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**South Korea and European Union opening markets using  
a bilateral Free Trade Agreement <sup>1</sup>**

**Abstract**

Both EU and South Korea are developed markets with intensive mutual trade relations. After European Commission prioritized South Korea as a partner for a FTA in 2006, this agreement has been initialled on 15<sup>th</sup> October 2009. Based on the text of this agreement and the Trade Sustainability Impact Assessment of the EU-South Korea FTA: Final Report – (Phase 3), I will attempt to assess the impact on the markets of both economies with more focus on the economy of EU.

The aim is to foresee the possible problematic sectors of economy which could be damaged by the agreement or on the other hand could benefit from it. To better comprehend the problem I will use as a minor method also comparative method that will compare the structure of GDP in both economies and the level of protective measures currently in use, such as customs duties. The FTA abolishes customs duties, some after a transition period, and removes other barriers to trade.

My analysis based on the literature I used aims to prove whether the FTA is an instrument to promote the competitive strength of both markets or not.

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## **Introduction**

In 2006 the European Commission of José Manuel Barroso focused on the Lisbon strategy and has implemented new ways to promote the EU competitiveness. As a vital part they presented The Global Europe strategy, which turned the EU trade policy toward a new generation of Free Trade Agreements with Asian markets and emphasised the importance of intellectual property and access to raw materials. Both are considered highly important to the European Community and are an issue of trade policy (European Commission, 2008). According to the Free Trade Agreement policy towards Asia, European Commission has been given the authorisations and directives to start negotiations with India, South Korea, ASEAN and, based on the ASEAN negotiating directives, with Singapore (European Commission, 2010).

South Korea Free Trade Agreement initiative is directed towards USA, Canada, China, India, Japan, EFTA (in force), ASEAN, Chile (in force), Singapore (in force), Mexico (Selen Sarisoy Guerin. et al., 2007) (WTO, 2008). South Korean economy is oriented on export, which forms 42.4% of their GDP. With this in mind, FTAs are clearly one of the instruments that can increase economic performance.

This paper covers possible impacts of the European Union-South Korea Free Trade Agreement (EU-South Korea FTA) on the EU economy and is based on analyses and studies which have been undertaken and the text of the FTA itself. It aims to show the incorporation of suggested problematic sectors and other recommendations regarding both its contents and chosen form.

In the last part of this text I will try to analyze the impacts and ramifications of EU-South Korea Free Trade Agreement and comment on problems that might arise in regard to its ratification. I will stress the importance and usefulness of this FTA.

## Basic comparative characteristics of EU and South Korea

Preliminary to the characterisation of the EU-South Korea FTA impacts, the important thing is to introduce the economies of both counterparts in terms of their geography and macro-economical indicators. Firstly to see the size of the consumer markets we can compare the number of inhabitants, in EU this accounts to 492 million within 4 324 768 km<sup>2</sup> and in South Korea 48 million within 99 720 km<sup>2</sup>, the number of inhabitants of South Korea is only 8 million higher than Spain (CIA, 2009). GDP at market prices of EU in 2008 was 12 506 billion Euro (Eurostat, 2010a) and for South Korea 643.9 billion Euro, which would be closest to the GDP of Netherlands. The GDP per capita was in EU in average 24 800 Euro in 2007 (Eurostat, 2010) and in South Korea it was 13 261 Euro in 2008 (European Commission 2009), which is about the same as in Spain. In Table 1 below we can see much better GDP growth dynamics of South Korea. Because of SOUTH KOREA'S HIGHER GROWTH DYNAMICS, it's obvious that South Korean economic performance will continue to converge with the performance of EU. This will be further supported by the implementation of the FTA. Table 2 shows the composition of GDP by sectors. In South Korea we can still see that services do not participate in GDP as much as in EU economy. Table 3 show the unemployment rates in both economies, these are very important numbers because one of the aims of the FTA for EU is to promote employment by creating new opportunities for EU producers and service providers.

	2005	2006	2007	2008	2009
EU	2.0	3.2	2.9	0.8	-4.2
South Korea	4.0	5.2	5.1	2.2	N/A

Source: Eurostat (2010b), European Commission (2009)

	Agriculture	Industry	Services
EU (2009 est.)	2.10%	25.90%	71.90%
South Korea (2008 est.)	3.00%	39.40%	57.60%

Source: CIA (2010b)

**Table 3: Unemployment rate, annual, in percentage**

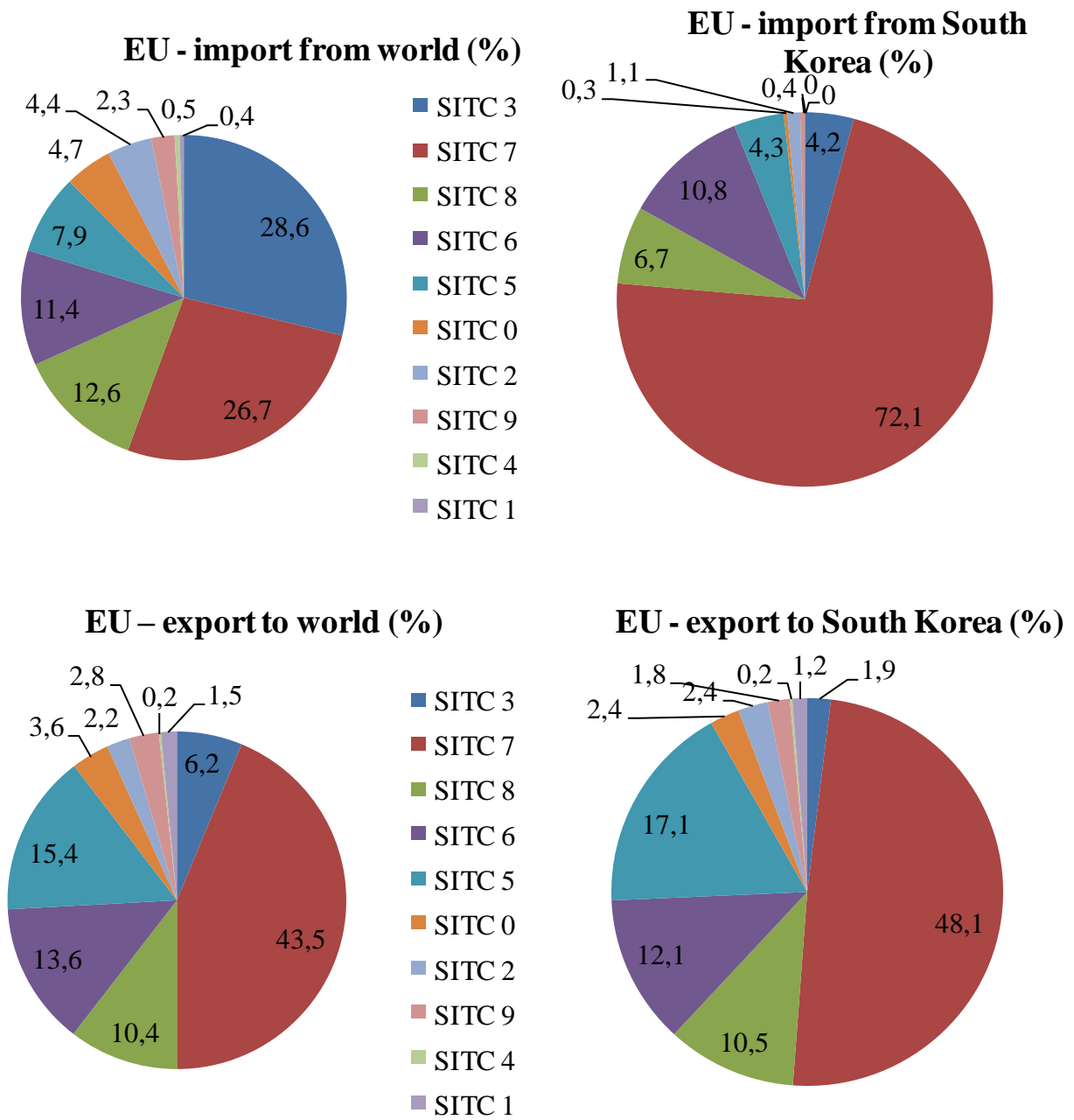
	2005	2006	2007	2008	2009
EU	8.90%	8.20%	7.10%	7.00%	8.90%
South Korea	3.60%	3.70%	3.30%	3.30%	3.20%

Source: Eurostat (2010d), CIA (2010a)

These basic characteristics are useful for further analysis, because this data allow us to see the size of both economies and their productivity in general. In the following Graph 1 (for SITC product classification see Appendix) we can see the percentage proportion of imports to EU from South Korea in comparison with total import from the world. It is clear that a very strong import sector from South Korea to EU is machinery and transport equipment (SITC 7) which forms 72 % of total value of imports from South Korea. The exports from EU to the world and to South Korea share basically the same goods structure.

In 2008 THE VOLUME OF THE EU TRADE with South Korea was 65 billion Euros. That constitutes of 39.4 billion in import (8<sup>th</sup> largest partner) and 25.6 4 billion in export (12<sup>th</sup> largest partner). EU is South Korea's 3<sup>rd</sup> largest partner in import and 2<sup>nd</sup> largest partner in export (European Commission, 2009).

**Graph 1: Trade in goods**



Source: European Commission (2009)

## **Analyses of the FTA impacts**

Negotiations for the EU-South Korea FTA were launched in May 2007. During the negotiations several independent studies and analyses regarding this FTA have been undertaken. This part of the paper follows their outcomes and compares them.

The Copenhagen economics (2007) analyses comes to the conclusion that both economies will benefit from the FTA, though the BENEFITS, BOTH RELATIVE AND ABSOLUTE, will be BIGGER FOR SOUTH KOREA. If considering the sectoral level, the study foresees gains for those sectors of economy under highest levels of national protection. For EU it means increase in other business services, communications, transport and other processed foods and decrease is expected in motor vehicles and electrical machinery. The study emphasizes the importance of the level of liberalisation to the increase or decrease in particular sectors of economy. As the most important gain from the FTA for EU would be the sector of services (a significant increase will occur in case of a full free trade agreement), it is important to include it into the agreement. The agricultural sector is seen as a minor part, less than 3 % of bilateral trade (see graph 1 EU - export to South Korea, SITC 0 + SITC 4), the lowering of tariffs for manufactured goods has little effect due to the fact that these tariffs are already low. According to this study the effect of a full FTA would be this:<sup>2</sup>

- Real Income Effects, in EU-25 the increase will be 4.7 billion of 2001 Euros (3.9 in services) and in South Korea, as mentioned above, this increase is higher, 10.5 billion of 2001 Euros (8.. in services).
- Real Income Effects in percent of national income, in EU-25 0.6 % and in South Korea 2.44 % (2 % in services).
- GDP, % change in value, in EU-25 0.3 % (0.2 in services) and in South Korea 1.6 % (0.9 % in services)
- Change in value of Exports in percent, EU-25 0.9 % and in South Korea 20.8 % (15.8 % in services)
- Unskilled labour employment, in EU-25 would in specific sectors decrease, the greatest decrease would be felt by the motor vehicles and electrical machinery manufacturing industry, both would decrease by 1.8 %. Also other manufacturing

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<sup>2</sup> this study is taking in account the EU-25, before the Bulgaria and Rumania enlargement

sectors would suffer a decrease. On the other hand the sectors of services would undergo an increase in employment rate, for example the communications by 0.5 % or other business services by 0.8 %. Skilled labour employment would suffer a slight decrease in almost every sector.

Selen Sarisoy Guerin et al. (2007) substantiate the FTA partnership with South Korea not just because of the economic performance in the past years (2006 and earlier), but also with the possible results of ten year development span in the future, South Korea's position in the automotive industry (because China most probably will catch up with South Korea) and South Korea's perspective in high-tech sectors. It is clearly stated, that these factors should be taken into account in the negotiations in terms of solving the issue of NTBs (non-tariff-barriers) in the automotive sector and IPRs (intellectual property rights). As a best option the study mentions: *A 'deep' FTA with South Korea that successfully eliminates not only the tariff barriers but also the non-tariff barriers, as well as securing investment and services liberalization, is the only option to maximise the economic benefits for the EU.* In addition transparency in the regulatory environment (standards and technical regulations) is the fourth element that is considered crucial.

The study, as well as Copenhagen economics (2007) (also because they work with the data from this study), mentions the gains from protectionist policy of SOUTH KOREA, which will enable it to receive about TWO-THIRDS OF THE GAINS. South Korea will gain the most in export of motor vehicles. EU on the other hand will gain in services. Selen Sarisoy Guerin et al. (2007) mention the strong need for dispute settlement mechanism, especially because they see the possibility that old NTBs will not to be removed or that new might be created. They emphasize the IPRs specifically they talk about copyrights, trademarks, geographical indications, patents and design. There is a suggestion of possibility to offer help to South Korea in implementation of IPR legislation.

Due to the specifics mentioned above, the study acknowledges that the text of the FTA will include many detailed annexes on tariff dismantling, services, sectoral steps as well as the need for horizontal provisions to prevent misuse of the right to regulate (the customer or environmental protection) for protectionist purposes. There is a suggestion of using least trade-restrictive measures of those available. This study considers the time needed by the negotiators to construct the text as a specific characteristic of this particular FTA. This suggestion has been very true, since we can see that the text has been completed after 8

rounds of negotiations which took place during a period of two years and six months. This is by all means a short time for such a complex international agreement.

In the following Table 4 we can see clearly a list of sectors that have been identified as gaining or losing as the data used for both studies show.

<b>Table 4: Sectors gaining and losing most from a full FTA agreement</b>				
	<b>EU</b>		<b>South Korea</b>	
Gainers	Other business services	0.7%	Motor vehicles	28.8%
	Communications	0.3%	Electrical machinery	27.1%
	Transport	0.2%	Iron and steel	18.1%
	Financial and banking services	0.2%	Non-ferrous metals	10.7%
	Other services	0.1%	Other machinery	10.6%
	Trade	0.1%		
Losers	Motor vehicles	-1.7%	Other business services	-23.1%
	Electrical machinery	-1.7%	Communications	-6.7%
	Non-ferrous metals	-1.0%	Beef	-2.25%
	Iron and steel	-0.9%	Other services	-2.4%
	Textiles	-0.6%	Other primary agriculture	-2.3%

Source: Copenhagen Economics 2007, Selen Sarisoy Guerin. et al. (2007)

The IBM (2008) Trade Sustainability Impact Assessment (TSIA) was expected to “make policy proposals (both trade and non-trade related) for optimising the outcome of the negotiations, preventing and/or mitigating possible negative impacts and enhancing positive ones including through the identification of flanking measures in the EU 27 and South Korea.” In general it doesn’t rate the FTA as having a very significant impact on the current state of trade relations because the economies are both very open to mutual trade. Though several sectors have been identified as problematic the overall effect on both economies is rather positive. IBM suggested some mitigating measures which they have identified and also flanking measures to complement the FTA to get better results in the covered courses of interest and economic outcomes.



The recommendations of the IBM (2008) TSIA to the FTA negotiators are covering following topics: PHASING OUT OF REDUCTIONS IN BARRIERS, RULES OF ORIGIN, SANITARY AND PHYTOSANITARY MEASURES, TECHNICAL REGULATIONS AND STANDARDS, INTELLECTUAL PROPERTY RIGHTS, INVESTMENT AND SUSTAINABLE DEVELOPMENT. In the field of phasing out reductions in barriers, two groups are detached. In the first group tariff reductions on automobiles and some of the more sensitive processed agri-food products should be phased out slower because they are sensitive parts of the market. The second group consists of environmental goods and services, some agri-food products such as wines and spirits, and pharmaceutical products. Here the phasing out of barriers can be faster. The rules of origin are to be regulated depending on the sector and the MFN (Most-Favoured-Nation) tariffs and barriers which are attached to it. Regulations on product labelling, sanitary and phytosanitary (SPS) measures, technical regulations and standards should not cause disproportion in trade. The bilateral approach to any type of regulation, old and new, shouldn't be excluding the products of the other partner from the market. Dispute settlement procedures are recommended in the study to help to reach the goals of the FTA. Particularly mentioned is development of standards in areas such as animal welfare, environmental ecolabels, use of international standards for SPS and mandatory technical regulations regarding automobiles, food products, electronics, and cosmetics. IPR are a sensitive issue, in some Asian countries there is a very low protection level of IPR which is a problem for many European industries and products. The assessment gives following recommendations:

- *Protection of Geographical Indications should be strengthened and enforcement improved.*
- *The protection of copyrights including audio-visual and digital property should be elaborated.*
- *Regulatory data protection for patent applications should be strengthened.*
- *Enhanced enforcement of intellectual property rights especially for audio visual and counterfeit goods is a particular priority.*
- *Enforcement procedures need to be elaborated allowing effective recourse to rights holders.*

In the matter of Investments IBM specifies the implementation of negative list that would define restricted investment activities in order to enhance coverage. Other important

dimension of foreign investments is their transparency in terms of investment regulatory policy and last but not least the commitment not to use the relaxation of environmental regulations or labour standards as an investment incentive. These dimensions should be incorporated in the FTA.

Both EU and South Korea are developed countries so a chapter dedicated to sustainable development should be included in the FTA. The two issues pinpointed by IBM are LABOUR STANDARDS and ENVIRONMENTAL AGENDA. Common commitments in both fields should be confirmed on both multilateral and bilateral level and a SUSTAINABLE DEVELOPMENT COUNCIL OR FORUM representing not the states but the stakeholders of both counterparts should be established and given the power to review any issue concerning the sustainable development agenda.

The assessment also gives a number of suggestions on the flanking measures to complement the implementation of the FTA. In the economic sector the focus is at SMALL AND MEDIUM ENTERPRISES (SMEs) both in South Korea and EU, creating contacts between the businesses, exchange of researchers and professionals and encouraging foreign investments and overall interconnection. In the social field are the recommendations connected to the improvement of employment options, core labour standards and decent work principles, promoting employment participation and gender equality. The third field of recommendations on flanking measures is environment. Key aspects are minimisations of negative environmental impacts by rapid liberalisation of environmental goods and services, and secondly investments in Clean Technologies as a part of co-operation on environmental regulation and policy.

## **EU-South Korea Free Trade Agreement**

It has been initialled in Brussels on 15th October 2009 and consists of 15 Chapters, 3 protocols, several annexes and appendixes, a number of understandings and a joint declaration. It is clear to see that many recommendations have been incorporated into the text of the FTA just by viewing its structure. Special attention is for example dedicated to the motor vehicles and parts in Chapter 2. Intellectual Property is strongly discussed in Chapter 10.

Following is the structure of the FTA:

### **Preamble**

### **Chapter 1** Objectives and general definitions

### **Chapter 2** National treatment and market access for goods

- Annex 2-A Elimination of customs duties
- Annex 2-B Electronics
- Annex 2-C Motor vehicles and parts
- Annex 2-D Pharmaceutical products and medical devices
- Annex 2-E Chemicals

### **Chapter 3** Trade remedies

- Annex 3 Agricultural safeguard measures

### **Chapter 4** Technical Barriers to Trade

- Annex 4 TBT coordinator

### **Chapter 5** Sanitary and Phytosanitary Measures

### **Chapter 6** Customs and Trade Facilitation

### **Chapter 7** Trade in services, establishment and e-commerce

- Annex 7-A List of commitments
  - Annex 7-A-1 [EC – Cross-Border Supply of Services]
  - Annex 7-A-2 [EC - Establishment]
  - Annex 7-A-3 [EC – Key Personnel and Graduate Trainees and Business Services Sellers]
  - Annex 7-A-4 [Korea - Commitments]
- Annex 7-B Most-favoured-nation treatment exemption
- Annex 7-C List of MFN exemptions
- Annex 7-D Annex on the additional commitment on financial services

**Chapter 8** Payments and capital movements

**Chapter 9** Government procurement

- Annex 9 Bot contracts/public works concessions

**Chapter 10** Intellectual Property

- Annex 10-A Geographical indications for agricultural products and foodstuffs
- Annex 10-B Geographical indications for wines, aromated wines and spirits

**Chapter 11** Competition

**Chapter 12** Transparency

**Chapter 13** Trade and Sustainable Development

- Annex 13 Co-operation on trade and sustainable development

**Chapter 14** Dispute settlement

- Annex 14-A Mediation mechanism for non-tariff measures
- Annex 14-B Rules of procedure for arbitration
- Annex 14-C Code of conduct for members of arbitration panels and mediators

**Chapter 15** Institutional, general and final provisions

**Protocols**

**Protocol 1** Rules of Origin

**Protocol 2** Mutual administrative assistance in customs matters

**Protocol 3** Cultural cooperation

**Understandings**

Understanding on the cross-border supply of insurance services as committed in the lists of commitments in Annex 7-A (List of Commitments)

Understanding on the Korean postal reform plan

Understanding concerning specific commitments on telecommunications services

Understanding on regulations relating to zoning, urban planning and environmental protection

**Impacts of the FTA entry into force and analysis of the text itself**

The most extensive parts of the FTA text are Chapter 2: NATIONAL TREATMENT AND MARKET ACCESS FOR GOODS and Chapter 7: TRADE IN SERVICES, ESTABLISHMENT AND E-COMMERCE. In these two chapters a majority of issues that might impact EU companies in the most direct way are identified. According to European Commission (2010a) the FTA will quickly remove 1.6 billion Euros of customs duties which

EU exporters pay every year, 850 million Euros immediately after entering in force. Sectors gaining the most in absolute numbers are MACHINERY & APPLIANCES – 450 million Euros in total (312 million Euros immediately) and CHEMICAL – 175 million Euros (143 million Euros immediately). Some other industries, which are smaller in absolute numbers, will get almost immediate relief of custom duties: TEXTILE EXPORTS 93%, GLASS 85%, LEATHER & FUR 84%, FOOTWEAR 95%, IRON & STEEL 93% and OPTICAL INSTRUMENT 91%. Custom duties on sensitive industrial products exports to EU will be liberalised after a transition period of 5 years for CARS WITH SMALL SIZED ENGINES, CONSUMER ELECTRONICS including TV SETS, VIDEO RECORDERS and LCD MONITORS, and 3 years for OTHER SENSITIVE GOODS, including CARS WITH LARGE OR MEDIUM ENGINES.

The agriculture sector, very often seen as important to EU, will also benefit from the FTA. Agriculture goods exporters would save 380 million Euros annually on duties for agricultural products. This is very significant, because South Korean duties on these products are very high (35% on weighted average). While some custom duties will be abolished at the time of FTA entry into force, for example WINE, other will be abolished after a transition period. One of the most important commodities is WHISK(E)Y, which has the average annual exports value of 176 million Euros. The total value of agricultural exports amounts to 1 billion Euros. The largest part of agricultural export from EU to South Korea is PORK with a value of 240 million Euros. Certain EU pork exports will have duty free access from year 5, whereas for the most sensitive product (FROZEN PORK BELLY) a 10 year transition period is assigned. In the area of agricultural products it is very probable that EU exporters will maintain and/or improve the competitive position on the South Korean market.

This agreement is sad to be the most ambitious FTA that includes services. The Chapter 7: TRADE IN SERVICES, ESTABLISHMENT AND E-COMMERCE covers several sectors of services, which will gain access to South Korean market. These sectors are TELECOMMUNICATIONS (2 years after entry in force of the FTA), SATELLITE BROADCASTERS (telephone and TV) and ENVIRONMENTAL SERVICES. EU shipping firms will gain full market access to South Korea, construction services will no longer have to work as subcontractors, all financial firms will gain substantial market access to South Korea and international express delivery services provided by EU companies will be allowed to operate in South Korean market. The chapter also covers air transport, European law firms advising in South Korea on non-South Korean law issues and their employees will be allowed

to use their home titles. Although the conditions for some sectors of services are very specific, this FTA is pretty much revolutionary in regard of providing access for EU companies on foreign market.

Intellectual property rights are also incorporated in the text of the Free Trade Agreement, because they play a very important role in European competitiveness. The Chapter 10 of the agreement includes developed provisions particularly on COPYRIGHT; DESIGNS and GEOGRAPHICAL INDICATIONS; strong section on ENFORCEMENT OF IPRs based on EU's internal rules; remuneration for use of EU right holder's music or other artistic works in South Korea. Many commercially important geographical indications are listed in this section, to be specific *Champagne, Scotch or Irish whisk(e)y, Grappa, Ouzo, Polska Wódka, Prosciutto di Parma, Szegedi szalámi, Jambon de Bayonne, Vinho Verde or Tokaji* and others.

## **Conclusion**

It is clear that the text of the agreement is very detailed in many regards, which I see as very positive. Sometimes the detailed text of an agreement can limit its possibilities, but considering the proportions of the agenda which this FTA covers, it is clear, that the negotiators had to cover all possibly problematic sectors to secure the successful implementation of this agreement. In this case the agreement partners come from two very different society models, which make it even more important to make the text very detailed, especially in those fields which might cause problems, such as IPRs or dispute settlement. The agreement incorporates transition periods, to secure some time to adjust and explore the competing businesses, to the most sensitive sectors. Incorporating problematic sectors into the Free Trade Agreement has been a step undertaken by the EU negotiators to build up a better position for EU firms which need to adapt before being fully exposed to the South Korean duty free exports. The question is whether the secured time will be enough and how the adjustments will affect the economies.

While keeping this in mind, this agreement will probably not bring much significant distortions to any of the markets participating on it. There are transition period mechanisms and dispute settlement mechanisms, which can very much moderate the possible negative effects. The great fears of the automotive industry, which speaks up the loudest, should probably be directing their fears toward China, which is becoming dangerous in the automotive sector towards its competition around the world (not just for EU but also to South Korea). The gains from the sector of services are very probable, since it is clear, that services in the EU have a much stronger position in GDP creation and South Korea still didn't develop its services segment that massive.

The most positive effect will probably be the increased productivity, efficiency and technological innovation in some sectors. This might help to fight the challenges which are descending on both economies. One of them is the aging population the other the global environmental challenges.

All these conclusions depend on whether the agreement will be actually ratified. It is possible to doubt this, because if some of the industrial lobbies will press hard enough against this ratification, the development influenced by the implementation of this FTA might not take place.

But even if the automobile market (for example) will not be liberalized in due time, as mentioned above, trade relations and mutual bonding of the market will continue to evolve. South Korean automobile industry would most probably continue to expand on European market despite this possible setback.

If the FTA would not be ratified, EU's services sector penetration on the South Korean market would be very impaired; in fact it might not be even possible in some sub-sectors for a long time. Based on the available literature, it is my belief that EU-South Korea FTA should be ratified for the benefit of both counterparts, although it will be more profitable to South Korea.



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## Appendix

The Standard international trade classification, abbreviated as SITC, is a product classification of the United Nations used for external trade statistics (export and import values and volumes of goods), allowing for international comparisons of commodities and manufactured goods.

The groupings of SITC reflect:

- the production materials;
- the processing stage;
- market practices and uses of the products;
- the importance of the goods in world trade;
- technological changes.

The main categories are:

SITC 0: Food and live animals

SITC 1: Beverages and Tobacco

SITC 2: Crude materials, inedible, except fuels

SITC 3: Mineral fuels, lubricants and related materials

SITC 4: Animal and vegetable oils, fats and waxes

SITC 5: Chemical and related products, n.e.s.

SITC 6: Manufactured goods classified chiefly by material

SITC 7: Machinery and transport equipment

SITC 8: Miscellaneous manufactured articles

SITC 9: Commodities and transactions n.c.e.

SITC Revision 4 was accepted by the United Nations Statistical Commission at its 37th session in 2006 and it is currently being implemented (Eurostat, 2010c)