

# EAST ASIAN ECONOMIC INTEGRATION: IMPLICATIONS OF A U.S.-KOREA FREE TRADE AGREEMENT

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## Introduction

The United States and Korea finished the eighth round of negotiations for a bilateral free trade agreement (FTA) in mid-March 2007, and the agreement is likely to be concluded eventually.<sup>1</sup> If the FTA is implemented, Korea will be able to join the global trend toward regionalism, and Korea will not be one of the countries coming late to regionalism. Also, the FTA will improve the relationship between the United States and Korea and lead to closer economic cooperation.

Korea concluded its first FTA with Chile in October 2002; this FTA was implemented in April 2004. The successful conclusion of the first FTA became especially important to Korea because other potential FTAs depended heavily on the first model but showed gradual improvements. Korea's second and third FTAs, with Singapore and the European Free Trade Association (EFTA), became effective in 2006. The experience will help the Korean government minimize risks and possible losses as well as to be better prepared for more active promotion of FTAs with large economies such as the United States.

The United States has long been Korea's most important partner in terms of trade and investment, in addition to the security alliance. Although the recent economic boom in China has caused Korea-China trade to grow rapidly, the United States has remained in first or second place in Korea's trade with other countries. In turn, Korea is also one of the important U.S. trading partners. The volume of trade between Korea and the United States increased steadily until 2004, when it saw a slight downturn owing to the depression of the economy. In 2005, according to U.S. trade data, Korea's exports to the United States reached

\$41.3 billion, while its imports from the United States were \$30.6 billion. Korea is the seventh-largest source of imports entering the United States, and Korea absorbed 3.05 percent of the total exports of the United States, which made Korea the seventh-largest consumer of U.S. goods.

Trade relations between the United States and Korea have been getting weaker over time. The proportion of exports to the United States out of Korea's total exports peaked at 39.98 percent in 1986 and declined to 14.54 percent in 2005. Korea's share of total imports entering the United States declined from 3.31 percent in 2000 to 2.60 percent in 2005, and Korea's share of U.S. exports declined from 3.58 percent to 3.05 percent during the period.

In spite of the close trade and investment relations between Korea and the United States, discussions regarding an FTA between the two countries were inactive for a long time. The two countries began official negotiations in June 2006. This paper will look into the emergence of regionalism in East Asia and try to draw implications for a U.S.-Korea FTA. In addition, this paper emphasizes the political and strategic significance of an FTA as well as its economic effects. That is, this paper argues that the two countries should evaluate a U.S.-Korea FTA according to its economic impact as well as its noneconomic importance.

The second section discusses the current progress of FTAs in East Asia; this is followed by a discussion of U.S. options vis-à-vis emerging regionalism in the region. The fourth section discusses the background to the negotiation of a U.S.-Korea FTA and economic effects of the FTA.

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1. Note that this article was prepared prior to the conclusion of the negotiation for a free trade agreement between Korea and the United States.

## Emerging Regionalism in East Asia

### *Internal and External Environment*

Since the end of the World War II, the world economy has witnessed two parallel trends of integration, namely, multilateralization of global economic and trading relations under the General Agreement on Tariffs and Trade (GATT) and, later, the World Trade Organization (WTO) and the regionalization of different economies or groups of nations. The European Commission, the predecessor of the European Union, was successful in regional economic integration through its establishment of regional FTAs, which later developed into a customs union, and then economic and political unions. Initial efforts for regional integration in Europe were launched right after the conclusion of the World War II, with the birth of the Organization for European Economic Cooperation (now called the Organization for Economic Cooperation and Development) in 1948 and the Council of Europe (CE) in 1949. The key turning point was marked by the signing of the 1952 Paris Treaty, laying the foundation for the formation of the European Coal and Steel Community in the same year. Important treaties and agreements in the second half of the twenty-first century led to the establishment of the European Economic Community, the European Community, and then the European Union (EU).<sup>2</sup> Outside the EU framework, economic integration efforts took place among some European countries, such as among the group of northern European countries or among neutral nations.

The United States has shifted its focus to regional and bilateral integration since the middle of 1980s and early 1990s: signing FTAs with Israel and Canada and then forming NAFTA; an FTA with Jordan; and more than 300 agreements of economic cooperation, trade, and bilateral investment during the two terms of the

presidency of Bill Clinton (1993–2001). Tremendous efforts to accelerate bilateral agreements have been made during George W. Bush's administration (2001 to the present), with the strategy of competitive liberalization—the term put forward by U.S. Trade Representative Robert Zoellick during George W. Bush's first term—creating competition in liberalization initiatives through a number of bilateral deals.

The WTO, created in 1995, allows some exceptions that permit the creation of regional trading agreements (see GATT, Article 24 and General Agreement on Trade in Services [GATS], Article 5), most of which are in the form of regional trade agreements, FTAs, or customs unions. The fundamental principle of the WTO is nondiscrimination, which means that each member shall accord immediately and unconditionally most-favored-nation treatment to any other member. The WTO framework, however, does not ban two countries or a group of countries from reaching agreements on deeper and wider liberalization than those committed in GATT and WTO. As a result, more than half of all regional trading agreements have emerged since the establishment of the WTO.

The WTO round of multilateral trade liberalization (called the Doha Development Agenda [DDA]) showed slow progress because issues of negotiation were extended in the Cancun WTO ministerial meeting to nontariff matters and are beyond the scope of pure trade (for example, Singapore issues).<sup>3</sup> More seriously, the DDA reached a deadlock in July 2006 without making any progress in agricultural liberalization. The developed and developing countries could not reach an agreement on such matters as elimination of agricultural tariffs and a reduction of agricultural subsidies.

The East Asian economic crisis in 1997–98 forced East Asia to seek a new motivation for reform and

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2. The Treaty of Rome signed in 1957 laid the foundation for the establishment of the European Common Market and Tariff Alliance; the Single European Act in 1985 eliminated nontariff barriers on movements of labor, goods, services, and then capital (1992). The Maastricht Treaty in 1992 marked the establishment of economic and monetary union, political union, as well as other fundamental institutional pillars needed for the coming European Union. The Amsterdam treaty of 1997 and the Nice Treaty of 2000 deepened institutional integration in the European Union, aiming at a comprehensive political union.

3. Singapore issues comprise four factors of transparency: in government procurement, trade facilitation, investment, and competition policies.

growth, with the East Asian countries shifting their foreign economic policies to regional and bilateral integration. Most East Asian countries, especially Korea, Singapore, Hong Kong, and China, made use of international trade for economic growth. Therefore, access to foreign markets, especially those of North America and Western Europe, constituted a prerequisite for maintaining the growth momentum of these East Asia countries.

Since 1999, East Asia has witnessed a strong proliferation of bilateral FTAs. Japan and Korea joined this trend by concluding bilateral FTAs, implicitly announcing that the WTO was no longer their only choice. In fact, the GATT-WTO framework is incapable of dealing effectively with new issues of international trade relations including trade in services, e-commerce, government procurement, and movement of labor. China and Thailand swiftly put forward their bilateral FTA initiatives, and the Association of Southeast Asian Nations (ASEAN), as a single bloc, is also speeding up arriving at bilateral commitments with Australia and New Zealand.

### *Evolution of FTAs in East Asia*

East Asia is the least developed region in terms of regionalism. The main regional trade agreement in East Asia is the ASEAN Free Trade Area (AFTA), set up in 1992. Currently, AFTA has 10 members and is pursuing trade liberalization. Recently, these countries have been discussing bilateral FTAs with China, Japan, India, and Australia, and New Zealand.<sup>4</sup> The evolution of FTAs in East Asia is summarized in the appendix.

In East Asia, until 2002 when the bilateral FTA between Japan and Singapore was signed, AFTA was the first and only FTA experiment aimed at strengthening ASEAN intrabloc trade. Until recently, the Northeast Asian countries—China, Japan, and Korea—have not participated in any regional trade agreements. After the Asian financial crisis, however, these countries began to show a great interest in establishing FTAs.

In 1998, Korea announced its plan to proceed with an FTA with Chile, and Korea also began a joint study with Japan. The Korea-Chile FTA negotiations were launched in December 1999 and concluded in October 2002. Japan and Korea developed bilateral FTA strategies with a view to accelerating domestic reform, maintaining their competitive positions in the international and regional markets, and responding to the rise of China. Both Japan and Korea felt they were coming late to the regional and bilateral races, as they felt the pressure of the United States and China in regional and global markets. The two East Asian countries originally faithful to the multilateral framework have realized that multilateral commitments are now of little help for domestic reforms; therefore, the establishment of bilateral FTAs has become a major card in their trade policy adjustments.

Japan and Korea faced strong resistance from their agricultural sectors with regard to commitments on market openness and liberalization. As a result, the two countries were rather cautious in selecting Mexico (in the Japan-Mexico FTA) and Chile (in the Korea-Chile FTA) as their partners in bilateral FTA negotiations. In the case of the Japan-Singapore FTA, the agricultural sector was removed from the negotiation table.

However, Japan and Korea are currently very active in seeking bilateral FTA partners in the region. A bilateral FTA between the two countries themselves is currently not under way, although they have discussed the FTA concept since 1999. Japan has signed a framework agreement with ASEAN and concluded FTAs with some individual ASEAN members, including Thailand, Malaysia, and the Philippines. At the same time, Japan is exploring the opportunity of having bilateral FTAs with non-East Asian countries. After implementing bilateral FTAs with Chile, Singapore, and EFTA, Korea concluded an FTA with ASEAN in 2006. Korea is currently conducting negotiations for bilateral FTAs with Canada, Mexico, India, and the United States.

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4. The Australia and New Zealand Closer Economic Relations Trade Agreement (known as CER) entered into force in 1983.

China shifted its policy to bilateral FTAs with visible geopolitical and geoeconomic motivations, taking advantage of exceptions obtained from being a WTO member. China, as a new member of the WTO, has been very active in taking advantage of the exceptions in the GATT-WTO framework to form the Framework Agreement on Trade and Investment with Hong Kong. China also signed a framework agreement with ASEAN as a whole in 2002 and implemented an FTA on goods with ASEAN in 2005. China is in the process of negotiating the chapters on services and investment as a part of the FTA with ASEAN, following the FTA on goods. Also, China is active in promoting FTAs with Australia and the oil-producing Middle East countries as well as a trial FTA with Japan and Korea.

The bilateral FTA policy of China has reflected its geopolitical and geoeconomic considerations, as well as pure trade motivations. China and ASEAN concluded negotiations for a bilateral FTA in 2004. The deals with ASEAN and those with each of its members created closer linkages, forming an economic sphere favorable to China, instead of seeing ASEAN “being whirled into” the orbit of Japan and the United States. Through bilateral FTAs, China could, to some degree, show its regional role in the expansion process of economic ties in East Asia.

The ASEAN bloc promotes external economic ties in order to strengthen its internal integration and maintain its competitiveness against the pressure of Chinese attraction. Yet, there seem to be individual-country efforts rather than collective action. It has been felt that, since the 1997–98 crisis, ASEAN has gradually lost its attractiveness compared with China in the eyes of international investors. The Asian crisis revealed defects in the structure of the economies of each member and the inefficiency of ASEAN cooperation mechanisms. It has become urgent to enhance each member’s internal reform and strengthen the economic ties among the members. Besides, Singapore and Thailand have actively found their own way out

through bilateral FTA channels. This has put ASEAN into a dilemma of regional integration intensification: agreement by word, not by heart.

ASEAN can only be attractive when it maintains an integrated market, such as AFTA, of considerable scale although the implementation of AFTA has not borne many fruits thus far.<sup>5</sup> Accordingly, ASEAN needs to take advantage of FTAs with the United States, Japan, China, Korea, and India to become the hub of East Asian bilateral and multilateral FTA commitments. This idea has, step by step, been put into practice,<sup>6</sup> but it will be successful only if ASEAN members do not form their own bilateral FTAs with those partners. Yet, what is happening in reality is the opposite of this assumption.

At present, ASEAN cooperation and integration efforts are taking place at various levels such as individual bilateral FTAs (Singapore, Thailand, Malaysia, the Philippines); ASEAN + 1 formula (with China, Japan, Korea, and India); ASEAN + 3 formula (with the Northeast Asian region); and the idea of setting up the ASEAN Economic Community that was put forward in 2003. ASEAN members’ efforts to form individual bilateral FTAs is an outstanding trend, and the ASEAN + 1 formula is getting some initial results.

Among ASEAN countries, Thailand is actively shifting toward bilateral FTAs because of the country’s internal political motivations and its desire to be in harmony with the wave of the establishment of regional and global bilateral FTAs. Malaysia and the Philippines have begun to consider their own bilateral FTAs seriously so as not to be reduced to an unfavorable position in international trade.

### ***Future Prospects for East Asian Regionalism***

Since 1998, political leaders of the ASEAN + 3 (China, Japan, and Korea) have established an annual summit in order to discuss economic cooperation measures in the region. The ASEAN + 3 process, which started

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5. AFTA created a market of 550 million people with a total gross domestic product of \$570 billion, half of the population and the GDP of China.

6. “Asian Powers Queue Up for Free Trade Deals with Southeast Asia,” *Asia Pacific Bulletin* (Asia Pacific Business Network [Canada]), 15 November 2002.

in 1997, can be a catalyst for East Asian economic integration. Since the first summit in Kuala Lumpur, Malaysia, in 2005, the region has been discussing the transformation of the ASEAN + 3 summit meeting into an East Asian summit for a more enhanced institutional approach in East Asian cooperation. Then, within this framework, the idea of an East Asian FTA (EAFTA), covering all countries in the region, is likely to gain more momentum among member countries.

There are many obstacles, however: differences in the political systems of the various countries, levels of economic development, as well as historical remnants. Despite these impediments, East Asia will overcome these and pursue economic integration in order to respond to the global trend of regionalism. The EU was enlarged, encompassing 10 central and eastern European countries; and a Free Trade Area of the Americas, which covers both North and South America, will be realized. Given the prospects of the advent of two major blocs, East Asia recognizes the need for deeper economic integration, including EAFTA. The question, therefore, becomes how to achieve East Asian economic integration. All potential member countries in East Asia have different ideas about and directions for pursuing a regional FTA. Another question is whether there is any way to narrow the gap among the countries with respect to their perceptions of East Asian economic integration. How can we maximize the synergy in integrating East Asia economically?

Many East Asian countries think that East Asia will be integrated in the future, and Northeast Asian countries—China, Japan, and Korea—are supportive of the establishment of an EAFTA.<sup>7</sup> Although they deliver different views on how to achieve it, they all agree that China, Japan, and Korea, which represent 90 percent of East Asia's GDP, must play a leading role in forming an EAFTA. China seems to advocate the merits of an ASEAN-China FTA and then an ASEAN + 3 approach, implying bilateral FTAs by China, Japan, and Korea with ASEAN. However, Ja-

pan might prefer an approach to East Asian regionalism by forming a Japan-Korea FTA first, and then concluding bilateral FTAs with ASEAN and China, taking into account the static and dynamic benefits.

Although East Asian regionalism could be developed in several directions depending on approaches by two major players in Northeast Asia, a Japan-Korea FTA seems to be a contributing factor for East Asian regionalism. Some believe that East Asia regionalism will shift from talk to action—resulting in a rapid spread of preferential arrangements—provided that at least one major FTA gets signed. Richard E. Baldwin predicts that the Korea-Japan FTA currently under negotiation may well be the trigger; arguments supporting this assertion are based on both historical analogy and political economic reasoning.<sup>8</sup> In the Americas and Europe, the 1990s witnessed waves of regionalism triggered by single idiosyncratic events of preferential liberalization—the U.S.-Mexico FTA in North America and the EU's Single Market program. Baldwin argues that the “domino theory” is the political economic logic behind the waves of regionalism. Put another way, trade and investment diversion created by a preferential trade arrangement among a nation's trade partners tends to stimulate extra political pressure within the nation to redress the discrimination. Because signing a new FTA is the easiest way to redress the discrimination, one FTA tends to encourage others. Moreover, Baldwin's paper argues that the “force for inclusion” and the cost of exclusion get stronger as more FTAs are signed, so the spread of FTAs can be quite rapid.

### **U.S. Options and the Evolution of East Asian Regionalism**

The United States is the most important trading partner for most of the East Asian countries. In addition, considering the international status of the United States—the sole superpower—and the high linkage of U.S. military and political relations with East Asia, East Asian countries will need strong relations with

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7. Ahn Choong Yong, Richard E. Baldwin, and Inkyo Cheong, eds., *East Asian Economic Regionalism: Feasibilities and Challenges* (Dordrecht, Netherlands: Springer, 2005).

8. Richard E. Baldwin, “East Asian Regionalism: A Comparison with Europe” (paper presented at conference on East Asian regionalism, Inha University, Incheon, Korea, May 2004).

the United States. If the United States is excluded from economic integration in the region, economic relations with the United States will be weaker. During recent years, East Asian countries have experienced slightly declining trade shares with the United States, and East Asian regionalism will enforce closer economic relations among East Asian countries. This is not good for either East Asian countries or the United States. East Asian countries especially will experience losses from trade diversion as well as trade conflicts with the United States during the integration process.

The United States will be more concerned with the development of a Japan-Korea FTA or a China-Japan-Korea (CJK) FTA among the possible FTAs in East Asia because the three countries in Northeast Asia make up 90 percent of the market power and economic power in East Asia.

A substantial internal consensus has formed in Korea regarding the idea that a Korea-Japan FTA can be a core force for integrating East Asian economies.<sup>9</sup> Although there are many concerns about the potentially negative effects of a Korea-Japan FTA on the Korean economy, including increasing Korea's economic dependence on Japan and increasing Korea's trade deficit with Japan, both parties are negotiating a bilateral FTA.

Choi and Schott negatively evaluate the progress of a CJK FTA based on several aspects, including rivalry between China and Japan,<sup>10</sup> although their evaluation misses the position and role of China in a CJK FTA. The review of a CJK FTA proposed by former Chinese prime minister Zhu Rongji in 2002 can be interpreted as a sign of China's uneasiness toward progress on a Korea-Japan FTA. The Trilateral Joint Research Project is being performed by the Development Research Center (DRC) of the State Council in China, the National Institute for Research Advancement in Japan (NIRA), and the Korea Institute for International Economic Policy (KIEP).

So far, Korean manufacturers have supported a CJK FTA, as shown by the support given to an FTA by the three countries at the China-Japan-Korea business forum in 2002. According to the Trilateral Joint Research Project team's questionnaire survey of business enterprises, a large proportion of respondents in the three countries supported the idea of establishing an FTA among China, Japan, and Korea (85 percent in China, 79 percent in Japan, and 71 percent in Korea). In addition, China proposed the introduction of an experts' group for examining the economic feasibility of an East Asian FTA at the 2004 ASEAN + 3 leaders' meeting. Subsequently, China led the group and finished the final report in July 2006, which was reported to the 2006 ASEAN + 3 leaders' meeting.

China seems to have proposed a CJK FTA as a stepping-stone to mid-term or long-term Northeast Asian regional economic integration. Rather than participating in a Korea-Japan FTA as a third member, it seems that China prefers to take the initiative for a CJK FTA and is taking the leading role in place of Japan in its formation. There are both pros and cons for China in launching a trilateral FTA. Although China has internal problems in pursuing FTAs, it also sees the merits of an FTA. China has strong leadership from its government, a consistent administrative system, and an absence of anti-FTA campaigning by nongovernment organizations. Thus, China has conditions favorable for an FTA and could produce distinct results within a short period after the government comes to a policy decision.

Discussions on a CJK FTA as proposed by China will continue. The difficulties in the formation of a CJK FTA may be differences in economic stages of development, political factors (historical problems and border conflicts), and political rivalry between China and Japan. If there are problems in launching a CJK FTA, the problems might be due to the uneasy China-Japan relationship, and a China-Korea FTA might take its place. During an October 2004 international conference on a China-Korea FTA organized by KIEP and

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9. Ibid.

10. Choi Inbom and Jeffrey J. Schott, "U.S.-Korea Trade Relations: Revisited" (paper presented at the eighth Committee for Korea-U.S. 21st Century, Washington D.C., 21-22 October 2003).

the Academy of Macroeconomic Research, a Chinese national think tank, Chinese scholars showed high interest in an FTA with Korea. In May 2005, China officially proposed official talks for a China-Korea FTA.

In the past, the United States explicitly expressed opposition to the East Asian Economic Group proposed by Prime Minister Mahathir Mohamad of Malaysia, and the United States encouraged East Asian countries to pursue open regionalism within the Asia-Pacific Economic Cooperation (APEC).<sup>11</sup> Now the United States seems to promote economic cooperation with East Asian countries not only by supporting the movement toward regionalism in East Asia but also by seeking to conclude bilateral FTAs with individual ASEAN member countries. During a visit to Thailand in April 2002, U.S. Trade Representative Robert B. Zoellick showed support for East Asian regionalism, including bilateral FTAs with China and Japan and bilateral ASEAN agreements, because of the contributions he anticipated these agreements would have for world trade liberalization.<sup>12</sup> President George W. Bush, in contrast, suggested the Enterprise for ASEAN Initiative (EAI) at the APEC summit held in Los Cabos, Mexico, in October 2002; this would promote economic cooperation with Southeast Asian countries.

Compared with the past, there are now many fewer reasons for the United States to oppose East Asian regionalism in economic terms.<sup>13</sup> First, the United States is pursuing regionalism, and the majority of economists now consider regionalism as contributing to the development of a multilateral trading system (building blocks). There has also been criticism over the roles of the United States and the Interna-

tional Monetary Fund in dealing with the financial crisis in East Asia.

As for national security, there are still many issues to be clarified regarding whether United States considers China to be a potential threat. There are three U.S. viewpoints toward China:<sup>14</sup>

- Positive viewpoint: The Chinese economy will not pose a threat because it will become increasingly dependent on neighboring economies. Stronger economic relations with neighboring countries will lead China to promote a more market-oriented economy and move irreversibly away from the old central planning and socialistic political system.
- Negative viewpoint: A situation of rivalry will exist, wherein there cannot be a constructive relationship established with China unless China's political system changes.
- Compromise: The United States should counter-balance China's rising power using military superiority while maintaining a positive outlook.

If the U.S. position on China is close to the negative or compromise options, the United States will be more concerned with the evolution of regionalism in East Asia if China, now the rising power in political, economic, and military areas, takes a hegemony position in East Asia, noting that China is competing for leadership in East Asia with Japan through FTAs.<sup>15</sup> This will lead the United States to pursue closer linkages with other East Asian countries. As mentioned before, one of the alternative policies the United States can take is to strengthen its relationship with Korea

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11. Bae Geung-chan, "Prospects on Regional Trading Blocs in East Asia [in Korean]" (Seoul: Institute of Foreign Affairs and National Security, 2000).

12. "USTR Reports on Free Trade Agreements in Southeast Asia," Office of International Information Programs, U.S. Department of State, Washington, D.C., 8 April 2002, [http://usembassy\\_australia.state.gov/hyper/2002/0408/epf110.htm](http://usembassy_australia.state.gov/hyper/2002/0408/epf110.htm).

13. Choi Tae-wook, "Relations between Multilateralism and Regional Trading Blocs: Focusing on China, Japan, and Korea [in Korean]," in *A China-Japan-Korea FTA: Current Progress and Tasks*, ed. Cheong Inkyo (Seoul: KIEP, 2003).

14. Lee Sang-hyun, "U.S. Policy on Japan and China and Its Impact on Northeast Asia [in Korean]" (Sungnam: Sejong Institute, 2003).

15. Cheong Inkyo, "Evaluating the Second Round of Korea-U.S. FTA Negotiations," *Korea Policy Review* 2, no. 8 (2006): 26–30.

and Japan if it is unable to control the expansion of FTAs in East Asia.<sup>16</sup>

The United States will be concerned about the economic and noneconomic losses it might suffer when it is excluded from East Asian regionalism such as a Japan-Korea FTA and a CJK FTA. The U.S. concern over FTAs in East Asia has been reflected in its approach toward ASEAN in 2002 through the introduction of the EAI, the conclusion of the U.S.-Singapore FTA, and discussions on a U.S.-Taiwan FTA. The United States cannot put a brake on the emergence of East Asian regionalism since the United States itself is also pursuing FTAs. The United States will have no choice other than to examine concluding more bilateral FTAs with East Asian countries.<sup>17</sup>

The United States needs to launch a bilateral FTA with one of the three Northeast Asian countries in order to respond to the evolution of East Asian regionalism because it is unlikely that the United States will join the Korea-Japan FTA or the CJK FTA currently under active discussion. The rapid progress being made in FTA negotiations in East Asia makes it essential for the United States to get involved in securing its economic and noneconomic interests. It remains to be seen which country the United States can work with to maximize its national interest when carrying out FTA negotiations.

## **Evaluation of a U.S.-Korea FTA**

### ***Evolution of a U.S.-Korea FTA***

The government of Korea officially began reviews for a U.S.-Korea FTA in 2003 as a part of its road map for the promotion of FTAs. In drawing the Korean government's first project to create an FTA road map, an FTA with the United States was not discussed seriously, not because Korea was not interested but because the United States did not show interest in an FTA with Korea. Also, the domestic conditions were not yet mature enough for a free trade pact with the

world's largest economy, and the United States had not been aggressive about forging a bilateral agreement. Thus, with little urgency, a U.S.-Korea FTA was categorized as a mid- to long-term objective. Trade ministers of the United States and Korea agreed to set up a working group for studying a bilateral FTA between the two countries in November 2004. The working group concluded that an FTA between the two countries would be beneficial for member countries in mid-2005.

On 18 January 2006, a week after President Roh Moo-hyun publicly confirmed the government's plan to introduce an FTA with the United States, a governmental decision was made to reduce the screen quota for domestic films, which was one of main barriers to a bilateral investment treaty (BIT) between the United States and Korea. Soon after, on 3 February, Seoul and Washington agreed to launch formal negotiations for a U.S.-Korea FTA. Both parties finished the third round of negotiations in Seattle in September 2006.

The idea of an FTA between Korea and the United States was raised by U.S. trade officials in the mid-1980s. However, formal discussions and debates in Korea were held back owing to political tension coming from sensitive issues concerning the liberalization of the agriculture and services industries. Twenty years later, however, official negotiations for a U.S.-Korea trade pact began through Korea's diplomatic efforts, although the United States appeared reluctant until mid-2004.

There were several reasons for the low interest on the part of the United States in an FTA with Korea. The United States had doubts about the political feasibility of the Korean government's FTA policies amid the poor progress of negotiations for a U.S.-Korea BIT that were in a stalemate for years. Despite Korea's proposal, the United States showed no interest in a bilateral free trade pact. But, as the Korean government attempted a policy of pursuing multiple FTAs simultaneously without any serious problems, mak-

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16. Choi, "Relations between Multilateralism and Regional Trading Blocs."

17. APEC can be an alternative for East Asian regionalism; however, it seems that APEC has lost its momentum for becoming a regional trading bloc because of its lack of progress on the Bogor Goals.



ers of trade policy in Washington began reviewing a trade pact with Korea in the latter half of 2004.

The United States tapped Korea even before Japan and China. Japan was regarded to have clear limitations in opening its agricultural market and reforming its closed business practices through an FTA with Washington. China is not yet ready for a high-quality FTA that Washington would like to introduce. A trade deal with Washington would also remove any impression that Korea is isolating itself from the global trend of FTAs. If a bilateral trade pact does take effect, Korea will be the only country in Northeast Asia to enjoy reciprocally preferential market access with the world's leading economy. The United States would be able to secure a foothold into the Northeast Asian economy, and Korea could realize its vision of a regional hub as it bridges the economies of the United States, China, and Japan. Korea is the third-largest economy in East Asia, and its trade and industrial sectors complement those of the United States. It is thought that the nation has a high potential for promoting various means of economic cooperation through a good trade partnership with Washington.

### ***Numerical Assessment***

Various studies have analyzed the numeric economic effects of a U.S.-Korea FTA. Three papers analyzed the tariff-abolition effect of a U.S.-Korea FTA using the CGE model. Cheong and Wang looked at three different scenarios where tariffs were removed under a U.S.-Korea FTA: absolute tariff abolition in every sector, tariff abolition in every sector except agri-

culture, and 50 percent tariff removal in the agricultural sector with 100 percent tariff removal in all other sectors.<sup>18</sup> Through this research, Cheong and Wang suggested that Korea could expect economic benefits from a U.S.-Korea FTA, but excluding the agricultural sector, which is expected to be a major point of contention in negotiations, would result in large losses for Korea. Choi and Schott concluded in 2001 that both countries could enjoy economic welfare gains if all sectors (agriculture included) were liberalized under the FTA.<sup>19</sup> They also predicted that the FTA would produce trade diversion effects for Japan and China.

Choi and Schott and USITC estimated the economic effects of a U.S.-Korea FTA using the GTAP model and GTAP database (version 4).<sup>20</sup> Although the model and database were similar, they produced somewhat different estimations owing to the applications of different aggregations in industries and regions as well as different model closure.

The major conclusion of the papers can be summarized as follows. A U.S.-Korea FTA would mean economic benefits for both countries, with substantial gains for Korea but modest gains for the United States.<sup>21</sup> Under a bilateral FTA, the GDP and welfare of both countries are expected to improve, favoring U.S. agricultural exports and Korean clothing and textile exports. Accordingly, USITC identifies these areas as most likely to be sensitive issues during negotiations, as Korean clothing and textiles exports would increase by \$70 billion while U.S. agricultural exports (including processed goods) would increase by \$140 billion.<sup>22</sup>

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18 Cheong Inkyo and Wang Yunjong, "Korea-U.S. FTA: Prospects and Analysis [in Korean]," KIEP working paper (Seoul: KIEP, 1999).

19. Choi Inbom and Jeffrey J. Schott, *Free Trade between Korea and the United States?* (Washington, D.C.: Institute for International Economics, 2001).

20. Ibid.; and Christine McDaniel and Alan Fox, *U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) between the United States and the Republic of Korea* (Washington D.C.: U.S. International Trade Commission, 2001).

21. Cheong and Wang, "Korea-U.S. FTA: Prospects and Analysis"; McDaniel and Fox, *U.S.-Korea FTA*; Choi and Schott, *Free Trade between Korea and the United States?*; Cheong Inkyo, "East Asian Economic Integration: Recent Progress and Prospects," Policy Study (Seoul: KIEP, 2002).

22. McDaniel and Fox, *U.S.-Korea FTA*.

**Table 1: Estimated Economic Effects of a U.S.-Korea Free Trade Area**

Researcher	Model	Major results
Kim Woo-taek, <i>The Economic Effect of the Korea-U.S. FTA</i> (Seoul: Korea Institute for Industry and Technology, 1986)	Armington model (partial balance)	Korea's exports to the United States increase 18.25 percent and imports from the United States increase 12.93 percent
		Korea's trade balance with the United States would increase by \$1 billion
"Impacts of a Korea-U.S. FTA on Korea's Trade [in Korean]" (Seoul: Korea Trade Committee, Research Institute of Industry, 1989)	Applies trade and industry indices (trade specialization index, etc.)	Korean goods that benefit: clothing, steel, metal, textiles, traveling goods
		U.S. goods that benefit: agriculture, chemicals, electronic machinery, general machinery
		Ambiguous goods: communication, automobiles, computers, general industrial machinery
Cheong Inkyo and Wang Yunjong, "Korea-U.S. FTA: Prospects and Analysis [in Korean]," KIEP working paper (Seoul: KIEP, 1999).	Multiregion, multisector CGE model	Korea's GDP improves by 0.36 percent and its welfare increases by \$21.5 billion
		Excluding the agricultural sector would decrease Korea's total welfare
Choi Inbom and Jeffrey J. Schott, <i>Free Trade between Korea and the United States?</i> (Washington, D.C.: Institute for International Economics, 2001)	Multiregion, multisector CGE model	In the long run, Korea and the United States can expect welfare to improve by \$10.9 billion and \$8.9 billion, respectively
		Korean exports and imports to the United States can increase by 30.3 percent and 49.4 percent, respectively.
Christine McDaniel and Alan Fox, <i>U.S.-Korea FTA: The Economic Impact of Establishing a Free Trade Agreement (FTA) between the United States and the Republic of Korea</i> (Washington D.C.: USITC, 2001)	Multiregion, multisector CGE model	The Korean and U.S. GDPs would improve by 0.69 percent and 0.23 percent, respectively
		Korean exports and imports with the United States would increase 21 percent (\$100 billion) and 54 percent (\$190 billion), respectively, causing Korean trade balance accounts with the United States to fall by \$90 billion
Cheong Inkyo, "A Strategic Approach toward a U.S.-Korea FTA" (paper presented at the eighth Committee for Korea-U.S. 21st Century, Washington D.C., 21-22 October 2003)	Multiregion, multisector CGE model, with increasing return to scale	Under the assumption of perfect competition, Korea's GDP will increase up to 0.25 percent, reaching 2.03 percent with economies of scale
		Korea's trade conditions would improve internationally

Source: Compiled by the author from various sources.

## Conclusion

As FTAs became more widespread and entrenched in the 1990s, they increasingly became a threat to non-member countries. Despite GATT-WTO Article 24 mandating that the overall trade barriers of any new regional or bilateral trade agreement be no higher than

preexisting ones, the trade diversion effects of regionalism are having increasingly negative effects on the trade of nonmember countries. A realistic Korean policy response to the spread of FTAs would be the establishment of FTAs with major trading partners such as the United States. Existing studies on FTAs show the potential effects for both the United States

and Korea, as this would be the most significant trade agreement into which Korea might enter.

Not only would a U.S.-Korea FTA allow both countries to benefit from preferentially favorable measures, it would likely reduce the number of trade disputes involving Korea. Even though a U.S.-Korea FTA would not eliminate all trade friction between the two countries, trade liberalization and measures for economic reforms in the FTA would likely reduce the frequency and severity of trade disputes between the two countries in the future, since some trade conflicts perceived by the United States originated from Korea's protective economic system. This paper concludes that the United States and Korea would gain benefits from a bilateral FTA. An FTA would have substantial political and strategic meaning for both countries. It is undeniable that noneconomic factors have been more important than economic factors, as the United States has formed FTAs with Australia, Singapore, Jordan, Morocco, and Israel.

An FTA between the United States and Korea will be a very important stepping-stone in developing the economy of Korea. Korean anti-FTA groups reproach the U.S.-Korea FTA as being of "low quality," but the contents of the FTA seem to be more comprehensive than any FTA Korea has concluded so far. It should be noted that, because of objections to the U.S.-Korea FTA, the government of Korea tried to conclude the negotiations with a policy of allowing exceptions for sensitive items from complete liberalization. As a result, just after the FTA negotiations concluded, Korean trade experts evaluated this FTA as a "medium quality FTA."<sup>23</sup> Also, in addition to economic gains, Korea will obtain large noneconomic gains from its FTA with the United States.

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23. Professors' Group for FTA Research, "Intermediate Evaluation for the KORUS FTA [in Korean]" (presented at a media conference at the Korea Chamber of Commerce and Industry, Seoul, 2 April 2007).

**Appendix Table: Progress of Major Free Trade Agreements in East Asia, 2006**

Free trade agreements	Stages of evolution				
	Discussion	Joint study	Negotiation	Signed (year)	Implementation (year)
<b>ASEAN</b>					
ASEAN Free Trade Agreement					X (1993)
ASEAN - China (CEC)			X		X (2005)
ASEAN - Japan (CEP)					
ASEAN - India				X (2005)	
ASEAN + 3		X			
ASEAN - Korea				X (2006)	
ASEAN - CER		X			
<b>Japan</b>					
Japan - Singapore					X (2003)
Japan - Mexico					X (2004)
Japan - Malaysia				X (2005)	
Japan - Korea			X		
Japan - Philippines				X (2005)	
Japan - Thailand				X (2005)	
Japan - Chile		X			
Japan - India		X			
<b>Korea</b>					
Korea - Chile					X (2004)
Korea - Japan			X		
Korea - Mexico			X		
Korea - China	X				
Korea - Singapore					X (2006)
Korea - Canada			X		
Korea - United States			X (2006)		
Korea - European Free Trade Association					X (2006)
Korea - MERCOSUR		X			
Korea - India		X			
<b>China</b>					
China - Hong Kong					X (2004)
China - Macao					X (2004)
China - Australia			X		
China - Brazil		X			
China - Chile				X (2005)	
China - GCC		X			
China - Thailand			X		
<b>Singapore</b>					
Singapore - Australia					X (2003)
Singapore - New Zealand					X (2002)
Singapore - United States	Signed trade and investment framework with the United States			X (2004)	
Singapore - European Free Trade Association					X (2003)
Singapore - Canada					X (2004)

Free trade agreements	Stages of evolution				
	Discussion	Joint study	Negotiation	Signed (year)	Implementation (year)
<b>Thailand</b>					
Thailand - China Thailand - Australia Thailand - United States	Signed trade and investment framework with the United States	X		X	X (2005)
Thailand - Japan Thailand - India				X	X (2004)

Source: Compiled by author from various sources.

Notes: CEC = Comprehensive Economic Cooperation; CEP = Comprehensive Economic Partnership; CER = Closer Economic Relations (free trade agreement between Australia and New Zealand); GCC = Gulf Cooperation Council; MERCOSUR = South American customs union.