

Lee (2012) emphasizes that in the early 2000s, based on its policy stance of openness and competition promotion, Korea expedited its trade liberalization in pursuing Free Trade Agreements with developing and advanced economies around the world.

2.3. After the Millennium

Until the early 2000s Korea's international trade policy used to be in line with GATT/WTO, expecting that trade liberalization would continue in a multilateral framework.

However, the failure of Doha round led the Korean government towards the idea of comprehensive, bilaterally concluded FTAs. [1]

From the early 2000s until now, Korea's trade policy, being in line with the GATT/WTO, has been focusing on pursuing active FTA policies more than any other country in the world. Moreover, during the recent decades, the Republic of Korea's trade structure by main partner countries has changed significantly. In 1986, the United States had the biggest share (30.8 %) in Korea's total trade and was followed by Japan with 24.6 percent. That time China had the largest trade share in Korea's total trade with 20.4 percent , followed by ASEAN (11.6%), by Japan (10%), the EU (9.6%) and the United States (9.3%).

Lee (2012) also observes that in September 2003, the Korean government announced an "FTA Roadmap" as its national economic development agenda and induced a policy shift from passive FTA stance to an active one. The Roadmap reflected two important policy principles. The first is that Korea should conclude as many FTAs as possible in a short period in order to recover its competitiveness in the world market and reduce the opportunity costs for Korean companies. The second principle is that the Roadmap pursues multitrack and simultaneous FTA negotiations with large economies.

Mention must be made of a new "trend" that free trade agreements which have been concluded for the recent decade are substantially different from the previous ones. In the professional bibliography the recent ones are frequently mentioned as "new generation" of FTAs, and in this context, it is worthwhile to quote Nagy (2017) who claimed: "New generation free trade agreements are opening a new age in international economic relations. International free trade has become one of the central global issues of the 21st century both in terms of fierce political debates and economic significance. It makes us necessary to re-think of our fundamental notions on global governance, state sovereignty and regulatory autonomy. The share of free trade in the global economy is becoming paramount and the emerging new-generation free trade agreements not merely abolish tariffs and quotas (as old-fashioned agreements did) but effectively open up national regulatory sovereignty to international governance, re-shaping regulatory autonomy, internationalizing national competences and raising serious questions of democratic legitimacy. New-generation

1 The Doha-round of trade talks was an attempted multilateral trade agreement. It would have been valid among every member of the World Trade Organization (WTO). It was launched in Doha, Qatar, WTO meeting in November 2001. Its goal was to finish by January 2005, but the deadline was then postponed to 2006, and the talks were finally suspended in June 2006 (Amadeo, 2016).

free trade agreements cover the whole spectrum of items (goods, services, technology, capital etc.), ambitiously, address not only traditional barriers to trade (such as tariffs and quantitative restrictions), but also, in a comprehensive manner, all trade restrictions and state acts (e.g. regulatory disparities, public procurement, certain fundamental rights issues)" (Nagy, 2017).

However, there are scholars and analysts, especially from the developing countries, who strongly oppose the trend of the new generation FTAs, blaming them for causing various disadvantages for the less developed countries. One of them is Purugganan (2015), who believes the new generation trade and investment agreements are a serious threat to the life and livelihoods of the poor and marginalized. These agreements go much beyond commitments to liberalize trade. They also comprise a number of economic policies that foster the market liberalization of goods and services, stronger and more restrictive intellectual property rights and also the lifting restrictions on investments and providing a higher protection for investors.

At the turn of the Millennium, Korea was one of the few East Asian economies which did not have any FTAs and was still striving for multilateral frames (Armstrong, 2012). It changed when the Chile-Korea FTA was signed in 2003 (and came into force in 2004). The economic effects of FTAs are in general quite limited with sensitive sectors exempted and difficult protection measures avoided. However, in case of Korea, the Korea-EU FTA (KOREU) and the Korea-USA FTA (KORUS) played noticeable roles in liberalizing Korea's heavily protected automobile and agriculture sectors. Moreover, the opening up of some service sectors to U.S. and European firms was also successful. These two agreements managed to include the phase-out of the protection of sensitive sectors in Korea including pork, dairy and other agricultural goods (with the exception of rice). Even though the tariff phaseout varies and is quite lengthy for some sensitive sectors (up to fifteen or twenty years for some products), they will eventually move to duty free in the longer run.

As for the agricultural sector it has to be mentioned that due to the natural endowments of Korea and as a result of the merely politically-motivated land reform (from the end of the 1940s through to the 1950s) the majority of Korean agricultural producers work on miniature and scattered family-based farmlands, and even though most of them have been organized into a comprehensive, two-level co-operative system they, especially rice producers could not be competitive on the market without heavy subsidies and protection (Neszmélyi, 2017). Therefore, it has always been a very sensitive issue from the perspective of the Korean trade policy.

Another major trade agreement that could engage Korea is the Trans-Pacific Partnership (TPP) which is a trade deal negotiated originally by nine, later on by 12 countries in the Asia-Pacific region. This promising initiative, however, seemed to be thwarted when the United States withdrew from it in 2017. Nevertheless, the most recent news (Karp, 2018) are slightly more optimistic, as the 11 remaining countries are supposed to sign an amended agreement on 8 March 2018 leaving the door open for the USA if it wanted to join later.

According to the information gained from the Korean Customs Service (KCS), as of January 2017 the Republic of Korea has concluded 15 Free Trade Agreements with 52 countries (including the 28 EU and 10 ASEAN members) that were effectuated and ratified. These partners are as follows: Chile, Singapore, EFTA, ASEAN, India, EU, Peru, U.S., Turkey, Australia, Canada, China, New Zealand, Vietnam and Colombia. Moreover, another 8 FTAs are under negotiations with 24 countries including the revision of FTAs with Chile, India and ASEAN (KCS, 2018).

3. The South Korean Foreign Trade in Figures

As for the foreign trade figures of the Republic of Korea, the statistical data of Global Edge of Michigan State University show that in 2016 the total exports of the Republic of Korea were around 495 billion USD while the total imports were around 406 billion USD, so that year Korea closed with an almost 90 billion USD positive trade balance. Figure 2 shows the trends of Korean exports and import between 1995 and 2016, while the exact trade figures of 2016 can be seen in table 1.

Table 1

Trade figures of the Republic of Korea in 2016

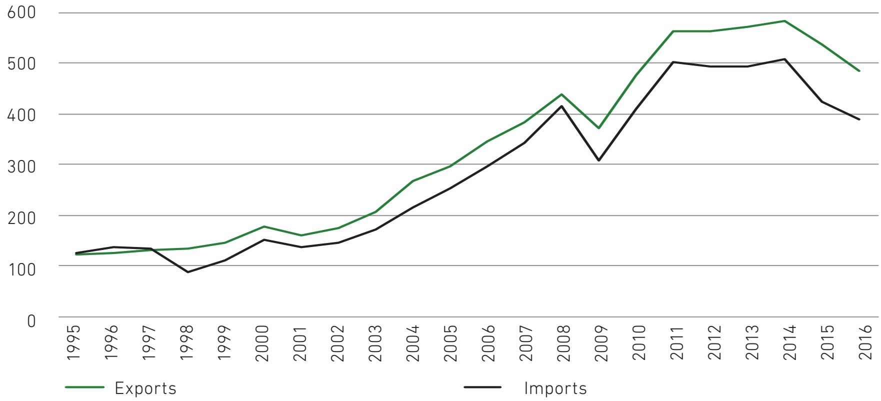
Total Exports, billion USD	495.4
Total Imports, billion USD	406.2
Trade Balance, billion USD	89.2
Exports of goods and services (% of GDP)	42.24
Imports of goods and services (% of GDP)	35.44

Source: Michigan State University (2018)
Note: the original values in USD were rounded by the author to billion USD

There were two main changes in Korea's foreign trade during the recent decade. One of them was the change in the structure of trading partners and the other was the shift in structure of export products.

Figure 2

Foreign trade turnover of the Republic of Korea between 1995 and 2016 (in billion USD)



Source: author's own compilation on the basis of Observatory of Economic Complexity (OEC)

South Korea exported goods in a value of 573.3 billion USD around the world in 2017. (On the basis of the world's total exports in the preceding year, it is roughly 3.6 percent of the overall global exports.) In terms of geographical destination, almost two-thirds (63.7 percent) of the Korean exports by value were shipped to other Asian countries, 14.7 percent was sold to North American buyers, 11.7 percent to Europe and 1.9 percent to African customers (Workman, D. 2018). After all, the Republic of Korea's main trade partners are located in Asia and in the Pacific region (see Table 2)

Table 2

Top 10 Export and Import Partners of the Republic of Korea (2016, billion USD)

Country	Export (USD)	Country	Import USD)
China	124.4	China	87,0
United States	66.7	Japan	47,4
Hong Kong	32.8	United States	43,4
Vietnam	32.6	Germany	18,9
Japan	24.4	Saudi Arabia	15,7
Singapore	12.5	Australia	15,2
India	11.6	Vietnam	12,5
Mexico	9.7	Qatar	10,1
Marshall Islands	7.8	Russia	8,6
Malaysia	7.5	Indonesia	8,3

Source: Michigan State University (2018)
Note: the original values in USD were rounded by the author to billion USD

It may be interesting to have a look at Table 3, where foreign trade figures of South Korea can be seen in the year 2000, just shortly after Korea's recovery from the Asian financial and economic crisis.

Table 3
The major trade partners of the Republic of Korea in 2000

	Turnover (billion USD)	Exports (billion USD)	Imports (billion USD)	Share		
				Total turnover %	In exports %	In imports %
World	332.8	172.3	160.5	100.0	100.0	100.0
USA	66.5	37.3	29.2	20.1	21.8	18.2
EU	39.2	23.4	15.8	11.8	13.6	9.8
Japan	52.3	20.5	31.8	15.7	11.9	19.8
China	31.2	18.4	12.8	9.4	10.7	8.0
ASEAN	38.3	20.1	18.2	11.5	11.7	11.3

Source: Neszmélyi (2003)

Comparing data of Tables 1 and 3 it can be seen that in total value South Korean exports grew from about 172 billion USD to 495 billion USD (cc. 287 percent growth) while in imports the growth is also significant—from about 160 billion USD to 406 billion USD. Yet the growth was more modest (cc. 254 percent) than the export figures show.

After China and the United States, the European Union was the third biggest export market for the Republic of Korea in 2016, while in case of imports, the European Union was the second after China, slightly ahead of Japan and the United States. Comparing this to the percentage figures of Lee (2012) referred to above, the European Union's position—in terms of ratio in Korea's trade partners—improved between 2011 and 2016. There has also been a change in trend in Korean exports by industry throughout the recent half century. According to Lee (2012) in the 1960s more than 72 percent of Korea's exports were primary industrial goods. Since the 1970s, Korea's major exports have consisted of industrial products. For example, in 2011 the share of industrial products was 97.2 percent. Among them, heavy and chemical products increased rapidly from 21.5 percent in 1972 to 91 percent in 2011 (see Table 4). In the 1960s the focus was on manufacturing and exports of labor intensive products like clothes and textiles. Then, in the 1970s, the Korean government boosted the development of heavy and chemical industries, such as steel, shipbuilding, and automobiles. From the 1980s until now, the Korean economy shifted gradually towards the exports of higher added value: the capital, technology and knowledge-intensive goods and services.

Table 4

Trend in Product Composition of Korea's Exports

Share (%)	1962	1972	1980	1995	2000	2011
Primary industry goods	72.3	11.1	7.7	4.9	2.8	2.8
Industrial products	27.7	88.9	92.3	95.1	97.2	97.2
Light	NA	67.4	48.4	19.9	16.2	6.2
Heavy	NA	21.5	43.9	75.2	81	91

Source: Lee (2012) on the basis of KITA

According to CIA World Factbook (2017) the main export commodities of the Republic of Korea nowadays are: semiconductors, petrochemicals, automobile/auto parts, ships, wireless communication equipment, flat display displays, steel, electronics, plastics, computers, while the main items of imports: crude oil/petroleum products, semiconductors, natural gas, coal, steel, computers, wireless communication equipment, automobiles, fine chemical, textiles. South Korea has significant reserves of foreign exchange and gold the total amount of which in 2016 was estimated 371.1 billion USD, while in 2015 it was 368 billion USD. The country's total amount of external debts was estimated 380.9 billion USD, while one year before it was 396.1 billion USD (CIA World Factbook, 2017).

Table 5

The 10 main export and import items of the Republic of Korea (2016)

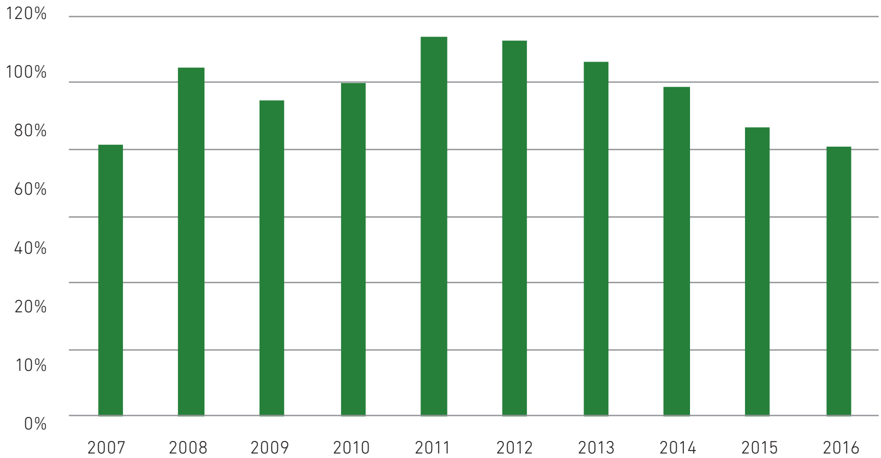
HS Code	Export (USD Billion)	HS Code	Import (USD)
(85) Electrical Machinery	134.3	(27) Oil & Mineral Fuels	81.8
(87) Motor Vehicles & Parts	62.7	(85) Electrical Machinery	75.2
(84) Industrial Machinery	58.2	(84) Industrial Machinery	46.0
(89) Ships & Boats	33.1	(90) Precision Instruments	17.5
(39) Plastics	27.6	(87) Motor Vehicles & Parts	15.2
(90) Precision Instruments	27.6	(72) Iron & Steel	14.3
(27) Oil & Mineral Fuels	27.5	(29) Organic Chemicals	11.0
(72) Iron & Steel	18.7	(26) Ores	10.9
(29) Organic Chemicals	17.9	(39) Plastics	10.1
(73) Iron & Steel Articles	11.1	(38) Chemical Products	6.7

Source: Michigan State University (2018)
Note: the original values in USD were rounded by the author to billion USD

The economy of the Republic of Korea is open. The indicator of openness—the ratio of the total foreign trade turnover and the GNI—developed from 80 to 113.5 percent. The bar graph also shows (on Figure 3) that the ratio grew till 2011 and since that year, it has been gradually decreasing, however 80 percent still reflects an economy which is open to quite a large extent.

Figure 3

Share of Imports and Export in Gross National Income (GNI) in South Korea from 2007 to 2016



Source: author's own compilation on the basis of Statista (2018b)

4. The Economic and Trade Relations between the European Union and the Republic of Korea

The EU-Korea Free Trade Agreement (KOREU) entered into force on 1 July 2011 marking the beginning of a new era in the EU-Korea trade relations. The FTA consists of 15 chapters, three protocols, and several annexes. Its main objectives were to liberalize and facilitate trade in goods, services and investment, open up government procurement markets, establish electronic commerce, promote competition between the markets of the two entities, foster foreign direct investment, and at the same time protect intellectual property rights. The two parties undertook the obligation to eliminate custom duties on originating goods of each party and to accord national treatment to goods of the other party (Papademetriou, 2010).

Karel De Gucht, European Commissioner for Trade, pointed out that the agreement brought to an end a process that had begun five years before with the European Commission's communication on 'Global Europe in a Competing World', which called for the EU to renew its engagement in Asia. Moreover, the EU-Korea FTA is the most ambitious and comprehensive trade agreement ever negotiated by the EU, and it is also the EU's first trade deal with an Asian country. The Agreement was expected not only to boost bilateral trade and economic growth in both the EU and Korea, but also to have a wider impact in Asia and elsewhere by signalizing the EU's openness to do business with third countries and its commitment to free trade. Further to all these, the Free Trade Agreement between the EU and the Republic of Korea (EU-Korea FTA) is the first of a new generation of FTAs (European Commission, 2010).

Korea was considered as a priority FTA partner for the EU in its trade policy strategy, and negotiations were launched in May 2007 in Seoul. After eight formal rounds of talks, the FTA was initialed by both sides on 15 October 2009. On 16 September 2010 the Council approved the FTA and the Agreement was officially signed on 6 October 2010 during the EU-Korea Summit in Brussels. The European Parliament gave its consent to the FTA on 17 February 2011. The Agreement has been provisionally applied since 1 July 2011. Import duties were eliminated on nearly all products (98.7 percent of duties in terms of trade value had to be eliminated in the course of five years), and there was a far-reaching liberalization of trade in services (including in telecommunications, environmental services, shipping, financial and legal services) covering all modes of supply. Under the EU-Korea FTA, EU industrial, fishery and agricultural products face substantially reduced or zero tariffs on import to Korea. As from 1 July 2011, the phased reduction and elimination of import duties led to a gradual increase of savings eventually totaling 1.6 billion EUR annually. The Agreement incorporates fundamental WTO rules on issues such as the prohibition of import and export restrictions. All export duties are prohibited as of the entry into force of the Agreement (European Commission, 2011a).

Before the KOREU was signed the value of the EU-South Korean trade turnover was around 54 billion EUR (2009). Moreover, the EU faced deficit with South Korea in trade of goods, however, in case of a few product category and also in services, the EU had a solid trade surplus. In terms of tariffs, South Korea and the EU were supposed to eliminate 98.7 percent of duties in trade value for both industrial and agricultural products within 5 years—until 1 July 2016, from the entry into force of the FTA. By the end of the transitional periods, duties had to be eliminated on almost all products, with a few exceptions in the agricultural sector. The quoted source of the European Commission claimed that KOREU was the most ambitious trade coverage ever achieved in an FTA negotiated by the EU (European Commission, 2010).

In 2016 the European External Action Service (EEAS) published a document (originally prepared in June 2011) which reflected the advantages of KOREU for the European Union. These are as follows:

- Tariff elimination for EU's exports of industrial and agricultural goods. The KOREU relieved EU exporters of industrial and agricultural goods to South Korea from paying tariffs. From the agreement it was expected exporters would save 1.6 billion EUR annually from not paying import duties. For instance, EU machinery exporters save 450 million EUR duties each year, and chemical exporters are relieved of over 150 million EUR duties. The EU has a strong agricultural presence in the Korean market with major exports in pork, whisky and dairy products. Before the agreement came into force, only 2 percent of EU agricultural exports to South Korea enjoyed duty free treatment. However, thanks to the Agreement Korean tariffs on these goods were eliminated.

- Improved market access for EU's services suppliers. The FTA opened several billion euros worth of new opportunities for EU companies in the services sectors. The FTA not only offered commitments on services on a par with those offered by South Korea to the US, but also went beyond those in sectors of specific EU interest.

- Tackling non-tariff barriers in electronics, pharmaceutical and medical devices sectors. Previously, EU exporters of consumer electronics and household appliances including television sets, computers, microwave ovens, mobile phones and telecom equipment, were obliged to duplicate cumbersome and expensive testing and certification procedures in order to sell in South Korea. Under the FTA, South Korea generally recognized European certificates and test results. Therefore, no duplicative tests or certification are currently required. The EU exporters of pharmaceuticals and medical devices have benefited from the strengthened transparency and predictability of South Korea's pricing decisions since the FTA entered into force.

- Improved market access for EU car manufacturers. The European car manufacturers benefit from a combination of elimination of South Korean duties and non-tariff barriers (NTBs). The previously imposed 8 percent tariff on EU cars exported to South Korea has been removed, which means that for every car worth 25,000 EUR exported to South Korea, 2,000 in duties are saved. Of even greater significance is the ambitious NTB package under which South Korea accepted equivalence of international or EU standards for all its significant technical regulations. This implies that now an EU manufacturer is able to sell cars in South Korea that have been produced in accordance with EU specifications, without being subject to additional testing or homologation. The FTA stipulated that there cannot be new, unjustified barriers in the automotive sector erected in the future and established a regulatory cooperation framework through a working group.

- Enhanced access to government procurement. The FTA offered the opportunity to expand procurement opportunities to public works concessions and "Built-Operate-Transfer" (BOT) contracts not covered by the WTO Government Procurement Agreement commitments. Such contracts are of significant commercial interest to European suppliers, who are recognized global leaders in this area. Guaranteeing the practical and legal accessibility of such tenders to European suppliers, the FTA provided substantial new tendering opportunities.

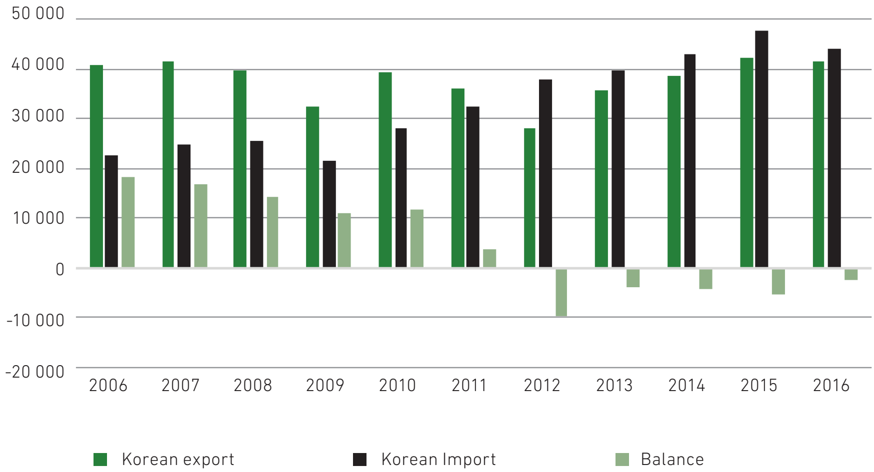
- Protection of intellectual property rights. A high level of protection and enforcement of intellectual property rights (IPR) is needed for European competitiveness. A comprehensive chapter covering provisions on copyright, designs, enforcement and geographical indications (GIs) was included in the EU- South Korea FTA. Concerning copyright, for instance, the agreement will facilitate the process of getting adequate remuneration for EU rights holders for the use in South Korea of their music or other artistic works. Regarding enforcement, the agreement includes state of the art provisions that go significantly beyond the provisions of the TRIPs Agreement. Korean consumers are eager for EU agricultural quality products, notably those protected by EU GIs, such as EU wines, spirits, cheeses or hams which have a very good reputation in South Korea. The FTA offered a high level of protection for commercially important European GIs and therefore prevented their misuse in the Korean market.

- Strong competition rules. The agreement prohibits and sanctions certain practices and transactions involving goods and services, which distort competition and trade between the parties. This implies that anticompetitive practices such as cartels, abusive behavior by companies with a dominant market position and anticompetitive mergers are not tolerated by the EU and South Korea and are subject to effective enforcement action, as they lead to consumer harm and higher prices. The FTA also remedies or removes distortions of competition caused by subsidies in so far as they affect international trade. The EU-South Korea FTA contains prohibition of certain types of subsidies considered to be particularly distortive.

- Securing horizontal commitments on transparency. The lack of the transparency of the regulatory environment has often been a concern expressed by European firms doing business in South Korea. It is therefore significant that this FTA included strong transparency commitments that apply to all regulations having an impact on matters covered by the FTA.

Figure 4

Trade flows and balance between the EU and the Republic of Korea, annual data 2006 - 2016 (million EUR)



Source: author's own compilation from European Commission (2017)

- Commitment to sustainable development. The EU-South Korea FTA established a framework for cooperation on trade and sustainable development. It comprised firm commitments on both sides to labor and environmental standards. The agreement also set up structures to implement and monitor the commitments between the parties through civil society involvement. Concerning labor, the FTA contains a shared commitment to the ILO core labor standards and to the ILO decent work agenda, including a commitment to ratify and effectively implement all conventions identified as up to date by the ILO (i.e. going beyond those conventions relating to the core labor standards). With regard to environment, there is a commitment to effectively implement all multilateral environmental agreements to which they are party. In addition, the EU-South Korea FTA ensured fast tariff dismantlement for environmentally friendly goods in order to promote sustainable development through green technologies.

- Effective and fast dispute settlement. The EU-South Korea FTA includes an efficient dispute settlement mechanism to ensure the enforceability of commitments undertaken and a mediation mechanism to tackle non-tariff barriers. The procedures envisaged under the dispute settlement chapter foresee arbitration ruling within 120 days, much faster than in the WTO (European Commission, 2011b).

Figure 4 discloses the trade flows and the balance between the EU and the Republic of Korea between 2006 and 2016. It is striking that in general between 2006 and 2011 (till the KOREU entered into force), the EU faced a trade deficit against South Korea, even though to a shrinking extent. Nevertheless, from 2012 there was a shift: the EU had a surplus against Korea in all the years until 2016. A further and more thorough analysis would be necessary to filter out other factors (e.g. changes in net exporters' prices or exchange rates) which could also influence the ad valorem turnover and surplus. Yet at first sight the shift in deficit/surplus the diagram shows, is really spectacular and can be the impact of KOREU on the EU, of the Korean trade to a significant extent.

5. Conclusion

The economic development policy of Korea that was based on massive export-expansion needed international openness and liberalized markets very badly, at least on those markets where Korea was or wanted to be present. On the other hand, it took decades, and the Republic of Korea had to experience the impacts of two major financial-economic crises before it gradually opened its market. Korea strived for liberalization on a global/multilateral basis, but after the stalemate of Doha round Korea had to find different solutions: concluding separate FTAs with many of its major trade partners. From among these FTAs, the KOREU can be considered the most comprehensive. It abolished most of the tariffs and eliminated a number of NTBs as well. Regarding the changes during the recent 1-1.5 decade in the Korea-EU trade - the overall turnover has significantly grown. Between 2000 and 2016 the European export started to grow faster (almost threefold) than the Korean export to EU countries. While in the period of 2006-2011 a considerable European deficit characterized the Korea-EU trade, but since the FTA entered into force, this deficit has turned back and since 2012 the EU has surplus in the Korea-EU trade. It means that while Korean export to the EU is more or less stagnant, the European Union's export to Korea grew spectacularly. At the same time, from Korea's perspective, there are also negative impacts from the KOREU FTA agreement, namely that Korea lost its previous export surplus against the European Union. This fact can raise further concerns. For example, its implications may even be more visible at the Korean labor market in the future (like in the case of Hyundai), while another warning sign is the relative backwardness of the Korean labor force in terms of productivity compared to the OECD average.

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