The China-Korea Free Trade Agreement and Its Economic Impact in Explicit Consideration of Foreign Direct Investment: A CGE Approach

Topic: 714C Special session: Computable General Equilibrium Modeling for Policy Impact Analysis
Author: Jong H. KO

The objective of this study is to conduct a quantitative assessment of the potential economic effects of the Korea-China FTA that came into effect on 20 December 2015 using the GTAP-FDI model that explicitly takes into account foreign direct investment (FDI) and foreign commercial presence differentiated by the country of location and ownership. In analyzing the potential economic effects of an FTA, the role of FDI becomes increasingly more important. FDI is associated with the international mobility of capital and FDI implies firms operating across national borders. Modeling FDI in a CGE framework should cover both of these aspects. This study is based on the concessions of trade liberalization agreed between Korea and China. In addition to trade liberalization through tariff reductions, ad valorem tax equivalents of FDI restrictions on FDI and foreign affiliates sales, which are calculated by multiplying FDI restrictiveness index with the elasticity of FDI with respect to the FDI restrictiveness index and the elasticity of foreign affiliates sales with respect to the FDI restrictiveness index, respectively, are used for policy scenarios of FDI liberalization. The impacts of the China-Korea FTA include macroeconomic effects such as real GDP, welfare, total exports, total imports, trade balance and terms of trade of the two countries as well as microeconomic effects such as production of domestic firms and foreign firms by sector, employment of domestic firms and foreign firms by sector, and exports and imports of domestic firms and foreign firms by sector.